

in 2005 to 3 per cent GDP in 2006 and remain within the Government's target rate of 3 per cent of GDP. The Government is expected to implement further reforms of the tax and customs administration in order to mobilize greater tax revenues, enhance fiscal transparency and strengthen the financial sector.

The GDP of Turkmenistan is expected to grow by 8-9 per cent in 2006-2007, assuming that the high international prices of hydrocarbons persist. The hydrocarbon sector and construction should be the main contributors to economic growth. Strong export revenue from the sale of gas would keep the current account in surplus in 2006.

The growing investment of China and the Russian Federation in the oil and gas sector of Uzbekistan could provide a major impetus to economic growth in that country, which could average 5.6 per cent annually in 2006-2007. High gold prices would enable the economy to maintain surpluses in its trade and current accounts and allow greater freedom in domestic policies. The textile sector's contribution to economic expansion should increase with a more competitive exchange rate for the national currency.

***High GDP growth will expand employment opportunities in most of the subregion***

Owing to high rates of growth, employment opportunities are expected to expand in most of the economies of North and Central Asia in 2006. The Russian Federation, for example, improved its labour-market conditions considerably in 2004-2005. Employment rose 2 per cent in 2004, owing to restructuring of industry and expansion of the service sector. In the first nine months of 2005, 2.4 million jobs were created and the unemployment rate fell by 1.7 per cent.

The unemployment rate in Kazakhstan declined steadily as a result of continuing economic growth and stood at an average of 7.8 per cent of the economically active population of just over 8 million in the first eight months of 2005. At this level, however, the country had the highest reported unemployment rate in the subregion, but other countries in the subregion report only registered unemployment, which is not comparable and may not measure unemployment accurately. The high rate also indicates

that there was a greater measure of structural reform in Kazakhstan than elsewhere in the subregion.

The labour market of Armenia developed favourably in 2004, and wages and incomes rose. However, progress in job creation slowed in 2005. The unemployment rate hardly changed, falling from 9.0 per cent in 2004 to 8.9 per cent in the second quarter of 2005 despite a high rate of emigration.

Output growth in Georgia in recent years has resulted in slow job creation, and the overall labour-market situation remains unfavourable. The unemployment rate rose from 10.7 per cent in 2003 to 12.5 per cent in 2004 due to large-scale cuts in public sector employment. The unemployment rate was much lower in rural areas than in urban areas owing to family, largely subsistence, farming although there was some seasonal work for the rural population.

The rate of labour migration from Tajikistan to neighbouring countries declined from more than 420,000 people in the first quarter of 2004 to 320,000 in the first quarter of 2005. Although the Russian Federation continued as the destination for roughly 90 per cent of this labour outflow from Tajikistan, the decline was due to greater job opportunities in Tajikistan, including new jobs related to the construction of hydroelectric power plants.

The slow pace of structural reform continues to dampen job creation in Kyrgyzstan. As a result, unemployment was higher than 4 per cent in the first four months of 2005. It is worth mentioning, however, that the actual number of people unemployed was much higher, possibly by one third more than the officially reported unemployment numbers.

## **Pacific island economies**

### **Overview**

***Modest growth continues***

Pacific island countries face many daunting problems in their quest for economic growth and sustainable development. These include the physical disadvantages of remoteness, smallness and dispersion, significantly raising transport and

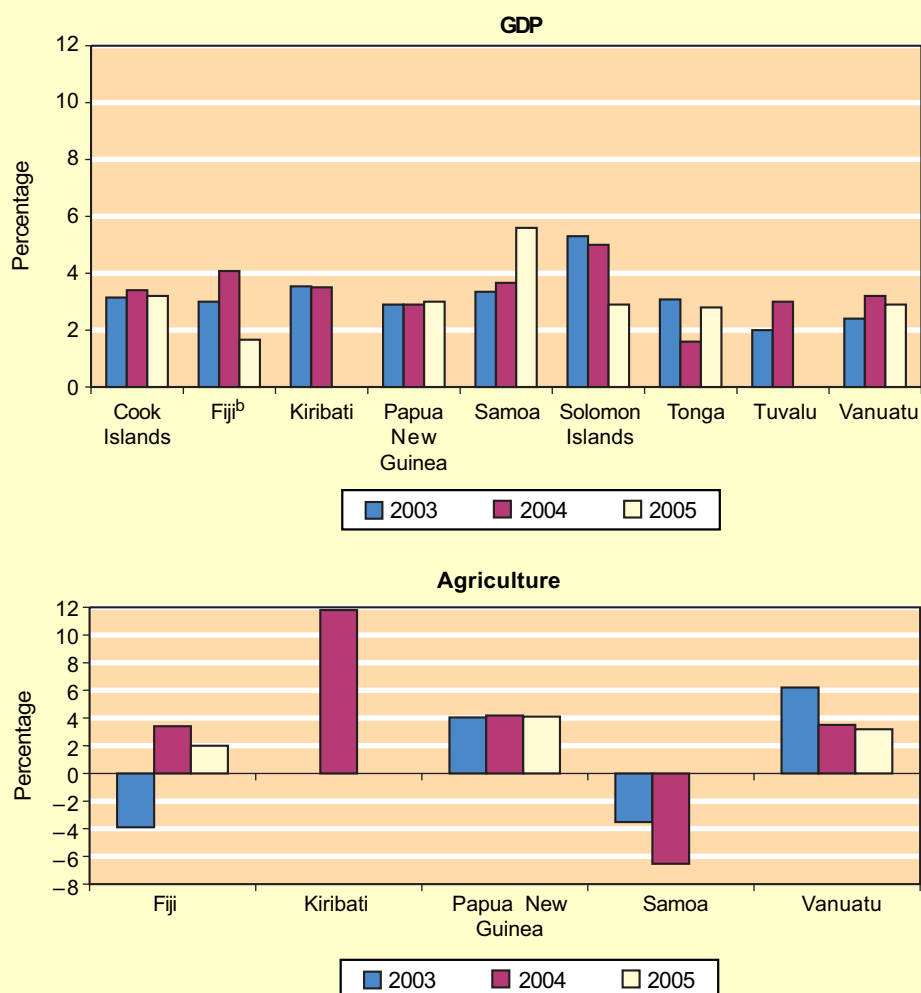
other development costs and limiting opportunities for realizing economies of scale. In many cases, rapid population growth exerts pressure on scarce resources and frustrates efforts to raise living standards. The severe shortages of professional and technical skills, paucity of domestic savings and vulnerability to external shocks pose further constraints.

Most Pacific island economies registered modest real GDP growth in 2005 (figure II.15). However, at growth rates of less than 3 per cent for most countries, there was little change from

the figures in 2004, and for Fiji and Solomon Islands the GDP growth rates were almost halved. Economic conditions in Pacific island countries in 2005 were relatively favourable, with good growth in tourist numbers, favourable movements in primary commodity prices other than petroleum and a strong performance from remittances. Moreover, there was no significant economic damage from natural disasters during the year.

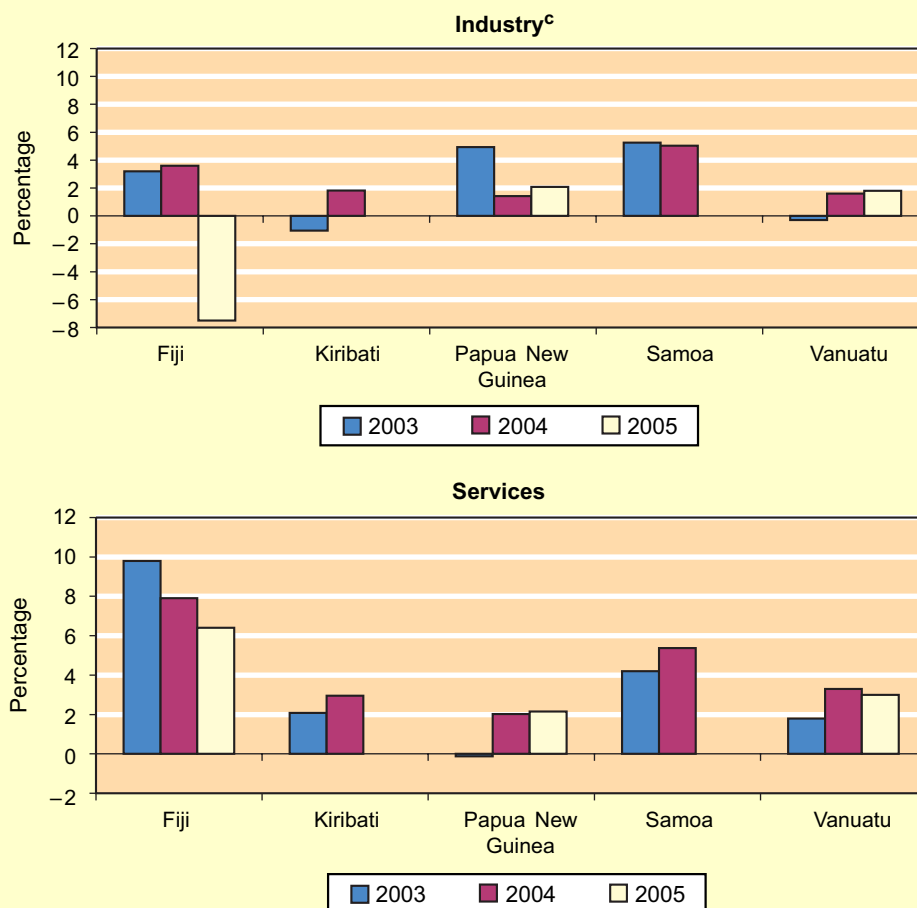
Most Pacific island countries continue to experience declining living standards as popula-

Figure II.15. GDP and sectoral growth in selected Pacific island economies, 2003-2005<sup>a</sup>



(Continued on next page)

Figure II.15 (continued)



Sources: United Nations Economic and Social Commission for Asia and the Pacific, based on national sources; Department of Treasury and Planning, Papua New Guinea, *2006 National Budget* (Port Moresby, 2005); Asian Development Bank, *Key Indicators of Developing Asian and Pacific Countries 2005* (Manila, ADB, 2005) and *Asian Development Outlook 2005 Update* (Manila, ADB, 2005).

<sup>a</sup> Growth rates for 2005 are estimates.

<sup>b</sup> Real GDP at factor cost.

<sup>c</sup> Industry comprises mining and quarrying; manufacturing; electricity-generation, gas and power; and construction.

tion growth rates outpace modest GDP growth rates. Also, average economic performance in these economies hides the fact that a small proportion of the people earn high incomes, while the bulk of the population is doing poorly and a larger proportion is slipping into poverty. The three major causes of poverty are a lack of employment and economic opportunities, lack of access to basic services (education and health) and lack of response by government institutions to the people's needs.

The small proportion of people who are doing well in Pacific island countries are mainly those benefiting from privileged monopoly positions, which were created largely by Governments. Conditions for the development of an open-market, competitive private sector are generally highly unfavourable. This is manifested in the frustration expressed by the private sector with the difficulties faced in trying to establish businesses in these countries.

Agriculture is an important source of income and employment in the majority of Pacific island countries, so investment in this sector is important. For land-rich countries such as Fiji, Papua New Guinea, Solomon Islands and Vanuatu, their development strategy has to focus on the rural sector. Investment must be aimed at improving agricultural productivity to increase rural people's incomes and savings so that they can be invested in activities servicing the rural sector. Increased research in new and improved varieties of crops and farming systems is also needed.

**Infrastructure, human resources and the investment climate need strengthening**

Costly and unreliable utilities and poor transport infrastructure are widespread problems in Pacific island countries. Most Pacific island countries have been unwilling to introduce a level of competition into utility industries, and where they have made markets more contestable, they have been slow to adopt effective regulatory arrangements. They have adopted monopoly positions, often public-private joint venture monopolies, that have led to internationally uncompetitive telecommunications costs.

Primary and secondary education is of relatively poor quality throughout most Pacific island countries. It is stronger in countries that have easy emigration access to metropolitan countries, for example, in Samoa and Tonga, where the prospect of higher-paying jobs overseas provides an incentive for investment in education. In countries such as Papua New Guinea, Solomon Islands and Vanuatu, the weak prospects of formal sector employment discourage investment in education. A better educated labour force is a prerequisite for increased investment and economic growth, but unless other constraints to investment are reduced, training will be insufficient or the trained labour force will leave the home country for overseas work.

The tourism industry makes an important contribution to many Pacific island economies. The recent increase in tourism numbers in some countries reflects a combination of factors, including the growing demand for safe destinations, increased marketing and increased air capacity and the entry of low-cost carriers. The South Pacific Tourism Organisation estimates that tourism is worth more than \$1.5 billion to the Pacific subregion. The challenge is to ensure

political stability, to encourage private investment in infrastructure such as hotels and roads and to step up marketing efforts in new tourist-originating markets, such as China.

Remittances, mainly from long-term emigrants, have also given strong support to Pacific island economies. However, the nature of remittances has been changing, with short-term off-shore employment opportunities becoming more widely available and with countries such as Fiji taking advantage of these opportunities. In addition, the rapid population ageing of high-income countries is providing job opportunities for Pacific island countries, which have large proportions of people in the under-25 age groups.

To accelerate GDP growth, increase employment opportunities (see box II.2) and reduce poverty Pacific island countries must improve their investment climate. Governments will have to develop secure rights to land; remove restrictions against the free movement of goods and services, investment, labour and technology; provide reliable transport infrastructure; reduce the costs of utilities; improve the regulation of natural monopolies; reduce red tape and bureaucratic control over the establishment of businesses and improve people's access to education and health.

**GDP growth performance**

**GDP growth declines in Fiji**

The real GDP growth of 2005 is estimated at 1.7 per cent, much lower than the 4.1 per cent achieved in 2004. GDP growth is projected to be 2.0 per cent for 2006 and 2.4 per cent for 2007, well below the nearly 4 per cent average for the period 2002-2004. The poor prospects for the sugar and the garment industries that led to a pessimistic outlook in the 2005 budget have not improved. The tourism industry is performing well, with resort hotels fully booked for the current tourist season; construction is under way on four resorts, and other resorts are planned. Remittances from overseas employment in nursing and teaching and from army and security personnel are continuing to grow: from F\$50 million in 2000 to F\$300 million in 2004 and F\$500 million expected in 2005. The Reserve Bank of Fiji estimates that an additional F\$150 million could be remitted in unrecorded transfers in 2005.

This boom in remittances is helping to sustain the economy in the face of the sharp decline in garment exports and the long-term decline in sugar production and exports. The expiration of the WTO Agreement on Textiles and Clothing on 1 January 2005 has led to the loss of 5,000 to 8,000 jobs in Fiji. The closure of one garment plant that was dependent on the United States market meant the loss of 3,000 jobs. The Government of Australia has extended the South Pacific Regional Trade and Economic Co-operation Agreement (SPARTECA) by seven years, giving some breathing space to the Fiji garment industry. However, the value of this access will decline as Australia lowers its tariffs in line with the global WTO agreement. The Government of Fiji is requesting the Government of Australia to lower local content requirements under the SPARTECA rules of origin from 50 per cent to 25-30 per cent. This would provide Fijian garment firms and employees some relief, but it would advantage mainly other countries exporting materials for the garment industry to Fiji. Fiji cannot hope to compete with major producers in standard products because of its high trade costs, small scale, remoteness and high wages relative to other garment-manufacturing countries. The only hope for the garment industry in Fiji is to find and exploit niche markets. The country's ability to move in this direction will depend on many factors, most importantly on product design and marketing.

The tourism sector in Fiji is continuing to grow strongly. Visitors increased by an estimated 7.7 per cent in the first six months of 2005, following an 18 per cent increase in 2004, when tourist numbers topped 500,000 for the first time. The Fiji Visitors Bureau forecast that visitor arrivals would reach a new record of 532,000 in 2005. Most tourists are from Australia and New Zealand, followed by European countries and the United States. With the terrorist bombings that occurred in some other tourist destinations and the avian influenza scare, tourism numbers in the Pacific subregion should grow robustly. Because China is expected to be a new growth market, Fiji and other Pacific island countries have been negotiating easier visa entry for tourists from China.

Growth in the country's tourism sector could be held back by the shortage of suitable accommodations, although resort developments under construction and in the planning stage will add over the next two years 2,000 first-class

rooms to those currently available. The Government has initiated a public-private partnership policy to encourage private sector participation. Construction of resort hotels is being facilitated by agreements between landowner groups and hotel owners for 99-year leases on land held under customary ownership. There are problems in the construction industry, however, with the continuing loss of skilled tradesmen in the wake of the 2000 coup. In the 2006 budget, the Government introduced a 5 per cent "bed" tax for resort owners, responding to claims that only 40 per cent of the tourist dollar remains in the country.

The sugar industry, with annual foreign exchange earnings of about F\$200 million, well below remittances and tourism, now accounts for only 6 per cent of GDP and 8 per cent of foreign exchange earnings. The Fijian sugar industry is in deep trouble with the upcoming loss of preferential prices for exports to the European Union and the United States. The Fiji Sugar Corporation, owner of the country's four sugar mills, has been losing money consistently in recent years, even though it sells two thirds of its sugar at two to three times the price on the global market. Farm yields are only half those of major producers, such as Australia and Brazil. In an attempt to stave off the necessary adjustment to the liberalization of the global sugar market under WTO, Fiji and various African, Caribbean and Pacific countries are petitioning the European Union to slow the pace of reduction in the preferential sugar price and to provide adjustment assistance. A subsidized loan of F\$86 million from the Government of India is being used to upgrade machinery in the four mills to improve efficiency. Sugar output has fallen from a peak of 517,000 tons in 1994 to an estimated 320,000 tons in 2005.

For the sugar industry to become viable, farm yields would have to improve substantially, the cost of transporting sugar cane to the mills would have to drop substantially and milling efficiency would have to rise. To achieve higher yields farmers will need more secure access to land, farms will need to be consolidated so that machine-harvesting can be used and the area of marginal land will have to be reduced substantially. The Asian Development Bank has provided a loan and technical assistance to help farmers displaced from their leaseholds land and farmers wishing to move out of farming sugar cane, so that they can develop new livelihoods.

Private investment in Fiji is well below the level needed to generate economic growth in the 5 per cent plus range and provide jobs for the 15,000 or more young people entering the labour force each year. Although increasing in recent years, total investment is still only about 17 per cent of GDP, and only about a quarter of this amount is private investment. Investment in public enterprises is earning poor returns, as most State-owned enterprises are losing money or earning close to zero returns on their investments. If growth is to move beyond the 2-3 per cent range, the challenge for the Government will be to create an environment in which private investment could increase rapidly and raise total investment to about 25 per cent of GDP. Increasing private investment will depend on a significant reduction in political instability and law and order problems. The Government should focus on actions, such as providing better transport infrastructure, ending the monopoly status of the telecommunications industries to reduce costs, resolving the impasse over land leases and reducing the red tape facing potential investors.

***Stable growth continues in  
Papua New Guinea***

The improvement in economic activity in Papua New Guinea that began in 2003 continued with a modest real GDP growth rate of 3 per cent expected for 2005. This three-year period of modest growth followed a three-year period of decline in real GDP, which eroded average per capita incomes. The construction sector is expected to drive growth in 2005, with several new projects under construction. The combination of low interest rates and strong domestic demand has translated into several new residential and commercial building projects. GDP in the agricultural, forestry and fishing sectors is expected to grow by 4.1 per cent in 2005, while the non-mining sector will grow by 3.2 per cent. The sector's strong performance reflects new fisheries licenses and increased production of cash crops as the maintenance and rehabilitation of feeder roads increase producers' access to markets. The petroleum sector is expected to grow by 11 per cent during the year, while the mining and quarrying sector is expected to decline by 4.5 per cent in 2005 reflecting a 6 per cent decline in gold production.

GDP growth for Papua New Guinea is projected at 3.5 per cent for 2006, underpinned by a 5 per cent increase in construction activity resulting from the initiation of work on the Ramu Nickel Project. Initial construction work on the Papua New Guinea-Australia gas pipeline will also contribute to growth. The mining sector is projected to grow by 5.8 per cent in 2006, with better productivity expected from all mines except the Porgera Gold Mine. It is hoped that the expected boom in government revenues from the gas project and related activities will be handled better than during the mining boom in the early 1990s.

Solomon Islands recorded GDP growth of 5 per cent in 2004. Growth for 2005 is estimated at 2.9 per cent, because of reduced earnings from tuna fishing and copra production. Receipts from fishing over the first nine months of 2005 declined by 49 per cent owing to seasonal conditions and the poor performance of the country's ageing fishing fleet. The fishing company in Solomon Islands, now under government control, is not performing as well as it was when it was privately owned, in part because of the loss of Japanese expertise and the links to the marketing network of Japan. The poor performance in the fishing and copra industries has meant greater dependence on logging for export and foreign exchange earnings. Log exports remained fairly stable during the years of internal conflict because logging is confined to the Western Province, a region of the country that has experienced relatively little fighting.

The rehabilitation of palm oil plantations on Guadalcanal Island has proceeded well, and production and export were expected to resume at the end of 2005. Gold production from the Gold Ridge Mine, closed during the period of civil unrest and considerably damaged, is expected in late 2006. This will be important for the economy as the mine was contributing about 30 per cent of GDP before the conflict.

Real GDP growth for Samoa in 2005 is estimated at 5.6 per cent compared with 3.7 per cent in 2004. Credit for the improved performance is due to the upswing in the construction sector in preparation for the 2007 South Pacific Games and a turnaround in agriculture and fishing. The construction industry grew by 29 per cent in nominal terms as of the end of June 2005, and a

further increase in real GDP of 3 per cent is expected for 2006, with the construction for the Games completed and the further improvements made in the agricultural and fishing sectors. Because of the much-improved performance of the Samoan economy over the past decade, per capita GDP has increased from about WS\$1,000 in 1995 to about \$2,000 in 2005.

The agricultural sector in Samoa has been performing poorly since damage was caused by Cyclone Heta in January 2004 and subsequently by drought. The fishing industry recovered somewhat in 2005 following the poor tuna catches since mid-2002. The recent difficult conditions have led to a rationalization of the fishing fleet, with marginal operators dropping out. This should result in a more resilient industry, better able to weather the inevitable fluctuations in catch and in global prices.

The economy of Samoa was supported strongly again in 2005 by remittances and tourism, the two largest contributors to national income and the balance of payments. Remittances account for up to 20 per cent of GDP, while tourism receipts account for about 15 per cent. Efforts are being made to increase tourism earnings, particularly through resort hotel construction. The recent joint venture between Polynesian Airlines and Virgin Blue should reduce the high costs of travel to Samoa.

Real GDP growth in Tonga recovered to an estimated 2.8 per cent in 2005 from 1.6 per cent in 2004 on better performance in agriculture and tourism and ongoing construction projects. Similar performance is expected in 2006 but will depend primarily on continuing growth in remittances, on an improved tuna catch, on the performance of the squash industry and on the Government's management of the fiscal problems resulting from large pay increases for public servants following a nationwide public strike in 2005.

Because of the high rate of emigration, Tonga's population growth rate is well below 1 per cent per year so, even with modest GDP growth rates, average income levels continue to rise. Private remittances average from T\$80 million to T\$90 million and can be expected to continue if economic growth in Australia and New Zealand continues at its recent pace. Offi-

cial estimates of remittances are likely to be low because of the large amount of cash that enters the country unofficially.

Apart from remittances, agriculture, fishing and tourism are the mainstays of the Tongan economy. The contributions of the squash and vanilla industries depend heavily on prices, which tend to be highly volatile. The fishing industry has also been in difficulty, with lower catches and lower prices, but better performance is expected. Tonga's tourism industry has been performing well, with increasing tourist arrivals and expenditures. The declining level of the pa'anga against the Australian and New Zealand currencies and the safe environment offered by Pacific island countries appear to have encouraged visitors. However, the number of visitors to Tonga fell over the first six months of 2005.

A modest expansion of economic activity was expected in Vanuatu for 2005, underpinned in part by rising output in the forestry and beef industries and a pickup in tourism following the start-up of low-cost flights from Australia by the "no frills" Pacific Blue Airlines. The economy has grown while inflation remained low. Vanuatu also maintains low interest rates and a reasonable level of international reserves, despite the political instability of the past few years and the disappointment over the absence of the growth dividend expected from the partially implemented Comprehensive Reform Programme. However, with the population growing faster than the economy, the long-term lack of improvement in average incomes persists. GDP per capita in real terms is reported to have fallen below the level of 20 years ago. The obstacles to achieving a much higher growth path appear to be the continuing political instability, the difficulties in mobilizing land for investment and the monopolies in key areas, particularly essential services.

The one bright spot has been the growth in tourist numbers over the past two years. In 2004, visitors to Vanuatu increased by 20.3 per cent and in the first six months of 2005, numbers increased by a further 11 per cent. The increases are attributed to the entry of low-cost carriers into the market and to better marketing. The safety of the Pacific subregion from terrorism and disease may be another reason, as is the continued good economic performance of Australia and New Zealand. Important for income

generation and distribution is the extent to which tourist expenditures flow through to local labour and producers of goods and services used in tourist resorts. Growing confidence in Vanuatu's tourism industry is reflected in plans for new hotels and extensions to existing properties that will significantly increase capacity. The industry's growth prospects could, however, be frustrated by financial troubles and political interference in the management of the national airline, Air Vanuatu.

In the longer term, Vanuatu's GDP growth is forecast to remain in the 2-3 per cent range. In its Article IV consultations on exchange arrangements, IMF has argued that Vanuatu has the potential for much improved economic performance, particularly in agriculture and tourism. Achieving this would require a reorientation of fiscal spending towards social and infrastructural needs, further financial sector reform and creation of a more investor-friendly environment. Areas for increased spending on the infrastructure include roads, electricity, water and transportation.

### Key macroeconomic policy developments

#### *Fiji enjoys greater macroeconomic stability*

The budget deficit of Fiji for 2005 is expected to be 4.3 per cent of GDP, up from 3.2 per cent in 2004 (see figure II.16). The Government has announced an expansionary fiscal policy for 2006, with an expected deficit of 4 per cent of GDP in 2006, which appears quite optimistic. With the next general election to be held in 2006, this is widely seen as a pre-election budget. It includes several concessions to the poorer sections of the population, including a zero value added tax rate on several basic food items and tax concessions on fuel-related items. However, the concessions will reduce revenue collection. The Government has also granted substantial income tax exemptions for new investment activities in several areas, thus forgoing additional revenue collections. The public debt is projected to increase substantially over the period 2006 to 2008 in order to fund the

Figure II.16. Budget balance<sup>a</sup> in selected Pacific island economies, 2003-2005<sup>b</sup>



Sources: United Nations Economic and Social Commission for Asia and the Pacific, based on national sources; International Monetary Fund, *Samoa: Selected Issues and Statistical Appendix*, IMF Country Report No. 05/221 (2005) and *Solomon Islands: Selected Issues and Statistical Appendix*, IMF Country Report No. 05/364 (2005); and Asian Development Bank, *Key Indicators of Developing Asian and Pacific Countries 2005* (Manila, ADB, 2005).

<sup>a</sup> Budget balance includes grants.

<sup>b</sup> Data for 2005 are estimates.

deficit, so debt-servicing costs will continue to rise. The public arbitrator has granted a cost-of-living adjustment to public service salaries that is not funded in the budget, and no initiatives were announced for reducing the number of civil service staff, which is believed to be quite high.

The Reserve Bank of Fiji raised the official interest rate from 1.75 to 2.25 per cent in October 2005, the first increase since May 2004. It justified the increase on the grounds that consumer credit growth remained strong and that robust domestic demand growth was resulting in rapidly increasing imports and rapid growth in mortgage lending, which if left unchecked, risked straining households' capacity to service rising debt. Total domestic credit rose by a further 22.6 per cent over the year as of September 2005, fuelled primarily by private sector credit, which grew by 23.4 per cent.

The Fiji dollar appreciated by 1.87 per cent against the Japanese yen, by 0.08 per cent against the New Zealand dollar and by 0.33 per cent against the United States dollar, and depreciated by 1.25 per cent against the Australian dollar in September 2005. After rising for much of the year, the effective exchange rate index of the Fiji dollar fell by 0.1 per cent in September 2005, pointing to an improvement in the country's international competitiveness, thanks mainly to lower domestic inflation (see figure II.17).

The inflation rate for 2004 was 3.3 per cent, and it was expected to be close to 3 per cent for 2005. In 2006, high global oil prices are expected to have a greater impact on other prices. The 2006 inflation rate is projected to be 3.0 per cent.

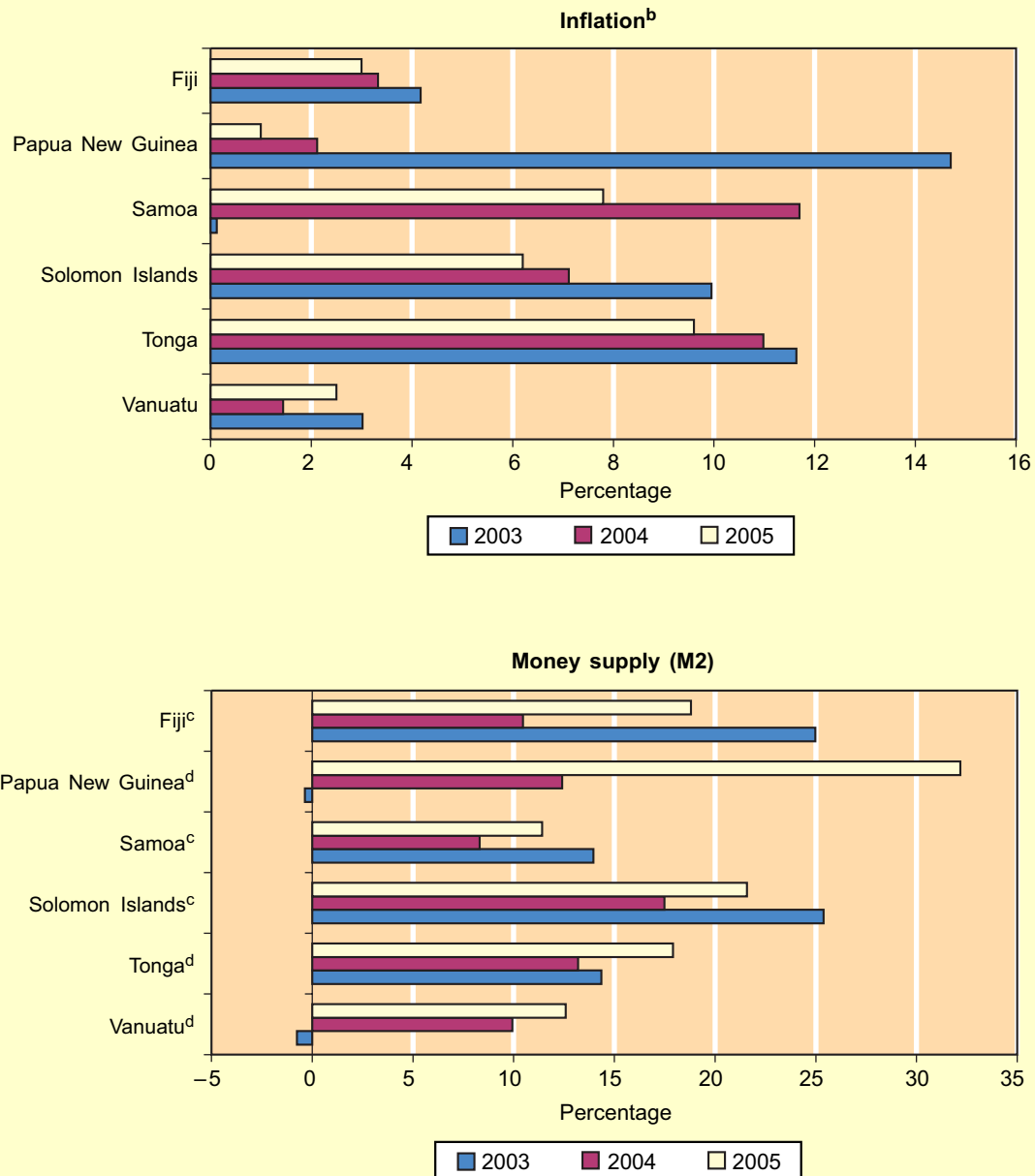
The budget deficit of Papua New Guinea for 2005 is projected to be 0.6 per cent of GDP, compared with the target of 1.0 per cent. The turnaround is due mainly to improved revenue performance and good fiscal discipline. Revenue for 2005 is estimated to have increased by 16 per cent over that of 2004. Total expenditure and net lending in 2005 is projected to increase by 24 per cent, reflecting mainly the Government's intention to use 400 million kina to assist in funding its equity interest in the Papua New Guinea-Australia gas project. Interest rates on government securities have fallen steadily with tight government expenditure controls and the related drop in inflation.

The Government is targeting a budget deficit of 0.6 per cent of GDP for 2006. A risk built into the 2006 budget may well be the expected prices for gold and oil for the next three years. The budget assumes that these prices will decline from current high levels, but only gradually; however, primary commodity price declines from peaks are characteristically quite rapid.

Good public expenditure control, together with the increased revenues from high prices for gold and petroleum, has provided scope for the Government to substantially reduce its public debt. When the current Government took office in 2002 the public debt to GDP ratio was about 80 per cent. This figure was expected to be 49.8 per cent of GDP at the end of 2005, reflecting prudent fiscal management and exchange rate appreciation. The improvement in budget performance, low interest rates, low inflation and the high level of foreign exchange reserves reflect improved macroeconomic management, which should provide an encouraging environment for investment. However, the country's coalition Governments have remained unable to implement the necessary changes in microeconomic policies, to lower the high cost and improve the reliability of the infrastructure and to tackle the significant law and order problems needed to improve the investment climate.

The Bank of Papua New Guinea maintained an accommodative monetary policy stance in 2005. The Kina Facility Rate remained unchanged at 7 per cent between December 2004 and August 2005 before being reduced to 6 per cent in September 2005. This measure reflected the good progress made in reducing inflation over the past few years and the absence of price pressures. Market interest rates have fallen well below the indicator rate, with short-term treasury bill rates as low as 3-4 per cent during the year, reflecting the excess liquidity in the market. The accommodative policy stance has been made possible by prudent fiscal management and strong global conditions, which have supported the exchange rate and moderated prices. Monetary policy is likely to remain accommodative in 2006 as long as inflation pressures remain subdued. The year-on-year average inflation rate for the quarter ending in June 2005 was 1.2 per cent and the rate is expected to rise to 3.4 per cent in 2006, largely because of higher global oil prices and the flow-through

**Figure II.17. Inflation and money supply growth in selected Pacific island economies, 2003-2005<sup>a</sup>**



Sources: United Nations Economic and Social Commission for Asia and the Pacific, based on national sources; Asian Development Bank, *Key Indicators of Developing Asian and Pacific Countries 2005* (Manila, ADB, 2005); and International Monetary Fund, *International Financial Statistics* (CD-ROM) (Washington, D.C., IMF, 2005).

<sup>a</sup> Data for 2005 are estimates.

<sup>b</sup> Inflation rates refer to changes in the consumer price index.

<sup>c</sup> Money supply for 2005 refers to January-September.

<sup>d</sup> Money supply for 2005 refers to January-October.

<sup>e</sup> Money supply for 2005 refers to January-August.

to most transport and production activities. However, with the expected construction boom the challenge to monetary policy will be increased.

The kina exchange rate was generally stable in 2004 and steadily appreciated through 2005, appreciating by 2 per cent against the United States dollar and 3.8 per cent against the Australian dollar in the first nine months. The stability of the currency reflects both an increase in the terms of trade from higher international prices of the country's key commodity exports and lower inflation reflecting the Government's sound economic management.

Average per capita income in Solomon Islands has been recovering slowly since the arrival of the Regional Assistance Mission to Solomon Islands in July 2003; it is now back to about 80 per cent of its level before the civil unrest during the period 1999-2003. The achievements since the arrival of the Mission have been significant. Law and order was quickly restored. Fiscal prudence has been developing and the public debt has been reined in; foreign exchange restrictions have been relaxed and foreign reserves have been increased to about eight months of import cover. Public services are also slowly recovering. These achievements have been realized because of considerable donor support. For example, donors funded about 55 per cent of the recurrent budget and almost the entire development budget for 2005. Since this level of donor support cannot be expected to continue indefinitely, the country will have to create an environment in which domestic savings and investment can play the major part in development.

Some relief on the fiscal front was provided when international creditors agreed to grant Solomon Islands a two-year moratorium on its debt repayments. The Honiara Club of creditors agreed on a framework for consultations on reducing the country's debt, provided Solomon Islands maintains its planned programme of fiscal discipline and economic reform. The 2005 budget had allowed for the use of up to 20 per cent of revenues for debt-servicing.

Investors in palm oil production and in the restoration of the Gold Ridge Mine have been given substantial tax concessions for a considerable period, a matter of concern because of the loss of potential government revenue. If over-

logging of the country's forests leads to a sharp decline in log exports and log export revenue within five years or so, this will create a large gap in government revenue. A major question is how this gap will be filled.

The 85 per cent of the population living outside the urban areas of Solomon Islands form the backbone of the economy, and enhancing their capacity to increase their livelihood is the most important factor in achieving significantly improved living standards. Most communities in rural areas were able to function during the previously mentioned unrest, which prevented what could have been much more widespread hardship. However, the productivity of rural activities is very low. Improving rural productivity will require government investment in physical and social infrastructure such as transport, safe water, power and health and education services. Research into new and improved plant species is also needed as are improved farming systems to lift productivity, improvements in the provision of market information and the means to raise and maintain quality standards and trade facilitation. The loss of resource rents from exploitation of forests and from mining gold and cultivating oil palm will make it very difficult for the Government to fulfil its functions.

The inflation rate in Solomon Islands in the three months to the end of October 2005 was 10 per cent, a considerable increase over that of the same period in 2004. The higher inflation has been due in part to the increase in fuel prices; inflation has flowed into transport and utility costs. In addition, the Mission exercise is being reflected in a surge in the housing rental component of the consumer price index.

A major concern for economic prospects in Samoa is the pre-election 2006 budget. Public sector salaries and wages are to be increased by up to 50 per cent over the next three years, an increase equivalent to 4 per cent of GDP. The rise in public service salaries and the expenditure commitments for the South Pacific Games are projected to sharply increase the budget deficit to 4.5 per cent of GDP, from its average range of 1-2 per cent over the past decade. The Government proposes to issue government bonds worth \$26.5 million to fund the 2006 deficit, in contrast to previous years when the much smaller budget deficits were funded from government savings held in the banking system.

Inflation in Samoa was expected to be about 7.8 per cent in 2005. This rate is lower than the rate in 2004 when Cyclone Heta damaged crops, which led to higher prices for local produce and import costs rose because of increased fuel costs. The continuing high fuel costs, the public service salary and wage increases and construction expenditures for the South Pacific Games present a severe challenge to the central bank in managing inflation and protecting foreign exchange reserves. Some budget relief may be provided by the Polynesian Airlines-Virgin Blue joint venture, which means that the Government will no longer have to cover airline losses. The central bank has announced that it will be tightening monetary policy to protect foreign exchange reserves. As a result, interest rates will rise, credit will be restricted and demand will be compressed.

The Government of Tonga has taken measures to improve revenue collection. Technical assistance is being provided with donor support to improve customs duty collections; current inefficiency in duty collection accounts for the loss of an estimated \$20 million in revenue annually. A new 15 per cent consumption tax has replaced the 20 per cent ports services tax levied on all imports as well as the 5 per cent sales tax and fuel tax. The consumption tax does not discriminate between imports and domestically produced goods and services and therefore does not distort resource allocation. Compliance costs are being kept low by requiring only businesses with an annual turnover of \$50,000 or more to register for the tax.

In Tonga, the monetary expansion from support provided to loss-making public enterprises that have been unable to meet their debt commitments appears to underlie the continuing high level of inflation and depreciation of the pa'anga. The inflation rate was expected to remain high in 2005 and 2006 because of high international oil prices and the increases in public service salaries agreed at the time of a sector-wide strike. Wage increases as high as 80 per cent are well in excess of the increases planned in the budget. The increases have no basis in labour productivity gains and therefore the real value of the nominal increases will be quickly lost to inflation through depreciation of the exchange rate unless the Government somehow reduces expenditures in other areas; however, this is highly unlikely. The expected

revenue increase from the value added tax will not be enough to shore up government finances.

The high inflation in Tonga will continue to place downward pressure on the exchange rate and the country's international competitiveness. The loss of international competitiveness may already be reflected in the downturn in tourist numbers in the first six months of 2005. Concerns over the sustainability of foreign exchange reserves and high inflation will likely see the Reserve Bank of Tonga attempt to maintain a tight monetary policy in order to dampen domestic demand and investment. However, past performance casts doubt on whether the Bank will be able to maintain this discipline.

Prudent fiscal and monetary management in Vanuatu has ensured continuing good performance on the inflation front. The inflation rate has been held to 2-3 per cent in recent years. High petroleum prices, reinforced by the rising United States dollar, present considerable challenges for restraining inflation and maintaining foreign reserves. Moreover, because of the low growth and lack of benefits arising from the Comprehensive Economic Reform programme, there could be strong public pressure for fiscal stimulus to promote economic growth, resulting in increased budget deficits in coming years.

### ***Developments in the external sector***

#### ***Higher commodity prices will aid growth but higher oil prices remain a problem***

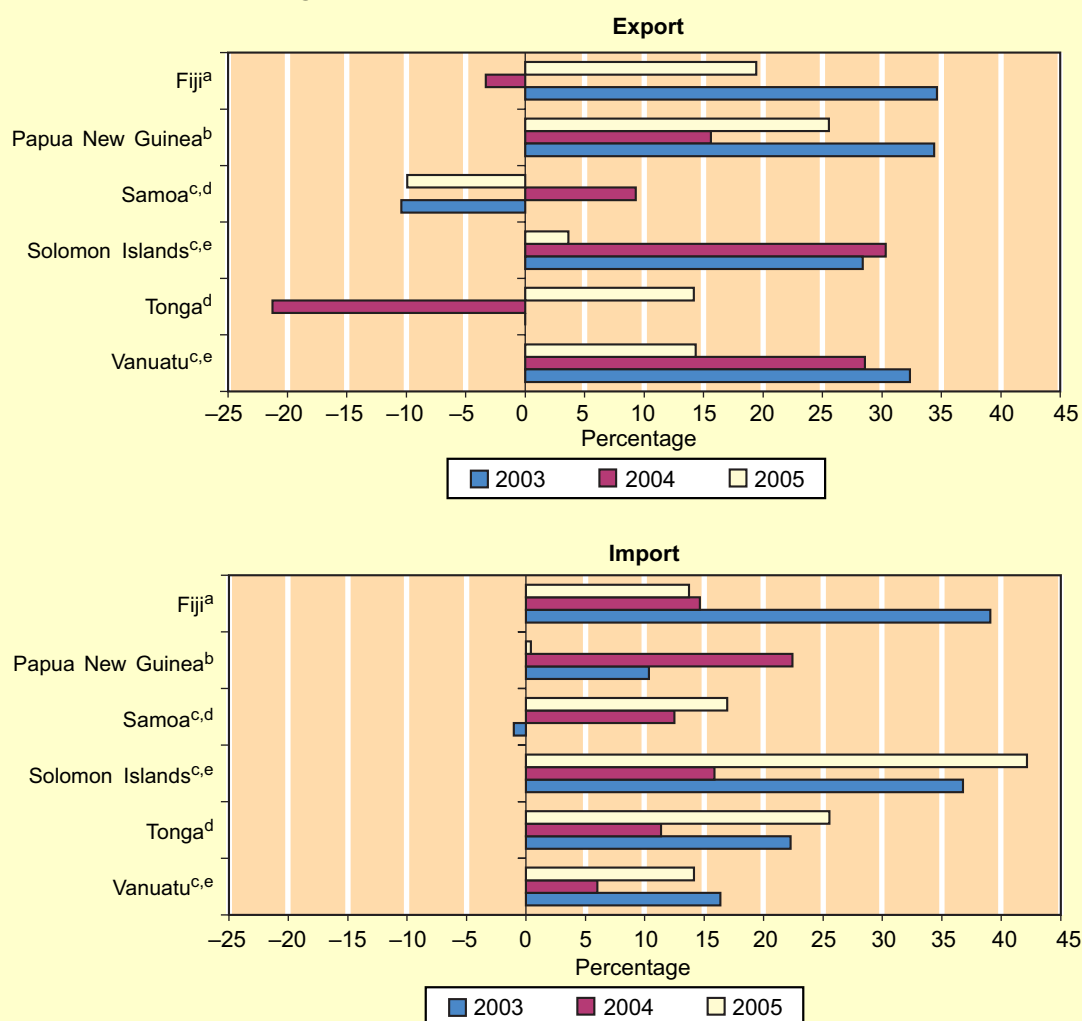
Higher world prices for primary commodities over the past three years have been a mixed blessing for Pacific island countries, except for Papua New Guinea. The sharp rise in the prices of oil, gold, copper and agricultural commodities enabled the Government of Papua New Guinea to reduce substantially the public debt and take the pressure off interest rates.

Increases in the prices for cocoa, copra and coconut oil have also benefited Solomon Islands and Vanuatu. However, palm oil prices declined between 2004 and 2005, and cocoa and copra prices fell in the third quarter of 2005, which may herald a period of lower prices for these commodities.

Pacific island countries other than Papua New Guinea rely heavily on petroleum imports for energy production and transport, and the sustained high prices for petroleum products have increased the costs of production and made it more difficult for the Governments to control inflation and the balance of payments.

Exports from Fiji have been declining because of the decline in sugar production and exports, the loss of kava markets due to the bans (since lifted) on the product in Europe and the United States and stagnant fish exports (see figure II.18). Total merchandise exports (in local currency terms) fell 11 per cent in the 12

**Figure II.18. Growth rates in merchandise export earnings and import spending in selected Pacific island economies, 2003-2005**



Sources: International Monetary Fund, Country Report No. 05/221 (2005), and *Public Information Notice*, various issues; Reserve Bank of Fiji website <www.reservebank.gov.fj>, accessed on 16 January 2006; Bank of Papua New Guinea website <www.bankpng.gov.pg>, accessed on 9 January 2006; and National Reserve Bank of Tonga website <www.reservebank.to>, accessed on 17 January 2006.

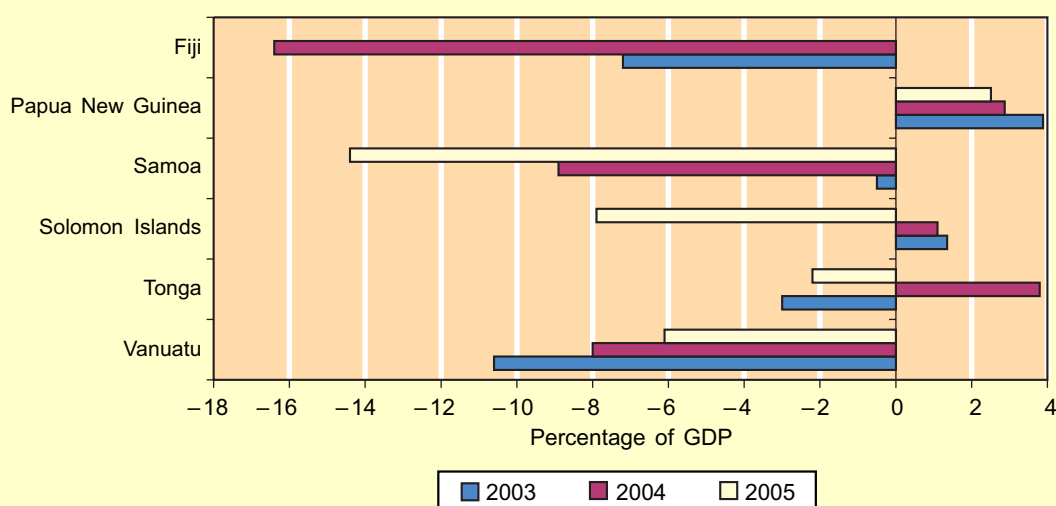
- <sup>a</sup> Growth rate for 2005 refers to January-June of that year.
- <sup>b</sup> Growth rate for 2005 refers to January-September.
- <sup>c</sup> Growth rate for 2005 is a projection.
- <sup>d</sup> Fiscal year data.
- <sup>e</sup> Data for 2004 are estimates.

months to September 2005, largely attributable to negative contributions from textiles, clothing and footwear and from fish that more than offset the positive contributions from sugar, re-exports of mineral fuel, ginger and mineral water. During the same period, merchandise imports rose about 20 per cent, with delivery of greater quantities of goods for consumption, investment and intermediate use. Imports grew by 13.7 per cent in the first six months of 2005. Garment exports to the United States declined in 2005, and market opportunities there and in the rest of the world are expected to worsen considerably as Fiji and other countries face the full force of East Asian exporters. A bright spot for the balance of payments has been the sharp increase in remittances from teachers, nurses and army and security personnel employed overseas (see figure II.19). Remittances were expected to rise from more than F\$300 million in 2004 to reach almost F\$500 million in 2005. The country's official foreign exchange reserves fell from F\$992 million at the end of June (equivalent to 5.6 months of import cover) to F\$940 million at the end of September 2005 (5.3 months of

import cover), reflecting sluggish export receipts and rising import costs. Exports were affected by the modest appreciation of the Fijian dollar in 2004. However, the exchange rate stabilized in 2005 (see figure II.20).

Papua New Guinea recorded a current account surplus of K 273 million in the first half of 2005 compared with a surplus of K 2 million in the first half of 2004, mainly because of a larger surplus in the balance of trade in goods and services (K 897 million in the first half of 2005 compared with K 461 million in the first half of 2004), which more than offset a larger deficit in the balance of income and transfers. This was mainly due to a higher merchandise trade account, which recorded a surplus of K 4,624 million in the first half of 2005, reflecting the higher export values of major commodities driven higher as a result of the increase in international prices. The value of Papua New Guinea's merchandise imports increased by 0.4 per cent in the first nine months of 2005 compared with the same period in 2004. The rise reflects increased business investments and an

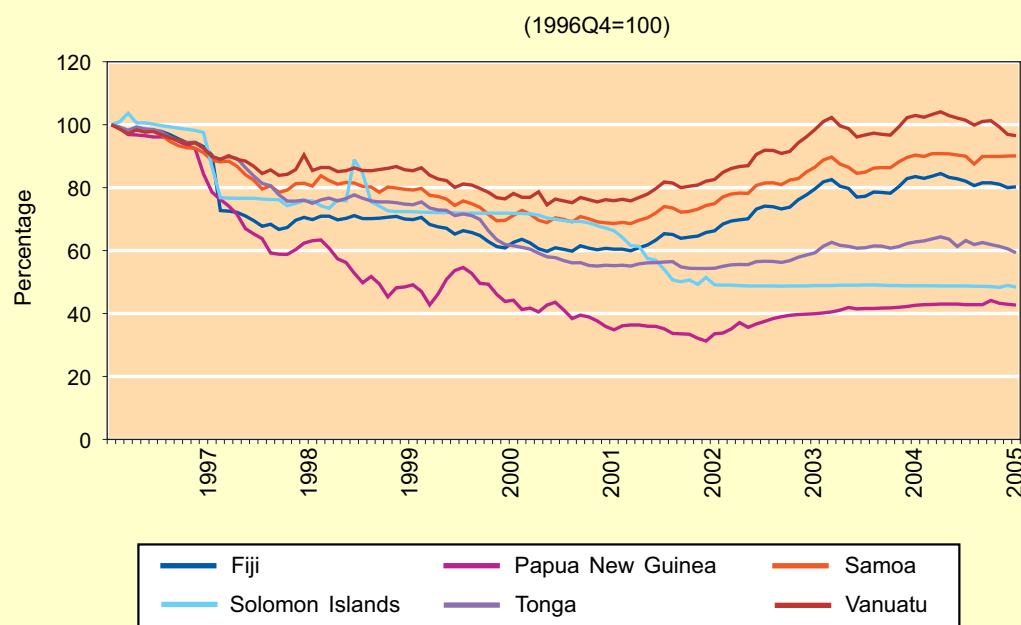
**Figure II.19. Current account balance in selected Pacific island economies, 2003-2005<sup>a</sup>**



Sources: United Nations Economic and Social Commission for Asia and the Pacific, based on national sources; International Monetary Fund, *Solomon Islands: Selected Issues and Statistical Appendix*, IMF Country Report No. 05/364 (2005); and Asian Development Bank, *Key Indicators of Developing Asian and Pacific Countries 2005* (Manila, ADB, 2005).

<sup>a</sup> Data for 2005 are estimates.

**Figure II.20. Index of exchange rates against the United States dollar in selected Pacific island economies, 1996-2005<sup>a</sup>**



Sources: International Monetary Fund, *International Financial Statistics* (CD-ROM) (Washington, D.C., IMF, 2005); and *The Economist*, various issues.

<sup>a</sup> Data for 2005 are estimates.

increase in domestic demand. Holdings of gold and foreign exchange reserves totaled K 2,135 million as of August 2005, sufficient for 5.2 months of import cover.

The underlying balance of payments position of Papua New Guinea is expected to be healthy in 2006, with solid global growth and high commodity prices boosting export receipts, and steady domestic demand and moderate price increases for imports curbing increases in the volume of imports. However, the country's external account could be heavily affected over time by the goods and services and capital flows associated with the Papua New Guinea-Australia gas project and the Ramu Nickel project. If the projects proceed as expected, this will result in a substantial rise in imports and a turnaround in the current account from a surplus in 2005 to a large deficit in 2006 in the range of 4-5 per cent of GDP.

The external trade deficit of Samoa widened to 45.7 per cent of GDP in 2004 as a result of sluggish export growth and higher import growth owing to rapid growth in the construction sector, which is largely externally financed, and higher prices for imported fuel. Slow export growth in 2004 was the result of weak performance in the agricultural and fishing sectors. The current account deficit was almost eight times larger than that of 2004, at 8.9 per cent of GDP. With better performance in the agricultural and fishing sectors in 2005, export performance is likely to record an improvement for the year. Fish exports were the top merchandise export earner for the quarter ending in June 2005, accounting for 39 per cent of exports. For that quarter, total exports increased 18.3 per cent over the same period in 2004. However, with imports increasing even faster, the trade deficit increased to 65 per cent of GDP in that quarter, and the current account deficit reached 14.4 per cent of GDP. Foreign exchange re-

serves as of June 2005 were equivalent to 5.9 months of import cover. The central bank expects that pressures on reserves, particularly from rising fuel costs, will cause import cover to fall to about 4.8 months in 2006.

Samoa and New Zealand recently reached an agreement that should enhance the access of Samoa to New Zealand markets. Niche markets in products such as taro, woven mats and tapa cloth are developing for countries such as Samoa and Tonga that have large overseas populations in New Zealand, Australia and the United States. Organically grown foods with eco-labelling certification could also provide export growth in products that fetch premium prices. Such export diversification will also enable the economy to better withstand external shocks. Development of niche markets that can command a premium price is also the only way to overcome the high costs of international trade that these small, isolated economies face.

Foreign exchange reserves of Solomon Islands at the end of October 2005 were at record levels owing to inflows of donor aid, improved export receipts and some investment inflows, mainly linked to the rehabilitation of the gold mine and oil palm plantation damaged during the civil unrest. Foreign reserves of SI\$705 million were equivalent to six months of import cover. With the fishing sector decline in diversification of exports is urgently needed to reduce the dependence on the forestry sector, which is said to be logging at three to four times the sustainable rate. Progress in getting the palm oil plantation back into operation has been rapid, and production was expected to begin at the end of 2005, which will contribute to export diversification. Imports are expected to increase, in view of the high import content of the investment rehabilitation projects under way and the high international fuel prices.

International prices for cocoa and copra, the main agricultural exports of Vanuatu, continued to be favourable in the first half of 2005. However, prices declined in the third quarter quite sharply for copra. Although bans on kava exports to Europe and the United States have been lifted, until the results of ongoing tests of the effects of kava on human health are known, it is unlikely that exports will be resumed. The kava industry in the Pacific is optimistic about the test results and expects that exports will be

resumed as early as 2006. There are prospects for new markets for kava in Asia, particularly in China, for pharmaceutical uses, but these markets also are not likely to open up until the scientific tests are concluded.

A trade dispute between Fiji and Vanuatu led to a six-month ban on kava exports from Vanuatu to Fiji, which had recently developed as an important market for Vanuatu. While the two countries are members of the Melanesian Spearhead Group, the lack of an effective mechanism for resolving disputes appears to present an important obstacle.

The foreign exchange reserves of Vanuatu rose further in the second quarter of 2005, owing mainly to an increase in donor funds and stronger foreign earnings from tourism. According to the Reserve Bank of Vanuatu, official foreign reserves rose from 6.8 billion vatu (\$63 million) at the end of March 2005 to 7.1 billion vatu at the end of June 2005, equivalent to 5.8 months of import cover.

### **Medium-term prospects and key policy issues**

#### ***Growth is expected to accelerate slightly in 2006 but longer-term challenges remain***

Despite high oil prices, current indications are that most Pacific island economies will continue to grow in 2006-2007 largely because of the expansion of the tourism sector, diversification in the agriculture sector, and remittances. However, GDP growth rates are expected to be modest as countries in the subregion continue to experience high population growth rates; thus, living standards are likely to decline in the medium term. Most Pacific island countries also expect low inflation rates in 2006, although this situation could change if major natural disasters were to strike.

There are uncomfortable levels of poverty in most Pacific island countries. The three major causes of poverty are lack of employment and economic opportunities, lack of access to basic services (education and health) and lack of response by the Government to people's needs, all traceable to unsatisfactory economic performance. However, more people live under conditions of hardship rather than absolute poverty.

Law and order problems are confined mainly to Fiji, Papua New Guinea, Solomon Islands and Vanuatu. Political instability is also a problem in a few of these countries. At the extreme, those countries have experienced coups, as in Fiji and Solomon Islands. More common across the Pacific are weak coalition Governments that make economic reform, particularly microeconomic reform, especially difficult. Contributing to the law and order problems in these countries is the large number of unemployed and underemployed youth who threaten person and property.

Education at the primary and secondary levels is poor throughout most Pacific island countries. Commentators lament the dearth of vocational training and the concentration on university training for the elite. Certainly, a better-educated labour force is a prerequisite for a country wishing to attract increased investment and to stimulate economic growth. However, unless other constraints to investment are reduced, the trained labour force in these countries will leave for overseas work and investment in education will not be made in the first place.

**Remittances play a major role  
in development**

Remittances have long been playing a major role in Pacific island economies such as Kiribati, Samoa and Tonga, but their importance and volume have risen dramatically in recent years. Where emigration has been possible, remittances have grown substantially; in Samoa and Tonga, remittances account for up to half of gross national income.

Pacific island countries consider emigration and the possibility of overseas employment for their youth as a safety valve in an environment of continued high fertility rates and stagnant domestic employment opportunities (see box II.2). Many of these countries are exerting pressure on their developed Pacific neighbours, Australia and New Zealand, to increase the intake of migrants from Pacific island countries. However, overseas employment and remittances should not be a reason for Pacific island countries to relax efforts to improve domestic investment environments.

**Box II.2. Lack of economic growth and employment opportunities  
in Pacific island countries**

Unemployment data are unlikely to give a true picture of the extent of unemployment in Pacific island countries. There is little in the way of public unemployment insurance or unemployment benefits. If people become unemployed, their families usually have to support them until they find a job. Thus, there is little incentive for people to notify the authorities that they are unemployed. The high unemployment rates shown for economies such as Cook Islands, the Federated States of Micronesia and Marshall Islands reflect to some extent the desire for employment in the formal sector, while the low unemployment rates for Samoa and Tonga could reflect the lack of interest in finding local jobs because of the high levels of emigration. In contrast, however, because of the large share of the population living in rural areas, it is unlikely that the low unemployment rates for Kiribati and even for Vanuatu truly reflect the numbers searching jobs in the formal sector.

Formal sector jobs account for only a very small share of the total labour force in some Pacific island countries and a much larger proportion in others. In countries where the bulk of the labour force is engaged in semi-subsistence activity, a combination of subsistence activity and cash-earning activity, the labour force may be seen as a pool of potential workers for formal sector employment. In countries where formal sector workers form a large part of the total labour force, this has occurred largely because of the migration of workers in search of employment overseas.

In most Pacific island countries large numbers of people have moved from rural areas to urban centres, partly in search of formal employment.<sup>a</sup> They are also looking for better educational opportunities for their children, improved access to health care and perhaps the attractions of urban life. Because of high

<sup>a</sup> Urban centre populations in most of the Pacific island countries are growing at rapid rates, up to 5-6 per cent a year, as a result of rural-urban migration.

*(Continued overleaf)*

The level of poverty in Samoa and Tonga is not much lower than in the Federated States of Micronesia and the Republic of Marshall Islands, although it is well below the estimates of poverty in Papua New Guinea, Solomon Islands and Vanuatu.

The poverty situation has likely deteriorated considerably in Solomon Islands because of the disastrous impact of the civil unrest on economic activities, which reduced average per capita incomes by about 25 per cent.

Many reasons can be advanced for the low per capita GDP growth rates and the poor investment and employment performance of Pacific island countries. Overall, the poor investment environment is the most obvious proximate cause.

While data on investment, particularly private investment, is almost non-existent for Pacific island countries, comparative data are available on the difficulties faced by those attempting to establish businesses. The Doing Business study of the World Bank ranks countries in terms of the difficulties in starting a business, registering property, getting credit, protecting investors, trading across borders, enforcing contracts and similar activities. Samoa, which has done the most among Pacific island countries to create a favourable environment for domestic and foreign investment, performs most poorly in terms of the bureaucratic steps involved in starting a business.

Insecurity of access to land is a problem common to most Pacific island countries, although to varying degrees. Most land is held under some form of customary tenure, rather than individual tenure rights that can provide reliable collateral for commercial borrowing. For example, Fiji has developed its sugar industry on the basis of long-term individual leasehold of land owned under "customary" communal tenure by land-owning groups; however, the conditions on the transfer of such leases erode the land's value as collateral.

At the other extreme is Papua New Guinea, where even the little land that is held under freehold title is sometimes under threat because of claims over it by former landowners. Also, the widespread nature of claims for in-

creased compensation from landowners when projects on leased land are seen to do well has created a climate of pervasive uncertainty.

Restrictive policies against trade in goods and services are another reflection of the antipathy towards open markets in Pacific island countries. Because of remoteness from major markets and the small size of domestic markets, Pacific island countries face very high costs in participating in international trade, except in mining projects where production costs may be internationally competitive. If these countries are to improve their economic performance, they have to take advantage of the economies of scale in trading with the rest of the world. Moreover, to compensate for the high costs of trade, they have to export products and services the prices for which would more than compensate for their high costs. This means they have to develop differentiated products in niche markets. They cannot depend on the export of basic primary commodities, for which they are at a cost disadvantage in relation to other producing countries. By placing barriers against the import of goods and services and capital, they increase the costs of producing for export markets by raising the costs of inputs. They should have completely open markets for trade, investment, labour and technology in order to maximize the opportunities for developing the differentiated products they need to export.

***Pacific island countries need  
better infrastructure***

Unreliable and high-cost utilities and poor transport infrastructure are other widespread problems in Pacific island countries. The rapid decline in the cost of telecommunications globally has accelerated the international fragmentation of firms, benefiting developing countries by offering new investment opportunities and jobs. The Pacific island countries have, for the most part, shut themselves off from this global phenomenon by adopting monopoly positions, often public-private joint venture monopolies, that result in internationally uncompetitive telecommunications costs. Pacific island countries have generally been unwilling to introduce competition into their utility industries, and where they have made markets more contestable, the countries concerned have been slow to adopt effective regulatory arrangements.

*(Continued from preceding page)*

fertility and high population growth rates, per capita agricultural production in Pacific island countries appears to be declining and it is probably becoming harder to maintain livelihoods in rural areas.<sup>b</sup> Because of the poor opportunities for formal employment, many rural migrants have not found jobs in the formal sector and therefore have to sustain themselves and their families with informal sector activity. Underemployment is a much more relevant issue for the Pacific island countries than unemployment.

Economies such as Cook Islands, the Federated States of Micronesia, Marshall Islands, Samoa and Tonga have relatively easy access to emigration, which reduces the working-age population and therefore increases formal sector employment as a percentage of the working-age population.

In the Pacific island countries that do not have such easy access to emigration, such as Papua New Guinea, Solomon Islands and Vanuatu, the bulk of the population (75 per cent or more) live in rural areas and earn their livelihood from mixed subsistence cash-crop activity. Most of those in rural areas are unskilled and would have little chance of migrating even if easier access to metropolitan countries were provided.

The Governments of Pacific island countries must improve the investment climate if they are to see increases in formal sector employment and reductions in unemployment and underemployment. Otherwise, workers will continue to leave for overseas employment or remain underemployed in the rural sector; another alternative is that they will continue to migrate to urban centres, where they will have to support themselves through legal or illegal informal activity.

<sup>b</sup> Mahendra, Reddy and Ron C. Duncan, "Causes of decline in Pacific island agriculture", (mimeo) (Suva, University of South Pacific, 2005); Marin Yari and Ron C. Duncan, "Food security: development issue for Pacific island countries", *Bulletin on Asia-Pacific Perspectives 2004/05* (United Nations publication Sales No. E.04.II.F.47), pp. 97-116.

Moreover, in the larger countries such as Papua New Guinea, Solomon Islands and Vanuatu, emigration and remittances cannot be expected to become as important as they are in the smaller and atoll economies.

For land-rich countries such as Fiji, Papua New Guinea, Solomon Islands and Vanuatu, where most of the populations continue to live and work in the rural sector, the development strategy should focus on the rural sector. Agricultural productivity has to increase so that rural incomes and welfare improve, helping to spur growth in rural services. Growth in the urban manufacturing and services sectors will create employment for labour that will be able to move out of the rural sector as its productivity improves. Increased research is needed to provide improved and new varieties of crops and improved farming systems. Improved access to markets for rural produce will demand improved infrastructure and better market information.

## **South and South-West Asia**

### **Overview**

#### ***Despite high oil prices, the momentum of growth was maintained ...***

Despite high oil prices, the South and South-West Asian subregion maintained its growth momentum in 2005. The continuing reforms and structural changes of the last few years are bearing fruit. The subregion's increasing integration into an expanding global economy, rising consumer spending and generally accommodative policies are also helping to foster economic growth. Both India and Pakistan have achieved impressive growth rates in recent years. On the basis of sustained high economic growth, India is increasingly becoming a leading contributor to global growth. A strong earthquake in October 2005 resulted in massive loss of human life and damage to property and infrastructure in Pakistan, but the impact on GDP