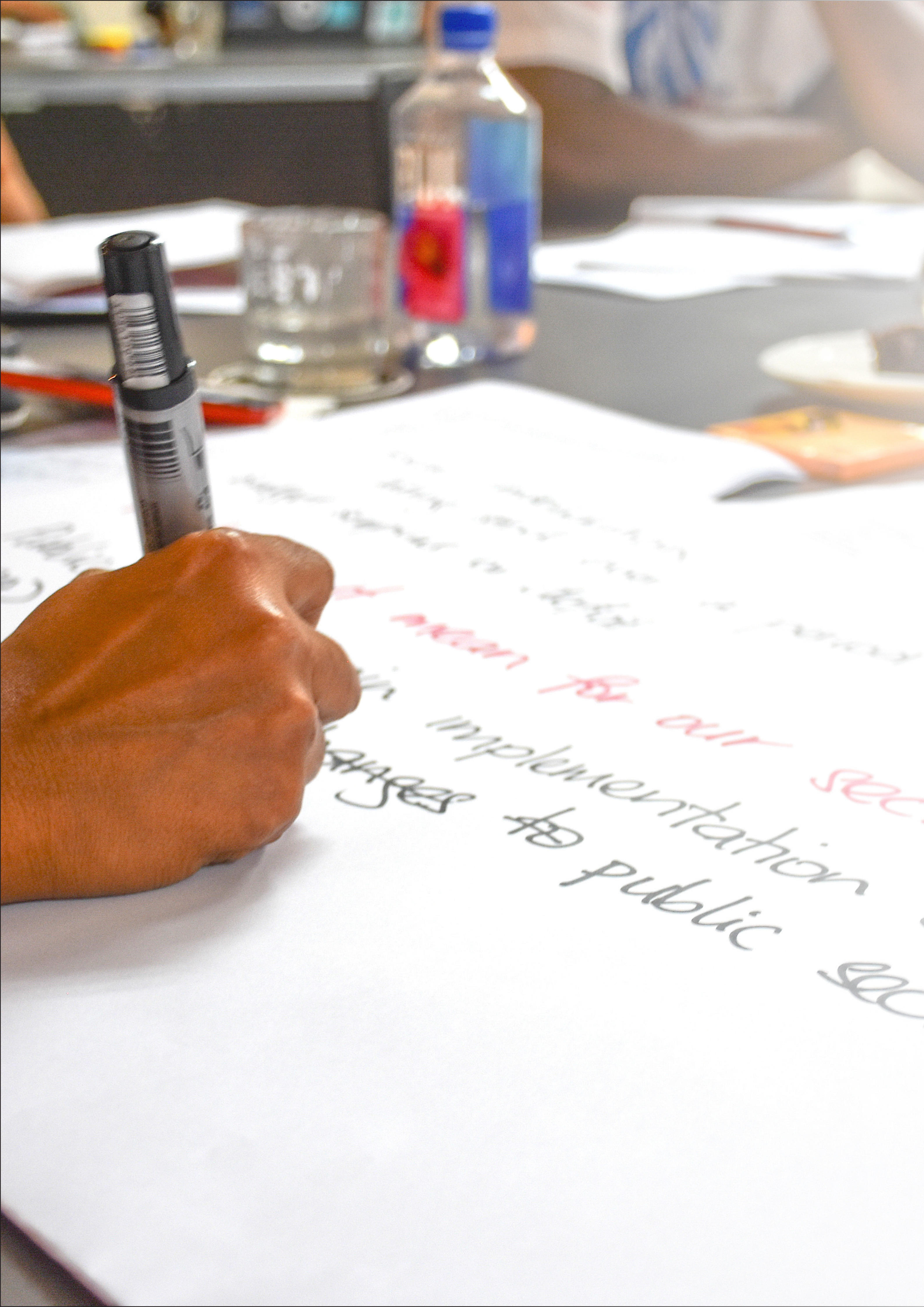
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CHAPTER 6: CONSOLIDATED RECOMMENDATIONS

Chapter 1 - Fiji's Debt Profile and Dynamics

Reaching almost the size of its entire economy at its peak, Fiji's unprecedented public debt has become the most pressing economic issue of the day. Like many developing countries, its debt skyrocketed and its economy virtually collapsed due to the Covid-19 pandemic. It is now stuck with very elevated debt levels, which, if poorly managed, will continue to drain limited fiscal resources, amplify its susceptibility to shocks, and weaken macroeconomic variables and in turn business outlook.

Fiji needs to redouble its effort in ensuring its debt burden is on a sustainable path and reduce the cost of debt servicing. Effective management of its public debt is vital in ensuring its economic resilience and long term development.

Proposals to Reduce Debt Burden

Ensure lowest possible cost of borrowing

- Given its inherent vulnerabilities, Fiji should maintain its classification as an IBRD-IDA "Blend" country and as a group B country of the Asian Development Bank (ADB), despite also being a middle income country, in order to access concessional finance and not be prematurely graduated from this classification.
- Fiji should prioritise concessional finance for its economic development and climate adaptation and mitigation needs. External borrowing on non-concessional and commercial terms exposes the country to the vagaries of the market and its associated risks including volatile market sentiments, sudden reversals in capital flows, high interest rates and exchange rate changes that could exacerbate the country's debt standing.
- Despite the official character of its public external debt only 29% or about FJ$1bn out of its FJ$3.66bn of this debt is deemed to be concessional in nature according to the government.[1] It will be beneficial to review each of these loans to ascertain whether the benefits are indeed accrued and if better terms could be sought.
- One of the key challenges for Fiji is mobilising new concessional financing for climate-related investments. Fiji was the first developing country to issue a green bond of US$50mn.[2] The coupon terms of the bond issued in domestic currency were five years at 4% per annum and 13 years at 6.3% with respective maturities of 2022 and 2030.[3] The government was required to make two biannual payments on 1 May and Nov 1 every year until maturity. The

previous government also announced in 2022 it was planning to issue a blue bond with the aim of raising US$50mn.[4] It is important to note the cost implications associated with debt instruments of this nature. There are concerns that these bonds tend to be more expensive to issue than conventional bonds,[5] as is the case of Fiji's green bond as noted by the OECD.[6] Governments and international organisations usually provide subsidies to meet the costs associated with issuances, including consulting and verification of green credentials.[7]

- Research has shown that there is little to no "greenium," to such bonds, while subject to the same risks as a conventional bond such as costly restructuring in a default and volatile market sentiments, especially if it is tapping on the international capital markets. Reputational risk from market sentiment could also worsen a country's macroeconomic variables, leading to capital flight and exacerbating its debt problem.

- As such, to keep the external debt composition as benign as possible, the government should stick to less risky terms with the lowest cost, and with conditionalities that do not run contrary to nationally-determined economic priorities, and respect the country's policy space and autonomy.

- With regard to domestic debt, apart from reducing its issuances of short-term bonds (treasury bills) in favour of long-term bonds, the government could consider bond buybacks and bond switches to reduce the pressure on its resources, especially before significant debt payments are due. This is among the proposals in the Government's "Medium Term Debt Management Strategy 2021-2023" and "Medium Term Fiscal Strategy 2024-2026" to manage the debt burden.
- In practical terms, it would be similar to the arrangement in which Fiji replaced its global bond for concessional finance from the ADB and World Bank in 2020, and consideration can be given for such options so as to reduce the debt burden in the medium term.

- As such, the Reserve Bank of Fiji can consider purchasing domestic government bonds from primary and secondary markets, especially when the government is faced with high pending debt payment obligations. Central banks in some developing countries, such as Indonesia and Philippines, took this route to support the financing needs of the government and reduce the debt servicing pressures amid the economic crisis caused by the pandemic.[8] Indonesia eventually passed the Financial Sector Development and Strengthening Law this year requiring its central bank to purchase government bonds in the primary market during crises in the future.[9] While there are concerns around independence of the central bank and the powers given to the president under the law, this option should be exercised under only defined instances and in accordance with the principles of good governance, particularly transparency and accountability.[10]

- Given the significance of contingent liabilities to overall debt sustainability, the performance of state-owned enterprises should be monitored. In addition, risk assessments should be made regularly and communicated to stakeholders and parliament as part of the government's public debt reporting.

Build in debt pauses or suspension mechanisms in all its borrowing

Automatic debt pauses or suspension mechanisms

- The government could consider negotiating clauses in all its borrowing transactions triggering automatic debt suspension when the country is hit with exogenous shocks including pandemics, natural calamities, political upheaval, civil war among others. The value of having such buffers in place was demonstrated during the Covid-19 pandemic, where several low-income countries were hit hard economically and struggled with heavy debt repayments, before the G20's Debt Service Suspension Initiative was launched to provide reprieve.

Natural disaster clauses

- These were adopted by both Grenada and Barbados in their debt restructurings in 2013 and 2015 respectively. There is increasing global support for inclusion of such clauses in debt contracts, including from the World Bank, which recently announced that it will include these clauses in its loan programmes for climate-vulnerable countries.[11] While they are designed to allow more fiscal space for countries to adequately respond to climate shocks,[12] they are limited to only specified natural disasters and typically have high monetary thresholds which have to be met before they can be triggered.

- Therefore, for Small Island Developing States like Fiji, the value in debt moratoriums cannot be overstated and natural disaster clauses are only a bare minimum. The key issue for Fiji would be to design clauses which provide sufficient fiscal space for the country to respond to a range of possible shocks.

Chapter 2 - Fiscal and Debt Sustainability

The current government has taken the bitter pill of fiscal consolidation in order to put the brakes on the pace of debt accumulation and improve its sustainability.

The government and policymakers will have to find a balance between keeping the lid on fiscal deficits, while prudently pushing ahead with the necessary spending and investments to ensure growth does not sputter. It will continue to face difficult trade-offs between maintaining fiscal sustainability and investing in structural transformation, including productive investment, climate action and sustainable development goals (SDGs). For example, forgoing investments in sustainable transformations not only undermines development progress but could also amplify vulnerabilities—to disasters, other external shocks and ultimately debt sustainability—down the line.

To retain and expand fiscal space for SDG-related investments in this challenging context, multipronged policy action is needed, at both the national and global levels.

- Domestically it could rigorously include differentiating how debt financing is used, and prioritising borrowing for productive investments that can create durable economic growth and thereby more fiscal space.

- Where needed and when the debt burden becomes too onerous and debilitating, it may seek pre-emptive debt restructuring to free up fiscal space. It should acquaint itself with pre-emptive, maturity managing tools such as debt re-profiling operations or other liability management operations.

- It should also be familiar and knowledgeable about the processes and policies around domestic debt restructuring, given that the bulk of its public debt is domestic. It should have a contingency plan in place for such an eventuality, so that the problem is not aggravated by a lack of understanding and not knowing what to do in such a situation.

- Externally, it could work with bilateral and multilateral development partners to put in place instruments and tools to create fiscal space in a time of crisis. This could include the following:
    - Commitments from official development partners for a standby or sinking fund that could be activated and utilised by Fiji under certain conditions or risk events

- All debt servicing including repayment, interest and charges are automatically suspended upon the national declaration of a crisis or emergency
- Debt obligations could also be scaled back depending on Fiji's ability to pay, as state contingent debt instruments are being explored[13]

- Given that only about 28% of its external public debt is on concessional terms, the government should negotiate with its official creditors better credit terms, which includes lengthening average maturities or lowering borrowing costs, so that Fiji is not further hampered and delayed in trying to achieve its SDGs and climate objectives.

- The advocacy for better borrowing terms and debt relief measures with the support of development partners could be done regionally with other Pacific Island Countries, especially when neighbouring countries are also facing similar fiscal and national debt challenges.

- Finally, creating fiscal space, making trade-offs, and ensuring that borrowings are used for the right development priorities and objectives are ongoing judgment calls that the government would have to make in consultation with its constituencies and citizenry.

Chapter 3 - Growth, External Liabilities and Debt Sustainability

Broadly speaking, GDP growth has a direct bearing on debt sustainability. General government debt-to-GDP ratio measures the gross debt of the general government as a percentage of GDP. It is a key indicator for the sustainability of government finance.

The higher the ratio, the less likely a country will be able to repay its debt. A high debt-to-GDP ratio is undesirable for a country, as a higher ratio indicates a higher risk of default. This, in turn, may increase the risk of a default and reduce business confidence. On the other hand, a declining debt-to-GDP ratio over time is a well-accepted indication that a country's debt is on a more sustainable trajectory.

The situation is at a critical juncture where fostering robust economic growth is not just an aspiration but an imperative. The data underscores a clear trajectory: enhancing exports and bolstering productivity stand out as viable levers to invigorate the economy and help contain the mounting debt challenge. However, realising these goals hinges on the ability to catalyse further productive investment. Fiji's policymakers are therefore tasked with a delicate balancing act—cultivating an environment conducive to economic expansion while simultaneously navigating a sustainable path out of debt.

To enhance and improve its external financial sustainability, which can be achieved by ensuring that the growth in exports exceeds the average cost of net liabilities (including external debt), here are some broad policy options:

- A comprehensive industrial policy, including adequate incentives and investments to support the growth and productivity of various industries, particularly those that are able to enhance Fiji's export performance.

- Light manufacturing should be diversified niche high-value, non-commoditised products, eg premium-quality sports and fashion apparel, and skincare products catering to the high-end segment of the market, which makes premium pricing possible.

- Further research and study into diversification of manufacturing sub-sectors, to identify where the new growth opportunities are.

- Agricultural productivity must be stepped up to drive growth. Higher productivity will have to come from modernisation, diversification, and commercialisation of the sector.

- The entire sugar value chain, from farm to factory to market, needs to be scrutinised to pinpoint the areas where costs can be reduced; farming and milling methods modernised; large-scale commercialisation effected; and more value-add created.

- Seize the potential to expand production of other primary sector outputs for high-margin niche markets, especially where Fiji has a competitive advantage.

- Maximise and prolong the benefits of tourism, which will involve expansion through diversifying the source of visitors and types of visits, and growing domestic and international linkages.

- Continuous skilling and re-skilling of the workforce is critical, especially to meet the needs of new industries that emerge in the course of restructuring.

- Remittances remain a critical input into the Fijian economy, however there are a number of key issues. Remittances need to be better utilised for productive purposes, and a balance needs to be struck with the impact of lost labour productivity from out-migration. Reducing remittance cost remains a priority issue.

- Reduce the cost of net external liabilities, especially with regards to public external debt. See recommendations for Chapters 1 and 2.

Chapter 4 - Debt Management and Good Governance

The need for a rigorous governance framework and institutional capacity cannot be overemphasised in light of Fiji's sizeable debt burden and its profound ramifications for its entire economy. Such a framework will not only help bring about prudent public debt management in Fiji, but will minimise the exposure to debt default risks and bring about the desired economic development achieved through judicious debt utilisation.

Additionally, a robust and effective debt management/governance framework and practice goes a long way in winning market confidence. Credit rating agencies' evaluations of a country's quality of debt management and policy setting capability are crucial considerations in ascertaining sovereign risk.

Ultimately, a policy perspective that combines the principles of accountability, professionalism, transparency and democratic participation, with a framework that prioritises social justice, realisation of SDGs, and development, should guide the pursuit of debt management and its sustainability.

Recommendations

Strengthened Legal and Institutional Reforms

The absence of dedicated statutory instruments can lead to discrepancies in the measurement and reporting of public debt, thereby interfering with transparency initiatives. Consolidating and harmonising debt management provisions into a comprehensive and single legislative act could enhance Fiji's transparency, accountability, and prudent debt management, fostering sustainable economic growth and development.

The government and the Ministry of Finance are advised to make appropriate changes in the Financial Management Act (2004) and the Finance Instructions (2010) to ensure consistency with the Constitution and provide clear accountability and governance arrangements for public funds. Good legislation defines and focuses powers, limits potential abuses of power, and establishes accountabilities for managing the government's debt liabilities to promote governance. Therefore, a robust legal framework is critical for effective public debt management, given the centrality of law to public debt.[14]

Government borrowing from domestic or external sources necessitates the existence of a well-established legal basis for incurring debt. Public debt contracting and management should be anchored in the constitutional framework of a state and supported by a legal framework based on coherent and coordinated structures with predictable rules and regulations. Therefore, the legal framework must be resolved, preferably through the consolidation of all debt-related provisions into a single comprehensive act of parliament dedicated to public debt management.

An Enhanced Debt Management Office (DMO)

Given the urgency and criticality of Fiji's current public debt burden, its DMO should be elevated in the policy-making process and its capacity enhanced accordingly:

- It should have a fair measure of professional independence, and be shielded from politicisation.
- It should have sufficient autonomy and mandate to carry out its objectives and work with other state entities including ministries, departments, the central bank, and state-owned enterprises.
- It should be directly led by the permanent secretary reporting to an executive board
- It should have an executive board/ management chaired by the Minister of Finance, comprising relevant stakeholders such as the central bank governor, the DMO head, parliamentarians, etc.
- The executive board/management of the DMO should be responsible for formulating the country's debt strategy and objectives, while the DMO is responsible for implementing the strategy and realising its objectives.
- Clear segregation of duties to ensure that no one person has sole control over the entire lifespan of a transaction (initiating, approving, recording, and verifying).
- Segregation of duties to provide protective controls.

Adopt International Best Practice Systems

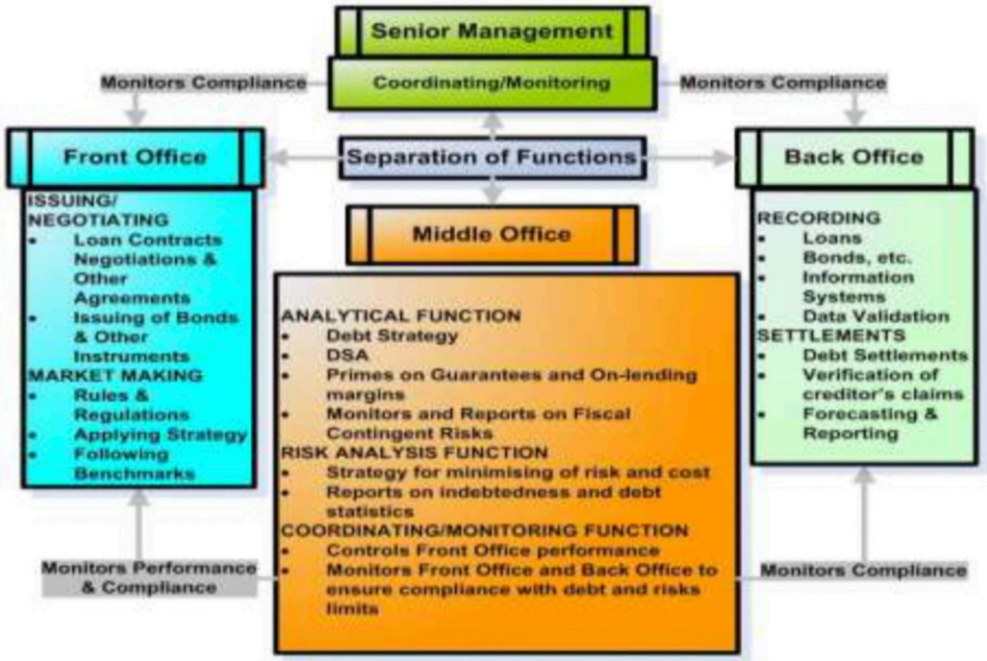
Figure 4-3: DMO Executive and Operational Roles and Functions

Executive Debt Management	→	**Direction and Organization**
Policy Function	→	Strategy
Regulatory Function	→	Structure
Resourcing Function	→	Staffing and Systems
Operational Debt Management	→	**Debt Dynamics and Practice**
Controlling/coordinating/monitoring	→	Control, coordinate and, monitor
BACK OFFICE		
Recording Function	→	Debt data and statistics
Operating/monitoring functions	→	Debt operations settlement and monitoring
MIDDLE OFFICE		
Analytical Function	→	Analysis and financial strategy
Risk analysis function	→	Minimise cost and risk
FRONT OFFICE		
Issuing/negotiating function	→	Securities, loans and restructuring agreements
Market-making	→	Government securities trading

Source: E.Cosio-Pascal, "The Debt Office and the Effective Debt Management Functions: An Institutional and Operational Framework," 2006, p. 5.

The OAG can play a critical role in ensuring effective debt management by independently verifying and ensuring that delegation of authority has been done in accordance with the law; borrowing purposes have been adhered to; that a debt management strategy is in place and is implemented faithfully; and debt reporting has been done in a transparent, adequate and timely manner. As such, the OAG is recommended to adopt guidelines

Figure 4-2: DMO Functions and How They Are Segregated



Source: UNCTAD, "Guidelines on Responsible Sovereign Lending and Borrowing," 2013, p. 38.

from the GUID 5250 issued by INTOSAI,[15] which is based on the auditing principles of the International Standards of Supreme Audit Institutions, and adapted for public sector audit institutions.

Aside from ensuring that debt management ultimately leads to its financial sustainability, the Fiji government should also require a Return on Investment or Internal Rate of Return assessment (which includes the positive externalities or risk mitigation impact) of the planned borrowing, especially for projects, and formulate relevant key performance indicators and metrics to ensure that the use of borrowings is economically justified and implemented in a manner that has the desired impact.

This chapter further supports and recommends that Fiji holistically implements the MTDS to enable a more transparent and accountable system beyond the current system. By doing so, greater transparency and accountability will be witnessed, allowing for enhanced government revenue, expenditure, debt and liabilities monitoring, thereby limiting and capping non-concessional borrowing. This entails ensuring that the MTDS facilitates the ratification of loans by parliament to promote an updated public debt register. The practical and proper use of the MTDS will enable the government to manage risk exposures arising from its debt portfolio, reduce macro-financial risks, reinforce the fiscal policy and support economic development priorities.

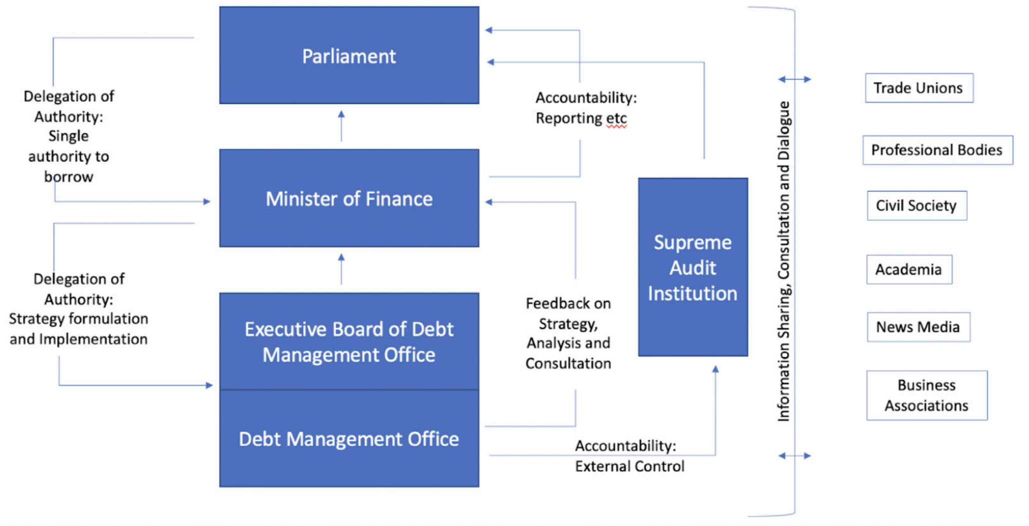
Enhancing Institutional Framework for Debt Management

Political factors and institutional weaknesses can undermine accountability mechanisms. For instance, weak parliamentary oversight, insufficient independent audit institutions, and a lack of informed public debate about public debt can all obstruct debt transparency initiatives. Mechanisms allowing for public participation, independent audits, and parliamentary oversight should, therefore, be established to ensure that debt procurement is conducted transparently and in an accountable manner. Given the technical nature of public debt management and the fact that many potentially significant debt-related transactions may not be immediately made public, the members of the legislature and the public must rely on the independent audits performed by the supreme audit institutions (SAI) to determine whether the government's public debt reports show the true condition of public debt and its most relevant details.

From a legal standpoint, affirming the active involvement of citizens in decision-making processes is crucial in promoting social cohesion and inclusivity. Transparency is closely linked to accountability, and without access to information, it is difficult to hold governments accountable for their borrowing decisions and debt management practices. Therefore, the Ministry of Finance must invest in adopting open data policies in the procurement (including terms and conditions), utilisation and management of public loans and debts. This ought to be done in a way that is transparent, accountable, participatory and inclusive. Elected officials and government institutions are more likely to act in the public interest when they know an engaged and informed citizenry scrutinises their actions. This, in turn, reduces the likelihood of corruption and mismanagement. As such, in the interest of public accountability, civil society organisations in Fiji should leverage section 25 of the Constitution to call for the publishing of consolidated information on Fiji's debt management in a way that is understandable to the ordinary citizen. While the government's recent attempt with the budget is a step in the right direction, this should also be extended to the country's debt situation.

The broad cast of stakeholders, decision-makers and elected officials required to ensure public debt is effectively mobilised and managed for the national priorities is captured in Figure 4-4:

Figure 4-4: Institutional and Governance Framework for Debt Management



Source: Author's based on chart from UNCTAD, Guideline on Responsible Sovereign Lending and Borrowing," p. 35

Chapter 5 - Climate Finance and Debt

Fiji, like other debt-burdened developing countries, is at a crossroads between dealing with climate change, fiscal health and economic development. On the one hand, they face certain climate risks and the economic havoc they wreak. Not attending adequately to these risks places Fiji in a vicious circle in which greater climate vulnerability raises the cost of debt— especially if it chooses to borrow from the markets—and diminishes the fiscal space for investment in climate resilience.

As financial markets increasingly price in climate risks and global warming accelerates, the risk premia of countries such as Fiji, if it does nothing, is likely to increase even further. On the other hand, the country is already deep in debt, and greatly expanding borrowings for climate action could risk the health of public finances further, bringing with it all the potential ramifications highlighted in the earlier chapters.

Given the intricate challenges presented in implementing climate initiatives and their broad implications, the government must formulate a robust climate finance strategy. This strategy needs to thoroughly evaluate all possible funding sources and financial mechanisms, carefully prioritising climate actions that align with the nation's development, climate resilience, and fiscal goals. Such a strategic framework is crucial to ensure that climate-related investments reinforce the nation's broader economic and environmental objectives.

In this regard, Fiji's climate finance strategy should include (and is not limited) to the following considerations:

- Identify the greatest existential and economic threat to Fiji and its people posed by climate change. Prioritise climate actions that will have the greatest impact on minimising known existential and economic impact, and managing known climate hazards and risks, so as to right size and stagger the amount of financing required.
- In this respect, well-chosen climate adaptation investments, by having a positive impact on growth, or by preventing growth from being derailed by climate change, can potentially help an economy outgrow its debt, advancing not just climate resilience but also debt sustainability in the longer run.
- Sequence the implementation of climate actions and interventions and in the process iterate and refine the efficacy of these interventions so that its financing can be better managed and deliver more bang for the buck.
- Conduct a cost-benefit analysis for each of these climate actions that takes into explicit consideration its impact on economic growth and development, and fiscal and debt sustainability.
- Conduct a comprehensive survey of all financing sources for its climate actions and objectives and weigh the pros and cons of each. It should also consider fiscal tools and incentives that can be employed to meet these costs over the long term.
- Continue to advocate for developed countries to live up to their responsibilities and international commitments to provide the necessary financing, in the form of grants, official development assistance, and highly concessional loans for climate action.
- Borrowing at market rates in the form of commercial loans or bond issuances should be subject to stringent scrutiny, especially by the government's debt management office and other relevant agencies, given how such borrowings deteriorate the public debt profile and dynamics—they tend to be expensive, denominated in foreign currencies, held by non-residents and impose costly

penalties in the event of defaults. Thus, the benefits of climate actions funded by such commercial borrowings should be clearly evaluated and articulated from the outset and mechanisms are put in place to ensure that they are in fact accrued. The borrower or issuer should strive to ensure the best possible terms in these loan and bond contracts, such as "hurricane clauses" for automatic debt service suspension, an appropriate forum for dispute resolution and agreed processes for restructuring in the event of a default.

- Identify climate actions that concomitantly deliver clear commercial and economic benefits. Private financing for such actions could be encouraged, and reduce demands on the public purse.

- Establish an automatic mechanism for a debt payment moratorium and comprehensive restructuring in the wake of external catastrophic shocks.

- Review debt sustainability frameworks to incorporate climate vulnerabilities and risk and impact assessments.

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