

Report No. 6372-FIJ

Fiji

# A Transition to Manufacturing

November 25, 1986

East Asia Programs Department

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## CURRENCY EQUIVALENTS

	<u>1985</u>	<u>May 1986</u>
US\$1	F\$1.152	F\$1.106
F\$1	US\$0.868	US\$0.904

## FISCAL YEAR

January 1-December 31

## ABBREVIATIONS

ANZCERTA	-	Trading Agreement between Australia and New Zealand
DP7	-	Fiji's Seventh Development Plan, 1976-80
DP8	-	Fiji's Eighth Development Plan, 1981-85
DP9	-	Fiji's Ninth Development Plan, 1986-90
EDB	-	Economic Development Board
EPZ	-	Export processing zone
ERP	-	Effective rate of protection
FGDP	-	Median family income in developing countries
FNTC	-	Fiji National Training Council
FSC	-	Fiji Sugar Corporation
FTUC	-	Fiji Trade Union Congress
HFCS	-	High fructose corn syrup
ICA	-	International Coffee Agreement
KORTA	-	Korean Trade Promotion Corporation
LOME	-	EEC trade convention with ACP countries
MNC	-	Multinational corporation
MOF	-	Fiji Ministry of Finance
NTB	-	Nontariff barrier
PIB	-	Prices and Incomes Board
PJT	-	Price Justification Tribunal
RBF	-	Reserve Bank of Fiji
REER	-	Real effective exchange rate
SDF	-	Skills Development Fund (Singapore)
SPARTECA	-	South Pacific Regional Trade and Economic Cooperation Agreement
TC/TS	-	Tons cane/tons sugar ratio
VAT	-	Value-added tax

The report was prepared by a mission that visited Fiji during early April 1986. Mission members were Shahid Yusuf (Mission Chief), R. Kyle Peters and Vladimir Konvalov. The report was discussed with the Fijian authorities in October 1986.

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## FIJI: A TRANSITION TO MANUFACTURING

### SUMMARY AND CONCLUSIONS

Fiji has made the most of its limited natural endowment. Planted to sugarcane, about 70,000 hectares of the most fertile land have yielded rich returns. The sunny beaches of Viti Levu have generated employment and attract a growing stream of tourists not only from Australia and New Zealand but also the US and Europe. The dense forests covering two thirds of the land area support a trade in logs and wood products while coconut groves, traditionally the props for the village economy, have continued to supply copra and coconut oil for the export market. Fiji's mineral wealth is limited, but income from gold mining, averaging \$15 million p.a. in the eighties, has provided a welcome supplement to other export earnings. These bases of economic strength should endure well into the future, although as sources of growth they are no longer dependable. Even allowing for the difficult international environment of the eighties, Fiji's performance has been below par, with the economy expanding at an average rate of 1.4% p.a. over the past seven years. Much of this growth is traceable to the services sector. The contribution of sugar was negative, declining by about 1% p.a. in real terms between 1979 and 1986. Similarly other directly productive activities such as manufacturing (non-sugar) registered minimal change. Since the population and the labor force have increased by over 2% p.a. in the eighties, per capita incomes are eroding and open unemployment now exceeds 10%. As the population of working age will grow yearly by more than 2% for the remainder of the decade, there is an urgent need to quicken the economic pace.

#### Sugar and Tourism

The Government's Ninth Development Plan explores development opportunities across a refreshingly broad canvas. Manufacturing, services, and agricultural diversification are all drawn into the strategic harness, but it is sugar and tourism that once again are accorded the leading role. Intensive cultivation, a small increase in planted area, and a significant improvement in the extraction ratio will, it is projected, raise sugar production from 484,000 tons in 1986 to 550,000-600,000 tons by 1990. Tourist arrivals are expected to grow by 11.5% p.a. spurred by the planned enlargement of hotel accomodation in the five star range. Jointly the two sectors will supply the impetus for 5% p.a. growth in GDP.

Past trends and the scenarios being drawn for the international sugar market as well as the tourist business cast some doubt on these projections. A number of constraints may come in the way. For output to follow the trajectory presented in DP9, more emphasis must be given to varietal research; extension services, which are being pinched by the Fiji Sugar Corporation's financial difficulties, will have to be improved; investment will be needed in transport facilities; sugar mills could require modernization so as to raise the extraction ratio; and it may become necessary to consolidate the many small sugarcane farms into larger units. All of these are likely to impede the shift in production trends that is called for. Conditions prevailing in the world market sharpen the uncertainty. Sugar prices have recovered from

the low point to which they had fallen in 1985, but the forecasts for the next five years are not especially encouraging. The dynamics of demand, competition from substitutes, large inventories and more or less stable production in the EEC will not permit a significant strengthening of prices. Fiji will continue to profit from sales under contract to the European countries and the US, but the net returns from sugar that is disposed of on the free market could be tiny.

Tourism enjoyed a prolonged spring during the seventies, which from the evidence accumulating during the eighties, appears to have passed. A period of moderate growth lies ahead. Fiji's prospects are also affected by some very special circumstances. Most visitors are from Australia and New Zealand, countries which are experiencing economic difficulties and being forced to depreciate their currencies thereby discouraging overseas travel. A declining US dollar may also dampen the enthusiasm for expensive long haul journeys among Americans. To attract larger numbers of upscale tourists from Europe and Japan, Fiji would need to invest heavily not just in premier hotel facilities but also in recreational infrastructure. Further, airlines that have been shy of terminating flights in Fiji or dedicating significant blocs of seats for journeys to the country will have to be brought around. Beyond this, the Government and hotel interests will need to mount a much more intensive marketing campaign aimed at upper income professionals in the industrial countries who evince the highest propensity for long haul travel, luxury accommodations, and extended vacations.

Fiji has amassed much experience in the sugar and tourist sectors, so it is logical to exhaust the remaining opportunities in these areas before giving attention to other possibilities. But there are indications that these industries have passed their prime and in the future will be hard pressed to match the contribution they made to growth, export earnings and employment during the seventies. Investment that will enhance productivity in the sugar industry and which will multiply the attractions of Fiji's tourist resorts should not be neglected, but the focus of capital accumulation must shift to the manufacturing sector which is likely to be the principal source of growth in the nineties but must be groomed for that role during the DP9 period. And because the domestic market is small, manufacturing development must henceforth be oriented towards exports.

With oil prices on the retreat, Fiji is leaving behind the adjustment problem that emerged in the early eighties. This should provide planners with a measure of freedom to pursue fresh initiatives and take steps to revive investment in chosen areas. Fiji's manufacturing sector accounts for a scant 10% of GDP. If sugar processing is subtracted, it is even smaller. From the very start, industry produced for the domestic market under the shelter of protective trade barriers and foreign companies predominated. In recent years local businessmen have branched into manufacturing, but overseas interests remain significant and import substitution is still the guiding strategy.

The approach advanced in this report leans on the experience of the East Asian countries that have surmounted the handicap of smallness by creating internationally competitive export industries. Certain elements of the strategies employed by the East Asian NICs, suitably modified to accommodate



Fiji's circumstances and the increasingly politicized trading environment, might well secure the country's needs. After briefly describing the developmental gambit perfected by the NICs, the report picks up five strands of the strategy and examines them in greater detail; first presenting a composite account of what the East Asians did; and then indicating how it might be interpreted in the Fijian context. The five are:

- (a) industrial incentives;
- (b) taxes;
- (c) trade patterns;
- (d) labor policies; and
- (e) policies towards information, marketing and product design.

### Industrial Incentives

Three factors account for the size and domestic bias of the manufacturing sector: Fiji's comparative advantage in producing sugar and catering for tourism; the inherent disadvantages stemming from geographical location and a limited internal market; and a system of incentives, created piecemeal, that gives a high degree of effective protection to import substituting industries. As the report suggests, the mantle of comparative advantage may be slipping from the traditional sectors by the close of the decade. Further, the message from East Asia is that size can be reduced to a minor hindrance through firm commitment to growth and a farsighted choice of policy. The report recommends that the Government should consider a phased removal of three deficiencies in the system of incentives:

- (a) the very high level of effective protection, that in a number of cases probably results in low or negative industrial value added;
- (b) the wide dispersion in tariffs and rates of protection which interferes with efficient resource allocation; and
- (c) the pronounced bias against export industries.

Cost and production data that would permit some fine grained recommendations are not available in Fiji, but a start at reform can be made using the information and the models at hand. The report proposes five measures:

- (a) removal of quotas and quantitative restrictions;
- (b) reducing the tariff ceiling;
- (c) elimination of the rebate certificate scheme;
- (d) simplifying and extending the duty drawback scheme to benefit exporters of manufactures; and

- (e) raising the basic tariff on imported inputs from 7.5% to 10% so as to lessen effective protection and maintain government revenues.

### Tax Policy

An adjustment of tariffs could go hand in hand with tax changes designed to encourage investment which maximize domestic resource mobilization. Currently, over 40% of total revenues (amounting to a quarter of the GNP) are derived from direct taxes and cross country comparisons indicate that the effective levels of income tax in Fiji are well above those in the dynamic East Asian economies. It is possible that the system dampens incentives, discourages savings and is responsible for the evasion that is reported among taxpayers from the upper income brackets. Several objectives must be met as closely as possible. Manufacturing investment needs stimulating; private savings that have stagnated for several years must be induced to rise; the Government must augment revenue buoyancy not the least because rates of public savings have been gravely eroded by increased outlay on administrative expenses; and any reform must not exceed the organizational capability of the tax department or place too great a strain on taxpayer compliance.

Implementing any tax scheme inevitably entails compromises as reality can often be contemptuous of tax principles. Recognizing this, the report advances a number of proposals which may pass the economic test but whose political and administrative feasibility will require a close scrutiny:

- (a) a movement towards lower marginal rates, with fewer brackets and less exemptions might be considered, as there could be gains in terms of efficiency, incentives and simplicity;
- (b) household savings could be stimulated through higher tax exemptions for interest and capital income;
- (c) investment incentives could be further strengthened by reducing corporate taxes;
- (d) a system of excise taxes applied uniformly to imports as well as domestic production and a movement from specific to ad valorem rates for excise taxes; and
- (e) the level and buoyancy of government revenues could be preserved by introducing a broad based retail sales tax carrying a low uniform rate and covering almost all items, including foodstuffs.

### Export Patterns

Among developing countries, the East Asian NICs have mounted the most impressive and recession-proof export campaigns. It is significant that the bulk of their exports are manufactured goods, sold largely in the US, Japan, West Germany and Britain, with the US absorbing a third or more. Several of these countries have close links with multinational corporations which have provided capital, technology and trading contacts. An examination of the East Asian export pattern shows that light manufactures such as

clothing and textiles remain very prominent but that the fastest-growing items are electronic products, telecommunication and office equipment, machinery, and transport equipment. The NICs are formidable competitors in a range of products where experience, labor skills, technological proficiency and market penetration techniques are critical.

To challenge the NICs in the areas they have so effectively colonized might be difficult for a newcomer, but Fiji might profitably imitate certain aspects of the East Asian export strategy: (a) as wages in Fiji's manufacturing sector approach those of the Southeast Asian economies, the gains from trade in light manufactures where the value added is low would be scanty and the growth prospects meager. The most fruitful approach would be to find niches in such areas as electronics, light machinery and fashion garments where small-batch production is needed and emphasis on design as well as quality can gain entry; (b) it is likely that the Pacific region will continue to increase its lead as the most dynamic trading area and countries such as the US and Japan may offer the best market opportunities for years ahead; (c) a number of countries have used preferential trading agreements as a springboard for manufactured exports. Fiji is a member of two: LOME-ACP and SPARTECA. The access they provide needs to be exploited more fully; (d) Export Processing Zones (EPZs) have in the past served as stepping stones to manufacturing development. Although their proliferation throughout the world, together with a slackening of direct foreign investment has diminished their attraction for planners, the creation of a suitable EPZ, so long as it does not entail a large outlay on infrastructure, could be a useful accompaniment to Fiji's trade agreements; (e) not just factor supplies but nontariff barriers, automation, the preferences of MNCs and exchange rate policies now affect a country's comparative advantage and the geographical distribution of production facilities in today's highly integrated trading milieu. Some of these are beyond the control of planners in Fiji but exchange rate policy, flexibly used, remains a potent instrument. East Asian NICs, in spite of the constraints imposed by small size, have been able to further their industrial and export ambitions through a deft handling of exchange rates. The Fijian authorities might find that faster results might be obtained if industrial incentives are orchestrated with actions on the exchange rate front.

### Labor Policy

The wages of unionized workers in Fiji's urban sector reflect the country's US\$1,700 per capita income, whereas industrial productivity lags behind that of middle-income countries in East Asia. There are those who believe that labor market conditions rule out the possibility of competitive manufactured exports on a substantial scale. On closer examination, the problem does not seem so acute. The market for industrial labor is dualistic, with nonunionized workers being paid wages that are appreciably lower. Export-oriented garment producers tap the informal labor market and are apparently not being hamstrung by high wage costs. A review of trends reveals that real industrial wages have been falling throughout the eighties and with unemployment expected to worsen, the pressure on informal and union wages will, if anything, be stronger. As in European countries with a good record in terms of wage inflation and work days lost through strikes, Fiji has, in the Tripartite Forum, an institutional means of centralizing and negotiating

wage claims. This mechanism for bringing together the unions, employers and the Government has functioned with tolerable success and was the vehicle for introducing voluntary guidelines in the early eighties. When the Nicoll and Hurst wage settlement for public servants threatened to spark a public sector-led wage spiral in 1984-85, the Government took decisive action by declaring a freeze. In effect, the system for regulating wages in Fiji lies between the European model and the more interventionist mode favored by some of the East Asian NICs.

The problem in future may have less to do with wages than with the availability of skills. Export-led industrialization along the lines it would be desirable for Fiji to pursue will be accomplished only if employers can mobilize adequate supplies of human capital. Entry-level vocational skills are not scarce; the higher order and specialized ones are. Two remedial policies deserve consideration. Currently employers pay a compulsory levy into a training fund but are poorly served by the existing arrangements. The needs of an accelerated industrial program will be even harder to satisfy. The training bottleneck requires the attention it has received, for instance, in Singapore. That country can also be a model for the development of technical capabilities in the fields of engineering, electronics and design, which take time to accumulate and are a precondition for attaining industrial maturity. Singapore has been unusually successful in persuading western governments and MNCs to provide funding and technical assistance for centers importing industrial skills. This might be a route Fiji could explore.

#### Information, Design and Marketing

Stimulating investment through fiscal, monetary, tariff and exchange rate policies can give industrialization the necessary push. But success of the kind enjoyed by the East Asian NICs has depended upon progress in four crucial areas: intelligence gathering, marketing, product design and technological absorptivity. Chapter VIII of the report describes the layered information system developed by Korea and then proceeds to examine the factors behind the market performance of certain products that might eventually suit Fiji's export capabilities: rum, watches, light machinery, fashion garments and horticultural commodities.

A comprehensive system for collecting, processing and disseminating information takes time to perfect and involves large expense. Fiji need not set its sights on an elaborate Korean-style edifice but even a basic structure providing market feedback and information on Fijian products to potential buyers, will take time to establish. Exports aimed at niches must be expertly tailored for the markets they are supposed to satisfy: they must be designed and promoted with the clientele in mind and carry the stamp of quality. Design skills, consistent and superior quality standards, and marketing expertise decide the fate of high value-added, niche-filling exports. They are the result of gradual accretion, but design schools, licensing, and foreign collaboration can accelerate what is inevitably a complex process.

## FIJI

### A TRANSITION TO MANUFACTURING

#### I. INTRODUCTION

1.01 Neither geography nor culture nor political forms preclude a country from sharing in the fruits of economic advance; what matters is the skill with which a constellation of policies mobilize domestic resources for development ends and enable the nation to grasp the trading and technological opportunities that have underwritten economic gains most notably in East Asia. When the local market is small, growth in production will inevitably depend upon sale overseas. But export demand is an exacting taskmaster calling for the fusion of entrepreneurship, technology, price competitiveness, marketing and product design. Policies must exert pressure on two axes: motivating businessmen to manufacture a competitive product in the requisite quantities; and ensuring an adequate supply of human and physical capital to finance plant and infrastructure and forge the human links in the chain which leads from technology absorption all the way to the marketing of a quality product. Capital accumulation can, for a time and in part, be financed through foreign savings and direct investment, but in due course the full burden of investment must come to rest upon national savings. Generating a level of savings sufficient to finance export-led growth of a high order becomes the final test of strategy calculated to achieve rapid development without departing over the medium-term from the requirement of domestic resource equilibrium.

#### Recent Performance

1.02 Among the island countries of the south Pacific, Fiji is the most populous. It is also richer than any of its neighbors, a tribute to the efficiency of the sugar industry, the lure of Fiji's tourist resorts and the country's resources of timber and gold. Favorable commodity prices and expanding sugar production permitted the GDP to grow by 5.8% p.a. in the first half of the seventies. In the latter part of the decade, earnings from sugar were squeezed by a period of depressed prices, but substantial public investment made possible a tolerable rate of expansion and steady, albeit small, gains in per capita income. Sugar lived up to its reputation as being a crop generating one of the handsomest net returns per hectare,<sup>1/</sup> and, in spite of its high

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1/ James Fry, Sugar: Aspects of a Complex Commodity Market, Commodities and Export Projections Division, Division Working Paper No. 1985-1, World Bank, 1985. Sugarcane's attractiveness is enhanced by its ability to withstand flood, droughts, hurricanes, pests and disease. As G. Hagelberg notes, "the misery of growing cane is nothing compared to the misery of growing other crops." in G. Hagelberg, Sugar in the Caribbean: Turning Sunshine into Money, in S. Mintz and S. Price eds., Caribbean Contours, Johns Hopkins Press, 1985.

import coefficient, tourism made a valuable contribution to the island's economy.

1.03 The weaknesses of a strategy tied to a cycle-prone primary commodity and a service industry that is hostage to the whims of novelty-seeking vacationers from a handful of industrial economies as well as the corporate goals of foreign airlines, hotel and tourist companies were revealed in the first half of the eighties. All the developing economies located on the Pacific perimeter have been buffeted by the erratic behavior of raw-material prices and the reduced tempo of world trade, but, whereas the exporters of manufactured goods seem to be regaining their stride, those that had pegged their hopes to the marketability of their primary exports are faced with lean times.

1.04 Since the beginning of the decade, the performance of the Fijian economy has fallen far short of expectations. Growth of GDP has averaged 1.2% p.a. and it has been propelled by the services sector rather than through an expansion of directly productive activities. With public sector employment leading the way the value of services grew 1.9% p.a. between 1979 and 1986. Meanwhile, agriculture rose by only 1.3%, while sugar declined by almost 1% p.a. Industry's contribution, including manufacturing, to value-added was the same in 1986, as in 1979. With population increasing each year by almost 2%, real per capita incomes have declined steadily (see Table 1.1). A surge in tourist arrivals combined with a record sugar harvest pushed the growth rate above 9% in 1984. At other times, the economy has stagnated, with investment and saving showing the effects of diminished economic momentum. Investment which peaked at 27% of GDP in the late seventies was below 18% in 1985, while the share of domestic savings in GDP was a meager 16% as against an average of 21.3% p.a. during 1975-80. A gap between capital spending and national savings that appeared in the early eighties had largely been erased by 1985, when the current account deficit was a little over 4% of GDP, but adjustment has been achieved not through higher savings and exports but by accepting lower levels of investment and a negative growth rate.

Table 1.1: FIJI -- BASIC ECONOMIC INDICATORS

	1970-75	1975-80	1980-84	1985 /d
GDP growth	5.8	4.1	1.2	-3.0
Population Growth Rate	n.a.	2.2	2.0	2.0
Unemployment Rate				10.2
Gross Domestic Investment (as % of GNP)	20.4	26.1	22.7	17.5
Gross National Savings (as % of GNP)	17.1 /a	21.3	16.3	13.3
Current Account Deficit /e (as % of GNP)	4.7 /a	4.8	6.4	4.2
Overall Budget Deficit (as % of GNP)	1.1 /a	6.5 /b	5.1 /c	4.8

/a 1971-1975 only.

/b 1976-1980 only.

/c 1981-1984 only.

/d Estimates.

/e Excluding official transfers.

Source: World Tables, World Bank; Ministry of Finance, Fiji.

1.05 A response that would reverse the economic slide has been slow in materializing for a variety of reasons. Per capita incomes exceeding US\$1,800, a relatively equitable income distribution and a moderate ratio of labor to arable land ensure most Fijians a measure of well-being. The elastic nature of rural village society has made it possible to absorb into part-time subsistence agriculture many of those who are unable to find or hold jobs in the urban centers. Hence, the pressures emanating from a scarcity of employment opportunities in the urban economy have been contained.<sup>2/</sup> Until recently, the alternative of living in village communities kept unemployment

2/ Continued reliance on subsistence agriculture by workers with urban jobs is described by E. Ponter, "The Growth of Wage Labor and its Consequences for a Fijian Village" in Fijians in Town, Institute of Pacific Studies, Suva, 1986. Urban work opportunities for Fijians and the nature of the unemployment problem are discussed by C. Gounis and H. J. Rutz, "Urban Fijians and the Problem of Unemployment," in Fijians in Town, op. cit.

in the 6-8% range, even though the formal sector has accounted for a decreasing percentage of the labor force since the late seventies. Some of the urgency of finding work for a population expanding at the rate of 2% p.a. has been blunted by the singular capacity of long-maintained rural social institutions to satisfy, at least partially, the material and cultural aspirations of the young. But a push towards export-oriented manufacturing activities has also been thwarted, first by the profitability of low-risk import substitution and by the belief that Fiji's geographical location, its small size and costly unionized labor force rule out any chances of effectively competing against East Asia's seasoned exporters.

1.06 Experience gained during the eighties argues against the tying of future economic progress to the residual potential of sugar. A shrinking supply of uncultivated land <sup>3/</sup> suggests that subsistence agriculture will have difficulty in satisfying the aspirations of new entrants and the increase in open unemployment to 10% in 1985 reflects a reluctance on the part of workers to either withdraw from the labor force or accept the sacrifices in terms of personal freedom which a return to the safety net of traditional society would entail. Finally, the forays by Fijian garment makers into international markets have been sufficiently rewarding to raise hopes, and they lend credibility to a development strategy assigning a major role to manufactured exports.

1.07 Taken together, these three factors--fluctuating earnings from sugar and tourism, worsening unemployment and the crystallization of new export possibilities--call for a reshuffling of strategic options. Fiji can ill afford further erosion of per capita incomes. Given the prices and demand being projected for sugar, timber and coconut oil (see Table 1.2), the likely trend in tourist arrivals and the scope for manufacturing development keyed to import substitution, it will be difficult to attain a rate of growth that will lead to rising living standards very much beyond the horizon defined by DP9. To revive economic performance, the country must create the environment and

3/ FIJI: PROPORTION OF UNUSED LAND BY CLASS, 1980

Type of Unused Land	Viti Levu (%)	Vanua Levu (%)	Other (%)
Suitable for arable or permanent crops with little or minor improvements	3	6	1
Suitable for pasture or afforestation, no improvements	3	4	3
Usable with major improvements	10	24	17
Unsuitable	84	67	78

Source: Gerald Ward, Fiji's Land Use System, 1980 monograph.



skills which are the ingredients of a competitive manufacturing sector and become adept at the game being played for ever-higher stakes by a group of East Asian economies.

Table 1.2: COMMODITY PRICE PROJECTIONS

	1986	1990	1995	2000
<b>Sugar (\$/MT)</b>				
Nominal	154.00	390.00	380.00	430.00
Real (1985 prices) /a	136.28	321.31	265.00	252.94
<b>Logs (\$/MT)</b>				
Nominal	150.00	164.56	206.50	253.30
Real (1985 prices)	132.74	136.00	144.00	149.00
<b>Coconut Oil (\$/MT)</b>				
Nominal	280.00	518.00	717.00	819.00
Real (1985 prices)	247.79	428.10	500.00	481.76

/a Deflated by the MUV.

Source: Commodity Division, The World Bank.

### The Perspective of DP9

1.08 The Government's Ninth Development Plan (DP9) clearly recognizes the importance of an export-oriented manufacturing sector for the long haul (see Table 1.3). But over the balance of the eighties it expects much of the impetus for a growth rate averaging 5% p.a. to be derived from tourism, sugar and other agricultural products. Neither the sugar industry nor tourism is by any means a spent force but even if we gloss over the weather-related problems of 1985, the trends perceived do not entirely support the scenario painted by DP9. Sugar is likely to be hemmed in by production and price constraints, whereas a 11.5% p.a. increase in tourist arrivals through the remainder of the eighties might be hard to sustain. Sugar and tourism remain the sectoral favorites of DP9 in spite of their checkered growth record mainly because of their familiarity, but the time may be at hand when manufacturing industry might be better placed to help fulfill the overall growth targets. Korea's dramatic leap towards industrialization in the early sixties used as a springboard little other than a rural economy which land reform and production policies had rendered efficient, egalitarian and politically supportive of the coherent, long-term, industrial program adopted by the Government of President Park. Because agriculture figures prominently in the Korean Government's political and economic calculations, close attention has been given to the rural terms of trade, which indirectly, reinforces a commitment to a flexible exchange rate policy stemming from Korea's export-led strategy.

**Table 1.3: DP9 PROJECTIONS**

	1980- 1985 /a	1985- 1990
<b>P.A. Growth Rates:</b>		
GDP Growth (at factor cost)	1.2	5.0
Sugar Production	-2.9	7.4
Tourist Arrivals	3.9	11.5
Manufacturing Value Added	-0.2	6.2
Sugar	-3.0	7.9
Other Food, Drink and Tobacco	n.a.	6.9
Other Manufacturing	0.9	5.0
Pop. g.r.	2.0	2.0
Labor Force g.r.	2.9	2.4
	1985/a	1990
GDI/GNP	20.0	21.8
GNS/GNP	16.6	19.2
CAD/GNP	3.4	2.6
Budget Deficit/GNP	5.5	3.4
Population ('000)	699.0	772.0
Unemployment Rate	10.2	7.2

/a This column reflects estimates at the time of the preparation of DP9, and not actual data.

Source: Fiji's Ninth Development Plan, 1986-1990, Central Planning Office, Suva, November 1985, pp. 13, 49, 89.

1.09 The experience of the Caribbean economies, some of which are in a better geographical position to capitalize on an expanding tourist trade, shows the limits to development confronting island countries that do not diversify away from an inherited sugar culture and the largely foreign controlled business of servicing tourist enclaves.

1.10 Fiji's principal trading activities are too important to be casually brushed aside. Hence the chapter which follows closely examines their prospects. The report then describes the elements of an industrial strategy that might be suited to Fiji's institutional conditions, its entrepreneurial capabilities and the skills of its labor force.

## II. THE FUTURE OF TRADITIONAL INDUSTRIES

### Sugar

2.01 The market for sugar is a troubled one. In 1985, almost 100 million tons were produced worldwide and about a third of this volume entered world trade, much of it in the form of raw sugar shipped in bulk form. Nearly 84% was sold under contract, the balance on the free market which, because of its small size, has traditionally been subject to pronounced fluctuations taking the form of five-year-long troughs interspersed by sharp peaks. One such peak favored producers in 1984 but a year later, large harvests and the accumulation of stocks equal to almost half the annual consumption pushed prices to their lowest point ever, less than three cents per pound. With all the major exporters sheltered by contracts negotiated under a higher price regime, the industry weathered the crisis and Soviet purchases had pulled prices past nine cents per pound by mid 1986. But with production costs now averaging 15-16 cents per pound, the latest downswing in the sugar market has once again exposed the vulnerability of countries whose fortunes are linked to those of sugar.

2.02 As a producer Fiji occupies the middle rank.<sup>4/</sup> The best year for the industry was 1984 when output reached 486,000 tons. Yield of cane per hectare is about average -- 40-50 tons per hectare -- as against 100 tons in Hawaii and Australia (for basic statistics on the sugar industry see Annex Table 1). But manual cutting, which allows the juiciest part of the cane just above the ground to be retrieved and reduces the amount of extraneous matter, has enabled Fijian farmers to achieve production costs that are among the lowest. A succession of hurricanes severely damaged the crop in 1985 reducing the output to 343,000 tons but projections for 1986 foresee a rebound to 420,000 tons. The DP9 takes a sanguine view of the future and anticipates that between 550,000-600,000 tons of sugar will be produced by 1990 from 78,000 hectares through a moderate annual increase in cane yield per hectare

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<sup>4/</sup> Sugar arrived in Fiji by a circuitous route. Domesticated in Papua New Guinea it was first processed in India from where the sugar culture spread to the Mediterranean region, then to the Americas with the help of Columbus. In the 1860s sugarcane was introduced to Fiji following the collapse of the cotton market after the close of the American Civil War. After a faltering start--the initial attempts to produce sugar in Wakaya failed because of low yields and disease--the industry finally established itself in the 1880s which is when the Colonial Sugar Refining Co. of Sydney started operations at Rewa. See S. R. Mintz, Sweetness and Power, Viking 1985, p. xix; R. Gerard Ward, Land Use and Population in Fiji, HMSO, 1965, p. 25; and J. Narayan, The Political Economy of Fiji, South Pacific Review Press, 1984, pp. 21-31.

and an appreciable improvement in the extraction ratio.<sup>5/</sup> From the perspective of development strategy, two questions are paramount. Can sugar continue to serve as a dynamic leading sector during the next five years and beyond? What is sugar's potential as an earner of foreign exchange?

2.03 The DP9 arrives at its target for sugar production in 1990 by assuming a 10% increase in cultivable acreage, a 20% growth in cane yield per hectare (from 50 tons to 64 tons) and a downward drift in the tons cane: tons sugar ratio (TC/TS) from 8.43 in 1986 to 8.17 in 1990. These certainly are within the realm of possibility but they do approach past trends and current constraints from an optimistic angle. Between 1974-76 and 1984 yield of cane per hectare rose by nearly 3.0% p.a. but a deteriorating TC/TS ratio held the increase in sugar output to 0.6% p.a. A continuation of past trends, 2.9% p.a. growth in sugar cane production and assuming no further erosion in the TC/TS ratio, would indicate that production would be less than 500,000 tons of sugar by 1990. A figure far short of the DP9 target.

2.04 Extrapolation neglects the changing stringency of constraints that could interfere with intensive farming. Fiji has 22,000 cane growers, a high percentage of whom are cultivating small, uneconomic holdings. In fact, some 13,000 contracts deliver an average of just 200 tons of cane with many selling under 100 tons. This reflects the proliferation of backyard cane farms and the inefficient practices of small producers. To remedy the situation while keeping over 70,000 hectares under cane would require institutional changes that facilitate a consolidation of holdings. The existing transport system has little excess capacity and would not be able to handle larger supplies without extensive modernization.

2.05 To encourage farmers to raise the quality of the land might also call for institutional amendments that determine the length and security of leasehold property. It is a commonplace in agricultural economics that tenant farmers faced with the risk of having their leases revoked are unlikely to make the investment of time and capital that will enhance soil fertility. To the extent that a proportion of the most efficient cane farmers fear the eventual loss of their leasehold property or expect to abandon farming, maintaining the quality of the soil will not be an important concern.

2.06 A system of smallholder agriculture and landholding institutions which vest inalienable ownership rights over 83% of the cultivable land in 6,600 mataqalis<sup>6/</sup> results in production technology and a rural land market that holds down the yield of a crop known to thrive best under the tightly regulated conditions found on commercial plantations.<sup>7/</sup> But the change in

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<sup>5/</sup> The extraction rate is commonly referred to as the tons cane/tons sugar (TC/TS) ratio.

<sup>6/</sup> An agnatically related social unit usually a lineage of the larger clan.

<sup>7/</sup> See E. Graham and I. Floering, The Modern Plantation in the Third World, Croom Helm, 1984.

yields is also affected by the plight of the Fiji Sugar Corporation (FSC). A parastatal organization which absorbed the assets and functions of the Australian owned Colonial Refining Corporation in 1971, the FSC has been vitally involved in every facet of sugar production: from the issuing of contracts to farmers to the export of raw sugar, the FSC is the driving force behind the sugar industry. If it falters, so does the industry. Lately, its financial health has been under siege and its financial difficulties could affect the future of sugar production. The FSC is responsible for research, extension, the distribution of fertilizer and the application of pesticides. It manages large experimental acreages, runs a rail system that collects cane and owns the mills where it is crushed. Low selling prices have been especially damaging to the FSC because Fijian farmers enjoy unusually generous contractual terms, receiving 72-75% of the selling price as against a 40-50% average elsewhere (60%, in Australia). Its operating costs have been creeping upwards since it employs expensive unionized labor on its plantations and factories. The longer the slump in prices persists, the harder it is for the FSC to sustain the scale and tempo of its research and extension efforts which strongly influence yields and varietal standards that are a determinant of the TC/TS ratio. Nor can the FSC find the resources to replace its decades-old crushing equipment which, although kept in a good state of repair, detracts further from the efficiency of the production system.

2.07 Each of the constraints described can be eased, but the institutions governing land distribution are not lightly tampered with and the financial problems of the FSC cannot be fully resolved in the absence of a recovery in prices. Extending past trends in production through the latter half of the eighties would seem, therefore, to define the bounds of possibility. To project a growth rate that is even higher may not be warranted.

2.08 Even if production follows the path delineated in DP9, what prices would sugar exports fetch? Over the past five years Fiji has sold three fourths of its sugar under favorably priced contracts and the balance on the open market. Contracted sales have provided a sorely needed umbrella in times of slump but two- to three-year contracts insulate the producer on a temporary basis only. Over the long term, the average contracted prices track those being registered in the market. Furthermore, if Fiji's exports rise well above a half million tons per annum, it is likely that not much more than 50% could be disposed of on contracted terms because of the purchase quotas enforced by the EEC and the US.

2.09 The volatility of sugar prices is legendary and is largely explained by the thinness of the free market relative to total production and trade.<sup>8/</sup> Small changes in supply can spark dramatic price movements. Equally conspicuous of late is a downward trend in real prices caused by enduring changes in the use and production of sweeteners, worldwide. Sugar consumption rose only 4.3% p.a. between 1980 and 1984 but total sugar supply spurred by higher production in Australia, the EEC, China and India increased by 19%. Global stocks in 1984 were twice the level of 1980 and 36% of total use. Further,

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<sup>8/</sup> About 16% of the sugar produced is sold on the free market.

annual consumption as a percentage of world supply was down 10 points at 74% as compared to that in 1980.<sup>9/</sup> By far the biggest consumers are the developed countries with the US in the lead. But in both the US and the EEC per capita demand is reaching a point of saturation. Income elasticity could soon be close to zero in the US and dropping below 0.2 in the EEC. Demand should continue growing in Japan and the centrally planned economies, but even in these countries per capita usage is quite high. Consumption will expand most steeply in the developing economies of Asia and Africa, although this is predicated on foreign exchange availability.

2.10 Dietary patterns, health concerns, high prices in the developed countries and effective purchasing power will be one set of factors influencing sugar demand; a second determinant will be the acceptability and prices of high fructose corn syrup (HFCS) and artificial sweeteners such as saccharin and aspartame. HFCS has already made deep inroads into the US market because of the abundant supplies of competitively priced corn, the ease with which corn gluten can be disposed of as animal feed, facilities for providing constant temperature storage and, most important, the receptivity shown by the country's large bakery-goods, beverage and confectionary producers. Corn syrup has annexed 38% of the US sweetener market. It is gradually enlarging its share in the EEC and should grow in line with the consumption of sweet beverages in Japan. Saccharin, which is cheap to produce has occupied a secure corner of the market for decades but, with the appearance of aspartame and technological advances in the designing of artificial sweeteners,<sup>10/</sup> the use of sugar substitutes will expand more rapidly, not only in countries where sugar is no longer of significance as a source of calories but also in cost-conscious developing economies as well. A tenth of Thailand's domestic market has been captured by artificial sweeteners. When the various elements that constitute the long run demand curve are brought together, world consumption of sugar cane is projected to grow by 1.7% p.a. until the year 2000.

2.11 While demand seems set to expand at a moderate pace, there is scant reason to believe that the supply situation will evolve in a manner that would appreciably modify price trends. Production in the US may decline by somewhat under a million tons to 6.8 million by 1990 as high cost growers withdraw from the industry. Further, the hurricane which devastated Cuban plantations in 1985 will probably depress output for two to three years. This could be more than offset by increased production in Brazil where the cane-based alcohol program has been rendered uneconomic by falling oil prices. Since 17% of all Brazilian cars run on pure alcohol and all of the rest use gasohol, an abrupt switch away from ethanol can be ruled out, but if a large acreage remains under cane the emphasis is bound to shift towards sugar so long as the projections call for low petroleum prices well into the nineties.

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<sup>9/</sup> R. A. Packenham, *The Caribbean Sugar Crisis: Consequences and Challenges*, Journal of InterAmerican Studies and World Affairs, 1986 Vol. 28, No. 1.

<sup>10/</sup> J. Elmsley, "Designing Sweetness to Order," New Scientist, October 31, 1985, p. 22.

2.12 Output in the EEC is expected to remain stable at 13.6 million tons for the several years with productivity improvements in the beet sugar industry continuing to counteract a downward movement in price supports. In East Asia, Thailand is aiming at a target of 3 million tons by 2000 as compared to 2.5 million tons in 1984, and a settled political climate should encourage Filipino farmers to regain ground lost during 1985-86 when production plummeted from 2.5 million tons (in 1984) to 1.3 million tons.

2.13 Market analysts expect that the overhang of stocks will diminish by 7.5 million tons between 1985-87, with inventories settling at the 25% level considered normal in the industry. But longer term supply and demand conditions presage free-market prices that will remain below long run average production costs. The World Bank projects that sugar will be selling for an average of about 13 cents (in 1985 prices) over the next one and a half decades (\$253 per ton). Contract sales to the US and the EEC will offer higher returns as stabilization programs in these two markets should result in prices that are respectively 20% and 13% above world levels. However, US imports are not expected to increase by more than 100,000 tons p.a. through the year 2000, nor is there much likelihood that the EEC will, other than marginally, augment its purchases.

2.14 As an engine of growth, beyond the current decade, the Fijian sugar industry seems an uncertain candidate unless the institutional and financial problems that have surfaced during the eighties can be resolved in the very near future. It will generate almost no additional employment. With price forecasts over the next decade being pitched at levels that are not very far removed from Fiji's admittedly low production costs, sugar will have difficulty retaining its reputation for profitability and as a source of foreign exchange earnings (see Table 1.2).

### Tourism

2.15 A number of island economies have sought to develop tourist industries because scale, marketing and skill-related barriers do not loom as large as they do for manufacturing, and frequently, overseas interests can be persuaded first to establish the hotel infrastructure and then to manage it. The spectacular increase in tourist traffic during the seventies fully vindicated the expectations of the earlier entrants into this field, but the multiplication of destinations offering an undifferentiated experience over the past ten years, combined with a slackening in the growth of tourist travel, has tarnished the industry's attraction. In the jargon employed by the trade, sun, sand, sea, sightseeing and shopping can be found in scores of appropriately sanitized locations around the world. International hotel chains ensure relatively uniform standards of service and accommodation wherever business draws them and tourist companies strive to give the travelers a minimum package of attractions. In such circumstances, it takes inspired marketing and unusual cultural appeal alongside the active collaboration of

airline and travel companies <sup>11/</sup> for one tourist center to pull far ahead of the pack. Sustained success has come to a few places, for example Singapore and Bali, but even these islands have felt the effects of slowing tourist traffic. With modernization, Singapore has lost its distinct Asiatic character. Malay kampongs have been displaced by tower blocks; Chinatown has shrunk to a few antiseptic lanes, local artisanal skills are on the wane and neither the food nor the remaining dancing troupes carry the mark of cultural distinction. These changes are discouraging Australians, Americans and Europeans to visit Singapore again although Asian tourists, who are impressed by the city's cleanliness, remain more enthusiastic. Bali, long a mecca for the discerning tourist, is also feeling the pinch of maturity with arrivals beginning to stabilize as fashion and the quest for new experiences tug the tourist to other locations.

2.16 Tourism ranks second only to sugar as an earner of foreign exchange and a healthy performance by this sector during the Ninth Plan period would undoubtedly help finance manufacturing diversification. Whether it can contribute significantly to growth as assumed by DP9 is less certain. Gross receipts rose to F\$161 million in 1984 from the average of F\$136 million in 1982-83 on the strength of 235,000 arrivals. Net receipts, after all imports by the industry are deducted, along with repatriated profits and dividends amounted to a third of this. Direct employment by the tourist sector remained stable at around 6,700 between 1977 and 1984 (although 300 new rooms were added, making a total of 3,900) while indirect employment rose from 3,000 to 9,000.<sup>12/</sup>

2.17 The tourism industry of Fiji is at a watershed. To maintain an 11.5% p.a. growth in tourist arrivals through the remainder of the eighties as indicated in DP9 and to lessen the leakage in tourist expenditures, an ambitious, costly and risk-laden strategy will need to be introduced in short order. But whatever approach is followed, obtaining results will be an uphill task. To divert the flow of long-haul tourists from other resorts to Fiji requires a distinct cultural appeal over and above the standard tourist package. It calls for shopping and hotel facilities of a superior class and an abundance of leisure activities, especially sightseeing. Fiji is deficient in each of these areas. The local culture has not been tailored and projected so as to attract tourist attention as has been done in Hawaii and Bali. Premier hotels, of which there are 3 with a total of around 1,000 rooms, provide respectable service but have yet to attain the exacting 5-star standards taken for granted elsewhere in East Asia. Tourists seeking bargains will not find them in Fiji's duty-free shops, and the infrastructure needed to support sightseeing and water sports is poorly developed. Building a few more hotels

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<sup>11/</sup> Travel agents sell three out of four tickets bought by air travellers, though this could change with innovations in ticket marketing, e.g., automatic ticketing machines.

<sup>12/</sup> Hotels in Western countries employ 7-8 staff per 10 rooms. Because of the layout favored and the extensive gardens and beach facilities, the employment rate in Fiji is almost twice as high.



could ease the shortage of rooms in the five-star range during the peak season, but it is not likely to enhance the country's appeal as a resort and such a move could depress the average yearly occupancy ratio, which is in the region of 58%. Investment in infrastructure for entertainment, if it is suitably lavish, could yield acceptable returns, but only if advances are achieved on several other fronts.

2.18 Currently the Visitors' Bureau spends F\$1 million on overseas promotion, leaving much of the marketing in the hands of foreign tour agencies. With hundreds of destinations over which to distribute their customers, these firms quite naturally put no particular effort into extolling Fiji's attractions. Moreover, Japanese travel agencies, which tend to direct tourist traffic to locations where their affiliates or JAL have hotel investments catering to the needs of the Japanese traveler, might discriminate against Fijian resorts. If the tourist market expands at a relatively slow pace in the late eighties, a country that does not take a lead in marketing its cultural and scenic assets cannot bank upon a large growth in tourist arrivals. An aggressive marketing campaign covering the European countries, Japan, the US and Australia would be expensive and would have to deliver on the promises made -- an even more costly undertaking.

2.19 Remote island destinations are at the mercy of major international airlines. Their flight arrangements determine the potential tourist traffic. When the range of passenger aircraft was limited, Fiji was admirably situated to service flights headed towards Australia. The advent of long-range jets and the emphasis that trans-Pacific carriers now place on serving the "Pacific gateway" cities means that fewer airlines call at Nadi and those that do dedicate only a limited number of seats specifically to serving Fiji. In the absence of a surge in tourist interest, the carriers will be unwilling to raise the frequency of their flights. An international airport near Apia in Western Samoa may even divert some traffic from Nadi's expensive facilities where the landing fees are second only to those levied at Narita. Airlines must be persuaded to give more attention to Fiji and it is not clear that increasing the number of first-class hotel rooms, as proposed under DP9, will be sufficient.<sup>13/</sup> Hotel space is not the binding constraint on the growth of tourist traffic to Fiji. Only an active promotional campaign paralleled by a substantial upgrading of facilities that is seen to produce results is likely to be convincing for the Pacific carriers.

2.20 For a country that taps the small market segment (16%) comprised of long-haul tourists it is important to attract the right kind of visitor. Those who seek five-star hotel accommodation, spend lavishly on local handicrafts and services, and stay for a week or more, bring the most revenue. So far, only a minority of the travelers to Fiji fit this description. The typical tourist is a young Australian with his family who spends nine days sequestered in a hotel enclave, organizes his time around beach activities and is quite circumscribed by a modest vacation budget. Americans who recently

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<sup>13/</sup> Currently the construction cost per room is F\$100,000. It was F\$46,000 in 1976 when the Regent of Nadi was completed and F\$37,000 in 1973.

displaced New Zealanders as the second largest tourist group (40,000 in 1984) have the right spending patterns but tend to stay about 6 days. Arrivals from Japan have declined to 15,000 in 1984 with the average length of stay being five days, which is disappointing as the Japanese predilection for first-rate hotels and shopping also place them in the desirable category. Finally there are the Europeans who select five-star hotels for a stay averaging a week and whose expenditures match those of the American and Japanese visitors. Some 20,000 European tourists visited Fiji in 1984, twice the number that came in 1980.

2.21 The strategy promising the highest net earnings would be one that increased the flow of upscale long-haul tourists. Unfortunately its application on a large scale may be ruled out for reasons of cost. American visitors are generally middle-aged and drawn from executive and professional groups. For them sightseeing and cultural activities are important and they demand hotel services of quality. Tourists from Japan tend to be young couples who attach a premium on sightseeing and shopping in surroundings where some Japanese can be understood. The Europeans come to enjoy the beach and the weather but want excellent hotel facilities. Drawing more such tourists to Fiji would involve investment in hotel facilities comparable to the best in East Asia and, in order to service the Japanese visitors, some involvement by the Japanese hotel companies, as has occurred in Hawaii. In addition, much capital would need to be sunk into the infrastructure of sightseeing, both human, organizational, and physical. Sites would have to be developed, tours devised, cultural performances staged and a small army of guides and functionaries created to serve the visitors.

2.22 Even if all this could be achieved in the space of a few years and foreign hotel companies induced to place more equity into their Fijian operations in spite of the below-average returns they currently receive, certain problems will remain. First, the peak winter tourist season in the Northern hemisphere coincides with the months when Fiji is most susceptible to cyclones. Second, tourist traffic from the US is projected to decline over the next few years because of a weaker currency. Third, there are a large number of Caribbean and African countries vying for the dollar of the sun-loving tourist clientele. Many are geographically better-placed to draw vacationers from America and Europe and will compete fiercely for the trade. Finally, Japanese and Australian travellers have increasingly sought US destinations over Pacific beach resorts. The weakening of the dollar can only strengthen the pull of the American continent.

2.23 Fiji was able to scale the ladder of per capita income during the sixties and the seventies because it could draw upon the economic energies of two successful export sectors. Efficient smallholders contributed to the growth of sugar, while a combination of local entrepreneurship, foreign capital, infrastructure development and the effective use of labor in service activities allowed tourism to flourish. Very probably, the foundations of the economy will continue to be secured by these two sectors for several more years. However, experience during the eighties and an educated guess regarding the future of these industries suggests that their contribution to growth and certainly to employment can only diminish. Heavy investment in these sectors will produce average rewards in terms of export earnings crucial for achieving further advances in prosperity. For that the country needs a new leading sector, and the only contender is manufacturing industry.

### III. NEW CONCERNS FOR TRADE STRATEGY

3.01 Industrial policy, whose ultimate purpose is to promote exports, must now contend with a politically charged trading environment. The time is past when the US could gaze indulgently upon East Asian economies preparing to loose a volley of light manufactures towards its markets. Trade is now a complex affair that calls for great swiftness in espying and seizing an opportunity. It is an enterprise, moreover, for which detailed knowledge of markets and the capabilities of competitors is becoming indispensable, giving the experienced players an increasing edge over newcomers. Brazil, Mexico and Columbia have robust export industries but it is the Pacific region that has emerged as the most dynamic trading arena (see Tables 3.1 and 3.2). A small open economy seeking to industrialize can do no better than to start by examining the last 20 years of East Asian economic history for it dispels many myths regarding the comparative advantage and cultural uniqueness of successful trading nations even as it underlines the virtues of doggedly pursuing export objectives and creating a domestic industrial environment that is both flexible and innovative.<sup>14/</sup>

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<sup>14/</sup> In East Asia alone, Linder notes, "There are countries rich in cultural resources and countries altogether lacking such resources. There are both sparsely and densely populated countries. All the major religions are represented. Some countries are racially homogenous; others are multiracial...some are militarily exposed [e.g., Korea] and devote much...resources to defense.... Virtually all constitutional systems are represented including the colonial government of Hong Kong.... As heads of state there are emperors, queens, elected and hereditary kings, presidents and generals." S.B. Linder, The Pacific Century, Stanford University Press, 1986.

**Table 3.1: PROPORTION OF INDUSTRIAL COUNTRY IMPORTS  
FROM EAST ASIAN COUNTRIES**

Exporter	All goods		Manufactures	
	1980	1984	1980	1984
Thailand	0.3	0.3	0.2	0.2
Malaysia	0.7	0.8	0.3	0.5
Indonesia	1.5	1.7	0.0	0.1
Philippines	0.4	0.5	0.3	0.4
China	0.6	1.1	0.5	0.8
NICS <u>/a</u>	3.2	5.8	5.2	6.3
<u>Total East Asia</u>	<u>6.7</u>	<u>10.2</u>	<u>6.5</u>	<u>8.3</u>
<u>All Developing Countries</u>	<u>22.2</u>	<u>25.3</u>	<u>11.7</u>	<u>17.1</u>

/a Korea, Singapore, Hong Kong, Taiwan.

Source: UN Trade tapes. Manufactures SITC 5-8.

**Table 3.2: RELATIVE CHANGES IN ASIAN-PACIFIC TRADE FLOW RATIOS  
1960-1983  
(%)**

Ratio	1960	1970	1980	1982	1983
Asian-Pacific exports over world exports	9.0	12.9	15.3	17.6	18.9
Asian-Pacific manufactured exports over world manufactured exports	8.7	14.2	19.9	20.4	
Asian-Pacific over trade of LDCs	43.2	68.8	34.4	40.8	42.6
U.S. trade with Asia-Pacific over U.S. trade with Europe (OECD)	48.1	70.8	97.8	109.5	122.3
EEC trade with Asia-Pacific over EEC trade with United States	61.9	50.2	70.3	68.2	71.7
Trade of Asian-Pacific LDCs over trade of the other LDCs (incl. oil countries)	21.7	30.0	28.8	34.3	39.9
Manufactured exports of Asian-Pacific LDCs over total manufactured exports of all LDCs	30.9	41.6	64.3	67.1	
Manufactured exports of Asian-Pacific NICs over total manufactured exports of all LDCs	24.2	36.2	56.2	58.8	

Note: The ten present countries or the EEC are included in the EEC statistics for 1960 although they were not all members at that time. "Manufactured exports" include SITC 5,6,7, and 8. U.N. 1984 does not give data on the manufactured exports of Korea, Malaysia, and the Philippines for 1982. Korean manufactured exports are assumed to have changed at the same rate in 1981-82 as those of Taiwan; the exports of Malaysia and the Philippines are assumed to have changed in parallel with the average for the other Asian-Pacific countries.

Source: S. B. Linder, The Pacific Century, Stanford University Press, 1986.

### Efficiency Thresholds

3.02 The ingenuity and enterprise of the East Asian NICs have altered the rules of the game for nations like Fiji that are on the threshold of export-oriented industrialization. For a broad range of light manufactures, metal products, engineering goods, machinery, electronic parts and transport equipment, the East Asian countries determine the standards in terms of price,

quality, technology, financing, supply capabilities and delivery schedules. If manufacturers in Korea or Hong Kong are prepared to fill an order for garments meeting exacting specifications at a certain price, then other producers must be in a position to match or even improve upon the capabilities of these suppliers if they want a share of the business. Further, if East Asian standards of factor productivity allow them to earn a particular return on assets, then competitors must be willing to settle for an equivalent rate of return, or if they wish to take aim at a higher range of profits, these will have to be sought through measures that raise the levels of productivity and technology. To put it differently, the Pacific region has become an integrated and a highly competitive market with buyers and sellers enjoying excellent access to information. The pace is being set across a broad range of parameters by a number of intensely dynamic exporters, hence other economies who desire a share of the business must be at least as efficient and offer terms that are comparable before they stand a chance of establishing a foothold in the export market. This is the basic hurdle that prospective Fijian exporters must overcome.

### Sunk Costs

3.03 A country that is serious about competing in world markets must cross an efficiency threshold in as short a time as possible but it is then faced with another entry barrier. Sunk costs give rise to cost asymmetries between incumbent firms overseas and new entrants. A producer who has written off his plant and equipment and advanced along his learning curve is far better placed than a business with new facilities which has to factor depreciation into its costs for several years. In certain capital intensive industries with relatively stable technologies such as iron and steel products, cement, fertilizers, non-ferrous metals, and petrochemical feedstocks, which are attractive to small open economies wishing to limit their import bills, create leading sectors that are rich in linkages and move rapidly with a standardized product into the export market, the problem of sunk cost can be an unsettling reminder of how expensive delay can be. To cite an example, a directly reduced iron plant in Malaysia efficiently constructed and of an optimum size cannot compete against bar and rolled products from established East Asian suppliers because the latter have written off most of their capital assets, feed their mini-mills cheap locally available scrap iron and have accumulated a valuable fund of experience. Ethylene, fertilizer and cement plants springing up in developing countries, even if they are of the appropriate scale, must also come to terms with these uncomfortable facts.

3.04 Lacking a long industrial tradition or much expertise at exporting manufactures, with a labor force that is still short on skills as well as factory discipline and a business class accustomed to operating in a sheltered domestic market, Fiji cannot afford any delay in the development of an export-oriented manufacturing sector. At the same time, a feasible strategy must be so drawn as to suit Fiji's special economic circumstances and accommodate the growth objectives. It will necessarily depart in some respects from the strategies that East Asian NICs deployed when they began industrializing. Being a late starter has its advantages but there are some attendant drawbacks as well.

### Value Added

3.05 With a per capita income of US\$1,800 and wage scales to match, Fiji is virtually debarred from labor-intensive manufacturing activities where the value added is modest and market access depends upon price competitiveness. Many of the mass-produced low-quality textile, wood, plastic and metal items fall into this category. They are the first choice of economies entering the first stage of industrialization, since the technology is stable and easy to master while capital costs are manageable. For this very reason they are already the preserve of countries where wages are half of what a Fijian manufacturer would expect to pay. Products which would be advantageous for Fiji to export fall in a different bracket. They are the ones that do not require much technological sophistication but quality, design and finish are critical, production is in lot sizes that can be handled by small producers and the speed of a manufacturer's response to an order or the discovery of an apparent niche in an overseas market is decisive. Armies of disciplined, low-paid workers do not count but superior entrepreneurship, technical and design skills, a flexible work force and government policies, that to a degree, socialize the inherent riskiness of these operations are vital. In other words, the entry of Fijian businessmen into a fast-moving export environment might have to be eased by way of schemes which provide a measure of insurance against risks that lie in store.

### Technological Capacity

3.06 Late entry means that a wide technological gap has to be bridged and, even with small-scale operations, some expensive automated equipment acquired and brought into use. Managers, technicians and manual workers must be imbued with the desire to master the new technology and where possible improve upon it. Manufacturers in Hong Kong, Korea and Japan are known to examine every new product and process development in their field with minute care and through reverse engineering, produce a comparable item in the shortest possible time that matches or exceeds the original in performance and carries a lower price. The availability of engineering craft and design skills of course contributes to the fleet-footedness of the NICs but entrepreneurial willingness to consider a wide range of opportunities and obtain financing for a host of ventures is by no means unimportant.

### Capital Supply

3.07 Exhaustive research into the wellsprings of East Asian growth have indicated time and again that a variety of factors contributed. Few would disagree, however, that an elastic supply of capital greatly abetted the designs of businessmen. Each of the East Asian NICs have conspicuously high levels of aggregate investment and channel a significant percentage of this directly and indirectly into manufacturing. High rates of capital accumulation have enabled these countries to equip their factories with the latest machinery, to create capacity in anticipation of demand and expand their facilities to stay abreast of market growth, diversify across a wide range of subsectors and, last but not least, find adequate seed money for assorted enterprises that occasionally become the nuclei of future leading sectors. The ability to generate a substantial volume of capital domestically can

enhance the momentum behind any strategy and especially one aimed at enlarging manufacturing capacity.

### NTBs and Geographical Shifts in Manufacturing

3.08 When the East Asian NICs started down the road to modernization, industrial economies were dismantling tariff barriers and trade restrictions. Now the climate has changed. Although tariff reforms have not been reversed, quotas, voluntary restraints and nontariff barriers have mushroomed as the US and the EEC struggle with the specter of deindustrialization. The consequences of this for exporters around the Pacific rim are threefold. First, there is a geographical shift in production, especially in the textiles and garments sector as countries that have filled their quotas move production facilities to places not subject to quota limits. This has benefitted Malaysia, Sri Lanka and Mauritius, for example. Second, most producers have begun moving up the quality and technology gradients so as to increase their returns from the sale of a fixed volume of goods. They have, in addition, modified the composition of their products to sidestep the restrictions. Silk, linen and ramie have gained in popularity as cotton and polyester garments bump against quota ceilings. Similarly, the construction of footwear is altered to navigate between the differing limits on plastic, leather and rubber items. Thus the locus of opportunities is constantly shifting with political forces, market saturation and technology leading the way.

### Direct Foreign Investment

3.09 A third concern relates to direct foreign investment (DFI). This has occurred in a succession of waves, the most recent cresting in the late seventies and early eighties. Electronics, broadly defined, was the principal focus and the multinational companies (MNCs) involved, concentrated on the East Asian economies that seemed politically stable, had a disciplined, low-wage labor force, offered attractive incentives, were equipped with the requisite infrastructure and had good transport links with the US and Europe. The electronics industry is in the throes of a revolution arising from a great increase in the sophistication of its product, automation of manufacture and a resistance to the export of jobs overseas. All of these have influenced the flow of DFI and the interest of the MNCs in searching for new and cheaper sites for their assembly operations. Unless a new industry sparks a fresh surge in DFI, the flow of manufacturing capital towards the developing world is liable to diminish. At the same time, after playing host to the MNCs for over two decades, many countries have realized that the gains from DFI, in the form of linkages, technology transfer and the acquisition of technical skills is quite limited, and the most sophisticated among the developing economies have already begun to look askance at DFI that results in marginal domestic value added and contributes very little towards industrial deepening.

### Fiji's Choices and Report Outline

3.10 Fiji's industrial strategy for the coming years must be shaped by many factors: external pressures are raising the costs of a delayed entry but at the same time they force a new exporter to attain an unusual level of



competence virtually from the start; the flimsy base to industrialization provided by agricultural activities, tourism, and a small inward-looking manufacturing sector; the scale of domestic savings as well as the supply of risk capital for emerging businesses; the availability of labor skills to support a niche-filling export drive; the nation's readiness to absorb manufacturing technology; and last, the likelihood of an ebb in DFI which would transfer even more of the burden of market penetration and technology assimilation on to local firms.

3.11 Industry can begin to displace Fiji's traditional sectors as a source of growth and exports if the country attains a stage of manufacturing capability commensurate with its income level, by-passing the earliest manufacturing stage that is centered upon unsophisticated mass-market items with a low value added. What a country gains from the first stage is a labor force enured to factory discipline; managerial training, market contacts and a reputation as a producer in a market segment where ruthless competition quickly eliminates those wanting in commitment. The only substitute for such experience is a strategy which is highly selective, that nurtures and harnesses local business skills and which promises an economic environment conducive to high entrepreneurial spirits.

3.12 Fiji must grope towards a viable strategy. No infallible recipe exists. But there is a body of empirical evidence which allows us to distill some guidelines and advance a clutch of suggestions. The report interrogates six bodies of development experience so as to expose an underlying matrix of rules and then proceeds to indicate how these might be employed in the Fijian context. Industrial incentives which determine the pattern of prices and profits across manufacturing subsectors come first. This is followed by a chapter where the attention shifts to tax policy and the manner in which it can influence overall investment as well as savings (Chapter V). Since it is the quest for new exports that is behind the urge to industrialize, Chapter VI examines the mix of exports from developing East Asian economies and their concentration across overseas markets. Export oriented growth, the effective marshalling of information on diverse aspects of foreign markets and institutional mechanisms which will promote its domestic utilization is investigated in Chapter VII. The chapter also asks how the foremost NICs have achieved such high standards of wage competitiveness and what lessons there might be for Fiji when it comes to exploiting the resource most crucial for industrialization. Fiji's geographical remoteness and the fixed costs of gathering information are major considerations: increasing and widening information channels will be virtually a precondition for market directed growth; and in the early stages, the information economy will need assistance from the government. This is discussed in Chapter VIII.

3.13 Randomly occurring niches in industrial markets are difficult to target, but an export drive that takes aim at just these lucrative opportunities must be able to call upon a few tried and tested tactics. Again, theory is of no help but the stories behind the exports of fashion garments from Italy as well as several East Asian countries, light machinery from Hong Kong, fruit from the Mediterranean region, alcoholic beverages from Mexico and the Caribbean islands and watches from Switzerland yield a variety of clues which are analyzed in the final Chapter. If niche filling is to be the guiding maxim of Fiji's export strategy such case histories could serve as the didactic springboard for local businessmen seeking overseas sales.

#### IV. INDUSTRIAL INCENTIVES

##### East Asian Approaches

4.01 The investment decision is a complex one and economics is frequently at a loss to explain why neighboring countries with broadly similar resource endowments and incentive regimes can register widely differing rates of private capital accumulation. Clearly, the entrepreneurial antennae is sensitive to many signals and situations can arise when economic messages are blurred or obliterated as a result of static generated by socio-political currents. That said there is considerable truth to the claim that over longer stretches the speed and direction of industrialization display the imprint of incentive policies influencing profits, risks, competition and the relative attraction of foreign markets. In each of the East Asian NIC's, policies governing taxes, protection and subsidies have definitely orchestrated industrial development, although close examination shows that these nations arrived at their current economic stations by varying routes even though they were all guided by much the same philosophy and hemmed in by constraints common to small open economies. An ample literature dwells on nuances of strategy; more important, however, is the composite model that can be dredged from this collective experience.

4.02 Import substitution supplied the initial motivation to industrialize but within a few years the smallness of the domestic market robbed it of momentum. At that stage it was obvious that future growth was predicated upon finding a breed of industry that could export. Some countries sought to create an export base by inviting foreign capital, others by putting their faith in home grown entrepreneurs but the evolution of incentive systems was markedly similar. Import substitution had necessitated high nominal tariffs on final products and exceedingly generous rates of effective protection. Profit margins also benefitted from tax holidays, depreciation allowances and not infrequently, subsidized credit. The economy paid a steep price for entrepreneurial well-being: first because the structure of incentives was profoundly biased against exports; second the magnitude of effective protection encouraged operations where the value added was low or negative; and third the domestic orientation of firms meant that plants were of uneconomic size and in no position to meet the test of international competitiveness at any point in the future.

4.03 Four major reforms of the incentive system signalled the move towards export-led growth. The bias against exports was perceived as a severe handicap and measures were introduced that assured export industries an equal degree of effective protection. This was achieved by cutting import duties on raw material and machinery imports destined for the export sector and trimming protection to import substituting industries. A gradual lowering of effective protection for industry as a whole was the second major reform. By the early seventies, countries such as Singapore and Hong Kong had brought effective

protection down to very modest levels banished all possibilities of negative value added and provided a powerful spur to industrial deepening.<sup>15/</sup>

4.04 When import substitution was the regnant philosophy, regulation and licensing in all its multifarious forms thrived. After thinking changed, it soon became apparent that a bureaucratic obstacle course would defeat the most zealous exporter. Some controls remained but each country endeavored to prune regulations and telescope the process leading from application by a prospective industrialist to the sanctioning of a license. The Economic Development Board in Singapore which took over the entire processing of industrial applications was perhaps the most radical instance of bureaucratic simplification, but all the NICs recognized the disadvantages of unnecessary meddling in an activity that was sufficiently fraught and risky to start with and began lightening their supervisory bureaucracies.

4.05 Unlike production for the domestic market, exporting is more dependent on the timely availability of adequate financing. Where capital markets were poorly developed and hostile towards manufacturers with insufficient collateral, this could pose insurmountable problems especially for smaller exporters. The NICs soon came to recognize this problem and the fourth innovation they introduced was an effective and relatively accessible system for arranging pre and postshipment export financing and servicing a part of the manufacturing sector's capital needs. Under prodding from the government, the banking industry gradually expanded its responsibilities and became in time, a hand-maiden for industry. (See Tables 4.1 and 4.2 for details on industrial incentives in Korea and Singapore.)

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<sup>15/</sup> See B. Balassa, Ed. Development Strategies in Semi-Industrial Economies, Johns Hopkins, 1982; A.J. Youngson, Hong Kong: Economic Growth and Policy, Oxford University Press, 1982; Mee Kan Nyaw and Chong-leong Chan, "Structure and Development Strategies of the Manufacturing Industries in Singapore and Hong Kong," Asian Survey, May 1982, Vol. 22, No. 5.

Table 4.1: KOREA -- SUMMARY OF INDUSTRIAL INCENTIVES

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Government Commitment to  
Export-Oriented Growth

In 1960, Korea's exports were abnormally low relative to country's size and stage of development thus there was an export potential waiting to be tapped. This, together with the low level of export, helps to explain the very large percentage increases which occurred. Success in export is also due to government's strategy and the flexibility government showed in altering incentives to meet changing circumstances. The initial rapid success in exporting also fueled later growth and helped attract foreign investment to Korea. A system of export targets for individual firms in particular markets was introduced in 1962. If exports fell below target, efforts were made to rectify the situation. Target levels were continually increased. The Government subsidized Korean Trade Promotion Corporation (KOTRA) was funded in 1964 to promote exports and undertake market research. It also sent trade missions abroad.

Exchange Rate

Most important policy change for opening the economy was adoption of a uniform exchange rate between 1961 and 1966, which corrected previous overvaluation.

Taxation

Exporters received a 50% reduction in direct taxes on income earned in export as well as allowance for accelerated depreciation.

Credit

Preferential rates on working capital loans to exporters. Rates reduced from 14% in 1960 to 6% in 1967; exporters also had preferential access to foreign exchange loans. By 1964 interest rate subsidies constituted more than 1/5 of total export subsidies.

Tariffs, Quantitative  
Restrictions

Exporters had unrestricted access to imported inputs they were exempt from import quotas, tariffs and indirect taxes on intermediate and capital goods (whether imported or purchased domestically) used to produce both direct and indirect exports. Trade controls were gradually relaxed after 1964; further liberalization occurred in 1967. The positive list of items which could be imported was replaced by a negative list. Rapid growth of imports that were exempt from custom duties left the average tariff on total imports unchanged.

Export-Import Link  
Schemes

Import entitlements were linked to export performance. From 1957, only firms whose export sales met certain targets could become registered importers. Export sales required before a company could register as an importer were continually increased, from \$10,000 in 1958 to \$300,00 in 1970.

Wastage Allowances

Exporters received generous wastage allowances on imported inputs for export production, in practice these allowances exceeded any reasonable estimate of genuine wastage and since many of the imported intermediate goods were otherwise prohibited, the legal resale of them enabled many exporters to earn additional profits.

Foreign Capital

Interest rate reforms of 1965 helped in attracting commercial lending to Korea and borrowing attractive to Koreans; interest rates were about 26% for borrowing from domestic sources, but only 12% for dollar-denominated loans, and even lower for those with government guarantees. Direct Foreign Investment increased substantially only after 1972, share of DFI in total foreign capital inflows rose to nearly 20%; inflows of foreign capital have been largely a response to Korean export performance.

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Source: B. Balassa, op. cit., and A. O. Krueger, The Development Role of the Foreign Sector and Aid, Harvard University Press, 1979.

**Table 4.2: SINGAPORE: SUMMARY OF INDUSTRIAL INCENTIVES**

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**Tariffs**

Tariffs were the preferred incentive for industrialization; rates were generally low, 58% of commodities subject to tariff protection led rate of 25% or lower; majority of imports were duty free. Exporters were exempted from import duties on all inputs. Other producers received liberal duty exemptions on imports of raw materials, intermediate goods, machines and other inputs not produced domestically.

**Export Incentives/Tax Incentives**

Tax allowances for marketing expenditures abroad, tax rate on profits received from exports by approved manufacturing companies was reduced from 40% to 4%, for a period of up to 15 years. Pioneer Industries Ordinance gave a 5 year period of relief from corporate tax for new companies producing for home or export market. In 1975 it was extended to 10 year period, and minimum requirement of S\$1 million of capital was removed so as to encourage development of smaller firms in high technology industries.

**Import Licensing/  
Quantitative  
Restrictions**

Quantitative restrictions reduced after move to export oriented industrialization. The number of commodities subject to QRs fell from 88 in 1965 to 3 in 1973. Quotas imposed in cases where domestic industries faced "unfair" competition. Quotas were officially regarded as temporary subsidies to domestic producers while they developed export outlets and were replaced ultimately by import duties.

**Foreign Investment**

Investment promotion activities were geared towards attracting foreign industries; a network of offices and representatives abroad was established. During the 1960s a large number of MNCs set up manufacturing and distributing facilities in Singapore. By 1973, nearly 75% of manufacturing investment was foreign and foreign firm accounted for 75% of manufacturing exports, excluding re-exporting in 1971.

Export Financing

In 1974, Government allocated S\$100 million for financing export bills at a quarter percent below prime rates, and for financing manufacturers who wished to expand their capital equipment for export production. Export Credit Insurance Corporation was established in 1975, with government contributing 50% of capital and remainder coming from commercial banks and insurance companies.

Credit

Economic Development Board (EDB) established in 1961 to promote incentives to private capital for establishing industries in Singapore. EDB provided factory sites on industrial estates, gave technical assistance (e.g. feasibility, market studies, technical and managerial training). EDB was provided with S\$100 capital grant to finance loans and equity participation in industry; firms could borrow up to 50% of the fixed capital requirements for up to 10 years, provided sum borrowed did not exceed their paid-up capital. Availability of long-term financing and EDB's less stringent standards of creditworthiness was more important than actual market rate.

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Source: B. Balassa, op. cit.

4.06 To summarize, the East Asian NICs commenced their attack upon export markets by modifying their incentive system in four respects: the bias against exports was whittled down; effective protection was reduced and the infrastructure comprised of tariffs, quotas and import duties rationalized; bureaucratic impedimenta that can make the processing of a project a sustained agony, were deliberately excised; and the capabilities of the financial market extended in just those areas where they tend to be most wanting viz., funding for small and medium scale manufacturing ventures and the automatic supply of export credit for firms directly and indirectly involved in trading. From the very outset, Hong Kong had the characteristics of a free trade zone (FTZ) and once Singapore had overhauled its incentive system and taken the export-led strategy to heart, the island more or less functioned as an FTZ. It is interesting to note that even the other East Asian NICs which for reasons of strategy and size settled for an intermediate position found it expedient to establish FTZs, partly as a competitive reflex but also because they recognized that FTZs brought in foreign capital and technology, could be made to spawn linkages with the rest of the economy, helped build the country's reputation as a manufacturer and created employment.

4.07 The NICs sought integration with the world trading economy as the avenue to future growth. It was a risky strategy. The certainties of import substituting industrialization were discarded out of the conviction that the economy could become internationally competitive and had to break with a pattern of development which was self limiting and suffocatingly inefficient. All four of the East Asian NICs gambled and won, but the odds against an export-led strategy running aground in the sixties were much smaller than they are today. Very few countries were seeking their fortunes in the world market. That is no longer the case, hence the reform package does not come with a guarantee. Many other economies are experimenting with variants of the East Asian approach and the chances of one emerging as a new Hong Kong in a few short years have decreased. The troubles Singapore has encountered during 1985/86 underline the changed state of affairs.

4.08 There remains one feature of development in the successful island economies which a discussion dealing with incentives for manufacturing must not overlook. Both Singapore and Hong Kong are major ports and have served as centers for flourishing service industries. Tourism, finance, insurance, brokering, ship repair and many others are intrinsic to the islands' vitality. Synergy between manufacturing and services is a major force and variety of direct, entrepreneurial and macroeconomic linkages have contributed to the efficiency of industrial incentives. Highly sophisticated financial markets provide immeasurable advantages for businessmen and in both countries, the annual influx, of free spending tourists greatly enlarges the potential clientele for local producers. In the end, the model is not so much blurred as substantially qualified. If growth is to be led by manufacturing, exports must expand. Industries that will become active traders require a particular mix of incentives and a close interaction with the world economy is unavoidable. However, the probability of a dramatic take-off by local industry or the rush of foreign capital into manufacturing activities is much smaller than it was during the industrial infancy of Singapore. For an island economy, exporting manufactures remains an attractive strategy but it can use all the help service industries are able to provide and other than in exceptional circumstances, the furious growth rates of the sixties and seventies may be a historical curiosum.

#### Fiji's Manufacturing Sector

4.09 The Fijian manufacturing sector is currently at the stage that Singapore had reached in the mid-sixties through a very similar import substituting strategy. Ever since independence in 1970, industrial growth in Fiji has been in areas such as food and beverages, plastic, wood, paper, metal and chemical products, largely serving low volume local consumer demand. The manufacture of construction materials was aided by Government spending on infrastructure, private housing investment and the expansion of the hotel industry in the seventies. More recently, a window opened by trade agreements with Australia has been a welcome break for garment producers. Veneer and plywood, although buffeted by the never ending turbulence in the world market, remain an important source of foreign exchange earnings and a new coconut oil facility near Savusavu promises to inject life into the moribund vegetable oils subsector.



4.10 Manufacturing growth has been stable if not spectacular over the past fifteen years and encouragingly, the non-sugar manufacturing sector has proved to be more resilient than all others during the difficult eighties (see Table 4.3). However, it remains small and has yet to mature. Manufacturing accounts for less than 10% of GNP and it employs 18% of the labor force.<sup>16/</sup> While manufacturing activities in Fiji are dominated by one industry, sugar processing, (about 27% on average for 1981-83), a wide range of goods are currently manufactured (see Table 4.4). Food processing, outside of the sugar industry, accounted for 29% of value-added in the manufacturing sector. A number of items are produced for local consumption as well as export--canned fish, a variety of fruit juices (e.g., coconut, orange, and passion fruit), bakery products, snack foods, tomato sauce, ghee, and processed ginger. The second largest manufacturing category, also reflecting Fiji's apparent comparative advantage in resource-based industries, is wood products, accounting for 9.4% of value added. This subsector contains a number of medium-sized furniture producers, who have recently gained some success in exporting to Canada, US and Australia.

4.11 With the exception of clothing and footwear manufacture, which still remains a small but growing segment in total manufacturing value-added (about 3%), the rest of the sector produces almost entirely for the domestic market. In fact, government officials estimate that about half of manufacturing value-added owes its existence to the government's policy of import substitution -- almost 70% of the nonsugar manufacturing subsectors. Machinery and equipment manufacture, the third largest component of the sector, is dominated by shipbuilding and ship-repairing. Small cargo vessels, fishing boats, and coastal vessels are produced for local, as well as regional companies. In addition to construction activities, servicing and repair work is done in Fijian yards. Two multinational firms with connections to Australia and New Zealand produce a limited range of chemicals. There is packaging and distributing of bulk chemicals for domestic use and for export to the surrounding Pacific states. One firm also manufactures paints for the local market, under the protection of high tariff walls. This brief summary of manufacturing activities does indicate that the nucleus of an industrial sector already exists in Fiji, though its orientations are distinctly inward-looking.

4.12 Most of the workers are unskilled and the operations they are involved in such as assembly and packaging result in a relatively low average level of value added for the sector as a whole. Emerging out of the investments by multinational corporations of which Australian owned Burns Philp and Carpenters are the most important, industry is still very much in the grip of foreign capital that has come to serve the domestic market and not, so far, in search of an export platform. Since the late seventies, Fijian entrepreneurs have begun playing a more prominent role with a leading company owned by Hari Punja active in flour milling, coconut oil refining, toiletries and ghee production. A small market size, strict licensing and a pervasive government

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<sup>16/</sup> Total formal sector employment is 79,000, that in manufacturing is 14,500.

**Table 4.3: GDP BY INDUSTRIAL ORIGIN**

	1975	1980	1985
GDP at market prices (million F\$)	502.4	983.7	1,350.0
	<u>GDP Shares</u>		
Agriculture (% of GDP)	25.0	29.3	15.5
Manufacturing (% of GDP) (includes sugar manufacturing)	10.7	10.9	8.7
Wholesale and Retail Trade (% of GDP) (including tourism)	19.0	16.5	15.4
	<u>GDP Growth Rates</u>		
	<u>1975-80</u>	<u>1980-85</u>	
GDP at market prices	4.1	1.3	
Agriculture	5.4	1.0	
Manufacturing	6.6	1.0	
Non-Sugar Manufacturing	-	2.8	
Wholesale and Retail Trade	3.2	1.1	

Source: World Tables, World Bank.

concern to avoid wasteful duplication of facilities has resulted in a high degree of industrial concentration. Several subsectors are the preserve of a single firm and in most instances between two and three producers divide the business among themselves. Industry is run oligopolistically and competition is contained.

4.13 The tourist industry has established some linkages with producers of food and beverages and to a lesser extent with manufacturers of wood products, textiles and toilet articles but as in the Caribbean countries the linkages have remained sparse and tenuous. Quality standards have not improved appreciably and there are few signs of a concerted effort by local entrepreneurs to offer acceptable substitutes for items the hotel industry continues to

import. As upscale hotels are frequently unable to satisfy their requirements from local suppliers in developing countries, this is not too surprising, but the weakness of the linkage mechanism around the sugar and fish sectors is more disturbing. Sugar has the potential for becoming the center of a thriving manufacturing subsector producing by-products (see Chart 1<sup>17</sup>) and as Peru has shown, anchovy fishing can have strong linkage effects.

**Table 4.4: VALUE ADDED BY MANUFACTURING SUBSECTOR  
(F\$ '000)**

FSIC /a Industry	Value Added		
	1981	1982	1983
Food manufacturing	57,201	66,624	40,519
(of which sugar)	31,306	38,084	11,022
Clothing and footwear	2,600	3,182	3,566
Wood products	8,836	8,588	10,231
Paper and printing	7,024	6,627	8,059
Chemical products	7,333	7,244	8,926
Non-metallic & basic metal products	4,843	4,710	8,310
Machinery and equipment	8,618	8,707	9,954
Miscellaneous products	772	566	831
<u>Total manufacturing</u>	<u>97,227</u>	<u>106,248</u>	<u>90,396</u>
<u>% Change</u>			
including sugar	7.9	9.3	-14.9
excluding sugar	7.2	3.4	16.4

/a Fiji Standard Industrial Classification.

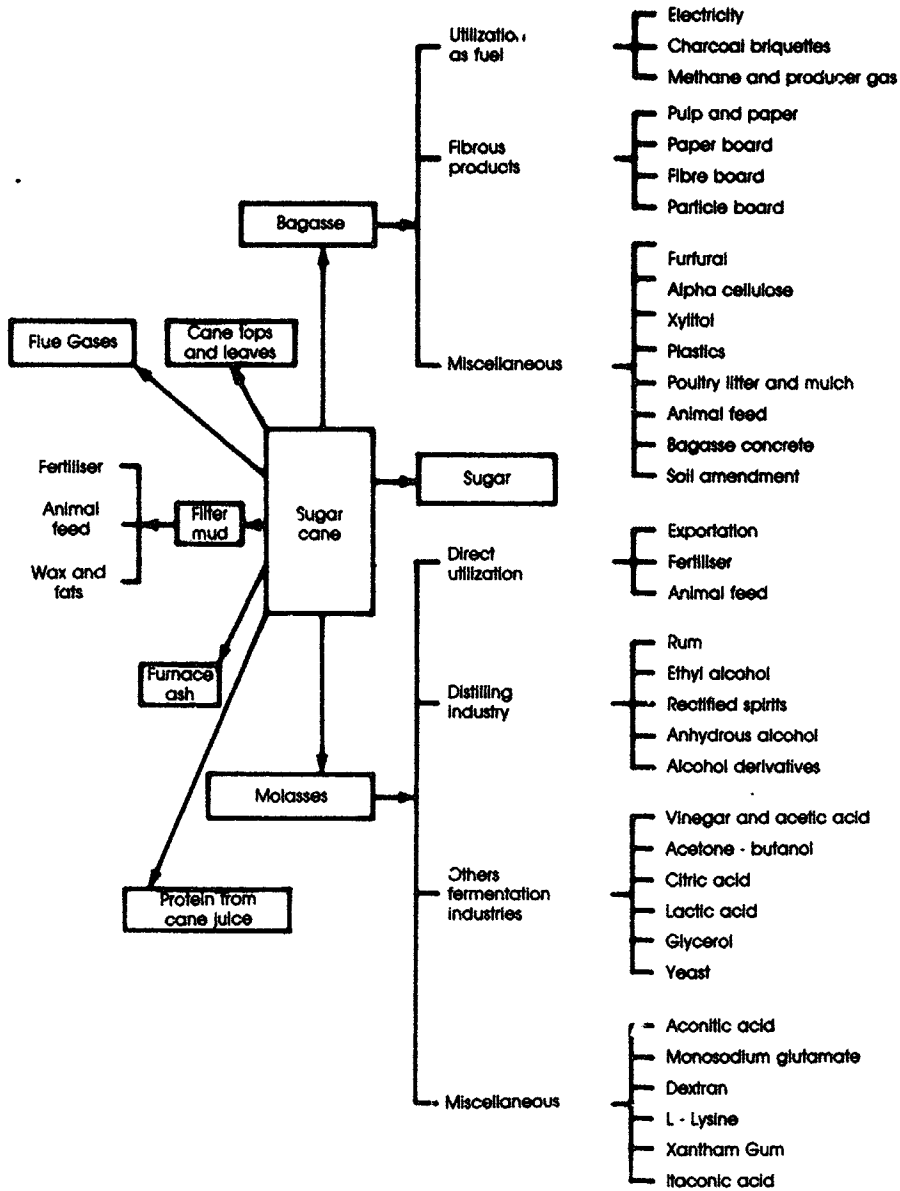
Source: 1983 Census of Industrial Production, Bureau of Statistics, October 1985.

4.14 Fijian bagasse is mostly consumed as fuel possibly ruling out the production of high density thin fibreboard, particle board or packing material. But molasses can be converted into yeast based animal feed, rum, ethanol and a range of chemicals, the three tons of filter muds obtained from every 100 tons of cane pressed can be used as fertilizer, while cane wax the preferred coating for citrus fruit, could be marketed commercially. The harvesting and transport of sugar cane can support small scale repair facili-

17/ M. Roemer, Fishing for Growth: Export-led Development in Peru, 1950-67, Harvard University Press, 1970.

CHART 1

**By-Products of the Cane Sugar Industry**



Source: *By-Products of the Cane Sugar Industry: An Introduction to Their Industrial Utilization*; J. Maurice Paturau, Elsevier Scientific Publishing Company, Amsterdam, 1982, p. 11

ties for machinery and metal working to supply spares for equipment used. In many countries such farm level activities have become the backbone of a thriving engineering industry. With Fijian small-holders preferring manual techniques of harvesting there is less scope for machine rebuilding and repair, nevertheless, the sugar sector has been strikingly unsupportive of manufacturing development. Fisheries, a far smaller subsector than sugar has been behind the appearance of a small ship-building industry and of repair services.<sup>18/</sup> Perhaps because the total landed catch is still just 5,800 tons (1985) the panoply of supporting firms that could be observed in Peru during the heyday of anchovy production have never surfaced. Suppliers of nets for instance, fabricators of processing equipment coolers, dryers; manufacturers of pumps, centrifugal separators and electric motors; metal workers; and firms specializing in fish meal.

4.15 To cite just one more example of linkages that have failed to take root, there is the case of the local furniture industry. Certain kinds of local timber are well suited for furniture, but manufacturers also require fabric, springs, material for padding, plastic based panels and sheets, resins, nails, metal brackets, jute backing, not to mention a variety of tools and machines to cut, shape, polish and assemble the individual pieces. Demand has grown with manufacturers serving a sizable domestic market; yet neither furniture makers nor other producers have found it profitable to exploit the linkages and commence the deepening of the industrial sector.

#### Past Incentive Policies

4.16 As is apparent from DP7 and DP8 and convincingly enunciated in the latest plan document, the government seeks industrialization that will help to diversify exports. In 1980, it created the Economic Development Board -- a statutory body composed of representatives from Government, the trade unions, private employers and rural sector -- to provide investors with a complete package of information and extension services "under one roof". To quicken entrepreneurial interest, the Government has offered an array of inducements including: income tax concessions; accelerated depreciation of assets; fuel economy relief; export incentives; carry forward of losses; import duty relief; protection through import licenses; and provision of developed industrial land. Details are given in Table 4.5. The sector has responded, but aside from a flurry of export activity in the garments industry, it has remained inward looking, shallow rooted and from all indications, uncompetitive by world standards. Many factors have contributed (some which are covered in later Chapters) but as was the case in the early history of the East Asian NICs high protection and a bias towards import substitution over exporting are major culprits. The modal rate in a rather complicated tariff schedule is 50% and most rates are below 85%. There is the usual cascading of tariffs with rates on consumer goods handily exceeding those levied on capital

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<sup>18/</sup> The shipbuilding industry in Fiji, dominated by Carpenters Industrial (an Australian MNC), has spawned a few industrial linkages into the steel-made equipment sector. See, E. Utrecht, Fiji: Client State of Australasia, University of Sydney, Sydney, 1984, pp. 242-244.

equipment and raw materials. As a large part of local production competes against imported consumer good and uses imported intermediates, the average level of effective protection is above 100%.<sup>19/</sup> Rebates of the tariffs levied on imported items used for manufacturing (see Table 4.6) further heightens the protective effect of the system.

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19/ Where an incentive structure for an entire industry is being considered, the nominal rate measure may sometimes give a misleading impression of the effect of protection on incentives for resource use in different industries. Given equal nominal rates on the outputs of two industries, the incentive provided for resource use in them may differ depending on, among other things, the importance of intermediate inputs in their cost structures and the level of protection afforded domestic production of inputs. Thus, whilst incentives such as tariffs on the output side benefit producers, tariffs on tradeable inputs penalize or tax the production process -- the effective rate concept measures the net extent of the incentives. Here it should be noted that the tradeable inputs include both those that are actually imported and those sourced locally, such as packaging material. The effective rate of protection may be defined as the difference between value added in domestic and world price terms, expressed as a percentage of value added in world prices. The basic effective rate formula, which is frequently used in evaluation of protection measures can be expressed as:

$$ERP = \frac{t_0 - x \cdot t_i}{1 - x}$$

where  $t_0$  = nominal incentive on output (taking into account if possible quantitative restrictions on imports)

$t_i$  = nominal incentive on inputs

$x$  = materials to output ratio, expressed in world price terms.

From this, it can be seen that the effective rate of protection is influenced by levels of tariffs (and the effects of quotas) on competing imports and on inputs and the materials to output ratio. In general the higher the nominal protection against competing imports, the lower the taxing effects on input and the lower is value added -- then the higher is the effective rate of protection.

Table 4.5: FIJI -- SUMMARY OF INDUSTRIAL INCENTIVES

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Rebate Certificates

Allow concession on duties on machinery and raw materials. Used to apply indefinitely but in 1984 it was decided that they should expire at end of that year. At same time, customs duty was increased to 5% for machinery and 7.5% for raw materials; these goods remain free of fiscal duty. However, the certificates were not abolished and guidelines for evaluation of requests for extension of rebates are still being prepared. In 1982, about 259 firms used the certificates for raw materials and total value of concession (in terms of duty forage) was about F\$31 million; 15 firms used certificates for machinery, with a concession value of F\$11 million.

Import Licensing

Used in an ad hoc fashion and usually provided for an indefinite period. Currently 45 food and other manufactured products are subject to import licensing which account for about 30% of value added in manufacturing. Moreover, 40% of the value-added covered by import licensing applies to food and agricultural products.

Price Controls

Two separate instruments (i) the Prices and Incomes Board (PIB) which administers the Counter-Inflation Act. As of April 1986, 39 goods were covered by a fixed percentage mark-up control; and 13 goods and services (mostly food and building materials) had fixed wholesale and retail prices. (ii) The Prices Justification Tribunal within the Ministry of Economic Development, Planning and Tourism, which is responsible for ensuring that ex-factory prices for locally produced goods benefitting from import prohibition are "not excessive."

Tariffs

Comprise fiscal and customs duties, with the former dominant. Almost 60% of tariff rates are below 20%. Tariffs range from relatively high rates on consumer goods (highest rates apply to motor vehicles) to lower rates on capital and intermediate goods. In most cases, the rebate certificate scheme means that scheduled tariff rates do not apply.

Export Incentives

- (i) Drawbacks: Drawback facility available for directly imported inputs used in production for export markets, based upon input-output coefficients. Does not include indirect exports.
- (ii) Taxation Incentives: Rebate on tax chargeable on export profits, varies according to local value-added of exported product, thus value of incentive varies in relation to profitability of exporting. Future incentive to exporters provided by tax deduction equal to 150% of approved expenditure on promotion and marketing of goods from Fiji

Pre- and Post-shipment Finance

Pre-shipment finance scheme introduced by the Reserve Bank of Fiji (RBF) in 1985 for export of non-traditional items (i.e. sugar, molasses, coconut oil and gold are excluded). Finance available through commercial banks at 8% p.a. interest (compared to 13.5% p.a. commercial bank lending rate); RBF refinances banks at 6% p.a. Exports under SPARTECA and LOME are granted facility automatically, other items require minimum of 40% local content. Postshipment financing available at similar interest rate. RBF only provides forward exchange cover to commercial banks trading in A\$ and NZ\$ for up to 6 months and limited to SPARTECA exports; risk of trading in other currencies is borne by exporter.

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4.17 The structure of incentives is a creature of piecemeal government intervention over 15 years, reaching down to the level of the individual firm. It is difficult to assess, remains subject to administrative discretion which injects considerable uncertainty into business planning and having been tailored to exact microindustrial specifications has eroded the incentive to raise efficiency. The mission did not embark on a detailed survey of levels of effective protection in Fiji, due to time and data constraints. The authorities recently tried to obtain some information on costs and profits from the manufacturing sector, but did not have much success. This occurred because it was widely believed that the government was preparing to adjust tariffs on the basis of profit levels. Further, published industrial statistics tend to be highly aggregated so as to protect the confidentiality of the very small number of firms inhabiting each subsector. For these reasons, proposals for a reform have been based on a qualitative approach whose empirical core is a listing of products subject to rebate certificate,



classified by the level of tariffs protecting outputs. The salient characteristics of the principal manufacturing activities are shown in Table 4.6. First a few words of elucidation. Although the unweighted average level of tariffs on competing imports of the sample is about 45%, once quantitative restrictions are factored in, it is likely to be higher. Almost half the products in this sample benefit from quotas and have a tariff of less than 35% on competing imports -- moreover, none of the products in the category with the highest tariffs (65% and over) have quotas on competing imports. This indicates that the protection for some production activities has been afforded by way of high (and increasing) tariffs, whilst for others it has been by way of quotas. Of course, the end result may well be the same. Another influence on output protection is the structure of excise duties, which are a tax on local production only and thus reduce the benefit of tariffs. In Fiji, excise taxes are levied as a specific tax (e.g., per kg) on the final goods involved; however, the rates are fairly low and less than half the products listed are subject to this levy.

4.18 The tariff on inputs subject to the rebate certificate is 7.5% and, in general, this rate could be taken as indicative of the taxing effect on inputs into local production, although there are some qualifications. First, not all imported inputs are subject to the concession (this may be because a locally produced input is available). For example, in the case of ice cream production, about 70% of imported inputs are subject to the scheduled tariff rate (not necessarily 7.5%). The weighted average tariff on inputs used in ice cream production is about 18%.<sup>20/</sup> Second, there are locally sourced inputs, such as packaging--which in turn are protected by way of high tariffs. This indirectly increases the costs to user industries. Only about one-fifth of the activities in the sample source more than 30% of their raw material requirements locally and these are listed as follows:

- |           |   |   |
|-----------|---|---|
| 50% +     | : | biscuits, cake mix, wooden handicrafts/sticks; louvre windows; fruits and vegetables; veneer and plywood; |
| 40% < 50% | : | butter, cooking oil and margarine, ice cream and peanut butter; and                                       |
| 30% < 40% | : | confectionary, buses, furniture, upholstery and mufflers.   |

4.19 The value-added ratios shown in Table 4.6 are in domestic prices which have been adjusted to the structure of protection. It is defined as the value of output less intermediates -- the latter including raw materials and what are referred to as nontraded such as electricity and business

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<sup>20/</sup> This information is derived from the limited returns made to the firm questionnaire--the input tariff of 18% appears to be much higher than usual.

Table 4.6: Value-Added, Protection Coefficients of Fiji's Industrial Sector

Product <u>a/</u>	Tariff Protecting Output (%) <u>b/</u>	Quantitative Restrictions	Excise Duty <u>c/</u>	Tariffs on Inputs (Subject to Concession - %)	Proportion Value-Added on Domestic Prices <u>d/</u>	Proportion of Raw Materials Locally Sourced <u>e/</u>
<u>65 percent and over</u>						
	(+)					
Beer	200	-	Yes (100)	7 1/2	0.16	0.26
Confectionary	80	-	Yes	7 1/2	0.27	0.31
Biscuits	80	-	-	7 1/2	0.28	0.66
Snack foods	80	-	Yes	7 1/2	0.18	0.13
Coke mix	80	-	-	7 1/2	0.28	0.66
Soap	72.5	-	Yes (20)	7 1/2	0.25	0.28
Detergent	72.5	-	Yes (20)	7 1/2	0.25	0.28
Paints	67.5	-	Yes (5)	7 1/2	0.24	0.16
Buses	67.5	-	-	7 1/2	0.43	0.38
Furniture	67.5	-	-	7 1/2	0.36	0.34
Upholstery	67.5	-	-	7 1/2	0.36	0.34
Overalls +	65	-	-	7 1/2	0.33	0.02
<u>50 &gt; 65 percent</u>						
Cello bags and tapes	57.5	Yes	-	7 1/2	0.30	0.02
Plastic containers	57.5	-	-	7 1/2	0.30	0.02
Cosmetics	57.5	-	-	7 1/2	0.25	0.28
Umbrellas	57.5	-	Yes (10)	7 1/2	0.36	0.16
Poly Bags	57.5	Yes	Yes (3)	7 1/2	0.30	0.02
Plastic products	57.5	-	Yes	7 1/2	0.30	0.02
Music cassettes	57.5	-	-	7 1/2	0.30	0.02
Incense sticks	57.5	Yes	-	7 1/2	0.54	0.09
Baby cream	57.5	-	-	7 1/2	0.25	0.28
Wooden handicrafts	57.5	-	-	7 1/2	0.48	0.59
Toilet preparations	57.5	-	-	7 1/2	0.25	0.28
Polythene bags	57.5	Yes	Yes (15)	7 1/2	0.30	0.02
Drinking straws	57.5	-	Yes	7 1/2	0.30	0.02
Plastic bottles	57.5	-	-	7 1/2	0.30	0.02
Wooden sticks	57.5	Yes	-	7 1/2	0.48	0.59
Butter	55	Yes	Yes (2)	7 1/2	0.21	0.45
Cooking Oil & Marg.	55	Yes	Yes (3)	7 1/2	0.31	0.41
Paper products	52.5	-	Yes	7 1/2	0.34	0.15
Stationary	52.5	-	-	7 1/2	0.34	0.15
Cardboard cartons	52.5	-	-	7 1/2	0.34	0.15
Aluminum utensils	52.5	-	-	7 1/2	0.29	0.05
Printed products	52.5	-	-	7 1/2	0.41	0.00
Envelopes	52.5	-	-	7 1/2	0.34	0.15
Toilet paper	52.5	-	Yes	7 1/2	0.34	0.15
Self-adhesive labels	52.5	-	-	7 1/2	0.34	0.15
Paper cups	52.5	-	-	7 1/2	0.34	0.15
Cards	52.5	-	-	7 1/2	0.34	0.15

Table 4.6: (Continued) Value-Added, Protection Coefficients of Fiji's Industrial Sector

Product <sup>a/</sup>	Tariff Protecting Output (%) <sup>b/</sup>	Quantitative Restrictions	Excise Duty <sup>c/</sup>	Tariffs on Inputs (Subject to Concession - %)	Proportion Value-Added on Domestic Prices <sup>d/</sup>	Proportion of Raw Materials Locally Sourced <sup>e/</sup>
<b>35 &gt; 50 percent</b>						
Cement	47.5	Yes	Yes (4)	7 1/2	0.35	
Dental cream	47.5	-	Yes	7 1/2	0.25	0.28
Louvre windows	47.5	Yes	Yes (4)	7 1/2	0.33	0.62
Candles	47.5	-	Yes	7 1/2	0.54	0.09
Stainless st. utensils	47.5	-	-	7 1/2	0.29	0.05
Ice cream	45	-	Yes (10)	7 1/2	0.21	0.45
Nails and staples	42.5	-	Yes	7 1/2	0.29	0.05
Solar heaters	42.5	-	-	7 1/2	0.29	0.05
Ropes	42.5	Yes	Yes	7 1/2	0.36	0.16
Footwear	40	-	Yes	7 1/2	0.26	0.00
Fruits and vegetables	40	Yes	-	7 1/2	0.11	0.61
Peanut butter	40	-	-	7 1/2	0.21	0.45
Foam	37.5	-	Yes (14)	7 1/2	0.30	0.02
<b>20 &gt; 35 percent</b>						
Solvents	32.5	-	Yes	7 1/2	0.25	0.16
Scouring powder	32.5	-	Yes	7 1/2	0.25	0.28
Batteries	32.5	Yes	-	7 1/2	0.22	0.04
Toys	32.5	Yes	-	7 1/2	0.36	0.16
PVC pipes	32.5	Yes	Yes	7 1/2	0.30	0.02
Fluorescent lights	32.5	-	-	7 1/2	0.22	0.04
Radio telephones	32.5	-	-	7 1/2	0.22	0.04
Polishes	32.5	-	-	7 1/2	0.25	0.28
Thinners	32.5	-	Yes	7 1/2	0.54	0.08
Lamps + holders	32.5	-	-	7 1/2	0.22	0.04
Adhesives	32.5	-	Yes	7 1/2	0.54	0.08
Brushes	32.5	-	-	7 1/2	0.36	0.16
Dusters	32.5	-	-	7 1/2	0.36	0.16
Flour	30	Yes	-	7 1/2	0.14	almost Zero
Crown corks	30	Yes	Yes (9)	7 1/2	0.36	0.16
Mosquito coils	30	-	-	7 1/2	0.54	0.08
Wheelbarrows	22.5	-	-	7 1/2	0.29	0.05
Trailers	22.5	-	-	7 1/2	0.29	0.05
Chalk	22.5	-	-	7 1/2	0.36	0.16
<b>Less than 20 percent</b>						
Roofing iron	17.5	Yes	Yes (2)	7 1/2	0.23	0.06
Poly sheets	17.5	Yes	-	7 1/2	0.30	0.02
Veneer and plywood	17.5	Yes	-	7 1/2	0.33	0.62
Metal cast goods	17.5	-	-	7 1/2	0.23	0.06
Steel wire slugs	17.5	-	-	7 1/2	0.23	0.06
Steel rods	17.5	Yes	Yes	7 1/2	0.23	0.06
Animal feed	15	-	-	7 1/2	0.18	0.13
Mufflers	15	-	-	7 1/2	0.43	0.38
Rulers	15	-	-	7 1/2	0.33	0.62
Metal containers	12.5	-	-	7 1/2	0.29	0.05
Prepared fish	10	-	-	7 1/2	0.11	0.61
Jewelry	10	-	-	7 1/2	0.21	0.04
Gas stoves	7.5	Yes	-	7 1/2	0.51	almost Zero

a/ Based on a listing of products compiled by the Ministry of Economic Development, Planning and Tourism—excludes cigarettes and tobacco for which specific rates of duty apply.

b/ The tariffs protecting outputs are those that applied prior to the revisions of April 1986. These revisions resulted in increases in tariffs in large part on those products already subject to high tariffs.

c/ Where available the estimated incidence of the specific excise duty rates (in terms of cif import prices) is shown in brackets.

d/ These proportions are averages for the FSIC group to which the product belongs.

e/

charges.<sup>21/</sup> On this definition almost half the activities have a value-added of less than 30% -- such relatively low ratios alone would tend to result in high effective rates of protection. However, the effective rate of protection formula is based upon value added in world prices, which is usually estimated by deflating the observed input-output data on the country imposing the tariffs.<sup>22/</sup> Taking only those items subject to a tariff of 50% and over (adjusting for excise taxes and assuming a "tax" on inputs of 15%) the following products may have negative value added in world price terms: beer, confectionary, biscuits, snack foods, cake mix, paints, cosmetics, baby cream and toilet preparations.

4.20 Apart from confectionary, biscuits and cake mix, these products have a relatively low percentage of value added (in domestic prices) and a limited reliance of locally sourced raw materials. By replacing imports of the final goods, they have most probably worsened the balance of payments since the free trade value of the final goods displaced by domestic production is less than the cost of the imported inputs.

4.21 Using Table 4.6 and the framework of effective protection allows the following generalizations:

- (a) that in absolute terms there is a considerable incentive to produce for the domestic market. Levels of protection are particularly high for those products benefitting from a tariff of 50% and over, with prima face evidence of negative value added in world prices. The average unweighted level of effective protection is of the order of 100%, with a range of infinite (for those products with negative value added) to below 20%. Thus there is considerable variation in levels of effective protection to import competing activities. It should be noted that non-traditional agricultural products such as fruit, vegetables and butter are also highly protected.
- (b) there is a significant anti-export bias -- on average the incentive to produce for the domestic market is at least five times greater than for the export market; and
- (c) the structure of incentives probably favors import competing activities in general (both manufacturing and non-traditional agriculture) at the expense of traditional agriculture. However,

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<sup>21/</sup> How value added is defined and in particular the treatment of non-traded, has a significant influence on effective rates of protection. Briefly the inclusion of nontraded with inputs is in line with the methodology suggested by Balassa. An alternative method is suggested by Corden, where nontraded are decomposed into their tradeable and value-added components -- the value added of nontraded is then included with primary value added.

<sup>22/</sup> An alternative approach is to take the value-added ratio of the production from the exporting country.

this issue is complicated by the structure of taxation -- some activities in all sectors are exempt from taxation which provides a considerable incentive.

### Incentive Reform

4.22 The earlier discussion of strategy pursued by the East Asian countries suggests that less protection and a removal of the anti-export bias should be given priority with care being taken to avoid cutting government revenues from duties on traded goods until alternative sources had been developed. Given Fiji's incentive system, implementing this strategy will entail: (a) eliminating quantitative restrictions and lowering tariffs on competing imports starting with the most highly protected items and working down; and (b) broadening and increasing excise taxes on local production and also enlarging the role of sales taxes. To give existing industries time to adjust, any reform may have to be spread over several years. Incentives for new activities should set with reference to those afforded existing activities which are close substitutes in production and/or consumption. Moreover, such incentives and the approach to be taken should be made publicly available. Some more specific details concerning a reform of incentives are as follows:

- (a) Quantitative restrictions introduce distortion and complexity into the incentive system and should be eliminated and a commitment made to avoid future use. Exceptions would be quotas imposed for non-economic reasons or under international agreements (such as coffee under ICA). The removal of quotas could be phased in over four years, with one quarter of the quotas to be withdrawn in each year. As significant number of products in this category have a tariff of less than 35% on competing imports--consideration could be given to increasing the tariff to the ceiling amount (as suggested below) on these products to lessen adjustment pressures, a move that would increase tariff revenues especially from products currently on the prohibited list. Eliminating quantitative restrictions would also make the Prices Justification Tribunal (PJT) redundant.<sup>23/</sup>
- (b) It is preferable that the tariff be used as an instrument for protection and the Government could consider initially introducing a tariff ceiling of 60% and reducing all rates above this level with the exception of certain items such as motor vehicles, beer and

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<sup>23/</sup> As mentioned previously there are two separate price control instruments in Fiji. The PIB mainly affects the sale price of various goods and in particular mark-ups after costs (although it is responsible for the ex-factory prices of flour and plywood). The powers of the PIB have been used vigorously at times to combat inflation. The PJT is the body which in theory is responsible for controlling ex-factory prices and therefore more directly influences resource allocation. In practice the PJT does not closely monitor prices due to a lack of staff. Moreover, initial prices were set at such generous levels that many manufacturers have not needed to request further increases.

cigarettes and tobacco, that bring in a significant volume of revenue. However, the level of excise duties should be increased on these latter products. To achieve the stated objective of eliminating the anti-export bias would then require bringing the tariff ceiling to below 30%. The exact scheduling of any tariffs cuts is by nature arbitrary and would need to be preceded by a decision on the future shape of the taxation system. For example, tax revenue could increasingly be derived from a consumption tax, in which case the levying of such a tax could be coordinated with a phased reduction in the ceiling tariff to 30% over a 4-year period. On the other hand if the path selected involved raising excise duties then there may be less scope for cutting tariffs on imports. To effect the combination of tariffs and excise duties

ment have to sacrificed in the short run to achieve longer term gains in efficiency and export potential. Dislocation can be minimized, as suggested above, by adjusting over the course of 3-4 years, but it is in the economy's long run interests to staunch the haemorrhage from industries with negative value added as speedily as possible and to prepare the ground so that exporters might flourish.

4.24 Undoubtedly, policymakers will have to take account of political concerns and the circumstances of individual subsectors in drawing up an acceptable proposal but from our estimates it appears that revenue loss need not deter a reform of the incentive system. As Table 4.7 shows revenues would increase even if the maximum tariff was lowered to 60% so long as an import duty was imposed on all imports including those by the government. Exempting public sector imports does reduce revenues but only by 4% which is a small price to pay for the gain in efficiency that could be achieved.

**Table 4.7: FIJI: FISCAL EFFECTS OF TRADE LIBERALIZATION**  
(as % of 1985 actual collections)

	1985 Actual Collections	Alternative Tariff Schedules			
		No Government Exemptions		Government Exemptions	
		Min. Duty 10% Max. Duty 80%	Min. Duty 10% Max. Duty 60%	Min. Duty 10% Max. Duty 80%	Min. Duty 10% Max. Duty 60%
Duty Collections	100.0	108.8	106.1	98.0	96.0

/a Assumes import duty rebate certificates are abandoned.

/b All items, which currently carry no duties, have duties imposed at the minimum rate.

Source: Staff Calculations.

## V. A TAX PROGRAM FOR GROWTH

### Tax Criteria

5.01 The principles of a sound tax system are well known. Vertical and horizontal equity, efficiency, administrative convenience and other criteria have been textbook staples for decades and serve as building blocks for tax policy. That they are rarely applied in a consistent fashion is traceable to the unbending complexity of the real world and not to a lack of conviction among experts. No country can boast a model tax system and this is an aspect of East Asian development which has been least fruitful in terms of lessons. Nonetheless, a close examination of the tax structure in the more rapidly growing economies does uncover certain common features that could be of interest to Fijian policy makers.

5.02 Fiscal strategies differ depending on whether the emphasis is primarily on growth or on achieving a more equitable distribution of income. A concern for growth with long-run resource equilibrium supports a tax framework that maximises investment and saving and which combines administrative simplicity with a fairly high revenue yield. Investment is encouraged by taxing capital income at low rates. This can be achieved through modest levies on corporate profits, by exempting dividends from income tax and by incentives such as investment tax credit and accelerated depreciation allowances. A favorable tax treatment of returns from various savings deposits and retirement schemes can encourage accumulation. Consumption as against accrual income taxes which are savings neutral can also serve the same objective. The public sector, in the early eighties, has been under pressure from high and unsustainable fiscal deficits. Except for 1982, a year of particularly poor revenue performance, the overall deficit has averaged around 4% of GDP, since 1979 (see Table 5.1). These deficits are traceable to a decline in central government, rather than the effects of a capital expenditure program. Two factors must be held responsible: first, a relatively stagnant revenue performance which, as of 1985 had not recovered to the level of 1980; and second, a rapid expansion of current expenditures, which in 1985 were 5% higher (as % of GDP) than in 1979.



**Table 5.1: CENTRAL GOVERNMENT SAVINGS AND INVESTMENT BALANCE**  
(as % of GDP at factor cost)

	1979	1980	1981	1982	1983	1984	1985	1986/a
Current revenues	27.1	31.5	26.7	25.0	27.5	29.7	28.0	26.4
Current expenditures	23.9	27.2	22.3	23.9	27.5	29.8	28.8	28.3
<u>Current Gov't Savings</u>	<u>3.2</u>	<u>4.3</u>	<u>4.4</u>	<u>1.1</u>	<u>0.0</u>	<u>-0.1</u>	<u>-0.9</u>	<u>-1.9</u>
Foreign grants	0.9	1.2	0.9	1.0	1.0	0.9	0.9	1.1
Capital expenditures /b	7.7	9.5	10.0	9.0	5.5	4.9	5.2	6.1
<u>Overall Deficit</u>	<u>-3.6</u>	<u>-4.0</u>	<u>-4.7</u>	<u>-6.9</u>	<u>-4.5</u>	<u>-4.1</u>	<u>-5.2</u>	<u>-6.9</u>

/a Estimates.

/b Includes net lending. This category is development expenditures; all outlays are not necessarily investment expenditures.

Sources: Ministry of Finance; Fiji Adjustment and Selected Development Issues, Report No. 5515-FIJ, The World Bank, August 1985.

5.03 Distortions depend on taxes at the margin. They are greatest when an activity is highly responsive to changes in returns. For instance, the economy can suffer serious losses if high taxes on upper income groups discourage effort or greatly increase the time and ingenuity expended on tax avoidance.<sup>24/</sup> A broad based tax with a low rate is the least distortionary, for example a consumption tax could meet this test as would a flat-rated income tax. Revenue needs and administrative simplicity are best met by broad based taxes which do not require the tax payer to record and report information that is inherently difficult to audit. A consumption tax can come in direct and indirect forms. For close to thirty years, an expenditure tax which displaces income taxes has figured prominently in many reform proposals. Its attractiveness is tied to simplicity and neutrality with respect to savings. Conceived as a cash-flow tax it would impinge upon wages,

<sup>24/</sup> Welfare losses stem from two sources: the income effect which arises from having to pay the tax--a loss that is offset by the benefits from public expenditure--and its size is determined by the average rate of tax paid; and the substitution effect which results from the disincentive effects of taxation at the margin and this depends only on the marginal rate of tax. J. A. Kay and M. A. King, The British Tax System, Oxford University Press, 1983, p. 16.

interest, dividends, gifts, cash from the sale of assets and cash raised by borrowing, i.e., over an individual's lifespan, all his earnings would be taxed. The base is broad and the problems arising from defining income, and valuing capital gains for tax purposes are eliminated. An individual assessing his tax obligations at the end of the year could claim deductions for any receipts not spent on consumption or gifts: repayment of interest, of principal on loans, purchases of shares, would all be deductible. In effect, the expenditure tax removes the bias against savings arising out of double taxation under the income tax and minimizes distortions by eliminating differential taxation of particular forms of savings and capital income. Recent examination of the administrative implications of the expenditure tax suggest that they are no more onerous than for income tax which should help dislodge one of the principal and longstanding arguments against a tax on what an individual takes out of a society rather than on what he contributes to it.<sup>25/</sup>

5.04 The expenditure tax still strikes many as being too revolutionary and therefore risky. Hence the preference is for an indirect levy on consumption, which somewhat inefficiently, serves the same purpose. Experience gathered by some 39 countries suggests that a Value-Added Tax (VAT) with few exemptions, limited rate differentiation, which is collected at the manufacturer or wholesale stage, offers a workable compromise. The VAT is superior to the sales tax because it can be designed with a broader base. When there is little variation of rates between products it is simpler to operate because of cashflow accounting and extensive use of linked tax accounts. Since the final seller must account for the purchases of other firms, collection costs are reduced and evasion rendered more difficult. The multistage collection that is a part of a many tiered VAT increases administration costs but provides a more accurate and reliable mechanism for excluding the tax from business costs and export prices. Finally, firms subject to VAT are induced to keep better records of purchases and sales which result in managerial gains. It is important not to exaggerate the virtues of the VAT. In the EEC, the transition to the VAT was beset by complications: evasion remains chronic, and administration has not been easy because governments have found it impossible to avoid using multiple rates, exemptions and zero rating to lessen regressivity and for excluding services where the value added is difficult to measure. The VAT can be a success only if it is seen as a major source of revenue, is applied at a fairly high rate, can be supported by a computerized tax administration with sophisticated procedures for cross-checking and is introduced in a business milieu where literacy, numeracy,

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<sup>25/</sup> See, J. A. Kay and M. A. King, The British Tax System, op. cit. Chs. 1, 4, 5; R. Albon, Taxation Policy in the Eighties, Allen and Unwin, 1986, chs, 1, 5, 20; Reforming Britain's Taxes, The Economist, 1986, pp. 2-7; and The Structure and Reform of Direct Taxation, Institute of Fiscal Studies, Allen and Unwin, 1978.

adequate recordkeeping practices and the use of cash registers is widespread.<sup>26/</sup> Where this is not the case; where the economic system is still fairly shallow with a few single stage manufacturing activities and a profusion of small retail outlets, inherently difficult to police, a retail sales tax is a better interim solution. Once people are used to the mechanics of a broad based sales tax and the economy has acquired depth, the VAT becomes an efficient next step.<sup>27/</sup>

5.05 Thus, a tax policy which is slanted towards economic growth, revenue yield and administrative convenience should, in principle, opt for a system symmetrically encouraging both savings and investment which uses a flat rated income tax combined and a broad based consumption levy with uniform rates or better still, adopts an expenditure tax.<sup>28/</sup>

#### How Burdensome are Direct Taxes in Fiji?

5.06 Empirical evidence that would lend credibility to the above proposal is a trifle patchy and indirect but it does exist. One feature which emerges from a review of income tax structures amongst the dynamic East Asian economies is the restraint in the use of direct taxes. This can be illustrated by

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26/ At the current 15% VAT rate, collection costs of the VAT in the U.K are 1.2% of revenues.

27/ For the experience of countries that have introduced the VAT see: H. J. Aaron, The Value Added Tax: Lessons from Europe, Brookings Institution, 1981; C. Sanford and M. Godwin, Administrative and Compliance Issues Unique to VAT Lessons from two periods of British experience, Development Research Department, World Bank, discussion paper 192, 1986; C. S. Shoup, Criteria for Choice among types of VAT, Development Research Department, discussion paper, World Bank, 1986.

28/ With the tax reform proposal currently under consideration in the US, the administrative complexity of income taxes with a multiplicity of rates and the apparent inequities stemming from allowable deductions has been under intense debate. Empirical evidence for flat taxes are contained in: "Is the Flat Tax a Radical Idea" James Gwertney and James Long, The Cato Journal, Fall 1985.

a number of indices provided in Table 5.2.<sup>29/</sup> The tax base index is the ratio of the income threshold at which a positive tax payment is made to the mean income of a standard family unit (FGDP). If the index is zero, all income is subject to tax. Where it is 0.5, families with income less than half of the FGDP are not subject to tax while those with incomes equal to the FGDP pay a tax on half their earnings. The larger the deductions, credits and zero bracket, the greater is the index and the smaller the tax base. How progressive the effective tax schedule is can be gauged from column 3 which gives the marginal tax rate at three quarters of the mean family income. Interestingly, the East Asian countries are fairly high on the tax base index -- Singapore being an exception -- ranging from 0.37 for Hong Kong to 0.47 for Thailand, suggesting that families with between a third and a half of mean family income pay no direct taxes. Fiji falls quite low on the scale, close to the level of Mexico and Tunisia. A similar story emerges from the marginal tax rate on 3/4 mean family income. From a low of 7% for Thailand, the East Asian economies reach a high of 25% for Hong Kong, still well short of Fiji's 32.5%.

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<sup>29/</sup> It is inherently difficult to compare income tax structures across countries, because of difficulties in measuring purchasing power equivalences, differences in income distributions and the differences in deductions, allowances etc. However, a recent study has attempted to classify income tax structures first by assuming a standard family size (equivalent to the average family size in developing countries) and then calculating the tax burden in various countries in comparison to the level of per capita income (as measured by the World Bank) times the average family size. With an average family size of five persons in developing countries, the index measures the relative income tax burden with reference to the benchmark figure of five times the GDP per capita (FGDP). See G.P. Sicat and A. Virmani, Personal Income Taxes in Developing Countries, World Bank, mimeo, 1986.

**Table 5.2: TAX BASE INDEX AND INITIAL MARGINAL TAX RATE**

Country	Tax Base Index (Y*/FGDP)	Marginal tax rate on 1st bracket	Marginal tax rate on 3/4 FGDP
<u>Fiji</u>	<u>0.18</u>	<u>5.0%</u>	<u>32.5%</u>
Ivory Coast	0.00	2.5%	1.2%
Jamaica	0.45	30.0%	45.0%
Thailand	0.47	7.0%	7.0%
Singapore	0.08	3.6%	22.5%
Hong Kong	0.37	5.0%	25.0%
Korea	0.39	7.1%	10.6%
Malaysia	0.47	6.0%	15.0%
Japan	0.11	14.5%	44.0%

Source: Sicat and Virmani, op. cit.

5.07 Table 5.3 brings out some more details on the steepness of the tax schedule. In many countries the highest tax rate gives a very deceptive measure of progressivity since it applies to no more than a handful of individuals. What matters is the number of families falling in the upper tax brackets. The table presents three indicators: the ratio of the highest bracket to the mean family income; the marginal rate on the highest bracket; and the rate on families earning three times the mean income. In Fiji the highest bracket is just five times the FGDP, similar to that in Malaysia. It is 8:1 in Korea and 21:1 in Thailand. Again, Hong Kong, Singapore and Thailand fall below Fiji in terms of the uppermost marginal rate and the rate on 3x FGDP. Malaysia is on par and Korea has a 70% levy on the highest bracket.

**Table 5.3: HIGHEST BRACKET AND HIGHEST MARGINAL TAX RATE**

Country	Ratio of highest bracket to FGDP	Marginal rate on highest bracket	Marginal rate on 3 x FGDP
<u>Fiji</u>	4.9	50.0%	45.0%
Colombia	12.1	49.0%	44.0%
Jamaica	0.9	57.5%	57.5%
Thailand	21.4	65.0%	22.0%
Ivory Coast	239.6	72.5%	2.2%
Hong Kong	0.2	25.0%	17.0%
Singapore	10.7	40.5%	36.0%
Malaysia	4.4	55.0%	45.0%
Korea	8.1	70.1%	44.6%

Source: Sicat and Virmani, op. cit.

5.08 From these tables it seems that Fiji taxes incomes much more severely than is the norm for East Asia, even after allowing for the changes introduced on January 1, 1986. To the extent that the system discourages economic activity and directs resources into tax evasion, it impedes growth. Rate differentiation (see Annex Table 2) also induces sometimes costly transactions to move income from higher bracket to lower bracket family members and since the taxpayer is subject to different tax rates in different years, to move taxable income from one year to the next.

#### Taxes, Savings and Investment

5.09 The relationship between tax incentives and investment is borne out by a wealth of economic research, though it is on occasion not very strong, and the growth implications can be evanescent when savings do not respond in parallel. Qualitative evidence (and some econometric as well) from the US, Europe and Japan suggests that net of tax returns are a powerful inducement for savers. Three countries where household savings are high provide strong tax incentives. In Germany, interest on deposits at savings and loan associations and insurance companies is tax exempt and there is a favorable tax treatment of dividends through the integration of corporate and income taxes. Dividend and interest income from government bonds, postal savings and bank savings deposits is largely exempt from taxes in Japan, while Italy exempts interest income from government bonds and levies 10-20% rates on returns from savings accounts, special savings stock and on dividends. Finally, experience with the individual retirement accounts (IRA) which are accorded tax privileges by the US government also lends a measure of credence to the hypothesis that taxes can influence savings behavior. By contrast high British income taxes may be guilty of depressing savings but are certainly responsible for concentrating what private savings there are in housing, life

insurance and pension funds leaving very little liquid assets in the hands of individuals, a factor that might account for the limited size of the small business sector in Britain. All this suggests again that direct taxes on a moderate scale, according special treatment to income from savings and capital, are likely to be most effective from the standpoint of growth.

### Taxes in Fiji

5.10 The comparative approach to tax policy is instructive. But in order to determine whether it can be used to advance some concrete suggestions regarding fiscal reform in Fiji, a more detailed picture of the country's tax system is needed.

5.11 Central government tax revenues are equivalent to 24% of GDP (1985); income from non-tax sources yields an additional 4% of GDP, resulting in a highly respectable revenue effort by the standards of middle income countries (see Table 5.4). Direct taxes are responsible for 45% of tax income, far in excess of the 25% average for semi-industrial countries and it is because of their high buoyancy that revenues have risen by over 10% p.a. since 1979, slightly ahead of expenditures (9.2% p.a.) (see Table 5.5). Large budgetary deficits and a stagnating economy during the first half of the eighties prompted the government to commission two studies: one by the IMF, the other by a Financial Review Committee.<sup>30/</sup> The first concluded that revenue requirements ought to be satisfied through a broadening of the indirect tax base. Few changes in direct taxes were called for as the system was not too onerous and did not have any significant disincentive effects. A contrary view was proposed by the Report of the Financial Review Committee which criticized the high rates levied on a small group of taxpayers. Both reports also recommended changes in import, excise and corporate taxes.

5.12 On a number of individual recommendations of these two reports, the government has acted. Import duties on raw materials and capital goods purchased by domestic industrial concerns, which were totally exempted from duty in 1982, have been raised to an average of about 7.5% in a series of discrete changes. Corporate income taxes have been raised twice in the eighties, most recently in 1986, with foreign companies now being subject to a 47.5% rate. On individual income taxes, the government sided with its own fiscal review committee and lowered effective taxes quite significantly starting on January 1, 1986 (see Annex Table 2). Preliminary estimates by the Ministry of Finance (MOF) indicate that revenues from individual income taxes will decline by 9% in 1986, despite an expected growth of 7.5% in nominal GDP.

5.13 Excise taxes, which as of 1983 were levied on the domestic production of 17 items that were under import licensing, were raised and the coverage has been gradually expanded to 47 items (the latest excises were enacted in November 1985). Preliminary estimates by the MOF project an increase of

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<sup>30/</sup> See: IMF, Fiji Selected Tax Issues, Fiscal Affairs Department, August 25, 1983; and, The Financial Review Committee Report, 1985, Parliament of Fiji, Parliamentary Paper No. 54 of 1985, August, 1985.

**Table 5.4: CENTRAL GOVERNMENT REVENUES**  
(as % of GDP at factor cost)

	1979	1980	1981	1982	1983	1984	1985
Taxes on income and profits	10.7	11.6	11.9	11.8	12.6	13.1	12.3
Taxes on property	0.1	0.1	0.1	0.1	0.1	0.1	0.0
Taxes on goods and services	2.2	2.2	2.5	2.7	2.9	2.7	3.2
Taxes on international trade	6.7	5.9	7.6	5.8	7.1	7.3	8.4
Other taxes	0.4	0.2	0.4	0.4	0.4	0.3	0.4
<u>Tax Revenue</u>	<u>20.1</u>	<u>20.0</u>	<u>22.5</u>	<u>20.6</u>	<u>23.0</u>	<u>23.5</u>	<u>24.2</u>
Nontax revenue	4.0	3.8	4.3	4.4	4.4	4.1	4.0
<u>Total Revenue</u>	<u>24.1</u>	<u>23.8</u>	<u>26.8</u>	<u>25.0</u>	<u>27.4</u>	<u>27.6</u>	<u>28.3</u>
Foreign grants	0.8	0.9	0.9	1.0	1.0	0.9	1.5

Source: Ministry of Finance.



Table 5.5: COMPOSITION OF CENTRAL GOVERNMENT REVENUES

	Income and profits	Taxes Domestic goods & services	Inter- national trade	Social security contri- butions	Nontax revenues
Industrial countries (20) <u>/a</u>	33.3	26.0	3.7	25.0	4.0
Semi-industrial countries (15) <u>/a</u>	25.3	30.6	14.5	13.0	11.1
Middle-income countries (55) <u>/a</u>	23.7	23.1	28.9	4.1	14.9
Least-development countries (14) <u>/a</u>	17.0	21.7	41.6	1.6	13.0
<u>Fiji</u> <u>/b</u>	<u>44.8</u>	<u>13.3</u>	<u>27.3</u>	<u>0.0</u>	<u>14.6</u>

/a Dated around 1980. Number of countries averaged in parentheses.

/b 1985, revised estimate.

Source: Government Finance In Development Countries, Richard Goode, 1984, The Brookings Institute, p. 91.

Fiji: Ministry of Finance.

goods and services revenues by 25% in 1986, as a result of these changes. These taxes continue to be levied on a specific rate per product rather than on a percentage basis. Taxes on miscellaneous services have also been raised and the taxation net expanded. Services such as bets, the rental of video tapes, night clubs, vessels and restaurants with liquor licenses, and motor vehicle hires were taxed beginning in 1984. In the last budget, live entertainment, the purchase of air travel tickets, commercial advertising, retail sales of liquor, yacht chartering and lottery tickets came under the miscellaneous service tax net. In addition, the hotel turnover tax was raised to 5% and was widened to include all purchases in hotels.

### Recasting the Tax System

5.14 Instead of a comprehensive reform of the tax system, the authorities have instead introduced piecemeal changes that are presumed to be collectively revenue neutral but which do reduce the overall tax buoyancy (see Annex Table 3 and 4 on tax buoyancies). Long term revenue needs have not been catered for, nor have the disincentives and distortions arising from high direct taxes, been firmly tackled. Frequent tax modifications generate uncertainty and are undesirable. At this stage, when a fresh industrial strategy is being considered a substantial tax reform that reinforced the industrial drive has its attractions. The elements of such a reform can be traced out drawing upon the earlier discussion.<sup>31/</sup> Translating it into reality will be a considerable task.

- (a) As described in Chapter 4 the tariff and import duty adjustments being proposed could have positive revenue implications. Even if duties are so configured that revenues fall, the decline should be marginal.
- (b) Ideally, the income tax could be reformed with an aim towards fewer brackets, lower tax rates, and fewer deductions and exemptions. Such a system would still be progressive although much less so than the current one. Moreover, tax administration would be simplified and the incentive to evade taxes would be reduced significantly.
- (c) To stimulate household savings, the exemption limits on interest and capital income might be substantially raised.<sup>32/</sup>

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<sup>31/</sup> See also D. Bradford, Untangling the Income Tax, Harvard University Press, 1986.

<sup>32/</sup> Currently, F\$200 of interest received by a resident individual from any bank in Fiji and F\$400 of interest in any loan raised by the government are exempt from income tax. The 1987 budget has proposed to raise these limits. Dividend exemptions are granted on a scale that is inversely related to total income, which declines to only a 33% deduction for incomes exceeding F\$9,600.

- (d) The corporate tax rate, which appears to be high in comparison to other East Asian NIC's, might be reexamined.
- (e) As indicated in chapter IV there is an advantage in applying excise taxes uniformly to imports as well as domestic production so as to minimize any unintended inducement to manufacture an item locally. Further, by moving from specific to ad valorem rates, some of the regressivity of excise taxes would be reduced and the inflation related erosion of real tax rates minimized.<sup>33/</sup>
- (f) Finally, the revenue deficiencies arising from the cuts in direct taxes would be made good through a broad-based retail sales tax carrying a low uniform rate but which covered items such as food and daily necessities that are generally exempted. Over the longer term, the authorities might plan on a suitably configured VAT.

The purpose of this reform of direct taxes would be to encourage work effort and investment, increase savings and minimize the distortions induced by high and differentiated taxes. A broad based consumption levy would ensure that the volume and buoyancy of revenues was preserved. Growth and efficiency would be well served. Through a suitable choice of rates and coverage for both direct, indirect and import taxes, revenue objectives could be realized. But, a system that is firmly oriented towards growth through industrialization would undoubtedly call for some sacrifice in equity, though it need not be large.

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<sup>33/</sup> See, R. Goode, Government Finance in Developing Countries, Brookings Institution, 1983, pp. 146-150.

## VI. TRADE: PATTERNS TRENDS AND INSTRUMENTS

6.01 Adversity is the true test of an export strategy. The recession which gripped world trade in 1985 cruelly segregated the economies of East Asia whose performance is keyed to exports. All but two faltered. Those which weathered the sudden drought and entered 1986 with their preeminence amongst the NICs reaffirmed are both almost exclusively exporters of manufactured goods. That the ability to trade in a wide range of manufactured products is the touchstone of successful growth in the eighties is resoundingly confirmed by international trade statistics. In the 5 years to 1985, the total volume of exports from developing countries declined by 4% but exporters of manufacturers increased their sales by 45%, whereas countries exporting fuel experienced a 34% drop in export volume.

### Flourishing Exports

6.02 There is much to be learned from the pattern of trade. It cannot teach a country how to enter the ranks of the NICs nor does it lead to an infallible industrial recipe. What these patterns can indicate, albeit indistinctly, is the principal locus of trading opportunities. Beyond that they can provide an early warning of trends which are working to shift this locus. From the mid-sixties until the close of the seventies, the highest rates of growth were recorded by vehicles and machinery and at least in the earlier part of this period it was the industrialized west which emerged as the most dynamic trading area. Both product groups remain strong and a glance at the ten most rapidly expanding imports into the US, Japan, the EEC and the East Asian economies between 1975 and 1981 shows that metal products, transport equipment and electronics have all risen in importance (see Tables 6.1-6.4). More significant, flagging economic performance in Western Europe and the tremendous strides taken by the East Asian nations have made the Pacific region the most active trading area.

6.03 The momentum of industrialization and trade around the Pacific Basin is so powerful that this area could continue to widen its lead over other parts of the world for years into the future. Further, a simple reading of trends suggests that office machines, telecommunication devices, electronic parts, transport equipment and machine tools which are among the strongest export candidates from the East Asian economies could lead the field until well into the nineties (see Tables 6.5 and 6.6). Between a third to one half the growth in exports from East Asia in the mid-eighties can be directly attributed to demand from the US.<sup>34/</sup> In fact the openness and absorptivity of

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<sup>34/</sup> US demand for East Asian exports has been vital for some time. Since the late seventies East Asian trade with the US has risen two and a half times the rate of US trade with the rest of the world. Each year the dollar volume amounts to \$30 billion more than the total US trade with Europe. In 1984, Japan, South Korea, Taiwan (China) and Hong Kong were among the top ten trading partners of the US. D. Aikman, Pacific Rim Little Brown, 1986, p. 9.

**Table 6.1: MAJOR IMPORT ITEMS INTO NORTH AMERICA  
RANKED BY GROWTH RATES, 1975-81**

**Fastest-Growing Imports from the World**

SITC	Item	Value in 1981 (\$ mln)	Growth rate (%)
285	Silver and platinum ores	638.7	40.68
672	Iron, steel primary form	449.5	37.16
734	Aircraft	4,343.6	35.31
681	Silver, platinum	1,778.8	30.55
689	Nonferrous base metals	679.9	30.16
731	Railway vehicles	361.9	29.08
678	Iron, steel tubes, pipes	5,718.5	28.78
896	Works of art	2,149.0	28.00
122	Tobacco manufacturing	317.2	27.36
715	Metalworking machinery	2,398.6	26.58

Source: UN Trade Data (World Bank Trade System).

**Table 6.2: MAJOR IMPORT ITEMS INTO JAPAN  
RANKED BY GROWTH RATES, 1975-81**

**Fastest-Growing Imports from the World**

SITC	Item	Value in 1981 (\$ mln)	Growth rate (%)
674	Iron, steel plate, sheet	250.1	145.21
672	Iron, steel primary forms	211.6	64.96
284	Nonferrous metal scrap	501.8	41.71
521	Coal, petrochemicals	99.9	39.57
735	Ships, boats	843.6	38.13
684	Aluminum	1,848.9	35.91
931	Special transactions	976.3	35.83
726	Electromedical x-ray equipment	142.0	34.69
734	Aircraft	1,340.5	33.39
842	Fur clothing	202.5	31.49

Source: UN Trade Data (World Bank Trade System).

**Table 6.3: MAJOR IMPORT ITEMS INTO THE EEC  
RANKED BY GROWTH RATES, 1975-81**

**Fastest-Growing Imports from the World**

SITC	Item	Value in 1981 (\$ mln)	Growth rate (%)
961	Coin, not of gold	908.8	159.02
285	Silver and platinum ores	905.6	35.14
734	Aircraft	8,976.0	31.82
521	Coal, petrochemicals	737.8	29.25
897	Gold, silverware, jewelry	1,091.6	26.77
332	Petroleum products	34,343.0	25.63
842	Fur clothing	813.3	24.17
681	Silver, platinum	2,047.0	24.09
689	Nonferrous base metals	935.8	23.32
891	Sound recorders	5,157.9	22.58

Source: UN Trade Data (World Bank Trade System).

**Table 6.4: MAJOR IMPORT ITEMS INTO EAST ASIA ECONOMIES  
RANKED BY GROWTH RATES, 1975-81**

**Fastest-Growing Imports from the World**

SITC	Item	Value in 1981 (\$ min)	Growth rate (%)
521	Coal, petrochemicals	93.6	97.37
951	War firearms	67.4	74.77
731	Railway vehicles	155.7	43.34
283	Nonferrous base metal ore	89.6	40.55
733	Road vehicles, nonmotor	165.7	37.75
851	Footwear	215.8	37.24
897	Gold, silverware, jewelry	206.1	37.14
841	Clothing	1,136.9	37.07
714	Office machines	736.3	35.51
891	Sound recorders	758.5	32.75

Source: UN Trade Data (World Bank Trade System).



the American market is a crucial counterpoint to East Asian development. Simple extrapolation supports a trading focus centered on the US. Not only has that country exhibited an insatiable appetite for an ever widening variety of imports, but the sophistication of American marketing and service industries also helps to catalyse the penetration of foreign goods. For new exporters attempting to carve a share of the business, this can be of inestimable value.

**Table 6.5: LARGEST MANUFACTURED /a EXPORTS FROM  
SELECTED ASIAN COUNTRIES TO MAJOR OECD ECONOMIES /b  
(US\$ million, ranked by 1983 value)**

SITC	Commodity	1975	1978	1980	1981	1982	1983
<b><u>KOREA</u></b>							
841	Clothing	895.7	2,173.4	2,447.8	2,995.0	2,979.0	2,951.6
851	Footwear	177.1	644.1	804.2	864.4	1,038.0	1,156.7
724	Telecommunications equipment	124.7	506.0	677.2	747.2	735.0	1,044.0
729	Electrical machinery, NES	206.0	430.0	511.8	494.0	580.6	824.4
735	Ships and boats	0.2	1.6	27.0	11.0	35.5	596.5
<b><u>HONG KONG</u></b>							
841	Clothing	1,625.5	2,860.3	3,832.2	3,921.8	3,861.2	3,972.5
894	Toys, sporting goods, etc.	240.4	588.3	886.6	943.0	1,104.4	903.7
724	Telecommunications equipment	208.2	368.4	529.7	572.5	566.9	760.0
864	Watches and clocks	63.5	379.5	784.2	710.7	547.1	650.9
714	Office machines	84.0	214.3	324.3	327.5	304.3	647.8
<b><u>SINGAPORE</u></b>							
729	Electrical machines, NES	230.4	376.2	870.4	889.8	968.3	893.5
714	Office machines	56.1	61.6	96.4	134.0	288.7	834.1
724	Telecommunications equipment	124.2	203.3	729.4	768.2	690.8	728.1
841	Clothing	81.4	153.8	305.4	308.0	308.2	312.0
722	Electrical power machinery	29.2	60.0	127.1	142.3	145.7	162.0

/a Manufactured exports are defined as SITC 5, 6, 7 and 8 minus 68.

/b Major OECD economies are USA, Japan, and EEC.

Source: World Bank Trade Data Base System.

**Table 6.6: FASTEST GROWING MANUFACTURED /a EXPORTS FROM  
SELECTED ASIAN COUNTRIES TO MAJOR OECD ECONOMIES /b  
(US\$ million, ranked by 1978-83 growth rate)**

SITC	Commodity	1978	1980	1983	Annual growth rate 1979-83
<b><u>KOREA</u></b>					
735	Ships and boats	1.6	27.0	596.5	226.7
672	Iron and steel, primary forms	13.5	161.9	223.4	75.5
725	Domestic electric equipment	11.3	22.2	125.7	61.8
521	Coal, petroleum, etc: chemicals	11.90	42.1	93.28	50.7
673	Iron and steel shapes	13.5	38.7	61.8	35.5
<b><u>HONG KONG</u></b>					
719	Machines, non-elec. NES	24.1	114.7	225.2	56.3
722	Electrical power machinery	69.9	132.9	281.4	32.1
714	Office machines	214.3	324.3	647.8	24.8
891	Sound recorders, producers	71.0	115.4	172.6	19.4
725	Domestic electric equipment	100.3	206.6	240.0	19.1
<b><u>SINGAPORE</u></b>					
512	Organic chemicals	1.1	4.4	84.7	138.9
714	Office machines	60.6	96.4	834.1	69.0
891	Sound recorders, producers	22.5	59.3	116.8	39.1
725	Domestic electric equipment	29.5	68.8	106.1	29.2
821	Furniture	16.0	38.7	53.3	27.2

/a Manufactured exports are defined as SITC 5, 6, 7 and 8 minus 68.

/b Major OECD economies are USA, Japan, and EEC.

Source: World Bank Trade Data Base System.

6.04 Trends in world trade have a certain inertia and can serve as fairly reliable forecasting tools for the medium run. If an export strategy were to be grounded in just the recent international trade patterns then the manufacture of machinery and electronic equipment, preferably with assistance from Japanese and Western companies, for sale to the US market, would be the most sensible course for a small open economy to pursue. Unfortunately, the choices are never so simple. The interpretation of trends cannot afford to ignore political, technological and economic changes worldwide that, over time, can undo a pattern of trade flows and replace it with a quite different one. Nor can trade policies ignore the country's current trading situation and the resources which can be mobilized for developing manufactured exports.

## Factors Influencing Trade

6.05 Trade is being subjected to pressures from many directions. Unemployment, deindustrialization and balance of payment worries have revived protectionist tendencies in the western countries. A large share of the manufactured exports from the developing world are subject to quotas or voluntary restrictions and having learnt their lesson, industrial groups in the West are now quick to react preemptively at the first sign of an impending attack by foreign suppliers by asking for legal or legislative injunctions. Close to one fifth of manufactured exports from the developing countries to the industrial nations are subject to non-tariff barriers (see Table 6.7). As protectionism affects the high volume items such as textiles and garments as well as the fastest moving products in world trade, for example micro chips, it is capable of arresting certain trends and profoundly influencing the product mix as well as the geographical pattern of exports. Hong Kong firms feeling the pinch of quotas began establishing subsidiaries in Malaysia, the Caribbean and Mauritius. China and Thailand enlarged their share of the garment business. Products are being upgraded; silk and ramie have partially displaced cotton and synthetic fibres. In short, the political tug-of-war is no less significant than economic forces. The LOME Convention, the Caribbean Basin Initiative, SPARTECA as well as other trade agreements have joined resource endowments and industrial policy as the arbitrators of comparative advantage.

6.06 The durability of trade patterns might also be compromised by two other developments: automation and movements in exchange rates. Revolutionary electronic innovations are making possible the automation of numerous labor intensive assembly operations in industries such as garments,<sup>35/</sup> semi-conductors, machinery and automobiles. Since these are the very activities which have enabled developing countries to industrialize and export, automation poses a serious threat. A reverse migration of assembly industries to the advanced nations could be immensely damaging to the industrial hopes of developing countries and it would certainly require a fundamental rethinking of what constitutes the best export opportunities.

6.07 Second, the flux in exchange markets, the realignments which have occurred between the currencies and the aggressive use of exchange rate policy to secure a trading advantage makes for great uncertainty especially for small economies seeking exports. As long as exchange markets remain fluid long run competitiveness in light manufactures and assembled products is built on shifting sands. And the flow of direct foreign investment cannot be projected with any assurance. In effect, industrial and exchange rate policies will need to be managed in tandem to give entrepreneurs stable long-run incentives in the face of a volatile, competitive trading environment.

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35/ Clothing, Chips and Competitive Advantage: The Impact of Microelectronics on Trade and Production in the Garment Industry, by Kurt Hoffman World Development, Vol. 13, No. 3, March 1985.

**Table 6.7: NONTARIFF BARRIERS - PERCENTAGE OF INDUSTRIAL COUNTRY  
IMPORTS FROM DEVELOPING COUNTRIES COVERED BY NTBs  
(% of imports covered)**

	All goods				Manufactures				Agricultural			
	All	US	EEC	Japan	All	US	EEC	Japan	All	US	EEC	Japan
Thailand	17.8	20.3	12.3	24.3	17.3	18.7	29.6	3.4	20.1	35.5	1.8	52.0
Indonesia	27.3	84.8	12.6	1.7	4.3	5.8	9.9	0.3	25.2	0.1	12.0	67.2
Malaysia	10.2	20.6	9.9	2.6	5.2	3.1	11.8	1.1	10.7	0.5	4.3	37.4
Philippines	14.9	20.0	21.7	4.2	20.1	19.5	36.1	2.2	13.1	20.3	5.0	11.5
China	26.2	59.1	34.1	11.5	30.5	51.7	40.2	6.0	36.6	59.2	19.4	41.8
NICs	23.8	38.6	26.7	6.3	22.4	23.6	26.7	3.5	24.7	21.4	9.1	43.4
Developing	32.2	53.6	22.4	8.1	20.5	19.4	27.6	4.2	23.6	19.5	17.5	45.9
Industrial	18.7	23.8	19.9	19.9	12.6	13.9	13.0	9.4	18.7	21.3	27.1	31.5

Note: As of June 1984 with 1981 import weights.

Sources: UNCTAD and World Bank data bank.

6.08 This is the backdrop against which Fiji's past export performance must be assessed and an attempt made at sketching future moves.

#### Manufactured Exports from Fiji

6.09 Compared to Mauritius or Jamaica, island nations that are broadly similar, Fiji's manufactured exports are a much smaller percentage of the total. They amounted to as little as 5% in 1985 whereas manufactures comprised close to 43% of Mauritius' exports; 20.5% of Jamaica's overseas sales fell into that category. Plywood veneers is the single largest item with a 35% share followed by clothing, soap, plastics, paint and perfumes (see Table 6.8). The direction of trade is heavily influenced by sugar contracts with the UK, Malaysia and Australia as well as the sale of gold to Australia. Once these transactions are netted out and the focus narrowed to manufactures, Fiji's principal trading partners are respectively: Australia, the US, New Zealand and the neighboring Pacific Islands (see Table 6.9). To Australia and New Zealand, Fiji sends vegetable oil, preserved fruit, clothing, plywood veneer, tinned fish and spices. This is a good mix of commodities since it includes some of the fastest growing imports into these markets (see Tables 6.10 and 6.11). Garments are also exported to the US and that country is an expanding market for Fiji's fruit juices and its high quality ginger.

6.10 On the positive side it can be claimed that exports of manufactures have risen steadily, between 1980 and 1985. But the magnitudes involved are modest and relative to comparators Fiji has been slow in diversifying its exports, seeking new outlets and in forging links with the dynamic economies around the Pacific rim. Experience gained by other nations who have trodden this very path offers four possibilities. Each, however, is hedged around by constraints rooted in the developments noted above.

**Table 6.8: FIJI - MAJOR EXPORTS BY THREE DIGIT SITC /a**  
(US\$ million)

	1975	1980	1983	Growth rate %	
				75-80	80-83
<u>Total (incl. gold)</u>	<u>138.3</u>	<u>283.0</u>	<u>174.0</u>		
Gold	10.4	15.2	16.4		
<u>Total (excl. gold)</u>	<u>127.9</u>	<u>267.8</u>	<u>157.6</u>		
<u>Food &amp; Live Animals (0)</u>	<u>117.9</u>	<u>248.6</u>	<u>136.0</u>		
Fish tinned (032)	0.2	10.6	14.5	123.0	2.9
Cereal (048)	0.6	1.9	1.9	31.2	0.5
Fruit preserved (053)	0.3	0.9	1.2	36.4	7.0
Sugar and honey (061)	114.4	229.6	112.6	17.1	-20.5
Spices (075)	0.7	1.5	2.2	15.2	15.3
Animal feeding (081)	0.7	0.9	1.0	10.8	5.5
<u>Beverages &amp; Tobacco (1)</u>	<u>0.1</u>	<u>0.1</u>	<u>0.2</u>		
<u>Crude Materials (2)</u>	<u>1.0</u>	<u>6.2</u>	<u>2.8</u>		
Wood shaped (243)	0.4	3.5	1.7	48.5	-16.3
Crude animal materials (291)	0.1	0.3	0.6	22.9	16.7
Crude vegetable materials (292)	0.2	0.3	0.2	9.0	-10.1
<u>Mineral Fuels (3)</u>	<u>0.0</u>	<u>0.0</u>	<u>0.0</u>		
<u>Animal &amp; Vegetable Oils (4)</u>	<u>6.0</u>	<u>8.1</u>	<u>10.4</u>		
Fixed vegetable oils (422)	6.0	8.1	10.4	15.9	6.7
<u>Chemicals (5)</u>	<u>0.4</u>	<u>0.9</u>	<u>1.7</u>		
Pigments, paints (533)	0.2	0.3	0.5	9.6	18.8
Perfume, cosmetic (553)	0.0	0.3	0.3	289.8	1.7
Soaps, cleaning (554)	0.0	0.2	0.5	47.7	39.3
Plastic material (581)	0.0	0.1	0.3	47.1	55.8
<u>Basic Manufactures (6)</u>	<u>1.9</u>	<u>2.4</u>	<u>4.2</u>		
Veneers, plywood (631)	0.7	1.2	2.5	11.3	26.0
Articles of paper (642)	0.2	0.1	0.2	3.1	33.7
Iron, steel univ. (674)	0.0	0.1	0.4	28.6	62.9
Steel, copper nails (694)	0.0	0.2	0.5	35.6	37.6
<u>Machines, Transport Equipment (7)</u>	<u>0.0</u>	<u>0.1</u>	<u>0.0</u>		
<u>Misc. Manufactured Goods (8)</u>	<u>0.3</u>	<u>0.7</u>	<u>1.1</u>		
Clothing (841)	0.0	0.1	0.5	18.9	51.7
<u>Goods, Nel (9)</u>	<u>0.3</u>	<u>0.8</u>	<u>1.1</u>		
Special transaction (931)	0.3	0.8	1.1	27.6	7.8
<u>Memo Items</u>					
Manufactures (5-8)	2.6	4.1	7.0	9.5	19.3
<u>As % of Total</u>					
Sugar	82.7	81.1	64.7	-	-
Gold	7.5	5.4	9.4	-	-
Manufactures (5-8)	1.9	1.4	4.0	-	-

/a Totals may not add due to rounding.

Source: UN Trade System.

**Table 6.9: FIJI - EXPORTS BY SITC SECTIONS AND DESTINATION**  
(%)

SITC	(0) Food	(1) Bev. & tobacco	(2) Crude materials	(4) Oils & fats	(5) Chemi- cals	(6) Manufac. goods	(7) Machi- nery	(8) <u>Misc. commodities</u> Manufac.	(9) NES	Total
<b>Destination</b>										
UK	51.6	0.5	3.3	0.0	0.0	0.0	0.9	0.0	0.4	37.3
Australia	1.2	0.0	14.4	41.6	9.0	34.9	16.5	35.6	97.8	17.1
US	9.9	1.4	2.3	57.8	0.4	17.4	0.0	9.1	0.2	13.3
Malaysia	16.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	12.0
New Zealand	3.6	40.4	37.1	0.4	6.6	13.6	35.8	13.5	0.6	4.4
Japan	4.1	0.0	19.1	0.0	0.0	0.8	0.0	0.9	0.1	3.5
Canada	2.9	0.5	1.4	0.0	0.1	0.0	0.0	0.3	0.0	2.2
China (PRC)	2.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	1.5
Singapore	1.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.8
Hong Kong	0.3	6.9	1.7	0.0	0.0	0.1	0.0	0.3	0.0	0.3
Pacific Islands	3.0	8.3	1.3	0.2	51.0	28.0	23.9	30.8	0.2	3.8
Others /a	3.6	42.2	19.5	0.1	32.9	5.2	22.9	9.3	0.8	3.8
<b>Total</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>
<b>Memo Items</b>										
SITC as % of										
Total Exports	72.0	0.1	2.9	9.4	0.9	3.0	0.1	0.9	10.7	100.0

/a Includes ship stores.

Source: Bureau of Statistics Fiji, Current Economic Statistic, April 1985, T. 84.

**Table 6.10: AUSTRALIA -- FASTEST-GROWING IMPORT ITEMS**

	Growth rates			
		1975-80		1980-84
046 Wheat	-20.57	(0.0)/ <u>a</u>	42.45	(0.0)
048 Cereal	9.55	(0.0)	20.24	(0.1)
053 Fruit preserved	19.83	(0.7)	15.79	(1.2)
642 Articles of paper	18.30	(0.0)	11.87	(0.0)
051 Fruit fresh nuts	15.67	(0.6)	11.81	(0.1)
899 Other manufactures	12.87	(0.0)	11.34	(0.0)
211 Hides skins	-32.11	(0.0)	11.03	(25.3)

/a In parentheses, Fiji's export share as a percentage of total imports in the terminal year.

Source: UN Trade Tapes.

**Table 6.11: NEW ZEALAND -- FASTEST-GROWING IMPORT ITEMS**

	Growth rates			
		1975-80		1980-84
046 Wheat etc. meal	12.94	(0.0)/ <u>a</u>	113.64	(0.0)
062 Sugar preps	17.88	(0.0)	31.57	(12.0)
661 Cement etc. bldg.	-13.49	(0.0)	28.48	(0.0)
422 Fixed vegetable oil	30.47	(0.0)	27.34	(2.6)
553 Perfume, cosmetic	17.63	(0.0)	20.65	(0.0)

/a In parentheses, Fiji's export share as a percentage of total imports in the terminal year.

Source: UN Trade Tapes.



## Trade Agreements

6.11 In several instances, trade agreements have served to trigger export growth. Mauritius is a good example. Market access to the EEC gained through the Lome convention has resulted in a flourishing garment industry which in 1985 displaced sugar as the principal export. Several of the Caribbean countries have begun to attract the attention of foreign investors following the Caribbean Basin Initiative and are starting to make their mark as exporters of light manufactures, processed food, fruit and vegetables. Haiti has, in a few short years, become a leading producer of baseballs, while a number of Central American countries do a thriving business in assembling garments from material shipped to them by US firms who take advantage of their low labor costs and US customs regulation 806/807.<sup>36/</sup>

6.12 Fiji stands to gain from two arrangements. First, SPARTECA was completed in Canberra during May 1980 and signed shortly thereafter at the Eleventh Pacific Forum held in Kiribati. It is a comprehensive nonreciprocal pact under which Australia and New Zealand provide privileged access to exporters located in the Forum Island countries. SPARTECA did not become a hinge for export-led growth in Fiji because of problems that are gradually being negotiated away. First, the rules of origin provided under this agreement were difficult to satisfy, particularly the value added component from New Zealand and Australia. The rules of origin specified that, in order to prevent the use of the islands as way stations for exports by third countries to Australia and New Zealand, at least 50% of the value-added must be from a Forum member or from Australia/New Zealand. But this was complicated by the additional provision that if the goods were exported to New Zealand, 50% of the value added had to originate in a Forum member or only New Zealand, and if the goods were exported to Australia, it must contain Australian value-added rather than New Zealand value-added. This arrangement involved numerous inconveniences: a manufacturer of knitwear, for instance, who exported to both New Zealand and Australia, had to separate his raw materials and guarantee that sweaters bound for the Australian market were made with wool from the same country. This provision was an outgrowth of the cool trading relations between New Zealand and Australia, which were resolved in 1985 by the ANZCERTA trading agreement. In late 1985, the rules of origin were changed allowing 50% value-added from a Forum nation and either New Zealand or Australia, as long as the item is freely traded between New Zealand and Australia. This move effectively removed the constraint on the value-added rules of origin.

6.13 A second constraint on the operation of SPARTECA arose from the range of goods embraced by the agreement. From the start New Zealand hewed to a negative list of items, not permitting passion fruit products, coconut cream, lime juice, footwear and apparel imports. Australia meanwhile, maintained a three-tier system of approved products with varying tariffs according

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<sup>36/</sup> US tariff items 806/807 permit the duty free entry of US components sent abroad for processing or assembly. See J. Grunwald and K. Flamm, The Global Factory, Brookings Institution, 1985.

to the tier in which the product was listed. This rule was considered unfair by the Forum members, who preferred the approach taken by New Zealand. After a prolonged debate, the Australians agreed to adopt a negative list beginning on July 1, 1986. This includes the following items: steel products, cars, textiles, sugar and footwear. But there is a separate agreement between the Australians and the Forum countries allowing about 67,000 units of clothing to be imported, as a special allowance, to the Australian textile quota scheme.

6.14 SPARTECA exerts a powerful fascination for Fijian exporters because the proximity of Australia and New Zealand together with traditional trading links make them the markets of choice. But the successive LOME conventions between the European Economic Community (EEC) and the African Caribbean and Pacific States (ACP) provide a privileged entry into a broader and more lucrative market. Under the LOME convention exports from the ACP states are covered by a general rule allowing freedom of access without quantitative restrictions and exemption from customs duties for a wide range of goods. Sugar is also eligible, although each producer is allotted a special quota at EEC prices.

6.15 As can be seen from the table, Fiji exports little other than sugar and tinned fish to the EEC and this state of affairs has persisted for the past five years. Nor have exports fared any better under SPARTECA as is apparent from Table 6.12. The quantum of goods bound for Australia and New Zealand has increased very modestly between 1983-85. This rather gloomy picture is redeemed by the interest that Australian buyers have shown in Fijian made garments and the rising demand for Fiji's rum in New Zealand.<sup>37/</sup>

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<sup>37/</sup> One thousand cases of rum were shipped to the US in 1985. Sales to New Zealand have averaged F\$300,000 p.a. for the past several years.

**Table 6.12: FIJI -- SPARTECA TRADE WITH AUSTRALIA AND NEW ZEALAND  
(F\$ f.o.b.)**

	1983	1984	1985/a
<b><u>Australia Spartecca Items</u></b>			
<b><u>Traditional</u></b>			
Coconut oil	4,281,218	7,709,883	4,474,179
Logs and dressed timber	97,626	685,961	516,191
Veneer and plywood	1,521,199	1,630,277	2,030,257
<b><u>Nontraditional</u></b>			
Fruit and vegetables	610,081	837,850	604,427
Passion fruit pulp	32,204	44,619	28,039
Taro (dalo)	25,463	142,199	75,338
Glycerol and lyes	-	30,828	42,224
Raw hides and skins	86,023	51,622	36,166
Stationery	20,528	83,843	116,450
Furniture	920	35,458	59,281
Apparel	364,357	510,558	1,1516,243
<b><u>Total</u></b>	<b><u>7,039,619</u></b>	<b><u>11,763,098</u></b>	<b><u>9,498,795</u></b>
<b><u>New Zealand Spartecca Items</u></b>			
<b><u>Traditional</u></b>			
Timber (dressed & undressed)	926,352	2,111,643	1,435,221
Veneer	174,333	309,315	297,433
Plywood	154,330	342,377	500,629
<b><u>Nontraditional</u></b>			
Spirits & beer	47,314	87,206	228,823
Soaps	171,802	99,652	160,570
Paints & varnishes	13,857	12,949	8,746
Nails	325,978	157,548	12,510
Matches	43,029	2,638	37,891
Canned fish	252,080	107,509	136,336
Sugar confectionary	142,877	118,560	37,865
Stationery	154,217	1,261	6,750
Travel goods	43,846	28,769	-
Coconut oil	116,095	70,838	290
<b><u>Total</u></b>	<b><u>2,576,110</u></b>	<b><u>3,450,865</u></b>	<b><u>2,863,064</u></b>

/a Provisional.

Source: Bureau of Statistics.

6.16 Trade agreements do not automatically unleash exports; at an opening, it is up to Fijian businessmen to force their way in through the breach that has been opened.<sup>38/</sup> The agreements must now be made to serve Fijian interests. If obstacles remain, exporters must learn how these might be side-stepped or, alternatively, problems should be resolved at the negotiating table.

#### Direct Foreign Investment

6.17 Several of the East Asian countries that have become exporters of high technology items relied on foreign investment to give them the capital, technology, management and market access: in a word, turn-key exporting is what they sought and achieved. As the long arm of politics has made itself felt on the trading scene, market access through politically influential foreign partners is virtually indispensable for certain types of products. Unfortunately, protectionist moves by the industrial nations has begun to discourage multinational corporations (MNCs) from locating their factories in places where the labor is cheap and fiscal incentives attractive. Instead, American, Japanese, and German companies that comprise the principal investors increasingly prefer to site production facilities in the industrial economies where much of the output is sold. Automation, by diminishing labor requirements, is contributing to this shift.

6.18 While the growth in DFI might be restrained, the shifting of investment between developing countries will continue to be driven by the quest for political stability, cheaper labor and the opportunities presented by preferential treaties. Thus, suitable incentives could draw Australian and New Zealand companies, who appreciate the avenues opened by SPARTECA, to Fiji. Capital from Hong Kong worried about the colony's future and seeking quota linked market access to the US and the EEC might also find Fiji a suitable platform for the production of garment and electronic items. And the appreciation of the yen will undoubtedly induce Japanese firms to source more of their labor intensive products from facilities overseas. Skillful salesmanship which emphasizes Fiji's political stability, infrastructure and incentives could attract more Japanese investment to the South Pacific.

#### Export Processing Zones

6.19 The earliest EPZs near Shannon airport, Penang, Singapore, Masan in Korea and elsewhere in East Asia were unusually effective in luring foreign investors. The demonstration effect induced many other countries to follow

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<sup>38/</sup> The barriers likely to be faced by Fijian businesses in new markets and the success which can emanate from assiduous market research and persistence is illustrated by Kiwi United's (a Fijian match manufacturer) attempts to penetrate the New Zealand market, in spite of the dominance of a major Australian company, Bryant and May. See, Pacific Island Business News, May 1981, p. 7 or for a summary, Fiji: Client State of Australasia, E. Utrecht, Transnational Corporations Research Project, University of Sydney, Sydney, 1984, pp. 240-1.

suit so that by the mid-eighties there were some 79 operational economic zones, export processing zones, and science parks available in 35 countries<sup>39/</sup> offering a fairly homogeneous package of inducements. Interestingly, American companies remain the largest investors, almost a third of the firms are connected with the electronics industry, textiles and garments is a close second; and more than half of the labor force of the EPZs, worldwide, is employed by manufacturers of electronics.

6.20 An EPZ in Fiji will not guarantee the results obtained by the pioneers in the late sixties and early seventies but the recent experience of Sri Lanka and Mauritius does provide grounds for hope. In spite of the competition from other zones, their geographical location and transport problems, they were notably successful, suggesting that the market may not be entirely saturated. Experience shows that EPZs flourish in countries enjoying political stability, where the supply of low-priced female labor is abundant and where an adequate infrastructure exists to serve the needs of industry as well as resident expatriates. Local entrepreneurial participation is certainly a plus, as are low freight costs to industrial markets and the ready availability of technical professional and repair services. In China and India the bureaucracy is a source of friction and discontent, whereas the organizational efficiency of some East Asian NICs is much admired by foreign firms.

6.21 Transport will remain a problem in the medium run though a growing EPZ would certainly attract airline interest, but Fiji could, in due course, deliver on the other essentials. Entering the EPZ sweepstakes, possibly through the creation of an industrial park near a major transport node and equipping it with electricity, water and sewerage facilities, might, therefore, be well worth considering as a strand in the export strategy. However, it is an option that should be tackled wholeheartedly or not at all. Satisfying the earliest arrivals through suitable preparations ensures continuing interest by foreign investors. As with any other service, the creation of an EPZ must be preceded by market research to assess the receptivity of MNCs and, once it has been launched, a marketing campaign would be needed for the Fijian EPZ to draw abreast of competitors.

### Exchange Rate Policy

6.22 An imaginative use of industrial incentives is one characteristic of development strategy coined by East Asia's NICs, but in a few cases the flexible management of the exchange rate was almost equally significant in maintaining export competitiveness and the relative profitability of outward-oriented activities. Korea, which entered the sixties with an economic structure dominated by agriculture, was especially bold in manipulating the exchange rate to influence the relative prices of its nascent manufactured products. A smaller open economy is somewhat more circumscribed in its use of exchange rate policies for industrial development, especially when import dependence is high and the modest size of the nontraded-goods sector minimizes

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<sup>39/</sup> See J. Currie, Export Processing Zones in the 1980s, Economist Intelligence Unit, Special Report No. 190, 1985.

the scope for an exchange-rate-induced movement in resources towards traded goods. However, the evidence from East Asian NICs, suggests that in spite of the constraints imposed by small size, they have been able to further their industrial and export ambitions through a debt handling of exchange rates.

6.23 The Fijian dollar has remained a relatively stable currency. Externally it has been most influenced by the parity of the Australian dollar; internally it has been affected chiefly by a conservative monetary policy, a large and efficient sugar industry and a well-protected manufacturing sector. From Chart 2 it can be seen that the real effective exchange rate was restricted to a narrow band through much of the eighties. It rose in mid-1985 but has since been declining, most recently because of a 5% depreciation of the Fijian dollar against the US\$ that occurred during June-July 1986. Appropriate manipulation of the REER could impart additional stimulus over the longer run to the production of tradeables if it were to depress the share of wage costs, which currently reflect the earnings and productivity in the sugar industry. On the other hand, from the perspective of the agriculture sector, there would appear to be scant cause for modifying policy. A decline in the REER would redistribute resources from importers to sugar producers with no change in sugar exports, the local cost of carrying external debt will increase, higher import prices will immediately impinge upon costs throughout the economy and the supply response from manufactured or even agricultural exports will be small in the short run.

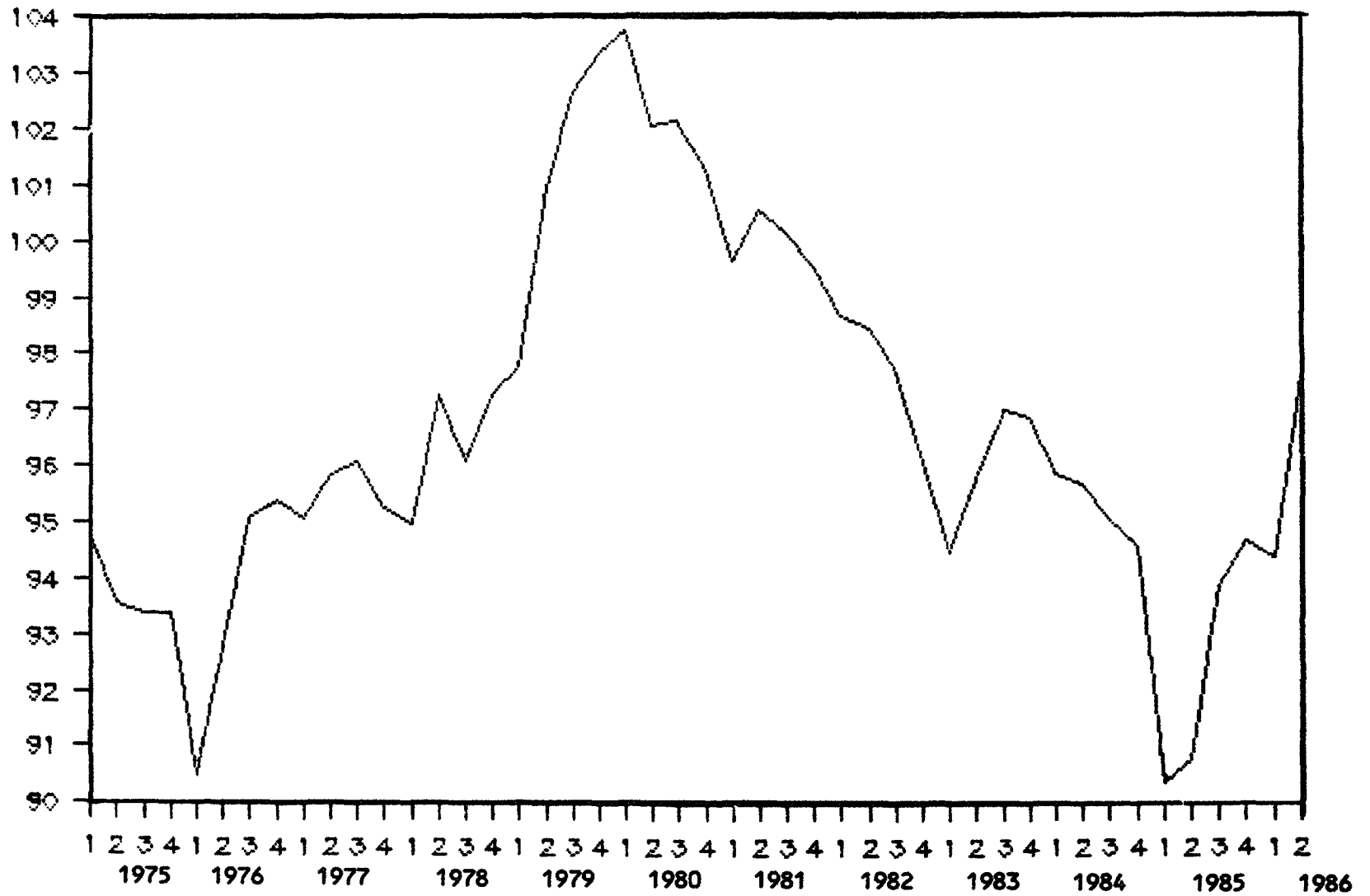
6.24 Using an explicit REER target may not be good policy because a long run equilibrium is practically impossible to define. Further, wage moderation combined with productivity growth may be a more efficacious route to industrial competitiveness than adjusting the REER. But exchange rate management, sensitively used, can complement the action of incentives discussed in Chapter IV and of labor market policies.

6.24 International trade patterns and the geographical distribution of import growth can serve as very rough indicators of what to produce and where to concentrate the effort of selling. Trade agreements can open trails through the accumulating undergrowth of nontariff restrictions. Direct foreign investment by way of an EPZ could widen the range of exports and exchange rate policy could sharpen incentives for local manufacturers by neutralizing Fiji's (productivity-adjusted) wage disadvantages. East Asian NICs have fashioned effective strategies from these. It is a matter of trying, of learning from experience and of persevering with an approach to development.

CHART 2

FIJI: REAL EFFECTIVE EXCHANGE RATE INDICES

REER INDEX



(1978-80 = 100)

## VII: LABOR MARKETS AND THE GROWTH OF EXPORTS

### Small States and the Control of Wages

7.01 Size can buy time. Large economies are able to take their time in adapting to changes in the international trading environment by modifying institutions, increasing investment in technology and new plant and remedying organizational weaknesses. In rare cases, their market power allows them to tailor the evolution of trading relationships to their convenience, forcing their competitors to shoulder some of the costs and dislocations entailed by shifts in technology and economic structure. Small states cannot easily bargain for time or special treatment. If the international market environment changes, they must adapt and absorb the cost of transition. Flexibility and the capacity to respond promptly to external events comes from a willingness among the various economic groups to reorganize and share the burden of vulnerability as well as the existence of robust institutional mechanisms for distributing costs and gains. As wages account for the lion's share of the national product, the speed of adjustment to change and the ability to seize an opportunity rests on the functioning of the labor market. Management skills, capital supply, the rate at which technology is assimilated, gains in productivity are all significant, but the flexibility of real wages is the final arbiter of a small economy's short-term competitiveness.

7.02 In Europe the smaller states that have prospered during the past three decades are those that have managed to embed a machinery for managing real wages within a democratic political framework. The ones lagging behind are countries where labor market relations do not lend themselves to the equitable sharing of costs. One view is that democratic societies that have experienced a long spell of stability, provide fertile soil for predatory interest groups bent upon enlarging their share of the economic pie.<sup>40/</sup> Unless the political system superimposes institutions that force these groups to negotiate and compromise, an anarchic situation develops which retards adjustment to external shocks. Countries such as Sweden, Switzerland, West Germany and Austria have been more or less successful in keeping this form of democratic sclerosis at bay by adopting centralized modes of wage and price setting that force the major economic actors to confront the national consequences of individual actions.<sup>41/</sup> In Sweden, the labor organization representing half the work force negotiates the pace setting wage bargains with the employers organization under the watchful eye of the government in an

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<sup>40/</sup> See Mancur Olson, The Rise and Decline of Nations: Economic Growth, Stagflation and Social Rigidities, Yale University Press, 1982; and Dennis C. Mueller, The Political Economy of Growth, Yale University Press, 1983.

<sup>41/</sup> A recent survey on industrial disputes shows that these countries have the lowest number of working days lost through strikes per 1,000 employees in the industrialized countries. See, The Economist, 2-8 August 1986, p. 81.



institutional setting that has deep roots and firm political acceptance. A tripartite committee composed of representatives from the Government, the unions and the employers influences prices and wages in Austria. And so on.

7.03 Conditions differ in the East Asian NICs, but market mediated or state enforced wage flexibility is the sine qua non of competitive strength. Hong Kong is at one extreme. Here the fluidity of the labor market is maintained by the relative weakness of trade unions, ethnic diversity that arrests the forming of wage coalitions, manufacturing foundations built off small firms that rely on family, kin and clan members for their labor and the pressure on wages exerted by a reserve pool of workers in the informal sector. At the other extreme lies Singapore, where the Government exercises extensive control over wages. Until the late seventies, the increase in labor costs was regulated so as to attract assembly type industries. Thereafter, the state attempted to push for high value added, technologically sophisticated industries by driving up wage rates. Recently, a severe slump in economic activity has forced the Government of Prime Minister Lee to squeeze wages and thereby restore Singapore's standing in certain traditional lines of manufacturing.

7.04 In between these two poles lies Korea, where a homogeneous work force in an integrated market is sensitive to labor demand pressures. However, these can be effectively dampened by government suasion that capitalizes on the weakness of trade unions and the widespread consensus on the key role of labor in building Korea's trading position and cushioning the country against swings in the international business cycle.

7.05 While political-institutional factors might be the central determinants of wage flexibility and market efficiency, in many countries vocational and technical training programs on a very wide scale have greatly facilitated the mobility of workers apart from contributing to their productivity. As a consequence, new industries find it easier to take-off, older ones to hold the ground in overseas markets.

#### Unions and Wages in Fiji

7.06 Fiji's labor market has many of the characteristics that a small economy needs in order to respond flexibly to external development and launch export-oriented manufacturing industries. The population of working age is large and growing. It numbered 420,000 in 1985 with the rate of increase over the next five years expected to be about 2.4% p.a. (see Table 7.1).

Table 7.1: LABOR FORCE GROWTH RATE

	1970-75	1975-80	1980-85	1985-90
Labor force growth rate	3.1	3.0	2.1	2.4

Source: 1970-75: Work and Income for the People of Fiji -- A Strategy for More than Just Survival, The Final Report of the Fiji Employment and Development Mission, Sussex University, November 1984.  
1985-90: DP9.

Currently, participation rates are 86% for men, 21% for women. Wage and salary earners make up 35% of the labor force and only 35% of workers have paid employment. The balance are self-employed or do not have jobs. Thus the potential supply elasticity of labor is large even allowing for the resistance that people from the rural areas, especially women, might have to seek industrial employment. Further, a high percentage of new entrants have primary and secondary education. These supply conditions will help reduce wage pressures and strengthen the forces making for rapid adjustment.

7.07 Fiji's Indian sugar workers unionized in 1921. Cane farmers followed suit in 1943 with the Fiji Kisan Sangh that became the Federation of Cane Growers in 1970 and emerged as the National Farmers Union eight years later. The hub of the union movement is the FTUC, set up in the early fifties, which serves as the umbrella for 33 of the country's 40 registered labor organizations. It has matured under the Government's tutelage, since the state has long believed that a centralized organization would induce the unions to act more responsibly. A Tripartite Forum chaired by the Prime Minister was created in 1976 bringing together employers, unions and the Government. It is designed to regulate wage contracts by reference to the CPI and business circumstances. However, the Government also retains considerable powers of direct intervention in the labor market and these were utilized to decisive effect in November 1984 when a freeze was imposed on wages, rents and dividends to nip an incipient wage price spiral led by the Nicoll and Hurst awards to public sector employees.

7.08 By and large the manufacturing sector has not been troubled by rising wage costs. In the critical sugarcane sector, for instance, real wages have declined at an average rate of 0.2% p.a. during 1980-85. For all industries, real wages fell 0.2% p.a. between 1975 and 1985, although they grew by an unsustainable 7.7% p.a. over the preceding 5 years (see Table 7.2).

Table 7.2: CHANGES IN MEAN HOURLY WAGE RATES  
(% change p.a.)

	<u>Agriculture</u>		<u>Manufacturing</u>		<u>All industries</u>		CPI
	Nominal	Real /a	Nominal	Real/a	Nominal	Real/a	
1970-75	20.3	8.6	19.4	7.8	19.3	7.7	10.8
1975-80	8.4	-0.1	9.0	0.0	9.2	0.0	9.3
1980-85	3.0	-4.0	4.7	-0.2	5.0	-3.8	6.9

/a Deflated by the annual change in the CPI.

Source: Ministry of Finance

But labor costs remain a frequent source of concern in the formal urban labor market, particularly in the unionized segment which accounts for some 35,000

workers. Given the levels of productivity many employers believe that wages are too high and rule out the possibility of outward looking manufacturing development. Undoubtedly, the earnings of the Fijian labor elite are close to those of industrial workers in the East Asian NICs, but remuneration of employees in the nonunionized and the informal sectors are much lower and clearly reflect market realities. It also makes little sense to use cost structure and productivity levels of the existing relatively inefficient import-substituting industries as the basis for judging future export potential. At these and much higher wage rates, other nations are successfully producing and trading a wide range of light manufactures. If a problem exists, the fault may be more in the production system engendered by incentive policies than the level of wages. By themselves, simple intercountry comparisons of hourly wages are almost meaningless.

7.09 In many respects, there are grounds for optimism regarding the future course of wages in Fiji and labor market developments. In general, educated manpower will be available in abundance for manufacturing industry. The recent trends in nonunionized and informal sector wages (see Tables 7.3 and 7.4) suggest that the slack in the labor market will moderate the wage demands of workers whether they are organized or not. Union membership has already begun to decline. An institutional framework -- the Tripartite Forum -- already exists to centralize wage negotiations, marshal a consensus and mobilize political sentiment behind rational economic policy. During its ten years the Forum has had a hand in containing wages, and besides, the Government is willing to intervene against an inflationary threat.

**Table 7.3: AVERAGE WAGES IN NON-UNION GARMENT FACTORIES, 1970-83**

Year	Suva		Lautoka	
	Avg. wage (in F\$)	No. of readings	Avg. wage (in F\$)	No. of readings
1970	0.16	102	-	-
1975	n.a.	19	-	-
1980	0.41	65	0.36	44
1981	0.57	77	0.44	68
1982	0.54	194	0.48	87
1983	0.63	183	0.51	95

Source: Ministry of Employment and Industrial Relations, Factory Inspectors Reports.

**Table 7.4: AVERAGE WAGE IN NON-UNION FURNITURE FACTORIES, 1970-83**

Year	Unskilled			Skilled/carpenters		
	Average wages		No. of readings	Average wages		No. of readings
	Mean	Median		Mean	Median	
1970	16	18	17	0.27	0.30	26
1975	34	38	3	0.55	0.50	30
1980	58	65	7	0.76	0.76	69
1981	58	65	21	0.81	0.80	58
1982	63	60	19	0.96	0.98	58
1983	63	65	14	1.10	1.10	44

Source: Ministry of Employment and Industrial Relations, Factory Inspectors Reports.

7.10 There are some powerful and well organized interest groups in the labor market such as the cane cutters and the public sector employers but they are not unaware that economic ruin could result from a battle for higher wages. Fijian unions are by no means docile but neither have they been guilty of the aggressive behavior which has, on occasion, pushed European and Latin countries to the brink of a crisis. Finally, as in Hong Kong and Malaysia, ethnic divisions are likely to retard the formation of a powerful labor bloc; the structure of manufacturing employment with small firms very much at the forefront is conducive to flexibility; and labor militancy will also continue to be tinged by family and kin ties that bind workers in many of the small enterprises to their employers.

### Skills

7.11 Industrialization need not be hampered by wage costs or labor supply--recent experience indicates that producers should have no difficulty in persuading young females to work in textile and electronics factories--but the availability of certain industrial skills, might constrain the manufacture of more sophisticated items. Currently there is no shortage of traditional craft or basic mechanical skills, in fact, the slowing of growth has created a surplus of vocational school graduates. Higher order skills remain scarce and the situation is made no easier by the absence of formal apprenticeship programs and the shortcomings of the FNTC to whom employers pay a compulsory

training fee.<sup>42/</sup> Companies have to make do with on-the-job training, or the assistance given by foreign equipment suppliers. In rare cases they are prepared to incur the high costs of overseas training for a few staff.

7.12 The industrial strategy discussed in this report cannot be implemented without an abundance of manufacturing-specific human capital. Many other countries in a similar predicament as Fiji are wrestling with this constraint, Singapore being one of the most enterprising. It established a first generation of training centers with the help of MNCs in the early seventies. Originally, all the centers operated on a cost-sharing basis with the government bearing the capital cost and half the recurrent expenditures. Since 1972, the state has assumed all costs, participating firms supplying only the software. In the early eighties, Singapore's Economic Development Board sought the assistance of the MNC and governments of industrial countries to establish a new generation of training centers to prepare GCE "A" level holders for modern technologies and product lines. They are the German-Singapore Institute of Production Technology, the Japan-Singapore Institute of Software Technology and the French-Singapore Institute of Electro-Technology. These institutes offer diploma courses in control engineering, instrumentation, microprocessor applications, CAD/CAM systems, cutting processes, design and production processes, industrial engineering and computer software technology. The EDB also runs three specialist units for industrial automation training in partnership with the American Computervision corporation and training institutes in Sweden and Japan.

7.13 Supplementing the work of the institutes in Singapore is the Skills Development Fund (SDF), financed by a 2% (of payroll) levy on employers which can be tapped by firms to upgrade skills and acquire advanced equipment, through a number of schemes--Training Grant, Interest Grant for Mechanization and Development Consultancy. There is also a scheme for nurturing skills needed by microelectronics and information industries. Aside from the SDF, employers also have recourse to the National Productivity Board which offers courses on measures for enhancing productivity and improving labor management relations, as well as two centers for computer study funded by the government.<sup>43/</sup>

7.14 Singapore's training infrastructure has been pieced together over a decade, a period marked by heavy foreign investment in the nation's manufacturing industry. Funding from MNC and technical expertise was readily

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<sup>42/</sup> The Fiji National Training Council (FNTC) operates a program of skill training for employees of manufacturing concerns in Fiji. The FNTC's operations are financed by a one percent levy, which is compulsory, paid by employers on their gross payroll. Employers can, theoretically, claim rebates up to 100% of these levies to pay for the training of employees.

<sup>43</sup> See I. Islam and C. Kirkpatrick, Export-led Development, labor market conditions and the distribution of income: The case of Singapore, Cambridge Journal of Economics, Vol. 10, No. 2, June 1986, pp. 115-117.

available. Circumstances in Fiji are very different and a program on such a scale may be impossible to duplicate over the medium term. But an early start at establishing centers for training in design and modern engineering and automation technology, possibly through support from foreign governments and overseas training institutes, should be considered. This could be one of the principal initiatives in a larger program of industrial skill development that also breathes life into the existing vocational training efforts and the employer funded FNTC scheme.

7.15 Behind East Asian economic successes is a long history of improvement in the quality of manpower. As industrial competition moves to a higher technological plane, skill enhancing policies can only grow in importance. It is a lesson Fiji must take to heart.

## VIII: THE MICROECONOMICS OF A NICHE FILLING EXPORT STRATEGY

### An Information System

8.01 Traditional approaches to industrialization that depend upon fiscal, monetary and trade related instruments have been exhaustively codified and widely applied. There are no secret recipes and most of the surprises have been explained away. Many countries are trying variants of the standard methods but those that are succeeding have generally gone beyond a mechanical application of tax and tariff rules. These economies have evolved an institutional architecture that makes innovative use of information on markets and technology. The East Asian NICs have undoubtedly derived much profit from economic textbooks but the capstone of their strategy has been a system of collecting information and techniques for bending it to their developmental purpose.

8.02 Market information is available in vast quantities from trade publications, from wire services, from buyers who flock to East Asia, from importers and from government agencies, to name just a few. It can go unused without a systematic procedure for analyzing, disseminating and acting. Japan and Korea have acquired their trading reputation because they realized that in today's markets being better informed about export possibilities than one's competitors is winning half the battle. Korea's information system, for instance, has three tiers: Korean embassies, the Trade Promotion Association which maintain a dense network of offices overseas and representatives of Korean companies, strategically located in major cities; excellent telex and telephone facilities; and company salesmen who frequently tour foreign markets so as to make contact with current and potential buyers, comprise the outermost tier.<sup>44/</sup> Buyers visiting Korea are seen as not just a source of orders but also information on product design, styling, packaging and market trends. The second tier, therefore, is the infrastructure of transport facilities, hotels, trade centers and tireless "facilitators" who meet, court and guide the buyers to win orders and establish a longer term relationship with an importing house or a retail chain which could be a continuing source of business, technical knowledge and market intelligence.

8.03 The third tier covers the mechanisms for collating and disseminating the information pouring in from the network overseas. This is done by a variety of bodies who rely on publications, meetings and personal contacts. The Korea Traders Association issues a Trade News Service, compiles and publishes monthly trade statistics and periodically releases material on export-import procedures. Many of the producer's associations have their own publications and all are active keeping their members closely informed about market trends, moves made by competitors, rules affecting Korean exports as well as

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<sup>44/</sup> For a more detailed discussion of the Korean system, see: Korea's Competitive Edge - Managing the Entry into World Markets, Yung Whee Rhee, Bruce Ross - Larson, and Garry Pursell, the Johns Hopkins University Press, Baltimore and London, 1984.

other aids for producers trying to navigate in choppy, obstacle-ridden, alien waters.

8.04 The system not only gathers information, it also transmits to buyers outside of Korea, by way of KOTRA publications such as the Overseas Market News and Korea Trade, a catalog of Korean export products. Exhibitions are another favorite device. There are also, advertising campaigns and promotional ventures with the large trading companies taking the lead supported by commercial staff at overseas missions.

8.05 Information on product demand is crucial for producers as is the network's ability to make known the range of items, Korean manufacturers are in a position to supply. But the industrial sector's international competitiveness depends on a steady flow of information on product and process technology and the numerous parameters relating to design, quality, finish and packaging that determine a products acceptability. No one conduit is adequate. Many have to be tapped but first, manufacturing concerns must have the technical personnel to apprehend and "unbundle" foreign technology. Technical information is worthless unless firms are equipped to absorb it. At the earlier stages when light consumer goods comprised the bulk of exports, foreign buyers and companies supplying equipment can light the way. Later as producer goods grow in importance overseas visits by company managers and technicians, licensing arrangements and joint ventures can be more effective. No rule emerges from the Korean and South-East Asian experience. The industry must find the mode most suited to its circumstances. The point is that there are multiple possibilities and it is vital for manufacturers to be listening at a whole range of synapses.

8.06 Korea, Singapore, Hong Kong, and Japan have each taken a position at the center of a web that draws market and technological intelligence from around the world. Each has mastered the art of weaving an industrial policy which embraces this material and of allowing a few key economic institutions to coordinate their activities so that manufacturing has the environment, the resources and the political support needed to benefit from the information. In Japan as well as several of the East Asian NICs, the official bureaucracy fully appreciates that its purpose is to create the conditions that will promote trade. The bureaucratic commitment to export goals is fundamental because it dissolves much of the red tape that is the bane of exporters in countries where officialdom is content to administer and is reluctant to prune the thicket of routines that hobble development plans. From observing East Asian governments in action, a number of maxims can be distilled. An economic bureaucracy that has detailed and timely information on such variables as exports and production is best equipped to launch countermeasures that will remove bottlenecks and maintain the industrial tempo. A comprehensive data-gathering apparatus that operates with the shortest possible lag seems a must for effective policymaking.

8.07 Of equal significance is the willingness to eschew a rule bound approach to fast moving situations. Achieving results rather than safeguarding procedures is the most efficient principle when the goal is growth through exports. An effective information system can provide a policymaker with the confidence to act because he can monitor the consequences and make adjustments



if the need arises. Bureaucratic stasis that feeds on long information lags can be avoided. Lastly, the information network can be used to cement a partnership between the government, banks, manufacturing firms and other service agencies, all of whom contribute to the success of an export strategy. But the message out of East Asia is that the alliance is instigated by the Government and it is reliable information and bureaucratic flexibility in responding to it which controls the risk and raises the rewards of concerted action.

### Coping with NTBs

8.08 Although Fiji is years away from becoming a large exporter of items now running afoul of nontrade barriers, advance preparation to cope with the political fallout from trade is desirable. Because Mauritius was able to capture a sizeable share of the knitwear market in Northern Europe and the US, it has to contend with quotas. The steady march of East Asian exports in the teeth of NTBs proves that, intelligently handled, the NTBs need not dampen the growth of export earnings. Trade barriers are far from impenetrable. They generally displace opportunities and do not eliminate them. A thorough familiarity with the fine print underlying NTBs and the capacity to manipulate legal and diplomatic instruments, can allow exporters to maintain their stride. Further, a comprehensive understanding of both the legal environment and the manner in which protectionist moves are implemented makes it possible for a developing country to negotiate an accord that is impermeable and restrictive in form, defusing political problems but porous and unrestrictive in substance. The wording used, how items are classified, and flexibility provisions are as critical as base levels or growth rates. In textiles, for instance, exporters have derived much mileage from category switching, borrowing against future quotas and carryover provisions. East Asian traders have, in the past, made full use of the ambiguity concerning the classification of shoes (rubber or nonrubber) and fabric (synthetic or cotton) of transshipment through quota free ports; and the export of subassemblies or half finished goods when the finished article come under a quota.

### Niches

8.09 The trading milieu of the eighties is doubly competitive for being an intensely political one. To acquire and retain markets, a constant battle must be waged to keep the economic edge and a measure of political advantage. Information alone will not lead to a marketable product, but it can decide whether and in what volume it is sold.

8.10 Economic theory, with some help from empirical findings, can be a useful guide in making general policy. Several competing architectural plans for a healthy business environment are at hand and lately the agony of choosing has been eased by the coalescence of professional opinion behind the market-directed approach. But in arranging a suitable "environment" the question of what should be produced and how export markets penetrated is left for supposedly knowledgeable entrepreneurs to ponder. This division of labor between economists and policy makers on the one hand and businessmen on the other, is a good one. Korean economic planners, for example, are in no position to effectively meddle with the micro-structure of textile production and

trade. They can try and regulate the climate which will allow this micro-structure to thrive. In recent years many formerly dirigiste economies have found it expedient to allow micro investment decisions to devolve into entrepreneurial hands.

8.11 Detailed centralized guidance regarding the subsectoral allocation of capital, product mix, technology and market orientation invites gross inefficiency. Many decisions are best handled by the market once the market has matured to the point where it efficiently manages the flow of information. Before that stage is reached, priming the market with information of a strategic nature as was done (and to an extent still is) in Japan, Korea and Singapore has its merits. Over the next few years, Fijian private industry will be emerging from its protective cocoon. It will be searching for ideas and market intelligence. As only the government can command the resources and the multiplicity of international contacts, industrial policy will for a time have to extend beyond environment building to the provision of guidance and information. Hence a system that will generate reliable domestic and international data with the least delay is a necessity. Because there are scale economies, only the Government can establish it and since the process will take time, the project deserves priority.

8.12 Studies commissioned by the Government and business organizations have uncovered some potential product markets and identified ways of entering. Much more will have to be done. However, the work already done in Fiji and elsewhere is revealing on how high value added industries suitable for small economies can emerge as exporters. Five encapsulated case studies presented below attempt to catch a glimpse of certain general principles that might be at work. These are not necessarily the industries, Fiji might choose to embrace but they come from a class that deserves attention. The five are spirits, fashion garments, watches, light machinery and tropical fruit.

### Spirits

8.13 Alcohol consumption in the developed countries is going through a period of turbulence. Strong drinks are on the retreat as health consciousness, after taking America by storm, invades Europe and the force of habit is being displaced by the demand for taste. In France and the US, alcohol consumption per capita is falling, and there is a definite preference amongst an aging Western population for less potent drinks. A number of interesting trends in the consumption and marketing of spirits can be identified. Whiskey blends are falling from grace. Light whiskeys are increasing their share of the market, but the real winners are the mixable beverages such as gin, rum and vodka, as well as cordials and liquors. Sweeter potions have also become fashionable. This extends even to red wine: the less tannic, bitter and acidic it is, the better it sells. Successful spirits are those that by virtue of mixability and lightness have created their own niches -- vodka, white rum and tequila fall in this category (see Table 8.1).

**Table 8.1: TOTAL CONSUMPTION OF SELECTED SPIRITS, 1982**  
(million cases)

Rum	Gin	Vodka	Scotch whiskey	Other whiskies	Cognac and Armagnac
51.8	43.2	59.4	65.0	112.4	8.9

Source: International Wine and Spirit Record of 35 major markets excluding COMECON countries.

8.14 A second trend is the rising demand for premium brands, in the case of whiskey, particularly single malts. The best selling gins and vodkas are those with a reputation for quality. Irish whisky has staged a comeback by concentrating on the premium end of the market where it competes against the best gins, vodkas and cognacs.

8.15 A third trend concerns marketing. Consumers are attracted by the shape and characteristics of the container. A plastic lined bag has gained wide acceptance in the UK, so has wine in cans. Wine sold in shapely glass jars has a strong appeal in the US. A Japanese producer has found that trendy names and bottles are appealing to the young. The marketing of spirits is increasingly controlled by the industry's giants with grocery chains becoming influential in the retail sphere. In Japan, a powerful sales network and tied bars offer intense competition to a newcomer attempting to penetrate the market independently of a local partner.

8.16 A light rum is the single most successful spirit in the world (see Table 8.2). And a variety of Caribbean rums have acquired a loyal following. Top-fermented, heavy-bodied and strongly scented rums from Jamaica hold a segment of the market, as do the bottom-fermented, light and weakly aromatic rums from Puerto Rico. The Mount Bay distillery of Barbados is famous for its redistilled rum which is blended with caramel, almond essence and angostura. None of these Caribbean rums command the market which Bacardi white does, nor have they managed to launch an immensely popular mixed drink such as the Margarita (which accounts for the strong sales of Mexican tequila in the US) but they earn respectable amounts of foreign exchange.

**Table 8.2: CONSUMPTION OF RUM WORLDWIDE  
(1982) /a**

Country	Million cases
Britain	4
France	5
Spain	5
Mexico	7
Canada	7
Venezuela	7
Colombia	13
West Germany	13
US	26
Other	13

/a Bacardi holds 30% of the world market. The remainder is with other brands.

Source: See Table 8.1.

8.17 Fiji exports its own rum on a very small scale (1,000 cases to the US in 1985). It is worth examining the prospects for larger sales. The above discussion offers the following hints:

- (a) A light, premium rum less than 90 proof will be most acceptable in the US market, that is by far the biggest and the worthiest target (see Table 3.3).
- (b) Fresh cane molasses are the best feedstock as they have low viscosity, high total sugar, nitrogen and phosphoric acid and low ash.
- (c) Rum distillation should be continuous, the product aged four to five years to increase acids-to-esters ratio and diluted with pure, deionized water.
- (d) The blend to be sought should have a distinct but subtle flavor. A marketing campaign that associates this with a new mixed drink improves long-term sales if the drink gains acceptability.
- (e) The shape of the container deserves careful attention.
- (f) Market tests followed by an advertising campaign that touches on the rum's exotic South Pacific origin would be needed to launch the product. It might be aimed at the well-to-do who are prepared to experiment.

(g) Since marketing could be expensive, a foreign collaborator, possibly one not in the spirits business, might be a valuable asset.

Table 8.3: CONSUMPTION OF DISTILLED SPIRITS IN THE US  
(sales in '000 cases)

	1968	1978	1983
Bacardi	2,100	6,200	7,673
Smirnoff	3,200	6,150	5,700
Seven Crown	7,850	6,200	4,900
Canadian Mist	-	2,300	3,350
Jim Beam	2,525	2,750	3,200
Jack Daniel's	-	1,875	3,175
Seagram's VO	3,475	3,875	3,050
Canadian Club	3,325	3,675	2,850
Popov	575	2,250	2,600
Windsor Supreme	-	2,475	2,600
Seagram's gin	1,050	2,350	2,525
Dewar's	1,050	2,200	2,400
Gordon's gin	2,550	2,600	2,250
Gilbey's gin	2,025	2,225	2,000
J&B Rare	2,075	2,650	1,825
Cutty Sark	2,150	2,150	1,500
Calvert Extra Blend	2,175	2,150	1,500
Old Crow	2,625	1,075	850
Imperial	2,275	1,175	625

Source: Business Week.

### Watches

8.18 Switzerland invented the electronic watch but the East Asians were the ones who brought it into mass production. Over a third of the watches manufactured worldwide in 1985 were Japanese. Other Asian countries accounted for 50%; Switzerland's share was 10%, but because the country still has a virtual monopoly over the superior brands, the Swiss took 45% of sales value. Watch making is a footloose industry no longer the preserve either of countries with a tradition of exact craftsmanship or economies that boast of a sophisticated scientific establishment. Designing and assembling the basic quartz mechanism has ceased to be a major engineering feat and production of the entire watch can be managed by an industrial sector of modest capabilities. It is also possible to import the electronic mechanism from Switzerland, Japan or some of the East Asian countries and put it inside a locally designed case.

8.19 As competition is intense, there is scant profit in assembling low priced watches using an imported mechanism. Even the manufacture of the entire piece, including the quartz innards, generates low returns if it is for the mass markets. However, the remarkable success of the Swiss Swatch and its imitators, Tiq, M-watch and Vidio-Clip have proved that a good idea, an innovative design backed by a skillful marketing campaign can derive mileage even out of an established slow moving product.

8.20 The Swatch, introduced in 1983, is an inexpensive restyled version of the Concord Delirium, a thin and costly watch first sold in 1979. It is available in a variety of startling designs accented by the use of bright color. Swatch has revolutionized the watch business in two respects. It has persuaded the targeted clientele of teenagers and young adults to treat the watch as a fashion accessory to be blended with other clothing. The message pressed home is that individuals should own an assortment of watches to go with their wardrobe. People own 2.5 watches on the average in the industrial countries. And until recently, the industry worked on the assumption that an individual purchased a watch once a decade. Because of innovations such as the Swatch the pattern is changing. During the mid-seventies 240 watches were sold in the US per 1,000 inhabitants; 425 in 1985. In just two years Swatch sales alone have risen to \$150 million.

8.21 Offering people an affordable, attractively designed product and inducing them to conceive of watches as an item much like shoes was a design and marketing breakthrough. Swatch also ensured that the product was reliable, well-finished, waterproof and easy to produce through innovations in other areas. There are three steps in the manufacture of a watch: the case; the mechanism; and assembly. Swatch brought these together into a single extensively automated operation where the final stage uses a laser to attach the crystal to the plastic case. Quality and production costs have benefitted from a design that minimizes the number of parts required. Purchasing parts from just a few suppliers reduces the expense of certifying and auditing associated manufacturers. And a less complex integrated system has allowed Swatch to market a product that assures quality at low prices.

8.22 The saga of Swatch contains some rules that are likely to be germane for niche hunting Fijian manufacturers. A search for niches must combine fact finding with a dash of social forecasting; how is the market evolving? What changes in consumption habits might people be willing to entertain? Further, a successful product capitalizes on a meaningful distinction and brings together performance, quality and durability in a handsome package. From the start it is designed to be visually appealing and to be simple to produce. Finally, an item such as the Swatch must be made with a certain type of customer in mind and sold in picked geographical locations through a distribution network that reinforces the products other attributes with a sensitive marketing drive.

### Machinery

8.23 Exports of machinery and machine parts from the East Asian countries are expanding as they attempt to complete the transition to industrial products less susceptible to market saturation and trade restrictions. Machinery

producers are thriving not just in Japan and Korea but even in the smaller economies such as Hong Kong and Singapore. Many have begun to acquire proficiency in manufacturing numerically controlled tools and automated equipment. The path taken by machinery producing firms provides valuable lessons for a newcomer like Fiji.

8.24 Machine-tool producers in the industrializing East Asian countries tend to be small, employing less than twenty workers. Their owners usually acquired experience and a little capital by working in a metal working or machinery firm which is why the existence of a machine repair infrastructure associated with the farming or fisheries sectors is of such importance. Most firms began life as repair establishments, edged into parts production and, after acquiring some capability in the areas of design and fabrication, started copying imported machines. Eventually they gained the confidence and the skill to adapt and modify foreign equipment, attaining thereby a distinct identity as makers of genuinely home-grown machinery.

8.25 In the early stages, skills were acquired through learning on the job rather than formal training but by the time firms were producing locally designed machines they had hired university-trained engineers. The ability to import high-quality castings, forgings, motors and hydraulics from overseas was a signal advantage and many firms profited from the advice given by component suppliers as well as local buyers. Entry into the business often had to do with the desire of domestic businesses to substitute complex and expensive imported equipment with local items that could be serviced and repaired more quickly. If a local firm were able to offer a simpler, competitively priced variant of standard machine tool and guarantee a ready supply of parts and service, he had the beginnings of a market. Designs, tried, perfected and matured through interaction with domestic buyers, could then be tested in the foreign market.

8.26 Export success depended very much on the producer's innovativeness. Simpler and robust machine tools suited for conditions in developing countries, sold at low prices, paved the way for entry into the world market. Once sellers broadened their range to include more sophisticated items, parts supply and repair services also gained in importance. In several of the East Asian economies government sponsored extension and training courses aided firms in surmounting design and manufacturing bottlenecks while technical institutes as in Singapore, allowed firms to upgrade skills. Hong Kong is something of an exception, but the other NICs have all supported the development of the machinery subsector through the provision of venture capital and special financing schemes. That machinery producers in Hong Kong have lagged behind as a consequence is apparent from their continued emphasis on the simpler machine tools, low expenditure on R&D and limited scale of operations.

8.27 The East Asian NICs appear to be moving into robotic and computerized machine tools as well as high-speed milling and grinding machines. In a few years there may be rich opportunities in the lower end of the machine tool market for new entrants to reap. Because it takes time to create a base for the manufacture of machine tools, Fiji must begin exploiting the domestic linkages from sugar cane, fish, wood and construction related activities to form the nucleus of a machine and metal working industry which, in due course, could be involved in the vigorous export market.

## Fashion Garments

8.28 The most consistently profitable segment of the international clothing business is fashion garments. Those countries such as West Germany and Italy which are already at the top are battling to retain their position. Enlarging market share is the goal of every other producer. Among the industrializing East Asian countries, Hong Kong has made the deepest inroads and has the strongest reputation. What is the profile of a successful fashion garments exporter?

8.29 To sell expensive clothing which conforms to the latest fashions in highly discriminating Western centers, a producer must be prepared to offer the latest designs in the most popular colors. Beyond that he must be ready with new offerings as seasons change. Hence design consciousness, the ability to produce in small batches with short lead times and to meet an exacting schedule are some of the desirable attributes.

8.30 Design capability flows from several sources. Obtaining specifications, ready to use patterns and molds from buyers presents the fewest difficulties. It is also possible to acquire licenses or even commission some of the famous freelance designers to prepare a line of clothing. For instance, Mary Quant now runs a studio which does work on contract; Karl Lagerfeld is another well-known name in this field. Assiduous study of the trade magazines together with frequent trips to the main centers of fashion is another option for a producer wishing to remain au courant in a fluid market. The riskiest but in the long run most effective approach is for a seller to design his own clothing. In developing countries such design skills are scarce for a variety of reasons. Fashion consciousness is weak and usually at a cultural tangent to the West; often a slowly eroding conservatism dulls the urge to experiment and is resistant to abrupt departures in style; the wealthy may be reluctant to patronise local designers and have no stomach for large expenditures on fashion garments with an ephemeral life span; and there may not be any design schools in a position to impart the requisite skills. Hong Kong has been able to escape from this mold because the cultural circumstances do not inhibit experimentation in dress--the island's youth are notoriously susceptible to the latest Western fads--and the growing monied classes show a taste for ostentatious living that can give the fashion industry the necessary economic impulse.

8.31 Aside from design, quality of product, neatness in finish and punctual delivery are what the industry expects of producers.<sup>45/</sup> West Germany's standing comes not from leadership in design but from a mastery of the logistics that ensures the timely delivery of quality products. Most developing countries fall short of meeting these requirements but the leaders in the field have shown how the problems might be tackled. Korea, Singapore and Hong Kong still rely heavily on buyers to provide exact specifications, assist with the quality control and provide information on technology. By

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<sup>45/</sup> For further details, see David Morawetz, Why the Emperor's Clothes are Not Made In Columbia, Oxford University Press, New York, 1980.



working closely with the purchasers, firms have been able to produce garments that are properly sized and labelled, strongly sewn, neatly finished and can pass the test of color fastness. Importers as well as the firms producing machinery can also keep the garment manufacturers abreast of developments in materials, material joining methods and automated cutting and sewing equipment that is reducing labor needs while lending precision to manufacture. Being able to import the best fabrics and select the unusual weaves, designs and colors is a tremendous advantage for the East Asians over Latin American producers who must do battle with an array of textile import controls imposed by their governments. And a sophisticated dyeing industry is a great asset in a business where the strength and variety of colors has come to matter more and more. To cite one example, the Italian company Benetton, which ranks as the world's largest producer of knitwear, has arrived at its position of eminence by mass producing medium priced and very colorful garments for a targetted market consisting of young females. By specially processing its wool the company has achieved high standards of quality. Subcontracting a large share of its production to small workshops has given Benetton flexibility. A process for dyeing assembled garments and a remarkable system of market feedback ensures a quick supply of saleable garments. Another Benetton innovation is the exclusive knitwear stores operated through franchise which allows the company to control window displays and arrangement of the merchandise, two marketing techniques that have proven very effective in attracting buyers of clothing.

8.32 Keeping close tabs on the needs of buyers calls for cheap and efficient communication facilities; ensuring that high value fashion garments can be delivered on schedule requires good air transport connections; and the necessity of maintaining frequent contact with importers makes the cost of air travel for local sales personnel and foreign visitors an important concern in the garment business. East Asia is steadily enlarging its competitive lead through strategic investment in transport and communication. It is something that other traders must match to a degree if they are not to be left behind.

8.33 These requirements will not be easy for a beginner like Fiji to satisfy in the short-term. But entry into the fashion garments market cannot be contemplated unless the country is prepared to emulate the leaders in the field. Over a hundred small firms are producing garments in Fiji and quite a number have been able to win export orders. A minor percentage of the orders are for quality apparel, an encouraging development, but the high fashion end of the market still remains beyond the reach of even the most enterprising exporters. To concentrate the clothing subsector's resources on producing low priced, mass market items would be a poor strategy. Fijian firms must move upscale as rapidly as possible and the Government can assist in a number of ways.

- (a) duty free access to quality fabric and material from the European countries and Japan would enhance competitiveness;<sup>46/</sup>

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<sup>46/</sup> The recent imposition of quota restrictions on knitwear fabric may interfere with the cost competitiveness of Fiji's garment industry.

- (b) the government might take the lead in putting together an apparatus for gathering market intelligence, and providing businessmen with additional incentives to travel overseas in search of orders; and
- (c) a textile and clothing design center and national design contests would be invaluable in grooming local talent and meeting one of the preconditions for entry into the fashion garments market. In addition, the government might take a hand in arranging licensing deals with foreign buyers that deal in high fashion clothing.

Horticulture

8.34 Exports of fruit and vegetables, except when they have been processed and packaged, fall outside the ambit of the manufacturing sector, but it is worth examining their potential as niche fillers for two reasons. First, Fiji appears to have a comparative advantage in producing so-called exotic tropical fruit. Second, advances in technology and marketing have rendered commercialized horticulture an activity akin to manufacturing. The horticulture trade expanded rapidly during the late seventies attracting much attention worldwide. A change in European eating habits away from bulky traditional winter vegetables high in carbohydrates such as turnips, potatoes and cabbage and towards fresh imported choice items, for example, green beans, eggplant, zucchini and strawberries, was one factor. Another was the vast increase in demand from the oil rich Middle East for a whole range of fresh fruit and vegetables. These two markets took their place alongside the U.S. as major consumers of these items. In fact, the EEC is now the largest market for horticulture products absorbing 55% of total fresh fruit imports and 60% of the worldwide sales of vegetables, while demand from the Middle East exceeds US\$1 billion (see Table 8.4)

Table 8.4: PER CAPITA CONSUMPTION OF FRUITS AND VEGETABLES  
(kg/person)

	Fruits		Vegetables	
	1975	1982	1975	1982
US	186	197	157	172
Western Europe	156	158	170	181
Eastern Europe	35	45	98	106
Middle East and Gulf States (Saudi Arabia)	88	150	91	135

Source: World Bank.

8.35 Since 1982, exports from the rest of the world to the three principal consuming areas have stabilized, creating conditions of chronic overcapacity and intense competition. Glasshouse grown tomatoes from the

Netherlands compete against Mediterranean produce. Cheap energy and subsidies have encouraged Arab farmers to begin producing items that were formerly imported. And improved transport connections have earned Chilean table grapes a share of European and American markets, while Kenyan vegetable growers are able to compete against local as well as Mediterranean suppliers for the much coveted European market "windows." For many items, tomatoes being an example, there is little to attract a new exporter. But as far as tropical fruit and vegetables are concerned, the market does not appear to be saturated. Products such as mangoes, bananas, okra, capsicum and aubergines can still command brisk sales in the Mid-East and the EEC not to mention the US. Entry into the business, however, requires preparation and sound organization.

8.36 Experience that has been gained in producing and trading bananas, pineapples and kiwi fruit indicates that a determined campaign can catapult countries like Thailand, Philippines and New Zealand to the front ranks but the road to export success is a long and costly one. Large-scale commercial production managed by skilled personnel is definitely advantageous from a financial angle because there are scale economies and the application of technology is facilitated. As the market for horticulture products has developed, it has adopted the standards and conventions applied to manufactures. Quality, shelf-life, standardization, ease of handling, uniform attributes, packaging, constant supply, steady improvement--all of these are demanded by customers and retailers. This requires continuous research and its conscientious application. Since the mid-seventies, horticulture has become a research intensive activity. Many recent advances in somatic embryogenesis, protoplast fusion and somaclonal variation will only raise the technological stakes in this field giving large, well-managed financially strong agribusinesses a decisive advantage.

8.37 In today's fast-paced markets where distribution and retail chains are scrambling to ensure an uninterrupted year round supply of a vast range of items, detailed daily information on prices and transactions is a must. Perhaps more so than with manufactures, the export of horticulture products requires that the seller become a part of the farflung communications network which regulates prices and the flow of commodities.

8.38 For many products, bananas being one of the foremost examples, an elastic supply of cheap labor and ample reserves of fertile land are needed to assure competitiveness and gain market share. Preparing bananas for shipment calls for destemming, removal of rejects, grading, washing, branding and packing in boxes. All of these are labor-intensive operations. The Philippines attracted the notice of multinational fruit companies and became one of the largest banana producers because agricultural labor and land were plentiful in Mindanao and elsewhere. Similarly, the mix of climate, soil, and labor together with encouragement from the Board of Investment, have made Thailand the second biggest exporter of pineapples in little over a decade. Mexico, Belize, Haiti, Brazil and South Africa have developed a lucrative trade in mangoes to the US, partly on the strength of elastic factor supplies and partly through their ability to develop and market a product that fits the US preference for grapefruit-sized mangoes.

8.39 Exporters of fruit and vegetables to the EEC generally sell on consignment through their own agents located in wholesale markets or on direct contract to major buyers. In the U.S., there is, in addition, extensive MNC involvement in the transport and marketing of fruit. Entry into the Japanese market is often difficult without the intermediation of a trading house with good distributive connections. The logistics of the horticulture trade are expensive and complex. Without an efficient, financially well endowed organization they cannot be effectively managed. Such organizations were created in Israel to market citrus fruit and in New Zealand to engineer the entry of the famed kiwi into the culinary universe of the Americans, the Europeans, the Japanese and the Arabs. Other countries, for example, Mexico, the Caribbean nations, Central American states and the Philippines have also depended upon the initiative of MNCs.

8.40 Shipping, ripening, wholesaling and the assurance of regular supplies to dispersed retailing outlets necessitates an intricate scheduling of production and transport. Introducing tropical exotics to a broad cross-section of the populace involves ingenious and prolonged advertising. Phased harvesting of the produce lengthens the period during which supplies are available; time chartering or affreighting are the preferred modes for arranging cheap and regular shipments, while containerization, where it is feasible, lowers costs and can be used for the purposes of ripening.

8.41 The eventual aim of a fruit exporter is to market a branded, firm specific, differentiated product that establishes a market niche with a loyal following. Banana companies that are confident about the quality of their product, the consistency of their standards and the reliability of their supply system, affix company labels to the fruit. Retailers are required to remove the brand stickers after a time to prevent the loss of goodwill from the sale of overripe fruit. Selling a branded product worldwide is the apogee of the horticulture business in terms of earnings and profitability. It should be the goal of a country like Fiji that wishes to become an important trader of tropical fruit and vegetables, but as the preceding discussion suggests, realizing this ambition entails careful planning, substantial investment, and the willingness to take risks.

8.42 There is no reason to concentrate on fruit and vegetables. Fiji has successfully exported fresh and processed ginger of high quality. On a limited scale, it has also begun tapping a market for taro and other root crops among Pacific Islanders settled in Australia, New Zealand and the US. Because fresh taro, the preferred form of this commodity, is bulky, has a moisture content of 60-70%, is easily bruised and subject to rapid decay, it is costly to transport and ideally needs to be air shipped in small batches. However, root crops are reducible to clean, fine, grain starches. Creating overseas demand for taro flour might be preferable as an avenue to higher exports. Of course, the problems of supply arising from fungal and viral diseases that are inducing farmers to substitute cassava for taro would also have to be tackled through a breeding program that leads to hardier and more productive strains. In other countries, cut flowers enjoy a thriving trade. Colombia, the second largest exporter sells \$150 million annually, mostly carnations purchased by US buyers. Fiji could supply orchids for the Japanese market during the peak wedding season in October-November when supplies from

Hawaii are limited. It might also be possible to cash in on the demand for anthuriums in the US and Europe. New Zealand is expanding its goat stock and hopes to export NZ\$100 million worth of goats and goat meat by 1990.<sup>47/</sup> A commercialized approach to goat raising could lead to Fiji's entry into this market.

8.43 In short, the possibilities are numerous, not only in traditional items such as melons, pawpaws, passion fruit, mangoes, and citrus, but also in products like okra, zucchini, squash, vanilla, cut flowers, seaweed (the source of agar) and meat. No doubt, the availability of air transport facilities at reasonable rates will remain a constraint unless carriers, persuaded by increased tourist traffic to raise the frequency of services, can be induced to combine this with additional cargo capacity. Pending a reduction in air shipment charges, it might be desirable to give more attention to the export of dried and processed fruit for which there is a growing market in the US and Japan. For instance, if shipping bottlenecks interfere with the trade in fresh bananas, weight and perishability problems could be sidestepped by concentrating on banana chips, dried whole bananas, banana figs and puree.<sup>48/</sup>

Table 8.5: FIJI: EXPORTS OF FRUIT IN 1985  
(Tons)

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Fruit	Tons
Passion fruit	520
Pineapples	36
Mangoes	130
Pawpaws	Limited sales to Australia and New Zealand

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Source: Fiji's Ninth Development Plan.

The first indications are encouraging. Markets in the US, Japan, the EEC and Australia could absorb far bigger quantities, but only if the country is able to assure buyers that it can meet the criterion of consistent quality and reliable supplies in the volumes desired. Much of the investment that will

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<sup>47/</sup> Production of goat meat in Fiji is estimated to be 700 tons in 1986.

<sup>48/</sup> See, B. Shaw, Food and Nutrition Policies for South Pacific Countries: Determinants of Government Planning; P. Sivan, Producing More Food in the South Pacific: What are the Possibilities; and S. Talagi, Improved Processing and Marketing of Pacific Island Foods, in R. R. Thaman and W. C. Clarke eds. Food and National Development in the South Pacific, U.S.P. Suva, 1983.

augment production must come from the private sector, but the experience of New Zealand and Israel suggest that the government might consider taking the lead in four areas.

- (a) establishing marketing organizations that define and enforce quality standards, manage the collection of produce, supervise the packaging, and assist in the dispatch of fruit and vegetables to importers worldwide. In this area, a joint venture with fruit marketing bodies from New Zealand might be helpful;
- (b) development of research and extension services that complement the efforts of the marketing agencies and have strong links with both the growers as well as the marketing system;
- (c) supporting institutional changes that would lead to the emergence of orchards and vegetable gardens on the scale needed if Fiji is to cement its currently rather tentative contacts with foreign contractors; and
- (d) negotiating with air cargo operators to augment services available to Fijian exporters.

## FIJI

## Basic Indicators of Fiji Sugar Industry, 1976-85

	Average 1976-78	1979	1980	1981	1982	1983	1984	1985/a
<b>Basic Data</b>								
Area harvested ('000 ha)	51	62	67	66	69	59	69	70
Cane production ('000 tons)	2,602	4,058	3,360	3,931	4,075	2,203	4,290	3,043
Sugar production ('000 tons)	335	473	396	470	486	276	480	341
Molasses production ('000 tons)	97	163	129	152	150	84	188	108
<b>Yield Statistics</b>								
Cane yield/ha	51.0	65.5	50.1	59.6	59.1	37.3	62.2	43.5
Cane/sugar ratio (TC/Ts)	7.8	8.6	8.5	8.4	8.4	7.9	8.9	8.9
<b>Prices</b>								
Growers prices (F\$/cane ton)	25.30	23.50	35.19	26.24	25.00	29.65	19.00	25.00
Growers sugar prices (F\$/sugar ton) /b	197.34	202.10	299.12	220.41	210.00	234.24	150.10	204.70
FOB export unit value price (F\$/sugar ton)	281	273	395	322	304	326	290	253
World price (F\$/sugar ton)	249	178	517	319	173	190	124	104
FOB price as % of world price	113	153	76	101	176	172	234	243
<b>Export Earnings (F\$ million)</b>								
Sugar	82	117	174	132	125	112	110	104
Molasses	2	7	12	10	5	3	7	7
<b>Total</b>	<b>84</b>	<b>124</b>	<b>184</b>	<b>142</b>	<b>130</b>	<b>115</b>	<b>117</b>	<b>111</b>
(as % of merchandise exports)	30	61	66	59	55	52	47	46
<b>Employment (number of workers)</b>								
Farmers	17,862	19,233	19,567	21,015	22,091	20,500	21,796	22,146
Cane cutters	13,705	17,003	19,300	19,411	19,911	11,295	16,244	12,924
FSC	3,486	3,620	3,951	4,000	3,708	3,521	3,871	3,400
<b>Total</b>	<b>35,053</b>	<b>39,856</b>	<b>42,818</b>	<b>44,426</b>	<b>45,710</b>	<b>35,316</b>	<b>41,911</b>	<b>38,470</b>
(as % of total employment)	n.a.	n.a.	n.a.	n.a.	22.6	17.1	19.9	17.9
<b>Value Added /c</b>								
Sugar agriculture (as % GDP)	10/d	12	10	11	12	7	11	8
Sugar agriculture (as % Total Agriculture GDP)	43/d	50	44	47	47	33	46	36
Sugar manufacturing (as % GDP)	4/d	5	4	4	5	3	4	3
Sugar manufacturing (as % of Total Manufacturing GDP)	33/d	36	33	35	37	24	35	26
<b>Total Sugar (as % of GDP)</b>	<b>14/d</b>	<b>17</b>	<b>14</b>	<b>15</b>	<b>17</b>	<b>10</b>	<b>15</b>	<b>11</b>

/a Preliminary data.

/b Growers price for sugar cane have been converted by cane/sugar ratio.

/c Percentage share at constant prices (1977 = 100), no current price data are available.

/d 1977-78 average only.

Source: Fiji: Adjustment and Selected Development Issues, World Bank, August 1985, Report No. 5515-FIJ.  
Current Economic Statistics, Bureau of Statistics, various issues.  
 Fiji Sugar Corporation estimates.

FIJI

Normal Tax Schedules for Personal Income Taxes

<u>Exceeds (F\$)</u>	<u>Does not exceed (F\$)</u>	<u>Tax F\$</u>	<u>Marginal rate on amount over Col 1 (%)</u>
<u>January 1, 1974 - December 31, 1980</u>			
0	600	-	7.5
600	2,000	45	12.5
2,000	3,000	220	17.5
3,000	4,000	395	22.5
4,000	4,500	620	25.0
4,500	5,000	745	27.5
5,000	5,500	883	30.0
5,500	6,000	1,033	32.5
6,000	6,500	1,195	35.0
6,500	7,000	1,370	37.5
7,000	7,500	1,558	40.0
7,500	8,000	1,758	42.5
8,000	10,000	1,970	45.0
10,000	12,000	2,870	47.5
12,000	-	3,820	50.0
<u>January 1, 1981 - December 31, 1985</u>			
600	2,500	30	11.0
2,500	4,000	239	18.0
4,000	5,500	509	27.5
5,500	7,000	922	32.5
7,000	8,500	1,409	40.0
8,500	10,000	2,009	42.5
10,000	12,000	2,647	45.0
12,000	20,000	3,546	47.5
20,000	-	7,347	50.0
<u>January 1, 1986</u>			
1,500	1,500		5.0
3,000	3,000	75	10.0
4,000	4,000	225	18.0
5,500	5,500	405	27.5
7,700	7,000	818	32.5
9,000	9,000	1,305	37.5
15,000	15,000	2,055	42.5
25,000	25,000	4,605	45.0
40,000	40,000	9,105	47.5
		16,230	50.0



FIJIElasticity of Major Taxes and of the Fiji Tax System, 1974-81

	Type of Tax	Elasticity coefficient	R <sup>2</sup>	Buoyancy Coefficient	R <sup>2</sup>
Income Tax /a	tax to base (GDP)	1.609	0.97	1.607	0.96
Company Tax /b	tax to base (GDP)	1.160	0.96	1.257	0.96
Excise Duties	tax to income (GDP)	0.203	0.85	0.972	0.98
Excise Duties	tax to base (IIP) /c	0.024	0.15	0.107	0.13
Import Duties /d	tax to income (GDP)	0.678	0.95	1.085	0.98
Import Duties /d	tax to base (imports)	0.574	0.94	0.911	0.91
Other Taxes /e	tax to base (GDP)	1.268	0.72	1.268	0.72
<u>Total Taxes</u>	tax to base (GDP)	1.101	0.99	1.294	0.99

## Notes:

1. Income tax includes personal tax PAYE, basic tax and provision tax.
2. Company tax includes dividends.
3. IIP is the Index of Industrial Production for all items excluding gold and sugar.
4. Import tax includes customs and fiscal duty.
5. Other tax includes hotel turnover, land sales and miscellaneous customs receipts.

## Source:

The Financial Review Committee Report, 1985, Parliamentary Paper No. 54 of 1985, Parliament of Fiji, August 1985, p. 13. Also see Analysis of the Elasticity of the Fiji Tax System, Jacqueline Harvey, Ministry of Finance, unpublished mimeo.

FIJI

Buoyancy Estimates of Central Government Revenues  
(1979-85)

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	Average for period <u>/a</u>
Taxes on individual income	1.30
Taxes on company income	2.00
Taxes on goods and services	2.40
Taxes on international trade	1.73
Other taxes	0.84
Tax Revenue	1.63
Nontax revenue	1.02
<u>Total Revenue</u>	<u>1.53</u>
Foreign grants	3.36

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/a Calculated using point elasticities.

Source: Annex Table 2.