CHAPTER II

ECONOMIC AND TRADE STRUCTURE

There are two concurrent themes in Southwest Pacific with regard to its politics of trade and economic relations. One, due to large asymmetries in the economic and trade structure of Pacific islands and Australia and New Zealand, there is unequal interdependence in the region.\(^1\) Two, Australia and New Zealand, two big states in Southwest Pacific, are no longer prepared to shoulder at least the economic responsibilities of the United States and have turned to Asian economies for trade and investment.\(^2\) Frustrated and disenchanted over the protectionist policies of US and EC and buoyed by the prospects of Asia-Pacific resurgence under the leadership of Japan and newly industrialized countries (NICs) in East Asia, they have tended more and more towards revising their economic options. It is in this perspective that the economic and trade structure of Pacific islands on the one hand and that of Australia and New Zealand on the other would be studied.

The economies of the island developing countries are basically dependent upon the agricultural sector with most of the people working on subsistence farms, cultivating coconuts, cocoa and a few cash crops like sugar, tea, spices.\(^3\) Forestry and fishing are the other important activities. Manufacturing operations have been by and large modest in most of these islands. However, there is no such thing as grinding poverty as we generally find in underdeveloped countries of the third world. In most third world countries the prime problems are poverty and the vicious circle of lack of productivity, due to lack of capital, lack of surplus for saving after minimum consumption needs are

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met. But in most of the islands of Southwest Pacific those conditions do not prevail. In most of them the subsistence farmer, producing from his own resources goods and services needed for his family, is still able to produce as much as he can consume, with the resources available to him. The result is that the subsistent, self-sufficient type of farmer in these islands has a higher standard of consumption than hundreds of millions of poorer peasants of Asia.  

The rapid development of local production and trade took place because metropolitan governments wanted the colonial governments to be self-supporting. Taxation provided finance for urgently needed improvements in health, education, and economic services. In the case of Fiji, as in the most other island territories this was done by attracting foreign enterprise, skill and capital which in turn combined with local surpluses of land and labour in the development of highly productive export industries and the commercial and other service industry required for their support. 

4 An idea of higher standards of consumption can be had from the median per capita income of around $900 in 1981. For details see "The Pacific Island Microstates" by Norman Meller in the Journal of International Affairs. In the case of Fiji, Fisk noted in 1970 that Fiji’s GDP per capita was "greater than that of any Asian country except Japan and Singapore ... about that three times that of India and nearly twice that of Thailand", E K Fisk, The Political Economy of Independent Fiji, (Canberra, 1970), p.11.


6 In the case of Fiji, note Robert T Robertson and Akosita Tamanisau, "Indeed the very survival of the colonial state depended upon the Fijian contribution of taxes and production of cheap food and export commodities ... Native tax alone provided 30 per cent of the state’s revenue; communal labour and charges revenue". For details see Robert T Robertson and Akosita Tamanisau, Fiji: Shattered Coups, (NSW, 1988), p.7.

7 Howard and Durutalo, n.5, p.140.
comprised subsistence farmers, some grew cash crops and were engaged as casual labour. The non-agricultural pursuits have been on the rise depending upon the industrial-mineral-tourist development, wholesale-retail trade and other services in the individual countries.

It may be mentioned that the island economies depend mainly on one or two primary commodities. The extent of such reliance can be visualized from some examples: sugar accounts for 70% of exports of Fiji; copra and coconut products for 70% of exports of Tonga and Vanuatu; copra for 50% of exports of Papua New Guinea; copra, coconut and cocoa for 60% of exports of Western Samoa and Solomon islands; and phosphate for 90% of export receipts of Kiribati. The requirements of most of the consumer and capital goods industries are met through import. Foodstuffs and beverages are sizeable in terms of import values; machinery and transport equipment, petroleum products, basic manufactured goods and chemicals contribute significantly to the import bill. The degree of dependence of these islands on trade varies from one country to another. The proportion of exports to GDP in 1981 was about 60% in respect of Solomon island, 46% in Papua New Guinea, 27% in Fiji, 20% in Western Samoa, and 18% in Tonga. During the same year, imports constituted as high a proportion as 82% of GDP in Tonga, 72% in Western Samoa, 60% in Solomon islands, 50% in Fiji and 45% in Papua New Guinea. Barring Papua New Guinea all the other islands have persistent trade deficits. Various factors have contributed to this situation. They lie inherent in the trade and economic structures of these island economies. Export earnings of major commodities of this region are susceptible to global price fluctuations.

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8 ibid.


10 ibid, pp.6-7.

FIJI

The Fijian economy is unique in nature and static in character. It is unique because it has most advanced economy among the Southwest Pacific islands with annual per capita GDP of SDR 1200. It is static because despite advanced economy it has had weak growth due to protection and regulation since independence. Growth rates achieved (2%) never exceeded the target (5%) during the plan period which followed independence. We shall discuss why this happened in the next chapter, where the focus is more on strategies for development during the last two decades. It will suffice to mention here that despite weak growth rates Fiji has remained a prosperous islands in the region.

Economic Structure

The prosperity of Fiji has been built almost entirely on the foundations laid by the sugar industry which is still the mainstay of the economy. The share of sugar (both production and processing) is about 15 per cent of GDP. The total production of about 500,000 metric tonnes per year is exported to the European Community on long term contract basis. This is to avoid volatility in prices.

However, it is the services sector (tourism, trading, government administration, finance, insurance) that accounted for a growing percentage of GDP during the 1970s reaching 60 per cent by 1980. Of these, distribution services accounted for one-third; government, community and personal services another third; financial business services and transportation the final third. In contrast productive sectors make up under 40 per cent of GDP. Agriculture, forestry

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12 Christopher Browne and Douglas A Scott, Economic Development in Seven Pacific Island Countries, IMF, Spring 1989, p.34.


14 Browne and Scott, n.12, p.24.

and fisheries plus mining amount to 24.4 per cent; manufacturing 12.2 per cent. As half of the manufacturing output consists of processed sugar, non-processing manufacturing amounts to only 6 per cent of GDP. It was the development of tourism in the 1970s which brought about the predominance of services contributing over half the total increase in real GDP over the period 1970-84. The tourist sector alone contributes 16 per cent of the GDP, far greater than in any other island country of the region. There were 250000 tourists in 1986. Thereafter the inflow of tourists got disrupted due to two coups in 1987 and political developments that followed.

In spite of Fiji's abundant natural resources and favourable agricultural conditions, Fiji's agricultural export commodity base is very narrow, resting almost entirely on sugar. Furthermore, Fiji’s self-sufficiency ratio in food is surprisingly low, being in the 35-40 per cent range. Thus, while the country's economic structure has progressively been diversified over the last two decades, the agricultural sector, potentially one of the most productive, has remained largely unchanged and undeveloped. But forestry sector is undergoing something of a transformation. In addition to small hardwood production in 1972 a major pine project was launched to produce quick growing softwood for domestic needs and export. Then, fishing industry has also expanded rapidly since 1972 having become the third largest foreign exchange earner after sugar and gold. Tuna fishing and processing has become a significant employer and contributor to national output.

In response to government's efforts to encourage import substitution, many manufacturing activities have emerged. These can be classified in eight major sub-sectors, food, clothing and footwear, wood products, paper and printing, chemicals, non-metallic products, machinery and equipment and miscellaneous. It is revealing that over the last two decades - a period of considerable structural change within Fiji's economy - the share of manufacturing has

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16 ibid, pp.73-74.

17 Browne and Scott, n.12, p.35.

18 UNIDO, n.15, p.73. Also see "Issues and Implications of Rising Food Imports: The Case of Fiji" by Pravendra Sharma in South Pacific Forum, vol.2 No.1, July 1985, pp.47-56.

19 ibid.
remained largely unchanged at approximately 10-12 per cent of GDP.\textsuperscript{20} One distinctive characteristic of manufacturing activity in Fiji is the lack of specialisation in individual enterprises and the horizontal integration of production of related or similar items. For ethnic reasons and for lack of controls, excessive competition has developed, fragmenting production for a small and limited market and sacrificing economies of scale. The protected market worsened the efficiency that resulted in low or negative value added. Under-utilized capacity became common raising cost of production. So the government introduced the scheme of tax holidays and Tax Free Zones. Investment incentives such as tax holidays are said to reduce the cost of production. But these measures may not succeed because as Cole argues, "it is widely agreed that investment incentives fail to attract all but 'footloose or fly by night' foreign investors who are nearly seeking to exploit such give-aways... For most producers tax holidays are of little value because they do not earn profit in early years of production".\textsuperscript{21}

\textbf{Structure of Sugar Industry}

The only activity related to manufacturing, which flourished, has been sugar and its processing. To understand why, it is necessary to understand some features of the organisation of the sugar industry.\textsuperscript{22}

In Fiji, the production of sugarcane is almost entirely in the hands of small local farmers. The size of holdings is small. This is the result of deliberate colonial policy of Colonial Sugar Refining (CSR) Company which set out in 1920s to transform an estate based cane growing industry into one based on small independent local farms. The company developed over the years, a wide range of co-ordinated services that enabled the small grower to produce cane of high quality with considerable efficiency. The services provided by the miller


\textsuperscript{21} ibid, p.45.

\textsuperscript{22} For detailed discussion of this aspect, see Bruce Knapman, \textit{Fiji's Economic History, 1874-1939: Studies of Capitalist Colonial Development}, NCDS monograph no.15, (Canberra,1987), pp.1-26.
made available external economies to producers. These services included research, the breeding and distribution of improved variety of cane, the development of improved cultivation practices, soil testing, fertilizer use, disease and pest control and the dissemination of the results of this research to the individual growers. As a result, the grower was able to compete effectively with other sugar industry throughout the world. This symbiosis between the large foreign owned sugar milling company and the small independent sugar farmer came to end in 1973 when Fiji was already an independent country. While there is a move now towards greater employment of hired labour, the small farm system continues to provide a considerable buffer during periods of low production and low sugar prices. The following highlights the importance of the small farm system:

"Not only does it increase the general impact of the industry by generating stronger multiplier effects, it creates a structure which is more flexible than most large scale farming system because of its ability to substitute family labour for hired and to switch gradually into other crops or even into subsistence production if the price falls to unmanageable levels".23

The decision of the CSR to withdraw from Fiji after a period of 100 years was one of the most important developments in the history of the industry. It followed disagreement on the terms of a new sugarcane contract that was to come into force after the expiry of the old contract in 1970. CSR had introduced a system of contract growing of cane by small tenant farmers following the termination of the indenture system in 1920 under which Indian labourers were brought earlier. After the pernicious indenture system was over, sugar industry again faced serious shortages of labour. To meet this threat, CSR introduced a system of contract growing of cane. The growers which happened to be small Indian tenant farmers disputed the share of the proceeds between them and the miller. It was Lord Denning who after a lengthy arbitration decided that the growers would receive 65 per cent of the sugar and molasses proceeds with a minimum price of F$ 7.75 per tonne and the miller would receive 35 per cent or less.24 This was a major victory for the growers. However, CSR was not satisfied.


It found its operations unprofitable on the basis of the sharing formula awarded by Lord Denning. It ceased its operations from 1 April 1973. The Fiji Sugar Corporation Ltd. (FSC) a public company established by the government took charge of sugar milling. It introduced changes to restructure the industry in 1984 when it was met with persistent demands from growers to give them a greater role in industry decisions.\(^{25}\)

Earlier, the major sugar industry institutions were the Independent Chairman’s Office, a Sugar Board and a Sugar Advisory Council. However, the new institutions under the changed structure after the 1984 Act of Parliament were\(^{26}\):

**Sugar Commission** which is responsible for the overall co-ordination amongst growers, the FSC, the Government and sugar industry unions.

**The Sugarcane Growers Council** that represents cane growers and is funded by levies imposed on the growers.

**The Mill Area Committees** to solve operational problems like harvesting, transport and allocation of cane supply quotas. For each Mill Area there is a committee in which there are representatives of cane growers, the FSC, the Government and industry unions.

**The Sugar Industry Tribunal** had been set up to solve disputes in the industry and to prepare a master award to replace the existing cane contract.

**Sugarcane Contract**

The contract which governs the relationship between the FSC, the millers and the cane growers is referred to as a Contract of General Application, also known as Sugarcane Contract.\(^{27}\) Each farmer has his own contract with the FSC on identical terms. The provisions of the contract are: to cover the sale and purchase of cane, harvesting and delivery, burnt cane, crushing

\(^{25}\) ibid.

\(^{26}\) ibid.

\(^{27}\) Government of Fiji, Laws of Fiji - Agricultural Landlord and Tenant, Suva, 1978,
operations, advances, storage, marketing, sale of sugar and division of proceeds. The contract also has penal provisions for burnt cane supplied to the mills to discourage burning of cane. The most disputed provision of the contract is the formula for division of proceeds between the FSC and the growers (see table below).

**Distribution of proceeds of sugar sale (%)**

<table>
<thead>
<tr>
<th>Total Sugar Produced</th>
<th>Growers share</th>
<th>FCS share</th>
</tr>
</thead>
<tbody>
<tr>
<td>Upto 325,000 tonnes</td>
<td>70.0</td>
<td>30.0</td>
</tr>
<tr>
<td>For every tonne over</td>
<td></td>
<td></td>
</tr>
<tr>
<td>325,000 upto 350,000</td>
<td>72.5</td>
<td>27.5</td>
</tr>
<tr>
<td>For every tonne over</td>
<td></td>
<td></td>
</tr>
<tr>
<td>350,000</td>
<td>75.0</td>
<td>25.0</td>
</tr>
</tbody>
</table>

The price per tonne of cane payable to each grower is derived by dividing the total growers' share of proceeds by the total tonnage of cane supplied by the grower in the season. Payment to individual grower is based on tonnes of cane delivered to the mill. This is different from the practice in many countries where in order to encourage the growing and delivery of high quality cane, payments to growers are based on sugar content. During 1986-88 the cane price ranged from $36 per tonne to $50 per tonne.  

Recently, the terms of the contract have been replaced by a Master Award, known as Kermode Award, a standard document that will govern the mutual rights and obligations of cane growers and the FSC. It shall be final and conclusive and cannot be challenged, appealed against, reviewed, quashed, called into question in any court and shall not be subject to prohibition, mandamus or injunction in any court according to Sugar Industry Act of 1984.

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29 Ali and Narayan, n.24, p.17.
30 Government of Fiji, Sugar Industry Act 1984, Section 64(3).
For details of Kermode Award see *Fiji Voice*, June/July 1990, p.11.
Fiji Indians have traditionally dominated cane production but lately, particularly after the two coups in 1987 increasing number of Fijians have entered the industry. Due to political upheavals, sugar industry has faced difficulties. The objective is to achieve a production level of between 550,000 and 600,000 tonnes per season. There is sufficient land area to achieve these targets, especially, after the identification of the largest area of ‘Seaqaqa Cane Development Scheme’. What is needed is improvements in cane and sugar yields and a congenial political climate.

Since independence in the early 1970s tourism has been actively encouraged by the government in order to reduce the country’s heavy dependence on sugar. But that has not been possible. Sugar is still the mainstay of the Fijian economy. It accounts for around 40% of Fijian exports. But frequent hurricanes, fluctuations in world commodity prices and the long distances from the world market centres have been a limiting factor. However, Fiji has managed to tide over the crisis arising out of fall in sugar prices because of its quota arrangements with the EC and the USA which enabled it to sell at prices higher than those in the open market. But despite such preferential arrangements exports have shown sluggishness over a long period. Cole has argued that this is due to inherent 'policy bias against exports'. He points out:

"In a small economy such as Fiji's because trade is high in relation to consumption, investment and national income, the effect of the export multiplier is much more important than in large economies. Because the small population (with inadequate economies of scale for most production for the domestic market) limits opportunities for domestic sources of growth, Fiji must not only export for balance of payment reason but also to achieve cost effectiveness at international prices. Imports substitution appeared to boost growth in the late 1970s and early 1980s but the effect was illusory, raising prices and undermining exports. The greater the success of import substitution, the higher the burden on the exporting industries became".  

31 Cole and Hughes, n.20, p.56.

32 ibid, p.58.
Volume of Trade

The trade scenario reflected declining growth rate in imports and a highly favourable export growth between 1979 and 1980. However, a contrary trend was witnessed in 1981 when the pace of imports grew phenomenally and exports decelerated to a significant extent. The balance of trade (Table 4 in Appendix I) has been in heavy deficit for many years.

The extent of the deficit varies significantly from year to year, affected by the wide fluctuations in commodity prices and output levels. The deficit in 1986 of F$ 184.2 million was the lowest for many years but the downward trend of the past few years was abruptly halted in 1987. In the aftermath of the coups the economy showed signs of deterioration.33

Composition

The largest item to contribute to substantial deficit has been the petroleum imports. However, they have been lower in recent years due to substitution (increasing use of hydro-electricity) and falling oil prices. Imports of machinery and transport are a result of increased tempo of industrial activity. Manufactured goods and food are important items of import signifying that Fiji satisfies a large part of its consumption demand through international trade while it has hardly anything except sugar and gold to pay for its imports. Reasons for high food imports are not far to seek. They can be attributed to a pattern of specialisation developed over a century, primarily under colonial rule. Consequently, there is a dichotomy in the structure of production between an advanced commercial sector which is devoted primarily to sugarcane and the domestic food sector which is largely semi-subsistent. Most of the land under arable crops is under sugarcane and infra-structural developments in agriculture have been concentrated in sugarcane growing areas. Other reasons leading to the poor performance of food production and high levels of food imports are the relatively high rate of population growth, relatively low rates of investments in agriculture and relevant forms of infrastructure (especially in non-sugar areas), land tenure problems and rural-urban migration. The rapid rural-urban drift of the 1960s and 70s

33 Robertson and Tamanisau, n.6, pp.172-73.
has led to changes in consumption patterns that favour imported agricultural products, concomitant with a decline in subsistence farming in rural areas.\textsuperscript{34} Another important factor is poor utilisation of land in Fiji. Of the total useable land only 33 per cent is being utilized.\textsuperscript{35} This may be attributed to the system of land tenure. Communal ownership of land is a major form of land tenure accounting for 83 per cent of the land in the country. Although land is communally owned and farming is carried out on the basis of individual family units, there is little security of tenure or recognition of such farmers’ rights by financial institutions. Due to this they are unable to offer collateral for borrowing and hence not eligible for most forms of credit.

Export diversification into agricultural exports other than sugar and gold has been limited due to narrow agricultural base. But prospects for low skill manufacturing exports are bright. Fiji can utilise its unskilled and semi-skilled labour in industries like clothing, footwear, electronic and watch assembly. Garment exports have recently shown a good potential. However, in 1984, the first year of major textile, clothing and footwear exports, the total value of the three reached only US $1 mn.\textsuperscript{36}

\textbf{Direction of Trade}

\begin{itemize}
  \item In 1986 34\% of imports came from Australia, largely petroleum products and food. The share has been declining in recent years. New Zealand (17\%) and Japan (14\%) are also significant sources of imports; manufactured goods and food are the key items from New Zealand with machinery and manufactured goods from Japan.\textsuperscript{37}

  \item Exports have been confined largely to a select group of countries viz. United Kingdom, Australia, New Zealand and USA. There are however, perceptible signs of change in shares of exports to UK and USA which have gradually declined whereas Malaysia has over the years recorded higher proportion of intake.
\end{itemize}

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Fiji’s sources of import are also moving from traditional colonial links with the UK and Australia to Asia.\textsuperscript{38} Markets that are complementary rather than competitive are likely to serve it best. Widening range of goods and services available in the newly industrialized countries at keenly competitive prices augurs well for Fiji’s balance of payments. But Fiji appears to be at a significant disadvantage particularly in respect of assembly type activities, based on imported components. It is difficult to see Fiji being broadly competitive with East and Southeast Asian exporters in the near future, given their high labour cost.\textsuperscript{39} Long term preferential treatment by importers would thus appear to be necessary to sustain such activities. However, these preferential treatments in itself may not be sufficient as the South Pacific Regional Trade and Economic Cooperation Agreement (SPARTECA), Stabex\textsuperscript{40} and national price stabilisation schemes indicate.

SPARTECA

SPARTECA is a preferential non-reciprocal agreement between Australia and New Zealand and the Forum island countries of the South Pacific. It was devised for trade diversion rather than trade creation objectives.\textsuperscript{41} It is important however to note that the possession of the comparative advantage in a primary product does not in itself imply a comparative advantage in its processing so that forcing the diversification and further processing of existing imports could easily involve significant resource costs.


\textsuperscript{40} Also known as Lome’ Scheme. Under the scheme the European Community provides financial and technical assistance to 66 countries of Africa, the Carribean and the Pacific, as well as tariff preferences for many of their products in European markets. Commission of European Communities (Brussels), "The Lome Convention and the Evaluation of the EEC-ACP Cooperation", Information Memo (July 1978). Also see SPEC Director’s Annual Report 1977/1978, SPEC (1978) 17, Suva, 1978, pp.30-31.

\textsuperscript{41} M. Robertson, The South Pacific Regional Trade and Economic Co-operation Agreement: a critique, NCDS working paper no.85/2, Canberra, p.4.
Like all South Pacific island countries Fiji has actively sought to diversify and to expand the domestic processing of its exports under SPARTECA. But it has not had a major impact on Fiji's exports. A liberalisation of conditions in 1985 had little result. For example, Fijian clothing exporters have found it difficult to interest Australian clothing importers in using part of their global quota to import Fijian clothing product. The best Fijian manufacturers are now using joint venture partners to provide market access and production expertise.

Macro Stabilisation Schemes

There are schemes floated by countries and agencies to ameliorate the poor performance of exports of small developing countries. Among these the IMF's compensatory financing facility and the European Community's Stabex scheme are important. Compensatory financing facility by IMF offers temporary loans in the event of an exogenous and temporary shortfall in export receipts. Such assistance is additional to that normally available under an IMF standby arrangement. Stabex scheme compensates Africa, Caribbean, Pacific (ACP) countries for declines in export earnings for specified products destined for the EC market.

From the point of view of a small island economy such as Fiji the chief benefits of such scheme accrue to national and international bureaucracies and may have quite large opportunity costs in terms of the use of the scarce trained people. In addition to their essentially trade diversion character these special trade schemes have several common features. They are extremely complex and hence use scarce trained labour. The administration of the schemes requires major bureaucratic efforts to ensure that rules of origin and other requirements are met.


43 South Pacific Commission (SPC), Report of the Feasibility Study of a South Pacific Regional Agricultural Stabilisation Scheme Noumea, 1980. The report examines the desirability and feasibility of existing regional stabilisation schemes. It advocates for supplementing the Stabex which hasn't covered many products in its list.
Foreign Aid and Investment

Australia has been the major source of aid to Fiji with Japan providing an increasing share. However, the position changed dramatically following the two coups as most countries suspended aid. A new group of countries - France, Indonesia and Malaysia - were quick to offer financial assistance. France announced a package worth A$16 million in 1988. With the formal resumption of civilian government in December 1987 the traditional donors have gradually started to resume aid, led by Australia which has offered A$ 7 million (US$ 5 million) for 1988. Although, the volume of country programmable aid was reduced from $20 million to $13.4 million in 1987-88, Fiji was still the largest recipient of Australian aid, after Papua New Guinea, in the Southwest Pacific. Multilateral aid, however, to Fiji is mainly project related and varies considerably from year to year.

Like in several other developing island nations foreign direct investment has played an important role in Fiji. It has been directed towards forestry and the tourist sector which flourished in Fiji during the late 1970s. Data for the region on financial flows in general and foreign direct investment flows in particular are sparse. The data in Table 11 in Appendix I give some indication of capital flows. However, foreign direct investment in Fiji as suggested by the United Nations is US$ 220 million. Some of the manufacturing in which foreign investors have been active are cigarettes, matches, breweries, copra-oil processing, canned fish, light engineering products among others.

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PAPUA NEW GUINEA

The largest Pacific island, Papua New Guinea, is rich in natural resources. It has abundant forests, sizeable mineral wealth and considerable hydro-power potential. Essentially an agricultural economy a large proportion of its population subsists on small farms and plantations cultivating coffee, cocoa, coconuts, timber and minor cash crops such as tea and rubber.

After a period of considerable, if somewhat uneven growth in the 1970s, Papua New Guinea experienced some economic difficulties during 1980 as world prices fell for major export commodities and higher prices for oil and other imports added to difficulties with the balance of payments. In 1981 there was some recovery with bigger outputs from Bougainville mine and investment in the OK Tedi project as well as a moderation of inflation under cautious monetary and fiscal policies. At the same time, however, falling prices for exports reduced the value of export receipts considerably during 1981. In 1982-83 the position stabilised with domestic exports overall remaining unchanged and production and investment slowing down; fiscal austerity did not allow public expenditure to compensate for the slowdown in private investment. Thus it was only with the turnaround of export prices in early 1983 that the tempo of economic activity began to change.

By the end of 1983, economic growth in Papua New Guinea had resumed at 1 per cent, largely induced by higher levels of export related activities. Earnings from gold and copper exports, resulting from increased prices, increased by 17 per cent in 1983. Increased coffee and cocoa earnings contributed to a 20 per cent in overall export earnings. However, again prices fell in 1987. Now there is a growing concern in Papua New Guinea about the plight of cocoa, copra and coffee. Coffee is PNG's largest agricultural commodity accounting for 14 per cent of the country's export earnings.

47 Cocoa prices fell by half in 1987. See also 'Pacific Island Commodity Prices' Pacific Economic Bulletin, Vol.4 No. 2 December 1989, pp.9-11. See also Table 14 in Appendix I.

48 ibid.
By 1984, growth of gross domestic product of Papua New Guinea was estimated to be 3.5 per cent which is substantially higher than the rate achieved over the period 1980-83. Real GDP is estimated to have risen by 6.7 per cent in 1985. Besides depending upon the world commodity prices, the economy depends crucially upon the rate at which production can increase at the OK Tedi gold and copper mines. Though predominantly a rural and agricultural economy, it has developed in the last 15 years a large enclave mining sector and of late there has been significant expansion in the urban industrial sector.

Gold is an important component of Papua New Guinea’s mineral production and is associated with large scale copper deposits at Panguna and OK Tedi. Both mine sites were enormously expensive to develop and required heavy investment by Japanese, West German, Australian and American mining companies; investment illustrative of the neo-colonial control exercised by Transnational Corporations over extractive industries in the Southwest Pacific. This is clearly evidenced in Papua New Guinea’s pattern of development which shows a reliance on a number of large, natural resource based projects which exhibit few linkages with its traditional economy. That is why economic performance has been strongly influenced by external factors.

Economic Structure

Primary production (excluding gold mines) contributes one-third of total output in Papua New Guinea, sustains 80 per cent of the population and contributes 50 per cent of export earnings. Yet in recent years performance of the agricultural sector has not kept pace with the modern economy. Output of major crops has stagnated particularly because there has been substantial migration of subsistence farmers to urban areas in search of wage earning opportunities.


and some movement towards cash crops amongst small holders.\textsuperscript{52}

Prior to the 1970s close to 90 per cent of the population was involved in subsistence agriculture. The monetized part of the economy was closely linked with Australian economy. It is not therefore surprising that in the early 1960s only 1 in 10 workers in PNG had jobs outside of agriculture.\textsuperscript{53} Nevertheless, agricultural performance has been mixed. Some sub-sectors have performed well including poultry, palm oil, log exports, pigs, prawns and to a lesser extent tea and coffee. However, production of food crops including rice and taro has grown very slowly. Others have performed badly, including sawn timber, rubber, cocoa, copra and beef. The share of agriculture in GDP has declined from 42 per cent in 1965-68 to 34 per cent in 1986. It is, however, revealing that despite fall in the share of agriculture in GDP, growth of the economy has remained sluggish.\textsuperscript{54}

Manufacturing sector has grown more rapidly than most other sectors in the post-independence period. Between 1970 to 1980 manufacturing has shown steady growth against agriculture and mining. Excluding mining the industrial sector in Papua New Guinea contributes 14 per cent of GDP with manufacturing contributing 10 per cent.\textsuperscript{55} Foreign firms play an important role in this sector. In 1973, 86 per cent of the manufacturing sector was in foreign hands.\textsuperscript{56} There are many constraints to the development of manufacturing industries which include delays in securing land for industrial sites, a small and fragmented domestic market, inadequate and expensive public utilities and transport, shortage of production skills and low productivity in relation


\textsuperscript{55} See Table 12 in Appendix I.

\textsuperscript{56} Browne and Scott, n.12, p.85.
Nevertheless, manufacturing growth reached 10 per cent per annum in the mid 1970s. The food products and wood based industry within the sector, showing important linkages between primary and secondary activities, accounts for the major share of growth with 40 and 22 per cent of value added respectively. However, manufacturing employment grew faster than manufacturing value-added bringing productivity levels down in its vein. The fall was most marked in the case of food products where productivity level fell by almost 40 per cent. It should be pointed out, however, at this stage that manufactured exports account for roughly 4 per cent of total exports. Copra oil and wood products (plywood, chopsticks, woodchips and veneer) accounted for 94 per cent of these manufactured exports. While manufacturing contributes negligible amount to the exports it has major reliance on imported inputs. In 1976-77, imported inputs comprised more than 70 per cent of the intermediate products.

**Volume of Trade**


Exports fell by nearly 18% in 1981 with all major exports including gold, copper and coffee showing lower figures.
Composition

Major items of imports were machinery, transport equipment, minerals, food and live animals and manufactured goods accounting for about 30%, 20%, 19%, 16% of the total imports during 1980-81 respectively. Papua New Guinea’s rice imports are up despite continuing efforts to increase local production. It has been estimated that farms so far established will produce 309 tonnes of rice but the imports - mostly from Australia - totalled 17,430 tonnes a year, which cost Papua New Guinea K26 million. The worrying factor is that the imported quantity is growing each year. In recent years food has accounted for one-fifth of all PNG’s merchandise imports and the volume of food imports like Fiji, has grown at about 4 per cent per annum since independence.

Papua New Guinea’s main exports consist of minerals (copper and gold) and agricultural production. There has been phenomenal growth in the volume of Papua New Guinea’s exports in early 1970s. In the 1960s, coffee and cocoa were the key sources of export growth. Then, from 1974, palm oil exports began to grow. During 1972-75 export of massive volumes of copper and gold from Bougainville overtook growth in agricultural exports. However, exports did not expand much in the latter half of the 1970s. But in the 1980s exports of some commodities expanded again. Between 1980 and 1984 the volumes of log and palm oil exports doubled and quadrupled respectively and the volume of gold exported in 1985 and 1986 was twice that of earlier years.

But growth in export volumes did not boost real incomes, partly because of unfavourable terms of trade. During the 1960s and 1970s the country’s terms of trade fluctuated around a flat trend. Between 1979 and 1982 they deteriorated and recovered only a little in 1986. Despite that there have been quite marked structural changes during the past two decades.

63 ibid.
First, there has been a decline in relative importance of agriculture as mining activities have grown. The economy is dependent more on foreign trade and the rural sector of the economy has become monetized. Exports of goods and services amounted to less than 20 per cent of GDP, prior to the early 1970s, but has accounted for about 5 per cent of GDP in recent years. Second, the rate of decline of agriculture, forestry and fishings' share of exports has been dramatic. Until the early 1970s more than 90 per cent of the country's export were from the primary sector (mainly agriculture). But since the mid 1970s that share has been only half as large. What is remarkable about Papua New Guinea's export structure is the extreme dominance of agriculture earlier and the continuing non-importance of manufacturing. Third, within the agricultural sector there have been considerable changes in the structure of exports. One set of changes has been in the relative importance of different cash crops. Around 1960 coconut products contributed almost one half of all export earnings, compared to about 6 per cent in the 1980s. Coffee and cocoa exports began in the late 1950s and contributed 30 per cent of all exports in the 1960s and nearly 1970s and still contribute between 20-25 per cent. Palm oil exports began in the mid 1970s and accounted for about 5 per cent of earnings by the mid 1980s. Meanwhile the share of rubber in exports has fallen from around 8 per cent in the early 1960s to less than 0.5 per cent today.

These structural changes in the economic and trade structure have made the economy of Papua New Guinea susceptible to domestic and international market pressures, which has made market intervention by the government inevitable in recent years. This aspect would be discussed in more detail in the next chapter where government strategies for development would be discussed.

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68 Goodman, Lepani and Morawetz, n.65, pp.111-12.

Direction of Trade

Yet another important change is found in the direction of trade which has shifted sharply since independence with the diversion of exports away from Australia and USA to Japan and Federal Republic of Germany. As sources of import, Japan and Singapore have joined Australia as major suppliers. The EEC, Australia and Japan together account for about two-thirds of the total exports from Papua New Guinea. Although, some progress has been made, particularly with the signing of the Lome’ III agreement in 1985 increasing access to these markets will not be an easy task.

Based on the analysis above of the economic structure of Fiji and Papua New Guinea, first, there appears to be greater volatility in exports than in import shares. Second, the combined shares of the largest three import and export trading partner provide no evidence that exports are more or less highly concentrated than imports across countries. Third, Australia and New Zealand together have a much larger share of imports than exports. Fourth, colonial influence shows itself in the larger shares of the UK in Fiji and that of Australia in Papua New Guinea. Fifth, given the similarity of the island economies, there is little intra-regional trade.

Foreign Aid and Investment

Papua New Guinea had relied upon Australian budgetary grants for 35 per cent of its current and capital budgetary expenditure between 1976 and 1980. In 1988-89, $303.3 million will be provided which will account for about 28 per cent of the Australian aid program. Papua New Guinea has a special relationship with Australia. This relationship goes back to the 19th century when Australia took over the administration of the territory of Papua. Aid has been an important feature of Papua New Guinea’s relationship with Australia

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70 Central Planning Office, Programme and Performance, 1982-83 Port Moresby, p.3.

71 ibid, p.4.


73 Australia’s overseas aid program, n.45, p.15.
ever since grants-in-aid were given to support the administration of the then separate territories of the Papua and the New Guinea. Grants-in-aid to the colony rose from $4 million in 1947 to $96 million in 1969-70.74 At the time of independence in 1975 it was agreed that Australian aid would be given mainly in the form of untied cash grants, marking a break from the earlier period of direct involvement in the formulation of Papua New Guinea’s budget. Then in 1980 on the recommendation of the Crawford Commission, the two governments agreed for a 5 per cent annual reduction in real terms in Australian aid. However, it was in December 1987 with the signing of the Joint Declaration of Principles (JDP) between the Prime Ministers of Australia and Papua New Guinea that one of the most important changes in the bilateral relationship occurred.75 The JDP aims at changing the bilateral relationship from the post-colonial phase of giving aid and advice to one of reciprocity and recognition of mutual benefits. Both governments also agreed that the real level of Australian aid should decline progressively in a predictable way, with the level of budget support remaining at $275 million for each of the next three financial year 1988-89 to 1990-91. Over this period budget support is expected to fall from around 16 per cent of Papua New Guinea’s government’s revenues to about 12.5 per cent. Australia also agreed that project aid component will increase from $15 million in 1988-89 to $20 million in 1989-90 and $25 million in 1990-91.76

Compared to Fiji, foreign direct investment in Papua New Guinea has been much higher and was estimated to be $860 million in 1978. The main inflows have been associated with minerals and petroleum explorations and development.77


75 Australia’s Overseas Aid Program, n.45, p.9.

76 ibid.

77 Economic Commission for Asia and the Pacific, United Nations Centre on Transnational Corporations, Proceedings of the Ministerial Round Table on Transnational Corporations and Developing Pacific Island Countries Bangkok, April, 1984, p.345. See also Table 23 in Appendix I.
AUSTRALIA

Australia has a diversified economy that has grown at a real average annual rate of 3% between 1980 and 1985. The annual growth in two years thereafter has been around 5%. Agriculture and mining were the mainstay of the economy till the beginning of this century. Transport communications and manufacturing were developed in the early part of the century and economic development entered a very rapid phase of expansion in the 1950s as manufacturing developed and Australia’s vast mineral resources attracted massive foreign capital.

Economic Structure

Agriculture

Most of the land in Australia is lying barren without any substantial rainfall. So, only a little more than two-fifth of the total land is used for farming. Of the total area (7.7 m sq. kms.) only one percent is under crops and only one-twelfth of that crop area is irrigated. Droughts and other harsh climatic factors cause large seasonal variations in agricultural output. Besides, agricultural commodities are open to considerable fluctuations in world prices. Between 1974-75 and 1978-79 pastoral activities contributed 43 per cent to gross farm output, crops contributed 48 per cent and most of the remainder came from poultry and pigs. The most important pastoral activities are sheep farming and beef cattle raising. Meat has become rather more important than wool as a contributor to gross farm output. Over the period 1974-75 to 1978-79 sheep farming accounted for one-half of the gross value of pastoral production. The value of wool sold was 4 times the gross value of lamb and mutton and that of beef was 3 times their value. The dairy products accounted for 8 per cent


of farm output, two-thirds of which came from the production of butter and cheese. Wheat, the most important crop is grown on a large scale in all states contributing 36 per cent of gross farm output in 1984-85. Output has more than doubled since 1955 owing to growing world demand for cereals. In 1972-73 it contributed only 7 per cent of gross farm output. The most important industrial crop is sugarcane, grown in the coastal regions of Queensland and Northern New South Wales (NSW). Australia's output of sugar has trebled since the late 1950s but it is subject to wide fluctuations in price. Other industrial crops principally tobacco and cotton are also important along with fruits and vegetables.

Mining occupies an important place in Australian economy. It has exportable surpluses of Aluminium, steaming and cooking coal, copper, iron ore, lead, manganese, natural gas, silver, tin, titanium, tungsten, uranium, zinc and zircon. The value of mineral products in 1983-84 was more than A$ 11,606 million. Metallic minerals contributed 33 per cent of this, and coal and petroleum 58 per cent. The most important minerals were black coal (31 per cent) and petroleum and gas (36 per cent).

Manufacturing

In 1983-84 the manufacturing contributed 18 per cent of Australia's GNP and absorbed about 18 per cent of the civilian labour force. Of the manufacturing sectors, food beverages and tobacco were by far the most important, yielding 19 per cent of manufacturing's contributions to GNP. Textiles yielded only 3 per cent and clothing and footwear only 5 per cent. Wood and its products including paper and printing yielded 16 per cent and chemicals, petroleum and coal products 9 per cent. Comparable figure for other sectors were: non-metallic mineral products 5 per cent, basic metal products 10 per cent, fabricated metal products 8 per cent, transport equipment 10 per cent, other machinery and equipment 11 per cent and miscellaneous manufacturing 5 per cent.

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81 ibid.


83 The Far East and Australasia, n.79, p.123.

84 ibid.
Australian manufacturers are highly protected. Nominal rates of tariff ranged from 4 per cent for mineral manufactures to 66 per cent for clothing which is also protected by quotas. This is also true of footwear on which the nominal tariff rate is 27.5 per cent. On an average nominal rate of protection is 15 per cent, compared with 5.8 per cent for the USA, 7.5 per cent for the EEC and 11 per cent for Japan. Effective rates of protection in 1978-79 were 151 per cent for clothing and footwear together, 59 per cent for transport equipment and 61 per cent for textiles. These high rates of protection grew out of an earlier policy of fostering import substitution industries. While more than 10 per cent of manufacturing output is exported, three-quarters of such exports come from industries processing basic metals and foodstuffs. As a result the international competitiveness of manufacturing industry has declined since 1970.

But after March 1983, the Labour government of Prime Minister Bob Hawke initiated certain policy measures which have dramatically changed the economy and contributed towards the accomplishment of a more rapid economic growth. These were meant to lift the agricultural sector from severe drought, deregulation of some of the highly protected manufacturing industries to generate greater efficiency and productivity and higher real income. Financial deregulation was brought about as one of the major steps in this direction. However, although protection levels on an industry by industry basis have been reviewed, the average effective rate of protection provided to the manufacturing sector has only declined modestly - from 21 % in 1982-83 to 19 % in 1986-87. The decline was mostly due to a reduction in measured assistance to industries protected by import quotas (eg. the textiles, clothing and footwear and

86 TCF Union Report, n.42, pp.29-31.
87 ibid.
motor vehicle industry). To speed up the process begun since 1983 in moving away from its post-war industry assistance policy which left large sectors of industry sheltered from international competition, Australia should reappraise the general levels of assistance provided to Australian industry, particularly in view of the competitiveness imparted by the devaluation of Australian dollar by 10% by the Hawke government. A recent survey has shown the weak performance of most Australian manufacturers. Nearly 61 per cent are operating below their capacity. According to the survey the short term outlook for Australian exports remains bleak unless Government takes appropriate measures.

Structural Changes in the Economy

Significant structural shift in the economy has taken place since the 1960s with a strong shift towards services industries the contribution of which to the GDP rose from a little over 50% in the early 1950s to 70% in the early 1980s. Traditionally, Australia's exports have reflected strong natural resource base. Large endowments of farming land, ocean shore line and minerals have provided a wide ranging source of primary products. Accordingly, the share of rural and mining exports has been considerably greater than that of manufacturing and servicing exports. Contribution of agricultural sector is growing in absolute terms but it is no longer the dominant source of export earnings. However, it accounted for an average of 45 per cent of Australian export income

89 The theoretical work on across-the-board tariff cut was done by the Industries Assistance Commission which submitted its report in 1982. But it was shelved when Labour Party came to power. However, it was soon realized that tariff reductions were necessary to make manufacturing internationally competitive and for the first time in 15 years it looked possible that there would be across-the-board cuts in tariff structure for manufacturing industry. *Business Review Weekly*, n.85, p.36 See also Submission to the Industries Assistance Commission Inquiry into General Reduction in Protection, ACFOA (December 1981).


in a period of 5 years from 1981-85. Therefore, this sector can be expected to remain the most important single source of export earnings in future. Growth has also been witnessed in the mining sector due to the exploitation of important discoveries of iron ore, petroleum, coal, natural gas and other minerals. Manufacturing remains the largest single contributor to the GDP but its share has steadily declined to 17% from 19% 5 years ago and 22% 10 years ago.92

**Foreign Trade**

The characteristic features of Australia’s foreign trade are its dependence on agricultural and mineral exports, with Japan, the USA, the UK and New Zealand as its major trading partners. Japan with its preference for imported raw materials provides the biggest export market. The perennial deficit on the current account has doubled since 1980 and has become a major concern for the Australian government. A recent report noted that Australia is the only industrial country that has not increased its proportion of merchandise exports to GDP (13.5) during the last 30 years.93

In 1983-84, it appeared that the government had succeeded to some extent in managing the deficit as it dropped. The phenomenon, however, proved to be shortlived, as the deficit again went high.94 Foreign debt fuelled current deficit was A$ 17.7bn in the financial year ended June 1989, which was about 5.4% of GDP. The principle cause of increase in the deficit has been the enormous growth in invisible outflows; these include transport and insurance costs on imports, interest and dividend payment repatriated abroad, foreign travel expenses and various other type of private and official monetary transfers overseas.95 Before that in 1960s and 1970s also Australia has had substantial deficits. During

92 Encyclopedia, n.82, p.1330.


94 See *Commonwealth of Australia, Budget Statement 1989-90* (Canberra, 1989) p.3.41.

the period 1960-74 it ranged from an average of A$ 409 million per year in 1960-64 to A$ 800 million per year in 1965-69 falling back to A$ 416 million per year for the period 1970-74. There were heavy capital inflows in the 1960s due to mining investment and further substantial investment in 1979-82, although this boom collapsed when world prices for minerals began to fall. Australia has long been regarded as a capital importer. In every year for the last three decades, Australia has had a net capital inflow. In 8 out of 10 years immediately preceding the oil price rises of the early 1970s, net capital inflows exceeded the current account deficit. However, in each year of the period 1973-80 net capital inflows failed to cover the current account deficit and this resulted in running down of the foreign exchange reserve. This trend has been reversed in 1980s with the net capital inflow exceeding the deficit in 4 of the 5 years to 1985. But the major source of capital inflow is foreign borrowings of interest bearing and repayable loans by private and government enterprises. The composition of debt has changed in the 1980s. Of the total foreign debt (US $79.43bn in August 1989) the private sector accounted for 63% net. The federal government has reduced its debt 'growth to nil'.

Several studies have suggested a way out of the present economic difficulty. A study by the Macquarie University in July 1989 suggested that the ratio of Australia’s net external debt to GDP could be stabilised at the present level if the current account deficit is reduced from 5.3% to 2.5% of GDP. Yet another survey of the Australian economy conducted by the OECD in December 1989 concludes the same. But OECD survey does not say anything about the method of reduction in deficit. The study by the Macquarie University, however, points out that to achieve the acquired reduction in deficit, Australia would have to turn its trade deficit into surplus. That would require a massive

96 Far East and Australasia, n.79, p.187


export effort, much more than the annual export growth of 6% during 1980s. Exports by the manufacturing and service industries would have to grow by 10% a year.\textsuperscript{101}

Against the background of a deteriorating balance of trade situation the importance of agricultural exports is underlined. Australia ranks as a major world exporter of agricultural products. The pattern of Australia’s agricultural export markets has changed markedly in recent years.\textsuperscript{102} Table 16 in Appendix I gives details of the three leading export markets for a number of Australia’s major agricultural commodities for the three years ended 1967-68 and 1980-81. The very heavy traditional dependence on the UK as a market has shifted towards Japan, United States, Asia and the Middle-east. Australia’s export market in such developed countries as Japan and the USA are influenced significantly by the policies pursued by these countries to support their domestic agricultural sectors.

Countries of the Middle East have become important markets for Australian meat, live sheep and wheat.\textsuperscript{103} Demand has grown principally because of high incomes from oils. Since the capacity of these countries to expand their own food production is limited, they can be expected to continue to import significant quantities of Australian farm products in the next decade. Demand for agricultural products in east and Southeast Asia is growing as a result of high population growth and rapid industrialisation.\textsuperscript{104} Australia has a comparative advantage in exporting agricultural commodities to these countries. The rapid expansion of intensive livestock industry in many Southeast Asian countries offers potential for expanding exports of feed grains. Demand for meat is also expected to rise.

\textsuperscript{101} Sydney Morning Herald, 24 April, 1990.

\textsuperscript{102} Parliamentary Paper No.430/1982, n.80, p.41.

\textsuperscript{103} See “Australia seeks to salvage live sheep trade” in The Asian Wall Street Journal, 8-9 September 1989. Australia’s live sheep trade with the Middle-East is poised to resume after 12 months of uncertainty caused by the rejection of several shipments, mostly on health grounds. See Financial Times (London), 26 July 1990.

\textsuperscript{104} Australian Exports, n.93, p.12. Also see the article “Towards a Pacific Economic Community” in The Asian Wall Street Journal, September 11, 1989.
South Korea and Taiwan have emerged as a market for primary products exports. These markets in recent have assumed tremendous importance.\textsuperscript{105}

Consider Australia’s exports to the 10 major East and Southeast Asian markets - China, Hong Kong, Indonesia, Japan, Malaysia, The Philippines, Singapore, Republic of Korea, Thailand and Taiwan. In 1986 these were valued at US $10,814 million. Compare this with Canada’s US$ 6758 million, and France’s US$ 4731 million, the United Kingdom’s 5811 million and one can see why Australia is the location from which to access Asian and Pacific markets.\textsuperscript{106}

The most striking feature of changes in the direction of Australia’s trade is its large and growing involvement with the Pacific basin. This area took three-fifths of Australia’s exports in 1962-63 and three-quarters in 1984-85. Exports to Europe were 38 per cent of the total in 1962-63 falling to 12 per cent in 1984-85. In 1987 the value of Australian exports to this region increased by nearly 20\% to US$ 12,826 million.\textsuperscript{107} This increase was no accident. Australian industry, and the government are committed to boosting exports, particularly in the manufacturing and service sector. Government policy has been to open up the economy.

Prospects for Australian agricultural exports to China look bright. The level of foodstuff imports is government controlled and depends upon relative priorities in annual and five year plans as well as on fundamental considerations such as China’s foreign exchange position and the level of world commodity prices from time to time. Demand for wheat imports is expected at least to maintain its present high level and Australia should retain its present share. However, annual import levels may fluctuate, reflecting changes in China’s domestic production. Exports of sugar to China could be expected to increase although more moderately than in the 1970s with a continuation of the current emphasis on expanding exports and accelerating development of light industries, growing opportunities should arise for agricultural raw materials and intermediate goods from Australia such as wool, cotton and other textile fibers.\textsuperscript{108}

\textsuperscript{105} ibid.
\textsuperscript{106} Department of Foreign Affairs and Trade, \textit{Australia’s Trade Policies}, (Canberra, May 1988), p.9.
\textsuperscript{107} ibid, p.9-10.
\textsuperscript{108} Department of Trade, Central Statistics Section, \textit{Australian Trade with Centrally Planned Economies and Yugoslavia}, 1986, p.4.
Australia’s agricultural exports to the USSR and Eastern Europe have been increasing. In 1980-81 the USSR accounted for 25% of Australia’s total wheat exports. For the coming decade wool appears to be the commodity with the best export prospects in these countries. Sales of meat and grain are also expected to expand.\(^9\)

The geographical distribution of Australian trade has changed over past few years with more than half the country’s exports now going to Asia. Japan is the most important market for Australian exports, absorbing in 1987-88 around 26% of total shipments followed by the USA with 11%. Between 1962-63 and 1983-84, Japan’s share rose from 16 per cent to 26 per cent touching a peak of 34 per cent in 1976-77. That of the USA was fairly steady at about 10 per cent while that of the UK fell sharply from 19 per cent to 4 per cent. New Zealand (6 per cent) and other South Pacific markets are now a more important export market for Australia than the UK and is the largest single market absorbing 20% of manufactured exports. These markets are, however, being increasingly eroded by competition, particularly from East Asia.\(^10\)

### Australia’s Trade Relations in the Southwest Pacific

The trade and economic relations between Australia and the independent island countries of the Southwest Pacific are governed basically by the South Pacific Regional Trade and Economic Cooperation Agreement (SPARTECA).\(^11\) There is another agreement - Papua New Guinea-Australia Trade and Commercial Relations Agreement (PATCRA) - which governs trade and economic relations between Australia and Papua New Guinea. These agreements aim to enhance the two way trade performance. One of the most significant aspect is that the island countries have duty free access to the Australian market for their products on a

\(^{9}\) ibid, p.6-7.

\(^{10}\) Australian Exports, n.93, pp.13-14.

\(^{11}\) For a detailed discussion on this aspect see The Parliament of the Commonwealth of Australia, Joint Committee on Foreign Affairs, Defence and Trade Report, Australia’s Relations with the South Pacific, 1989, p.19.
non reciprocal basis. But these concessions have come under severe criticism in recent years.\textsuperscript{112}

Australia’s export performance in 1988-89 in the region worsened with a decrease in exports due to decreased sales of refined petroleum products. In 1988-89, Australia’s exports to the FICs, PNG and the French territories were valued at $1208.4 million (2.8% of total exports) and imports at $300.5 million (0.6 of total imports).\textsuperscript{113} Trade with the region therefore remains relatively small compared to Australia’s other regional trading partners such as New Zealand and ASEAN countries. However, the region remains an important destination for manufactured products from Australia.

PNG and Fiji are Australia’s main markets in the Pacific area in 1988-89 taking together 77.8% of Australia’s total exports to the region and providing 67.7% of imports. Australia has the major share of the import markets of the larger economies in the region, with petroleum products, manufacturers and foodstuffs being particularly important. Australia’s Balance of Trade in 1988-89 showed a $680 million surplus with PNG and a $228 million surplus with the rest of the region. Australia’s current account balance in 1987-88 showed a $441 million surplus with PNG and a $51 million surplus with the rest of the Southwest Pacific. These figures more accurately reflect the degree of balance in the overall economic relationship Australia has with the countries of the region.\textsuperscript{114}

In the area of services trade, the limited statistics available show Australia has a small surplus of $85 million in 1987-88 with PNG and a continuing deficit with the rest of the region.\textsuperscript{115}

Australian investment in the region has a strong historical base. The level of Australian investment in 1987-88 to PNG and Fiji was $1,803 million and $57 million respectively. The value of the Australian level of investment in the rest of the Southwest Pacific was $520 million in 1987-88.\textsuperscript{116}

\textsuperscript{112} William Sutherland, n.l, p.2.
\textsuperscript{113} ibid
\textsuperscript{114} ibid.
\textsuperscript{115} ibid
Positive factors which are contributing to the level of Australia's exports to the region and its competitiveness include the decline in the value of the Australian dollar, the return to high levels of Australian tourism to the region, expertise in the consultancy and construction areas, position as the traditional supplier and telecommunications links. The development of exports of services (tourism, aviation, medical, telecommunications, banking, insurance) and some construction opportunities would appear to offer the main avenues for the expansion of Australia's overseas earnings from the South Pacific.

Challenges facing Australia in maintaining its commercial profile in the region include the difficult economic circumstances of most South Pacific economies (due mainly to their small narrow economic base focussing on one or two commodities); increased competition from New Zealand, Japan, South Korea, China, Malaysia, Taiwan, Singapore; the effects of trade in subsidised agricultural products by the USA and the EEC; the tied aid policies of Japan and the EEC; the development of import substitution industries in PNG and Fiji assisted by tariff and non tariff barriers and the weakening of traditional linkages with Australia in some of the islands. 117

Australia's economic and trade relationship with the region has become a major element in the overall levels of economic security and self reliance. The islands look primarily towards Australia for assistance in their economic and trade development because it is the largest developed country and market in the region with the necessary economic skills and resources they require.

Additional factors in Australia's trade relationships will arise from the possibility of developing in the longer term closer economic relations in the region through broader-based agreements, the continuing development difficulties faced by the smaller FICs, and the gradual emergence within the island of leaders less strongly oriented towards Australia.

**Multilateral aspects of Australian Trade**

Australia has in the past been firmly committed to a multilateral trade system involving active participation in international commodity arrangements, and other multilateral institutions addressing trade issues such as the United Nations Conference on Trade and Development and the OECD. However, failure

117 Australia's Relations with the South Pacific, n.111, p.6
to participate in Dillon, Kennedy and Tokyo rounds of multilateral trade nego-
tiations of GATT on the grounds that they were not concerned with
agriculture, caused considerable damage. In the ongoing Uruguay Round of GATT,
the earlier policy was reversed.\textsuperscript{118}

Australia made a major input to the process of reform in agriculture
through its role in the Cairns Group of Agricultural Fair Traders. Created
at Australia’s initiative, this group of 14 developed and developing
countries has been successful in ensuring that agricultural reforms is a high
priority in the Uruguay Round. But Australia’s credibility is weakened by
its continuing relatively high protection levels and by the ‘use of trade issues to
further political objectives’.\textsuperscript{119} But to derive maximum negotiating benefit,
Australia has announced its preparedness to negotiate tariff formula cuts and
to phase out all quantitative restrictions designed to protect Australian
industry. Although GATT rules for the conduct of agricultural trade have proved
to be ineffective, it has been felt that Australia should not depart from its firm
commitment to GATT. After all it does constitute a forum in which some
pressure can be brought to bear against countries pursuing damaging trade practices.

Also, Australia continues to adhere to the most favoured nation
(MFN) principle central to the GATT under which concessions negotiated with
one country are automatically extended to other GATT members.\textsuperscript{120} Such
a principle is important to a country of Australia’s relative economic importance.
It is felt that it would have limited bargaining strength if it is faced with dis-
crimination by other more economically powerful countries.

\textsuperscript{118} See the text of the address by the Minister for Trade Negotiation, Michael Duffy
to the 20th Conference of the National Farmers Federation in Canberra on 22

\textsuperscript{119} Australian exports, n.93, p.xxi. Also see Department of Foreign Affairs and

\textsuperscript{120} Text of the speech Uruguay Round - Montreal Mid-term Review by the
NEW ZEALAND

By international standards New Zealand is a country of moderate affluence. At the same time it has a number of structural features which resemble with that of developing countries notably in its external dependence. Historically, there has been a concentration on a relatively narrow range of farm exports. Diversification into manufacturing and service industry has been necessary in recent decades to employ the growing labour force but still the agricultural sector remains by far the most important in the economy of New Zealand.

Farm products - chiefly wool, dairy products, lamb, mutton and beef - comprise about 70 per cent of merchandise exports.\textsuperscript{121} Agricultural exports, thus, provide a major chunk of foreign exchange. Manufacturing industry, however, relies on this foreign exchange for its raw materials and capital equipment. High transport cost is an important component of New Zealand's external trade because of large distances from other world market centres. A stage has been reached now where the future of farming is threatened. In recent years, however, exports have been diversified successfully.

Primary Industry

Agriculture

Farming and associated processing industries play a far greater part in the economy of New Zealand than in most developed countries because of their export orientation. The volume of agricultural export has steadily increased because of increasing investment in land improvement, farm machinery and better livestock. Total export receipts from the agricultural sector for the year ending June 1985 represented 64 per cent of total export earnings.\textsuperscript{122} This has been a historically low proportion. Cropping, fruit growing, horticulture and miscellaneous farming activities are of increasing importance. New Zealand


is virtually self-sufficient in meat while barley, maize, peas and potatoes are other significant crops mainly for the local market. Seeds are grown in quantity mainly for export and production of apples, pears and kiwi fruit (a hybrid variety of Chinese gooseberry) is also export oriented. Tobacco cultivation has long been fostered as a means of import substitution so that New Zealand now produces about one-half of its needs.

But the continuing high level of inflation in farm input prices which averaged 14 per cent annually in 1979-86 has reduced the cash surplus available for reinvestment on farms due to which farmers have increased their borrowings. Uncertainty continues to surround the markets for dairy products and wheat exports. The higher levels of output and improved returns as a result of a currency devaluation in 1984 assisted the meat and wool industries in 1984-85. Wool production in the 1980s has therefore been about 15 per cent higher than the average for the 1970s and demand, weakened earlier by the world wide economic recession, has recovered.

The forestry provides employment to 3 per cent (40,000 people) of the labour force contributing 7 per cent of New Zealand’s export earnings. More than 450,000 hectares of exotic forests were planted between 1966 and 1981 and land and capital continued to be attracted to forestry at a steady rate.

New Zealand has a wide variety of fish in waters around its coastal islands and many of these are recognized to be commercially valuable species. An important factor in the recent growth of the fishing industry was the enactment of the Territorial Sea and Exclusive Economic Zone Act in 1978 which gave New Zealand control over the fisheries and resources in approximately 4.1 m. sq kms of sea surrounding New Zealand’s territory. Joint ventures with foreign partners have contributed substantially to the development of the industry.

Mining activity has been very limited. Production of coal in 1983 totalled 2.5 m. tons valued at more than NZ $ 94m. Natural gas has become

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124 The Far East and Australasia n.79, p.697.
125 ibid., p.698.
economically important especially now that the on-shore supply has been supplemented by off-shore gas from the large Maui fields which has an expected life of 30 years.

Manufacturing Industry

This sector contributes more than 25 per cent of GDP and employs about the same proportion of the labour force. In recent years, output has been growing at an average annual rate of 5 to 6 per cent. Processing primary products accounts for about one-fifth of manufacturing, the remainder covering a wide range of activities characterized by orientation towards the domestic market, but the growing attention to exports. Only about one-half of manufacturing output comes from factories employing more than 100 workers and those employing more than 500 workers account for only one-fifth.\textsuperscript{126}

The construction industry in New Zealand has three distinct parts: construction of dwellings, pre-dominantly of timber in single units; commercial and industrial construction notably of middle-rise office buildings; and heavy engineering associated with major development projects many of them related to the provision of energy resources. Since the mid 1960s the industry as a whole and especially its residential component has been subject to marked cyclic fluctuations about a slowly falling trend, with a sharp fall in housing in the 1970s, as a result of migration changes and a halt to population growth.

Throughout in 1950s and the 1960s the average rate of growth of real GDP was more than 4 per cent which was not much less than the average for OECD countries, but New Zealand's performance during 1970s particularly after the 1973-74 oil price shock was comparatively worse, with terms of trade substantially deteriorating.\textsuperscript{127} Between 1975-82 there was virtually no real growth. Large fiscal deficits emerged in the late 1970s and together with the parallel development of the external imbalance, acted to create a mounting burden of debt in which the external component was increasingly important. By the early 1980s economic performance as measured by a wide range of


\textsuperscript{127} The Far East and Australasia, n.79, p.699.
indicators - growth, unemployment, inflation, external deficit, budgetary imbalance and debt - had deteriorated substantially. Such a decline is the outcome of falling real household disposable income, of the impact of the strength of the New Zealand dollar, on the competitive position of importers and exporters.

Foreign Trade

In 1950 the UK took nearly two-thirds of New Zealand's exports; it now accounts for only 13 per cent, having been overtaken by Australia, Japan and the USA. These 4 countries together now take 55 per cent of exports. Similarly, in the case of imports, the importance of the market share of the UK has greatly diminished from 60 per cent in 1950 to 13 per cent in 1984, which placed it behind the USA, Japan and Australia. Relative importance of Australia, Japan and USA has increased since 1950 but that of Japan with which there was virtually no trade in 1950 has grown most spectacularly. The combined market share of imports of these countries is now 56 per cent while that of the UK has fallen to 9 per cent. Despite protectionist tendencies in New Zealand's trading partner countries including the EEC, growth of exports has been essential for survival. So they have been diversified in recent years, both as regards the commodity composition (horticultural products, venison, frozen fish, timber and paper products and dried milk products) and geographical composition (lamb to the middle east, wool and mutton to the USSR). Export sales of manufactured goods (excluding those from primary processing industry) have reached the level of 20 per cent of export earnings. Forest products were expanded steadily to comprise about 10 per cent of export receipts in 1982. This proportion, however, subsequently fell to 7 per cent.

Two of New Zealand's largest industrial enterprises are New Zealand Forest Products Limited and The Fletcher Challenge Corporation. Both produce large quantities of sawn timber and chemical pulp; the former also produces kraft and

128 Department of Statistics, n.121, p.34.

129 ibid, p.35.

130 ibid.

other coarse papers and the latter newsprint and the chemical pulp. They are largely responsible for the export of timber (mainly to Japan) and pulp and paper (mainly to Australia). More recently two large groundwood mills have been established by Japanese-New Zealand consortia again almost entirely for exports.

Another large enterprise is New Zealand Steel Limited which is exploiting iron deposits with the benefit of a secure domestic market. In the 1980s it has undergone a large scale expansion, aimed at increasing iron and steel producing capacity fivefold. An Australian-Japanese consortium operates a large aluminium smelter. The great bulk of the resulting metal is exported to assured markets in Australia and Japan. New Zealand is having persistent deficit in its balance of payments. The current account deficit reached a peak of 13.6 per cent of GDP in 1974-75. But decreased to an average of about 5 per cent in the early 1980s. In 1983-84 it stood at 5.6 per cent and in 1984-85 at 6.4 per cent. The restrictive trade policy applied to agricultural products by some of the New Zealand trading partners has resulted in the failure of the terms of trade to improve. In fact the ratio of export to import prices declined at over 5 per cent between 1981-82 and 1984-85, to a level lower than in any year since 1975-76. Since the oil crisis at the end of 1973, the New Zealand economy has been faced with a fundamental change in the relationship between export prices and the cost of imports. This has resulted in a severe shortage of foreign exchange. Since 1977 a major feature in New Zealand's external accounts has been the persistent deterioration of the balance of trade in services. The deficit on such invisible trade in recent years has reached more than one-quarter of total current account receipts. The main reasons for this has been: official debt servicing, increasing interests, profits and dividends payable to overseas residents, transport costs and the travel expenses of New Zealanders overseas.

Closer Economic Relationship (CER) Agreement

The increasing interdependence of the Australian and New Zealand economies has led those countries' governments to put in place a Closer Economic Relationship (CER). Its main objective is to encourage the develop

132 Department of Statistics, n.121, p.52.


ment of economically strong productive structures in both the countries. The CER agreement between New Zealand and Australia was signed on 14 December 1982 following 3 years of negotiations. The bilateral trade agreement took effect on 1 January 1983. Two basic mechanisms have been set in place by the CER agreement: the phasing out of tariffs both ways over a 5 year period and the progressive elimination of import licensing and tariff quotas.\textsuperscript{135}

In 1988 both the countries undertook a review of their closer economic relationship.\textsuperscript{136} They took a big step recently in June 1990 towards integrating their economies by scrapping trade barriers which were initially on the tariff free list.\textsuperscript{137} The agreement has been immensely successful for New Zealand, which has gained free access for its low-cost agricultural exports to the relatively large Australian market of 17m people. Trans-Tasman trade has grown from 11 percent of New Zealand’s total trade 30 years ago to around 19 percent, and is roughly in balance, compared to a 4 to 1 imbalance in Australia’s favour in the 1950s.

CER is of less significance to Australia, for which the small New Zealand market of just over 3m people is a lower priority than the traditional markets in Europe and North America and the growing economies of Asia.

Trade in services is scheduled to be reviewed by the end of year 1991 but progress is likely to be hampered by the slow progress of domestic reform in Australia. Agreement on a common investment regime is complicated by an Australian treaty guaranteeing that no country will be given a more favourable investment regime than Japan.\textsuperscript{138}

\textsuperscript{135} ibid.
\textsuperscript{136} ibid, p.6.
\textsuperscript{137} “New Zealand and Australia Scrap Trade Barriers”, Financial Times, (London), 2 July 1990.
\textsuperscript{138} ibid.