CHAPTER III

STRATEGIES FOR TRADE AND ECONOMIC DEVELOPMENT

By now it has become clear that the scenario which obtains in Southwest Pacific is of unequal economic relationship with hardly any attempt on the part of weaker nations to influence the others’ decision-making. There are two reasons. Internally, their economic and trade structure is weak so they have to depend on their big brothers - mainly Australia and to some extent New Zealand - for aid, trade and investment. Externally, their one or two commodity structure cannot withstand the vagaries of global commodity price fluctuations. For small nations the economic security is predominant in their concerns. Therefore, they do recognise the need to look out and diversify. This is evident in their strategies for trade and economic development.

Another much more important scenario which obtains in Southwest Pacific in recent years is of crucial economic relationship between the big brothers - Australia and New Zealand and the major powers, mainly EEC, UK and USA. This scenario is rather more important as it is this scenario which has lately put into question the whole alliance structure in Southwest Pacific which is closely allied with the West. Pragmatism is slowly taking precedence over the traditional ties. The position of Southwest Pacific in general and Australia and New Zealand in particular in the global economic order has undergone a process of dramatic transition over the last decade and a half. “This transition has implications for both economic and politico-strategic dimensions”, notes Richard Higgott.¹

Realisation by Australia and New Zealand of this ‘politico-strategic’ dimension of transition of world economy is of very recent origin. It will be studied in the discussion of their trade and economic strategy, which would follow after the discussion of the trade and economic strategies by Fiji and Papua New Guinea.

I

Strategies for the development of small island countries presupposed an understanding of the social customs, traditions and aspirations of people living there. The special circumstances within which they operate and the inherent weaknesses of their economies are of relevance in determining the speed of economic growth. A recent World Bank report recognised a number of serious

ings and create employment opportunities. In that most countries have substantially raised the rate of public investment. Attention has focused on transport, including roads, harbors, shipping services and airport and airline facilities; domestic and external telecommunication; public utilities like electricity, water etc; and education and health. This build up of infra-structure has been intended to facilitate private investment.

The structure of Private Direct Foreign Investment (PDFI) in the Southwest Pacific is quite different from that of the other countries in Asia-Pacific. Manufacturing and services have been the largest recipient of foreign capital in Asia-Pacific. However, in the Southwest Pacific foreign investment has been largely concentrated in mineral development in Papua New Guinea and to a lesser extent in Fiji and Solomon Islands, and in tourism development in Fiji, Vanuatu and elsewhere. In Asia-Pacific investment has mainly come from the United States, Japan and the European communities. But in Southwest Pacific Australian investors predominate with New Zealand and Japan taking a back seat. Investment from European communities is on a government to government basis. While PDFI is generally welcome in Pacific island countries, it is not allowed without appropriate safeguards. The former colonies feel, often quite rightly, that they experienced a century of imperialist exploitation. Therefore, many have taken measures (such as the taxes and dividends paid to the Papua New Guinea Mineral Resources Stabilisation Fund) to ensure that a major part of the profit accrues to the government. Graeme Dorrance suggests two cautions that should be taken in any assessment of PDFI in the Pacific islands. One relates to PDFI generally, the other is specific to the Pacific islands area. According to him all investment incentives, in particular fiscal

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incentives have little effect in encouraging PDFI. Most capital exporting countries have taxation system that result in fiscal incentives by capital importing countries being subsidies for the exporting countries. Other incentives such as export zones are equally weak in attracting PDFI. The effect of Fiji’s program in this regard appears to be overestimated.10 As far as protectionist measures like tariff, quotas etc. are concerned, Dorrance points out that they have attracted investment in high cost production that draws resources away from more productive activities and discourages PDFI in export oriented and other real income raising investment. The relatively slow growth of the Pacific islands may be partly due to encouraged PDFI and tariff and other protection. In fact Fiji welcomes tariff protection which would encourage PDFI to produce local substitutes for otherwise imported commodities.11 Another caution which Dorrance suggests is that the Australian and New Zealand markets are tiny by international standards. They are not as conversant with international markets as investors from larger countries. Therefore, if the Pacific islanders want to encourage PDFI they should look to broader horizons as sources of development finance.

In addition to what Dorrance has suggested there are several other reasons for the sluggish growth of private investment. Infrastructure remained rudimentary, transport costs high and markets fragmented besides lack of clear access to land.12 Communal ownership of land has been a major impediment to agricultural investment and growth in both Fiji and Papua New Guinea. Traditional practice and legislation have severely restricted transfer and leasing of land.13 In view of the widespread social repercussions, few governments have been willing to contemplate radical changes in land reform. Yet another reason for lack of private investment has been the shortage of skilled labour due to


migration. Although a high degree of automaticity has usually permitted inward and outward capital movements, little foreign direct investment has been attracted since independence in Papua New Guinea, except for mining enterprises. The Papua New Guinea government issues annually a National Investment Priorities Schedule that has a long list of activities in which foreign investment is encouraged. The first of Papua New Guinea’s eight aims is to encourage "a rapid increase in the proportion of the economy under the control of Papua New Guinea individuals..." A ministerial statement in March 1988 declared that no foreign investor could begin operations in retail sales, as a real estate agent or in the sale of used cars and fast foods; and that regulations were being drafted to ban foreign controlled wholesale activities. Nevertheless, PNG’s mining sector has had a major impact on economic growth in the post-independence era, its employment potential has been limited and local purchase of materials and equipment small.

The public sector remains the main source of employment reflecting increased current and capital spending by both the Central government and the Public enterprises. Though Fiji has developed a diversified private services sector that includes a large tourist industry and trade and financial services, the public sector has been by far the most important source of employment. The public sector in Papua New Guinea consists of the National government, nineteen provincial governments, local authorities and a number of non-

14 In Papua New Guinea shortage of skilled labour arose due to the departure of expatriates after independence in 1975, while in Fiji this problem arose recently due to migration of many Fiji-Indians in the aftermath of coups in 1987. See Satendra Prasad (ed.) Coup and Crisis: Fiji - A Year Later (Victoria, 1988), pp.80-82.


18 Goodman, n.15, p.147. See also Browne and Scott, n.12, p.10.
sought to decentralise economic activity by location, broader ethnic participation in development and improvement of life in rural areas. Increased national self-reliance was a major objective. Since independence, Fiji has been able to energise its development activities, attract foreign capital and effect transformation from a predominantly rural economy to a service economy. The Eighth Development Plan (1981-1985) envisaged expansion and diversification of the primary sector. It emphasised the need to provide adequate number of socially productive jobs with sufficient real incomes and to promote increasing self-reliance for improved standard of living of the majority of the population. The plan laid heavy stress on enlarged agricultural production. Governmental efforts concentrated on a number of export-oriented commodities, especially cocoa, ginger and sugar. Besides, the potential for large scale exploitation of fisheries resources was recognised. Known deposits of bauxite, silver, gold, lead, zinc, iron, phosphate, marble and potential energy were increasingly harnessed. Exploration of oil and natural gas is also underway. The Alliance Party government (led by Ratu Sir Kamisese Mara) which ruled Fiji since independence from Britain in 1970 counted on 5% annual economic growth during the plan period. But growth was barely 2% annually at the end of the plan. Low sugar prices, a bad drought, a series of hurricanes, the stagnation of tourism etc. caused serious setbacks. However, tourism has entered a boom period. The government is now giving immediate priority to tourism. It wants to exploit this fully to quickly generate jobs and cash, while longer term agricultural and industrial plans mature. Fiji’s planners also believe that the country’s economic prospects depend largely on how successful it is in cutting population growth. So reducing the annual birth rate (from around 29 per 1000 to 25 per 1000) by 1990 was made a key target of the country’s Ninth Development Plan. Fiji’s Ninth Development Plan (1986 - 1990) also aimed at achieving real GDP growth of 5% a year. On the output side, emphasis was given to the growth of resource based industries. The plan retained the diversification and distribution objectives. Broadly, the objectives of Fiji’s Ninth Development Plan were to attain a dynamic growth oriented industrial structure, expand

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output, particularly for exports, increase efficiency and competitiveness, facilitate and encourage vigorous private sector.24

Within this planning framework, the economy was expected to advance making optimal use of the available human and physical resources and to reduce income disparities. To this end the government sought to create an appropriate infrastructure throughout its planning period. While progress has been made towards sustained development through the creation of economic and social infrastructure, the supply side of the economy has remained relatively unresponsive to policy changes25. The growth of agricultural productivity and the development of industry and private services has been slow. The main source of employment as discussed above has been the public sector but budgetary constraints have limited opportunities for job creation.

The Policy of Import Substitution and Tax Incentives

Although import substitution was the major objective that progressed well till the Sixth Plan, it was not to be taken as far as full self-sufficiency. Rather there was a concentration on activities with export possibilities.26 In the Eighth Plan both export and import industries were encouraged with high priorities to industries based on local primary commodities and the production of inputs required by primary and other sectors. Industries based on imported raw materials were to produce essential items for the domestic markets and goods for export. Low priority was given to industries based on imported raw materials and producing non-essential items.


25Browne and Scott, n.12, p.5.

One of the notable features of Fiji's planning experience has been that manufacturing got a boost which took various forms. Some manufactures have been established for the purpose of industrialisation with the emphasis on 'infant industries'. This category of industries is highly protected. Another set of manufacturing includes food processing (bakeries and dairy products), heavy building material such as cement and bricks and locally processed raw materials for import substitution and exports. A last category of manufacturing is labour intensive processed goods (mainly clothing) which is set up to export to world markets. However, the protection structure to manufacturing has come under severe attack by the critiques.

Tax incentives aimed at stimulating industrial development are now fairly common in the Southwest Pacific. The most common incentives are income tax holidays and relief from import duties on raw materials and capital equipment to induce local and foreign entrepreneurs in manufacturing and related industries. It is assumed that tax incentives can influence investors in several ways: by speeding up the recoupment of investment outlay or by offsetting the disincentive effect of various risks. Besides mobilising additional funds and entrepreneurial skills, tax incentives can help to direct investment into priority industrial project as, for example, export enterprises based on local resources and related 'comparative advantage' factors, as well as appropriate import substituting industries. In the case of Fiji, there are two principal measures - import controls and tariffs - that have protected domestic manufacturing. Cole has criticised these measures. According to him tax holidays and tax incentives schemes do not attract foreign investors because they cannot earn profits in the early years of production. Some other critiques also point out that before making any decision foreign investors take several other factors into considera
tion, for example, political stability and normal domestic tax structure. Supporters of this view claim that the main consideration in investment decisions is long term profitability.

Even the Ninth Development Plan which has now been dropped concluded:

"It is becoming evident, both from comparative studies conducted by such international bodies as the IMF and the World Bank and the discussions with the private sectors that incentives alone do not play the most critical role in investment decisions. Political, economic and financial stability are more important considerations. The best incentive, therefore, is to have open and as much as possible unregulated financial and economic structures that are durable and not subject to arbitrary interference".  

However, despite these criticisms and harms done to Fiji's manufacturing, tax holidays and tax incentive schemes have flourished especially after the 1987 coup.

In addition to tax schemes the government is following a very liberalised policy on foreign investment. Concessions are provided to encourage new investments. No major restraint has been put on repatriation of funds; other concessions include tariff concessions on imported plant, machinery and equipment and raw materials.

Development Assistance

In the overall development strategy of Fiji, technical assistance in terms of skilled manpower has been vital. Australia, New Zealand and Asian Development Bank among others have been the major supporters. In addition to


32 Fiji’s Ninth Development Plan, n.24, p.100.

33 “Fiji has attracted more foreign investment in the last fifteen to eighteen months than we have ever done in the last seventeen years” said Mr Berenado Vunibobo, Minister for Trade and Commerce, in Radio Fiji interview on 9 July 1989.
assisting with manpower, donors have provided support by way of training both in-country and overseas. All of this assistance has been channelled through development banks called Development Financial Institutions (DFIs).34 These DFIs have flourished all over Southwest Pacific. They are an instrument of official policy - some of them are required by law to act with government’s own wishes as to the direction in which the economy is to develop. Skilled manpower and money which together provide a catalyst for development are major resources of DFIs. Asian Development Bank (ADB), The Australian Development Assistance Bureau (ADAB), New Zealand’s External Aid Division (NZ/EAD), The International Bank for Reconstruction and Development (IBRD), The European Economic Community (EEC), and various UN agencies, all play an important role in the provision of resources for Southwest Pacific DFIs.35

In the case of Fiji, Fiji Development Bank gets all the funding and technical assistance from the sources described above. It has concentrated on support for the rural sector in that category. The Bank’s Annual Report 1982 reveals that current loans to agriculture and fisheries total in excess of 5093, are valued at $27.3 million and have been built up to that level over 15 years.36 While its major lending thrust has been in support of the cane industry, particularly the development of new areas in Vanua Levu, the bank has also provided support for rice and general farming, the beef and dairy industry and has contributed substantially to national self-sufficiency in the poultry industry. FDB has been given a special responsibility to assist the Fijian people into the commercial and industrial sector. In addition to loan finance it provides training and supervision and is designed to help the indigenous people overcome disadvantages viz a viz other races involved in the business sector of the Fijian economy.37

34 UNIDO, n.23, p.93.


37 The Fiji Development Bank(FDB) special loans to Fijians have increased dramatically averaging $1m a month. See Focus on Fiji, November 1989 a news bulletin of Ministry of Information, Suva, Fiji, p.13.

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The Economic Development Board (EDB) with wide ranging task of an advisory and promotional nature was formed in 1980. The EDB advises government on possible location for various types of industry, the need for government investment, promotes the development of industrial estates and promotes Fiji as a place of investment for overseas funds. Development and technical assistance was meant basically to fulfill two goals. One, to diversify industrial structure for import substitution and two, to rapidly increase manufactured exports. The development and technical assistance is proclaimed, therefore, to provide assistance in developing a more effective industrial policy making structure capable of providing increasing domestic economic linkages and exploiting the countries' international comparative advantages. It was also supposed to provide assistance in conducting market surveys, design appropriate institutional support structures and provide relevant training and assistance to enterprises for production and export growth.38

Whether those objectives have been fulfilled or not is a matter of considerable debate. However, it should be stressed that Fiji, eager to reduce its dependence on Australia and New Zealand is finding ways to strengthen links with Southeast Asia.39 This is all the more due to deteriorating condition of the economy.

It is heading for a disaster. Unemployment is rising. The crisis in sugar industry is much deeper. Sugar farmers of Indian origin have protested against the overthrow of a democratically elected government and subsequent adoption of the new Constitution to entrench the political control by native Fijians. The country's four sugar mills were shut down independently. The tourist industry which earned US $ 192 million in 1986 from visitors - mainly from Australia, New Zealand, the US and Japan - is facing a squeeze. In

38 UNIDO, n.23, p.93.

39 Cole, n.26 p.67. According to Michael Taylor, "It can be conjectured that the 'aid with dignity' that Fiji currently receives may also be modified and re-oriented by the changing strategic balance of the South Pacific." See Michael Taylor (ed.), Fiji: Future Imperfect, (Sydney, 1987), p.12.
addition to this Fiji faces longer term problems as a result of the coup. At this time suspension of aid and investment from overseas was crippling. The government did, however, manage to get some aid and investment. But it has exposed the vulnerability of the Fijian economy.

To meet the country's new economic situation, the interim government is seeking alternative economic strategy which may be summarised as follows: (i) revitalize and stabilize the economy and install confidence in private sector through appropriate incentive measures and counter-cyclical budgetary policy; (ii) rely on sugar sector for underlying strength of the economy (as well as for providing a substantial portion of government revenue) to support the diversification program; (iii) promote agricultural diversification, export-oriented industrialisation and tourism for growth, foreign exchange earnings and employment creation; (iv) maintain external competitiveness of the economy and restrain domestic consumption; and (v) ensure that the macro-economic policy framework and the institutional support provided are conducive to achieving rapid economic transformation. The government has acted resolutely on deregulation and reduced the size of government. Since 1988 the economy has recovered somewhat, thanks not only to booming sugar sales and tourist arrivals but also because new labour intensive industries such as garment manufacture, are flourishing. Since August 1989, export-oriented factories readily have been granted a 13 year holiday from corporate tax. The Byzantine foreign investment controls have been replaced. Deregulation and the reorientation to export markets were implemented with great skill and foreign trade is being liberalised. The government is also seeking aid from China, Taiwan, Malaysia and South Korea.

40 The French aid to Fiji has since been resumed. In fact France has increased its commitment after the coup. See Stephen Henningham, "French Spending in the South Pacific" Pacific Economic Bulletin, December 1989, vol.4, no.2, pp.30-38. Various sources of foreign aid are given in Table 8 in Appendix I.

41 Robertson, n.31, p.44. But economic prospects do not look bright in the absence of confidence in the present system of government. See also Bruce Knapman, "Economy and State in Fiji: Before and After the coups", The Contemporary Pacific, vol.2 no.1, Spring 1990, pp.59-86.

42 Radio Australia Transcripts: Canberra 19,20,22,30 April 1990.
But despite massive and costly tax holidays, investment is not back to pre-coup levels. The economic recovery has triggered inflation. The new Constitution has partially disenfranchised the citizens of Indian descent and enshrined unchallengeable powers for the Chiefs. The lesson that is emerging in Fiji, is that building long term prosperity requires economic and civil liberties that are most credibly backed by democracy and free markets. Both promote and require civil freedoms. Fiji’s economic recovery will stall until the political stalemate is broken in favour of equality.

PAPUA NEW GUINEA

Papua New Guinea before independence was governed by Australian government which obviously had its colonial interests to look after while formulating the strategy. However, after independence the aim of Papua New Guinea government was to create a package of incentives which would lead to the development of suitable environment and ensure increasing participation by nationals. For this reason, therefore, a particular importance has been attached to small enterprise development. It is intended to encourage the establishment of small modern factories and traditional rural industries based on simple technologies together with an informal sector primarily providing service function associated with manufacturing because of the relative ‘ease of entry’ for nationals. Government purchasing policy has been reorganised to give preference to locally manufactured products and it is proposed to provide a supporting technical extension service for small enterprises. A series of large, natural resource based projects have been used to generate revenues for programs aimed at a more equal distribution of economic benefits and at self-reliance. This policy has achieved significant progress, successfully reducing dependence on Australian aid - now providing under 30 per cent of total expenditure as against 50 per cent in 1970. The program of economic stabilisation during the last

43Goodman, Lepani and Morawetz, n.15, pp.41-43.


decade has also been largely successful even at times of high international inflation and major fluctuations in Papua New Guinea’s terms of trade. The impact of fluctuating world prices for export commodities and other uncertainties for producers and for the budget has been minimised with the help of price stabilisation funds. Monetary and exchange rate policies have held domestic inflation below international levels, contributing to the stability and international credit worthiness of the economy.

However, the move to increase national control of the economy has limited the use of expatriate expertise. Decentralisation increased the size of the public sector, although it may well be at the local level. Trade policies have been open and liberal. There has been no explicit policy to use trade measures to promote local industries, although some protective tariffs have been granted on an ad hoc basis. Government interventions in industry have been fairly limited.

Industrial policies have been presented in (a) ‘framework for industrial development’, issued in 1975, (b) “National Development Strategy” 1976 and (c) in the 1984 White Paper on Industrial Development. Industrial development has been given secondary importance to agricultural and rural development. In 1983, this overall strategy was extended to include criteria of decentralised location of industry, use of locally produced inputs, potential for fostering linked industries and skills and possibilities for exports.

A package of incentives for small scale industries has been introduced at the national level. This includes tax rebates for infant industries in proportion to wage costs (to reduce labour costs in start-up situations), flexible depreciation allowances, export incentives, import controls on competitive products, taxation incentives associated with training and transport costs and marketing/promotional costs.

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48 Goodman, Lepani, Morawetz, n.15, pp.55-56.
Broadly, successive governments followed three sets of policies, exchange rate policy, fiscal or budgetary policy. These were basically to achieve following development objectives:

- rapid increase in the proportion of the economy under the control of the Papua New Guinea nationals.

- a more equitable distribution of economic benefits.

- decentralisation of economic activity, planning and government spending.

- emphasis on small scale, artisan, service and business activity.

- the development of a self-reliant economy, less dependence on imported goods and services so that the economy is better able to meet the needs of its people through local production.

- increasing capacity to meet government spending needs from domestically raised revenue; and

- government involvement to be limited in those sectors of the economy where control is necessary to achieve the objectives outlined above.

The Development Plan 1989-93 which was submitted to Parliament on 8 November 1988, together with the budget for the year 1989, sets out the following medium term objectives: (i) the achievement of sustainable economic growth; (ii) the creation of income-earning employment opportunities particularly in rural areas; (iii) the reduction of economic and social inequalities; and (iv) the establishment of fiscal self-reliance. The Government emphasises the basic commitments of achievements of integral human development, which includes among others: (i) provision of adequate means of shelter, food and water; (ii) educational opportunities for all citizens; (iii) access to health care and social welfare services; (iv) protection of basic human rights by means of the constitution and the law. To achieve its medium-term objectives, the Government is pursuing the following strategies: (i) improve its resource allocation by redirecting expenditures away from consumption towards investment projects in the economic and

49 Development Plan 1989-93, National Planning Office (now the Department of Planning), Port Moresby, p.15.
infrastructure sectors; (ii) improve the effectiveness of its resource management; (iii) increase the effectiveness and improve management of external assistance; and (iv) promote and support private sector investment initiatives.

Macro-economic Policies

The key element in macroeconomic policy since independence has been ‘hard currency’ strategy. The government’s objective in the period immediately after independence up to the early 1980s was to keep the inflation down and maintain balance of payments and foreign debt within manageable limits. This decision was necessitated by two compulsions. One, wages in Papua New Guinea were fully linked to the consumer price index and as long as this full linkage persisted the exchange rate could not be used as an instrument to effect Papua New Guinea’s competitiveness and hence the balance of payments. In the absence of any exchange controls, devaluation would have raised domestic prices and because of full linkage domestic wage costs without improving the country’s competitiveness. So devaluation of Kina was ruled out. Two, the economy of Papua New Guinea remains extremely open. The government required the use of public expenditure and foreign aid to maintain balance of payments. Therefore, the exchange rate policy was directed to maintain price stability and balance of payments equilibrium by controlling the level and rate of growth of public expenditure.

However, the deterioration that occurred during 1980-82 in Papua New Guinea’s terms of trade, balance of payments, international competitiveness prompted important policy changes in a marked departure from earlier policy. The Kina was allowed to depreciate. This did improve Papua New Guinea’s international competitiveness but it did considerable harm to agricultural exports as well. However, the redistributed effect of exchange rate changes since the early 1980s has boosted the Kina returns to Papua New Guinea’s rural export industries. As regards fiscal or budgetary policy, the government has

50Browne and Scott, n.12, pp.6-7.
51Goodman, Lepani, Morawetz, n.15, p.54.
52Jarrett and Anderson, n.44, p.58.
been pre-occupied since independence with the need to restrain the growth of public expenditure. From 1978 onwards it was intended that there should be a steady increase of 3 per cent a year in real public expenditure which fortunately was realised. This was due to decline in agricultural commodity export prices, the need to curtail drawdowns from the Mineral Resources Stabilisation Fund (MRSF) and the problems at the OK Tedi mines.\footnote{Pacific Economic Bulletin, December 1988, vol.3 no.2, pp.6-8.} The draw down from the Mineral Resources Stabilisation Fund came down from 21 per cent of total internal revenue in 1981 to only 7 per cent during 1982-87.\footnote{Goodman, Lepani and Morawetz, n.15,p.57.} This was because of the low prices of copper concentrates and rising mining costs throughout the 1980s. The government's budget statements yearwise give strong recognition to this fact. However, the sources of internal revenue were to be increased for which the government relied on indirect taxes, personal income tax, company tax\footnote{Government of Papua New Guinea, Ministry of Finance; Budget 1987, 1988, 1989, n.34, pp.50-51.} and other miscellaneous sources.\footnote{UNIDO, n.34, pp.50-51.} But the personal income taxes are confined to urban wage earners. At present much of the personal income tax revenue is received from expatriates, though that contribution will tend to dwindle if the government's indigenisation of the work force continues any further. Economists have suggested taxes on trade. But this opens up the question of what is an optimal trade policy regime for raising a given amount of tax revenue. There could be a number of economic advantages to be gained from a complete overhaul of the trade policy regime which involved removing all barriers to imports and replacing them with a flat rate of tax on exports. But in Papua New Guinea's case it is doubtful whether such benefit may accrue because it cannot apply uniform tax on all the commodities.\footnote{UNIDO, n.34, pp.50-51.} The government is constrained because of limited short term capacity of the economy to allow for increased import substitution or export expansion simply as a result of exchanged external price signal. It should be argued that structural constraints to improve production responses need to be addressed by a broad range of medium term development policies which include co-ordinated exchange rate and wages policies.
This brings us to the third variant of macro-economic policies i.e. wages policy. From independence in 1975 to March 1983 wages in Papua New Guinea were almost fully linked to the consumer price index. There have been moves recently in favour of partial rather than full indexation which is expected to decrease relatively high wage levels. The lesson which the government has learnt is that if Papua New Guinea is to have any chance of getting started in even the simplest of industries, real wages will have to be reduced substantially. High wages discourage investment in manufacturing both for exports and for import substitution. The linking of minimum wages to the consumer price index has meant that real wages could not be reduced significantly even though sharply worsened economic circumstances and prospects for the 1990s have made this imperative. The centralised wage indexation system like Fiji, inherited from the colonial administration has significantly reduced the extent to which the Papua New Guinea’s authorities are able to adjust to changed economic circumstances.

Papua New Guinea faces serious economic challenges. Economic growth has been slower than in many other countries in the region. Skilled and trained people and financial resources for development are in short supply. Skill shortages exist at all levels and in all sectors in Papua New Guinea and are a serious obstacle to development. This has also reduced the level and quality of government services, weakened the management of industrial enterprises, limited the expansion of production and accounted for the continuing need to use expatriate manpower. Current ratio of skilled to unskilled workers is well below the national average in primary industry, manufacturing, building and construction. This has been mainly due to migration from rural to urban market centres, owing to large urban-rural wage gap. Minimum wages, first introduced

57 For a detailed discussion of Wages Policy see Goodman, Lepani and Morawetz, n.15, pp.59-60.


59 The Hongkong and Shanghai Banking Corporation, Business Profile Series: Papua New Guinea, Solomon Islands and Vanuatu, October 1985, p.87.

in 1945 had far reaching effects. The high levels of both rural and urban minimum wages compared to other developing countries have discouraged the export of manufactures and encouraged the substitution of capital for labour.\footnote{ibid} Consequently, its growth strategy has come under severe attack. An ADB report points out that it requires some changes in the medium term.\footnote{Asian Development Bank, \textit{South Pacific Operational Handbook}, February 1989, p.33.} Similarly, a World Bank report recommended a 6 point strategy for medium term development.\footnote{World Bank, n.2, p.26.}

- support for agriculture
- a major program of rural infrastructure
- investment in human resource development
- increased investment, promotion of the private sector and
- institutional reform and staff development in the public sector.

**Finance**

Thus far, the financing of Papua New Guinea's major projects was achieved through direct foreign investments and overseas borrowing. But now government needs to increase the proportion of its revenues raised internally, not least because of the falling Australian aid transfers. Domestic revenues are already constrained by the small size of industrial and commercial sectors. Therefore, it needs to seek some expansion of broader based domestic avenues as in the medium to long-term direct revenue flows from the enclave projects will not suffice for the needs of the majority.\footnote{Government of Papua New Guinea, Department of Finance, \textit{Budget Documents 1987-88}, p.4 and 17. See also \textit{Far Eastern Economic Review}, 3 August 1989, p.18}
Government policy aims, therefore, to increase its investment ratio in the total Government expenditure. The Public Investment Program (PIP) for 1989-93 will be accompanied by appropriate policies to enhance private investment in the non-mining sectors. The overall PIP is centred around a set of investment programs and projects that contribute towards increasing rural employment, earning net foreign exchange, maximizing the use of concessional finance, enhancing institution-building, human resource development and law and order.

**Strategies to Counter Export Instability in Fiji and Papua New Guinea**

Both Fiji and Papua New Guinea are an open economy, small in size and away from world market centres. They rely on one or two primary commodity's exports. A basic drawback of this is seen as the instability in their export receipts, incomes and ability to import. Since the causes of instability are largely external and beyond the direct control of domestic policy instruments, the island economies adopted some stabilisation schemes and diversification policies to counter external instability. As discussed in the previous chapter, the IMF's compensatory financing facility and EC's Stabex scheme have provided stability to the export receipts of Fiji and Papua New Guinea. Primary commodity exporting countries have experimented extensively with such schemes to achieve higher and more stable prices of individual export products. Emphasis is more now on regional agricultural stabilisation schemes.

It has also been argued that along with stabilisation schemes there should be diversification into other tradeable goods. An ESCAP report notes "A convincing body of empirical evidence shows that export proceeds from primary products and raw materials generally tend to be cyclically more unstable and

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65 The 1989 Budget has brought about a marked change in the Government policy. Now the emphasis is on reducing public investment and giving a boost to private sector. See Department of Finance, *Budget Document 1989*, pp.24-25.

66 Ibid.

grow more slowly from those from manufactured goods."68 It can be concluded, therefore, that policies to encourage further processing of primary exports or the development of labour intensive assembly industries are highly desirable to stabilise overall export receipts. Fiji has diversified over a period of time but its manufacturing exports are not very large. Nevertheless, the Government is pursuing a rigorous policy to boost the export of this category (garments). It has taken advantage of EC's stabilisation schemes which stabilised exports receipts.69 Papua New Guinea established commodity stabilisation fund which operated since 1976 for its three major cash crops, coffee, cocoa and copra and since 1984 for palm oil. The funds have been accepted by growers and have been successful in moderating income fluctuations. The successful operation of commodity stabilisation fund pre-supposes a firm commitment on the part of growers to exercise restraint in good years in order to enjoy the cushion against the bad years and supplementary mechanisms are required to prevent governments from expanding absorption financed by such funds.70 The reason why commodity stabilisation funds have not taken off in Fiji is because individual sugar farmers are reluctant to contribute levies in the absence of security of land tenures. In Papua New Guinea, however, the export crops are produced either on alienated land or on customary held land.

However, this is not to argue that the role of traditional demand management tools, fiscal and monetary policies, in stabilising domestic income and expenditure is nil. Nevertheless, it should be stressed, as noted by Cole and Parry that there is "limited scope for these instruments to offset domestic instability because of the rapid leakage of expenditure into imports."71 The difficulty is that the government's internal revenue tends to fluctuate with export commodity price cycle because of corresponding fluctuations in the income and expenditure tax bases.


69 In the recently ended Lome' Convention meeting in Suva, Fiji is to receive more than $26 million in aid from the European Community during the next five years. Radio Australia; Transcripts; 26 March 1990.

70 Kiele, n.67, p.72

71 Cole and Parry n.46, p.85.
AUSTRALIA

Australia occupies an important place in the Southwest Pacific, both as regards its size as well as its economy. Its economy has been closely aligned with west. Any development in the developed economies in the west will have its corresponding repercussions on the Australian economy, which in turn, affects the economies of small island nations. Therefore, it is important to study the strategies that have been followed from time to time with regard to Australia's developmental efforts. These strategies have consistently followed the developments in international economic environment. One of the several reasons, it is said, why the Liberals held power for so long (1949-72) was the prolonged economic boom which affected the entire western world, and which, in Australia, was characterised and promoted by massive inflows of capital, by migration and by industrialisation. Most Australians enjoyed a vastly improved standards of living in the 1950s and the 1960s and despite the fact that Australia's economic performance did not match that of comparable countries, Menzies and his successors reaped the benefits of sustained growth and rising living standards.

The World Economy and Australia

However, a number of significant developments have taken place in the developed markets economies of the west since then affecting the international economic environment. International liquidity grew extremely rapidly in the first half of the 1970s. There was an increase in dollar holdings outside the US, associated with the final breakdown of the Brettonwoods system of fixed exchange rate. This increase in liquidity was accentuated by the 'Petro dollar recycling' strategy pursued after the first oil shock. The resulting expansion of the world capital markets and greater financial intermediation meant that capital transactions came to play a more important part in the determination of exchange rates relative to underlying trade balances. As a result differences in financial conditions between countries assumed an increasing role in the determination of

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73 ibid.
exchange rates, with important consequences in the 1980s.\textsuperscript{74}

Many developments during the last decade have grown out of or have been strongly influenced by the structural developments which took place in the world economy following the two disruptive oil price shocks of the 1970s. The oil shock led to considerable disruption in trade patterns. Difficulty in the process of economic management in the industrialised countries, together with the general slowdown in economic growth and rising levels of unemployment contributed to the growth in protectionist sentiments and domestic trade distorting subsidies. Consequently, during the 1980s there was sluggishness in the growth of world trade.\textsuperscript{75} Market prices of commodities responded sharply to the recession, with the dollar prices of non-energy commodities falling on average by over 20 per cent between 1980 and 1982. This fall in commodity prices was a major contributing factor to another problem for the international economic system - the debt crisis.\textsuperscript{76} The World Bank's recent analysis of commodity prices suggests the recent strengthening, particularly of base metal's prices. It is partly the result of the depreciation of the US dollar and partly the result of strong industrial demand in Japan, US and some of the Newly Industrialised Countries (NICs) which was however, a result of a switch in US fiscal policy from 1982 towards a more expansionary stance leading to growth in US domestic demand and import demand.\textsuperscript{77} This led to burgeoning US budget and trade deficit which it sought to reduce by increasingly resorting to protectionist measures. That triggered a series of counter protectionist measures among the developed countries.\textsuperscript{78} Agricultural exports are another target of attack so much so that it threatened the Uruguay Round of multilateral trade talks being held under GATT auspices since 1986. The US and EC are divided on the issue. The US proposal calls for 'tariffication' of import access barriers and the phasing out of

\textsuperscript{74}The Economist, 22 September 1990, p.67.


\textsuperscript{76}ibid, p.43


both export subsidies and the most trade distorting forms of internal support. As opposed to this, the EC position still seems pre-occupied with preserving the fundamentals of Common Agricultural Policy (CAP). It disagrees with the US proposal to phase out export subsidies and certain forms of internal support.

Meanwhile, there has been phenomenal growth in the Western Pacific Region (WPR).\textsuperscript{79} Structural change in Japan has been accompanied by moves by the Asian NICs into areas of trade and industrial productions previously dominated by Japan (such as textiles and more recently ship building, steel, automobiles and certain consumer products).\textsuperscript{80} At the same time countries in the region at lower stages of industrial development (ASEAN and to some extent China) are taking the place of the NICs in exporting labour intensive products, suggesting the potential for complementary development between the ASEAN economies and the NICs, similar in scope to that which existed between the NICs and Japan during the 1960s and 1970s. This movement along the development chain is being accelerated by the structural changes currently underway in Japan, particularly by the transfer of technology and management expertise through Japanese direct investment into the region.\textsuperscript{81}

The most dramatic recent development in the international scene has been the extra-ordinary and very rapid change in the Eastern Europe and Soviet Union. The movement of Eastern European economies towards

\textsuperscript{79}Many of the market oriented economies in the Western Pacific that have grown impressively in the past twenty years, are highly dependent on international trade. The value of Japan's foreign trade is about 17 \% of its GNP, 14 \% for US and 28 \% for the European Community. As opposed to this for Australia the comparable ratio is 28 \%, Indonesia 31 \%, China and the Philippines each 33 \%, Thailand 45 \%, New Zealand 52 \%, South Korea 70 \%, Taiwan 88 \% and Malaysia 96 \%. Michael Richardson, "A warning from the Pacific", International Herald Tribune, 11 January 1989.


\textsuperscript{81}Japanese private investment is about 8 billion dollars during 1990. See "Domestic budget cuts force US to reduce economic aid in Asia", The Asian Wall Street Journal, 21 August 1990.
market orientation presents both challenges and opportunities for world trade. Substantial infrastructure already exists in these countries for industrial and agricultural production. Therefore, the first priority is to increase the currently low productivity of the existing capital stock by utilising existing plant, machinery and equipment more efficiently. In these years of transition there are significant opportunities for the transfer of organisation and management skills, perhaps through joint ventures.

Thus, the international economic environment confronting Australia is characterised by continued uncertainties, in part the legacies of structural developments in the world economy since the 1970s. Focus today is on the paramount economic challenge of transforming Australia’s trade in the face of a too large balance of payment or current account deficit, the high levels of foreign debt and an increasingly onerous debt servicing burden. Australia’s trade problem has been accentuated by the collapse in world commodity prices since 1985.\(^\text{82}\) Current account deficit increased to 6 per cent in 1985-86 reflecting a sharp deterioration in terms of trade.\(^\text{83}\) The terms of trade declined by more than 16 per cent in the 3 years to 1986-87.\(^\text{84}\) Besides this, growing protectionism has seriously affected Australia’s trading interests especially in agricultural exports.

Apart from deteriorating and unfavourable world trading environment, there are long term structural factors which have contributed to the decline in Australia’s trade performance and significance as a world exporter over the past 30 years. A major structural factor has been Australia’s excessive dependence on a weakening base of primary commodities that have experienced price declines. Also, share of Australia’s manufacture and service in world trade is negligible, which is a fast growing area in world trade.\(^\text{85}\)

\(^{82}\) FEER, n.72, p.68.

\(^{83}\) Australian Bureau of Statistics, Balance of Payments, Australia, Category No.5302.0, 1989, p.18.


\(^{85}\) ibid.
However, substantial changes to the pattern of Australia’s exports have occurred since the 1950s, both with respect to composition and direction. This aspect has already been discussed in the earlier chapter. These changes have been largely associated with the rapid expansion of mineral exports and the increasing importance of the Western Pacific Region as a destination for Australia’s exports. Exports of mineral and fuels, now account for about 29 per cent of total exports as against 2 per cent in the early 1950s. Similarly, the major change in the direction of Australia’s merchandise exports has been the move away from traditional European markets (especially the UK) towards the rapidly expanding Western Pacific Region. The share of Australia’s exports to the WPR has expanded rapidly, from under 20 per cent in the early 1950s to about 55 per cent in the early 1980s (including exports to New Zealand). Japan emerged as Australia’s major export market in 1966-67. But in view of Japan-US trade war, Australia has felt threatened in recent years. Its exports to WPR have also come down. Australia competes with US in selling some A$ 5 billion worth of exports a year to Japan. If Japan discards commercial considerations in favour of political, Australian exports will be vulnerable in a number of key fields - local beef, computer software and whole range of manufactured goods. Already, it has lost to the United States A$ 400 million worth of share of Japanese beef imports. The Japanese claim that this is because of the type of beef Australia has to offer, but Australian policy makers suspect that there is a strong element of politics involved. Australia has already suffered a substantial cut in its share of total Japanese imports, from 9.4 per cent in 1972 to almost half today. If Australia had maintained its share of Japanese market, it would

86 ibid.

87 Department of Foreign Affairs and Trade, Australian Foreign Affairs Record, vol.61 no.4, April 1990, (Canberra), p.188.

88 ibid, p.189.

89 Japan last year agreed to liberalise greatly its own market for beef which would see quantitative restrictions phased out by the end of 1990. This is particularly valuable for the Australian beef industry which is looking to negotiate further reductions in the Japanese beef tariff in the Uruguay round. ibid., p.190.

90 ibid.
a major step in this process. The amalgamation reflects the central importance of trade in Australia’s foreign relations. Trade policy objectives can be advanced more effectively by linking them with the conduct of political and strategic relations. Within this administrative framework, the government has consolidated export promotion of manufactures and commodities with the relevant domestic industry departments to ensure that trade performance has an appropriate role in the government’s broader economic and industry activities.92

The role of macro-economic policies in Australia’s trade performance is two-fold. In the longer term, macro-economic policy needs to support Australia’s international competitiveness and to create an environment conducive to the increase in the level of investment required to achieve an increase in net exports. In the short term macro-economic policy may be needed as a stabilisation instrument, for example, to restrain the growth in domestic demand in the face of excessive import growth or to reduce destabilising fluctuations in the exchange rate which could reduce international competitiveness. Government’s current strategy reflects these objectives. Firstly, in the short term, it is intended to constrain excessive growth in domestic demand (and thus imports) so as to help reduce Australia’s substantial current account deficit. Secondly, the strategies intended to promote wage and price outcomes consistent with the need to retain and build upon, the significant improvement to Australia’s competitiveness arising from recent successive depreciations of the Australian dollar. Thirdly, it is designed to facilitate investment in, and a transfer of resources to, the import competing and exporting sectors.93

The reduction in the public sector has led to decline in Australia’s domestic saving reflected in the projected Commonwealth budget surplus for 1987-88 of around $580 million. It has helped to make possible an easing of financial conditions reflected in a reduction in the yield on 10 year treasury bonds from 13.45 per cent at the end of March 1987 to 11.90 per cent at the end of March 1988.94 This reduction in interest rates is of considerable significance given the

92 Australian Exports, n.84, p.23.

93 ibid., p.21.

94 FEER, n.72, p.68.
importance of promoting investment in the tradeable goods and services sector. The wages policy has also reflected these broad economic objectives. The Prices and Incomes Accord with the ACTU has been of particular significance. The accord has become Labour’s main anti-inflation instrument. It has contributed to the centralised wage fixation system. This has been critical to decline in industrial disputes and helped to ensure commitment to retaining the gains from the depreciation of the Australian dollar, by avoiding excessive nominal wage increases.

The government has emphasised the need to carry out wide ranging reforms in particular sectors designed to improve the flexibility and efficiency of the economy. This has been reflected not only in the government’s industrial policy but also in measures to address other domestic impediments to Australia’s trade competitiveness. An integrated set of industry policy has been designed to encourage a more internationally oriented and competitive manufacturing sector which is the fastest growing area of world trade along with services sector. For mature industries (such as steel and textiles, clothing and footwear) this has involved special transitional programs designed to increase efficiency and reduce the need for heavy protection against imports.95

The industrial policy has also sought to develop Australia’s strength in new areas in which Australia can develop competitive activities, especially those of strategic significance for the economy. The recently released Information Industries Development Strategy is an important example which includes a number of initiatives in such areas as skills formation, marketing and encouraging investment and research and development. It reflects an awareness of the need to improve trade in information industries, products and services, as well as an appreciation of how critical these industries are for the competitiveness of other sectors.96

Policies to encourage research and development (such as the 150 per cent research and development tax concession and the Grants for Industry Research and Development Scheme) have been important aspect of the government’s approach to industry policy. Foreign investment guidelines applying to the manufacturing sector have been significantly liberalised and strong efforts have been made to promote further foreign investment, especially in competitive export-oriented activities.


During 1985, a number of major policy decisions were taken. Deregulation of financial markets was completed with the abandonment of monetary targeting as an instrument of policy and the decision to allow 15 foreign banks to operate in the domestic banking market. At a national tax summit, held in July 1985, the government proposed radical changes to the taxation system. The government’s preferred option encompassed a widening of the income tax base together with greater reliance on indirect taxation through the introduction of a broad based consumption tax. But since it met with the strong opposition a compromise tax reform was agreed in which consumption tax was abolished. The main provisions included a capital gains tax, a two-stage reduction in marginal income tax rates etc.

Faced with the prospect of continued current deficit and concern over the accumulation of foreign debt, the government introduced a number of reforms and liberalisations to open up the economy and attract foreign investment. In particular, the Hawke government promulgated a package of reforms late in 1985 to relax various regulations for direct foreign investments. The package included provisions modifying requirements that foreign investors first seek Australian nationals to participate in acquisitions or takeovers. Also, the maximum value for foreign investment projects not requiring approval by the Foreign Investment Review Board (FIRB) was raised from A$ 2 million to A$ 10 million. Further, foreigners were allowed to acquire real estate upto A$ 600000 without government approval, and the 50 per cent local equity participation in real estate investments was only applied to those costing more than A$ 10 million or taking more than 5 years to complete. In July 1986 additional requirements were relaxed. The previous requirement that proposals in a manufacturing sector demonstrate economic benefits has been suspended. The government now approves all proposals to acquire existing manufacturing businesses or to establish new manufacturing businesses, unless the

97 FEER, n.72, p.68.
99 ibid.
proposal is judged to be contrary to the national interest. Additionally, the previous requirement of 50 per cent Australian equity in foreign investments proposals has been abolished in the following cases:

1. acquisitions of real estate for development, whether for resale or retention
2. acquisitions of service industry real estate and,
3. acquisitions of businesses or the establishment of new businesses in the tourism industry such as hotels and tourist resort.

As of the end of June 1986, direct equity investment in Australia, from all countries amounted to $10.1 billion. If portfolio investments and foreign borrowings of public and private entities are included, the total value of foreign investment amounted to $68.9 billion. During 1985-86 fiscal year, inflows of foreign investment capitals (including portfolio and equity) reached a record $13.4 billion. Most of this inflow, however, resulted from a substantial rise in offshore borrowings by private companies and the public sector. Japan was the largest contributor, edging out the United States for the first time in recent years.

But, the government's policy on foreign investment has been severely criticised in Australia by the economic nationalists. Foremost among them have been Ted Wheelwright and Crough. A major concern of economic nationalists about foreign investment is that important decisions pertaining to the Australian economy, both at the micro and macro level are made from outside Australia. According to Wheelwright and Crough, this means that 'it is impossible to plan or develop an economy according to local needs or requirements'. It becomes therefore more difficult for governments to control national economic systems because key variables have become less susceptible to national forces and more susceptible to international forces. A second major concern of economic nationalists in relation

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102 ibid.

to foreign investment is the outflow of profits associated with the presence of trans-national corporations within Australia. This concern is expressed particularly in relation to the mining industry. Most of US equity investment in Australia was in mining till 1985.¹⁰⁴

Notwithstanding the criticism by the economic nationalists, Australian government continues with its liberal foreign investment policy. Foreign Investment Review Board set up by the government provides guidelines for foreign investment and executes the government policy. Besides encouraging foreign investment, arrangements for the promotion of Australia's trade have also been made through the establishment of Australian Trade Commission (AUSTRADE) which commenced operations in January 1986. AUSTRADE provides more effectively, through one organisation, a full range of government services to the exporter including those provided through the Export Finance and Insurance Corporation, the Export Development Grants Board, and the Australian Overseas Project Corporation.

Given the current limitations of multilateralism, there has been a greater tendency in Australia to use bilateral approaches in the development and expansion of trade especially agricultural trade.¹⁰⁵ In this regard it has been felt that the maintenance of frequent high level ministerial missions, particularly to new markets and countries with centrally planned economies is necessary. There is a possibility of re-emergence of certain Eastern European countries as substantial producers and consumers of agricultural products and raw material. This will have implications for Australia's export prospects, both in Eastern Europe and third markets. Agriculture is relatively strong in most East-European economies. Similarly, the prospects of sustained medium-term growth in the OECD area and continued strong growth in the Asia-Pacific region, offers Australia, the opportunity for buoyant trade growth in the 1990s.¹⁰⁶ But if Australia


¹⁰⁵Department of Foreign Affairs and Trade, Annual Report 1987-88, pp.56-57.

¹⁰⁶For a discussion on recent Pacific economic growth and its impact on Australia see Kym Anderson, Peter Drysdale et.al., n.80, Chapter II.
is to take advantage of those opportunities and reduce its current account deficit and foreign debt levels, it will have to meet a number of major challenges. In particular, Australia needs to ensure that the economy is sufficiently flexible to respond to changes in the pattern and composition of trade.

Inflation needs to be brought in line with major trading partners. This will also be important if Australia is to fund the investment needed to expand productive capacity to capitalise on trade opportunities in the Asia Pacific region, without having to continue to rely on high rates of foreign borrowings. Australia urgently needs to correct the present shortfall of domestic savings relative to investment, in order to stabilise its foreign debt; The pace of domestic micro-economic reform - including transport, communications and labour market reform - will need to be sustained in order to boost productivity and hence improve the competitive position of export industry. Most of the new markets for agricultural products are in countries where governments involve themselves directly in trade to a significantly greater extent than in more developed countries. In these markets, Australia needs to pursue trade policies to improve its access to markets by lowering barriers to trade and by removing massive subsidies which distort markets, particularly for its agricultural products.

For many of these countries the Australian government has established mixed or joint commissions on trade to explore the possibilities and identify the items for trade. But Australia's trade strategy is affected by moves within North America, Europe and the western Pacific towards increased regional co-operation. Although, limited in its immediate impact, the US-Canada free trade agreement might generate in the medium term stronger competitive pressures against the narrow product range, which Australia trades in the North American markets. The integration of Europe in 1992, may have positive


108 Anderson, Drysdale, et.al., n.80, Executive Summary.

implications for Australian business' interests mainly because of liberalisation as a result of harmonisation of EC regulation. But the prospects are limited in the light of tendency towards protectionism and strengthening of EC links with Eastern Europe after the changes that took place recently. An important development in the context of new changes in world trade, is the coming together of Asia and Pacific in form of Asia Pacific Economic Cooperation (APEC)\textsuperscript{110} Started at the initiative of Bob Hawke, the Prime Minister of Australia, APEC offers a means for Australia to be closely involved in the evolution of the region - developing gradually a more effective means of consultation about economic issues and helping to avoid any relapse into protectionism. It offers a forum which can help to address trading tensions in the region, especially between the US and Japan and the Newly Industrialised Economies. Though APEC is in its very early stages and it will take time for it to develop common, shared views about economic issues, it has been argued that it will do much to condition the outcome of the dynamic changes in Eastern Europe, Europe 1992 and the evolving relationships between the major economic powers.\textsuperscript{111}

**NEW ZEALAND**

During the 1970s, the New Zealand economy has been characterised by one of the slowest average rates of real economic growth in the OECD, more particularly when expressed in per capita terms; by a serious and persistent deficit in the balance of payments current account due to 1973-74 oil price shock (which has been financed chiefly by the accumulation of a substantial official overseas debt); by a rise in unemployment and throughout most of the period; by relatively high rate of inflation. Inflation averaged 15 per cent and unemployment emerged for the first time in the post-war period as a serious problem.\textsuperscript{112}

\textsuperscript{110}APEC includes 12 Asia-Pacific countries namely Australia, New Zealand, South Korea, Taiwan, Japan, the United States, Canada, Singapore, Thailand, Indonesia, Malaysia, the Philippines, n.107, p.4.

\textsuperscript{111}ibid., pp.14 and 17.

\textsuperscript{112}FEER, 23 November 1989, p.98.
1974-82, GDP growth averaged 0.9 per cent annually. A prolonged wage and price ‘freeze’ from June 1982 to early 1984 suppressed the symptoms of inflation but re-emerged in 1984 and 1985 following the lifting of controls and a 20 per cent devaluation of the New Zealand dollar in July 1984. But with the rapid shift towards a much more competitive economic structure in the same period and a sizeable reduction of the fiscal deficit, the inflation rate was brought under control. Substantial growth from 1983 to 1985 led to a reduction in unemployment. But these two are a continuous problem for the government. Although, some of the difficulties have been due to external factors, in the form of prolonged periods of international recession, unfavourable terms of trade and restricted market access for some of New Zealand’s agricultural exports, there can now be little doubt that the country’s economic difficulties have been aggravated by the slow pace of domestic adjustments.

New Zealand’s economy is predominantly an agricultural one. In the very early days of European colonisation, New Zealand’s infant farming industry exported basic food items like potatoes, grain, butter and cheese to the Australian market. However, with the development of wool trade, Britain became New Zealand’s principal export market, absorbing 70 per cent of New Zealand’s export by 1860. The introduction of refrigerated ships in 1882 made it possible to diversify exports of farm products but also underwrote the development of New Zealand’s economy as a complement to Britain’s. Initial rapid expansion took place in exports of frozen mutton and lamb, with dairy produce export expanding greatly only in the 20th century. While the dependence on the British market continued in the post 1945 years, there has been a conscious effort at market diversification since the 1960s, an effort that was given a special boost with Britain’s membership of the European Community in 1973. The range of diversification is reflected in the growth of beef exports.

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113ibid.


115ibid.


117ibid.
to the US, cheese and forest products to Japan, lamb exports to the middle-east, Canada and the US and wool exports to the USSR. Special terms of access to the European Community were negotiated for New Zealand's lamb and butter. With the introduction of common EEC marketing regime for sheepmeats in 1980, New Zealand entered into a voluntary restraint agreement whereby sheepmeat exports to the EEC were limited to an annual quota in return for a reduction in the Community's import tariff. The special arrangement for butter marked an acknowledgement of New Zealand's dependence on access to the British market. The quota of New Zealand butter permitted for supply to the British market, nevertheless, has been slowly but steadily reduced.

The strategy by which New Zealand has negotiated its annual quotas with the European Community has been not quite without problems. Also for much of this period manufacturing was heavily protected and this together with agricultural trading difficulties contributed to New Zealand's relatively slow growth. In later years, it lost its market in Britain and subsequently had to face problems with its agricultural exports. The decades from the mid 1950s to date have been a prolonged transition period for the New Zealand economy. The transition has been from an economy heavily dependent on pastoral exports and a single market, the UK, to one whose exports industries and markets are now much more diversified. Much of the diversification in the 1960s and 1970s into new economic activities tended also to withdraw resources from immediate production, for example the establishment of new forestry plantations and the switch of dairying land to horticultural production, specially kiwi fruit. This restructuring and the increasingly outward-orientation of New Zealand manufacturers is expected to contribute to economic growth in future.

The implementation of a range of different initiatives since the election of a labour government in mid 1984 has influenced both, the extent and pace of economic change. Reflecting the importance of agriculture to New Zealand (70 per cent of export income in 1981-82), New Zealand farmers are given considerable support by the government. Perhaps, the most significant export arrangement is the Supplementary Minimum Price Scheme.

118 Upton, n.114, p.7
119 FEER, n.112, p.43
120 Upton, n.114, p.23.
applying to beef, sheepmeat, butter fat and wool which makes up the prices received for these products to a level intended to provide farmers with reasonable requirements for living expenses, farm operated expenditure and new development. It is the New Zealand government’s stated intention that prices set under this scheme should not diverge significantly from the prices determined in international trade over the medium term. These arrangements are operated in tandem with the grower-funded price smoothing mechanism operated by marketing boards in New Zealand. Sizeable payouts have been made under this scheme. In addition to these schemes, the New Zealand government also provides credit at nominal rates, a fertiliser price and transport subsidy and assistance with farm settlement finance, irrigation arrangements, farm finance and taxation concessions to agriculture.\textsuperscript{121} Agricultural products in raw and processed form qualify for sizeable export incentives and in some cases have access to the Rural Export Suspensory Loans schemes which assists with the developments of export facilities.

However, to give economy a facelift and to keep pace with the latest trends in international trade and also to satisfy growing domestic demand in recent years the government has taken some additional measures. The main factors underpinning buoyant domestic demand conditions appear to have been high levels of capacity utilisations and profitability in the business sector in 1984-85, medium term business confidence and the creation of new investment opportunities through policies aimed at reducing government intervention in the economy.\textsuperscript{122} The moves taken in 1984 and 1985 to deregulate the financial and foreign exchange sectors of the New Zealand economy are part of a broader range of measures designed to promote more rapid economic adjustments. These include measures to reduce the fiscal deficit, to phase out or reduce protection, to eliminate export incentives and subsidies, to pursue a reform of the taxation system and generally to promote an economic environment conducive to flexibility and adaptability for both private and the public sectors.\textsuperscript{123} The government sees its role as one of encouraging the efficient operation of markets and thus promoting in the longer term more sustainable economic growth. The importance of a sound underlying micro-economic

\textsuperscript{121}ibid.

\textsuperscript{122}ibid.

\textsuperscript{123}Terry Hall, “New Zealand accelerates the sell-off of state assets”, \textit{Financial Times}, 29 March 1990.
policy and the close interrelationship between the fiscal, monetary and exchange rate policies, are now well recognised. A new analytical framework has been developed since 1984 and the tools of policy are being put into place.\textsuperscript{124} A real change, however, would take time as there are still some important fundamental transitional issues to be resolved. Extensive deregulation, the process judged to be a necessary - but not sufficient - condition for a more effective monetary policy, has taken place quickly. It offers no guarantees or panaceas. What remains essential is the durability of the commitment to soundly based policies once these are properly implemented.

Through most of the post war period the New Zealand financial system was heavily regulated, with the objective of meeting the government financing and political objectives rather than allowing financial institutions to be competitive and efficient. The brunt of this policy fell on the trading banks. Interest rates were controlled and reserve ratios and other controls were imposed with the objective of controlling credit and also forcing the institutions to buy government stock.\textsuperscript{125} The fiscal deficit which has been large since the mid 1970s was in substantial part financed by the borrowings from the Reserve Bank. These traditional policies were totally reversed during the period of labour government. Interest rates and other controls were abolished. The Ratio system and credit growth targets were scrapped. The government financed its internal deficits by selling stock at market rates. The Reserve Bank now targets the ‘primary liquidity’ (or monetary base) of the financial system. With removal of controls, including those on foreign exchange movements, the finance sector has undergone rapid change and has become more international.\textsuperscript{126}

Despite these policies the country is treading a delicate path between deficits and borrowings on the one hand and massive unemployment and business failures on the other. Until the world scene improves, until better prices are obtained for farm produce and until more manufactured goods can be produced and exported, there will continue to be balance of payments and budget deficits.

\textsuperscript{124}FEER, n.112, p.68.

\textsuperscript{125}Hall, n.123, p.66.

\textsuperscript{126}ibid.