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Foreign Direct Investment and Employment Creation in Pacific Island Countries: An empirical study of Fiji

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Executive Summary

Among the 14 Pacific island countries (PICs), Fiji, with its relatively better endowments in land and human resources as well as physical infrastructure, has been one of the ten favourite destinations of foreign direct investment (FDI) in Asia-Pacific. Past studies confirm that FDI contributed to economic growth of Fiji. Firstly, it added to domestic savings and reduced the resource gaps and cushioned them against possible adverse effects of current account deficits. Secondly, it enabled Fiji to step up its export-related activities by specifically focusing on resource development, employment creation and skills development. Soon after the two military coups of 1987, Fiji, which was isolated by bilateral donors in the region, was forced to explore and develop new areas of growth such as the export oriented garment industry with FDI from East Asia. The gains from FDI include not only creation of employment in those sectors, which attracted overseas investors, but also of additional employment opportunities in ancillary sectors, which are supportive to all production oriented activities in the economy.

This paper undertakes an econometric study of the impact of FDI in Fiji during a 30-year period. In the absence of data on Fiji's employment in FDI sectors either in aggregated form or by specific sectors, we are constrained to use data on formal sector employment as a proxy. This implies that employment in both formal and FDI related activities move in the same direction and proportion. The paper investigated the relationship between employment and foreign direct investment for Fiji through a multivariate modeling strategy by including GDP. We found unidirectional long run causality running from foreign direct investment to employment and a unidirectional causality running from foreign direct investment to GDP in the short-run.

The policy implications of the study are that Fiji should continue not only its current proactive policies to attract FDI inflows but also maintain appropriate environment including political stability for retaining the inflows. Past negative net inflows in the immediate years after the two coups of 1987 and in 2000 were clearly due to poor domestic investor confidence. Further, with a view to improve the employment database especially in regard to FDI related activities, we suggest that the Fiji Trade and Investment Bureau (FTIB), which is the screening and appraising authority, should stipulate while approving the FDI proposal that overseas investors should file returns on employment in their ventures in regard to employment by categories of skilled and unskilled; by levels such as plant, supervisory and managerial; by local and foreigners; and by gender. Further, FTIB should be entrusted with the responsibility for collecting the data. Enabling legislative amendments should be introduced in the FTIB Act towards these purposes. Improved data collection will go a long way to assess the impact of FDI.

Introduction

A large body of empirical literature on foreign direct investment (FDI) in developing countries in various regions, including the Asia-Pacific region has shown that FDI's social and distributional impact on the host country has been generally favourable (Hill and Athukorala 1998, Sun 1998, Sun 1996, Jansen 1995, Athukorala and Menon,1995, Schive 1990). Aside from bringing in a package of highly productive resources into the host economy, which include production know-how and process technology, managerial skills, improvements in accounting and auditing standards and information on international markets, there have been noticeable creation of jobs not only in those sectors attracting FDI inflows but also in the supportive domestic industries.

A recent study by Asian Development Bank (2004) emphasizes the need for appropriate policies for regional development, besides the importance of flexibility in labour markets, for exploiting the forward and backward linkages provided by FDI. Such policies have been found to ensure the spatial distribution of benefits in terms of additional job creation in hinterland. Malaysia and Thailand, which attracted FDI inflows into their export-oriented, labour intensive and natural resource based industries including palm and rubber plantations enjoyed periods of nation-wide prosperity triggered by frequent booms in world commodity prices (Hill and Athukorala 1998), in the process conferring benefits on the hinterlands as a consequence of balanced regional development policies.

Our paper focuses on the Pacific island countries (PICs)[1]. The objective of this paper is to undertake an empirical study on creation of employment opportunities by FDI in Fiji. The choice of Fiji, as case study, is dictated mainly by data constraints relating to availability of reliable time series of a longer period compared to other PICs. In the context of regional integration envisaged under the Pacific Plan[2], which was endorsed in 2005 by the regional organisation known as Pacific Islands Forum[3], FDI inflows have assumed great importance for future economic growth in the region. A single market economy (SME) of about 7.5 million population brought about by an economic union of

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[1] The 14 Pacific island countries are: Cook Islands, Fiji, Kiribati, Republic of Marshall Islands, Federated States of Micronesia, Nauru, Niue, Palau, Papua New Guinea (PNG), Samoa, Solomon Islands, Tonga, Tuvalu, Vanuatu.

[2] The Pacific Plan, endorsed by the 14 PIC leaders in October 2005 is based upon four pillars of (i) economic growth; (ii) sustainable development; (ii) good governance and (iv) security. One of the major initiatives undertaken by PICs was the signing of the Pacific Island Countries Trade Agreement (PICTA) signed in 2002 with the objective of ushering in a free trade area by 2010 (Jayaraman 2005).

[3] The Pacific Islands Forum comprises 14 Pacific island countries, namely Cook Islands, Fiji, Kiribati, Republic of Marshall Islands, Federated States of Micronesia, Nauru, Niue, Papua New Guinea, Samoa, Solomon Islands, Tonga, Tuvalu, Vanuatu and the region's two developed countries, namely Australia and New Zealand. Australia, the biggest aid giver to the PICs, bears nearly 80 percent of the operating costs of the Forum as well.

PICs, is expected to offer much greater incentives for overseas investors than at present. An SME is more likely to attract FDI inflows for investment in consumer goods industries for exports to the regional market since such a large economic space assures the investors of unhindered trade in their products between all PICs.The paper is organised on the following lines: in section 2, trends in FDI and employment in Fiji are reviewed; section 3 deals with the data and methodology adopted for the empirical study, while section 4 presents the results of the study; and the final section 6 lists some conclusions with policy implications.

Trends in FDI and Employment in Fiji

Among PICs, Fiji, Solomon Islands and Vanuatu have been attractive countries for FDI for past two decades. All the three PICs were among the top 10 destinations for FDI in developing Asia-Pacific region (Table 1). The PICs have become increasingly appreciative of the fact that in the light of declining external aid, it would be prudent to place greater emphasis on FDI inflows, which have been acknowledged to be the most constructive of all capital inflows for the emerging markets. FDI inflows as non-debt creating flows, not only supplement domestic savings, but also contribute to fostering domestic managerial skills and transfer of technology (Jayaraman 1998). In terms of contribution to gross capital formation, FDI's share has been substantial (Table 2). Further, they are less volatile and less prone to sudden withdrawal due to shift in sentiment (Jayaraman and Choong 2006).

Table 1: Top 10 Destinations for FDI in Developing Asia: 1991-1993 and 1998-2000 (Average Inflows per capita in US$)

1991-1993			1998-2000		
Rank	**Country**	**US$**	**Rank**	**Country**	**US$**
1	Singapore	1,234	1	Hong Kong	5,006
2	Hong Kong	667	2	Singapore	2,826
3	Malaysia	264	3	Korea	172
4	Vanuatu	164	4	Malaysia	154
5	Fiji Islands	104	5	Taipei, China	121
6	Solomon Islands	51	6	Vanuatu	94
7	Taipei China	49	7	Thailand	94
8	Kazakhstan	42	8	Kazakhstan	87
9	Thailand	36	9	Azerbaijan	71
10	Maldives	29	10	Fiji Islands	63

Source: Asian Development Bank (2006

Table 2: FDI as % of Gross Capital Formation in Top 10 FDI Destinations in Asia-Pacific Region

1991-1993			1998-2000		
Rank	**Country**	**%**	**Rank**	**Country**	**%**
1	Vanuatu	53.1	1	Hong Kong	75.7
2	Fiji Islands	38.7	2	Cambodia	45.3
3	Vietnam	32	3	Kazakhstan	42.7
4	Solomon Islands	26.5	4	Singapore	39.3
5	Singapore	23.1	5	Azerbaijan	38.9
6	Malaysia	22.8	6	PNG	36.5
7	Cambodia	17.9	7	Vanuatu	28.2
8	Kyrgyz Republic	15.2	8	Kyrgyz Rep.	24.4
9	Hong Kong	13.2	9	Thailand	22.1
10	PNG	12.1	10	Vietnam	19.7

Source: Asian Development Bank (2006)

Past trends

The term FDI would normally refer to substantial equity stake and effective control of enterprises. However, in the context of growing services sector in developing countries, a broader definition seems to have been emerging. This now refers to non-equity participation by foreigners by way of licensing, franchising, joint ventures with limited equity participation and R&D cooperation (de Mello 1997). Historical ties with the United Kingdom, Australia and New Zealand have largely influenced FDI flows to PICs in some specific areas.

Most of the FDI inflows to PICs in the past were primarily of the natural resource exploiting type: the former Australian–owned Colonial Sugar Refinery (CSR), a plantation venture in the 19th century becoming a successful export oriented investment and resort hotels; palm oil and cocoa plantations in the Solomon islands in the 1960s owned by British interests, and tuna fisheries and canning by Japanese investors in the 1980s and the cattle ranches on Santo island of Vanuatu, supplying beef exports to Japan and Europe. These natural resource based FDI inflows were later on followed in the 1980s by FDI in export-oriented, labour intensive garments and other industries due to deliberate policies (Jayaraman and Choong 2005, Gani 1999). Aside from agriculture-based industries, the sun-sea-surf linked tourism activities induced in recent years substantial FDI inflows from well- known international resort-hotel chains.

The third type of investment, known as market seeking, was mainly limited to retail trade, as the populations of PICs were small. These included retailers including Burns Philp and Carpenters of Australia, which set up supermarket chains. In the early 1990s, Japanese investors showed interest in setting up export-oriented type of investments in light industries. The Yazaki automobile wiring harness plant in Samoa is a leading example, which exported its products to car assembling plants in Japan and Australia. The newly industrialised countries such as Korea, Malaysia and Singapore also entered the scene. Their interests were confined to the services sector.

Table 3 provides FDI flows to Fiji in US million dollars during the recent period (1985-2002) as well as in percent of GNP. The stock of FDI in 2002 is reported to be US$1,211 million, which is around 66% of GNP (United Nations Conference Trade and Development 2006). The FDI flows were highly susceptible to political conditions as evidenced by their decline soon after the 1987 and 2000 coups.

Table 3: FDI Inflows to Fiji : 1985-2002
(U$ Million and % of GNP)

Year	Net FDI Flows (US$ Million)	Net FDI Flows (% of GNP)	Year	Net FDI Flows (US$ Million)	Net FDI Flows (% of GNP)
1985	21.8	2.0	1994	67.5	3.8
1986	8.0	0.6	1995	69.5	3.7
1987	-10.8	-1.0	1996	2.4	0.1
1988	23.5	2.2	1997	15.6	0.8
1989	13.1	1.0	1998	107.0	7.0
1990	92.0	6.8	1999	-33.2	-1.9
1991	5.2	0.4	2000	-69.3	-3.0
1992	103.6	6.6	2001	95.3	2.4
1993	91.2	5.7	2002	51.5	1.5

Source: World Bank (2006a)

Available studies show that FDI has contributed to economic growth of Fiji (Gani 1999, Jayaraman and Choong 2006). First and foremost, it has added to domestic savings in all countries and reduced the resource gaps and cushioned them against possible adverse effects of current account deficits (Jayaraman 1998). Secondly, it enabled PICs to step up its export-related activities by specifically focusing on resource development, employment creation and skills development (Parry 1988). With additional incentives soon after the two military coups of 1987, which led to a temporary period of political and economic isolation resulting in the suspension of bilateral support from the metropolitan governments in the region, Fiji was able to explore and develop new areas of growth such as the export oriented garment industry with FDI from East Asia (Eleck *et al.* 1993).

Trends in employment

On the basis of definition relating to reference population (15 years and older), Fiji's labour force is estimated at 332,000 in 2005, which is about 39 percent of total population of 848, 000 (Asian Development Bank 2005, International Labour Organisation 2003). The labour force is expected to rise to 368,000 in 2015, and 395,000 in 2030. About 41,000 were reported to be unemployed, which constitutes 12 percent of the labour force.

Table 4: Selected South Pacific Islands: Labor Force Estimates

Country	2003 ('000)	2015 ('000)	2030 ('000)
Fiji Islands	332	368	395
Papua and New Guinea	2,641	3,476	4,562
Solomon Islands	237	318	448
Tonga	36	40	39

Source: Asian Development Bank (2004), International Labor Organization (2003)

Table 5: Selected South Pacific Islands: Estimates of Unemployment in 2003

Country	Unemployment Rate (%)	Unemployed ('000) (%)
Fiji Islands	12.1	41
Kiribati	2	1
Republic of Marshall Islands	30	5
Federate States of Micronesia	2.6	1
Palau	2.3	224

Source: Asian Development Bank (2005)

Rapid rise in employment was recorded after 1989, when the interim government soon after the military coups took steps to deregulate the economy and introduced far-reaching liberalisation measures. In the years between 1989 and 1995, on average, the increase in employment was about 3.77 percent. Such huge increase in the employment was attributed to export promotion policies implemented by the government. Since 1989 the textile, clothing and footwear (TFC) industry, which was mainly geared to supplying garments to export markets, contributed to increases in the formal sector employment. In 1989, a 133 percent increase in the employment was experienced in TCF industry, which emerged as a major contributor to the Fiji economy, besides sugar and tourism. Fiji's TCF industry rapid development over the 1990's has been due to several favourable factors. The latter include preferential treatment for entry to various markets, the country's relatively low labour cost, offer of an attractive package of fiscal incentives and the gradual contraction of the industry in neighboring countries namely, Australia and