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Economic reforms and political challenges

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On July 25, Reserve Bank of Fiji (RBF) announced its monetary policy stance. Noting the continuing subdued global economic conditions and the downward revision by International Monetary Fund of its earlier world growth estimate of 3.3 percent to 3.1 percent, RBF decided to maintain its benchmark interest rate at 0.5 percent. This rate is operative since October 2011.

Fiji's trade deficit has widened during January-April. It reflects the improved bank lending for construction and investment activities. The RBF is confident that investment to GDP ratio for 2013 will exceed Government's target of 25 percent.

This optimistic prediction was preceded by confidence boosting news from a major economy as well.

Early this week, by winning the upper house elections in Japan, Prime Minster Shinzo Abe's party has got the upper hand in both houses of parliament. The victory has now raised high hopes for Japan's economic recovery. Only recently, the one- party ruled China overtook Japan as the world's second largest economy.

The United States President is directly elected. Since his party does not command a majority in the lower house, he is not able to proceed with an economic agenda of his own. On the other hand, Japan has a parliamentary system with the Prime Minister from the legislature. Since his party and partners now command a majority in both houses of parliament, it is expected he can push through the required measures.

Monetary and fiscal stimuli

Sworn in as Prime Minister of Japan early this year, Mr. Abe took bold steps. Unlike any past prime minister, he patterned his initiatives along the lines of the US Federal Reserve for soaking the economy with massive additions to money supply, and the Keynesian fiscal remedies. Abe's initiatives, ably supported by Bank of Japan have yielded solid results.

Abe has three arrows of economic strategy. Two of which are already used: quantitative easing for targeting 2 percent inflation by 2015 and 4 percent nominal growth; and fiscal deficit spending. The third arrow is set of reforms for stimulating private investment, which will be presented to the parliament.

In the first quarter of 2013, Japan recorded an annualized four per cent growth rate. It is attributed to program of monetary stimulus. Massive increases in money supply and inflationary expectations resulted in depreciation of its currency by 25 percent against the US dollar, boosting growth in exports by more than 7 percent.

Seven PMs in seven years

The past governments, with seven prime ministers in seven years, failed to move the economy. The economic worries of Japan are now more than two decades old, longer than the current recessionary conditions of other advanced economies: the US, UK and the Euro zone, which started only in 2008.

Japan's troubles began in 1989-90, when the "bubble economy" of high property and stock market prices burst. The debts incurred on securing them suddenly became bad debts. Banks stopped lending to companies. Factories shifted overseas and domestic unemployment rose. People curtailed their consumption and prices of goods fell. That only caused further deflationary conditions, with consumers postponing consumption, expecting prices would fall further.

The fiscal stimulus measures by past governments were in the wrong direction. There were needless additions to infrastructure, with large chunks going to Japan's construction companies which were connected with ruling parties. The public debt rose, more than 200 percent of GDP and is expected to reach 240 percent by 2013. The government is borrowing more to finance past debts.

With the latest upper house victory, Prime Minister Abe has to launch his third arrow, the much awaited reforms, when the legislature meets in a month. The focus is on promoting private investment.

Reforms deal with the following: cutting the corporate tax burden; removing sixty year old labour regulations offering lifetime employment in big corporations; liberalising rules for consolidating agricultural land; access to more imports through the Trans Pacific Partnership trade talks; streamlining approval of medical-industry products; resuming nuclear power generation; and addressing funding shortfalls in the social-security system.

Reforms in the Pacific

In any economy, small or big, reforms pose political challenges.

Asian Development Bank (ADB)'s latest Tonga Economic Update notes the government's fiscal position remains at significant risk, given the high level of public debt, the large public sector wage bill, and poorly performing state enterprises. The reforms proposed by ADB are formidable: Aside from improving policy environment for economic growth and private sector development, urgent reforms are suggested for liberalizing trade and foreign direct investment; simplification of tax system and broadening the tax base; and revamping and even closure of poorly performing public enterprises.