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Report No: PGD336

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT AND

INTERNATIONAL DEVELOPMENT ASSOCIATION

PROGRAM DOCUMENT FOR

A PROPOSED DEVELOPMENT POLICY LOAN AND
A PROPOSED DEVELOPMENT POLICY CREDIT
COMPRISING

AN IBRD LOAN IN THE AMOUNT OF US$50 MILLION AND
A DEVELOPMENT POLICY CREDIT IN THE AMOUNT OF SDR37.2 MILLION (US$50 MILLION EQUIVALENT)
TO

THE REPUBLIC OF FIJI

FOR THE

FIJI RECOVERY AND RESILIENCE SECOND DEVELOPMENT POLICY OPERATION

June 3, 2022

Macroeconomics, Trade And Investment Global Practice
Urban, Resilience and Land Global Practice
Finance, Competitiveness and Innovation
East Asia and Pacific Region

Republic of Fiji

GOVERNMENT FISCAL YEAR

August 1 – July 31

CURRENCY EQUIVALENTS

(Exchange Rate Effective as of April 30, 2022)

Currency Unit

SDR1 = US$1.3443

ABBREVIATIONS AND ACRONYMS

ABP	Annual Borrowing Plan
ADB	Asian Development Bank
A/NZS	Australian/New Zealand Standard
ACH	Automated Clearance House
ATM	Average Term of Maturity
CCA	Climate Change Act 2021
CFC	Care Fiji Commitment
CNY	Chinese Yuan Renminbi
CVA	Climate Vulnerability Assessment
CPF	Country Partnership Framework
CPSD	Country Private Sector Diagnostic
DPO	Development Policy Operation
DRCF	Disaster Rehabilitation and Containment Facility
EFL	Energy Fiji Limited
ECAL	Environment and Climate Adaptation Levy
EOIs	Expressions of Interest
ERPA	Emission Reduction Payment Agreement
FA	Fiji Airways
FCPF	Forest Carbon Partnership Facility
FDB	Fiji Development Bank
FJ$	Fijian Dollar
FMHS	Fiji Meteorological and Hydrological Service
FMS	Fiji Meteorological Service
FNPF	Fiji National Provident Fund
FSCL	Fiji Sugar Corporation Limited
FY	Fiscal year
FDI	Foreign Direct Investment
FIRC	Foreign Investor Registration Certificate
GHG	Green House Gas
GRS	Grievance Redress Service
GDP	Gross Domestic Product
GFNs	Gross Financing Needs
ISEFF	Import Substitution and Export Finance Facility
IBRD	International Bank for Reconstruction and Development
IDA	International Development Association
IFC	International Finance Corporation
IMF	International Monetary Fund
J-NR	National Jobs for Nature Rehabilitation Policy 2022-2032
LMO	Liability Management Operations
MPAs	Marine Protected Areas
MAC	Market Access Countries
MTDS	Medium Term Debt Strategy
MTFS	Medium Term Fiscal Strategy
MSMEs	Micro, Small and Medium-sized Enterprises
MCTTT	Ministry of Commerce, Trade, Tourism and Transport
MOE	Ministry of Economy
NAP	National Adaptation Plan
NBSAP	National Biodiversity Action Plan 2020-2025
NCCP	National Climate Change Policy 2018-2030
NDC	Nationally Determined Contributions
NDP 2017	5- and 20-Year National Development Plan 2017
NOP	National Ocean Policy 2020-2030
NPLs	Non-Performing Loans
PER	Public Expenditure Review
PFTAC	Pacific Financial Technical Assistance Center
PPAs	Performance and Policy Actions
PEFA	Public Expenditure and Financial Accountability
PFM	Public Financial Management
PPP	Public Private Partnership
Q	Quarter
RTGS	Real Time Gross Settlement System
RBF	Reserve Bank of Fiji
SDR	Special Drawing Rights
SOEs	State Owned Enterprises
SDFP	Sustainable Development Finance Policy
SCD	Systematic Country Diagnostic
TA	Technical Assistance
TC	Tropical Cyclone
UA	Unemployment Assistance
UNFCCC	United Nations Framework Convention on Climate Change
US$	United States Dollar
VAT	Value added tax
WB	World Bank
WBG	World Bank Group
WHO	World Health Organization
WMO	World Meteorological Organization

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REPUBLIC OF FIJI
FIJI RECOVERY AND RESILIENCE SECOND DEVELOPMENT POLICY OPERATION

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SUMMARY OF PROPOSED FINANCING AND PROGRAM

BASIC INFORMATION

Project ID	Programmatic	If programmatic, position in series
P175543	Yes	2nd in a series of 2

Proposed Development Objective(s)

The development objective is to: i) promote private sector-led economic recovery; ii) enhance climate, disaster and social resilience; and iii) strengthen debt, public financial and fiscal management.

Organizations

Borrower:	REPUBLIC OF FIJI
Implementing Agency:	Ministry of Economy

PROJECT FINANCING DATA (US$, Millions)

SUMMARY

Total Financing	**100.00**

DETAILS

International Bank for Reconstruction and Development (IBRD)	50.00
International Development Association (IDA)	50.00
IDA Credit	50.00

INSTITUTIONAL DATA

Climate Change and Disaster Screening

This operation has been screened for short and long-term climate change and disaster risks

Overall Risk Rating

Substantial

Results

Results Indicator Name	Baseline	Current Value	Target
1: The annual volume of payments made electronically through the Real-Time Gross Settlement System	148,786 (FY2019)	158,105 (FY2022)	185,930 (FY2024)
2: Number of outstanding corporate bond issuances	0 (FY2019)	0 (FY2022)	2 (FY2024)
3: Volume of foreign investment commitments	US$24.3 million (median 2015 to 2019)	0 (2022)	US$27.9 million (FY2024)
4: (i) Percentage of area within the national jurisdiction legally designated as Marine Protected Areas that contribute to climate resilience; and (ii) establishment of the Adaptation Registry	(i) 1 (ii) None (FY2021)	(i) 1 (ii) None (FY2022)	(i) 5 (ii) Established and made publicly available (FY2024)
5: Share of 150 grant funded activities implemented by women community groups	0 (FY2021)	30 (FY2022)	35 (FY2023)
6: Percentage of import permits for steel reinforcement material being manufactured in accordance with the revised standard, or suitable equivalent standard, provided to the Border Control Agency	0 (FY2019)	0 (no applications received due to border closures) (FY2021)	100 (FY2024)
7: Implementation plan for developing and piloting/testing impact-based multi-hazard early warning	None (FY2022)	None (FY2022)	Completed (FY2024)
8: Share of social assistance programs that include gender-sensitive and disaster responsiveness criteria for determining assistance	0 (FY2021)	0 (FY2022)	50 (FY2024)
9: (i) external (FX) debt as percent of total public debt; and (ii) the number of instruments	(i) 26 percent (ii) 396 (FY2020)	(i) 36 percent (ii) 396 (FY2021)	(i) 30 percent (+/-5%) (ii) 320 (FY2024)
10: Number of programs across budget agencies performing gender impact assessments and collecting sex-disaggregated data for monitoring and evaluation	None (FY2020)	15 (FY2021)	35 out of 200 (FY2024)
11: The value added tax as percent of GDP	4.6 percent (FY2021)	6.4 percent (FY2022)	7.1 percent (FY2024)
12: The annual revenue impact of the film rebate reduction	0 (FY2020)	0 (FY2021)	0.4 percent of GDP (FY2024)

IBRD and IDA PROGRAM DOCUMENT FOR A PROPOSED LOAN AND CREDIT TO THE REPUBLIC OF FIJI

1. INTRODUCTION AND COUNTRY CONTEXT

1. **The proposed operation aims to support the Republic of Fiji (Fiji or Recipient or Borrower) in its efforts towards sustainable and resilient recovery.** This is the second in a series of two development policy operations that will provide US$50 million equivalent from IDA and US$50 million from IBRD. The Program Development Objective and pillars of the proposed operation are to: (i) promote private sector-led economic recovery; (ii) enhance climate, disaster, and social resilience; and (iii) strengthen debt, public financial and fiscal management.

2. **Fiji experienced an economic crisis of unprecedented scale in 2020 and 2021 due to the COVID-19 pandemic and climate-related events**. Real GDP contracted by 15.2 percent in 2020 and a further 4.1 percent in 2021 in the wake of the outbreak of the Delta variant. The country was also hit by recurrent Tropical Cyclones (TCs) Harold (2020), Yasa (2020), Ana (2021) and Cody (2022). The shocks upended the authorities' fiscal policy goals and sent public debt to an all-time high of about 88 percent of GDP at end-FY22 from 49 percent before the pandemic.

3. **The reopening of Fiji's borders to tourism in December 2021 signaled a major step for economic recovery.** A COVID-19 vaccination rate of over 95 percent of the adult population and the adoption of World Health Organization (WHO) best-practice standards and protocols for COVID-19 control enabled border reopening. Tourists and visitors have begun to return from traditional source markets, especially Australia. The initial tourist arrival figures are encouraging, but full recovery is likely to be slow. COVID-related risks remain including the emergence of potential new variants. The recovery will also depend upon the implementation of the Government's reform program to improve the efficiency and inclusiveness of the business environment and financial sector. The economy's high dependence on tourism adds to the vulnerability of sustained recovery and highlights the need for diversified sources of growth.[1]

4. **The war in Ukraine is expected to increase Fiji's financing needs, and heighten inflationary pressures, weighing on domestic consumption and business activity.** Russia and Ukraine are not key trading partners or primary tourism markets of Fiji. However, Fiji is a net importer of fuel, food and fertilizer, which make up around 40 percent of imports. The war in will exacerbate already elevated global commodity prices with adverse impact on consumers, disproportionately hurting poor households. Global supply chain disruptions may further intensify inflationary pressures and slow down growth. Combining the revenue and expenditure impact, the war in Ukraine is expected to increase Fiji's financing needs by US$18 million in FY22 and US$32 million in FY23 and will increase considering the effect of the supply chain disruptions.

5. **Fiji is highly vulnerable to extreme weather events, which are increasing in frequency and intensity due to climate change**. Fiji's geographical location, large coastal area - where the population and major assets are located - make it vulnerable to climate change. Due to climate change, extreme weather events - including tropical cyclones, floods and heavy rainfall - are likely to become more intense and frequent.[2] Sea level rise and storm surge will further affect many sectors, people's livelihoods, food and water supply. The Global Adaptation Index (ND-GAIN) ranks Fiji as the 88th most vulnerable country in the world, but also stresses that it has good capacity to adapt. Fiji's Climate

[1] WBG Country Private Sector Diagnostic (CPSD).

[2] IPCC 2021. Sixth Assessment Report of the Working Group 1, Summary for Policy Makers; The World Bank Group and Asian Development Bank 2020 - Climate Risk Profile: The Pacific Region. World Bank. 2017. Climate change and disaster management. Pacific Possible: Background Paper 6.

Vulnerability Assessment (CVA)[3] concluded that climate change will amplify the current risks to highly vulnerable sectors such as transport, water, fisheries, and the environment. It estimated the losses in these sectors could range from around 5 percent to 20 percent of annual GDP. This is evidenced by the impacts of recent cyclones and floods, with estimated damages and losses ranging from 20 percent (TC Winston in 2016) to 3.3 percent (TC Harold in 2020) of annual GDP. The CVA also found that by 2050, an additional 3.8 percent of the population is likely to fall into poverty because of climate change, and investments in these vulnerable sectors and social protection programs would help reduce these impacts.

6. **The reopening of the border offers opportunities for improved employment and income generation.** Historically, Fiji has had one of the lowest rates of extreme poverty in the Pacific, with less than 3 percent of the population living under the US$1.90 per person per day poverty line in 2019. Half the population lives below the US$5.50 per person per day line. The well-being of Fijians was severely impacted by the COVID-19 pandemic as major hits to the economy over the last two years (border closures and domestic lockdowns) led to widespread losses of employment and incomes. The recent reopening of borders should help the economic recovery of the poor and the vulnerable as employment opportunities start to re-emerge.

7. **This programmatic Development Policy Operation (DPO) series supports the Government's efforts to address short- and long-term challenges to sustainable and resilient recovery**. Pillar 1 aims to create an improved environment for private sector development and promote private sector-led economic recovery through reforms to the legal and regulatory frameworks for financial markets infrastructure and private investment. Pillar 2 aims to enhance climate, disaster and social resilience through reforms that support strengthening of institutions, rehabilitation of degraded ecosystems and strengthening of early warning systems. Pillar 3 supports measures to strengthen debt, public financial, and fiscal management through reforms enhancing debt transparency, increasing revenue mobilization, and reducing tax expenditures.

8. **This operation aligns closely with the World Bank Group (WBG) COVID-19 Crisis Response Approach Paper and the Green, Resilient and Inclusive Development (GRID) approach**. Three of the four pillars of the WBG Approach Paper are addressed by one or more reform measures supported by this proposed operation: (i) the social response - protecting the poor and vulnerable; (ii) the economic response – supporting businesses; and (iii) the climate and disaster response - strengthening of policies and institutions. The operation also has a strong focus on debt management and overall fiscal sustainability aligned with the approach paper. The proposed reforms align with the three dimensions of the GRID[4] through Pillars 2 (green, resilient) and 3 (inclusive) development.

9. **The macroeconomic policy framework is adequate for the purposes of this development policy operation.** Growth is projected to recover 6.3 percent in 2022 and rise to 7.7 percent by 2023 driven by a recovery in private consumption and investment supported by positive turnaround in tourism activity as COVID-19 restrictions ease and borders reopen. Monetary policy has been appropriately accommodative with manageable inflation and substantial foreign exchange reserves. The exchange rate peg is expected to continue to provide a credible nominal anchor. The Government is committed to fiscal consolidation with the fiscal deficit projected to fall to 6.4 percent of GDP in 2023, after a peak of 12.8 percent in 2021. This will be achieved through efforts to enhance domestic revenues and contain spending. Public debt is sustainable and expected to peak in 2022 at 89.3 percent of GDP and decline thereafter, supported by fiscal consolidation, the resumption of economic growth and prudent debt management policies. The fiscal consolidation will be achieved through efforts to mobilize domestic revenues and to contain spending through

[3] CVA is available from: www.gfdrr.org/en/publication/fiji-climate-vulnerability-assessment-summary.
[4] World Bank (2021). Green, Resilient, and Inclusive Development (GRID).

strict wage bill control and a reduction in operating subsidies and capital outlays.

2. MACROECONOMIC POLICY FRAMEWORK

2.1. RECENT ECONOMIC DEVELOPMENTS

10. **Fiji recorded one of the steepest contractions in the world and the worst in its history in 2020 due to COVID-19 and cyclones.** With the onset of the pandemic and border closures in 2020, Fiji's tourism sector, representing nearly 40 percent of GDP, collapsed. As a result, real GDP contracted by 15.2 percent in 2020 and is estimated to have contracted a further 4.1 percent in 2021 in the wake of the Delta variant outbreak. Extensive damage to agriculture, public buildings and tourism facilities from TC Harold and TC Yasa in 2020, and TC Ana in 2021 resulted in further deterioration in economic activity (see Table 1). A strong government response and support from multilateral and bilateral support has been critical to Fiji's ability to weather the worst of the crisis. This included the acceleration of the vaccination program underpinning Fiji's reopening to tourism, on which the economy depends.

Table 1: Demand and Supply Contributions to GDP Growth

	2018	2019	2020	2021 Est.	2022 Proj.	2023 Proj.	2024 Proj.	2025 Proj.
Real GDP Growth	**3.8**	**-0.4**	**-15.2**	**-4.1**	**6.3**	**7.7**	**4.7**	**4.5**
Demand Side								
Private Consumption	2.5	-0.3	-11.5	-3.4	4.6	5.3	3.2	3.1
Government Consumption	0.8	-0.1	-3.7	-0.9	1.3	1.7	1.0	1.0
Capital Formation	0.8	-0.1	-2.9	-0.7	1.0	1.3	0.8	0.8
External balance of goods and services	-0.3	0.1	2.9	1.0	-0.7	-0.6	-0.3	-0.3
Supply Side								
Agriculture	0.4	0.0	-1.5	-0.5	0.7	0.9	0.5	0.5
Industry	0.8	-0.1	-3.2	-0.9	1.5	1.8	1.1	1.0
Services	2.6	-0.3	-10.4	-2.7	4.1	5.1	3.1	3.0

Sources: Ministry of Economy and World Bank staff calculations.

11. **The current account deficit widened to 15.6 percent of GDP in 2021 from 13.2 percent of GDP in 2020, driven by a sharp drop in the service balance**. With the onset of the pandemic, tourism receipts dropped by around 94 percent in 2021 from pre-pandemic levels. The trade gap narrowed by 11 percent of GDP from 2019 to 2020 due to increased agricultural exports and lower imports, with a contraction in import of fuel and capital goods offsetting the rise in imports of health-related equipment to combat COVID-19. Pressure on the balance of payments has been cushioned by the influx of external financing (loans and grants from multilateral and bilateral creditors), steady growth in remittances, the sale of 44 percent of Energy Fiji Limited (EFL) for FJ$441 million (4.5 percent of GDP), and the additional 2021 IMF SDR allocation (see Table 2).

12. **The shocks upended the fiscal policy objectives, with resulting fiscal deficits and contracting GDP driving up public debt ratios**. Prior to the shocks, the tax to GDP ratio averaged 24 percent—higher than many of Fiji's peers and higher than the average for East Asia and the Pacific. The Government had been implementing an expenditure-

based fiscal consolidation, which included stabilizing capital spending at pre-TC Winston levels, tightening control over current spending, and charting a downward trajectory for public debt. The prolonged COVID-19 and multiple TC shocks have reversed these trends. A steep fall in revenue combined with fiscal stimulus to mitigate the impact of the pandemic pushed up the fiscal deficit to 5.9 percent of GDP in FY20 and 10.8 percent in FY21. As a result, the public debt-to-GDP ratio increased to 79.0 percent in FY21, from 48.7 percent in FY19 (see Table 3). Cumulative debt-creating flows in 2020 and 2021 have mainly been the outcome of an increased primary deficit (20.9 percent of GDP) and declining GDP (12.3 percent of GDP).

Table 2: Key Macroeconomic Indicators

	2018	2019	2020	2021 Est.	2022 Proj.	2023 Proj.	2024 Proj.	2025 Proj.
Real Economy	Annual percentage change, unless otherwise indicated							
GDP (nominal FJ$, mn)	11,651	11,874	9,921	9,508	10,355	11,472	12,377	13,068
Real GDP Growth	3.8	-0.4	-15.2	-4.1	6.3	7.7	4.7	4.5
Per Capita GDP (in current US$)	6,317	6,176	5,103	5,163	5,586	6,146	6,587	6,907
GDP deflator	1.5	2.6	-3.6	1.3	2.7	3.9	5.2	3.2
Consumer price inflation, period average	4.1	1.8	-2.8	3.0	5.0	3.0	2.7	2.7
Fiscal Accounts	Percent of GDP							
Revenues	27.6	25.2	25.0	23.0	22.6	23.8	25.4	25.4
Expenditures	31.6	29.5	33.1	35.8	34.7	30.2	29.4	28.5
General Government Balance	-4.0	-4.3	-8.1	-12.8	-12.1	-6.4	-4.0	-3.1
Government debt	46.6	51.6	71.5	85.4	89.3	86.3	83.8	82.6
Domestic	34.1	38.5	51.3	56.6	55.0	53.6	51.6	51.0
External	12.5	13.2	20.2	28.8	34.3	32.7	32.2	31.6
Balance of Payments	Percent of GDP, unless otherwise indicated							
Current Account Balance	-8.4	-12.6	-13.2	-15.6	-8.8	-7.0	-6.8	-7.4
Trade Balance	-24.2	-25.2	-14.4	-14.7	-18.6	-20.0	-21.4	-21.6
Goods Imports	42.4	44.0	32.3	34.6	37.6	38.0	39.1	38.9
Goods Exports	18.2	18.8	17.9	19.8	19.0	18.0	17.7	17.3
Services (net)	16.6	14.9	-1.7	-5.8	7.8	13.5	15.6	15.9
Primary Income (net)	-6.4	-8.2	-6.1	-5.0	-7.0	-7.5	-8.1	-8.2
Transfers (net)	5.6	5.9	9.0	10.0	9.0	7.0	7.1	6.5
Foreign Direct Investment (net)	-8.5	-6.5	-5.0	-7.5	-5.4	-5.9	-7.2	-7.2
Foreign Reserves (in US$, mn)	964	1,027	1,011	1,570	1,536	1,501	1,559	1,551
In months of retained imports	4.1	7.3	7.7	9.9	8.5	7.7	7.3	7.1
Selected Monetary Accounts	Annual percentage change, unless otherwise indicated							
Base Money	-9.9	15.2	13.5	28.6	5.6			
Credit to private sector	7.3	4.6	-3.1	-0.4	-3.2			
Interest (key policy rate, %)	0.50	0.50	0.25	0.25	0.25			
Other memo items								
Nominal GDP (US$, mn)	5,581	5,496	4,574	4,662	5,077	5,625	6,069	6,408
Exchange rate (FJ$/USD, period average)	2.09	2.16	2.17	2.04	2.04	2.04	2.04	2.04
Remittances (% of GDP)	4.8	4.9	6.6	7.1	6.5	5.8	5.3	5.2

Sources: Ministry of Economy, and IMF and World Bank staff estimates.

13. **Domestic resource mobilization was severely affected by the steep decline in economic activity and COVID-19 tax relief measures**. Tax revenues fell from 24.0 percent of GDP in FY19 to 14.6 percent in FY21. This was partly

driven by subdued economic activity from the collapse of the tourism sector as GDP contracted by nearly 20 percent over this period. Substantial temporary fiscal relief measures in FY20 and FY21 included: (i) tax rate reductions and exemptions (including VAT and customs tariff exemptions for medical supplies, duty and excise reductions for motor vehicles and electronic appliances, and a reduction of the airport departure tax); (ii) tax base changes (including accelerated depreciation for new constructions approvals obtained in 2020 and increased deductions on wages under the employment taxation scheme); (iii) the elimination of the service turnover tax; (iv) increased tax expenditures (including incentives for tourism and export investment); and (v) administrative measures (including relaxed requirements for tax return filing and payments). The temporary COVID-19 tax measures are estimated to have contributed to slightly over half of the fall in tax revenue, with the other part stemming from the negative economic impact. Grants from development partners and divestment of 44 percent of the Government's share of EFL, equivalent to 4.5 percent of GDP cushioned part of the steep fall in tax revenues, but total revenue still fell from 27.0 percent of GDP to 22.1 percent of GDP between FY19 and FY21.

Table 3: Key Fiscal Indicators

	FY18	FY19	FY20	FY21	FY22 Proj.	FY23 Proj.	FY24 Proj.	FY25 Proj.
Fiscal Accounts			Percent of GDP					
Total Revenues	28.5	27.0	25.1	22.1	22.5	22.4	25.0	25.9
Tax revenues	24.9	24.0	20.3	14.6	17.1	18.2	21.3	22.5
Non-tax revenues	3.6	3.1	4.8	7.5	5.4	4.2	3.7	3.5
Total Expenditure	32.9	30.6	31.0	32.9	37.1	31.2	29.7	29.4
Current expenditures	20.4	20.6	21.6	22.6	24.0	21.4	20.3	19.9
Personnel	8.4	8.6	9.1	9.6	9.8	8.6	7.7	7.4
Goods & services	2.3	2.4	2.6	2.6	2.7	2.3	2.0	2.0
Current Transfers	6.3	6.1	6.1	6.0	6.4	5.6	5.8	5.7
Interest	2.5	2.7	3.2	3.7	3.7	3.9	3.8	3.8
Other	0.8	0.8	0.6	0.6	1.4	1.0	1.0	1.0
Capital expenditures	12.1	9.6	9.1	10.0	12.7	9.4	9.1	9.2
Government VAT (SEG 13 VAT)	0.3	0.3	0.3	0.3	0.5	0.4	0.4	0.3
Net Deficit	-4.4	-3.6	-5.9	-10.8	-14.6	-8.8	-4.8	-3.5
Government Debt	45.9	48.7	61.8	79.0	87.8	87.5	84.8	83.1
Domestic	33.1	36.3	46.0	54.1	56.0	51.4	49.4	48.2
External	12.8	12.4	15.8	25.0	31.7	36.2	35.4	34.8
Sectoral Spending			Percent of total spending					
General administration	19.4	20.1	19.9	19.1	18.7			
Social services	26.8	30.5	31.5	29.8	28.4			
Economic	9.1	8.8	9.5	7.5	7.8			
Infrastructure	20.8	20.9	14.9	15.4	15.3			
Miscellaneous	22.9	18.5	23.2	27.0	28.5			
Government VAT (SEG 13 VAT)	1.0	1.1	0.9	1.2	1.3			

Sources: Ministry of Economy, and IMF and World Bank staff estimates.

14. **Nominal expenditure declined in FY20 and FY21, but public spending-to-GDP increased due to the economic contraction.** The authorities implemented nominal expenditure cuts equivalent to 2.1 percent of 2019 GDP in FY20 and a further 1.4 percent of 2019 GDP in FY21 underscoring their commitment to fiscal consolidation. Nominal expenditures in FY21 were 11 percent below the FY19 levels, including a 9 percent cut in personnel spending, a 20

percent reduction in recurrent transfers, and 14 percent reduction in capital outlays. The cuts were implemented through scaling back spending and suspending activities in non-priority areas, including on the wage bill (e.g., overtime, allowances), travel and communication, and targeted cuts to large expenditure programs in infrastructure and for tertiary education. Non-discretionary expenditure requirements, including for the wage bill; contractual obligations for goods, services, and capital projects; and interest payments, also limited the scope for further expenditure cuts in the short term. Despite these nominal expenditure cuts, the substantial fall in GDP led to an increase in expenditure relative to GDP from 30.6 percent in FY19 to 32.9 percent of GDP in FY21 (see Table 3).

15. **The authorities achieved expenditure cuts while providing stimulus to cushion the impact of the pandemic.** COVID-19 support expenditure measures provided through the FY20 COVID-19 Response Budget and the FY21 budget included: (i) funding for public health activities to contain the spread of COVID-19; and (ii) support to businesses in the formal and informal sectors, including through transfers to the informal sector and financial support to businesses affected by COVID-19 restrictions.[5]

Table 4: Financing Needs and Sources

	2018	2019	2020	2021	2022	2023	2024	2025
				Est.	Proj.	Proj.	Proj.	Proj.
				In US$mn				
Total Financing Needs	**-347**	**-572**	**-320**	**-379**	**-148**	**-163**	**-276**	**-260**
Current Account Deficit	-470	-693	-604	-727	-445	-393	-414	-491
Scheduled Debt Amortization	123	121	284	347	298	230	138	230
Total Financing Sources	**-347**	**-572**	**-320**	**-379**	**-148**	**-163**	**-276**	**-260**
Foreign Direct Investment	-672	-357	-227	-349	-273	-332	-435	-473
Portfolio Investments (net)	34	-17	177	105	29	32	35	38
Other Net Inflows on Capital and Financial Account	-232	-275	-297	-597	-383	-193	-68	-44
External Debt Disbursements	397	173	14	599	664	434	250	210
Reserve Assets	125	-96	13	-137	-185	-104	-58	8

Sources: Ministry of Economy, and IMF and World Bank staff estimates.

[5] Fiscal measures were complemented by significant stimulus measures financed by non-budgetary sources through loan repayment holidays - offered by commercial banks and concessional loans from the Reserve Bank of Fiji - and the pension fund, the Fiji National Provident Fund (including substantial reductions in pension fund contributions for employers and employees, and access to pension funds for eligible and unemployed FNPF members due to COVID-19 related restrictions with Government top-ups for those with insufficient balances).

Table 5: Gross Deficit Financing and Burden Sharing

	FY20	FY21	FY22 Proj.	FY23 Proj.	FY24 Proj.	FY25 Proj.	FY20	FY21	FY22 Proj.	FY23 Proj.	FY24 Proj.	FY25 Proj.
			(US$ millions)						(percent of GDP)			
Net Deficit	-293	-513	-717	-474	-280	-218	-5.9	-10.8	-14.6	-8.8	-4.8	-3.5
Total Revenues	1,253	1,051	1,105	1,209	1,471	1,625	25.1	22.1	22.5	22.4	25.0	25.9
Tax revenues	1,012	693	839	982	1,253	1,407	20.3	14.6	17.1	18.2	21.3	22.5
Non-tax revenues	241	358	266	227	218	218	4.8	7.5	5.4	4.2	3.7	3.5
Total Expenditure	1,546	1,564	1,822	1,683	1,750	1,842	31.0	32.9	37.1	31.2	29.7	29.4
Current expenditures	1,076	1,073	1,178	1,156	1,194	1,246	21.6	22.6	24.0	21.4	20.3	19.9
Personnel	455	455	483	464	452	462	9.1	9.6	9.8	8.6	7.7	7.4
Goods & services	127	125	131	124	119	125	2.6	2.6	2.7	2.3	2.0	2.0
Current Transfers	302	285	312	304	339	360	6.1	6.0	6.4	5.6	5.8	5.7
Interest	159	178	182	210	226	238	3.2	3.7	3.7	3.9	3.8	3.8
Other	32	31	71	54	59	61	0.6	0.6	1.4	1.0	1.0	1.0
Capital expenditures	456	477	621	505	535	577	9.1	10.0	12.7	9.4	9.1	9.2
Gross deficit (including loan redemption)	-583	-1,349	-887	-670	-476	-365	-11.7	-28.4	-18.1	-12.4	-8.1	-5.8
Financing												
External Financing	166	692	467	342	214	164	3.3	14.5	9.5	6.3	3.6	2.6
Of which:												
ADB	66	281	155				1.3	5.9	3.2			
AIIB		56						1.2				
JICA	21	52	87				0.4	1.1	1.8			
EIB		8	12					0.2	0.3			
WB	67	168	154				1.3	3.5	3.1			
Domestic Financing	417	657	421	328	262	201	8.4	13.8	8.6	6.1	4.4	3.2
Grants (included as part of non-tax revenue)	31.2	139.2	105.0	24.5	24.5	24.5	0.6	2.9	2.1	0.5	0.4	0.4
Of which:												
Australia	11.9	75.9	63.9				0.2	1.6	1.3			
New Zealand	5.3	30.1	28.4				0.1	0.6	0.6			
United Nations	6.6	8.6	3.0				0.1	0.2	0.1			
European Union		15.8	6.0					0.3	0.1			
Japan	0.6	0.4					0.0	0.0				
China	4.8	0.1	0.3				0.1	0.0	0.0			
India	0.02						0.0					
World Bank			0.7						0.0			
Asian Development Bank			0.0						0.0			

Sources: Ministry of Economy, and IMF and World Bank staff estimates.
* The data are reported in Fiji's fiscal years, which start on August 1 and end on July 31st.
** External financing sources mainly comprise concessional loans (low interest rates with longer grace periods and repayment terms) from multilateral institutions. Total external financing also includes disbursements from infrastructure loans.

16. **Monetary policy was eased to counter the impact of COVID-19 and remains accommodative.** The Reserve Bank of Fiji's (RBF) monetary policy objectives are price stability and maintaining adequate foreign reserves. The RBF's strategy has been to keep the overnight policy rate low to ensure price stability and use the statutory reserve deposit requirement as an active tool to manage liquidity in the banking system. The RBF took several steps to support the economy at the onset of the pandemic including: (i) reduction of the overnight policy rate to 0.25 percent in March 2020; (ii) expansion of funds in the Disaster Rehabilitation and Containment Facility (DRCF) and the Import Substitution and Export Finance Facility (ISEFF); and (iii) purchase of FJ$300 million (3 percent of GDP) of Government bonds to assist in financing the fiscal deficit. In May 2021, the RBF reduced the interest rate charged to financial institutions from 1 percent to 0.25 percent on the DRCF, ISEFF and Housing Facility (HF). This reduced the maximum

interest rate charged by lending institutions to eligible customers from 5 percent to 3.99 percent. Inflation fell to a historic low of -2.8 percent at end 2020, in the context of a substantial output gap, and on account of lower food and fuel prices as well as reduced tariffs and taxes implemented to mitigate the impact of the pandemic. In 2021, inflation has been increasing throughout the second half due to a surge in global commodity prices and continued supply chain disruptions, reaching 3.0 percent at year-end.

17. **The exchange rate has been relatively resilient during the pandemic.** Fiji operates a fixed exchange regime, with the Fiji dollar pegged to a basket of currencies as one of the tools to implement monetary policy and manage foreign reserves. The exchange rate depreciated by about 4 percent in real effective terms in 2020 and by about 1.5 percent in 2021. Gross official reserves stood at US$1,011 million (7.7 months of prospective imports) at end-2020 and remained at a comfortable level due to the inflow of external loans and increase in inward remittances. Reserve coverage was also boosted by the IMF 2021 SDR allocation (US$133.6 million), which will be held to further cushion reserves. Reserves at end-2021 were US$1,570 million (9.9 months of prospective imports) but are projected to gradually fall back to the pre-pandemic trend over the medium term.

18. **Fiji's financial system remains broadly sound and stable but a further future weakening in bank profits and capital buffers appears unavoidable**. Fiji's financial sector assets are dominated by commercial banks at 40.8 percent and the Fiji National Provident Fund (FNPF) which provides pension services to its members at 29.2 percent. Of the six commercial banks, only one is locally owned. The rest of the financial sector consists of insurance companies (7.5 percent), credit institutions (2.9 percent), Fiji Development Bank (FDB) (2.6 percent), the RBF (14.5 percent), insurance brokers (0.2 percent), authorized forex dealers (0.1 percent), unit trusts (1.4 percent), and the Housing Authority (0.8 percent). The banking sector remains well-capitalized with a capital adequacy ratio of 21.8 percent at the end of September 2021, compared to 19.3 percent in the same period of 2020. This is well above the minimum requirement of 12 percent. The improvement is explained by an increase in Tier 2 capital and the declines in credit risk weighted assets. Due to subdued economic activities, credit growth has been marginal amounting to 1.2 percent as of end-June 2021 with no change from the same period in 2020. Underpinning this cycle is the commercial banks negative credit growth of 1.6 percent as of June 2021, largely attributed to the tightening of credit standards pertaining to the risk perception of the general economy. In addition to subdued credit growth, the impact of COVID-19 is likely to continue to heighten the bank sector vulnerabilities, particularly asset quality.

2.2. MACROECONOMIC OUTLOOK AND DEBT SUSTAINABILITY

19. **The outlook is subject to considerable uncertainty and hinges on how the reopening of borders and resumption of tourism unfolds**. The economy suffered a cumulative 20 percentage point contraction over the past three years, but economic recovery is expected to start in 2022, driven by the re-opening of borders to international travel in December 2021 and initiatives to rejuvenate the domestic economy. Tourist arrivals are conservatively expected to be 40 percent of pre-pandemic level by 2022 taking into account the potentially adverse impact of global inflation and price hikes on tourism but to gradually pick up over the medium term with 70 percent and 90 percent of 2019 arrivals in 2023 and 2024, respectively. The economy is projected to grow by 6.3 percent in 2022, 7.7 percent in 2023 and to surpass pre-pandemic level by 2024. Growth is predicated on tourism sector recovery and pick up in domestic demand as the labor market and business activity rebounds. Virtually all sectors of the economy are anticipated to grow, but large contributions are expected from accommodation and food services, transport and storage, financial and insurance activities, manufacturing, agriculture, and retail.

20. **Monetary policy is expected to remain accommodative in the short term to support growth, but inflationary**

pressures are expected to gain momentum in the forthcoming months. Inflationary pressures are expected to continue in 2022 due to higher global prices for food and fuel, exacerbated by the impact of the war in Ukraine, supply chain disruptions, and cyclone-affected local supply. A recently announced phased increase in the minimum wage is also expected to feed through to the overall wage structure and may add upward pressure to prices over time. Escalating food and energy prices, which account for more than a third of total imports, are expected to indiscriminately affect the poorest and most vulnerable and burden ailing businesses, arrest economic activity and delay potential growth. Year-end inflation is projected to rise to 5.0 percent by end- 2022 but to moderate to 3.0 percent in 2023, contingent on the duration and effect of the war and other key risks. The RBF intends to maintain its accommodative stance support the recovery, citing a large negative output gap and the inefficacy of monetary policy in addressing inflation from a supply-side shock. Fiscal consolidation is also expected to contain inflationary pressures over the medium term, complemented by mitigative policies such as zero-rating of VAT on staple food and essential items, and fiscal duty reduction on fuel in the FY22 Revised Budget.

21. **The current account deficit is projected to narrow gradually over the projection period as tourism inflows start to rebound.** The narrowing of the deficit in 2022 to 8.8 percent is driven by an anticipated recovery of international tourism, leading to a gradual rebound in the services balance. The trade deficit is projected to remain above the 2021 level with the projected rise in imports exceeding goods exports which are expected to remain muted as results of the successive tropical cyclones which destroyed a large part of the sugar harvest and curtailed gold mining due to flooding. The current account deficit will converge to 7.4 percent of GDP in 2025 from 15.6 percent in 2021. This is founded on further increases in the services and secondary income balance on account of higher anticipated tourism and remittance inflows. Personal remittances by the overseas diaspora rose to 7.1 percent of GDP in 2021 supported by stimulus packages in source countries and cheap mobile money transfer platforms.

22. **The Government is planning a substantial fiscal consolidation of 6.0 percent of GDP by FY24 (compared to FY21) to safeguard debt sustainability**. The Government recognizes the significance of fiscal consolidation and its urgency to prevent a thinning and constricted fiscal space that would affect growth outlook. The FY22 fiscal deficit is projected at 14.6 percent of GDP. This is below the 16.2 percent estimated in the Government's original budget despite the continuing expenditure demands to support economic recovery and mitigate poverty impacts of the pandemic. Expenditures will also be impacted by the surge in global food and fuel prices, further exacerbated by the war in Ukraine. As the impact of the multiple shocks subsides, the fiscal deficit is expected to gradually decline to 4.8 percent of GDP by FY24, reflecting the Government's commitment to consolidation. It aims to maximize highly concessional financing with multilaterals expected to be the largest source of external borrowing in FY22-FY24 and the only bilateral borrowing envisaged during the same period is from Japan (see Table 5). The World Bank is currently conducting a Public Expenditure Review (PER) that will identify strategic revenue and expenditure measures over the medium-term. The planned consolidation effort is about evenly split between revenue and spending measures as explained next.

23. **The Government is planning to implement measures to raise revenues equivalent to 2.9 percent of GDP by FY24 (compared to FY21)**. The gradual uptake in economic activity linked to the reopening of borders and easing of travel restrictions, combined with tax reforms included in the FY22 Revised Budget are expected to increase tax revenue collections from 14.6 percent of GDP in FY21 to 17.1 percent in FY22. Initial measures supported by this operation cover VAT rate increases from 9 to 15 percent on selected goods and services (partially offset by zero-rating of a list of essential items affected by global inflationary pressures) and a reduction in corporate income tax incentives affecting the film tax rebate scheme (see Prior Action 7 for details). This trend is expected to continue over the medium-term as more comprehensive revenue reforms are phased in, comprising rate and base changes for personal and corporate income taxes (including reduction in tax incentives), and dividend and excise taxation. The

slow rebound in revenue compared to GDP in 2022 and 2023 is due to the extended COVID-19 supporting policies The gradual phasing out of these relief measures, which are currently extended on a six- or twelve-monthly basis, are expected to partially compensate for reduced non-tax revenue collections (including COVID-19 related grants).

24. **The FY22 Revised Budget included two tax relief measures to alleviate the impact of higher fuel and food prices.** The first of these tax expenditures was the zero-rating of VAT for 21 essential everyday items. Those listed are: flour, rice, canned fish, cooking oil, tea, powdered milk, liquid milk, baby milk, potatoes, onion, garlic, dhal, salt, sugar, sanitary pads, soap powder, soap, toilet paper, toothpaste, cooking gas and kerosene. The zero-rating of VAT on these items is expected to result in an annual revenue loss of 1.6 percent of GDP, starting from April 1, 2022. The Government also reversed the fuel duty increase introduced in the COVID-19 response budget in FY20 (when fuel prices were low) to offer relief to consumers and businesses, reverting back to the pre-pandemic duty levels of 20 cents per litre duty for diesel and 46 cents for petrol. International crude oil prices have increased to over US$100 per barrel with indications of further increases in the near-term. This has translated to higher domestic fuel prices, which are affecting transportation costs, consumption and business activity, and risk undermining Fiji's economic recovery. The measure is expected to result in a revenue loss of 0.6 percent of GDP for the 12-month period starting March 25, 2022. The lower collections from the two relief measures are expected to be more than offset by tax policy reforms supported under Prior Action 7, forecast to result in a net positive impact of 0.7 percent of GDP. The Government will monitor food and fuel prices and reverse tax relief measures in a targeted, pro-poor manner as global market pressures ease.

25. **The Government is targeting expenditure consolidation amounting to 3.2 percent of GDP by FY24 (compared to FY21).** The authorities aim to limit annual spending increases in nominal terms over FY22-FY24, reaching pre-pandemic spending levels only by FY25. This is expected to lead to a substantial consolidation relative to GDP as the economy recovers. Strict nominal wage bill control, projected to be maintained at FY21 levels or 9.4 percent below pre-pandemic spending of FY19, will contribute substantially. Increased controls on goods and services spending are expected to result in a similar trend. While COVID-19 support is projected to cause higher spending on transfers in FY22 (including for unemployment benefits and household electricity subsidies), the phasing out of support programs (including unemployment benefits, COVID-19 financial relief support for businesses and the credit guarantee scheme, and assistance for Fiji Airways), one-off election expenses, and the completion of several major construction projects will result in nominal reductions in subsequent years. Targeted nominal increases in capital outlays will lift spending to pre-COVID levels by FY25 and, together with quality of spending improvements, will contribute to the strong growth performance over the medium-term.

26. **Public debt has increased significantly since 2020 reflecting the severe and protracted impact of the pandemic.** Central government debt, excluding guarantees, has surged to 87.8 percent of GDP in FY22. This increase is due to the sharp contraction in output and rise in primary deficits attributed to the impact of the pandemic and TCs. Gross financing needs (GFNs) rose to record highs of about 28.4 percent of GDP in FY21 compared to 11.7 percent of GDP in FY20 (see Table 5). This is expected to subside to 12.4 percent in FY23. External financial support from official sources, particularly ADB, IDA/IBRD and JICA helped finance the GFNs.

27. **Public debt is sustainable, with fiscal consolidation, but near-term risks are heightened.**[6] Under the baseline scenario, the public debt to GDP ratio is expected to continue its upward trajectory in 2022 rising to about 90 percent of GDP, as pandemic-related fiscal support expires (see Figure 1). Thereafter, it is set on a downward trajectory but

[6] A World Bank-led DSA was prepared for the purposes of this operation on the basis of the macro framework presented in the Program Document using the MAC DSA template. The results of this DSA are broadly consistent with the most recent DSA published by the IMF in December 2021 in the context of the Article IV Consultation (IMF Staff Report No. 21/257).

remains above the 70 percent Market Access Countries (MAC) benchmark over the projection horizon. The pandemic shock is expected to be temporary and sustained growth and primary surpluses support a decline in public debt over the projection period, and therefore debt is deemed sustainable. However, the debt-to-GDP ratio is projected to reach 81 percent of GDP in 2026, and the ratio remains 30 percentage points of GDP above the 2019 pre-pandemic level. GFNs exceeded the MAC benchmark, 15 percent of GDP, in 2020-2021 and the breach persists in 2022. However, they decline gradually thereafter to 7 percent of GDP in 2026 in line with the envisaged fiscal consolidation.[7]

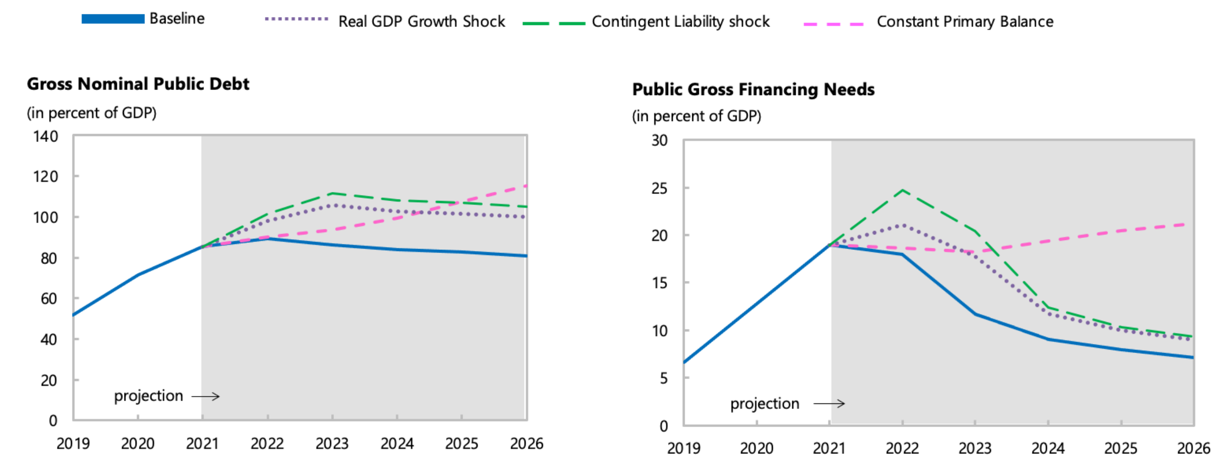
28. **The elevated public debt generates vulnerabilities to a broad range of shocks.** Uncertainties around current projections including possible COVID-19-induced hysteresis effects (e.g., changes in tourism spending pattern) reinforce the relevance of the sensitivity analysis. A more prolonged impact from the pandemic with subdued growth of 1 percent per annum in 2022-2023 (against an average of 7 percent in the baseline) would increase the public debt level to 106 percent of GDP in 2023. A combined macro-fiscal shock (incorporating the largest effect of individual shocks on all relevant variables) would push the debt ratio up further to over 114 percent of the GDP in 2023. The constant primary balance scenario—the most extreme scenario—shows that if the deficit remains at the 2021 level, public debt climbs to 115 percent of GDP in 2026. While the likelihood of this occurrence is low, it demonstrates the centrality of a growth-oriented fiscal consolidation to debt sustainability. The stochastic debt projections taking into account Fiji's past macro-fiscal volatilities also illustrate the risk of government debt hovering around 110 percent of GDP over the medium-term.

29. **Fiji faces the additional risk of realization of contingent liabilities from the broader public sector.** Contingent liabilities stood at 17.2 percent of GDP at end-FY21, of which 11.1 percent of GDP reflected total publicly guaranteed debt stock. The three largest borrowers, Fiji Airways (FA), FDB and Fiji Sugar Corporation Limited (FSCL) account for around 90 percent of the guaranteed debt. Other contingent liabilities including payments due for ADB and IBRD subscriptions, provincial and municipal councils' debt and litigation claims accounted for around 6.1 percent of GDP at end-FY21. State Owned Enterprises (SOEs) are considered market producers, but there is a risk that contingent liabilities may materialize, and these are being carefully monitored by the Government. There was a guarantee call of FJ$25.5 million (0.3 percent of GDP) for the FSCL bonds in FY21 and the financial situation of FA, FDB and FSCL has deteriorated during the pandemic. All three are classified as 'high risk' by the authorities in the FY2021 debt report. FA secured US$65 million in COVID-19 liquidity support from ADB in 2021 of which US$40 million a loan from ADB and US$25 million financing from Leading Asia's Private Infrastructure Fund (LEAP) administered by ADB. If 70 percent of the contingent liabilities were to materialize in 2022 and 2023, the public debt ratio would rise to 111 percent of GDP in 2023.

30. **The authorities are implementing debt and fiscal management policies that help minimize risks associated with contingent liabilities.** Actions taken include applying commission fees to guaranteed debt, recovering funds in conformity with the 2004 Financial Management Act (article 62), and closely monitoring guaranteed entities to ensure that fiscal risks are assessed and mitigated in a timely manner. FA benefitted from total loan guarantee ceiling of US$455 million in 2020 backed by a 15 percent commission. Following the settlement of the FSCL defaulted bond in 2021, the Government is in the process of finalizing a loan agreement to recover the funds. Lastly, the Government closely monitors the financial performance of the beneficiaries of guarantees as evidenced by the risk assessments disclosed in the FY21 debt report.

[7] The financing assumptions are in line with the authorities' debt management strategy that targets a foreign-currency denominated debt stock of 32.2 percent of GDP by FY23 as well as the current annual borrowing plan that sets a financing mix between domestic (47.4 percent) and foreign (52.6 percent) borrowing for FY2021/22.

Figure 1: Fiji: Public Debt Sustainability Analysis - Baseline and Alternative Scenarios



Source: WB MAC DSA template.

31. **The risks associated with the high level of public debt are mitigated by the debt profile.** Domestic debt, payable in local currency accounts for 70 percent of public debt at end-October 2021, primarily in the form of government securities of which 95 percent are long-term bonds and the remainder in T-bills. The FNPF holds about 70 percent of the bonds while T-bills are held by commercial banks. Public debt held by nonresidents, and denominated in foreign currency, was 30 percent of total debt putting both indicators in the moderate risk category well below the high-risk MAC benchmark levels, 45 percent, and 60 percent, respectively. The average term to maturity (ATM) of the overall public debt portfolio is above 10 years limiting rollover risks and the high share of fixed-rate debt, 80 percent of the total debt portfolio, contains variability in debt servicing costs. As of end-March 2022, 15 percent of Fiji's external debt (owed to IBRD and ADB) carried a variable interest rate: and there were no commercial loans. Rising global interest rates will have an impact on debt service costs but given the nature of the loans affected this is expected to be small and mitigated by the fact that both IBRD and ADB loans have embedded options to fix the rates.

32. **Fiji has finalized suspension agreements under the Debt Service Suspension Initiative (DSSI).** As of end-October 2021, Fiji's bilateral debt represented 30 percent of total external debt, with 61.6 percent of the bilateral debt owed to China while remaining 38.4 percent to JICA. In November 2021, the Government concluded the final DSSI agreement with China Exim-Bank and signed the Memorandum of Understanding (MOU) on the DSSI arrangement with JICA resulting in the total suspension of debt service payments amounting to US$34.5 million, equivalent to 0.74 percent of GDP. The temporary suspension of these payments has created fiscal space to provide support to the COVID-19 response in social, health and economic programs.

33. **The Government's commitment to prudent debt management is also demonstrated by the endorsement of Performance and Policy Actions (PPAs) under IDA's Sustainable Development Finance Policy (SDFP).** The Government has committed to two PPAs in FY22 to further strengthen debt management. For the first PPA (PPA1), it has endorsed preparation of an annual borrowing plan (ABP), consistent with the current Medium Term Debt Strategy (MTDS), and confirmed the ABP will be published on its official website; and committed to ensure effective implementation of the ABP with respect to targets for external and domestic borrowing set in the MDTS. For the second PPA (PPA2), the objective is a Liability Management Operations (LMO) Policy, approved by Cabinet and

published on the website of the Ministry of Economy (MOE) to encourage development of the domestic market and enable the Government to pursue active debt management operations such as buybacks, switches and callbacks. PPA1 and PPA2 constitute a prior action (Prior Action #6) of this operation.

34. **The banking system has adequate liquidity levels though the impact of pandemic raises uncertainty and has led to a growth in non-performing loans (NPLs).** Liquidity levels across the banking sector increased as of 30 June 2021 from the year before, driving down interest rates on deposits, and consequently roll over funding costs. Commercial banks' funding profile indicates a somewhat elevated reliance on short-term funds over the same time period with these funds increasing to 53.8 percent on 30 June 2021 from 48.2 percent the year before as a share in total funding. NPLs increased from 5.3 percent in September 2020 to 7.5 percent in September 2021. NPLs continue to be concentrated in the retail loan book. While the NPL levels for commercial banks remain manageable, the growth rate is of concern noting that the trend may increase further as most of the COVID-19 loan forbearance measures ended in March 2022. COVID-19 financial hardship assistance was provided to 15 percent of Fiji's commercial banks' gross loans as of October 2021, down from 18.8 percent in June 2021. Of these financial hardship loans, 75 percent are still classified as performing loans, 14 percent as special mention loans and 11 percent as NPLs. A general increase in provisioning levels was observed across the banking industry, narrowing net interest margins and reducing banks' risk appetite.

35. **While the outlook is generally positive, vulnerabilities have been exacerbated by the pandemic-induced economic shock, and risks are heightened**. Economic recovery and medium-term outlook hinge on a full recovery of tourism and return to pre-pandemic tourism and spending patterns. However, risks to these outcomes are heightened by pandemic-related risks associated with spread of the COVID-19 omicron variant and potential emergence of new COVID-19 variants. Fiji faces the constant and high risk of natural disasters particularly the impact of tropical cyclones. Uncertainties around the outcome of the General Election, expected to take place between July and November 2022, and widely anticipated to be a close race may weigh on business confidence and slow investment. Fiji is also exposed to risks stemming from the anticipated slowdown in the global economy, supply chain disruptions, energy price volatility and mounting inflationary pressures, all further worsened by the war in Ukraine.

36. **The macroeconomic policy framework is adequate for the purposes of this development policy operation.** Growth is projected to recover 6.3 percent in 2022 and rise to 7.7 percent by 2023 driven by a recovery in private consumption and investment supported by positive turnaround in tourism activity as COVID-19 restrictions ease and borders reopen. Monetary policy has been appropriately accommodative with manageable inflation and substantial foreign exchange reserves. The exchange rate peg is expected to continue to provide a credible nominal anchor. The Government is committed to fiscal consolidation with the fiscal deficit projected to fall to 6.4 percent of GDP in 2023, after a peak of 12.8 percent in 2021. This will be achieved through efforts to enhance domestic revenues and contain spending. Public debt is sustainable and expected to peak in 2022 at 89.3 percent of GDP and decline thereafter, supported by fiscal consolidation, the resumption of economic growth and prudent debt management policies. The fiscal consolidation will be achieved through efforts to mobilize domestic revenues and to contain spending through strict wage bill control and a reduction in operating subsidies and capital outlays. The IMF and the World Bank are providing reform recommendations to the Government based on a tax policy review and an ongoing PER, respectively.

2.3. IMF RELATIONS

37. **Fiji does not have a program with the IMF.** Article IV Consultations are conducted on a 12-month cycle. The

last Article IV consultations concluded in December 2021. Executive Directors commended the authorities for their swift action to cushion the impact of the pandemic and to accelerate vaccinations, which, together with the reopening of borders, have improved economic prospects. Given heightened uncertainty, macroeconomic imbalances, and vulnerability to climate shocks, the Directors stressed the importance of policy adjustments and macro-structural reforms aimed at facilitating stronger, greener, and more sustainable growth. They underscored that, as the recovery strengthens, fiscal consolidation will be needed to safeguard sustainability and place the public debt-to-GDP ratio on a steady downward path. They recommended a roadmap to guide the implementation of phased revenue reforms and expenditure rationalization, in line with the economic recovery. Directors emphasized the need to address the increase in contingent liabilities related to SOEs, develop contingency plans, and strengthen governance and transparency. They also encouraged further building climate resilience and mainstreaming climate adaptation considerations into fiscal policy planning.

3. GOVERNMENT PROGRAM

38. **The Government continues to incentivize and engage the private sector in the COVID-19 recovery and medium-term growth agenda.** The latest budget includes several incentives (both on the expenditure side and on taxes) to encourage investment by the private sector as well as concessional financial packages to enable Micro, Small and Medium-sized Enterprises (MSMEs) to remain operational during the COVID-19 pandemic. In addition, the Government is moving forward on a range of additional reforms to improve the business environment and strengthen access to finance. Some of these measures that are underway include a new financial sector inclusion strategy, an MSME access to capital bill, trade facilitation reforms, and measures to improve efficiency in construction permits and insolvency. The Government's streamlined online process has led to the issuance of business licenses within two days (compared to 11 days previously) and has helped register 19,277 businesses in a year.

39. **The Government has an ambitious climate change agenda and remains committed to providing social assistance in response to natural disasters and economic shocks**. It has integrated climate and disaster risk and resilience into the 5- and 20-Year National Development Plan 2017 (NDP 2017), which guides investments in multiple sectors. It has passed legislation and established policies that form the institutional framework to meet its NDP 2017 objectives and international obligations across multiple conventions, including those for climate change, disaster and biodiversity. Fiji's active social assistance programs has enabled the Government to provide assistance to the poor, the vulnerable and affected individuals and households during the COVID-19 pandemic and in the aftermath of TCs.

40. **The Government is committed to mitigating fiscal risks and enhancing debt management**. The fiscal impacts of COVID-19 pandemic have highlighted the importance of managing fiscal risks and maintaining a prudent debt management strategy over the medium-term. The Government's debt policies aim to: (i) lower borrowing costs by maximizing concessional financing from bilateral and multilateral partners, including refinancing of the global bond in October 2020; (ii) actively manage the loan portfolio to ensure prudent liability management with an optimal cost and maturity structure; and (iii) develop and efficiently manage the domestic market. The Government also aims to strengthen budget execution and cash management, including through mandated annual procurement and cash plans; and improve the management of assets and maintenance of a register of non-financial government assets.

41. **Fiji launched a National Gender Policy in 2014 that serves as a roadmap to promote gender equality in government planning, legislation, employment, health services and safety from violence**. The Policy recognizes that "ethnicity, disability, religion and gender often intersect and create a multiplicity of sources of discrimination against women". It is consistent with the Government's commitment to implementing the Women's Plan of Action (WPA

2010- 2019) based on the Beijing Platform for Action, and with its commitment to the Convention on the Elimination of All forms of Discrimination against Women. The Policy is also aligned with the Sustainable Development Goals (SDGs) and Fiji's commitment to Agenda 2030 on poverty (no-one left behind). It also emphasizes the importance of strengthening women's decision-making on natural resource use, conservation and climate resilience.

4. PROPOSED OPERATION

4.1. LINK TO GOVERNMENT PROGRAM AND OPERATION DESCRIPTION

42. **The reforms proposed in this second operation are closely aligned with the Government's current policies and the priorities identified in the NDP 2017**. Specifically, the first development objective supports the Government's efforts to promote private sector-led economic recovery through measures aimed at modernizing and digitalizing the payment system and promoting foreign investment by creating the necessary legal foundation and framework. The second objective supports the Government's efforts to address the effects of climate change through legislation and a set of policies focused on improving the climate resilience of marine, coastal and terrestrial ecosystems and strengthening its early warning systems. The third development objective supports the Government's efforts to strengthen debt management and transparency, through coherent borrowing strategies and providing a legal framework to support amendments made to the financial management legislation. All three pillars include gender dimensions, with focus on women's employment and role, aligned with the National Gender Policy in 2014.

43. **The operational design reflects lessons learned from the previous DPOs, and those in other small Pacific islands.** It acknowledges that in low-capacity environments, achievement of desired outcomes requires both the approval of a policy reform and support for close monitoring of its implementation. Specifically, lessons learned are:

- ***Selectivity.*** The country's small size and limited number of government officials assigned to each task is an argument for limiting the focus to key priorities and prior actions. This operation focuses on three central elements of Fiji's development agenda, reflected in the pillars, which are critical to achieving the goals set out in the NDP 2017.
- ***Government ownership.*** The proposed operation supports reforms that have strong government commitment and ownership and are closely aligned with its own priorities as articulated in the budget statement, the medium-term program of fiscal consolidation and the NDP 2017.
- ***Coordination among development partners.*** The proposed operation follows established good practice in the Pacific Islands where a joint donor matrix for budget support is adopted, focusing on reducing the Government transaction costs and increasing the policy impact.
- ***Technical assistance.*** Continued technical assistance is necessary to support stakeholders that have not worked with development policy operations and for implementation and dialogue to strengthen reform.

4.2. PRIOR ACTIONS, RESULTS AND ANALYTICAL UNDERPINNINGS

44. **The development objectives of the DPO Program remain the same while the Program has been strengthened and adjusted in light of emerging government priorities** (see Annex 4). The changes reflect the deeper challenges, including the need for fiscal consolidation while protecting the most vulnerable, created by the COVID-19 pandemic coinciding with multiple tropical cyclones. Specifically, this has meant increased priority on attracting foreign and domestic investment, a focus on climate resilience, protecting the marine and land ecosystems, and reduced fiscal deficit. The reforms in this second DPO (DPO2) continue to support the long-term goals of the NDP 2017. The main enhancements and adjustments are summarized below:

- A new Prior Action (PA#2) that strengthens the framework for investment and replaces Indicative Trigger#2 (Small Business Access to Capital Bill). The addition of the Investment Fiji Act 2022 and regulatory framework for the implementation of the Investment Act 2021 reflect the increased priority of galvanizing domestic and foreign investment to support the post-pandemic recovery. Work on improving SME access to finance is ongoing, with a draft bill expected in late 2022. Progress has been slow because of the need to prioritize immediate measures to respond to the pandemic, the challenges in organizing consultations due to restrictions imposed by the pandemic, and by the novelty of some features of the Bill (such as crowdfunding) which are new to Fiji and require more extensive consultation than anticipated.
- Two reforms for enhancing climate and disaster resilience (PA#3 and PA#4) replaced Indicative Trigger#3. Climate Change Act 2021 (PA #3) and National Jobs for Nature Rehabilitation Policy 2022-2032 (PA#4) contribute to improving the resilience of Fiji's land and marine ecosystems. These replace Indicative Trigger#3 (amendments to the Environment Management Act (2005) and Customs Act (1986)) that were completed in December 2020. Fiji's leadership in reducing marine pollution helped accelerate its own agenda and that of the region. This included a ban on a major source of pollution - foamed polystyrene - earlier than anticipated.
- A new Prior Action (PA#5) that strengthens early warnings for climate related and a range of other hazards is now included in the program and replaced Indicative Trigger#4 (revision of Fiji Standard AS 4055 and the Fiji Standard A/NZS). Standards related to wind loads and/or earthquake of buildings are completed but cannot currently be enforced. The revised National Building Code (NBC) will include requirements for changes to wind loads and/or earthquake, but its completion has been delayed due to the pandemic related border closures and internal travel restrictions. Given that four cyclones hit the country over the past two years, with delayed warnings, the Government prioritized legislation to improve its early warning system as reflected in the new PA#5: Fiji Meteorological and Hydrological Services Bill 2022.
- Indicative Trigger#5 on the establishment of a Social Registry was dropped. Due to the pandemic related travel restrictions, experts could not enter the country in 2021 to complete the work required, which is now expected to be completed in 2023.
- Given the need for fiscal consolidation and enhanced debt sustainability, PA#6 was introduced to replace Indicative Trigger#7 (revision of Finance Instructions and Procurement Regulations). While there is a strong commitment from the authorities to revise the Finance Instructions and Procurement Regulations, fiscal and debt sustainability has risen on the agenda. Moreover, preparation of the Finance Instructions and Procurement Regulations was delayed by COVID-19 travel restrictions with capacity further constrained by the difficulty in hiring consultants on the ground. Given that Fiji's tax revenue declined significantly to about 15 percent of GDP in FY21 (from 24 percent in FY19) due to the impact of the pandemic on business activity

and tax relief measures, fiscal and debt sustainability concerns have taken precedence and the Government's revenue collection measures are now included as a prior action.

Pillar 1: Promoting Private Sector-led Economic Recovery

45. **The first development objective is to create an improved business and investment environment to mobilize private sector financing and promote a private sector-led inclusive economic recovery**. This includes cross-sectoral actions to strengthen financial markets infrastructure as well as promoting investment. The proposed reforms under this pillar implement key aspects of the National Payment System Act 2021, which will help strengthen the ability of Fiji's financial sector to efficiently and inclusively intermediate access to finance for individuals and businesses as well as improving the Government's delivery of payments. Beyond financial markets, the pillar builds on previous work to establish a comprehensive investment framework for foreign and domestic investment with reforms to strengthen the regulatory and institutional environment for investment. Attracting, facilitating and retaining foreign investment is key to accelerating economic recovery from COVID-19 both for established sectors such as tourism that require an influx of new investment to respond to changing client expectations, as well as to economic diversification. Together, the actions included in the pillar will help crowd in commercial financing to support an inclusive recovery.

46. **Reforms in this pillar build on previous DPO experience and analytical work including the WBG Country Private Sector Diagnostic (CPSD)**. The prior actions in Pillar 1 focus on the implementation of major legal reforms that were previously adopted including the National Payment System Act 2021[8] and the Investment Act 2021,[9] which were complemented by extensive WBG technical assistance. DPO2 will help ensure these reforms are properly implemented through regulations for digital payment systems and investment as well as a stronger institutional capacity for investment promotion and retention. The DPO is well aligned with the 2022 Fiji Country Private Sector Diagnostic (CPSD). One of the recommendations of the CPSD - to delineate the role of Investment Fiji in attracting, facilitating, and retaining investment – is included as a prior action under this pillar.

Prior Action #1: To expand the scope of the payments system and promote digitalization, the Recipient, through its Minister for Economy, has made the National Payment System Regulations 2022.

47. **Payment and settlement systems are vital to the development of digitalization of government payments and e-commerce and can help strengthen resilience to natural disasters.** These systems enable consumers, government entities, businesses and other organizations to transfer funds in real time between accounts in different financial institutions and are essential to the day-to-day business of the economy. These systems also allow for much faster processing which can bring about efficiency gains, but which also requires a strong oversight and regulatory framework. At the consumer or household level, the lack of a comprehensive regulatory framework has limited interoperability, forcing customers to hold multiple accounts and cards, which translates into long delays in clearing cheques and high fees and charges. The lack of a robust digital payments system also results in greater use of physical payments which have a higher emissions profile due to the travel that is often required to complete a physical payment or access cash. MSMEs are particularly impacted by the lack of digital payments systems as it limits their ability to engage in online sales. Revolutionizing the payment system is fundamental to the overall goal of developing, strengthening, and diversifying the financial system and expanding access to finance.

48. **The Reserve Bank of Fiji (RBF), in collaboration with the Government, and with technical assistance from**

[8] Supported by the Fiji Recovery and Resilience First Development Policy Operation with a Catastrophe-Deferred Drawdown Option DPO1-P173558.

[9] Supported by the Fiji Second Fiscal Sustainability and Climate Resilience DPO- P168402.

WBG, has introduced a new national payment system. The framework for reform has three main elements: (i) an enabling legal and regulatory framework for the national payment system benchmarked to international best practices; (ii) an upgraded modern Real Time Gross Settlement (RTGS) and an Automated Clearing House (ACH) to facilitate and ensure the safe and efficient transfer of large value and retail payments; and (iii) a new Central Securities Depository (CSD) system to ensure proper liquidity management mechanisms within the financial sector and support capital market development. These payment reforms are expected to lead to increased use of electronic payments, reducing risks in the financial sector, lowering the incidence of human error and speeding availability of funds. The Government will optimize the mechanisms to receive taxes and custom duties, transfer intra-government funds, pay salaries and duties to the various vendors or transfer social benefits in a safe and inexpensive way. The electronic payments system will also strengthen Fiji's economic and climate resilience by increasing the speed of payments and mitigating risks of service disruption in the aftermath of extreme weather events and other crises. These capabilities will play an important role for disaster preparedness and response and can contribute to improved coping and adaptive capacity.[10] The RBF is the key counterpart for the implementation of the new system and has the necessary technical, financial and human resources to successfully roll-out the new systems.

49. **DPO2 is supporting the adoption of the National Payment System Regulations 2022, which establishes the regulatory framework for payment systems including retail payments instruments and services.** The regulatory framework builds on the National Payment System Act, enacted on February 12, 2021, (NPS Act) as supported under DPO1. The NPS Act provides for establishment of the national payment system and for its regulation, oversight, and supervision by the RBF. The NPS Act also authorizes the Minister for Economy (as the Minister responsible for finance) to issue subsequent regulations related to its implementation. These subsequent regulations, the National Payment System Regulations 2022 (NPS Regulations), were gazetted on April 29, 2022. The NPS Regulations will allow the RBF to implement a framework designed to license and regulate payment system operators and service providers with the objective to promote safety, soundness and competitiveness of the financial system. The NPS Regulations will enable new payment solution providers to enter the market and these new providers will expand the scope of the current payment solutions by offering new products and services. Simultaneously, the NPS Regulations will ensure protection for providers and users through a set of procedural requirements and obligations for licensed payment service operators including licensing, disclosure, consumer protection, risk management and interoperability with other providers. Likewise, the NPS Regulations will allow for dematerialization of the infrastructure for debt security registries, depositories and settlements. The latter is critical for the development of capital markets.

50. **The regulatory framework for payment systems enables the implementation of the Government's National Payment System Strategy which emphasizes the climate and disaster resilience benefits of digital payments.** Payment systems can play an important role in the response to natural disasters and extreme weather events such as cyclones, by helping affected communities, especially those in climate vulnerable locations, quickly and efficiently receive payments and access to finance to better cope with impacts and recover faster. This is particularly relevant as physical payments are likely to be dangerous or inaccessible due to the effects of the natural disaster on infrastructure such as banks, transportation links, and government service centers. Fiji's draft National Payment System Strategy 2022-2026 explicitly recognizes this role, stating, "Digital payments play an important role in supporting climate mitigation and adaptation by changing how the products and services are delivered to the vulnerable population in the aftermath of natural disasters. In 2016, following Tropical Cyclone Winston, Fiji was at the forefront of leveraging digital payments via mobile money to disburse millions of aid to those affected. The mobile money platform proved to be an efficient and effective channel for distributing aid and was utilised during the climate

[10] Christophe Béné, Rachel Godfrey Wood, Andrew Newsham and Mark Davies. (2012) "Resilience: New Utopia or New Tyranny". IDS Working Paper 2012 (45).

events that followed." The strategy goes on to note how digital payments can support mitigation efforts by providing more inclusive access to finance that can be used to help the most vulnerable with financial services to help strengthen their resilience and better prepare for any climate risks.

51. **Expected Results:** The introduction of legal and regulatory framework for payment systems through the National Payment System Act 2021 and the National Payment System Regulations 2022 will enable the growth of digital payments in Fiji. Successful implementation of the system and ongoing capacity building to operationalize the system such as advanced RTGS is critical. This work is ongoing and supported by WBG TA.[11] The expected results of this prior action will be measured through an increase in the annual number of payments made electronically through the RTGS from 148,786 in FY2019 to 185,930 (approximately by 25 percent) in FY2024.

Prior Action #2: To promote foreign and domestic investment, the Recipient has: (i) enacted the Investment Fiji Act 2022; and (ii) through its Minister for Commerce and Trade, made the Investment (Reserved and Restricted Activities) Regulations 2022 and the Investment (Foreign Investors Reporting) Regulations 2022.

52. **Over the past 10 years, foreign investment has grown gradually, driven mainly by the tourism (hospitality) sector and non-tradable services including finance and real estate**. Over the period between 2010 and 2019, Fiji's net foreign direct investment (FDI) inflows averaged 6.6 percent of GDP, well in excess of the upper middle income country average of 2.5 percent of GDP. Fiji's FDI performance has been driven by a favorable level of *de facto* openness to FDI coupled with an improving business environment and the creation of *Investment Fiji,* a trade and investment promotion agency. The legal and regulatory environment for FDI, however, has been less conducive with barriers to market access such as universal screening of foreign investors, long list of reserved and restricted activities, a complex work permit scheme, and inefficient procedures to start a business or gain access to industrial land. FDI inflows dropped sharply by 25 percent in 2020 following severe TCs Harold and Yasa and continued to fall in 2021 due to the economic disruptions driven by the pandemic. As noted in the WBG Country Private Sector Diagnostic for Fiji, it will be critical to delineate and strengthen the role of Investment Fiji to engage with investors in order to grow Fiji's FDI inflows and diversify them toward efficiency seeking investment.

53. **The Government, led by the Ministry of Commerce, Trade, Tourism, and Transport (MCTTT) has taken an important step to reform investment policy legislation with the enactment of the Investment Act 2021 (Investment Act) - the first major reform to foreign investment regulations since 1999**.[12] The Investment Act addresses the key weaknesses and gaps in the previous legislation. It does so by; (i) broadening the scope to provide for equal treatment to all investors, abolishing the Foreign Investor Registration Certificate (FIRC) approval process, (ii) rationalizing the negative list, and (iii) introducing a broader range of treatment and protection guarantees for foreign investors coupled with related obligations. As a result, the new law significantly improves the legal basis for foreign investment.

54. **Under DPO2, the Government is undertaking the next generation of investment reforms, building on the foundational reforms of the Investment Act**. The prior action includes two elements. The first is the enactment of the Investment Fiji Act 2022 which addresses the institutional context for investment promotion by revising the mandate, functions, and governance of *Investment Fiji*. The second element of the prior action is the adoption of two key regulations to implement the Investment Act. The Investment Act authorizes the Minister for Commerce and Trade (as the Minister responsible for investment) to issue subsequent regulations related to its implementation. The first of these subsequent regulations, the Investment (Reserved and Restricted Activities) Regulations 2022, will open the economy for foreign investment by rationalizing and significantly shortening the list of economic activities

[11] Fiji Payment Project (605169) and Financial Sector Support in Pacific Island Countries (P174933).

[12] The Investment Act came into effect upon publication on 03 June 2021.

currently restricted for foreign investment. The regulations also improve the ease of monitoring and enforcement while keeping in place protections for small domestic businesses by moving to a transparent minimum investment threshold rather than the previous approach of individual certification of foreign investors. The second regulation, the Investment (Foreign Investors Reporting) Regulations 2022, streamlines reporting requirements for foreign investors by merging reporting with the standard business registration process. The reporting will be organized as an online process with a minimum administrative burden for the foreign investor. Both the Investment (Reserved and Restricted Activities) Regulations 2022 and the Investment (Foreign Investors Reporting) Regulations 2022 were gazetted on April 29, 2022.

55. **The regulatory reforms are accompanied by an institutional reform to strengthen *Investment Fiji*, the trade and investment promotion agency**. Prior to the Investment Act 2021, *Investment Fiji* played a largely regulatory role leaving a critical gap in the country's institutional resources for trade and investment promotion. As these regulatory functions have now been made redundant by the Investment Act and the related regulatory changes included in DPO2, *Investment Fiji* can now focus on carrying out the role of a promotion agency in investment attraction, facilitation, and after-care. This revised mandate will help speed Fiji's recovery from COVID-19 as *Investment Fiji* will focus more institutional resources on active investment attraction in key sectors including tourism. This shift in institutional focus requires a revision to the mandate, functions, structure, and governance of the agency. These changes are introduced through the Investment Fiji Act 2022. The WBG has worked closely with *Investment Fiji* on the design of this new institutional role and will continue to provide technical assistance and capacity building support as the changes are implemented. The Act was gazetted on April 7, 2022.

56. **Expected results.** The results indicator for the prior action will measure the volume of investment commitments. The COVID-19 pandemic resulted in a dramatic decrease in commitments in 2020 and 2021 so the baseline figure that will be used is the median volume of commitments between 2015 and 2019, which is US$24.3 million. The target is set at US$27.9 million, representing a 15 percent increase from the baseline.

Pillar 2: Enhancing Climate, Disaster and Social Resilience

57. **The second development objective is to enhance climate, disaster and social resilience.** Fiji is highly vulnerable to climate related risks including heavy rainfall, cyclones, floods, storms, and droughts. These hazards are interrelated and act as additional pressures to those from other human activities on land and marine ecosystems. The risks and impacts of climate change are likely to increase over the coming decades and put further pressure on people, livelihoods, ecosystems and institutions. Climate-related risks have caused damage and losses of up to 20 percent of Fiji's annual GDP,[13] and have taken the country years to recover. The Government recognizes these challenges and has integrated climate and disaster risk across multiple areas in its NDP 2017. This pillar supports the Government in its efforts to strengthen its institutions and enable implementation of the adaptation actions to reduce these risks and improve the effectiveness of early warning systems to decrease risk to lives, livelihoods, and assets.

58. **The pillar builds on reforms supported through previous DPO series.** The Second Fiscal Sustainability and Climate Resilience DPO (P168402), supported the approval of the National Climate Change Policy 2018-2030 (NCCP) and the Climate Resilient Building Guidelines. DPO1 (P173558) of this series, included reforms that revised the structural steel Standard to address failure of multi-story buildings in cyclonic winds. DPO1 also supported the National Ocean Policy 2020–2030 (NOP), reflecting the Government's focus on its extensive ocean and marine areas.

[13] Estimated damages of 2014 GDP equivalent from category 5 TC Winston which hit Fiji in March 2016.

It also supported reforms for better targeting of social assistance and climate resilience of the poor and vulnerable. The digitalization of the payment system under PA1 will contribute to further strengthening of this assistance through use of mobile phones. Such system was used for the distribution of cash grants as part the 2021 COVID 19 response package.

Prior Action #3: To enhance climate resilience, the Recipient has enacted the Climate Change Act 2021, which provides legal authority for the Minister responsible for climate change to coordinate and implement climate adaptation actions.

59. **The Government has developed plans and policies to address climate risks, but their implementation has been delayed.** The main documents developed since 2014 with a focus on climate change include the Green Growth Framework for Fiji, the NCCP, the Low Emission Development Strategy, the National Adaptation Plan (NAP) 2018, and the NOP 2019.[14] Although there has been some progress on the climate mitigation aspect of Green Growth and Low Emission Development Strategy, the lack of institutional arrangements needed for a coordinated and multi-sectoral approach for the NAP and NOP which focus on climate resilience has hampered their implementation. The delays have been further exacerbated by limited technical and financial capacities in the Government. The Government enacted the Climate Change Act 2021 (gazetted in September 2021) to address these challenges, include provisions for climate resilience of land and marine ecosystems and provide the legal authority to the Minister for Economy (in his capacity as the Minister responsible for climate change) for coordination and implementation of climate adaptation actions.

60. **International experience and analytics from implementing climate resilience actions shows the effectiveness of multi-sectoral approaches coordinated through central ministries**. Fiji's CVA, supported through a World Bank TA, concluded that climate change will amplify the current risks.[15] These include risks from increasing urbanization and development along coastlines as well as those related to changing climate. The CVA highlighted that many goals for key sectors in the NDP 2017 - such as transport, water, health, tourism, human settlement, fisheries and the environment - are highly vulnerable to climate change. It estimated the cost of investments in these sectors, including conservation of land and marine ecosystems, to be F$9.3 billion (approximately US$4.2 billion) over 10 years. The CVA highlighted the need for modernization of legislative and regulatory frameworks.

61. **This reform supports the institutional arrangements for implementing the NOP and the NAP.** The Climate Change Act 2021 (CCA Act) provides the legal framework for the institutional arrangements, including the authority to the Minister responsible for climate change (Minister) for coordination across government entities. It provides an umbrella legislative framework for implementation of climate actions, and was developed over a three-year period with support from development partners, including the WB. The land-based emission reduction included in the CCA Act was a requirement for WB to sign the Emission Reductions Payment Agreement as part of the Forest Carbon Partnership Program.[16] The institutional arrangements stipulated in the CCA Act are highlighted below:

- **"Part 4 – Governance"**. It provides the Minister with the power to oversee the implementation of and promote compliance with the CCA Act. It empowers the Minister to ensure the Director of Climate Change and International Cooperation Division is appointed. That Division is currently in the MOE. It also empowers this Director to develop and maintain a publicly available Adaptation Registry to capture

[14] These are available from *https://www.greengrowthknowledge.org/sites/default/files/downloads/policy-database//A%*20Green*%20Growth%20Framework%20For%20Fiji.pdf* and *https://www4.unfccc.int/sites/NAPC/Documents/Parties/National%20Adaptation%20Plan_Fiji.pdf* respectively.
[15] CVA is available from: www.gfdrr.org/en/publication/fiji-climate-vulnerability-assessment-summary
[16] URLis https://www.worldbank.org/en/news/press-release/2021/01/28/world-bank-and-fiji-sign-agreement-to-reduce-forest-emissions-and-boost-climate-resilience.

adaptation projects being implemented.

- **"Part 11 - Climate Change Adaptation and Resilient Development"**. It includes the governance structure through the establishment of the NAP Steering Committee for the implementation of the NAP. The NAP includes adaptation measures identified through a stakeholder consultation process which are aligned with the CVA findings. The CCA Act includes the need for resource mobilization.
- **"Part 13 - Oceans and Climate"**. It stipulates the governance structure through the establishment of the NOP Steering Committee required for the implementation of the NOP which has a focus on improving climate resilience Fiji's vast marine and coastal ecosystems. It also provides the legal framework for reducing plastic pollution to improve the health and resilience of oceans. The CCA Act binds the Government to meet the 2030 target for Marine Protected Areas (MPAs) – RI#4 (i).

62. **Expected Result**: The result indicator targets the institutional arrangement necessary to implement climate adaptation actions and mechanisms to measure implementation progress. For the implementation of the NOP and the NAP, the results indicator in part (i) captures the outcome of the Government's interim target for the expansion of the MPAs which contribute to climate resilience of coastal and marine areas and communities (a result for PA3 in DPO1). The target to be achieved by 2024 is at least 5 percent of area within the national jurisdiction is legally designated as MPAs with a baseline in 2020 of 1 percent. The current value is also 1 percent; the Government has held consultations with the stakeholders for demarcation of the potential MPAs accounting for around 30 percent of the marine area. In terms of the implementation of the NAP, which requires coordination amongst multiple stakeholders, the result indicator in part (iii) captures the establishment of publicly available Adaptation Registry to help monitor progress of priority adaptation investment activities identified in the NAP and aligned with those in the CVA.

Prior Action #4: To enhance the climate resilience of ecosystems, the Recipient, through its Cabinet, has approved the National Jobs for Nature Rehabilitation Policy 2022-2032, which fosters traditional management of resources to reduce degradation of land, coastal and marine ecosystems.

63. **Fiji's land and marine biodiversity and ecosystems are being adversely affected by climate change and other human activities**. The frequent cyclones, storm surges and coral bleaching caused by increasing ocean temperatures and ocean acidification are damaging many of the coral reefs. The projected increase in these hazards and risks will further adversely affect coral reefs, which are important for marine and coastal ecosystems, livelihoods, economic activities, and traditional customs. Under Fiji's Constitution, people have a right to clean and healthy environment as well as access to and benefit from natural systems. Traditional management practices have sustainably managed ecosystems that are the basis of meeting food, shelter and livelihood needs[17]. However, many ecosystems are facing multiple and increasing pressures from human activities, such as forestry, farming and fishing.

64. **Local communities play a major role in reducing land degradation and increasing rehabilitation**. Land degradation is a major issue globally and affects human well-being, jobs and livelihoods. [18] Local communities can help reduce land degradation and broader environmental degradation, contribute to ecosystem resilience and improve their own livelihoods. However, as many communities have limited financial and technical resources, experience from other countries has shown that provision of grants for community-led activities can help address

[17] This is highlighted in the National Biodiversity Strategy and Action Plan (NBSAP) 2020-2025.
[18] Land Degradation. Global Environment Facility.
Https://www.thegef.org/sites/default/files/publications/gef_land_degradation_bifold_2019.pdf.

these challenges. Given the role women play in farming and livelihood activities, engaging women groups can also contribute to successful outcomes.

65. **The National Jobs for Nature Rehabilitation (J-NR) Policy contributes to climate resilience of ecosystem.** At its meeting on April 13, 2022, Cabinet approved the J-NR Policy. Given the recognition of the extent of the conservation and rehabilitation work required, the Government, with support from World Bank TA, developed the J-NR Policy. The J-NR Policy is underpinned by the Environment Management Act 2005 which stresses the need for sustainable use of natural resources. The objectives of the J-NR Policy are to reduce degradation of land, coastal and marine ecosystems through protection, restoration and rehabilitation efforts.[19] The J-NR Policy fosters traditional resource management to address land degradation and facilitates this through establishment of a small grant mechanism for community-led initiatives and larger grants for local/provincial governments.[20] The eligibility criteria for the grants under the J-NR Policy include identification of activities that would deliver climate resilient outcomes. It acknowledges the importance of engaging women and supports targeted outreach to women's groups in rural communities. Such efforts are expected to enhance the role and visibility of women in local activities supported under the policy. Examples of activities that will be funded through the grant mechanism include eradication or removal of invasive species in forests and coastal areas, planting mangroves and seagrass and coastal protection to enhance climate resilience and contribute to improved carbon storage.

66. **A phased approach will be used for the implementation of the J-NR policy.** Given that protection, restoration and rehabilitation of ecosystems with increasing impacts of climate change will require a long-term approach, adoption of a phased approach has many advantages. It can help the Government test different solutions, sustain the support to communities that have limited capacity and address any increasing risks. The first phase is the provision of small grants to overcome the financial support needed for community-led initiatives and is funded by the Government. The IDA funded Social Protection COVID-19 Response and System Development (P175206) will provide additional financing for cash for works paid for beneficiary organizations, with a particular focus on women. Simultaneously, a World Bank TA will provide assistance to the Government to finalize grant operations manual drawing on good global practices for such mechanisms. This manual will be used for training to improve the capacity of the grant recipients and strengthen monitoring and evaluation of the outcome of the grant-funded activities.

67. **Expected result:** The result indicator reflects the opportunity to strengthen participation of women in ecosystem rehabilitation activities and deliver climate resilience outcomes. By FY2023: share of 150 grant funded activities implemented by women community groups with a baseline of zero and a target of 35 percent.

Prior Action #5: To strengthen the early warning system for disaster preparedness, the Recipient, through its Cabinet, has approved the Meteorological and Hydrological Services Bill 2022, which establishes the Fiji Meteorological and Hydrological Service.

[19] As part of the COVID-19 pandemic stimulus package, a Policy Paper was developed by Ministry of Environment to implement the Jobs for Nature Rehabilitation Programme. The cash for works - continuation of the Government funded Jobs for Nature Programme – was supported under the Fiji Social Protection COVID-19 Response and Systems Development Project (P175206). The J-NR Policy goes beyond this type of support and helps develop processes and mechanisms that can foster traditional land management approaches to reduce land degradation and increase rehabilitation.
[20] The project documents note the ongoing legal challenges to the validity of the 'No jab, no job policy. The policy makes it a condition of employment for all employees in Fiji to be vaccinated against COVID-19, with exceptions for individuals who are employed and are yet to receive the COVID-19 vaccines due to medical condition. The FY22 Budget includes funding for 150 community grants that will be provided under the JN-R Policy and the recipients could be subject to the 'No Jab, No Job' policy that came into effect 2021. There is a residual risk, that some grant recipients could be excluded, but the risk is marginal given that at least 95 percent of adults are now vaccinated.

68. **The Fiji Meteorological Services (FMS) is the lead agency that provides early warnings for climate related and a range of other hazards**. Although FMS has been operating for almost fifty years, it does not have the formal authority to request and analyze the necessary information for generating and transmitting early warnings. Further, it does not have the authority to provide warnings for hydrological hazards, such as floods and heavy rainfall. Lessons and experiences from other countries suggest that a single agency and its head should have the responsibility and authority for coordinating and transmitting these warnings. This is best achieved through a regulatory framework which provides formal authority to a lead agency, clarifies its roles, responsibilities and procedures for coordination and transmission across the range of hazards and ensures an annual operating budget and financial sustainability to provide such services. Given that hydrometeorological events are increasing due to climate change, strengthening of early warning systems will contribute to climate resilience. The outreach activities on the importance of adhering to early warning included in FMS' Strategic Plan 2021-24 will also contribute to preparedness. To this end, the Government has developed the Meteorological and Hydrological Services Bill 2022.

69. **The Meteorological and Hydrological Services Bill 2022 (Bill) ensures that Fiji has an entity with a formal authority to issue early warnings and to coordinate the necessary information and analysis.**[21] At its meeting on 29 April 2022, Cabinet approved the Meteorological and Hydrological Services Bill 2022. The Bill provides the necessary framework for such an authority. It provides the mandate for Fiji Meteorological and Hydrological Service (FMHS) to be established and stipulates that FMS will continue and function as the FMHS. The Bill states that the FMHS will be the lead agency that synthesizes and transmits all early warnings in Fiji. Based on good practices from other countries, the Bill provides the Director of Meteorological and Hydrological Service (Director) the sole power to issue weather warnings and alerts. The Bill enables the FMHS to issue impact-based warnings that contribute to Fiji's multi-hazard early warning system; these can contribute to reducing risks to lives and livelihoods and reduce damage to assets. It requires FMHS to provide advice to other government entities, which may be required during disasters. It also requires FMHS to establish and upgrade networks, infrastructure and equipment for meteorological observation and the collection of meteorological and hydrological data and information.

70. **The development of the Bill has been supported by a TA through the World Meteorological Organization (WMO) and from the WB.** As FMS acts as a regional center for cyclone warnings, the implementation of the FMS Bill will be supported by both partners and contribute to improving early warning at regional level. The Government envisages that the Bill will be presented to Parliament in the second half of 2022 and debated by the Parliament in the first half of 2023. WB TA will continue to provide support for any necessary revisions and for the implementation of this reform.

71. **Expected Result:** Within the timeline of the operation, it is not possible for the Government to recruit enough personnel to develop and transmit impact-based multi-hazard early warning. The result captures the first necessary step in the process for having an impact-based multi-hazard early warning for the most commonly occurring weather-related hazards experience in Fiji. By FY2024, the FMS (as the interim agency) will finalize an implementation plan to develop, test/pilot/transmit impact-based multi-hazard early warnings for weather-related events (such as cyclones and floods) with a baseline of none for FY2022.

[21] Although the Government has been revising its Disaster Management Bill over the past few years, it has not focused on legislation to strengthen its early warning system. This is the first engagement for the Bank and expands the coverage of support for climate and disaster resilience.

Pillar 3: Strengthening Debt, Public Financial and Fiscal Management

72. **The third development objective is to strengthen debt, public financial and fiscal management.** The impact of the COVID-19 pandemic on Fiji's public debt level and tax revenue was severe. Borrowing to cover the fiscal impacts of COVID-19 and contraction in growth raised public debt to 79 percent of GDP at end-FY21 from 48.7 percent of GDP at end-FY19. The pandemic severely strained government finances with tax revenues falling by almost 50 percent to around 15 percent of GDP in FY21 from 24 percent in FY19. This pillar supports the Government's efforts to strengthen fiscal management and meet its goals for fiscal consolidation with measures aimed at reducing the public debt burden through prudent borrowing policies, proactive management of the public debt portfolio and implementing reforms directed at raising revenues. The authorities' over-arching objective, set out in the NDP 2017 and the medium-term fiscal strategy, is to reduce the fiscal deficit and put the public debt-to-GDP ratio on a downward trajectory once the economy rebounds.

73. **The Government's debt management policies are articulated in the MTDS published on the website of the MOE and incorporated in the Annual Budget for FY22**. They are centered on: (i) lower borrowing costs by maximizing concessional financing from bilateral and multilateral partners; (ii) actively managing the loan portfolio to maintain an optimal cost and maturity structure; and (iii) develop an efficient domestic debt market. The formulation and implementation of an ABP is key to operationalizing the MTDS and managing the risks embedded in the debt portfolio, specifically the potential variation in the cost of debt service and its impact on the budget. An LMO Policy that enables the Government to pursue active debt management operations such as buybacks, switches and callbacks is an important element of the enabling environment for an efficient domestic debt market.

74. **DPO reforms build on those supported by DPO1 and previous DPOs.** The reforms supported by previous operations include: (i) implementation of an MTDS to help manage borrowing costs through an optimally balanced debt portfolio consistent with the Government's cost-risk trade-off preferences; (ii) a Medium-Term Fiscal Strategy (MTFS) that strengthened fiscal discipline and initiated fiscal consolidation through expenditure-side measures consistent with debt sustainability; and (iii) a Government Guarantee Policy aimed at managing risks associated with contingent liabilities. Additionally, the Finance Management (Amendment) Bill included in the FY21 budget aims to increase the efficiency, effectiveness, and accountability of the Public Financial Management (PFM) system.

Prior Action #6: To improve debt management, the Recipient, through: (i) its Ministry of Economy, has prepared the Annual Borrowing Plan Fiscal Year 2021-2022 (ABP) consistent with the current Medium-Term Debt Management Strategy, and has published the ABP on its website; and (ii) its Cabinet, has approved a Liability Management Operations Policy (LMO Policy) that enables the Recipient to pursue active debt management operations such as buybacks, switches and callbacks; and has published the LMO Policy on its Ministry of Economy's website.

75. **The implementation of the ABP and the LMO Policy are Fiji's SDFP PPAs for FY22.** The World Bank's Debt Unit provides technical assistance for the ABP while implementation of the LMO Policy and ongoing capacity building to execute LMO transactions are supported by IFC's Fiji Capital Market Project.

76. **The authorities have established and strengthened the framework for debt management with the formulation and publication of the 2021-2023 MTDS**. This was Fiji's first MTDS aiming to ensure financing needs are met at a minimal cost, subject to prudent level of risk. It was also designed to guide broader debt management goals, including creating an efficient market for Government securities. Formulation of the MTDS was supported by the prior DPO and was one of the PPAs under the SDFP. The MTDS was incorporated into the FY21 budget document and made public on the website of the MOE prior to release of the budget in mid-July 2022.

77. **Debt transparency has been increased with a regular publication of cost-risk indicators of the debt portfolio.** The most recent debt bulletin, published in December 2021, shows that the cost and market risk targets set in the MTDS were observed by end-October 2021. Exposure to the foreign exchange rate risk was contained by keeping foreign currency denominated debt at 30.2 percent of total debt portfolio against an end-FY23 target of 32.2 percent. The cost of debt and refinancing risks to the portfolio were reduced. The weighted average interest rate declined by 90 points to 4.7 percent at end-October 2021, from 5.6 percent at end-FY20 reflecting a decrease in interest rate for long-term bonds and an increase in external concessional financing. The average time to debt refixing (ATR) and the ATM increased to 9.3 years and 10.6 years at end-October 2021, from 7.5 years and 8.7 years, respectively, at end-FY20. This was achieved by increasing long-term bond issuances and disbursements of external concessional loans. The MTDS targets for cost risk indicators at end-FY23, specifically a weighted average interest rate of 4.7 percent and ATR and ATM of 8.0 years and 9.9 years, respectively, were achieved by October 2021.

78. **The objective of the ABP is to increase transparency and to operationalize the MTDS.** The ABP is the primary vehicle to inform creditors and market participants about the Government's financing objectives, and debt issuance in the upcoming budgetary year. This enables the Debt Management Office (DMO) to map out the financing requirements throughout the year and identify the appropriate debt instruments to be used, consistent with the cost and risk targets of the MTDS. The absence of an ABP was one of the few components 'colored red' or missing in the latest Debt Transparency Heatmap assessment, published in January 2022. Sustaining a positive rating would however hinge on borrowing plans being available on an annual basis.

79. **The ABP has domestic and external financing components that will be monitored against the targets set out in the MTDS**. The ABP expressed the gross funding needs, specifying the projected split between domestic and external debt instruments. The external component of the ABP specified the estimated financing volumes from each external source. For domestic financing, the volumes raised through securities, such as T-bills, or T-bonds and loans were identified. The ABP implementation will be regularly monitored and updated to reflect any significant budget revisions.

80. **To support Fiji's MTDS and domestic debt market development, the Government has approved the LMO Policy[22] to support the Financial Management (Amendment) Act 2021**. DPO1 supported the Cabinet approval of the Financial Management (Amendment) Act 2021, which was subsequently endorsed by Parliament. The Cabinet approved the LMO Policy at its meeting on 13 April 2022. A key amendment in the Financial Management (Amendment) Act 2021 (Section 60, titled "Debt management operations") provides the legal platform for debt management operations. It gives authority to the Minister responsible for finance to *"approve debt management operations involving call options, bond switches and buy backs, consistent with the debt management strategy to achieve the necessary government objectives to manage debt according to international best practices"*. The LMO Policy supports and provides the necessary framework that will create potential fiscal savings through risk management and lower domestic financing costs.

81. **The LMO Policy is a guide for the Government to conduct call options, bond switch and buyback operations.** In the context of Fiji, the LMO Policy will: (i) stimulate yield curve development and improve price discovery; (ii) stimulate secondary market activity; (iii) offer the potential to lower government's cost of domestic financing; and (iv) broaden the investor base. The LMO Policy will also help to increase market liquidity and to mitigate refinancing risks. This will be achieved by reducing the outstanding amount of government securities close to maturity to smooth out the redemption profile, reduce refinancing risk, and extend the average time to maturity. Likewise, a switch facilitates the portfolio consolidation into fewer, larger, and more liquid benchmark government bonds. As a result,

[22] This work is ongoing and supported by IFC's Fiji Capital Market Project.

the availability of additional opportunities for issuance (by way of switching) will enable increased stability and regularity in the issuance calendar.

82. **The next phase of the reform is the formulation of an annual program on call options, bond switches and buy back consistent and aligned with the LMO policy**. This will be based on the targets outlined in the MTDS and/or with the ABP and published by the MOE. This publication will include details of the aggregate annual targets for LMO operations with indicative dates in the Government bond auction calendar that give investors the opportunity to plan the restructuring of their bond portfolio in an efficient and transparent manner.

83. **Expected Results:** The expected results of this prior action with a target date of FY2024 include: (i) External (FX) debt will be targeted at 30 percent (+/-5%) of total debt; and (ii) reduction in the number of domestic debt instruments from 396 to 320.

Prior Action #7: To enhance revenue mobilization, the Recipient has enacted the Value Added Tax (Revised Budget Amendment) Act 2022, which increased the VAT rate applicable to: (i) the importation and supply of selected goods; and (ii) prescribed services, from 9 percent to 15 percent.

84. **The sharp contraction in growth due to the global pandemic reduced tax revenue significantly in FY21 to about 15 percent of GDP from a pre-pandemic level of 24 percent.** In order to improve revenue collection and support investment and economic recovery, the Government made several tax legislation amendments. They are part of the comprehensive revenue reform package that will be phased in over the medium-term and include VAT rate changes, reforms to corporate income tax incentives, and revisions to the personal income tax rate structure. Specifically, supplementary to the Revised 2021-2022 Budget, the Government has enacted the Value Added Tax (Revised Budget Amendment) Act 2022.

85. **The Government increased VAT on the importation and supply of 22 goods and 16 prescribed services from 9 percent to 15 percent through the enactment of the Value Added Tax (Revised Budget Amendment) Act 2022.** Goods and services now subject to higher VAT rate include: alcohol & tobacco; certain white goods; perfume, jewelry & watches; stereos and sound systems; electrical machinery and equipment; textiles, clothing & footwear; mobile phones; passenger vehicles; and professional services such as legal and accounting, management and consultancy, architectural and engineering, scientific research and development, advertising and market research, veterinary activities and other professional, scientific and technical activities. The revenue gain from this legislative amendment is expected to be 1.8 percent of GDP per year starting from April 1, 2022.

86. **The Value Added Tax (Revised Budget Amendment) Act 2022 has increased the VAT rate of prescribed services at 15 percent VAT.** Prior to this, a VAT rate of 9 percent was charged on prescribed services together with a 5 percent Environment and Climate Adaptation Levy (ECAL). The ECAL on prescribed services was removed by the Environment and Climate Adaptation Levy (Revised Budget Amendment) Act 2022 while the VAT rate on the same services was increased from 9 percent to 15 percent through the Value Added Tax (Revised Budget Amendment) Act 2022. The prescribed services include hotels, aircraft carriers, boat tours and the entertainment sector. The annual revenue impact of this measure is 0.7 percent. Together, the increase in VAT rate on the importation and supply of selected goods and prescribed services are estimated to generate additional revenue equivalent to 2.5 percent of GDP annually starting from April 1, 2022.

87. **Going forward, as the recovery strengthens, Fiji is expected to continue to implement measures to streamline and strengthen revenue mobilization.** There are structural problems in the design of Fiji's tax system that existed prior to the recent shocks. Among others, the personal income tax structure is overly complex, and corporate

income tax and capital gains tax collection is undermined by excessive tax incentives. Subsequent reforms will target improvements, including simplifications in tax bases and rates and the phasing out of temporary COVID-19 relief measures currently extended on a six to twelve monthly basis, to the personal income tax rate structure, corporate income tax incentives, the VAT system, and excise taxation. This is complemented by tax administration improvements, including through a new tax information system that facilitates taxpayer compliance and collects real-time data for better decision-making, forecasting, and planning (including for risk-based tax audits). Timing and sequencing of reform actions are important to avoid adversely impacting the near-term economic recovery while protecting the poor and vulnerable. The Government receives reform advice in the area of domestic resource mobilization by the IMF and through an ongoing World Bank PER.

88. **Expected Results:** The measure introduced will have an estimated annual positive net impact on tax revenue of 2.5 percent of GDP starting from April 1, 2022. Complemented by tax administration improvements (including economic recovery impacts) this will lead to a VAT to GDP ratio increase from 4.6 percent of GDP in FY2021 to 7.1 percent of GDP by FY2024.

Prior Action #8: To reduce tax expenditures related to film production, the Recipient, through its Minister for Economy, has made the Income Tax (Film-making and Audio-visual Incentives) (Amendment) Regulations 2022.

89. **Fiji has an extensive range of tax exemptions and incentives.** IMF (2021) notes that Fiji has more than 40 different tax exemptions and incentives, which greatly complicates the tax system. These exemptions and incentives fall under five categories: (i) tax holidays, usually for periods of 5, 7, 10 or 13 years, mostly dependent on the level of investment and focused on specific sectors or regions; (ii) investment allowances (i.e., a tax deduction for capital expenditure in addition to depreciation deductions); (iii) accelerated deprecation; (iv); additional deductions (e.g., 300 percent deduction for wages paid to certain employees, or the 60 percent deduction of export income); and (v) tax rebates (e.g., for the film sector).

90. **Fiji's poor revenue performance in recent years is also attributable to the excessive use of tax concessions.** Adverse consequences of tax exemptions and incentives in Fiji also include: (i) creation of distortions leading to inefficiencies in production and consumption; (ii) complication of tax administration and compliance; (iii) creation of perception of unfairness (inequity); and (iv) creation of room for evasion and avoidance.

91. **Recalibration of the film tax rebate aims to save revenue while keeping Fiji internationally competitive.** Fiji's film tax rebate is a subsidy to encourage film making and audio-visual production. The amount of rebate claimed was FJ$38.3 million in 2018 and FJ$34.9 million in 2019. Fiji's film rebate was very generous, compared to the largest rebates in other regions, for example in Europe the rate in Greece is 40 percent; in Asia/Oceana (apart from Fiji) Kazakhstan has a rate of 30 percent and Australia gives a 40 percent tax credit; in Latin America/Caribbean, Colombia has a 40 percent; and in North America some US States have a rate of 35 percent. Under the new provisions, introduced through the Income Tax (Film-making and Audio-visual Incentives) (Amendment) Regulations 2022, Fiji's film tax rebate is reduced from 75 percent to 20 percent, and based on expenditures incurred in Fiji and paid to Fiji residents for goods and services. Additionally, the maximum rebate payable per approved final certificate will not exceed FJ$4 million. The Income Tax (Film-making and Audio-visual Incentives) (Amendment) Regulations 2022 were gazetted on April 3, 2022. The Minister for Economy (as the Minister responsible for finance) is authorized to make the regulations under the Income Tax Act 2015.

92. **Expected Results:** The annual revenue impact of the film rebate reduction is estimated at 0.4 percent of GDP starting April 1, 2022.

93. The analytical underpinnings of the proposed program are summarized in Annex 6.

4.3. LINK TO CPF, OTHER BANK OPERATIONS AND THE WBG STRATEGY

94. **The proposed operation is fully aligned with the objectives and proposed outcomes of the Country Partnership Framework (CPF) covering FY21-24.** The CPF builds on the findings of the Systematic Country Diagnostic (SCD) (Report #120106) submitted to the Board in June 2017. The SCD was structured around strategic priorities to accelerate Fiji's growth toward the dual goal of ending extreme poverty and prompting shared prosperity in a sustainable manner; specifically strengthening fiscal sustainability; improving the investment climate; and building resilience to climate change. These core priorities, which underpin the NDP 2017, remain central to the new CPF.

95. **The country program has undergone significant adjustments in light of the COVID-19 pandemic.** The CPF proposed a range of measures to support Fiji's response to and recovery from the COVID-19 pandemic. Revisions to the Small Islands Economies Exception reclassified Fiji as an IDA-eligible country as of 1 July 2019, expanding the envelope of financial resources and instruments available to the country. Fiji has gained access to the World Bank's Fast Track facility for COVID-19 and the Fiji COVID-19 Emergency Response Project (P173903), which aims to help prevent, detect and respond to the threat posed by COVID-19 and strengthen national systems for public health preparedness. To strengthen Fiji's social protection policy and programs, an IDA Fiji Social Protection COVID-19 Response and Systems Development Project (P175206) was approved in February 2021. Furthermore, the Government has requested support to revive the tourism industry through critical investments and master planning for the second largest island of Vanua Levu.

96. **The proposed operation also builds on the considerable policy engagements and investments by the IFC.** The IFC Country Strategy has two key pillars: sustainable infrastructure and sustainable tourism; and gender and climate resilience are mainstreamed across program. A joint WBG Country Private Sector Diagnostic for Fiji has been finalized highlighting opportunities to leverage the role of the private sector across the economy and help spur a private-sector led economic recovery, notably in the deep dive sectors of healthcare, outsourcing services, and agri-logistics. Now with its borders open, and Fiji entering a 'new normal' of COVID-19, central to the IFC program is: (i) enabling environment for the private sector; (ii) accelerating inclusive and climate-smart private investment in key growth sectors; and (iii) enhancing standards and gender inclusion**.** The program supports investment policy and regulatory reforms to improve the enabling environment for doing business and offers opportunities to develop renewable energy projects and attract investment into public utilities through Public Private Partnerships.

97. **Several important IFC projects and initiatives are under underway.** A tourism advisory program is helping Fiji revive its tourism sector and develop a strategy for the development of Vanua Levu, Fiji's second largest island as a tourism destination. A capital markets reform project and a payment systems reform project are designed to introduce corporate bonds to attract capital and a national payment system architecture that allows the banking system to function efficiently when making and receiving payments. To advance the IFC Gender program for Fiji, IFC is supporting the Government of Fiji through establishment of the Fiji Early Childhood Care and Education Taskforce and the development of a Guidance Note on Fiji Early Childhood Care Services Policy and Regulation Framework. In addition, IFC is working with Fiji firms to close gender gaps in employment and increase women's recruitment, retention and promotion. The Public Private Partnership (PPP) program has led to the first health sector PPP in the Pacific with the establishment of Health Care (Fiji) PTE Limited. IFC is undertaking an affordable climate resilient housing project, to build in excess of 2,000 housing units in six sites across the country. IFC has also signed a mandate

with utility Energy Fiji Limited to develop an independent power producer project in Viti Levu using best practice global knowledge and technology on solar energy. A number of different instruments and facilities are being explored to enable access to local currency financing at a reasonable cost, which would help close some of the deals around green buildings and roof top solar projects.

4.4. CONSULTATIONS AND COLLABORATION WITH DEVELOPMENT PARTNERS

98. **This operation has been developed through an extensive and high-level consultation process, with a broad range of stakeholders**. Public meetings encompass professional groups, business leaders and representatives from all facets of civil society. Changes to national legislation reflect broad-based input from all relevant sectors of the economy. Prominent and widespread reports in local and national media also underscore the Prime Minister's commitment to reforms and served as a channel for garnering public support. The consultative process draws from NDP 2017 "Transforming Fiji", which combines a long-term transformational 20-year Development Plan with a comprehensive 5-year Development Plan and action agenda with specific targets and policies aligned to the long-term goals.

99. **In preparing this operation, the World Bank worked closely with other development partners**. The operation's objectives mirror the priorities of the ADB Country Partnership Strategy 2019-2023 and are within the parameters of the Government of Australia's extended aid and technical support program. Consistent with established practice in the Pacific, the operation uses a joint policy matrix for budget support, led by the Government, that reduces transaction costs for the Government and maximizes the policy impact. The World Bank consults regularly with the ADB, European Union, the Australia and New Zealand High Commissions, and the IMF and its Pacific Financial Technical Assistance Centre (PFTAC) to coordinate policy advice and technical assistance.

5. OTHER DESIGN AND APPRAISAL ISSUES

5.1. POVERTY AND SOCIAL IMPACT

100. **The policy measures supported under this DPO series are expected to promote financial inclusion, attract foreign investment, build resilience to climate and disaster shocks, strengthen debt and public financial management, and raise government revenues**. All the proposed actions have the potential to have positive poverty and social impacts. However, in some instances, this will depend on the implementation details, while in other instances, potential negative impacts will be further assessed. In the following paragraphs, these impacts are summarized for each prior action. Details are presented in Annex 7.

101. **The proposed payments digitalization reform under PA1 is expected to have a positive social and poverty impact, although sharing the benefits most inclusively will depend upon the success of current initiatives to boost access.** The policy reforms under PA1 aim to increase the total volume and share of payments made electronically. Expanding digital financial services (DFS) can provide low-income households with access to affordable, safe and convenient tools that can help increase their economic opportunities, especially for those that are under- or un-served by traditional financial services. The COVID-19 pandemic and government responses, such as lockdowns, have stressed the benefits of DFS. For instance, mobile money remittances to Fiji increased by 279 percent between March and October 2020 (GSMA, 2021), providing a critical lifeline of support at a time when physical payments and

transfers were largely unavailable. Ensuring the benefits of digital finance are shared inclusively will depend upon connectivity access, while risks such as those related to consumer protection and financial capabilities require attention. Fiji's high penetration of mobile subscribers at 84 percent (the highest in the Pacific) coupled with the country's national financial inclusion strategy that includes several initiatives to promote the adoption of digital payments among the poor and vulnerable are expected to help mitigate these risks.

102. **The benefits of the PA2 reforms on the poor are uncertain, and dependent on the types of jobs that are created through this investment.** The expected increases in FDI inflows from the reforms under PA2 would stimulate economic growth overall. However, the extent to which Fiji's poor and vulnerable can benefit from this growth depends on the extent to which the jobs created are accessible to the bottom of the income and skills distribution.

103. **The reforms under Pillar 2 are likely to improve Fiji's ability to protect its poorest from shocks and the long-term effects of climate change, with PA4 contributing to meeting livelihood needs**. Both the CCA (under PA3) and the Meteorological and Hydrological Services Bill 2022 (under PA5) build long-term resilience to climate and disaster shocks. This is particularly important for poor households that do not have access to formal risk management mechanisms, e.g., savings or insurance, and are thus more dependent on support from the Government. While some of the components of Fiji's climate change efforts may disrupt the livelihoods of poor individuals, such as those working in small-scale fisheries and forestry, the National Jobs for Nature Rehabilitation Policy directly mitigates that by providing grants to community groups for rehabilitating ecosystems and improving climate resilience. For PA4, the P177674 project documents notes the ongoing legal challenges to the validity of the Government's 'No Jab, No Job' policy. As the 150 community grants under the J-NR Policy were approved in the FY22 budget, some grant recipients could be subject to the 'No Jab, No Job' policy that came into effect in 2021 as noted earlier. There is a residual risk, that these recipients could be excluded, but the risk is marginal given that at least 95 percent of adults in Fiji are now vaccinated.

104. **The debt, public financial and fiscal management reforms under Pillar 3 will strengthen Fiji's ability to sustain its social spending in the long run**. The improvements to debt management and public financial management supported under PA6 ensure the robustness of the Government's finances. This robustness will minimize the long-term risks of Fiji's ability to sustain its social spending in areas such as education, health, and social protection, all of which disproportionately benefit the bottom of the wealth distribution.

105. **The tax revenue raising reforms under PA7 and PA8 are unlikely to have major impacts on poverty.** First, an increase in the VAT rate from 9 to 15 percent will enhance revenue mobilization, but it will come at the cost of a reduction in households purchasing power and well-being, if not mitigated. The impact of such reform is expected to fall disproportionately on households in the top of the welfare distribution, as the items subject to the VAT increase are mostly consumed by richer households. The implementation of a temporary zero-rating on essential items could offset the welfare loss among the poor, given that essential everyday items account for a considerable share of their consumption baskets (about 16 percent). However, this mitigation measure may lead to inefficiencies in the allocation of government support. Second, increased taxes on prescribed services are expected to be mainly paid by tourists. From a suppliers' perspective, a higher VAT rate for prescribed services could create a burden for small business owners, though providers of these services tend to be high-end businesses. Third, the impacts of a more restrictive and reduced film tax rebate on the poor are uncertain and will depend on the nature of their relationship with the film-making industry (e.g., employment, business ownership, sale of goods and services). Ultimately, the impact of the combined tax revenue raising reforms on Fiji's poor and vulnerable will depend on how the additional government revenue is spent, for example, on whether it translates into greater social spending and public infrastructure.

5.2. ENVIRONMENTAL, FORESTS, AND OTHER NATURAL RESOURCE ASPECTS

106. **Policy actions under Pillar 2 are likely to have significant positive effects and most under pillars 1 and 3 are not expected to have significant negative effects on Fiji's environment, forests and natural resources (see Annex 5).** PA1 and PA6, which deal with electronic payments, and alignment of debt management with revised PFM legislation respectively, are expected to have neither positive nor negative effects on the environment, forests and natural resources. PA2, which promotes foreign investment and revises the regulatory framework for implementing the legislation, could potentially have negative impact on natural resources and ecosystems, especially in there are tourism-related investments near coastal areas or riverine catchments which can impact forests, rivers and increase sedimentation and pollution. However, the Government has a strong EIA system which is well established and is required for public and major private sector work. Therefore, potential risk will be mitigated through such processes; however, there is a risk of negative effects if the EIA process is not adhered to. The Government is also working towards development of a Blue Economy Framework for sustainable development and economic growth supported through a WB TA that will contribute to reducing the risk of negative externalities. The regulatory framework under the PA also includes a transparent process for entry of foreign investment and specifies that investors undertake investment activities that protect the environment. Collectively, these provisions mitigate potential negative effects on the environment from potential increase in foreign investments. Under Pillar 2: (i) PA3 supports the climate resilience agenda of Fiji, with a focus of the reforms being on implementation enhancing resilience of land and marine ecosystems - including the large ocean area. Such actions are likely to have positive effects on the environment given the adverse and increasing impacts of climate change. Conservation and sustainable efforts supported through the MPAs and as part of PA3 will also help ecosystems thrive and provide goods and services to the people and the economy; (ii) PA4 supports rehabilitation of degraded ecosystems and is likely to have significant positive effects on the environment, forests and natural resources; and (iii) PA5 is supporting the effectiveness of early warning systems that will contribute to timely action by the Government and population at large to reduce loss of some assets, thereby putting less demand on the environment.

107. **Fiji's systems for reducing adverse environmental effects and enhancing positive effects is reasonably strong at the policy level and they are being strengthened through support of WB TA**. The Ministry of Environment derives its legal mandate from the Environment Management Act 2005–Part 2 Administration. The ministry promotes the sustainable use and development of Fiji's environment and implements the EIA process. The EIA unit is one of four units in the Ministry and its role is to examine and process every development proposal, which is referred to it by an approving authority, or which may come to the attention of the unit as having a significant environmental impact. As a Ministry rather than a department, it has expanded its staff and improved the oversight of the EIA process. Divisional offices in Labasa and Lautoka provide additional support. Rural Local Authorities also work with the Ministry of Environment in the implementation of the Environment Management Act 2005 and monitor the conditions of EIAs within their area. The WB's engagement in Fiji in environmental impacts is relatively new but deepening.

5.3. PFM, DISBURSEMENT AND AUDITING ASPECTS

108. **Fiji has been actively reforming its PFM practices in recent years, with support from development partners.** The 2019 PEFA report, published in February 2020, established a new baseline using the 2016 PEFA methodology. Overall, the results of the 2019 PEFA show a PFM system in Fiji that is on track to be strong regarding control of the

execution of the budget. The notable weaknesses in timeliness of the annual financial statements impinges Fiji from fully realizing the benefits of its sound external scrutiny. This is off-set by good in-year budget execution reports and an emerging internal audit with the establishment of a proper framework. The budget process is evolving, and some features of a multi-year approach are in place and reflected in the budget calendar, but it is hindered by the absence of a functional or program classification system and the absence of key performance indicators. Unrealistic revenue forecasts contribute to the inability to realize the prepared budget. In-year revenue reporting is good as is revenue administration. On the expenditure side, cash planning is relatively effective, and for all intent and purposes, replaces the budget forecasts. Effective commitment control enables effective management of the budget's release determined by monthly warrants linked to cash availability which is guided by the budget's priorities. However, this also requires rearranging the budget as planned expenditures cannot be funded, which can result in cash rationing.

109. **Fiji has put in place a comprehensive PFM improvement program and has been successful in implementing PFM reforms in the past.** The 2019 PEFA report and PEFA Handbook, Volume IV: *Using PEFA to support PFM improvement*, guided the development of the Public Financial Management Implementation Pan (PFMIP) 2020 – 25. The priority areas of the five-year reform plan include: (i) budget preparation; (ii) budget execution and internal control; (iii) revenue management; (iv) management of assets and liabilities; (v) accounting and reporting; and (vi) cross-cutting issues. The general government budget is made publicly available each year on the Government website.

110. **Fiji had an IMF Safeguards Assessment in 2011, and this review of the Foreign Exchange Control Environment is based on RBF's publicly available audited financial statements.** The RBF publishes annual audited financial statements that are both prepared and audited in accordance with internationally recognized standards. The 2016/2017, 2017/2018, 2018/2019 and 2020/21 audit opinions were all unqualified but emphasized matters related to divergence from International Financial Reporting Standards IAS21. This divergence does not impact significantly on the fair representation of the RBF's financial statements.

111. **Fiji's legal framework for public procurement is comprehensive.** It is comprised of the Procurement Regulations 2010 (and amendments), which were issued under the Financial Management Act 2004. The Regulations define that the guiding principles procurement are: (i) value for money; (ii) economy and efficiency, (iii) open and fair competition, (iv) integrity and public confidence in the procurement process, and (v) accountability and transparency. Procurement by competitive tendering over FJ$50,00 is administered by the Fiji Procurement Office (FPO). The Fiji Roads Authority (FRA), which has a significant capital expenditure budget, manages its own procurement, which is regulated by the FRA Act 2012. Both FPO and FRA have e-tendering portals and potential supplier can register for free. According to the 2019 PEFA report, the procurement procedures were found to be effective because (i) information on competitive tendering is maintained electronically by both FPO and FRA, which allows for effective monitoring; and (ii) over ninety per cent of the value of tenders awarded was done by competitive methods. Weaknesses relate to the fact that the country's systems provide for independent complaints system and that public access to procurement information was found to be limited.

112. **The fiduciary risk rating for the operation is moderate.** The weaknesses noted above in Fiji's PFM and foreign exchange environment are not expected to pose more than a moderate risk to the achievement of the PDO of the proposed operation. The main weaknesses in the foreign exchange environment are being mitigated by the additional measures described below. Ongoing challenges include limited procurement and contract management capacity. Fiji's procurement legal, regulatory and institutional framework is considered suitable for use under donor financed projects, subject to clarifications of application of donor Procurement Regulations.

113. **IBRD and IDA financing will be disbursed according to IBRD and IDA disbursement procedures for**

development policy operations. The full amount of the IBRD loan and IDA credit will be disbursed against satisfactory completion of the specified policy actions and the Government agreement as summarized in the Letter of the Development Policy, and adequacy of the macroeconomic policy framework, and is not tied to any specific purchases. Once the total financing is approved by the Board and becomes effective, the proceeds of the IBRD loan and IDA credit will be deposited by the WB, at the request of the Borrower, into a dedicated Foreign Currency Deposit Account that forms part of the official foreign exchange reserves, and an equivalent amount in FJ$ will be immediately accounted for in the Government's budget management system. As a due diligence measure, within 30 days of receipt, the Borrower will provide a written confirmation to the WB. In the past there has been delays in the receipt of the certification letters and the Borrower is encouraged to adhere to the deadline in the future. Disbursements will not be linked to specific purchases. The proceeds of the operation will not be used to finance expenditures excluded under the General Conditions for IBRD Development Policy Financing dated December 14, 2018 (revised on August 1, 2020, December 21, 2020, April 1, 2021, and January 1, 2022) and IDA Development Policy Financing dated December 14, 2018 (revised on August 1, 2020, April 1, 2021, and January 1, 2022) (collectively, General Conditions). If, after being deposited in a government deposit account, the proceeds of the operation are used for excluded expenditures as defined in the General Conditions, the WB will require the Borrower to refund the amount directly to the WB. Any such amount refunded to the WB shall be cancelled.

114. **The Post Cyclone Winston Emergency Development Policy Operation and First Fiscal Sustainability and Climate Resilience Development Policy Loan audits have been received with no material issues in the audit reports**. The Second Fiscal Sustainability and Climate Resilience DPO did not have an audit requested by the WB. The audit reports of the dedicated Foreign Currency Deposit Account for each fiscal year in which receipts exist, if requested in writing by the WB, will be required to be received within nine months of the end of the Recipient's fiscal year in which the disbursement is made. In that event the Borrower would report: (i) receipts—the exact sum received into the deposit account and its supporting details; (ii) payments—(a) payments made in foreign currency by major categories, and (b) transfers to the Government Treasury account for local currency budget expenditures; and (iii) balance.

115. **The closing date for the proposed operation March 25, 2024**.

5.4. MONITORING, EVALUATION AND ACCOUNTABILITY

116. **The MOE is responsible for coordinating the monitoring and evaluation of the results indicators for the proposed operation**. MOE will monitor the results indicators pertaining to revenue, debt management, and execution of the economic support package, and will collaborate directly with the relevant ministries and agencies on the other result indicators. MOE has demonstrated effective and good capacity to coordinate the monitoring and results evaluation of budget support operations to date.

117. **The results indicators chosen for the operation were selected with a view to the ready availability of data of reasonable timeliness and quality**. Monitoring and evaluation of the indicators will be supported by the data provided by relevant Government ministries and agencies, and data from publicly available sources. Progress against actions and outcomes will be collaboratively tracked, and any necessary remedial actions identified and supported jointly by the ADB, PFTAC, and the World Bank.

118. **Grievance Redress**. Communities and individuals who believe that they are adversely affected by specific country policies supported as prior actions or tranche release conditions under a World Bank Development Policy

Operation may submit complaints to the responsible country authorities, appropriate local/national grievance redress mechanisms, or the WB's Grievance Redress Service (GRS). The GRS ensures that complaints received are promptly reviewed in order to address pertinent concerns. Affected communities and individuals may submit their complaint to the WB's independent Inspection Panel which determines whether harm occurred, or could occur, as a result of WB non-compliance with its policies and procedures. Complaints may be submitted at any time after concerns have been brought directly to the World Bank's attention, and Bank Management has been given an opportunity to respond. For information on how to submit complaints to the World Bank's corporate Grievance Redress Service (GRS), please visit http://www.worldbank.org/GRS. For information on how to submit complaints to the World Bank Inspection Panel, please visit www.inspectionpanel.org".

6. SUMMARY OF RISKS AND MITIGATION

119. **The overall risk of the operation is substantial.** Ongoing risks are associated with the COVID-19 pandemic the war in Ukraine and the ever-present threats of natural disasters. Each of these factors could lead to significant macroeconomic impacts and put additional stress on already strained government capacity. To the extent possible these risks are mitigated by the reforms supported by this operation, and the financing provided.

120. **Political and governance risk is substantial due to the COVID-19 crisis and the election that is to be held between July 2022 and January 2023**. The Fiji First party was returned to power in November 2018 for another four-year term gaining an outright majority, albeit by a slimmer margin than in 2014, in an election process conducted fairly, according to an international observer mission. This continuity has served to maintain the reform momentum and keep policies aligned to the priorities set out in the NDP 2017, but national elections must be held sometime between July 2022 and January 2023. The political process behind these elections may complicate the Government's ability to undertake reforms in the short term. The proposed operation focuses on areas where the Government has already established a strong track record This, and close coordination with other development partners, and appropriate consultation with the broader group of stakeholders, including the private sector, should partly mitigate risks.

121. **Macroeconomic risk to Fiji's economy is high given the prolonged impact of the COVID-19 pandemic and the war in Ukraine.** The Government's COVID-19 vaccination is impressive, but the increased incidence of COVID-19 infection due to the emergence of new and more infectious variants may lead to stricter containment measures which could weaken consumer and business confidence, dampen the prospects of a swift economic recovery, and suppress the Government's ability to generate public revenues. The authorities are also confronted with the inflationary pressures due the rise in global commodity prices following disruptions to supply chains and the war in Ukraine. Taken together these factors may severely constrain the fiscal space needed to generate economic growth, support businesses and livelihoods, and possibly divert the Government's focus from implementation of longer-term reforms and fiscal consolidation. Another major natural disaster could also threaten macroeconomic stability, create additional hardships on the population, and slow-down the structural reform agenda as the Government prioritizes disaster recovery and reconstruction efforts. These risks are mitigated by financing from the proposed operation and other development partners that will alleviate fiscal pressure from any such shocks in the short run. In the medium-term, policy reforms to strengthen fiscal sustainability, debt management and social and climate resilience supported by this operation will bolster recovery.

122. **Sector Strategies and Policies risk is substantial.** While sectoral strategies and policies have become more coordinated in recent years, and specifically in the NDP 2017, these are largely at the level of strategy with key regulations and institutions still nascent. The policy and institutional measures supported by this operation will

ultimately strengthen the design and delivery of private sector policies. However, there is a residual risk of coordination failures in the transition to the new policy framework. This risk is mitigated in two primary ways. First, the prior actions have been carefully developed to build on policy areas that are significant and long-term government priorities. Secondly, the WBG has provided extensive TA in the policy areas for several years and this TA will continue to help ensure the new sectoral policies are properly implemented.

123. **Environmental and social risk is substantial.** Fiji is on a tropical cyclone belt and, on average, one cyclone passes through Fijian waters each year. Localized flooding during the wet season (November to April) is common. Such events are outside the reforms supported through the operation and implementation delays can hamper the achievement of results. The reforms that enhance climate resilience of coastal and marine areas will help minimize the risks. These reforms build on those supported by the previous DPO which focused on resilience of buildings, including in rural areas and customary land, thus benefitting the poorest and most vulnerable populations. PA2 could potentially have negative impact if tourism-related investments near coastal areas or riverine catchments impact forests, rivers and increase sedimentation and pollution. The Government has recently demonstrated the strength of its EIA process by successfully prosecuting a firm that violated environmental legislation related to coastal area development. The Government is continuing to be supported by development partners to further strengthen its EIA process.

124. Institutional Capacity for Implementation and Sustainability is substantial. Fiji has thin administrative capacity which could hamper reform implementation. This risk is partly mitigated by close and ongoing dialogue between the Government and the WB, and careful selection of prior actions that are key priorities for the Government. The Government, WB and other development partners have discussed and reviewed the requirements for each action to ensure expectations regarding the timeframes for implementation are realistic. Limited administrative capacity is also mitigated through the provision of dedicated TA from various development partners to support the achievement of nearly all specified actions. Significant and far-reaching reform programs, such as the one supported by this operation, require ongoing commitment and engagement throughout implementation. This program is tailored to Fiji’s country circumstances and supports, within the context of an ongoing, broader budget support engagement between the Government, WB and other development partners.

Table 6: Summary Risk Ratings

Risk Categories	Rating
1. Political and Governance	Substantial
2. Macroeconomic	High
3. Sector Strategies and Policies	Substantial
4. Technical Design of Project or Program	Moderate
5. Institutional Capacity for Implementation and Sustainability	Substantial
6. Fiduciary	Moderate

7. Environment and Social	Substantial
8. Stakeholders	Moderate
9. Other	
Overall	Substantial

ANNEX 1: POLICY AND RESULTS MATRIX

Prior Actions		Results		
DPO1	**DPO2**	**Indicator Name**	**Baseline**	**Target**
Pillar 1: Promoting Private Sector-Led Economic Recovery				
Prior Action #1. To improve the efficiency of payment system and foster digital solutions, the Recipient, through its Cabinet, has approved the National Payment System Bill 2020.	Prior Action #1. To expand the scope of the payments system and promote digitalization, the Recipient, through its Minister for Economy, has made the National Payment System Regulations 2022.	Results Indicator 1: The annual volume of payments made electronically through the Real-Time Gross Settlement System	148,786 (FY2019)	185,930 (FY2024)
Prior Action #2. To develop wholesale corporate bonds market, the Recipient, through the Ministry of Economy, has approved the Companies (Wholesale Corporate Bonds) Regulations 2021.	Prior Action #2. To promote foreign and domestic investment, the Recipient has: (i) enacted the Investment Fiji Act 2022; and (ii) through its Minister for Commerce and Trade, made the Investment (Reserved and Restricted Activities) Regulations 2022 and the Investment (Foreign Investors Reporting) Regulations 2022.	Results Indicator 2: Number of outstanding corporate bond issuances Results Indicator 3: Volume of foreign investment commitments	0 (FY2019) US$24.3 million (median 2015 to 2019)	2 (FY2024) US$27.9 million (FY2024)
Pillar 2: Enhancing Climate, Disaster and Social Resilience				
Prior Action #3. To enhance resilience of coastal communities by protecting marine ecosystems, the Recipient, through its Cabinet, has approved the National Ocean Policy 2020-2030	Prior Action #3. To enhance climate resilience, the Recipient has enacted the Climate Change Act 2021, which provides legal authority for the Minister responsible for climate change to coordinate and implement climate adaptation actions.	Results Indicator 4: (i) percentage of area within the national jurisdiction legally designated as Marine Protected Areas that contribute to climate resilience; and (ii) establishment of the Adaptation Registry. Results Indicator 5: Share of 150	(i) 1 (ii) None (FY2021)	(i) 5 (ii) Established and made publicly available (FY2024)

Prior Actions		Results		
	Prior Action #4. To enhance the climate resilience of ecosystems, the Recipient, through its Cabinet, has approved the National Jobs for Nature Rehabilitation Policy 2022-2032, which fosters traditional management of resources to reduce degradation of land, coastal and marine ecosystems.	funded activities implemented by women community groups	0 (FY2021)	35 (FY2023)
Prior Action #4: To improve the resilience of buildings to climate risks by specifying minimum requirements of structural materials, the Recipient, through the Ministry of Commerce, Trade, Tourism and Transport, has approved the Fiji Standard A/NZS 4671 for Steel Reinforcing Materials	Prior Action #5. To strengthen the early warning system for disaster preparedness, the Recipient, through its Cabinet, has approved the Meteorological and Hydrological Services Bill 2022, which establishes Fiji Meteorological and Hydrological Service.	Results Indicator 6: Percentage of import permits for steel reinforcement material being manufactured in accordance with the revised standard, or suitable equivalent standard, provided to the Border Control Agency Results Indicator 7: Implementation plan for developing and piloting/testing impact-based multi-hazard early warning	0 (FY2019) None (FY2022)	100 (FY2024) Completed (FY2024)
Prior Action#5: To better target social assistance programs and improve socioeconomic and climate resilience of the poor and vulnerable, the Recipient, through its Cabinet, has approved the Social Assistance Policy: Protecting the Poor and Vulnerable		Results Indicator 8: Share of social assistance programs that include gender-sensitive and disaster responsiveness criteria for determining assistance	0 (FY2021)	50 (FY2024)
Pillar 3: Strengthening Debt, Public Financial and Fiscal Management				
Prior Action #6. To improve debt management, the Recipient, through its	Prior Action #6. To improve debt management, the Recipient, through: (i) its	Results Indicator 9: (i) external (FX) debt as percent of total public	(i) 26 percent	(i) 30 percent (+/-5%)

Prior Actions		Results		
Cabinet, has approved Fiji's first Medium Term Debt Management Strategy Fiscal Years 2021-2023 and made it publicly accessible on the Ministry of Economy's website.	Ministry of Economy, has prepared the Annual Borrowing Plan Fiscal Year 2021-2022 (ABP) consistent with the current Medium-Term Debt Management Strategy, and has published the ABP on its website; and (ii) its Cabinet, has approved a Liability Management Operations Policy (LMO Policy) that enables the Recipient to pursue active debt management operations such as buybacks, switches and callbacks; and has published the LMO Policy on its Ministry of Economy's website.	debt; and (ii) the number of instruments	(ii) 396 (FY2020)	(ii) 320 (FY2024)
Prior Action #7. To strengthen public financial management, the Recipient, through its Cabinet, has: (i) approved the Financial Management (Amendment) Bill 2021; (ii) applied Gender Responsive Budgeting principles in its FY2020-2021 budget process with regard to two pilot ministries, namely, the Ministry of Commerce, Trade, Tourism and Transport and the Ministry of Fisheries; and (iii) agreed that Gender Responsive Budgeting principles will be rolled out to other ministries in the future.	Prior Action #7. To enhance revenue mobilization, the Recipient has enacted the Value Added Tax (Revised Budget Amendment) Act 2022, which increased the VAT rate applicable to: (i) the importation and supply of selected goods; and (ii) prescribed services, from 9 percent to 15 percent. Prior Action #8. To reduce tax expenditures related to film production, the Recipient, through its Minister for Economy, has made the Income Tax (Film-making and Audio-visual Incentives) (Amendment) Regulations 2022.	Results Indicator 10: Number of programs across budget agencies performing gender impact assessments and collecting sex-disaggregated data for monitoring and evaluation Results Indicator 11: The value added tax as percent of GDP Results Indicator 12: The annual revenue impact of the film rebate reduction	None (FY2020) 4.6 percent (FY2021) 0 (FY2020)	35 out of 200 (FY2024) 7.1 percent (FY2024) 0.4 percent of GDP (FY2024)

ANNEX 2: FUND RELATIONS ANNEX

Republic of Fiji—Assessment Letter for the World Bank, Asian Development Bank, and the Asian Infrastructure Investment Bank
May 15, 2022

Recent Development, Outlook, and Risks

1. **The economic impact of the COVID-19 pandemic on Fiji has been severe, but a recovery is now underway.** Real GDP contracted by a cumulative 20.5 percent in 2020–21 due to the sudden stop in tourism after March 2020 combined with successive local COVID outbreaks and related restrictions on movement and business activity. After a successful mass vaccination campaign,[23] Fiji reopened its borders in December 2021 and eliminated quarantine requirements for incoming visitors in early April 2022. Based on visitor arrivals data through March and advance booking data through the end of the year, total visitor arrivals could reach as high as 50 percent of 2019 levels in 2022. Together with promising signs for other sectors, real GDP growth for 2022 has been revised up from 6.2 percent (at the time of the Article IV in December 2021) to 10.8 percent.

2. **Inflation has surged in the wake of higher international commodity prices since the beginning of the war in Ukraine.** Projected average inflation in Fiji for 2022 has been revised up from 2.5 percent at the time of the Article IV Consultation to 5 percent (end-of-period inflation of 4.5 percent). The upward revision reflects the steep increase in global commodity prices—particularly food and fuel. A recently announced phased increase in the minimum wage is also expected to feed through to the overall wage structure and may add upward pressure to prices over time. The Reserve Bank of Fiji (RBF) intends to maintain its accommodative stance for the time being, citing a large negative output gap and the inefficacy of monetary policy in addressing inflation from a supply-side shock.

3. **The sharp hike in international commodity prices is also undercutting some of the expected gains in the external accounts.** The overall balance of payments was relatively unaffected during most of the pandemic. Notwithstanding the loss of tourism inflows, the trade deficit was lower than average during 2020–21—reflecting an offsetting reduction in imports from the tourism sector, lower aggregate demand, and lower prices for fuel imports. Fiji has also benefited from strong growth in inward remittances, which grew by 22.9 percent in 2020 and 17.6 percent in 2021. A large increase in foreign exchange inflows related to bilateral and multilateral loans and grants, together with the additional allocation of SDRs allowed foreign exchange reserves to rise to $1.5 billion in 2021, compared to about $1 billion at end-2019. The external current account deficit is projected to reach 11.3 percent of GDP in 2022. This is an improvement relative to the 2019 deficit of 12.6 percent, but it is significantly weaker than the 8.8 percent of GDP deficit projected at the time of the Article IV Consultation and reflects higher import costs. Fiji's external reserves are projected to remain ample at 6.8 months of import cover by end-2022 but will likely continue to decline in the face of high import costs and current policies over the medium-term, broadly in line with projections under the 2021 Article IV staff report.

[23] An estimated 95 percent of those over age 18 have been fully vaccinated, with ongoing vaccination campaigns for the 15-17 and 12-14 years of age cohorts.

4. **The effects of the pandemic on Fiji's fiscal and debt positions have been marked.** The government fiscal deficit expanded to 12.9 percent of GDP in 2020 and 13.3 percent in 2021, compared to an average deficit of 3.4 percent over the preceding five years. The deterioration was driven by a sharp drop in revenues—partly from the loss of tourism but also from sweeping cuts to taxes, tariffs, and excises as part of the FY20–21 official budget. Nominal expenditures actually decreased during the pandemic as the government declared a freeze on new civil service positions and trimmed capital spending. Public debt-to-GDP increased from 49.0 percent of GDP in 2019 to an estimated 87.2 percent at end-2021 (mainly via loans from multilateral and bilateral partners). The government has also taken on significant contingent liabilities during the crisis, mainly to support state-owned Fiji Airways and the Fiji Development Bank. Total contingent liabilities have risen from 10.8 percent of GDP in July 2019 to 16.9 percent of GDP in July 2021.

5. **The macroeconomic outlook is subject to an unusually high level of uncertainty.** While business confidence appears high, concerns center on the risk of a new COVID variant, the timing of national elections, and further supply chain disruptions slowing investment. IMF staff estimate a confidence interval of about +/-1.5 percentage points around the projection for GDP growth. The outlook for inflation is also uncertain and projections are currently predicated upon the assumption in the April World Economic Outlook regarding no further expansion of sanctions, and a gradual reduction in world petroleum prices over the medium-term. Critically, it's not clear how long the momentum seen in the opening months of 2022 with respect to visitor arrivals and tourism can be maintained as competing locations reopen borders and loosen restrictions.

Policy Response and Settings

Fiscal Policy

6. **To mitigate the impact of the COVID-19 pandemic, the Fijian authorities undertook a series of macroeconomic and financial measures.** The first step was a stimulus package of FJ$1 billion (8.7 percent of GDP) in a supplemental budget on March 26, 2020. Most of the stimulus came from non-budgetary support via the Fiji National Provident Fund (FNPF), loan repayment holidays offered by commercial banks, and concessional loans from the central bank. The package also included supplemental transfers and expenditures on public health as well as tax and tariff reductions. The second stage came through the FY2020–21 budget and included major changes to Fiji's tax and tariff regime. At the center of the budget was a reduction or elimination of fiscal and import excise duties on over 1,600 items, removal of the Services Turnover Tax, and cuts to the Environment & Climate Adaptation Levy (ECAL), and the departure tax, which collectively reduced revenue by about 5 percent of GDP. These policies were continued in the FY21–22 budget. While a strong and timely response, the heavy emphasis on permanent cuts to taxes, tariffs, and excises was not entirely appropriate.

7. **The government announced a "mini-budget" in early April 2022 to incorporate recent fiscal outturns and introduce measures to address the impact of rising prices.** Key measures included zero rating the VAT on 21 essential consumer items, eliminating the ECAL, raising the VAT rate from 9 to 15 percent on a list of other items (mostly white goods), and a phased increase in the minimum wage. The zero rating is reported to be temporary to alleviate price pressures (in the absence of a cash-transfer system), and the increase in the VAT rate on selected items is aimed at maintaining revenue neutrality. An overall fiscal deficit of 12.4 percent of GDP is projected for FY21–22, compared to 13.7 percent at the time of the Article IV Consultation. Public debt is expected to be lower than projected earlier, ending

FY21–22 at about 86.4 percent of GDP (compared to 89.8 percent of GDP projected at the time of the Article IV).

8. **The authorities acknowledge that the revenue profile created by these successive changes is not sustainable over the medium-term and are committed to fiscal consolidation.** They agree to pursue a small primary fiscal surplus as the desirable anchor to guide fiscal policy and help ensure a steady decline in the debt-to-GDP ratio, and that the shift to consolidation will need to begin with the FY22–23 budget. The downward shift in government tax revenue resulting from pandemic-era measures combined with two years of economic contraction is roughly equivalent to 5.5 percentage points of GDP. The authorities agree that a further streamlining of expenditures will be needed over the medium term, but also that a significant part of the decline in tax revenue will need to be recouped to achieve a sustained primary budget surplus of about 1 percent of GDP (sufficient to put the ratio of public debt to GDP on a downward path). Taken together, this will likely require a reduction in recurrent expenditure to about 15-16 percent of GDP (from a peak of 21.2 percent in FY21–22), accompanied by both policy and administration reforms to bring tax revenues up to at least 22 percent of GDP on a sustainable basis (compared with an estimated 16 percent in FY21–22).

9. **The fiscal outlook carries significant risk, including implementation risks.** While the staff views the reduction in the overall fiscal deficit underlying the baseline scenario (9.9 percent of GDP over the next three years) as feasible, it will take a concerted policy effort encompassing a broad range of revenue reforms together with an improvement in tax administration and collection. Further expenditure reforms will be needed to generate savings but must be considered carefully so as not to endanger the provision of essential government services and investment. Careful planning and political commitment will be needed, including during a pre-electoral period. An important milestone in this respect will be the forthcoming FY22–23 budget, which will need to lay out in detail the steps to be taken. Key risks include the emergence of a new COVID variant, a waning of tourism inflows beyond 2022, continued supply chain issues, a dampening of investor confidence surrounding national elections, or the onset of a natural disaster. Fiji remains vulnerable to climate change, natural disasters, and other external shocks—at a time when fiscal buffers have largely been depleted: should unfavorable shocks materialize, they would need to be met through a combination of new loans, grant financing, and compression of public spending (most likely capital expenditures).

Monetary and Exchange Rate Policy

10. **The RBF eased monetary policy at the outset of the pandemic and is unlikely to shift the policy stance in the near future.** The RBF lowered the overnight policy rate on March 18, 2020, from 0.5 to 0.25 percent. The influx of external loans and grants has been unsterilized and has led to a large level of excess liquidity in the banking system (roughly F$2.1 billion as of March 2022). Interest rates have declined substantially, but the gap between lending and time deposit rates has widened. Private sector credit has begun to rise this year. Given the large negative output gap and that the source of the recent surge in inflation is from import prices, the current monetary stance remains appropriate. However, careful monitoring in the months ahead is needed given the possibility of demand side pressures emerging as the economy recovers, second round effects, and from wage-price dynamics in the wake of phased increases in the minimum wage.

11. **The exchange rate has remained relatively resilient during the pandemic, and reserves are at record highs.** The Fiji dollar is pegged to a basket of currencies amid capital mobility. The exchange rate

has depreciated by about 8.3 percent in real effective terms since the onset of the pandemic through March 2022. Given the significant build-up in international reserves related to increased pandemic related financing flows, reserve cover hit a record high (7.4 months of prospective imports) in 2021. The IMF's 2021 SDR allocation to Fiji of about USD 133.8 million further boosted foreign reserves. However, foreign exchange reserves are expected to decline over the medium-term, and fiscal adjustment will be essential to maintaining external balance. Continued monitoring will be needed with respect to currency movements and the stability of the peg to the basket.

12. Fiji maintains exchange restrictions for payments on current international transactions, some of which were tightened on April 2, 2020. These restrictions include: i) limits on large external payments and ii) the tax certification requirement for the transfer of profits and dividends abroad, proceeds of airline ticket sales, and for making external debt and maintenance payments. These restrictions are inconsistent with Article VIII, hamper Fiji's international trade, and discourage foreign investment. They should be phased out with a view to proper sequencing based on Fiji's tax compliance risks and consistency with the peg.

Financial Sector Policies

13. The banking sector appears sound overall, but the level of risk has increased with the effects of the pandemic. The stability of the banking system is underpinned by the dominance of large foreign banks that operate as branches and have access to their parent banks for capital and liquidity. However, the effects of the pandemic and the sharp contraction in economic activity are visible in banks' balance sheets. NPLs as a share of total loans have risen to a record high of 8 percent as of June 2021 compared to 3 percent at end-2019 (and to 30 percent for credit institutions, compared to 25.7 percent at end-2019). These levels could rise further as loan repayment holidays are lifted and given the impact of recent inflationary pressures.

14. Enhanced supervision will be needed as Fiji enters the post-pandemic and support measures are reduced. The latest stress tests indicate all banks are capable of withstanding moderate credit risk shocks while still complying with minimum capital requirements. The RBF has already enhanced on-site examination of banks and credit institutions—prioritizing asset quality and provisioning standards—and has mandated prudential reporting specifically on loans under repayment holidays. In terms of macroprudential surveillance, the RBF has yet to deploy tools to address potential systemic issues arising from the pandemic. The RBF has also requested technical assistance from the IMF on extending its stress testing framework, and on implementing recommendations from the 2018 Financial Sector Stability Review on emergency management.

Structural Issues

To support the recovery and enhance prospects for diversification, continued emphasis on structural reforms will be needed. The recent passage of the new Investment Act 2021 is a welcome step in this regard. However, there remain a number of important opportunities to improve Fiji's competitiveness and business environment. Completion of work on a digital national payment system will broaden financial inclusion and enhance the efficiency of government transfers while reducing corruptions risks. Further development of the domestic debt market could support a broadening of the investor base and funnel capital to new medium and long-term investments. Addressing skills gaps and labor mismatches and simplifying labor market regulations would also help boost employment and facilitate the creation of new small and medium-size enterprises.

Debt Sustainability

15. **Under the current baseline scenario, the public debt-to-GDP ratio is expected to fall gradually over the medium-term, but debt sustainability remains subject to significant risks.** It assumes the authorities implement revenue and expenditure reforms consistent with the consolidation strategy discussed above, and that tourism flows continue to rebound and support a steady recovery with no new major shocks. Under this scenario, the overall fiscal deficit should decline to 2.5 percent of GDP by FY24–25 (equivalent to a primary surplus of about 1 percent of GDP), and the ratio of public debt to GDP should fall to 71.1 percent by the end of the medium-term in FY26–27. As noted above, this scenario is subject to wide degrees of uncertainty and risk, and close monitoring of economic outcomes and policies is warranted. Risks to this projection include policy implementation risks. Absent sufficient adjustment to put the ratio of public debt to GDP firmly on a downward trajectory, the fiscal trajectory and medium-term outlook would be unsustainable. Other risks include a slower economic recovery (which could be contingent on COVID-related shocks); materialization of contingent liabilities from state-owned enterprises; and natural disaster risk. Particularly important to mitigate these risks is the development of a detailed medium-term fiscal framework to guide policy making, rebuild fiscal buffers in a growth-friendly way, and create space to respond to future natural disasters and ensure public debt sustainability.

IMF Relations

16. **Fiji is on a standard 12-month Article IV consultation cycle.** The 2021 Article IV consultation was concluded by the IMF's Executive Board on December 3, 2021, and the staff report was published shortly thereafter (IMF Country Report No. 21/257).

17. **The Fund provides technical assistance and training from headquarters, PFTAC, and the Singapore Training Institute.** The regional resident representative is also based in Suva and is in frequent communication with the authorities.

Table 1. Fiji: Selected Economic Indicators, 2019-27

	2019	2020	2021	2022	2023	2024	2025	2026	2027
			Est.	Proj.					
Output and prices (percent change)									
Real GDP	-0.6	-17.2	-4.0	10.8	8.1	6.4	4.6	3.5	3.5
GDP deflator	2.2	-1.1	1.2	5.0	3.5	2.8	2.7	2.5	2.5
Consumer prices (average)	1.8	-2.6	0.2	5.0	3.5	2.8	2.7	2.5	2.5
Consumer prices (end of period)	-0.9	-2.8	3.0	4.5	3.5	2.7	2.5	2.4	2.4
Central government budget (percent of GDP)									
Revenue	25.6	20.4	21.7	23.3	24.9	25.7	26.0	26.0	26.1
Expenditure	30.0	33.3	35.0	32.4	30.2	29.0	28.5	28.5	28.4
Overall balance	-4.4	-12.9	-13.3	-9.1	-5.3	-3.2	-2.5	-2.4	-2.3
Primary balance	-1.6	-9.2	-9.5	-5.2	-1.4	0.6	1.3	1.4	1.5
Central government debt	49.0	71.1	87.2	83.5	79.3	75.5	72.8	71.1	69.3
External sector (percent of GDP)									
Current account balance	-12.6	-12.9	-13.1	-11.3	-8.1	-8.0	-8.0	-7.8	-8.1
Trade balance	-25.4	-14.8	-20.8	-23.8	-24.6	-25.2	-25.0	-24.5	-24.2
Services balance	14.9	-1.9	-4.9	7.4	12.2	13.6	14.0	14.1	13.8
Primary Income balance	-8.2	-6.3	-5.5	-8.2	-7.8	-7.6	-7.5	-7.6	-7.7
Secondary Income balance	6.1	10.1	18.2	13.3	12.1	11.2	10.6	10.2	10.0
Capital account balance	0.1	0.1	0.1	0.1	0.1	0.0	0.0	0.0	0.0
Financial account balance (-= inflows)	-11.8	-7.8	-17.1	-12.8	-10.2	-8.3	-8.0	-7.6	-7.5
FDI	-6.5	-5.1	-8.0	-6.4	-6.8	-7.0	-7.0	-7.1	-7.1
Portfolio investment	-0.3	4.0	0.5	0.5	0.5	0.5	0.5	0.5	0.5
Other investment	-5.0	-6.6	-9.6	-6.9	-3.9	-1.8	-1.5	-1.0	-1.0
Errors and omissions	2.4	4.7	6.6	0.0	0.0	0.0	0.0	0.0	0.0
Change in reserve assets (-=increase)	-1.8	0.3	-10.7	-1.5	-2.1	-0.3	-0.1	0.1	0.5
Gross official reserves (in months of prospective imports)	7.3	6.2	7.4	6.8	6.6	6.3	6.0	5.6	...
External central government debt	12.7	19.0	27.2	29.8	29.7	28.9	27.9	27.0	26.1
Money and credit (percent change)									
Domestic claims of depository corporations	4.9	2.3	3.9	...	...	...	...	...	...
Claims on private sector	4.6	-3.1	-0.1	...	...	...	...	...	...
Broad money (M3)	2.7	1.2	11.1	...	...	...	...	...	...
Monetary base	15.2	13.5	48.8	...	...	...	...	...	...
Central Bank Policy rate (end of period)	0.50	0.25	0.25	...	...	...	...	...	...
Commercial banks deposits rate (end of period)	1.10	0.54	0.42	...	...	...	...	...	...
Commercial banks lending rate (end of period)	6.30	6.12	5.77	...	...	...	...	...	...
Memorandum items									
Exchange rate, average (FJD/USD)	2.16	2.17	2.07	...	...	...	...	...	...
Real effective exchange rate, average	113.4	107.7	102.8	...	...	...	...	...	...
GDP at current market prices (in millions of Fiji dollars)	11,843	9,707	9,432	10,971	12,271	13,421	14,416	15,295	16,230
GDP at current market prices (in millions of U.S. dollars)	5,482	4,476	4,555	5,299	5,926	6,482	6,962	7,387	7,838
GDP per capita (in U.S. dollars)	6,127	4,975	5,035	5,824	6,479	7,047	7,527	7,858	8,339
Real output gap	-0.9	-14.5	-19.3	-12.4	-7.2	-3.6	-1.6	-0.6	0.4

Sources: RBF, Ministry of Economy and IMF staff estimates and projections.

ANNEX 3: LETTER OF DEVELOPMENT POLICY

**Attorney-General and Minister for Economy,
Civil Service and Communications**

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30 May 2022

Mr. David Malpass
President
World Bank
Washington DC 20433 USA

Dear President Malpass,

Fiji - Recovery and Resilience Second Development Policy Operation (P175543)

1. Following an unprecedented nine years of consecutive economic growth, 2020 saw Fiji's sharpest economic contraction in history and one of the worst in the world due to COVID-19 and Tropical Cyclones (TCs) Harold (2020), Yasa (2020) and Ana (2021). Real GDP contracted by 17.2 percent in 2020 and is estimated to have contracted a further 4.1 percent in 2021 in the wake of the Delta variant outbreak. Extensive damage to agriculture, public buildings and tourism facilities from the TCs resulted in a further deterioration of economic activity.

2. Our Government mobilized a comprehensive response to COVID-19 through the FY20 COVID-19 Response Budget and the FY21 Budget which included funding for: (i) public health activities to contain the spread of COVID-19; (ii) support to businesses in the formal and informal sectors, financial support to businesses affected by COVID-19 restrictions, and subsidies for concessional loans to micro, small and medium-sized enterprises; and (iii) support to individuals, including through financial aid to persons affected by COVID-19 restrictions and the unemployment assistance scheme.

3. These measures, combined with a robust vaccination campaign that has resulted in a vaccination rate of over 95 percent have allowed Fiji to begin reopening its borders. Tourist arrivals are now at just under 50 percent of pre-pandemic levels and the economy is projected to grow by more than 11.3 percent in 2022. However, the recovery is likely to be slow and risks remain due to the potential emergence of new variants, the Russian war in Ukraine, and Fiji's high vulnerability to cyclones and floods.

4. The fiscal impacts of the COVID-19 pandemic have highlighted the importance of fiscal consolidation and re-emphasised the necessity of Fiji's consistently prudent debt management. Fiscal space has been squeezed by COVID-19 and the recurrent climate-related events, including TCs Harold, Yasa and Ana as well as the significant economic costs of smaller flash flooding events. The current account deficit widened to 15.6 percent of GDP in 2021, relative to 13.2 percent of GDP in 2020, but we expect this to narrow to 8.8 percent in 2022, in line with pre-pandemic levels. The fiscal deficit is expected to gradually decline to 4.8 percent of GDP by FY24, from the projected 14.6 percent of GDP in FY22. Fiscal consolidation will be driven by a combination of targeted revenue and expenditure measures contributing 2.9 and 3.2 percentage points of GDP, respectively,

by FY24 compared to FY21. The increase in VAT rate on the supply and importation of selected high-end goods and prescribed services through the enactment of the Value Added Tax (Revised Budget Amendment) Act 2022, and revision of film-making and audio-visual incentives through the making of the Income Tax (Film-making and Audio-visual Incentives) (Amendment) Regulations 2022 while the economy is recovering signifies our strong commitment towards fiscal consolidation now and in the foreseeable future. Complementary fiscal measures include a comprehensive revenue reform package (currently in preparation) and a stabilization of spending in nominal terms over FY22-FY24, leading to a substantial consolidation relative to GDP as the economy recovers.

5. Domestic resource mobilization was severely affected by the steep decline in economic activity and COVID-19 revenue response measures. Tax revenues fell from 24.0 percent of GDP in FY19 to 14.6 percent in FY21. This was driven in approximately even shares by subdued economic activity from the collapse of the tourism sector and the tax measures provided for in the COVID-19 response package including tax rate reductions and exemptions, tax base changes, the elimination of the service turnover tax, and administrative measures. Grants from development partners and divestment of shares in Energy Fiji Limited offset part of the fall in tax revenues. To further support fiscal consolidation, we plan to prioritize high-spending capital projects on a stricter value-for-money basis in FY2022 and FY2023. We have been prioritizing reforms to introduce a multi-year perspective towards planning and budgeting as well as mandating feasibility and economic cost-benefit analyses as criteria for the appraisal and selection of new investment projects, including in infrastructure.

6. Promoting private sector growth and investment remains a key policy priority and central to the COVID-19 recovery. Even amid the pandemic, we passed major framework legislation to reform our foreign investment laws (the Investment Act 2021) and to expand digital payments (the National Payment Systems Act 2021). We have since enacted subsequent legislation and made regulations in both areas, including the Investment Fiji Act 2022, the Investment (Reserved and Restricted Activities) Regulations of 2022, the Investment (Foreign Investors Reporting) Regulations 2022, and the National Payment System Regulations 2022. We remain on track to adopt a Small Business Access to Capital Bill in 2022 and to finalize our financial inclusion strategy. Now, as the economy begins to recover and our COVID-19 support measures expire, we will focus on new reforms to improve the business environment with the objective of catalyzing private investment into traditional areas such as tourism and agribusiness, while also promoting diversification.

7. Fiji, like other Pacific Island countries, faces existential risks from natural disasters and other climate impacts. Scaling up activities to enhance the resilience of our people and of vulnerable areas and sectors continues to be a central element of our Climate Change Policy 2018-2030 and development agenda. To this end, on 24 September 2021, the Climate Change Act 2021 was enacted. This Act provides a regulatory framework for actions that contribute to meeting our international and national aspirations for climate adaptation and mitigation. It is a pleasure to note that we are one of the few Small States and middle-income countries in the world to pass such legislation. The Act provides a framework to help develop and implement climate change measures and policies that will safeguard the future of Fiji by legally binding us to our commitment of net-zero carbon emissions by 2050. The Act also allows us to conduct carbon trading and to meet our international obligations to sustainably manage and enhance the resilience of our land and coastal ecosystems as well as protect the marine biodiversity in our expansive

oceans. The Act provides legal authority for the Minister responsible for climate change to coordinate and implement climate adaptation actions, which we see as being essential for Fiji to progress towards climate-resilient development. In addition to enacting the Climate Change Act 2021, we are taking steps to improve climate resilience through revisions to the National Building Code (NBC) which will be adopted by 2023.

8. During the lockdown, when the Ministry of Environment officials were not able to travel, they proposed to rely more heavily on the traditional management expertise within communities. Specifically, the community is engaged and, through a grant mechanism, compensated for the rehabilitation, protection, and restoration of land, coastal and marine ecosystems. This provided socio-economic and environmental benefits. With the support of the World Bank and other partners, we are pleased to have developed and approved through our Cabinet a National Jobs for Nature Rehabilitation Policy 2022 - 2032 with an implementation period of 10 years and provision of grants to communities and local administration. Finally, as part of our efforts for climate and disaster-resilient development, our Cabinet has also approved the Meteorological and Hydrological Services Bill 2022. It provides the mandate for Fiji Meteorological and Hydrological Service (FMHS) to be established and will contribute to improving the efficiency, effectiveness and quality of our early warning systems. This is much needed with the increasing cyclones and floods that we have faced over the past few years. We also look forward to World Bank's technical assistance to make these warnings easy to understand by all stakeholders so that they can take action to reduce risks to lives and livelihoods and damage to assets.

9. Our debt management policies prioritize borrowing from multilateral creditors. Most new borrowings are on concessional terms, and we have successfully refinanced the US$200 million global bond that matured on October 2, 2020, with lower-cost loans from multilateral creditors. We are also participating in the Debt Service Suspension Initiative (DSSI) with our two bilateral partners, China Exim-Bank and JICA, resulting in the total suspension of debt service payments amounting to US$34.5 million, equivalent to 0.74 percent of GDP. The temporary suspension of these payments has created fiscal space to provide support to the COVID-19 response in social, health and economic programs. Going forward, in line with our medium-term debt strategy, new external borrowing will maximize concessional financing with multilateral development banks, with only limited bilateral borrowing from Japan envisioned. We have also committed to two Policy and Performance Actions for the Sustainable Development Finance Policy under IDA. These commitments include the Annual Borrowing Plan Fiscal Year 2021-2022 prepared and published by the Ministry of Economy, and the Liability Management Operations Policy which has been approved by Cabinet and published.

10. We remain fully committed to our development agenda to create an inclusive society that provides equal opportunity for all Fijians and expands national access to a climate-resilient network of public services, notably in education and health. The challenges that we, and every other country, faced in 2020 and 2021 illustrate the urgency of realising this vision. Our Government is firmly committed to implementing an ambitious set of reforms to move forward and improve the environment for private sector growth and investment; enhance our climate and disaster resilience; and strengthen debt and public financial management. These reforms are closely aligned with our priorities in the NDP and reflected in the policy matrix elaborated in partnership with the World Bank and other development partners.

11. Against this backdrop, we seek the World Bank's favorable consideration of our request for a proposed development policy loan of US$50 million and a proposed development

policy credit of US$50 million equivalent, based on Fiji's completion of the reform measures set out in this policy matrix.

12. We look forward to the continuing engagement of the World Bank in Fiji and take this opportunity to again extend our sincere appreciation for the close relationship we have had with the World Bank over many years.

Thank you.

Aiyaz Sayed-Khaiyum
Attorney-General and Minister for Economy

cc: Acting Solicitor General, Office of the Solicitor General

ANNEX 4: INDICATIVE TRIGGERS AND PRIOR ACTIONS

Indicative Trigger as Envisaged in DPO1	Proposed Prior Action in DPO2	Comment
Pillar 1: Promoting Private Sector-Led Economic Recovery		
Indicative Trigger #1. To improve the efficiency of payment system and foster digital solutions, the Recipient, through Reserve Bank of Fiji, has approved a new oversight framework for payments and guidance on retail payments instruments and services.	Prior Action #1. To expand the scope of the payments system and promote digitalization, the Recipient, through its Minister for Economy, has made the National Payment System Regulations 2022.	**Unchanged.** wording revised to reflect that the regulations are broader than just retail payments.
Indicative Trigger #2. To ease access to capital by small and medium-sized enterprises, the Recipient, through its Cabinet, has approved a new Small Business Access to Capital Bill.	Prior Action #2. To promote foreign and domestic investment, the Recipient has: (i) enacted the Investment Fiji Act 2022; and (ii) through its Minister for Commerce and Trade, made the Investment (Reserved and Restricted Activities) Regulations 2022 and the Investment (Foreign Investors Reporting) Regulations 2022.	**Replaced.** Reflects increased priority on foreign and domestic investment following the adoption of the Investment Act of 2021. There is a draft bill on small business access to capital, but consultations have been slowed by COVID-19 pandemic, putting Cabinet review beyond the DPO timeline.
Pillar 2: Enhancing Climate, Disaster and Social Resilience		
Indicative Trigger #3. To reduce marine plastic pollution, the Recipient, through its Cabinet, has approved amendments to the Environment Management Act (2005) and Customs Act (1986) to phase-out foamed polystyrene	Prior Action #3. To enhance climate resilience, the Recipient has enacted the Climate Change Act 2021, which provides legal authority for the Minister responsible for climate change to coordinate and implement climate adaptation actions. Prior Action #4. To enhance the climate resilience of ecosystems, the Recipient, through its Cabinet, has approved the National Jobs for Nature Rehabilitation Policy 2022-2032 which fosters traditional management of resources to reduce degradation of land, coastal and marine ecosystems.	**Replaced.** New Prior Actions reflect the Government's priority and progress on climate change through passing of legislation.
Indicative Trigger # 4. To improve the resilience of single- or two-story housing and other building structures to increased wind loads due to changing climate, the Recipient, through the Ministry of Commerce, Trade, Tourism and Transport, has revised the Fiji Standard AS 4055 for Wind Loads for Housing and the Fiji Standard A/NZS 1170.2 – Structural Designs Actions Part 2: Wind action	Prior Action #5. To strengthen the early warning system for disaster preparedness, the Recipient, through its Cabinet, has approved the Meteorological and Hydrological Services Bill 2022, which establishes the Fiji Meteorological and Hydrological Service.	**Replaced.** Reflects the increased priority on early warnings to contribute to improved disaster risk management. The housing standards were determined to be voluntary and were dropped.[24] Also the revised National Building Code (NBC) was expected to include requirements for changes to wind loads and/or earthquake, which was delayed by pandemic restrictions. Thus, there was no regulation for the standard to be enforced.
Indicative Trigger #5. To identify and support the poor and vulnerable as a		**Dropped**. Establishment of the Social Registry could not be completed due to experts not

[24] Under the Trade Standards and Quality Control Act 1992, there is no Regulatory Authority to monitor and enforce voluntary standards until the NBC is revised.

critical element of implementation of the Social Assistance Policy, the Recipient, through the Ministry of Women, Children and Poverty Alleviation, has established a Social Registry.		being able to come into the country due to COVID-19 border closure However, the result under the DPO1 has been revised to capture implementation of the Social Assistance Policy
Pillar 3: Strengthening Debt, Public Financial and Fiscal Management		
Indicative Trigger #6. To improve debt management, the Recipient, through the Ministry of Economy, has implemented an annual borrowing plan consistent with the Medium Term Debt Management Strategy and integrated it into the Medium-Term Fiscal Strategy.	Prior Action #6. To improve debt management, the Recipient, through: (i) its Ministry of Economy, has prepared the Annual Borrowing Plan Fiscal Year 2021-2022 (ABP) consistent with the current Medium-Term Debt Management Strategy, and has published the ABP on its website; and (ii) its Cabinet, has approved a Liability Management Operations Policy (LMO Policy) that enables the Recipient to pursue active debt management operations such as buybacks, switches and callbacks; and has published the LMO Policy on its Ministry of Economy's website.	**Changed.** Expanded to also include FY22 SDFP PPA2.
Indicative Trigger #7. To strengthen public financial management and align with the Public Financial Management Amendment Act, the Recipient, through its Cabinet, has approved revised Financial Instructions and Procurement Regulations.	Prior Action #7. To enhance revenue mobilization, the Recipient has enacted the Value Added Tax (Revised Budget Amendment) Act 2022, which increased the VAT rate applicable to: (i) the importation and supply of selected goods; and (ii) prescribed services, from 9 percent to 15 percent. Prior Action #8. To reduce tax expenditures related to film production, the Recipient, through its Minister for Economy, has made the Income Tax (Film-making and Audio-visual Incentives) (Amendment) Regulations 2022.	**Replaced.** Reflects increased priority on fiscal consolidation to ensure debt sustainability in view of substantial decline of tax revenue due to COVID-19. Commitment from the authorities to revise the Finance Instructions and Procurement Regulations remains strong; however, preparation has been heavily delayed by COVID-19 restrictions with capacity further constrained, including difficulty in securing and getting consultants on the ground.

ANNEX 5: ENVIRONMENT AND POVERTY/SOCIAL ANALYSIS TABLE

Prior Actions	Significant positive or negative environment effects	Significant poverty, social or distributional effects positive or negative
Pillar 1: Promoting Private Sector-Led Economic Recovery		
Prior Action #1. To expand the scope of the payments system and promote digitalization, the Recipient, through its Minister for Economy, has made the National Payment System Regulations 2022.	No positive/negative impacts	Positive
Prior Action #2. To promote foreign and domestic investment, the Recipient has: (i) enacted the Investment Fiji Act 2022; and (ii) through its Minister for Commerce and Trade, made the Investment (Reserved and Restricted Activities) Regulations 2022 and the Investment (Foreign Investors Reporting) Regulations 2022.	Potentially negative, but mitigated through provisions in the legislation and the TA for strengthening the EIA oversight	Uncertain as impacts will depend on the types of jobs created
Pillar 2: Enhancing Climate, Disaster and Social Resilience		
Prior action #3. To enhance climate resilience, the Recipient has enacted the Climate Change Act 2021, which provides legal authority for the Minister responsible for climate change to coordinate and implement climate adaptation actions.	Significantly positive	Positive
Prior Action #4. To enhance the climate resilience of ecosystems, the Recipient, through its Cabinet, has approved the National Jobs for Nature Rehabilitation Policy 2022-2032, which fosters traditional management of resources to reduce degradation of land, coastal and marine ecosystems.	Significantly positive	Significantly positive
Prior action #5. To strengthen the early warning system for disaster preparedness, the Recipient, through its Cabinet, has approved the Meteorological and Hydrological Services Bill 2022, which establishes Fiji Meteorological and Hydrological Service.	Positive	Positive
Pillar 3: Strengthening Debt, Public Financial and Fiscal Management		
Prior Action #6. To improve debt management, the Recipient, through: (i) its Ministry of Economy, has prepared the Annual Borrowing Plan Fiscal Year 2021-2022 (ABP) consistent with the current Medium-Term Debt Management Strategy, and has published the ABP on its website; and (ii) its Cabinet, has approved a Liability Management Operations Policy (LMO Policy) that enables the Recipient to pursue active debt management operations such as buybacks, switches and callbacks; and has published the LMO Policy on its Ministry of Economy's website.	Could be positive	Positive with the reforms minimizing risk for sustaining social spending and benefit the poorest
Prior Action #7. To enhance revenue mobilization, the Recipient has enacted the Value Added Tax (Revised Budget Amendment) Act 2022, which increased the VAT rate applicable to: (i) the importation and supply of selected goods; and (ii) prescribed services, from 9 percent to 15 percent.	Not positive nor negative	Positive with the reforms minimize risk for sustaining social spending and benefit the poorest
Prior Action #8. To reduce tax expenditures related to film production, the Recipient, through its Minister for Economy, has made the Income Tax (Film-making and Audio-visual Incentives) (Amendment) Regulations 2022.	Not positive nor negative	Positive with the reforms minimize risk for sustaining social spending and benefit the poorest

ANNEX 6: DPF PRIOR ACTIONS AND ANALYTICAL UNDERPINNINGS

Prior Actions	**Analytical Underpinnings**
Pillar 1: Promoting Private Sector-Led Economic Recovery	
Prior action #1. To expand the scope of the payments system and promote digitalization, the Recipient, through its Minister for Economy, has made the National Payment System Regulations 2022.	The WBG "Assessment of the National Payment System in Fiji" (November, 2020) completed under the Fiji Payment Project (605169), recommends strengthening the legal and regulatory framework for payments. This included introduction of a legislative framework and supporting regulation. Ongoing technical assistance is delivered through this project and the Financial Sector Support in Pacific Island Countries PASA (P174933). In addition, the importance of payment system infrastructure is also captured in the Fiji SCD, Fiji CPF and Fiji IFC Country Strategy.
Prior action #2. To promote foreign and domestic investment, the Recipient has: (i) enacted the Investment Fiji Act 2022; and (ii) through its Minister for Commerce and Trade, made the Investment (Reserved and Restricted Activities) Regulations 2022 and the Investment (Foreign Investors Reporting) Regulations 2022.	The Fiji Country Private Sector Diagnostic (P605557) (February 2022) includes the reform of Investment Fiji as a key cross cutting recommendation that will help promote competitiveness across the economy. The regulatory framework for foreign investment has been further developed with technical assistance from IFC's Fiji Investment Competitiveness Project (601927) and is based on the reforms to the Investment Act that was included as a prior action in the previous DPO series (Fiji Second Fiscal Sustainability and Climate Resilience P168402). The Competitive Pacific for Economic Transformation Program (P175568) is also working on sector reforms to promote investment.
Pillar 2: Enhancing Climate, Disaster and Social Resilience	
Prior Action #3. To enhance climate resilience, the Recipient has enacted the Climate Change Act 2021, which provides legal authority for the Minister responsible for climate change to coordinate and implement climate adaptation actions.	OECD report "The United Kingdom's pioneering Climate Change Act" highlights the need for a long-term coordinated framework for effective climate action to the country to meet its climate outcomes and targets. *https://www.oecd.org/climate-action/ipac/practices/the-united-kingdom-s-pioneering-climate-change-act-c08c3d7a/*
Prior Action#4. To enhance the climate resilience of ecosystems, the Recipient, through its Cabinet, has approved the National Jobs for Nature Rehabilitation Policy 2022-2032, which fosters traditional management of resources to reduce degradation of land, coastal and marine ecosystems.	United Nations Environment Programme – UNEP - (2021) report "Becoming #GenerationRestoration: Ecosystem restoration for people, nature and climate" concludes that restoration of ecosystems delivers multiple benefits to the country and the world and make ecosystems more resilient to climate change. https://wedocs.unep.org/bitstream/handle/20.500.11822/36251/ERPNC.pdf
Prior Action#5. To strengthen the early warning system for disaster preparedness, the Recipient, through its Cabinet, has approved the Meteorological and Hydrological Services Bill 2022, which establishes Fiji Meteorological and Hydrological Service.	World Bank (undated), *Draft Early Warning System Needs Assessment and Investment Plan for the Pacific Islands* sets out recommendations to improve early warning systems, including institutional and regulatory strengthening.
Pillar 3: Strengthening Debt, Public Financial and Fiscal Management	
Prior action #6. To improve debt management, the Recipient, through: (i) its Ministry of Economy, has prepared the Annual Borrowing Plan Fiscal Year 2021-2022 (ABP) consistent with the current Medium-Term Debt Management Strategy, and has published the ABP on its website; and (ii) its Cabinet, has approved a Liability Management Operations Policy (LMO Policy) that enables the Recipient to	Wheeler, Graeme, 2004. "Sound Practice in Government Debt Management," This study shows that prudent government debt management has critical linkages to the development process. It reduces the financial risk the Government faces, lowers the economy's vulnerability to financial shocks, strengthens the market infrastructure and institutions needed to support an efficient domestic financial market, and helps foster sound public sector governance practices. The WB/IFC report on "LMO in Fiji" (September 2020) recommends the need to develop a LMO policy for Fiji that outlines the objectives, scope, methodology, arrangement and

pursue active debt management operations such as buybacks, switches and callbacks; and has published the LMO Policy on its Ministry of Economy's website.	execution of operations, eligibility criteria, and other procedural requirements. The report also highlighted that the LMO policy will be critical in creating an enabling framework for these transactions whilst also providing clarity to participants on the integrity of the process
Prior action #7. To enhance revenue mobilization, the Recipient has enacted the Value Added Tax (Revised Budget Amendment) Act 2022, which increased the VAT rate applicable to: (i) the importation and supply of selected goods; and (ii) prescribed services, from 9 percent to 15 percent.	Fiji PER (forthcoming, July 2022) finds that the impacts of the COVID-19 pandemic, coinciding with multiple tropical cyclones, have led to one of the worst economic contractions in the world, increasing the urgency and scale of the fiscal adjustment needed. The study recommends that enhancing domestic revenue collection, including through tax policy reforms, will be key to achieving the revenue target required for fiscal sustainability.
Prior Action #8. To reduce tax expenditures related to film production, the Recipient, through its Minister for Economy, has made the Income Tax (Film-making and Audio-visual Incentives) (Amendment) Regulations 2022.	IMF (December 2021) notes that charting a course back toward macro-fiscal equilibrium is a clear priority and proposes a roadmap for fiscal adjustment that would target a sustainable primary budget surplus by the end of the medium-term. The proposed roadmap comprises a phased series of policy measures to raise selected tax and excise rates, scale back tax holidays, broaden the tax base, and increase the efficiency of revenue collection. The report notes that implementation of measures in the roadmap would also help align Fiji's tax regime with international practice and enhance the efficiency of taxation.

ANNEX 7: DETAILS OF POVERTY AND GENDER ASPECTS

Poverty aspects

The proposed payments digitalization reform is expected to have a positive social and poverty impact, although sharing the benefits most inclusively will depend upon the success of current initiatives to boost access.

Financial inclusion can drive development and reduce poverty in the long-term. Actions aimed at promoting financial inclusion have the potential to help people escape poverty by facilitating investments in human capital, increasing resilience to shocks, and financing business activities and acquisition of assets. However, many poor people lack access to the financial services that can serve these functions, such as bank accounts (Demirguc-Kunt et al., 2018). The evidence suggests that poor and vulnerable families rely more heavily on cash instruments than those in higher-income deciles. Estimations based on the 2019 Fiji HIES indicate that 14 percent of wage earners in the bottom 40 percent of the distribution received wages in cash, compared to 9 percent of those in the top 60 percent. Low-income individuals are slightly more likely to pay electricity and water bills using cash, although the proportion of utility payments made in cash tends to be large across all type of households.

Digital payments have the potential to expand inclusive access to financial services. Digital technologies enabled by the widespread ownership of cell and smart phones offer an opportunity to access faster, more affordable, more tailored, and more convenient financial services, especially for those that are under- or un-served (Sahay et al., 2020). Fiji has the highest mobile subscriber penetration rate in the Pacific at 84 percent (GSMA, 2019).[25] The high level of mobile phone penetration can be used as an advocacy tool for digital payments. In fact, Fiji was one of the first Pacific countries to launch mobile money services in 2010, with services offered by both main mobile players, Vodafone and Digicel (Bruett, 2010; RBF, 2012). The use of e-money rather than cash saves considerable travel time and costs and reduces the risks of theft. Digital wallets can be used for a wide range of payment transactions such as receiving remittances, wages, and government subsidies, making purchases, or paying utility bills and school fees (Reddaway, 2020). Moreover, as individuals and businesses make digital payments, they create an electronic record of their receipts/sales and expenditures, which enables financial service providers to assess their credit risk. Digital financial services (DFS) can provide low-income households with access to affordable and convenient tools that can help increase their economic opportunities.

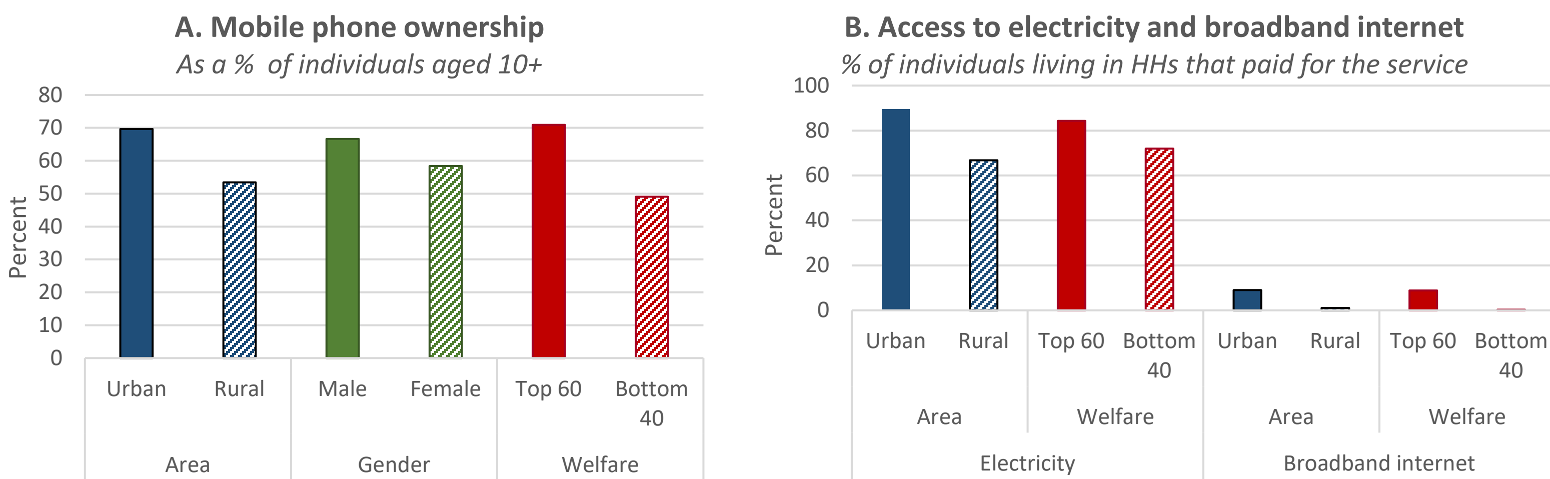
The COVID-19 pandemic and government responses, such as lockdowns, have stressed the benefits of DFS. While traditional financial services are predominantly built on cash transactions and face-to-face interactions, DFS enable remote, contactless, and cashless payments and transactions. Several studies indicate that the pandemic has accelerated the development and use of DFS (Agur et al., 2020; Arner et al, 2020; Auer et al., 2020; Pazarbasioglu et al., 2020). Didiet et al. (2022) show that there has been a marked spike in worldwide financial app downloads, especially of non-bank financial apps (*fintech*), during the peak months of the COVID-19 pandemic. The adoption of digital payments has facilitated an effective, quick, and wide-reaching deployment of government support programs to those who need them the most, including to those in the informal sector and those who do not have access to bank accounts (IMF, 2020; Gentilini et al., 2021). In addition, digital payments facilitate the processing of remittances in times of crisis (World Bank, 2021). Mobile money remittances to Fiji increased by 279 percent between March and October 2020 (GSMA, 2021). In the Pacific, the United Nations Capital Development Fund has worked with mobile network operators to temporarily

[25] In 2018, mobile internet penetration and smartphone adoption were 60 and 43 percent, respectively.

wave fees for mobile remittances to help maintain the flow of remittances. Remittances are an essential source of income for many poor Fijian families, accounting for 11 percent of the income of recipient households.

Ensuring the benefits of adopting digital finance are received by all will depend upon connectivity access, while risks such as those related to consumer protection and financial capabilities require attention. Advances in digital financial inclusion are likely to be more equitable when accompanied by policies that address the different circumstances facing consumers and provide for the skills development, regulatory protections, and product designs suited to their needs. Consumers need connectivity, including reliable electricity, ownership of a mobile phone, access to internet, and digital skills to manage mobile apps. These tools and skills are not evenly distributed across the population. Access to DFS can be challenging for women, elderly, rural populations, and poor adults, as they often have limited financial and digital literacy, limited access to digital infrastructure, and lack experience with financial services more broadly (Figure 1). Transitions can be particularly difficult for such parts of the population. Moreover, users who lack financial experience or struggle with literacy and numeracy might be especially vulnerable to financial abuse. A strong consumer protection framework is critical as people shift towards DFS.

Figure 1. Access to infrastructure by population groups



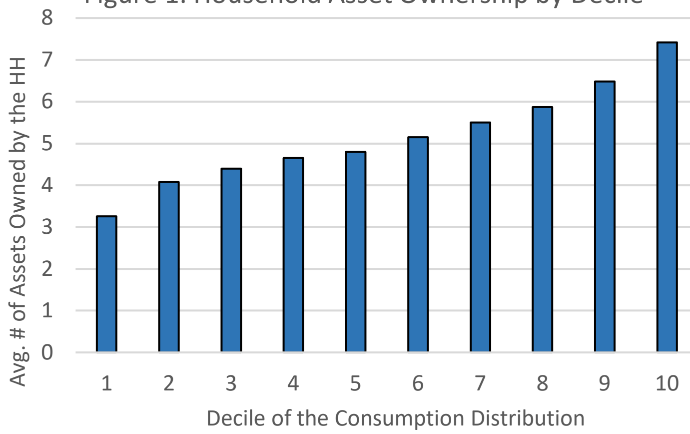
Source: World Bank using HIES 2019.

Fiji has a national financial inclusion strategy in place that includes several initiatives to promote the adoption of digital payments among the poor and vulnerable. Some of the actions under the financial inclusion plan include: (i) increase access points for payment services; (ii) promote greater network connectivity at reduced costs in all regions; and (iii) implementation of digital financial literacy initiatives. Regarding the latter, all six commercial banks in Fiji offer financial literacy training programs, which are delivered to rural and remote parts of the country. There are also radio and television weekly programs in vernacular language to continue to advocate and create awareness. In addition, Fiji implemented the Education Curriculum Development Project (FinED Fiji) aimed at educating primary and secondary school students about personal finance. The expansion of digital payments is not mutually exclusive with ongoing access to existing payment systems. That is, consumers will still have the option to use the payment systems that they are currently using. Although in the long-term some retailers may shift toward digital payments first, this transition could take years or even decades.

The proposed increase in the VAT rate will be mitigated by the temporary zero-rating on essential items, and is as a result unlikely to have major impacts on poverty in the short run. Should the zero-rating on essential items eventually be removed, the impact on poorer households could be better addressed if part of the increase in VAT collection were spent on pro-poor programs.

The proposed increase in the VAT rate from 9 to 15 percent on a selection of 20 goods and services is unlikely to have major effects on poverty and inequality. The VAT increase affects a limited set of items including luxury goods (e.g., perfume, jewelry, watches), alcohol and tobacco, clothing and footwear, and durable goods, such as white goods, electrical machinery, and vehicles. These items are mostly consumed by households in the top of the welfare distribution. For example, individuals in the bottom decile live in households that own 3 major assets on average, while individuals in the top decile live in households that own 7 major assets on average (Figure 1). Clothing and footwear and tobacco and alcohol represent about 2.3 and 0.9 percent of the consumption basket of the poor, respectively. Although the tax-induced price effect constitutes a welfare loss, it is expected to be progressive.

Figure 1. Household Asset Ownership by Decile



Source: Pacific Poverty Assessment (2022).
Note: Assets include vehicles (cars, trucks, outboard motors), major household goods (generators, lawn mowers, brush cutters, home solar systems, water pumps, refrigerators, washing machines, clothes driers, cookstoves, hot water systems, air conditioners), and other goods (radios, stereos, TVs, video/DVD players, landline telephones).

Accompanying measures to alleviate the impact of higher prices could offset the welfare loss associated with the proposed VAT increase and even result in poverty reduction. The implementation of a zero-rating on 21 essential everyday items could act as a poverty mitigation policy given that these items account for a considerable share of the consumption basket of the poor (Figure 2).

While the reduced rate on essential items is likely to mitigate the proposed VAT increase with respect to poverty impacts, it may lead to inefficiencies in the allocation of government support. This mitigation measure would affect spending on essential items by all households, regardless of their place in the welfare distribution. This means that richer households will receive support even if they do not need it, resulting in a waste of public resources. For instance, the top two deciles of the welfare distribution account for 30 percent of total purchases of essential items, whereas the bottom two deciles represent only 11 percent of total spending on essential items (Figure 3). Moreover, if the reduced rate is only temporary, its removal will see an increase in poverty. Should the zero-rating on essential items eventually be removed, the impact on poorer households could be better addressed if part of the increase in VAT collection were spent on pro-poor programs.

In addition, the proposed zero-rating on essential items does not consider other characteristics of the consumption baskets of the poor. For example, lower-income households are more likely to buy from informal places (Bachas, Gadenne, and Jensen, 2020). Moreover, a relatively larger portion of their consumption comes from gifts and home production, which do not carry any tax burden.[26] Therefore, the mitigation effect of a zero rating on purchases of essential items is likely to be smaller than originally estimated.

Figure 2. Relative consumption of essential items by decile

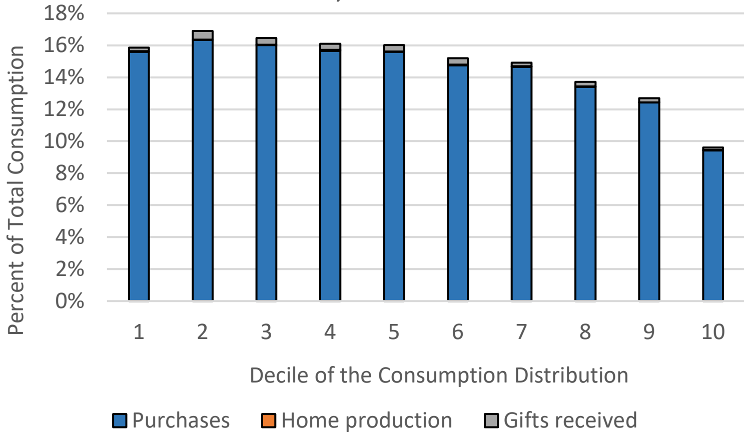
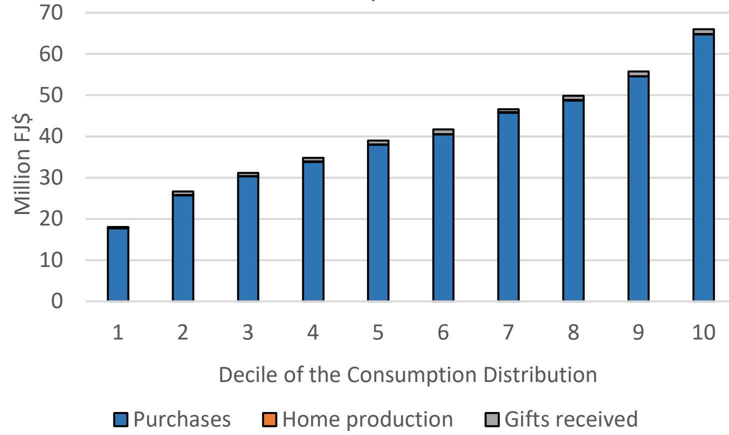


Figure 3. Absolute consumption of essential items by decile



Source: Authors' calculations based on the HIES (2019).
Note: Essential items include sugar, flour, rice, canned fish, cooking oil, tea, powdered milk, liquid milk, baby milk, potatoes, onion, garlic, dhal, salt, sanitary pads, soap powder, soap, toilet paper, toothpaste, cooking gas, and kerosene.

Increased taxes on prescribed services are unlikely to have major effects on Fiji's poor and vulnerable, while they can help the Government raise additional revenues. Prescribed services are mostly related to the tourism sector. Estimations based on the 2019 HIES show that spending on holiday trips within Fiji only account for 0.4 percent of the consumption basket of the poor. Prescribed services also include meals, beverages, and any other services provided in a licensed bar or restaurant, and entry fees and all services provided within cinema premises. Still, these services represent about 0.7 percent of the consumption of individuals in the bottom decile of the welfare distribution, compared to 2.6 percent of those in the top decile. From the suppliers' perspective, a higher VAT rate for prescribed services could create a burden for small business owners and slow down recovery in the private sector. The prescribed service providers will be subject to the new VAT rate of 15 percent, from 9 percent.[27] This tax increase could result in lower profits or higher prices (if it is passed on to consumers), potentially affecting demand for such services. However, these service providers are generally high-end businesses that target high-end consumers. As a result, the VAT policy is unlikely to have major direct effects on Fiji's poor and vulnerable populations.

The impacts of a more restrictive and reduced film tax rebate on the poor are uncertain and will depend on the nature of their relationship with the film-making industry. The film tax rebate is a tax incentive provided to film producers on production costs spent in Fiji. This incentive is designed to make Fiji a more attractive location for overseas film investment. The extent to which Fiji's poor and vulnerable would be affected by this reform depends on the relationship that this population group has with the film industry (e.g., employment, business ownership, sale of goods and services). It would also depend on how the additional government revenue is spent, for example, if it translates into greater social spending.

[26] Assuming gifts are out of own production and not themselves purchased by the giver.
[27] Although businesses with an annual turnover below FJD 3 million were originally not subject to the ECAL, they were still subject to the standard VAT rate of 9 percent.

Gender Aspects of Prior Action #4

In Fiji, women have limited access to paid employment opportunities, especially in rural and remote communities. Nationally, women (aged 15+) are 38 percent less likely to participate in the labour force than men.[28] This gap is even more pronounced in rural areas, where women represent less than a third of the employed population.[29] Within households' subsistence activities, including agriculture and fishing, there is also a clear gender division of tasks. Rural women are commonly engaged in garden weeding and maintenance, processing of subsistence crops, floriculture, handicrafts (such as weaving baskets and masi) and gleaning for invertebrates in soft bottom, reef and mangrove habitats, while men most often undertake clearing of land, ploughing, planting and harvesting, as well as offshore fishing activities.[30]

Women are underrepresented in leadership positions, both at the national and the local level. They represent 19.6 percent of the current Members of Parliament (up from 11 percent in 2006)[31] and 21 percent (4 out of 19) of minister and assistant minister positions (as of late 2021). At the local level, traditional governance structures continue to hinder women's meaningful participation in decision-making, especially in relation to land and the environment. Traditional village and district chiefs need to be holders of customary titles, less than ten percent of which are estimated to be held by women.[32] Even if women and youth representatives can speak at weekly village meetings, in most places men continue to dominate decision-making processes related to community land use, management of natural resources and engagement with government and civil society.[33]

The National Jobs for Nature Rehabilitation Policy (2022-2032) acknowledges the importance of engaging women in nature conservation and aims to strengthen women's voice and access to paid employment within rural communities. Men and women's distinct roles within agriculture and fisheries have translated into specialized types of knowledge related to management of natural resources and climate resilience. Preventing women's equal participation in natural resource management within communities could, therefore, undermine its effectiveness and exacerbate the impact of climate change on their livelihoods. Previous experience from Fiji and elsewhere in the Pacific has shown that rural women's traditional connection to native plant species and coastal areas as a source of livelihood has facilitated women's successful participation in several community adaptation programs, including mangrove planting, forest restoration, and giant clam growing.[34] Based on this, the NJ-NR Policy adopts a focus on promoting women and vulnerable groups' participation in nature conservation and livelihood activities and monitors the percent of successful grant application awarded to village women's groups.

The Gender Aspects of Prior Action #1

The expansion of digital financial services has the potential to overcome the disproportionate time and mobility

[28] Fiji Employment and Unemployment Survey 2016.
[29] Ibid.
[30] Asian Development Bank. 2019. *Fiji gender assessment of agriculture and the rural sector*.; Dumaru,P. 2010. *Community-based adaptation: enhancing community adaptive capacity in Druadrua Island, Fiji.* Wiley Interdisciplinary Reviews: Climate Change.
[31] Beijing Declaration and Platform for Action +25. Fiji Progress Report. May 2019.
[32] Ministry of iTaukei Affairs. 2015. Annual Report.
[33] Asian Development Bank. 2019. *Fiji gender assessment of agriculture and the rural sector*.
[34] Ibid. See also the Rewa Delta restoration project and SPC's Sustainable Forestry and Landscape Management Program.

barriers that women face in Fiji and bridge the gender gap in financial inclusion in the country.[35] The findings of the 2020 Financial Services Demand Side Survey[36] (DSS) show that more women (19 percent of women and 15 percent of men) in Fiji had a mobile money account in 2020, while men were still more likely to have a bank account (82 percent of men and 75 of women). Moreover, the 2020 DSS findings reveal that women were more likely than men to have used their mobile money accounts over the 12 months preceding the survey and that women are now more likely to use internet banking, with 60 percent of internet banking users being female in 2020 (compared to 43 percent in 2014).

Digital solutions for the retail sector have strong potential for disproportionate positive impact on women. Female entrepreneurship in Fiji is centered around trade: 40 percent of female entrepreneurs and 12 percent of male entrepreneurs (including own-account workers and employers) work in the sector.[37] Women are especially overrepresented among market vendors: UN Women estimates[38] suggest that about 85 percent of vendors are female. Digital payment services have been shown to hold multiple benefits for female retailers, such as improved safety, an alternative source of data to prove creditworthiness (as women are less likely to own the physical assets needed for loan collateral), and access to e-commerce platforms, which could in turn be an effective coping mechanism against unexpected closures, such as the ones seen during the pandemic.[39]

[35] Based on the latest Financial Services Demand Side Survey by the Reserve Bank of Fiji (2020), there is a 7pp gender gap in access to formal financial services in Fiji.
[36] Reserve Bank of Fiji. 2020. Financial Services Demand Side Survey.
[37] Fiji Employment and Unemployment Survey. 2016.
[38] UN Women Asia Pacific. 2020. Surviving in the market space. https://asiapacific.unwomen.org/en/news-and-events/stories/2020/08/surviving-in-the-market-space
[39] Global Partnership for Financial Inclusion. 2020. Advancing Women’s Digital Financial Inclusion.