Pacific island economies

Subregional overview and prospects

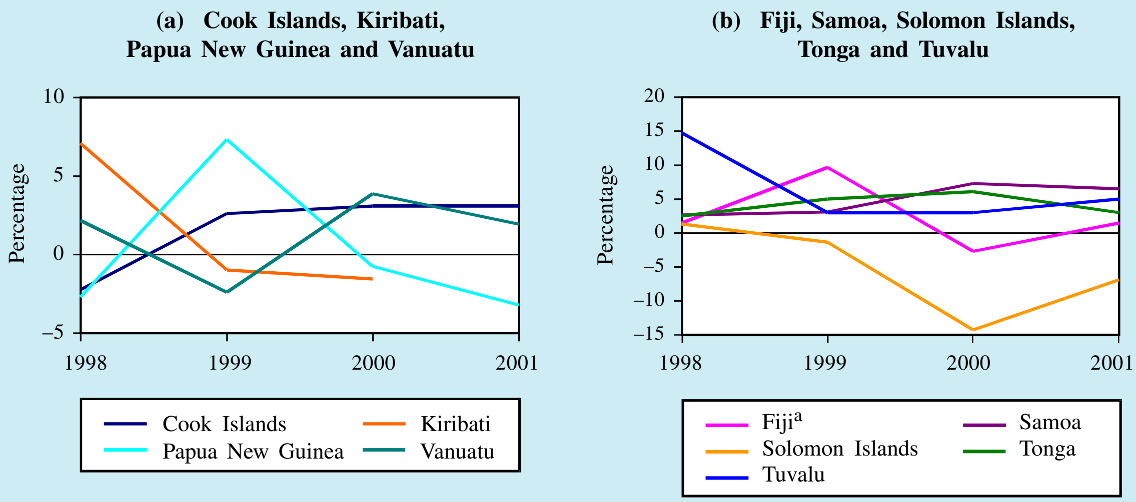
Weak economic growth in 2001 owing to lower external demand, sluggish agricultural production and civil disturbances in some economies

In common with most other developing subregions of ESCAP, the economic performance of Pacific island economies as a whole weakened or remained weak in 2001, a reflection of lower external demand resulting from the global economic slowdown and several domestic constraints, including sluggish agricultural production and civil disturbances in several economies. Fallout from the September 2001 terrorist attacks in the United States was on balance relatively limited in respect of the Pacific island economies; the United States was an important source of tourists to only a few island economies in the South Pacific. Furthermore, a large number of Pacific islands could be regarded as low-risk destinations, involving equally low-risk travel. Private remittances were important to a large number of island economies and the terrorist-induced sharper slowdown in the United States could affect the flows from Pacific islanders working in Hawaii and on the American west coast to a certain extent. Early estimates indicate a drop of 12 per cent in remittances to Tonga in September and October 2001.

Samoa continued to record impressive growth, with GDP going up by 6.5 per cent in 2001, while Tuvalu gained 5 percentage points in the value of total output during the year. However, the deteriorating law and order situation resulted in a decline (of 3.3 per cent) in aggregate production in Papua New Guinea. GDP contracted further in Solomon Islands; indeed, widespread civil unrest lowered the total output by 23 per cent during the period 1999-2001 (figure II.6). GDP growth rates were relatively low or modest elsewhere in the Pacific island subregion. For example, the economy in Fiji had lost almost 3 percentage points in output in 2000 but the subsequent return to democracy, plus renewed business confidence and higher tourist arrivals, added 1.5 per cent to GDP in the following year.

Agriculture remained the major source of subsistence and cash income for the large majority of the population virtually throughout the Pacific island subregion. Generally, this sector did not perform well for two years in a row (2000 and 2001) in Fiji, Samoa and Solomon Islands; a setback to agricultural output was also recorded by Papua New Guinea, Tonga and Vanuatu for 2001. This adverse development, compounded by lower prices for several major export items, not only weighed heavily on domestic economic activities and services but might also have set back hard-earned progress in poverty eradication in many parts of the island subregion.

Figure II.6. Rates of GDP growth of selected Pacific island economies, 1998-2001



Sources: ESCAP, based on ADB, *Key Indicators of Developing Asian and Pacific Countries 2001* (Oxford University Press, 2001); and *Asian Development Outlook 2001* (Oxford University Press, 2001); and national sources.

Note: Figures for 2001 are estimates.

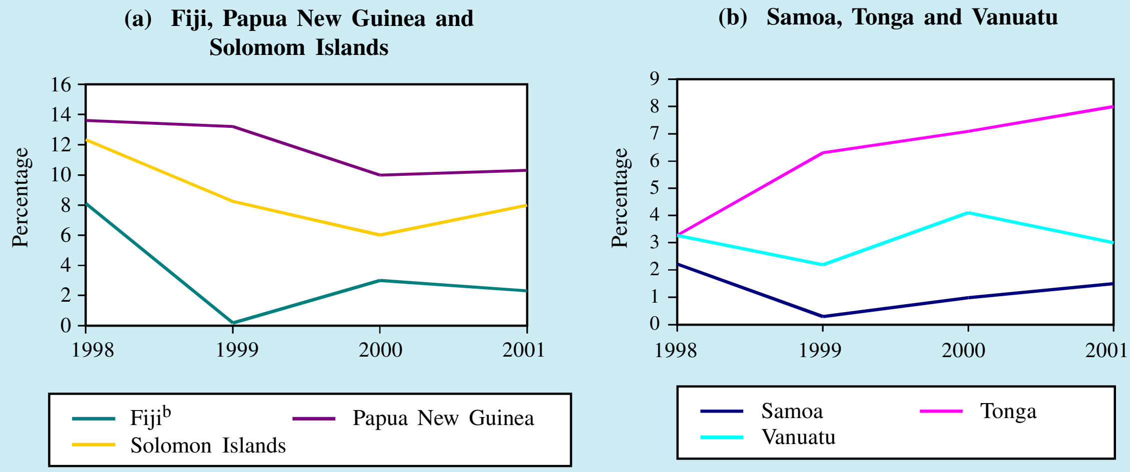
[a] Real GDP at factor cost.

Sluggish agricultural production and weakening exchange rates pushed up inflation in most Pacific island economies in 2001

The behaviour of consumer prices was equally varied among the Pacific island economies (figure II.7). Inflation has been rising in Tonga for a few years and remained at a relatively high level in Papua New Guinea and Solomon Islands in 2001. Price increases were modest elsewhere in the subregion, while Samoa has been experiencing a remarkable degree of price stability for several years. Virtually all Pacific island economies are heavily dependent on imports, mainly, but not exclusively, from Australia, Japan and New Zealand. Weakening exchange rates and, in a number of countries, poor agricultural production and higher food prices were the main cost-push force behind the patterns of inflation observed in the subregion in 2001. With few exceptions, demand factors played a limited role in pulling up prices, as the budget deficits and money supply (M2) growth had been within manageable and modest limits.

External trade performance was disappointing in some countries of the subregion, with merchandise export earnings falling off in 2001 (figure II.8). This represented the confluence of several factors, including lower world prices and reduced external demand compounded, in several cases, by setbacks to production and export volumes, resulting from widespread

Figure II.7. Inflation of selected Pacific island economies, 1998-2001[a]



Sources: ESCAP, based on ADB, *Key Indicators of Developing Asian and Pacific Countries 2001* (Oxford University Press, 2001); and *Asian Development Outlook 2001* (Oxford University Press, 2001); IMF, *International Financial Statistics,* vol. LIV, No. 10 (October 2001); and national sources.

Note: Figures for 2001 are estimates.

[a] Changes in the consumer price index.
[b] Year-on-year percentage change.

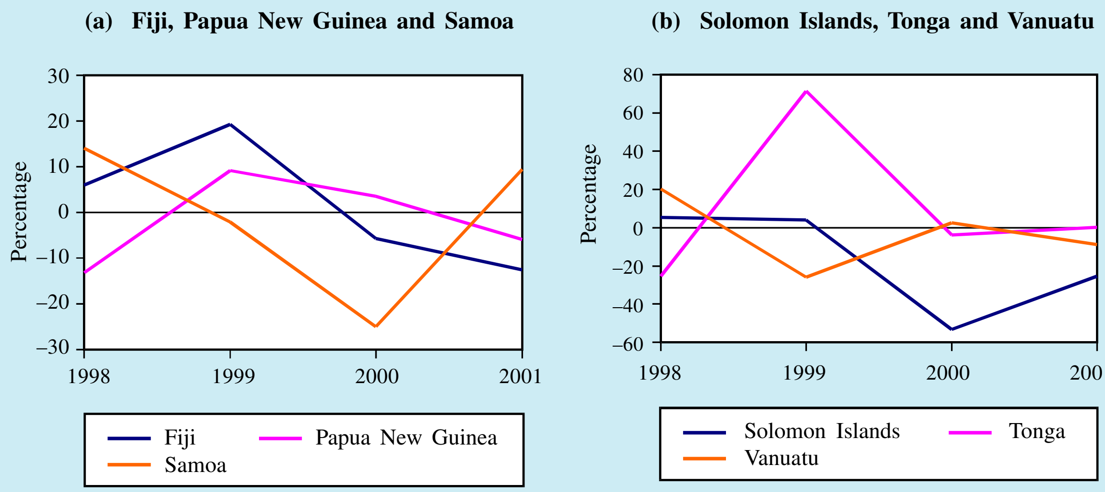
Lower merchandise export earnings in 2001 reflected falling world prices and demand, and setbacks in production and export volumes as a result of civil disorders in some economies

civil disorders, falling ore quality and the approaching exhaustion of oil reserves. Again, Samoa was a notable exception to this overall trend, but the higher export receipts came from a low base since the country's export earnings had contracted by about one quarter in 2000. Expenditure on imports generally mirrored the patterns of export earnings for 2000-2001. Domestic demand was considerably weakened by poorer economic performance and GDP growth, and higher landed prices of imports owing to the exchange rate depreciation in several economies.

Sizeable receipts from tourism and large inflows of private remittances and official transfers eased considerably the shortfalls on the external trade (goods and services) and current accounts of several countries. From the available data, it appears that there were no severe balance-of-payments crises in the island subregion in 2001. The foreign reserve position was stable as a whole, while the service burden on external debt was mostly manageable.

As is to be expected, the economic outlook for the subregion for 2002 remained mixed; as a whole, however, a strong recovery in the United States economy would have important, positive spillover

Figure II.8. Growth rates of merchandise export earnings of selected Pacific island economies, 1998-2001



Sources: IMF, *Direction of Trade Statistics* (CD-ROM), January 2002; and national sources.

effects on global demand for goods and services and on the subregion's export performance. Other things being equal, GDP was expected to be more robust, for example, expanding in the range of 2.5 to 5 per cent in Fiji, Samoa, Tonga and Vanuatu. The projected stimulus from external merchandise trade would play an important part in the above scenario. However, such growth would also be driven by a reasonable recovery in tourist arrivals, improved agricultural output and better consumer and investor confidence. All these positive developments, in turn, would depend very much on the elimination or minimization of law and order problems and of other civil disturbances or political uncertainties.

GDP performance

Low economic growth has led to some setbacks in per capita income, domestic employment and poverty alleviation efforts

For a variety of reasons of both local and external origin, the recent patterns of economic growth have been rather uneven within Pacific island economies. GDP growth has been low to moderate in recent years and few economies have been able to sustain consistently high rates of expansion in economic activities (table II.8). Largely as a result, there have been some setbacks in per capita income and domestic employment, which have had an impact on the living standards and poverty alleviation efforts. The severe economic crisis in Solomon Islands was noted earlier.

Table II.8. Selected Pacific island economies: growth rates, 1998-2001

(Percentage)

		Rates of growth			
		Gross domestic product	*Agriculture*	*Industry*	*Services*
Cook Islands	1998	−2.3	2.8	−6.2	−3.4
	1999	2.7	2.5	4.6	2.5
	2000	3.2	..	..	..
	2001	3.2	..	..	..
Fiji[a]	1998	1.4	−7.2	3.1	3.3
	1999	9.7	16.1	9.8	8.0
	2000	−2.8	−1.2	−7.4	−1.1
	2001	1.5	−0.5	−1.8	3.5
Kiribati	1998	7.3	8.1	35.3	7.3
	1999	−1.0	1.0	41.9	−1.0
	2000	−1.6	−1.8	−34.5	−1.6
Papua New Guinea	1998	−2.8	−11.3	9.7	−6.5
	1999	7.6	4.3	5.7	12.4
	2000	–0.8	9.1	−5.4	–4.0
	2001	−3.3	0.9	−6.1	–4.4
Samoa	1998	2.6	7.0	−9.4	7.1
	1999	3.1	−3.5	4.3	5.2
	2000	7.3	1.5	17.0	5.4
	2001	6.5	0.5	10.0	7.0
Solomon Islands	1998	1.3	−4.2	11.4	4.0
	1999	−1.4	−7.2	41.8	−3.6
	2000	−14.5	−16.1	−35.5	−7.2
	2001	−7.0	−10.0	−33.0	0.6
Tonga	1998	2.5	0.3	4.2	7.7
	1999	5.0	−3.1	15.7	6.7
	2000	6.1	9.1	6.3	4.6
	2001	3.0	2.8	8.2	1.2
Tuvalu	1998	14.9	0.7	21.5	16.0
	1999	3.0	..	..	..
	2000	3.0	..	..	..
	2001	5.0	..	..	..
Vanuatu	1998	2.2	9.1	6.7	−0.1
	1999	−2.5	−9.3	5.2	−1.7
	2000	4.0	2.5	8.4	3.7
	2001	2.0	−2.0	3.5	2.5

Sources: ESCAP, based on ADB, *Key Indicators of Developing Asian and Pacific Countries 2001* (Oxford University Press, 2001) and *Asian Development Outlook 2001* (Oxford University Press, 2001); and national sources.

Notes: Figures for 2001 are estimates. Industry comprises mining and quarrying; manufacturing; electricity, gas and power; and construction.

[a] Real GDP at factor cost.

GDP in Papua New Guinea and Vanuatu went up by 0.2-1.4 per cent a year on average over the period 1998-2001. In contrast, economic activities in Samoa have been on an upward trend with GDP gaining almost 6 percentage points a year over the period 1999-2001. However, the rapid expansion in Tonga, averaging over 5.5 per cent annually in 1999-2000, could not be sustained in 2001.

Growth in output stalled in Fiji owing to the political coup in 2000 and the subsequent loss of market confidence

The political coup of May 2000 and the related civil unrest in Fiji led to the loss of market and consumer confidence, a tighter monetary policy approach and other measures to control capital flight, and lower tourist arrivals for the year as a whole. Largely as a result, GDP contracted by 2.8 percentage points in 2000. However, the prolonged political crisis was compounded by the weak performance in agriculture and industry, despite a steady easing of monetary policy from late 2000 through 2001. Domestic credit to the private sector had fallen since May 2000, while aggregate output stagnated and GDP gained only 1.5 per cent in 2001. Among the hardest hit were inward tourism (down by almost 11 percentage points in 2000) and industrial activities (down by over 12 percentage points). In particular, informal sanctions, led largely by the international union movement, resulted in the collapse of garment exports, which had earlier eclipsed sugar exports to become Fiji's second most important export item after tourism services. Garment factory closures and worker lay-offs continued into 2001, along with persistent weaknesses in sugar production and processing (owing to ongoing difficulties in land-lease arrangements) and gold production. All these factors led to a contraction in industrial value added, expected to be 1.8 per cent for the year. The agriculture sector (including fisheries) remained stagnant after a small decline in output had been recorded in 2000. Inward tourism recovered moderately in 2001 but the recovery was not sufficient to provide the needed domestic up-lift, with the result that GDP went up modestly for the year. In that context, mass lay-offs in the tourism and garment industries have led to a degree of hardship and unemployment rarely, if ever, seen in Fiji before. The poor and less well educated in particular have suffered more severely from the consequences.

Law and order problems among the factors affecting growth in Papua New Guinea

The economy of Papua New Guinea had recovered strongly in 1999, a performance driven largely by relatively solid growth in the agriculture and service sectors, and renewed industrial strength. It has since been on the decline, with GDP gaining less than 1 per cent in the following year and then falling by 3.3 percentage points in 2001, as against an annual population growth rate of about 2.3 per cent. Among the causal factors and forces were weaknesses in policy management and implementation, some negative repercussions from the structural reform programmes and the continued deterioration of law and order. The last factor combined with lower export prices to dampen the output and earnings from Papua New Guinea's main export crops of coffee, copra, cocoa and palm oil. At the same time, weak demand from Asia and a restrictive export tax regime caused a drop in forestry output. The slump in the agriculture sector continued into 2001. Minerals had become a mainstay of the economy, but the diminishing oil reserves in the Southern Highlands contributed to a reduction of about 8 per cent in the mineral sector output for both 2000 and 2001.

Weakened manufacturing, construction and service activities resulted in an overall decline in industrial value added, averaging over 5.7 percentage points annually in 2000-2001, as well as a further deterioration of 4.4 per cent in service sector output in 2001. Indeed, the economic performance of Papua New Guinea was much constrained by the adoption of a tight monetary policy approach in an effort to conserve foreign exchange and abate the depreciation of the kina. Lending rates averaged over 17 per cent in 2000, contributing to a squeeze on private sector credit, which grew by just 3.2 per cent in 2001. Sparked by lower oil prices, among other factors, the kina depreciated again in late 2001, which could lead to renewed monetary tightening.

Higher growth in Samoa driven by the construction and tourism industries

Samoa was the one bright spot within the Pacific island subregion: GDP per capita grew by 23 per cent between 1995 and 2000. Aggregate production, again driven by construction activities and booming services, was expected to gain another 6.5 per cent in 2001. The solid expansion in construction resulted partly from the series of structural reforms and a refocused development strategy in the public sector, and culminated in a number of donor-assisted infrastructure projects and increased investment from the private sector as well. Largely as a result of this, industrial output went up by an average of 13 per cent a year in 2000-2001, a development facilitated by the ready availability of private sector credit, which expanded by 25 per cent in 2000 and was expected to grow by a further 16 per cent in the following year. Meanwhile, higher private remittances from abroad and increased inward tourism served to stimulate commercial activities and other domestic services. Indeed, gross tourism receipts constituted over 17 per cent of GDP in 2000, and the service sector as a whole, which had expanded by over 5 per cent a year in 1999-2000, recorded another solid gain of 7 percentage points in 2001. This sector now contributes 55 per cent of GDP, compared with a relative share of 19 per cent for agriculture (including fishing), whose weak performance in 2001 was not, however, a severe constraint on aggregate domestic economic activities.

A large contraction in the Solomon Islands economy as a result of the political crisis

The Solomon Islands economy has been badly affected by the political crisis and the associated civil unrest and widespread disruption which began in 1999. In particular, GDP plummeted by 14.5 per cent in 2000 and was expected to go down by another 7 percentage points in the following year, despite the peace agreement reached in 2000. Domestic activities in agriculture, forestry and fisheries were severely affected by the civil disturbances, with output going down by an annual average of over 11 per cent in the period 1999-2001. In turn, this served to dampen industrial activities, which contracted by over a third in each of the years 2000 and 2001. Cutbacks in new bank lending in an environment of increasing risk were a compounding constraint. In particular, domestic credit to the private sector fell by more than a fifth in 2001 and the higher risk premium on debt was reflected in the sharp widening of the interest rate margin; while the average deposit rates were reduced from 3.0 to 0.7 per cent from 2000 to 2001, the average lending rates were relatively stable, at the high level of just over 15 per cent, in 2001.

Fish products and palm oil were the Solomon Islands' second and third biggest exports after forestry products. Palm oil processing ceased in 1999. Solomon Taiyo Ltd. ceased its fishing and fish processing operations in 2000, but resumed its activities in mid-2001 following nationalization. Copra and cocoa production, already low in the first half of 2000, was halved as a result of the insolvency of the Commodities Export Marketing Authority towards the end of 2000. However, the Authority's operations were restarted late in 2001 through a rescue package underwritten by Taiwan Province of China. Forestry operations, although considerably disrupted, remained the only source of growth in the commercial sector.

Reduced economic growth for Tonga and Vanuatu in 2001

The economy of Tonga had expanded strongly in 1999-2000, with GDP expansion averaging over 5.5 per cent each year. This owed much to large inflows of private remittances from Tongans working abroad; such resources not only accounted for the bulk of foreign exchange earnings but also sustained a considerable portion of consumption expenditure in the country. Another economic stimulus came from agriculture and, to a much lesser extent, industrial production. The agriculture sector, by and large, had performed better than many others in the Pacific island subregion thanks to various measures to improve the (export) marketing of agricultural produce as well as to diversify its composition (from squash to water melons, root crops, fruit and vegetables). The growth process was facilitated by a commensurate credit expansion, by 13 per cent in 1999 and 18 per cent in 2000, to the private sector, mostly for industrial and commercial purposes. Strong GDP growth, however, was not sustainable in 2001 and aggregate output was expected to go up by 3 percentage points, reflecting a sharp decline in agricultural output, from over 9 per cent to below 3 per cent from 2000 to 2001. In addition, the service sector continue to decline; growth in local value added fell continuously from almost 8 per cent in 1998 to just over 1 per cent in 2001. Another factor was the grounding of Royal Tonga Airlines' only jet used on international routes, while inward tourism was further reduced by the fallout from the 11 September 2001 terrorist attacks; the United States was Tonga's second biggest tourist market.

Vanuatu was another island country whose economic performance was not keeping up with the population growth rate of 2.6 per cent; in particular, aggregate output went up by less than 1.5 per cent a year over the period 1998-2001. Economic activities decelerated noticeably, and GDP growth fell from 4 to 2 per cent from 2000 to 2001. In spite of a more accommodating monetary policy approach, domestic credit expanded marginally (by less than 1 per cent) in 2000, while the average borrowing rates remained high, at over 13 per cent, as against 13.5 per cent in 2000. Services constituted about 70 per cent of GDP; this sector was underpinned by tourism and, to a lesser extent, the provision of financial services. Strong growth in inward tourism and the associated multiplier effects led to the sharp upturn in Vanuatu's GDP in 2000. However, the growth momentum could not be sustained in the following year, when there was a considerable deceleration in the output of industry and services and a contraction of 2 per cent in agriculture. Lower world prices for copra, the most important agricultural commodity in Vanuatu and a principal source of cash income for the rural community, led to a continued fall in its production in both 2000 and 2001.

Inflation

Inflation remained at relatively high levels in Papua New Guinea and Solomon Islands in 2001

Two trends in consumer prices were discernible in the Pacific island subregion. Inflation was on an upward trend in Tonga, while it remained at a relatively high level in Papua New Guinea and Solomon Islands in absolute terms. However, increases in consumer prices were moderate elsewhere, including Fiji, Samoa and Vanuatu (table II.9). Papua New Guinea has recorded double-digit inflation for several years; consumer prices were higher by about 10 per cent in 2000 and 2001, despite modest increases in the money supply (M2), low levels of fiscal deficits as a proportion of GDP and weak demand in consequence of economic contraction. The economy was highly dependent on imported consumer and producer goods, and the depreciation of the kina by 8 per cent against the Australian dollar in 2001 pushed up the landed costs of imports. In addition, there were the lagged effects of higher oil prices in 2000.

Table II.9. Selected Pacific island economies: inflation and money supply growth (M2), 1998-2001

(Percentage)

	1998	*1999*	*2000*	*2001*
Inflation[a]				
Fiji[b]	8.1	0.2	3.0	2.3
Papua New Guinea	13.6	13.2	10.0	10.3
Samoa	2.2	0.3	1.0	1.5
Solomon Islands	12.3	8.3	6.0	8.0
Tonga	3.3	6.3	7.1	8.0
Vanuatu	3.3	2.2	4.1	3.0
Money supply growth (M2)				
Fiji	–0.3	14.2	–2.1	–1.4[c]
Papua New Guinea	2.5	9.2	5.0	2.1[c]
Samoa	2.5	15.7	16.3	13.8[c]
Solomon Islands	2.5	7.0	–0.7[c]	..
Tonga	14.7	11.9	18.8	15.5[c]
Vanuatu	12.6	–9.2	5.5	11.6[c]

Sources: ESCAP, based on ADB, *Key Indicators of Developing Asian and Pacific Countries 2001* (Oxford University Press, 2001) and *Asian Development Outlook 2001* (Oxford University Press, 2001); IMF, *International Financial Statistics,* vol. LV, No. 1 (January 2002); and national sources.

Note: Figures for 2001 are estimates.

[a] Changes in the consumer price index.
[b] Year-on-year percentage change.
[c] January-September.

Inflation in Solomon Islands showed a downward trend during the period 1998-2000 but picked up again in the following year, rising from 6 to 8 per cent in 2001, despite the ongoing contraction in economic activities totalling more than 21 per cent in 2000-2001. This reversal was attributable to the ongoing shortages in the production and marketing of essential goods (including foodstuffs), resulting from the civil disturbances, and to the higher cost of imports. There were large deficits in the external current account, which deteriorated from a surplus of almost 9 per cent of GDP in 1999 to a deficit of 18 per cent in 2000 and a further deficit of 8 per cent in 2001 (table II.10). Such a high degree of external imbalance, in turn, was a reflection of the rising level of aggregate absorption, with the fiscal deficit going up from less than 4 per cent of GDP in 1999 to an average of 7 per cent in 2000-2001. The upward trend of inflation in Tonga, from 3.3 to 8 per cent between 1998 and 2001, was in part attributable to a weaker exchange rate, which depreciated by 8 per cent up to November 2001 against the Australian dollar; imports from Australia and New Zealand dominate Tonga's consumption.

Table II.10. Selected Pacific island economies: budget and current account balance as a percentage of GDP, 1998-2001

(Percentage)

	1998	*1999*	*2000*	*2001*
Budget balance as a percentage of GDP				
Fiji	5.1	–0.2	–3.0	–6.0
Papua New Guinea	–1.6	–2.6	–1.9	–1.4
Samoa[a]	2.1	0.3	–0.7	–2.3
Solomon Islands[a]	–1.6	–3.9	–5.0	–8.8
Tonga[a]	–4.3	–1.4	–0.9	–0.5
Vanuatu	–6.7	–0.9	–7.4	–2.5
Current account balance as a percentage of GDP				
Fiji	–3.5	–2.4	–1.1	–0.7
Papua New Guinea	–0.5	4.0	8.6	9.4
Samoa	9.6	–8.3	–5.6	–11.4
Solomon Islands	2.7	8.8	–18.1	–8.1
Tonga	–11.8	–3.8	–6.9	–4.3
Vanuatu	2.0	–5.5	4.8	5.8

Sources: ESCAP, based on ADB, *Key Indicators of Developing Asian and Pacific Countries 2001* (Oxford University Press, 2001) and *Asian Development Outlook 2001* (Oxford University Press, 2001); IMF, *International Financial Statistics,* vol. LIV, No. 10 (October 2001); and national sources.

Note: Figures for 2001 are estimates.

[a] Excluding grants.

Consumer prices went up moderately in other Pacific island economies in 2001

The available data for other Pacific island economies provided a different picture. In Fiji, inflation went down from 3 per cent in 2000 to an estimated 2.3 per cent for the following year. Poor GDP performance and the ensuing weak domestic demand helped to contain pressures on consumer prices, despite the impact of higher world prices on energy products. Another stabilizing influence was money supply (M2) growth, and the current account deficits were, by and large, marginal. The exchange rate was relatively stable and, despite the collapse in exports after the political coup, there was no great pressure to devalue the Fijian dollar; there was a corresponding collapse in import demand as well. It is worth noting the one-off effect on consumer prices of the legal dispute over the removal of VAT on a number of food items made by the previous Government.

Samoa enjoyed remarkable price stability among Pacific island economies, inflation being contained within the narrow range of 0.3 to 1.5 per cent during the period 1999-2001. Such enviable stability signified a new era of responsible fiscal and monetary management which, in turn, was manifested in relatively stable exchange rates. The budget shortfall as a proportion of GDP was modest, while the current account deficit, although relatively high, was sustainable in view of the healthy level of foreign reserves of $51 million in 2001, or almost five months of import cover, as at November 2001. The modest increase in consumer prices in 2001 was largely due to higher prices for food and some energy products; however, inflation was projected to be around 2 per cent or less in the medium term. Vanuatu was another island country with relatively stable prices. The flow-on effects of higher prices for imported energy products contributed to an inflation rate of over 4 per cent in 2000. Pressures on consumer prices moderated in the following year along with a much lower budget deficit at 2.5 per cent of GDP, compared with over 7 per cent in 2000, and appreciation of the vatu against the Australian dollar by 7 per cent in 2001. Domestic consumption is import-intensive in Vanuatu and Australia supplies nearly half of its imports.

Foreign trade and other external transactions

Slight improvements in trade deficits for some Pacific island economies in 2001

International trade presented a dismal picture in 2001, with setbacks of varying degrees of seriousness in merchandise export earnings virtually throughout the Pacific island subregion (table II.11). Export values declined in Fiji, Papua New Guinea, Solomon Islands and Vanuatu. Samoa recorded an increase of under 10 per cent in trade earnings but this was not sufficient to compensate for a contraction of 25 per cent in 2000. Tonga's exports also went down by about 4 per cent

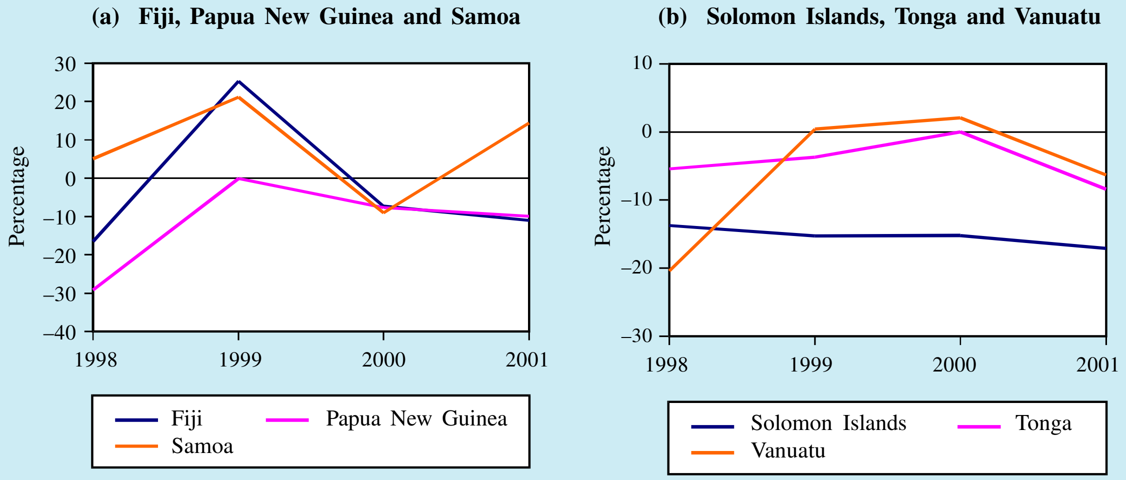
Table II.11. Selected Pacific island economies: merchandise exports and their rates of growth, 1998-2001

	Exports (f.o.b.)				
	Value (Millions of US dollars)	*Annual rate of growth (Percentage)*			
	2000	*1998*	*1999*	*2000*	*2001*
Fiji	572	6.0	19.3	−5.7	−12.5
Papua New Guinea	2 024	−13.2	9.2	3.5	−6.0
Samoa	14	4.0	−2.1	−25.0	9.5
Solomon Islands	69	5.6	4.0	−53.2	−25.3
Tonga	12	−25.5	71.5	−3.7	0.1
Vanuatu	26	20.2	−26.0	2.5	−8.8

Sources: IMF, *Direction of Trade Statistics* (CD-ROM), January 2002; and national sources.

in that year, but remained unchanged in 2001. The patterns of import spending (figure II.9) followed a roughly similar trend to that of export receipts in 2000-2001, although the rates of compression of import expenditure were generally less pronounced than those associated with export earnings.

Figure II.9. Growth rates of merchandise import spending of selected Pacific island economies, 1998-2001



Sources: IMF, *Direction of Trade Statistics* (CD-ROM), January 2002; and national sources.

Lower oil production led to a decline in export receipts in Papua New Guinea in 2001

Papua New Guinea is by far the largest trader in the subregion; its exports constituted 44 per cent of GDP in 2000. Merchandise exports, which had recovered and expanded strongly (by over 9 percentage points) in 1999, have been on a declining trend since then, despite favourable prices for several commodities; their value rose by only 3.5 per cent (to $2 billion) in 2000 and then contracted by 6 per cent in the following year. The value of mineral exports, equivalent to 77 per cent of the total trade earnings, was dominated by oil and gold, both of which suffered from lower export prices and volume in 2001, the lower volume being due to reserve depletion. Oil production was down by about 16.5 per cent in 2001 compared with the previous year's level. Exports of forestry products were stagnant and, in volume terms, remained at half of the levels traded prior to the financial and economic crisis in East and South-East Asia. Earnings on agricultural exports also declined, as a result of lower prices received for the main export crops such as coffee, cocoa, palm oil and copra. The coffee industry, once the dominant export activity and the main source of cash income for rural Papua New Guineans, has been on a gradual decline largely because of law and order problems.

Spending on merchandise imports, which had amounted to around $1 billion in 2000, fell and was almost 8 per cent lower; it dropped by another 10 per cent in 2001 (table II.12). In fact, import expenditure had contracted every year since 1998, in part a reflection of economic and structural adjustment problems in Papua New Guinea. However, the trade surplus, over $1 billion (or almost 29 per cent of GDP) in 2000, was expected to rise to over 31 per cent as a result of a sharper fall-off in import value in 2001. The deficit on the external services was also smaller, while the current account surplus, at $0.3 billion (or almost 9 per cent of GDP) in 2000, would remain at around 9-10 per cent as a result of a greater surplus on the trade account for 2001. The deficit in the external capital account trebled to $184 million in 2000, mainly owing to increased loan repayments from the Government and from minerals companies. However, the current account surpluses were much larger than the capital account shortfalls, resulting in a balance-of-payments surplus of $130 million in 2000 and about $162 million in 2001. International reserves had dropped to $90 million in June 1999, contributing to the steep slide of the exchange rate of the kina (figure II.10). The reserves were successfully rebuilt to over $300 million (or four months of import cover) in 2001. External debt had fallen to 68 per cent of GDP in 2000, with a debt-service burden of 11 per cent of GDP.

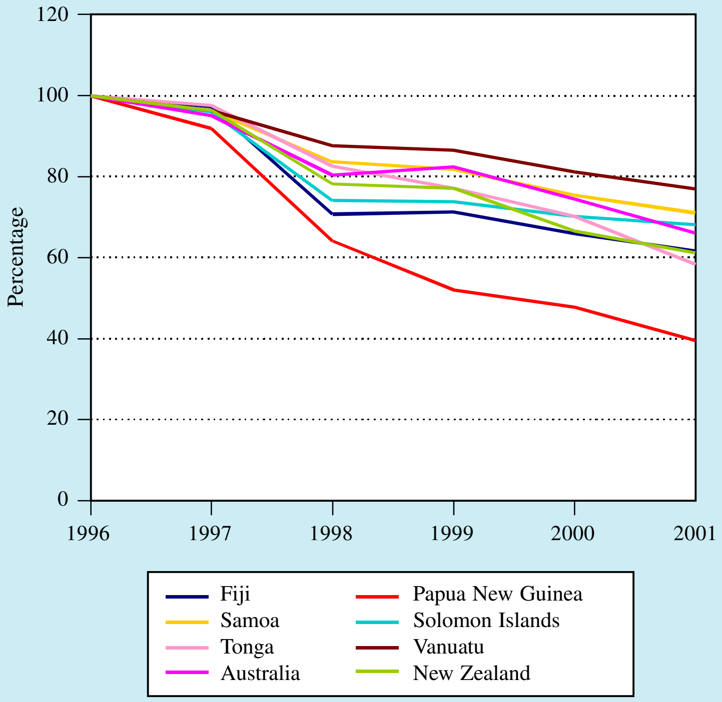
Table II.12. Selected Pacific island economies: merchandise imports and their rates of growth, 1998-2001

	Imports (c.i.f.)				
	Value (Millions of US dollars)	*Annual rate of growth (Percentage)*			
	2000	*1998*	*1999*	*2000*	*2001*
Fiji	833	−16.5	25.3	−7.3	−11.0
Papua New Guinea	999	−29.2	−0.1	−7.7	−9.9
Samoa	105	5.1	21.2	−9.0	14.4
Solomon Islands	92	−13.7	−15.3	−15.2	−17.1
Tonga	61	−5.4	−3.7	0.0	−8.4
Vanuatu	78	−20.4	0.4	2.1	−6.3

Sources: IMF, *Direction of Trade Statistics* (CD-ROM), January 2002; and national sources.

Figure II.10. Index of exchange rates against the United States dollar of selected Pacific island economies and Australia and New Zealand, 1996-2001

(1996=100)



Source: IMF, *International Financial Statistics,* vol. LV, No. 1 (January 2002).

Note: Figures for 2001 are for January-November except for Solomon Islands and Vanuatu, in which case they are for January-October.

Lower export earnings in Fiji owing to a sharp fall in garment and sugar production

Merchandise export earnings by Fiji, another large trader in the Pacific, fell by almost 6 per cent (to $0.6 billion) in 2000 and by a further 12.5 per cent in the following year. The two main export items, garments and sugar, were affected by informal sanctions led by the trade union movement in the aftermath of the political coup and the subsequent losses of markets, including in Australia and New Zealand. The sugar industry was in difficulty over land-lease arrangements, which had an adverse impact on crop planting and hence on sugar-cane harvesting and processing. Total cane production for the 2001 season amounted to 2.8 million tons, yielding just over 293,000 tons of sugar, a sharp decline by 26 and 14 per cent compared with the respective output levels in the 2000 season. Such minor export commodities as gold, timber and copra did not perform well for a variety of reasons, including declining ore quality, weak orders and low export prices. However, exports of fresh fish were expected to do better as a result of secure markets in Asia and the United States. In an effort to boost the depressed export sector, a new export credit scheme was introduced in July 2001 to ensure the on-lending to exporters of a minimum of 5 per cent of the amount of deposits in commercial banks.

Tourism-dominated service exports which, as a whole, had fallen by almost 21 percentage points in 2000, recovered strongly to an expected growth rate of 8 per cent in the following year. The tourism industry had been hit particularly hard by the political and civil disturbances; visitor arrivals dropped to around half of the initial projections for the second half of 2000, leading to a total loss of 28 per cent in visitor numbers for the whole year. While some of these losses were recouped in 2001, it may take several years for tourism to recover fully in the light of the damage to Fiji's reputation, especially in Australia and New Zealand. Moreover, imports were also on a downward trend, so that the merchandise trade deficit remained relatively unchanged at around 16 per cent of GDP in both 2000 and 2001.

The current account deficit went down to around 1 percentage point of GDP in 2000-2001. Strict capital controls implemented after the coup were gradually eased in 2001 along with the stability of foreign exchange reserves, which went down slightly from $420 to $390 million from the end of 2000 to the end of 2001; the latter figure was sufficient to cover four months of imports of goods and services. Fiji's external debt, dominated by public sector obligations, remained relatively low at under 10 per cent of GDP, with an external debt-servicing burden of 2 per cent of GDP.

Merchandise export earnings in other parts of the Pacific island subregion, although critical to the economies concerned, were relatively small in absolute value (in the range of $12 to $70 million in 2000). Exceptionally, exports from Samoa rose by just under 10 per cent in 2001, from a contraction of about a quarter (to $14 million), owing to poor earnings on fish exports in the previous year. The closure of the coconut oil mill affected exports of coconut oil in 2000, but processing was to recommence in 2002. There is now considerable scope for Samoa to attract further investment and boost exports in the garment industry.

Substantial trade deficit and strong foreign reserve position in Samoa in 2001

Generally, however, Samoa continued to experience a substantial trade deficit, which was expected to reach $105 million, equivalent to 44 per cent of GDP, for 2001; higher import spending by over 14 percentage points was fuelled by increased domestic investment. Tourism brought in some $40 million in both 2000 and 2001, nearly three times the merchandise export value. Private inward remittances went up by 9 per cent to reach $45 million in 2000, thus continuing to underpin growth in private consumption and investment expenditure. The overall current account deficit had dropped to under 6 per cent of GDP in 2000 but was expected to expand to over 11 per cent with the sharp increase in imports of goods and services in 2001. However, the external capital account surplus was expected to rise from 6 to 10 percentage points of GDP from 2000 to 2001, an improvement led largely by higher inflows of official finance for public investment projects. There was a small surplus (0.4 per cent of GDP) in the overall balance of payments in 2000 and a projected deficit of 1.3 per cent for the following year. Nevertheless, Samoa's foreign exchange reserves remained strong, amounting to $51 million (or about five months of import cover) as at November 2001. Total external debt went down from over 100 per cent of GDP in the early 1990s to less than 64 per cent currently; the debt-service burden was rather light, at just over 2 percentage points of aggregate output.

Solomon Islands' merchandise exports registered a severe setback

In Solomon Islands, the export base was collapsing; widespread civil unrest contributed to a deep contraction in earnings of over half (to $69 million) in 2000 and a further drop of one quarter during the ensuing year. Gold mining operations ceased in mid-2000, causing a fall of almost three quarters in export earnings, while the closure of the Solomon Taiyo Ltd. operations resulted in a drop of over three quarters in the value of fisheries exports. Copra and cocoa exports were halved in 2000 as a result of the civil unrest and the insolvency of the Commodities Export Marketing Authority towards the end of 2000. The value of merchandise exports in 2001, at just one third of the 1999 level, was thus the lowest in two decades. The prospects for any significant upswing in merchandise exports are not encouraging in the short term. The Gold Ridge mine and palm oil plantations had suffered extensive damage, while a positive push from the resumption of export fisheries in 2001 would probably not be sizeable until at least 2002. The lingering business uncertainties in the country constituted another constraint.

Solomon Islands had enjoyed sizeable merchandise trade surpluses which, in 1999, had stood at 14 per cent of GDP. The export collapse has since transformed this surplus into a substantial deficit of over 9-10 per cent of GDP over 2000-2001. The external current account balance followed a similar pattern; a surplus of around 9 per cent of GDP in 1999 turned into a deficit of 18 per cent in the following year and, owing largely to lower service imports and higher aid transfers, to 8 per cent in 2001. There had been some capital flight in 1999 but capital controls and higher ODA helped to turn a deficit of $19 million into a capital account surplus of $22 million from 1999 to 2000; the surplus was expected to be higher in 2001. Nevertheless, the overall balance of payments was in a shortfall, amounting to $19 million (or 27 per cent of export earnings) in 2000. Foreign exchange reserves continued to fall, so that they amounted to less than $20 million (around two months of import cover) towards the middle of 2001; they have been rebuilt moderately since. External debt accounted for more than 70 per cent of GDP, although the debt-service burden was relatively low at under 4 per cent of GDP.

Inward remittances in 2000 twice the value of exports of goods and services in Tonga

Earnings by Tonga on merchandise exports fell by almost 4 per cent (to $12 million) in 2000 and remained stagnant (in dollar terms) in the following year. Some three quarters of such earnings came from squash and fish, whose exports, as well as those of niche-market roots crops, fruit and vegetables, strengthened somewhat in 2001. Merchandise exports, equivalent to over 8 percentage points of GDP, were small compared with expenditure on imports which, although declining steadily from the late 1990s, amounted to some $56 million in 2001. The trade deficit in goods and services, at just over one third of

GDP in 2000, was funded largely from inward transfers, mostly of a private nature. Such resources netted Tonga $43 million in 2000, equal to 27 per cent of GDP, or twice the value of the exports of goods and services.

The overall current account deficit was expected to improve slightly from about 7 per cent to just over 4 per cent of GDP from 2000 to 2001. However, failed investments overseas from the Tonga Trust Fund could have an impact on the transfer account in the short to medium term. Surpluses on the external capital accounts were expected to rise from $0.2 to $4 million (or just below 3 per cent of GDP) from 2000 to 2001. However, the overall balance of payments was in deficit, amounting to the equivalent of 7 per cent of GDP in 2000 and 1.5 per cent of GDP in 2001. Foreign reserves, which had recovered to $15 million by the end of 2000, fell back to $11 million (or just over two months of merchandise import cover) in 2001. Tonga's external debt-service burden was manageably light, at just over 2 per cent of GDP for a total debt equivalent to almost two fifths of GDP in 2000.

Vanuatu's large trade deficit in 2001 offset by a substantial surplus on service trade

Merchandise exports from Vanuatu, which had grown just slightly to reach $26 million in 2000, contracted by almost 9 per cent in the following year. The principal export commodity, copra, was suffering from low external prices, although a new coconut oil mill was expected to add more value to that export production activity. Other important export items, notably beef, timber and kava, also faced weak external demand. Similarly, merchandise imports grew modestly (just 2 per cent in 2000), despite higher world oil prices and an increase in the capital imports needed for public infrastructure projects. Import spending, however, dropped by over 6 per cent in 2001, largely as a result of lower economic activities and consumption in Vanuatu during the year.

The large trade deficit of some 22-23 percentage points of GDP was more than offset by the substantial surpluses on the service trade, which averaged over 29 per cent of GDP in 2000 and 2001. Exported services went up by 13 per cent to $129 million, of which about $56 million came from tourism receipts in 2000; in comparison, merchandise exports earned $26 million in the same year. Service exports would be down slightly in 2001, in part as a result of the appreciation by 7 per cent of the vatu against the Australian dollar and its cost-push impact on tourists from Australia, which was the origin of two thirds of all holiday visitors to Vanuatu. Surpluses in the external current account, in the range of 5-6 per cent of GDP over 2000-2001, were generally more than sufficient to cover shortfalls in the external capital account of $11 million (or just under 5 per cent of GDP) and an expected lower deficit of $9 million for the following year. The overall balance of payments showed a small surplus of just over $1 million in 2000 and an expected surplus of over $4 million in 2001. Foreign reserves of $30 million in the second half of 2001 were enough for five months of import cover. External debt reached just 28 per cent of GDP in 2001, involving servicing commitments of around $1.5-1.7 million over 2000-2001.

Key policy issues

Pacific island economies face many challenges in their development efforts

Pacific island economies face many daunting challenges in sustaining the ongoing process of economic and social development, and not just because of their great isolation from the main trade and investment partners and the often huge dispersal within their own internal boundaries. There are other special needs inherent in economies small in size and with limited human and physical endowments, a narrow resource and production base and a fragile ecology. In several of these economies, inward private remittances from migrants and migrant workers have helped to sustain domestic consumption and investment. But there are trade-offs, too, in the patterns and policies of human resources development, and in the provision of social welfare and safety nets, especially for the resident population and their skills base. Most Pacific island economies have also been the destination of comparatively large amounts of ODA in per capita terms. The general concern is not just with aid fatigue, a phenomenon which can perhaps be read from the declining trend in ODA flows worldwide, especially in the 1990s (discussed in chapter IV of this *Survey*); there are also such ever-pressing issues as effective aid coordination and absorption.

GDP growth has not been satisfactory

In the 1990s in particular, a large number of Pacific island economies implemented a series of economic and structural adjustments and reforms to enhance domestic economic efficiency and flexibility, especially of the private sector. However, GDP growth has not been satisfactory virtually throughout the whole subregion in recent years, as reviewed earlier, not least in relation to the need for job creation commensurate with the number of new labour force entrants and, more generally, for ongoing poverty reduction and human development. Other matters of concern are the rising aspirations and popular demand for improved services in an environment of dwindling resources at the disposal of "leaner and meaner", or downsized, Governments.

Globalization poses more challenges for Pacific island economies

The effective and innovative management of change in small and remote island economies is rendered even more complicated in two other dimensions, which may be complementary but nevertheless require policy and institutional measures and directions of a largely dissimilar nature. One concerns the timely and cost-effective responses to the diverse impulses and imperatives, in particular the higher and more frequent volatility, and the ripple effects and contagion associated with globalization and regionalization. The highly adverse impact of the financial and economic crisis in East and South-East Asia on several island economies is an illustration of this. The other dimension relates to island countries' own efforts to integrate better into the new economy; this is an economy driven increasingly by rapid advances in ICTs and characterized by new and innovative forms and modalities of industrial organization and management, including by the multiplying nexus and networks of supply and production at both the global and regional levels made possible by the speedy progress of ICTs themselves.

Capacity-building and ongoing learning a pressing issue in the Pacific island subregion

Capacity-building and ongoing learning to achieve enhanced efficiency and competitiveness, at both the domestic and external levels, and in production as well as in the process of continuous structural diversification, is a pressing issue in the subregion. This applies especially in view of the gradual erosion of preferential treatment long accorded to Pacific island economies and of the more intensified competition faced by Pacific island economies; such competition is a result of the upward trends in the liberalization of trade and investment and other financial flows, including through WTO, and other regional and subregional arrangements. A related problem in this context is the recent blacklisting by the Financial Action Task Force on Money Laundering (set up by the Group of Seven in 1989) of several island economies in the Pacific as being non-cooperative in the global fight against money laundering.

Various subregional cooperative initiatives to address common issues

It is thus encouraging that many Pacific island economies, with the help of subregional organizations such as the Pacific Islands Forum Secretariat, have been working actively together on many issues of common interest and concern, such as in combating money laundering activities, raising international awareness concerning their vulnerability to global warming and enhancing intrasubregional and extrasubregional trade and investment flows. The endorsement of the Pacific Agreement on Closer Economic Relations and the Pacific Island Countries Trade Agreement by Pacific island leaders at the thirty-second meeting of the Pacific Islands Forum, held in Nauru in August 2001, is a concrete example of such cooperation. Both agreements provide a basis for increasing regional and subregional integration and a means to ensure more effective preparation of their economies to respond better to the push and pull forces of globalization. These agreements will come into force once they have been ratified by a sufficient number of signatory States.

Good governance is indispensable for sustained and equitable growth

Effective and sustainable external integration is dependent on domestic policy reform and economic restructuring as an ongoing undertaking, and is not a one-off exercise. In turn, good governance is indispensable in this context because reform and restructuring are not free of costs, pain and dislocation. As indicated earlier, profound damage has been caused to the economic base and the social fabric of several Pacific island economies by civil unrest, law and order problems and political disturbances and uncertainties. This emphasizes the need for the formulation of national strategies to promote good governance.

The necessary readjustments and rebuilding of political, social and economic policies and institutions can be a relatively long-term process. Nevertheless, such rehabilitation and reconstruction remain a prerequisite for the restoration of domestic and external market perceptions and sentiments in the economies concerned and more generally in the subregion itself.

Poor and uneven GDP performance has an impact on poverty and poverty alleviation efforts

An acute and chronic lack of reliable, comparable and up-to-date data and micro-level information makes it difficult to gauge the changing patterns and levels of poverty in the Pacific island subregion. From cursory observations drawn from the pace and direction of economic growth and structural transformation in the subregion, poverty may have been on the rise in the second half of the 1990s (box II.4). Aggregate output in several island economies in recent years has not increased sufficiently faster than the rate of population growth to permit any noticeable improvement in per capita incomes and standards of living. The patterns of GDP expansion themselves have also been relatively uneven; boom-and-bust conditions create adjustment problems, with costly implications for poverty alleviation and reduction efforts. Whether temporary or more lasting in nature, mass lay-offs and retrenchment of workers, wage freezes, arrears in payments and so on have contributed to unemployment, hardship and poverty not often seen before in several Pacific island economies. Furthermore, the social and economic conditions and positions of many persons have been greatly affected and eroded by widespread civil disturbances and political unrest, social tensions and persistent problems in law and order enforcement. The serious disruptions in transport and marketing have been particularly severe for those living in the rural areas and working on plantations; their principal means of cash earnings are through small-scale commercial agriculture and fisheries or plantation employment.

Extreme poverty may have been moderated by traditional access to land

Extreme rural poverty may have been moderated by universal access to land by the majority of the people in most Pacific island economies, the so-called "subsistence affluence" phenomenon. Commercial agriculture itself has been an important source of monetary earnings for a very large number of people, through small-scale cash cropping or plantation work. However, a matter of persisting concern is the fact that the agriculture sector has not performed consistently well in most parts of the subregion in recent years. Concerted efforts have been made to improve

Box II.4. Economic performance and living standards in Guam, the Marshall Islands and New Caledonia

The absence of reliable data makes it difficult to determine the extent of poverty in many Pacific island economies. However, poverty levels may be on the rise and standards of living on the decline, given the poor and uneven economic performance in several parts of the subregion in recent years. On average, expansion in aggregate output was insufficient to keep up, or barely kept pace, with the rate of population growth in a large number of Pacific islands. In fact, GDP contracted by an annual average of 5 per cent in the Marshall Islands and 0.8 per cent in the Federated States of Micronesia during the period 1996-2000; in comparison, the population grew by an annual average of 1.5 and 1.9 per cent respectively during the same period. A similar trend was observed in Guam and New Caledonia in the period 1996-2000; Guam experienced an annual contraction of 2.3 per cent in aggregate output, while New Caledonia's GDP remained virtually unchanged. The average population growth was 2.3 per cent a year in Guam and 1.7 per cent in New Caledonia. All these patterns imply some stagnancy or reduction in the standard of living and, by implication, a rise in unemployment and disguised unemployment. Outmigration helps to relieve some pressures from the labour market, but this option is either not open to all island economies in need, or not at the rate and volume required.

In fact, Guam, with a per capita GDP of $16,575, which is slightly lower than that of New Caledonia ($16,973), has seen higher levels of poverty in recent years. According to the United States Census Bureau, the percentage of people living below the poverty level in Guam increased from 14 per cent in 1990 to 23 per cent in 2000. There has also been a rise in the percentage of single-mother households, about 1 in 14 households in 1990 and 1 in 10 a decade later. An allocation of $26 million was made in fiscal year 2001 for temporary assistance to needy families; however, owing to resource constraints, funding for fiscal year 2002 was reduced to $16 million. This could mean a reduction of about 57 per cent in the temporary assistance for welfare recipients, unless additional or supplementary resources are forthcoming.

The Guam economy was in a buoyant state in the early 1990s but this could not be sustained and output, for example, declined by 2 per cent in 1998 and by another 10 per cent in 1999 before expanding again by 2 percentage points in 2000. However, the economy was not expected to expand in 2001. Tourism is the central pillar of economic activities in Guam, and Japan has been by far the dominant source of tourists; Japanese visitors averaged more than 1 million, or four fifths of the total number of visitor arrivals, annually during the period 1995-2000. However, as a result of the feeble economic performance in Japan, the higher unemployment level and the lower yen exchange rate, any significant increase in tourist arrivals from Japan is unlikely. The economic downturn in the United States has been another compounding factor in the economic difficulties facing the Guam economy in 2001 and perhaps in part of 2002 as well.

productivity and to foster the viable diversification of crops. However, progress appears to have been slow, thus contributing to the urban migration of people in search of more rewarding employment and other opportunities. This has added further pressures on the already overstretched infrastructure and services in urban areas, creating social tensions and other problems. Furthermore, there now seems to be a new generation of people born and raised in urban centres who are largely displaced from their traditional entitlements to land in their villages of origin. The need to generate adequate, gainful job opportunities is self-evident and, in this context, the promotion of activities and services of an informal nature merits reconsideration.