(11) The effective implementation of the Integrated Framework for Trade-related Technical Assistance to Least Developed Countries should be accelerated.

(12) The multilateral trade rules governing regional trade arrangements should be supportive of regional integration efforts and provide adequate flexibility to the Asian and Pacific least developed countries in adjusting to a more liberalized and competitive trade regime under these arrangements.

(13) Fast-track accession to WTO should be allowed for the least developed countries without asking them to assume obligations or commitments that go beyond what is applicable to WTO least developed country members.

Pacific island economies

GDP growth in this subregion remained positive in 2000 although the political crises and civil unrest in Fiji and Solomon Islands during the first half of the year contributed to a substantial contraction in their total output. In most cases, the growth rate recorded was lower than in 1999. Inflation within the subregion was generally on the decline, reflecting stable import prices from the main trading partners, especially Australia and New Zealand. However, higher oil prices put pressure on inflation and the budget from the second half of 2000. The various reforms and revenue-enhancing measures contributed to declining or low levels of budget deficits and a comparatively moderate rate of money supply growth in several countries in 1999. However, the fiscal position became relatively more fragile in some economies in 2000 as a result of revenue shortfalls or higher public spending or both.

Growth performance

In Fiji, GDP grew marginally in 1998 but expanded strongly by 6.6 per cent in 1999. The growth momentum, however, was stopped in 2000 with the political crisis and its severe economic reverberations. Despite a considerable increase in the sugar cane crop, GDP was estimated to fall by 12.5 per cent, the deepest contraction recorded since 1961 when GDP statistics were compiled (table II.5). Sugar cane output of 4 million tons, with sugar production of 450,000 tons for 2000, was much higher than the respective levels a year earlier. Nevertheless, the agricultural sector expanded by only 1 per cent owing to the adverse impact of the political crisis on domestic transportation and marketing of farm produce. The sector itself had grown by a massive 18.3 per cent in 1999. Its future outlook is clouded by land tenure problems for tenants (who are mostly third- to fourth-generation immigrants from India), lower investment in sugar cane cultivation, and the uncertainties of continuing market support from the EU, especially since the coup.

Tourism, Fiji's biggest industry with a relative share of some 20 per cent of GDP, was also on a downward trend with average daily arrivals of 600, about half the pre-crisis volume. There has been some recent recovery after heavy discounting on airfares and accommodation, but hotel occupancy rates were low, at 20 to 30 per cent for June 2000, compared with 80 to 90 per cent for the same month last year. As a whole, earnings on tourism were reduced by more than 50 per cent in the second half of 2000 and by 30 per cent for the calendar year, causing a contraction of some 20 per cent in the service sector for the year. Recovery of this sector is heavily contingent on the restoration of political stability and law and order. Manufacturing activities, particularly the large and rapidly growing garment industry, were hampered by international union boycotts of Fiji and reduced domestic demand for local manufactures because of the crisis. All these contributed to an estimated decline of 10 per cent in industrial sector output activity in 2000; industrial growth had been especially robust at over 10 per cent in the previous year.

The ratio of investment to GDP in Fiji, which exceeded 13 per cent in 1999, fell marginally to 12 per cent in the following year and is expected to remain dampened in the short term. No large public-sector investment projects are on-stream while several new hotel projects ready for, or already

Table II.5. Selected Pacific island economies of the ESCAP region: growth rates, 1997-2000

(Percentage)

		Rates of growth			
		Gross domestic product	*Agriculture*	*Industry*	*Services*
Cook Islands	1997	–2.8	12.2	6.4	–7.4
	1998	–2.3	2.8	–6.2	–3.4
	1999	2.7	2.5	4.6	2.5
	2000	3.3	..	..	..
Fiji[a]	1997	–0.9	–13.0	1.4	2.4
	1998	1.4	–7.2	3.1	3.3
	1999	6.6	18.3	10.4	2.6
	2000	–12.5	1.0	–10.0	–20.0
Kiribati	1997	2.3	–12.0	18.8	5.1
	1998	8.3	12.9	24.8	5.1
	1999	1.5	..	..	..
Papua New Guinea	1997	–5.2	–6.0	–12.3	4.2
	1998	1.4	–6.1	9.9	0.4
	1999	3.2	3.7	6.6	0.2
	2000	0.8	0.9	–4.3	4.5
Samoa	1997	1.5	–5.9	–1.0	5.7
	1998	2.6	7.0	–9.4	7.1
	1999	5.3	6.0	4.0	5.5
	2000	3.5	3.0	1.0	5.0
Solomon Islands	1997	–0.9	3.7	–11.7	–1.6
	1998	1.3	–4.2	11.4	4.0
	1999	–1.7	–7.5	25.1	–5.5
	2000	–13.5	–10.5	–21.5	–12.0
Tonga	1997	–1.4	–3.0	–8.1	1.8
	1998	0.1	–2.1	–5.7	3.2
	1999	2.2	–0.9	9.3	2.7
	2000	5.2	8.0	2.7	4.4
Tuvalu	1997	3.5	5.8	4.0	2.7
	1998	14.9	0.7	21.5	16.0
	1999	3.0	..	..	..
Vanuatu	1997	0.6	4.9	–18.0	2.0
	1998	6.0	6.7	8.9	5.4
	1999	–2.5	–11.3	7.5	–0.6
	2000	4.0	..	..	..

Sources: ESCAP, based on ADB, *Key Indicators of Developing Asian and Pacific Countries 2000* (Oxford University Press, 2000) and *Asian Development Outlook 2000* (Oxford University Press, 2000); and national sources.

Notes: Data for 2000 are estimates. Industry comprises mining and quarrying; manufacturing; electricity, gas and power; and construction.

[a] Real GDP at factor cost.

under, construction are now put on hold; and so, too, are other private sector projects. On the other hand, savings went up from 13 per cent of GDP in 1997-1998 to around 19 per cent in 1999 in the wake of vibrant agricultural and economic performance. The savings rate was expected to fall off sharply to a crisis-induced level of 12 per cent in 2000.

After a marginal recovery in 1998, the economy of Papua New Guinea grew strongly at 3.2 per cent in the following year, but was estimated to have stagnated in 2000. The new government, which came into power in July 1999, has embarked on an extensive programme of structural reform, including improvements in standards of governance and of discipline in fiscal and economic management. GDP is projected to expand by about 3.1 per cent in 2001 and 4.7 per cent in the following year, with the main stimulus coming from the construction of the long-awaited gas project and the coming on-stream of a large nickel mine. Indeed, poor governance had led to a slump in investment, especially in construction, during the period 1998-1999. The trend was recently reversed; investment is expected to reach 42 per cent of GDP in 2000 from 29.4 per cent of GDP in 1999. The savings rate is estimated to increase substantially to 34.4 per cent in 2000 despite a shortfall in the National Provident Fund of more than $56 million (almost 1.5 per cent of GDP).

Mining and petroleum have long dominated the country's industrial sector whose contraction in 2000, at 4.3 per cent, was significantly down from a growth rate of 6.6 per cent a year earlier and of about 10 per cent in 1998. The higher expansion in 1998 was due to the coming on-stream of the Lihir gold mine and the resumption of full production at the Ok Tedi and Porgera mines after drought-related disruptions and the commencement of production at the Gobe oil fields. The contraction in industrial output in 2000 was mainly due to a fall in oil production at Kutubu fields, coupled with disruptions in production at the Moran oil fields in late August 2000 when the pipelines were damaged by a landslide. Meanwhile, agriculture (including forestry and fisheries) recovered somewhat from the drought-affected contraction of over 6 per cent in both 1997 and 1998, with output growth of 3.7 per cent in 1999. The sector remained rather subdued, with an expansion of 1 per cent in 2000, because of a sharp decline of more than 30 per cent in coffee production. Law and order problems and the deterioration in transport infrastructure have acted as the two main constraints on agricultural production in general, and the coffee industry in particular.

The Samoan economy has continued to perform well in recent years with remarkable price stability and output growth of 2.6 per cent for 1998 and 5.3 per cent in 1999; the outlook for 2000 remains healthy and GDP was expected to be 3.5 per cent higher. Agriculture accounted for two thirds of domestic employment and most of export earnings. Favourable weather conditions and good fishery harvests drove output up by 6 per cent in 1999 although the expansion dropped back to 3 per cent in the following year. Industrial activities, including the production of automotive parts, recovered from a sharp contraction in 1998 to grow by 4 per cent but the levels of industrial value added slowed somewhat to about 1 per cent in 2000 as a result of a slowdown in the construction sector following strong growth in the previous year. The service sector, with a relative share of 58 per cent of GDP in Samoa, expanded by 5 per cent in 2000 largely because of a boost in tourism; tourists initially bound for Fiji, which became affected by the political crisis, chose instead to visit Samoa. A new air services agreement was signed with New Zealand to open more routes between the two countries.

In Solomon Islands, the economy has been largely paralyzed by the civil and military unrest, which erupted in 1999 and dragged on until the October 2000 Peace Agreement, with over 100 deaths. The widespread looting and vandalism that followed drastically cut investment and created great consumer and business uncertainties. This devastation came in the midst of the drive for reform, supported by ADB and the World Bank, to improve standards of governance, among other objectives. GDP was then expected to grow strongly, but it declined by 1.7 per cent in 1999 and is expected to drop by 13.5 per cent in 2000. The downward economic spiral will continue if the Peace Agreement cannot be upheld. Indeed, the agricultural sector (including forestry and fisheries) has remained on a declining trend, with output contracting by slightly over 4 per cent in 1998 and widening to over 10 per cent in 2000. In particular, the sole palm oil plantation, with $20 million in export earnings and employing 2,000 persons, was closed in June 1999 and there was lower production of other major export crops, especially copra and cocoa. Fishing operations by the country's largest company were suspended in late 2000.

The Gold Ridge, the first large-scale mining operation in Solomon Islands, helped boost industrial sector production by over 25 per cent in 1999; its output was to grow by another 35 per cent in 2000, but the mine was closed in June because of the civil unrest. Prospecting and construction activities, and other manufacturing operations (including the brewery), were also stopped, with the result that industrial value added would be over 21 per cent lower for the year. Output from the service sector also fell by some 12 per cent during the year. Electricity generation faced severe problems of uncollectable fees and charges after significant donor-funded investment to upgrade supply and extend the transmission network. Tourism and the retail industry have crashed, causing many hotels and shops to close. Rehabilitation of mining, industrial and servicing equipment and operations would be costly and would take several years.

The Tongan economy recovered from a stagnant economic performance lasting three years to expand by 2.2 per cent in 1999 and another 5.2 per cent in 2000. The agricultural sector has been on a decline since 1997 because of droughts (during the period 1997-1998) and severe cyclones (from the end of 1998 and to early 2000); it rebounded with 8 per cent growth in 2000. Meanwhile, higher construction and rehabilitation activities lifted industrial output by 9.3 per cent in 1999 with further growth of 2.7 per cent expected in the following year. Tonga was one of the first nations to greet the new Millennium and tourist arrivals were up 40 per cent in the last quarter of 1999; this also benefited retailing and manufacturing, with the latter driven largely by food and beverage processing. The service sector (accounting for 52 per cent of GDP) expanded by almost 3 per cent in 1999 and by another 4.4 per cent in 2000. Tonga's future economic prospects are very much contingent on both tourism and inward remittances from Tongans living abroad.

In Vanuatu, per capita income has declined slightly in recent years owing to a high population growth rate of 3.1 per cent. Total output contracted by 2.5 per cent in 1999, but is expected to expand by 4 per cent in 2000. The agricultural sector (with 22 per cent of GDP) declined by 11.3 per cent in 1999 mainly because of much lower copra prices and production; the 2000 coconut crop also faced a new threat in weevil infestation. Meanwhile, beef output was on the rise following a downturn during the East Asian financial crisis; niche marketing of this high-quality product, mainly to Japan, and the sale of 20-kilogramme packs to departing tourists was successful. Services, particularly tourism and finance-sector-related activities, accounted for more than two thirds of the country's GDP. Tourist arrivals for 1999 were adversely affected by the recent political turmoils in Fiji, which acted as a transport hub for Vanuatu; the value added from services was thus dampened to 0.6 per cent for the year. Local bottlenecks in accommodation and air transport capacity have also served as a constraint on the vigorous and sustained development of tourism activities.

Among the smaller Pacific island economies, GDP in Cook Islands rebounded by 2.7 per cent in 1999 with further growth of 3.3 per cent expected in 2000. Output had declined since 1995 mainly as a result of an extensive restructuring of the public service, including the corporatization of public-sector enterprises. Expansion in black pearl production and construction activities contributed to strong industrial growth of almost 5 per cent in 1999. Meanwhile, a higher volume of tourist arrivals, by 6.5 per cent in 1999, helped lift the value added from services by 2.5 per cent. There was a diversification of the market with tourists from Canada accounting for one third of the increase.

In Kiribati, higher copra production, an expansion in public administration and the construction of aid-funded projects were behind the high GDP expansion of 8.3 per cent in 1998. Economic activities tapered off in the following year and the Japanese-funded construction of a new wharf underpinned output growth of 1.5 per cent in 1999. The economy of the Marshall Islands recovered from a three-year decline owing to reform-related expenditure and employment cuts, and bad weather conditions. The modest GDP growth of 0.5 per cent in 1999 was attributed to aid-funded public works, the construction of a tuna-processing factory and higher agricultural production. The Federated States of Micronesia also went through a two-year economic slippage with output expanding by 0.3 per cent in 1999. This subdued recovery was driven by a higher level of private-sector activities in one state, Chuuk, while economic activities continued at a slow pace elsewhere in the country. The economy of

Tuvalu experienced an economic boom in 1998, with GDP growing by almost 15 per cent, largely on account of a one-third expansion in public-sector activities; the sector was equivalent to one fourth of GDP. Output went up moderately at 3 per cent in 1999, largely reflecting an expansion in public construction activities.

Inflation

After the devaluation-related pickup in consumer prices in 1998, inflation in Fiji has been on a downward trend at just 2 per cent in 1999 and about 1 per cent in 2000 (table II.6). The continued strength of the United States dollar and higher oil prices were

Table II.6. Selected Pacific island economies: summary of macroeconomic indicators, 1997-2000

(Percentage)

		1997	*1998*	*1999*	*2000*
Fiji	Savings/GDP	13.1	13.3	19.0	12.0
	Investment/GDP	12.5	12.0	13.4	12.0
	Budget balance/GDP	–6.4	4.6	–0.7	–4.0
	Current account balance/GDP	–1.6	–3.5	7.9	1.9
	Money supply growth (M2)	–8.7	–0.3	14.2	6.6[a]
	Inflation rate[b]	3.3	5.7	2.0	1.0
Papua New Guinea	Savings/GDP	23.0	28.3	29.3	34.4
	Investment/GDP	27.1	30.3	29.4	42.0
	Budget balance/GDP	0.1	–2.1	–2.2	–1.5
	Current account balance/GDP	–4.2	–0.5	1.3	6.5
	Money supply growth (M2)	7.7	2.5	9.2	2.5[c]
	Inflation rate[b]	3.9	13.6	14.9	12.2
Samoa	Budget balance/GDP[d]	0.3	2.1	0.3	–5.0
	Current account balance/GDP	3.9	9.6	–8.9	–5.7
	Money supply growth (M2)	16.5	2.2	12.5	11.1[a]
	Inflation rate[b]	6.8	2.2	0.3	2.0
Solomon Islands	Budget balance/GDP[d]	–4.6	–1.6	–2.3	–4.5
	Current account balance/GDP	–10.0	2.7	11.7	0.8
	Money supply growth (M2)	6.7	2.5	7.0	1.1[a]
	Inflation rate[b]	8.1	12.3	7.8	4.0
Tonga	Budget balance/GDP[d]	–1.2	–4.3	1.0	–0.7
	Current account balance/GDP	–1.6	–11.8	–5.0	–4.3
	Money supply growth (M2)	7.8	14.7	11.9	4.5[e]
	Inflation rate[b]	2.1	3.3	4.4	4.5
Vanuatu	Budget balance/GDP	–2.7	–6.7	–1.2	–1.8
	Current account balance/GDP	–7.6	2.0	–4.5	–3.2
	Money supply growth (M2)	–0.4	12.6	–9.2	–8.3[a]
	Inflation rate[b]	2.9	3.9	2.8	1.5

Sources: ESCAP, based on ADB, *Key Indicators of Developing Asian and Pacific Countries 2000* (Oxford University Press, 2000) and *Asian Development Outlook 2000* (Oxford University Press, 2000); IMF, *International Financial Statistics,* vol. LIII, No. 9 (September 2000) and *International Financial Statistics,* vol. LIII, No. 12 (December 2000); and national sources.

Note: Data for 2000 are estimates.

[a] January-September.
[b] Referring to changes in the consumer price index.
[c] January-June.
[d] Excluding grants.
[e] January-August.

largely offset by falling prices of domestically produced and marketed goods and services owing to a slump in demand and economic activities following the political turmoil. Consumer prices would likely be higher in 2001 as a result of the continuing high levels of domestic oil prices, an upswing in domestic activities, and a possible further depreciation of the Fijian dollar; the currency went down by 7.8 per cent in relation to the United States dollar in 2000.

The kina in Papua New Guinea had experienced considerable downward volatility in value since its floatation in 1995. Consumer prices edged up marginally, from 13.6 per cent in 1998 to just under 15 per cent in 1999, despite the imposition of price controls on utilities and domestic air travel, and a relative stabilization of the currency in the second half of 1999. The price controls, however, caused large losses in state-owned enterprises. Inflation was expected to be lower, at just over 12 per cent in 2000, as the currency continued to hold firm owing to improved fiscal and economic conditions and the inflow of large concessional loans.

Samoa has experienced remarkable price stability with inflation of less than 3 per cent over the past three years and, notably, a negligible rise in consumer prices in 1999. There was, to begin with, low inflation in the Australia and New Zealand, the country's two major sources of imports; in addition, the local currency remained firm against the Australian and New Zealand dollars. In addition, supplies of agricultural produce were ample, especially in 1998-1999, while import prices benefited directly from the ongoing process of tariff reductions. Inflation picked up to an estimated 2 per cent in the following year, partly on account of higher oil prices and a depreciation of the country's currency by some 10 per cent against the United States dollar.

Consumer prices were brought under control in Solomon Islands after a decade of relatively high inflation, often at a double-digit rate; these prices went up by less than 8 per cent in 1999 and by just 4 per cent in 2000. The indexation of wages to inflation was stopped; productivity improvements would determine future wage increases. Public-sector wages were also frozen in 1999. On the other hand, the main cost-push forces included the shortage of fresh food induced by the civil unrest and a small depreciation of the local currency against the Australian dollar and the Japanese yen. Australia and Japan account for about 60 per cent of imports; prices of imports from these countries went up by 8.3 per cent in 1999. In addition to higher oil prices, further inflationary pressures would be felt if the local currency were to weaken.

Inflation was on a marginally rising trend in Tonga, from an annual average of 2.7 per cent during the period 1997-1998 to around 4.4 per cent annually in the following biennium. Domestically produced goods and services rose by 3.4 per cent in 1999. The slight rise in the inflation rate (to 4.5 per cent) in 2000 was largely attributable to increases in oil prices and in the salaries of public-sector employees (by 20 per cent) during the second half of 2000, together with higher import prices caused by the depreciation of the local currency by around 6 per cent against the currencies of Australia and New Zealand.

Vanuatu is another island country with considerable price stability, inflation standing at 2.8 per cent in 1999 and 1.5 per cent in 2000 and the outlook on prices remaining largely stable. Easier supplies of subsistence food products and the appreciation of the local currency (by 3.3 and 7.7 per cent) against the Australian and New Zealand dollars contributed to a stabilizing influence on consumer prices in 2000. These two developed countries have been the main import suppliers to Vanuatu and many other island economies as well.

Most other Pacific island economies use the currencies of Australia, France, New Zealand and the United States as legal tender, and changes in their price levels generally mirror those in the metropolitan countries. By and large, inflation was low or falling in these economies, except in Cook Islands and Tuvalu. Consumer prices in the Marshall Islands rose by 1 per cent in 1999. In Cook Islands, an unexpected inflation of just over 5 per cent in 2000 reflected a rebound from the prolonged decline in the earlier years. In Tuvalu, higher prices for transport services and miscellaneous items lifted the inflation rate to 7 per cent in 1999.

Trade

In Fiji, the merchandise trade deficit improved sharply to stand at $207 million in 1999, with export earnings rising by almost two fifths, to $568 million, on account of a surge in sugar and garment exports (table II.7). Meanwhile, the value of imports dropped by 1.6 per cent to $775 million. The continuing

Table II.7. Selected Pacific island economies: merchandise exports and imports and their rates of growth, 1997-2000

	Exports (f.o.b.)					*Imports (c.i.f.)*				
	Value (millions of US dollars)	*Annual rates of growth (percentage)*				*Value (millions of US dollars)*	*Annual rates of growth (percentage)*			
	1999	*1997*	*1998*	*1999*	*2000*	*1999*	*1997*	*1998*	*1999*	*2000*
Fiji	568.0	–21.1	–16.1	39.4	2.0	775.0	–1.9	–16.8	–1.6	–5.0
Papua New Guinea	2 019.0	–14.7	–16.1	12.8	6.7	1 118.0	–2.6	–27.0	3.2	2.2
Samoa	18.1	50.0	26.3	–2.1	–9.0	114.8	–3.0	–5.2	20.9	–13.6
Solomon Islands	150.8	6.8	–8.8	6.0	–33.6	134.7	12.6	–14.5	–16.0	–27.2
Tonga	12.5	–23.1	–38.5	73.3	4.0	62.6	–2.7	–9.5	–0.7	–3.3
Vanuatu	25.3	16.7	–0.7	–17.1	8.0	77.2	–3.1	–5.5	5.0	1.0

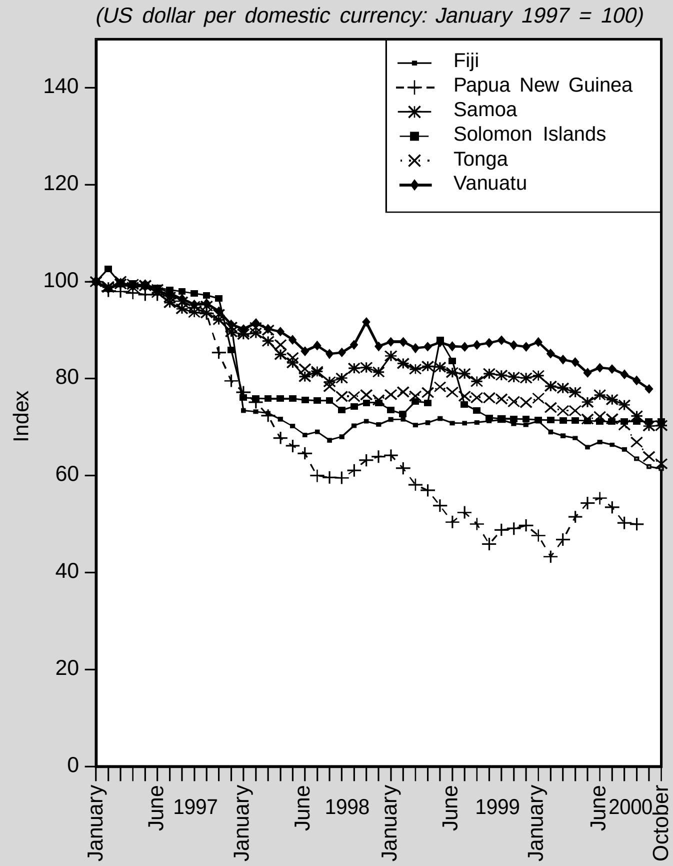
Sources: United Nations, *Monthly Bulletin of Statistics,* October 2000; and national sources.

strength of tourism, the country's biggest foreign exchange earner, lifted service exports to $684 million in 1999, thus contributing to a higher surplus of $306 million on the service accounts. Subsequently, the adverse impact of the political turmoil, particularly a boycott by domestic and overseas trade unions in the handling of non-essential items, made itself felt. There was a small increase of 2 per cent in export earnings relative to a sharper contraction of 5 per cent in import spending, with the trade deficit going down further to $157 million (or about 10 per cent of GDP) in 2000. Interruptions to the supply of raw materials, particularly to the garment manufacturers, and delays in delivery to clients severely affected production and trade flows. In addition, lower imports were caused largely by a fall of 21 per cent in the purchase of investment-type inputs. The slump in tourism will lead to a smaller current account surplus of about $35 million; the same surplus stood at $144 million, or 7.9 per cent of GDP, in 1999.

In Papua New Guinea, merchandise exports increased by 13 per cent to $2 billion (equivalent to 49 per cent of GDP) in 1999 because of higher oil prices; such earnings were projected to rise by another 6.7 per cent to account for 54 per cent of GDP in 2000. In particular, crude oil exports brought in $0.8 billion, or nearly 35 per cent of export receipts, up from an average of 25 per cent over the period 1998-1999. Earnings on gold, the other main export commodity, increased by 16 per cent (to $516 million) during the first nine months of 2000 compared with the corresponding period of 1999. Export value will be boosted significantly, by upwards of $0.6 billion a year, with the completion in 2003 of the gas pipeline project to the north of Australia. On the other hand, largely as a result of adverse weather and bottlenecks in infrastructure and rural extension services, agricultural exports fell by almost 5 per cent to $472 million in 1999, and by another 1 per cent in 2000. The export volume of cocoa and copra remained well below their respective 1997 levels while that of coffee exports has dropped off marginally since 1998, despite a sharp depreciation of the local currency during the same period (figure II.2). A much-anticipated recovery in log exports was tempered by the continuing increase in effective export tax rates, export volumes in 1999 being half those of 1996.

Spending on imports was growing at a much slower rate of just over 3 per cent in 1999 (to $1.1 billion) and 2.2 per cent in 2000, resulting in a trade surplus of almost $1 billion (almost 22 per cent of GDP) in 1999 and $1.1 billion (or 28 per cent of GDP) in 2000. The balance on the trade and service accounts together was much smaller, at $154 million in 1999 and $405 million in 2000, because of large deficits in the service trade. This surplus is

Figure II.2. Index of exchange rates of selected Pacific island economies, 1997-2000



Source: IMF, *International Financial Statistics* (Washington DC), various issues.

expected to contract until 2003 as imports of goods and services are expected to expand in support of the construction of the gas pipeline project and the new nickel mine. In addition, the predominance of large foreign-owned mineral development projects contributes to sizeable deficits in the investment income account; the shortfall amounted to $275 million in 1999 and is expected to rise further in the near term because of high oil prices. The transfer account was in surplus, by $174 million in 1999 mainly owing to ODA receipts, but the current account balance was much smaller, $53 million (or 1.3 per cent of GDP) in 1999. This surplus is expected to reach $259 million (or 6.5 per cent) in 2000.

In Samoa, merchandise exports rose strongly to just over $18 million, while imports reached $115 million, or 56 per cent of GDP, in 1999. As has long been the case, the substantial trade deficit ($96.7 million or 46 per cent of GDP) has been offset in a large part by inward remittances from Samoans living abroad, by external aid, and by tourism receipts. Private remittances, for example, reached $32 million in 1999 and an even higher level is expected for 2000. Meanwhile, tourist spending was estimated at almost $41 million, or 20 per cent of GDP, in 1999. Significantly, overseas Samoans comprised almost one half of the volume of visitor arrivals, while the unrest in Fiji served to divert some of the tourist flows to alternative destinations, including Samoa. Prospects for the industry are promising with more extensive air links to source nations. As in other Pacific island countries, there exists an acute shortage of hotel rooms (totalling some 700 in current capacity), although this constraint should be somewhat relieved with the coming onstream of new resort projects over the medium term.

Earnings from merchandise exports in Solomon Islands expanded in 1999 at a much slower rate of 6 per cent than earlier expected in view of the first full year of production from the Gold Ridge mine. Gold was the second biggest export item with a relative share of over a quarter. The most important foreign exchange earner, logs, went up in value by 14 per cent in response to revived demand from East Asia, although fishery exports, the third largest item, were hampered by low tuna prices and heavy taxation. Export of palm oil, copra and cocoa also suffered from the civil unrest, which is expected to cause overall earnings to drop by one third in 2000. In particular, palm oil exports were virtually halted, gold exports dropped by 50 per cent and could be nil in 2001, and fishing exports were some 20 per cent lower and were expected to drop further in 2001. Setbacks of various magnitudes were also experienced by cocoa, copra and log exports.

Merchandise imports fell by over 16 per cent in 1999 and by another 27 per cent in 2000. This sharp downward trend in part reflected the completion of the construction phase of the Gold Ridge mine, and in part was the result of the unrest-induced contraction in consumption expenditure, and a fall in the import of inputs because of the closure of mining operations, as well as in capital goods owing to the cancellation of major investment projects. Gold mining helped transform a merchandise deficit of over $18 million in 1998 into a surplus of about $16 million in 1999; a smaller surplus of about $2 million is expected for 2000. Large inflows of aid and investment, among other inward transfers, yielded a current account surplus of almost $43 million (or 11.7 per cent of GDP) in 1999. This surplus is expected to be significantly lower at just under $3 million in 2000 owing to the falling trade surplus, higher income outflows, and a contraction in aid and other transfers.

Tonga registered a sharp increase of over 73 per cent, to $12.5 million, in export earnings in 1999, a reflection of the solid recovery of agricultural production from natural disasters, including droughts and cyclones. Squash exports doubled to $5.6 million in 1999 despite a glut in the market and hence low prices; those of fish and seaweed more than doubled to $3.7 million and should continue to grow strongly in view of government efforts to improve conditions for commercial fishing. The value of other exports such as vanilla, kava and root crops was also higher in 1999. At the same time, there have emerged new opportunities for niche exports following a relaxation of quarantine requirements in New Zealand for certain fruits and vegetables from Tonga, although there was a setback in early 2000 with New Zealand imposing a temporary ban on Tongan papayas. Merchandise exports are expected to rise further to $13 million in 2000.

Merchandise imports were on a slightly declining trend, amounting to $62.6 million in 1999, compared with $63 million a year earlier, and $60.5 million in 2000. The substantial trade deficit of over $50 million (or 33 per cent of GDP) in 1999 and $47.5 million in 2000 was marginally offset by a small surplus on the service account of $3.6 million; tourism receipts provided more than one half of earnings on service exports of almost $18 million. Prospects for the country's tourism sector are reasonably bright in 2000 and 2001 although the crisis in Fiji could be expected to have some negative repercussions for the industry. Meanwhile, inward remittances from overseas Tongans went up from $38 million in 1998 to $43.3 million (or 28 per cent of GDP) in 1999 and are expected to remain at the same level for 2000. Nevertheless, the current account continued to be in deficit although the magnitude of this shortfall declined to $7.6 million (or 5 per cent of GDP) in 1999 from $12.1 million in 1998, and is expected to decline further to $6.6 million in 2000.

Vanuatu's merchandise exports, at $25.3 million in 1999 (or just under 11 per cent of GDP), fell by 17 per cent because of weather-related sharp declines in earnings on copra and kava. Beef exports remained strong at $3.2 million in 1999, and are likely to rise in future years, particularly to the Japanese market. Merchandise imports in 1999 amounted to over $77 million (or 33 per cent of GDP), an increase of 5 per cent over the previous year. The trade deficit has improved somewhat in 2000 with higher earnings on copra, beef, timber and kava, while import spending remained subdued.

Tourism and financial services were among the main foreign exchange earners; tourism brought in $55.5 million (or 24 per cent of GDP) with forecasts for further growth in 2000 as a positive spillover from the civil disturbances in Fiji. Service exports reached $128 million, up 13 per cent, in 1999 but the large surplus on this account was negated by other outflows so that the current account remained in deficit by $10.5 million (or 4.5 per cent of GDP); the shortfall is expected to improve marginally to $7.5 million in 2000.

Capital inflows and outflows

The high level of foreign reserves in Fiji at the time of the coup, at $395 million, was adequate to cover imports for six months. Subsequently, controls on capital outflows to stem capital flight included a reduction in the ceilings on foreign exchange transactions, the introduction of higher interest rates, and a withdrawal of some powers delegated to commercial banks for approving foreign exchange transactions. These measures have been effective in helping to avoid a foreign exchange crisis, although capital inflows have dwindled rapidly. ODA from Australia and New Zealand was suspended in the aftermath of the coup. There was a subsequent, partial relaxation, but new projects remained on hold. Portfolio investment will not resume quickly until the resolution of security of tenure in property, land in particular. Investment projects approved prior to the coup amounted to $300 million, of which some $160 million related to the development of large tourism projects; these are now on hold as well.

Papua New Guinea recorded a current account surplus of 1.3 per cent of GDP in 1999 compared with a deficit of 0.5 per cent of GDP in 1998. As noted earlier, the large surplus on the trade balance combined with a surplus on the transfers account more than offset the deficit in the invisibles account. The marked deterioration in confidence had culminated in substantial capital flight with foreign exchange reserves falling by mid-1999 to just two weeks of import spending. Along with the new government, relationships with bilateral and multinational donors as well as resumed private capital inflows, mostly in the mineral resources sector were restored. Nevertheless, a deficit of $123 million was recorded in the capital account in 1999 although a surplus of $30 million was expected for 2000. External debt servicing has been growing steadily in recent years, reaching 2.7 per cent of GDP in 1999; public-sector debt accounted for around half of the outstanding obligations.

In Samoa, official flows by far dominated capital account transactions. Two major projects to improve the education system and rural water supply, funded respectively by ADB ($7 million) and the EU ($50 million), will boost domestic economic activities, including those from the local providers of goods and services, and revenue prospects in the medium term. On the other hand, money laundering is posing a new and growing threat to financial institutions in many Pacific island countries. A Money Laundering Prevention Act, passed in June 2000, resulted in the seizure of $14 million in September (see box II.2). The balance of payments turned into a deficit equivalent to 3 per cent of GDP in 1999, compared with a surplus of 3.7 per cent in 1998, primarily because of increased private-sector imports in response to a higher level of economic activities. Foreign reserves remained healthy at $65 million in 2000 and were adequate to cover more than six months of import expenditure. At the same time, external debt was manageable at $68 million as of 1998; this amount was about 74 per cent of GDP and some 70 per cent of such obligations were held by the public sector.

Capital flight caused by the ethnic tensions in 1999 transformed a capital account surplus of $18.4 million in Solomon Islands in 1998 into a deficit of $22.3 million in 2000, in spite of higher official inflows in support of the reform programme; a steady deficit of $22 million was expected for 2000. On the other hand, the country had recorded a balance-of-payments surplus for some years so that the level of foreign reserves had gone up from under $17 million in 1994 to almost $57 million (or five months of import cover) by the third quarter of 1999. Reserves have recently been depleted, dropping to $37.5 million in 2000. The outstanding external debt reached $165 million, or 47 per cent of GDP, at the end of 1999 although the burden of debt servicing was about 2.7 per cent of GDP. Almost three quarters of such obligations lies within the public sector with official external arrears, amounting to $10.8 million at the end of 1999. This continued to be a problem. These arrears were reduced early in 2000 as part of the reform programme being supported by multilateral institutions.

Box II.2. Efforts to curb money-laundering activities in Pacific island countries

Money laundering comprises endless variations on a simple theme: taking money earned in illegal activities and moving it through one or more transactions so that it looks legal. Once cleansed, the funds can easily be spent on legitimate deals, such as real estate or stock. The illegal means could be in the form of illegal arms sales, smuggling, and the activities of organized crime syndicates including, for example, drug trafficking and running prostitution rings.

The problem of money laundering began to be taken seriously in the 1980s when organizations such as the United Nations and the Basel Committee on Banking Supervision started looking into the problem. But it was not until the Financial Action Task Force on Money Laundering (FATF) was set up by the Group of Seven (G7) in 1989 that coordinated action really began. One of the first tasks of FATF was to spell out a number of measures, that became known as the "Forty Recommendations" which national governments should take to combat money laundering. They cover the criminal justice system and law enforcement, and the financial system and its regulation. In addition, the European Union and the Organization of American States have also established antimoney-laundering standards for their members while the Caribbean, Asian and Eastern European countries have created regional FATF-type groupings. As a result, some countries have adopted measures against money laundering. However, the problem has by no means been resolved.

FATF announced, in June 2000, a blacklist of 15 countries as " non-cooperative" in the global fight against money laundering. Included on this list are four Pacific island countries, the Cook Islands, the Marshall Islands, Nauru and Niue. Palau, Samoa, Tonga and Vanuatu have also been cited in the past.

Countries blacklisted by FATF have been subjected to sanctions. For example, Western banks, such as Deutsche Bank and Bankers Trust, did not permit any dollar-denominated transactions in Nauru, Palau and Vanuatu in 1999 in the wake of a United States Government investigation into how illicit money was laundered through the Bank of New York and Nauru. Similar sanctions were imposed on Niue by the United States banking system in January 2001 when Niue gave a law firm in Panama the exclusive right to register "international business companies" in the country in return for around $1.6 million a year, which is a substantial portion of Niue's budget. Thus, money laundering can pose significant risks to an economy. The potential macroeconomic consequences of money laundering include inexplicable changes in money demand, prudential risks for banks, contamination effects on legal financial transactions, and volatile capital flows and exchange rates owing to unanticipated cross-border asset transfers. There are social and political dimensions as well; it can lead to the overall weakening of the social fabric and collective ethical standards.

Some Pacific island countries have taken several initiatives in recent years to address this problem. At the national level, several of them, including the Cook Islands, Niue, Samoa and Vanuatu, have recently enacted money-laundering legislation. The recent seizure of $4 million by authorities in Samoa, which was part of a $14 million fund belonging to a group of American Samoan businessmen, partly indicates the success of some Pacific island countries in combating this problem. The Government of Samoa confiscated the funds after the group tried to transfer $4 million to the United States. This followed a joint collaboration between the United States Federal Bureau of Investigation (FBI) and the Attorney General's office in Samoa which proved that the funds were connected to money-laundering activities. At the subregional level, the issue of money laundering has been discussed widely. For example, police chiefs from Pacific island countries met in New Zealand in October 2000 and agreed that the Pacific subregion was being increasingly targeted for money-laundering activities. The meeting among other things, discussed the importance of establishing financial intelligence units, with the aim of monitoring financial and investment schemes to ensure their legality. It also discussed the impact of the Internet on criminal activities in the subregion. The meeting underlined the complexity of electronic crime and the need for governments to interact and create a legislative framework for security purposes.

Pacific island countries are also cooperating with relevant agencies at the global level to combat money-laundering activities. For example, several of them attended the conference jointly organized by OECD and the Commonwealth Secretariat in January 2001 in Barbados to discuss money laundering and related issues. The meeting established a joint working group comprising representatives of the Commonwealth Secretariat, the Caribbean Community, the Pacific Islands Forum and the OECD countries and territories. The working group, which is co-chaired by Australia and

(Continued overleaf)

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Barbados, has 12 members of which two, the Cook Islands and Vanuatu, are from the Pacific subregion. This group met in London in late January 2001 and identified a number of areas of agreement in relation to the need for dialogue and cooperation. However, the meeting ended with an acknowledgement that further work was needed to achieve a mutually acceptable process and the creation of a truly inclusive global forum. The group will hold its second meeting in Paris in March 2001. Meanwhile, Japan, in cooperation with OECD, hosted another meeting in Tokyo in February 2001 to discuss the harmful tax practice issues. The Tokyo meeting resolved that Pacific island countries would ask OECD to agree to the same level of constructive dialogue with non-OECD members as it had given its own members.

It is of the utmost importance for the international community to work closely with the affected countries as they endeavour to curb money-laundering activities. Apart from raising awareness of the problem within both the government and the private sector, technical and financial assistance should be provided to these countries to establish the necessary legal and regulatory tools and develop administrative competence to combat the problem. It is also important for governments to ensure prudential supervision of the financial sector. One of the major requirements is for financial institutions to know their customers. They should not operate anonymous bank accounts and should take steps to identify the customers when transactions are carried out on behalf of third parties. Financial institutions should also pay particular attention to large, complex or unusual transactions, and report any suspicions to the authorities charged with tackling money laundering. The supervisory authorities should ensure that all financial institutions have adequate programmes in place to guard against money laundering.

Tonga's capital account surplus of $5.2 million in 1999 was expected to reach almost $6 million in 2000. Aid and concessional loans dominate capital account transactions as inward FDI has been comparatively limited. Foreign reserves of $21 million at the end of 1999 were adequate to finance three months of import spending. The large wage increase granted to public servants could put pressure on the balance of payments, and hence on the reserve level, unless efforts are made to contain a budget deficit blow-out. External debt servicing averaged $3.9 million over the period 1999-2000; the amount was equivalent to 2.5 per cent of GDP and 30.5 per cent of earnings on merchandise exports.

Allegations of money laundering against some financial institutions in Vanuatu prompted an outflow of funds from the banks in 1998. Even though the trend was reversed in 1999, some outflows were again recorded in the first half of 2000 as banks placed some of their assets offshore. Vanuatu's traditional capital account surplus reached almost $29 million, or 12 per cent of GDP, in 1999 with virtually the whole amount being the result of net official capital inflows. Foreign reserves, at $43 million or more than six months of import cover, at the end of 1999 remained at a healthy level despite a steady decline in 2000.

Fiscal and financial developments

The fiscal position in Fiji deteriorated considerably, from a surplus of 4.6 per cent of GDP in 1998 to a shortfall of 0.7 and 4 per cent respectively in the following two years as revenue declined along with higher spending on the security forces and on rehabilitation. The falling level of debt (from 58 to 54 per cent of GDP between 1997 and 1999) will again be on an upward trend. Foreign debt accounted for 31 per cent of the total debt in 1999. Among the responsive stabilization measures was an expenditure reduction strategy encompassing a reduction of 12.5 per cent in salaries and wages for public servants, of 20-30 per cent in operating and other grants, and of 30 per cent in capital spending. However, a reversal through ad hoc arbitration of the salary cut is expected to cost an extra F$10 million with the attendant pressure on the fiscal position. Other policy initiatives included budgetary support to indigenous Fijians for increased participation in commerce and government, tax and duty concessions to exporters, and a $2 million grant for inward tourism promotion. Meanwhile, the tight monetary policy stance proved reasonably effective in controlling foreign exchange transactions and restraining capital flight in the aftermath of the coup in the second half of 2000, as was discussed earlier. Money supply (M2) growth also decelerated sharply to under 7 per cent for the first nine months.

In Papua New Guinea, the budget deficit, which increased significantly in 1998, stabilized at around 2 per cent of GDP over the period 1998-2000, but total debt servicing has become an increasing burden and was equivalent to almost 4 per cent of GDP in 1999. Among the new tax measures were higher excise rates and the introduction in July 1999 of a value-added tax to pay for a reduction in tariff rates in line with WTO and Asia-Pacific Economic Cooperation commitments. However, the lack of capacity to enforce compliance may lead to shortfalls in projected revenue collection from the new measures. At the same time, tighter controls on spending were enforced along with the concerted promotion of domestic competition and a sweeping programme of privatization, with proceeds from the divestiture of the government bank, the national airline and the utilities being used to retire government debt. Monetary policy remained relatively tight to bring down inflation and to stabilize the currency; M2 grew at significantly less than the inflation rate over the period 1998-2000. However, a deterioration in investor confidence to mid-1999 and high interest rates lowered the volume of lending to the private sector as a share of GDP considerably. The trend should be reversed in future years, with nominal interest rates steadily coming down, a stable exchange rate and improved investor confidence from 2000.

Samoa was able to realize a budget surplus for several years, thus maintaining a macroeconomic environment both stable and highly conducive to private investment. The privatization programme, begun in 1999, was on track with further divestiture to take place in 2000. However, there were increased outlays on education and health, together with a higher public-sector wage bill. On the other hand, taxes on exports and dividends were abolished along with a reduction in corporate tax rates (from 35 to 29 per cent), in tariffs (to a maximum of 20 per cent), and in taxes on equipment and raw materials. Largely as a result, the budget surplus of 0.3 per cent of GDP in 1999 was transformed into a comparatively large deficit of 5 per cent in 2000. A cautious monetary stance contributed much to domestic price and financial stability; inflation being 2.2 per cent or lower during the period 1998-2000. M2 has expanded moderately, with private-sector credit going up at a faster rate, for example, by 16 per cent in 1999. The composition of such credit shifted away from personal loans and manufacturing sector credit to the primary sector and to a wide range of services, including construction, trade, transport and communications, and business services.

In Solomon Islands, the large fiscal deficits of the earlier years were significantly reduced to an average of less than 2 per cent of GDP during the period 1998-1999, compared with 4.6 in 1997. Tax revenue increased in 1999 mainly because of improved receipts from import taxes and higher tax revenues from log exports; the improvement owed much to an upgrading and tightening of customs procedures as part of an extensive reform programme. However, with the civil unrest, the budget shortfall was again on an upward trend, reaching an estimated 4.5 per cent of GDP in 2000, despite tighter expenditure controls. Attention is also being focused on the privatization of state-owned enterprises, including those in manufacturing, forestry and agriculture. The financial system, which had been greatly burdened by poorly performing government debt, was considerably strengthened with the reinstatement in early 1999 of the government securities market, while $40 million in frozen treasury bills were successfully converted to medium-term bonds. By and large, M2 was growing relatively slowly, reflecting the improved fiscal position, especially in 1998 (by just 2.5 per cent) and 2000 (by 1 per cent as of September). Indeed, there could be some degree of monetary contraction later in the year in line with the sharp decline in industrial and service sector output, and hence GDP, as a result of the civil unrest in the country.

The fiscal position also improved sharply in Tonga where the budget shortfall had reached 4.3 per cent of GDP in 1998; a surplus of 1 per cent was realized in the following year mainly because of under-spending in the development allocation. A budget deficit of 0.7 per cent of GDP was expected for 2000, but the shortfall could be larger in the next year because of the 20 per cent pay rise granted to civil servants with no changes being made for compensatory revenue-raising measures. Tax revenue, amounting to around 16 per cent of GDP in 1998, is mostly based on import duties. Development expenditure is mainly supported by ODA inflows and government outlays are set to increase if the plan to develop Tonga's own university is to proceed in place of the currently shared funding of the University of South Pacific in Fiji. Interest rates have remained unchanged over recent years although this may change in 2001, given the moderately rising trend in inflation. The stated policy is to keep real deposit rates positive. M2 grew by almost 12 per cent in 1999 mainly owing to an expansion in private sector credit; lending to agriculture went up strongly but the sector remains a minor recipient in the commercial bank lending portfolio.

Vanuatu also registered a marked improvement in the fiscal position with the budget deficit falling to an average of 1.5 per cent of GDP during the period 1999-2000, compared with 6.7 per cent in 1998. A low level of shortfall was possible in 2000 because a lower tax revenue, 17.8 per cent of GDP (due to a reduction in turnover taxes on financial transactions), was offset by falling current spending to 20.5 per cent. This was largely the result of planned reductions in salaries and transfers. Monetary conditions were eased in response to the slowdown in economic activities in the second half of 1999 so that M2 expanded year-on-year by 1.5 per cent in the first quarter of 2000. This stance was reversed in June, and the money supply contracted by 8.3 per cent by September 2000, compared with a contraction of 9.2 per cent in 1999.

ODA has been comparatively much more important to the fiscal position and, for that matter, to economic activities in the smaller Pacific island economies. In Cook Islands, government finances were strengthened in 1999 through both operating and overall surpluses. The debt-service burden was eased after the restructuring of external debt in September 1998. Interest payments were modest at 12 per cent of tax revenue and the debt stock was equivalent to 78 per cent of GDP. The 2000 budget aimed at a balanced operating account, with revenue to rise by 9 per cent and operating expenditure by 15 per cent.

There were fiscal surpluses in Kiribati in 1995 and 1997-1998 but a deficit, equivalent to 32 per cent of GDP, emerged in the 1999 budget largely because of lower fishing license fees, $A13 million in 1999 compared with $A43 million in 1998. External concessional loans financed about one fourth of the deficit, the remainder being covered by the Consolidated Fund (44 per cent) and the Revenue Equalization Reserve Fund (31 per cent).

In Tuvalu, the projected budget deficit (24 per cent of GDP) became a surplus in 1999 because capital expenditure was 32 per cent below the appropriated level. The 2000 budget provided for an increase of 15 per cent in revenue, mainly from the Tuvalu Trust Fund and external grants, and a substantial rise of 72 per cent in operating expenditure; the rise was to meet projected higher expenditure on personnel, goods and services. Contributions to the Falekaupule Trust Fund, established in late 1999 with ADB loans, community contributions and matching government grants, were expected to reach a capital base of $A14.6 million in 2000, thus generating an annual amount of some $A0.6 million to finance outer island development projects.

Under the Compact of Free Association with the United States, Marshall Islands was provided with an annual block grant during the period 1986-2001, with $40 million a year in the final five years. Public finances have been considerably strengthened through major reforms involving the rationalization of several ministries, a reduction of one third in the number of government employees between late 1995 and March 1999, an extended wage freeze, and a reduction or elimination of subsides to state enterprises. Parallel efforts have also been made to strengthen the tax system. The consequent, large drop in recurrent and capital expenditure contributed to the budget surpluses over the period 1996-1998. However, a deficit of $9 million (or about 9 per cent of GDP) in 1999 resulted from overspending and revenue shortfalls emanating from the reduction in import duty from 12 to 5 per cent.

In the Federated States of Micronesia, grants under the Compact of Free Association with the United States accounted for 47 per cent of total government revenue, while tax collections provided just 14 per cent. Extensive reforms have been carried out in anticipation of reduced Compact funding, including public-service downsizing and public-enterprise rationalization, so that government expenditure went down from 80 per cent of GDP in 1993 to 70 per cent in 1998. The large bulk of operating expenditure (some 85 per cent), however, continued to be accounted for by outlays on wages and travel. Meanwhile, external debt continued to decline to 38 per cent of GDP in 1999, compared with 66 per cent in 1993. The debt-service ratio, at 25 per cent of export earnings in 1999, is projected to reach just 3 per cent by 2002.

Policy issues and responses

As noted earlier, ODA plays a crucial role in sustaining the economic and social development process in many small Pacific island economies, and so does the public sector. The private sector is weak because there is no minimum critical mass for economies of scale and scope, particularly in the so-called "micro-island" economies. Many of these small islands have initiated and implemented forcefully a series of economic, structural and administrative reforms, and liberalization and deregulation measures in recent years, often with the assistance and close collaboration of multilateral agencies and bilateral donors. There have been credible, positive gains from such reform efforts, including improved governance and reduced mismanagement, better public-sector cost-efficiency and productivity, and a larger role for the private sector in domestic economic activities.

It is important that the multidimensional, long-term social consequences arising out of some of these initiatives be given due attention. To begin with, most island countries, both large and small, do not have adequate social safety nets to cater for the large number of employees adversely affected by various downsizing and rationalization measures within the public sector. The informal, but strong, traditional cultural bonds have provided some measure of social protection but this is, at best, a transitory solution. Such bonds are being gradually eroded by cultural changes, overseas migration and urbanization. The high incidence of law and order problems and serious ethnic conflicts and civil unrest in several parts of the Pacific are perhaps symptomatic of the rising social tensions.

Inward remittances from Pacific islanders living and working overseas have been an important source of income and foreign exchange in many island economies, both large and small. These flows will continue for the near future but, again, they cannot be counted on over the longer term. There are increasing difficulties for overseas migration to the traditional recipient countries. Moreover, as the early migrants retire and are replaced by subsequent generations of their children, the initial strong attachment to the old homeland as well as commitment to send large sums of money to the relatives back "home" tend to diminish or disappear. Economic diversification, one of the frequently mentioned options, is easier said than done in most Pacific islands where the wide range of constraints and handicaps, especially those imposed by small size, lack of natural resources and a trained workforce, land tenure and ownership problems, remoteness and high vulnerability to natural disasters, have long remained binding and formidable.

In the above context, the acute and widespread lack of skilled and semi-skilled human resources reflects, among other things, the inadequate resources devoted to education and training and the low priority placed on secondary and tertiary education and on vocational training in several countries. At the same time, the high rates of overseas migration from certain countries, including Fiji (due to the civil disturbances), Samoa and Tonga, have been possible because of the high investment in education made by them. The socio-economic cost of depletion of the already scarce human resources base to local development efforts is high, notwithstanding the large flows of inward private transfers so far received. A related issue in this connection is the need to invest adequate resources in the development and maintenance of ICT infrastructure and related human resources development. In fact, the South Pacific Forum, at its thirtieth meeting held in Palau in 1999, adopted a "Vision for the Pacific Information Economy". Donor countries and agencies are urged to work closely with island countries to enable them to access and use ICT to promote ongoing learning from the global store of knowledge as well as to better exploit global market opportunities for the development of their economies.

Indeed, Tuvalu has gained valuable resources with the leasing of its internet domain ".tv". The country, one of the five least developed countries in the Pacific subregion, has relied almost entirely on external resources, and not trade, for its socio-economic development as the export-oriented agricultural sector is virtually non-existent. Such external resources include principally ODA, inward private remittances, especially from Tuvaluan sailors working on overseas vessels, and rental returns through fishing and fishing licensing. In addition to the Tuvalu Trust Fund, established in 1987, the country has successfully created another innovative financing scheme through the use of its Internet suffix, ".tv", to earn much-needed foreign exchange. In 1998, Tuvalu signed over the rights for its ".tv" Internet suffix name to a Canadian firm and, in return for permission to use the name, Tuvalu was guaranteed $50 million over a 10-year period plus a 15 per cent stake in the company selling rights to domain names ending with ".tv".

About 170,000 organizations have registered a domain name ending with ".tv", and the additional quarterly income of some one million United States dollars is starting to change the lives of the country's 10,600 inhabitants. The deal has effectively doubled the income of Tuvalu and the extra resources are being used to build infrastructure, including roads, electricity transmission networks in outlying islands and new schools. The airport was also extended to accommodate Boeing 737 aircraft, thus making it possible for Tuvalu to export seafood for the first time. The money earned from the deal has also been used to meet the annual membership obligation of $20,000 of the United Nations; Tuvalu became the 189th member in September 2000.

In addition to ODA and inward private remittances, tourism has long been an important foreign exchange earner for many island economies in the Pacific; the subregion still enjoys a considerable comparative advantage in tourism. Nevertheless, the industry itself is highly susceptible to the contagious ripple effects from negative publicity arising from the political instability and civil unrest in Fiji and Solomon Islands. Around one million tourists visit the various Pacific islands a year but, according to the South Pacific Tourism Organization, the number will fall off considerably as the subregion has been unfairly and indiscriminately painted as unstable. Likewise, many investors and market participants have become nervous about development prospects in the subregion.

It is true that some islands have benefited considerably from the recent diversion of the tourist flows away from the trouble spots. But such a short-term diversion is purely transitory, given the zero-sum nature of this gain. In the long term, growth in inward investment and in tourism hinges largely on stable and sustainable economic growth and social advancement in the subregion as a whole. Meanwhile, however, island economies will have to monitor closely and be well aware of the harmful, long-term impact of certain activities and schemes from fly-by-night investors and from money laundering operations in their concerted pursuit of innovative measures to raise fiscal revenue and investment resources. There are several examples of serious financial damage caused by fly-by-night investors while money laundering is posing a new threat to the financial integrity of many island countries. It is thus encouraging that both issues are being discussed widely at the subregional level and that legislation against money laundering has been put in place in several countries to deal with this new threat (see box II.2).

North and Central Asia

This subregion displayed, by and large, the best economic performance in recent years. The recovery process, which had started in 1999, strengthened further in 2000 thanks to the robust global economy, solid economic growth in the Russian Federation, and the stable demand for and favourable prices of major subregional export products. There are several net exporters of oil and gas in this subregion. They benefited greatly from the significant rise in the price of oil.

The recovery was accompanied by improved fiscal balance. Notable achievements were also recorded in the area of international trade with the subregional economies continuing to unify customs regulations and tariffs to boost intra-trade among members of the Commonwealth of Independent States (CIS), and to adjust trade policy regimes to prepare for admission to WTO. Indeed, Georgia became the 137th WTO member in 2000, being the second country from the subregion to have joined the world trade body. Likewise, the promotion of subregional economic cooperation continued to receive priority attention. In October 2000, for example, the five member countries of the CIS Customs Union (Belarus, Kazakhstan, Kyrgyzstan, the Russian Federation and Tajikistan) decided to upgrade the Union status into the Eurasian Economic Community. Meanwhile, Kazakhstan, Kyrgyzstan, Tajikistan and Uzbekistan approved a two-year action programme to expedite the creation of a single economic entity under the Central Asian Economic Union, and a five-year strategy of economic development and integration.

Two other developments promise improved longer-term prospects for subregional economies: improved tax collection and financial sector reform.