

# Structural Transformation in Graduating Pacific Least Developed Countries (LDCs)

---

Daniel Gay

**Disclaimer:** The views expressed through the Macroeconomic Policy and Financing for Development (MPFD) Working Paper Series should not be reported as representing the views of the United Nations, but as views of the author(s). Working Papers describe research in progress by the author(s) and are published to elicit comments for further debate. They are issued without formal editing. The shaded areas of the map indicate ESCAP members and associate members. The designations employed and the presentation of material on this map do not imply the expression of any opinion whatsoever on the part of the Secretariat of the United Nations concerning the legal status of any country, territory, city or area or of its authorities, or concerning the delimitation of its frontiers or boundaries. The United Nations bears no responsibility for the availability or functioning of URLs. Opinions, figures and estimates set forth in this publication are the responsibility of the authors and should not necessarily be considered as reflecting the views or carrying the endorsement of the United Nations. Any errors are the responsibility of the authors. Mention of firm names and commercial products does not imply the endorsement of the United Nations.

**Please cite this paper as:** Gay, Daniel (2021). Structural transformation in graduating Pacific least developed countries (LDCs). MPFD Working Paper Series, No. ESCAP / 1-WP / 2. Bangkok: ESCAP.

Available at: <http://www.unescap.org/kp>

Tracking number: ESCAP / 1-WP / 2

**About the author:** Daniel Gay, adviser on the least developed and developing countries to the United Nations and the Organisation for Economic Co-operation and Development (OECD).

This paper has been prepared at the request of the United Nations Economic and Social Commission for Asia and the Pacific (ESCAP), in support of the project “Strengthening capacities of Asia-Pacific LDCs, with a particular focus on SIDS, to progress towards the SDGs through structural transformation while dealing with the implications of graduating from the LDC category”. It has benefited from the comments and suggestions made by Yusuke Tateno.

# Table of Contents

Abstract.....	5
1. Background and introduction.....	9
2. Key development challenges.....	11
2.1. Unique characteristics .....	11
2.2. Economic growth .....	13
2.3. Structural transformation .....	15
2.4. Trade .....	16
2.5. Transfers and government expenditure.....	20
2.6. Implications .....	22
3. Impact of LDC graduation.....	24
3.1. Official development assistance .....	25
3.2. Trade.....	27
3.3. Other international support measures .....	28
4. Lessons from graduating and graduated countries .....	30
4.1. Vanuatu .....	30
4.2. Samoa .....	30
4.3. The Maldives .....	33
4.4. Cabo Verde .....	35
5. Possible future strategies, policies and sectors.....	36
5.1. Linkages .....	37
5.2. Institutional arrangements .....	38
5.3. New technologies .....	39
6. Conclusions.....	43
References .....	45

# Abstract

The Pacific least developed countries (LDCs) are not industrialising. Most of the shift in economic output over the past 20 years has been toward services and away from agriculture. Almost all new jobs created have been in services. Economic progress, mostly via tourism, is vulnerable to global volatility such as the COVID-19 pandemic. Services are inherently less productive, as is agriculture. Trade liberalization has

underdelivered and exports in three of the four regional LDCs have become less diversified since 2000. The traditional conception of structural transformation therefore appears inappropriate. This implies a need to think creatively about analysis and policies. New, context-sensitive ways of thinking about economic transformation must be conceptualized and enacted to promote the next phase of economic development.

**Keywords:** structural transformation, LDC graduation, Pacific countries, least developed countries.

**JEL classification numbers:** O11, O14, O56, P41, P45.

Some of the Pacific LDCs' special characteristics are well-known, but the extent of these countries' smallness, isolation and fragmentation is sometimes underappreciated or misunderstood. The Pacific LDCs fall within the world's smallest 15 economies. Collectively, at US\$2.4 billion, the combined GDP of all four Pacific LDCs (Kiribati, Solomon Islands, Tuvalu and Vanuatu) put together would be around the same size as that of the Central African Republic and slightly smaller than Lesotho, ranking around 168th in the world.<sup>1</sup> The four Pacific LDCs have a combined population of only 1.1 million. Kiribati has the world's 12<sup>th</sup>-largest exclusive economic zone, and all the Pacific LDCs feature in the top-40 EEZs by size. No Pacific island capital is within 2,000km of Sydney or Auckland, and shipping is expensive, infrequent and irregular. Such a combination of challenges is unique in the world economy, inhibiting scale economies, increasing trade costs, limiting the possibilities for market-led development and ultimately necessitating a strong role for the state. Average government expenditure has historically formed the equivalent of around eight-tenths of GDP across the four countries – although it is much higher in Kiribati and Tuvalu than in Solomon Islands and Vanuatu.

Thinking about structural transformation should therefore acknowledge the critical importance of transfers, non-market transactions, aid, state service provision

and government backstopping. Tourism, agriculture and fisheries should not be underestimated. Backward and forward linkages between these sectors should be improved. But the economy in recent decades has been underpinned by non-commercial activities. The special characteristics of Pacific LDCs will be extremely difficult to overcome through broad-based, spontaneous market-driven growth – and this reality reinforces the need for a prominent role for government and development cooperation. Economic strategy must take this into account.

LDC graduation is unlikely to make much material difference to the economies of any Pacific Island LDC other than Solomon Islands, which has signed an interim Economic Partnership Agreement with the European Union to compensate for the loss of fisheries preferences after losing access to the Everything But Arms (EBA) scheme. This lack of impact is largely because international support for LDCs is in areas which are of limited benefit to the Pacific islands or because support measures are delivered irrespective of LDC status. It is also because the private sector in each country is so small, and therefore the impact of economic incentives like goods market access is minimal. Goods exports are low and often diminishing, and official development assistance (ODA) is stable or mostly increasing despite graduation. Aid to Samoa has increased steadily in

<sup>1</sup> Vanuatu graduated from the LDC category in December 2020 but for the purposes of the analysis is still considered alongside the other three LDCs.

the years after graduation in 2014, a progressively higher proportion as grants rather than loans. Any reluctance to graduate on the part of governments is largely an act of rational symbolism. It is a defensive insurance strategy aimed at actively maintaining sources of foreign exchange. In effect governments do not want the international community to believe that the development push has ended. Continued LDC status sends a signal of these countries' need for continued international development support. It also enables them to collaborate with other, larger countries, which is important in mitigating the impact of climate breakdown.

[The inappropriateness of conventional structural transformation theory means that horizontal policies aimed at altering economic incentives across the entire economy will continue to fail or fall short of their objectives.](#) Several structural adjustment initiatives or broad national private-sector initiatives in recent decades have not succeeded or have failed to deliver promised outcomes. Attempting to further government presence in the economy will be counterproductive and will reduce aggregate demand, or will not work because there is insufficient management expertise, competition and market size. The increase in external market access due to trade preferences has disappointed. Traditional trade agreements with minority trading partners such as the European Union or United States are likely to have a limited impact. Most tariffs in domestic and foreign markets are already low, and the domestic supply response to international conditions is highly inflexible. Non-market sources of economic activity will remain unavoidable, and it will be important to accept this reality, as well as a renewed

focus on niche areas of private-sector growth.

[The international community, trade and development partners must take these realities into account.](#) The existential threat posed to Pacific LDCs by climate change implies that the international community has an obligation to help, via carbon pricing and energy subsidy reforms, promoting low-carbon, climate-resilient infrastructure investments, and improving transboundary climate data collection. The international community must also assist with climate adaptation and mitigation through disaster risk transfer and financing. In effect the sums of aid invested are also relatively good 'value' given the size of the region and its environmental significance. ODA and aid should remain critical to the economic landscape, even after graduation. Services, particularly local content-intensive tourism, will remain important. Capacity-building and technical assistance may be directed more toward infrastructure and new, specific technologies in particular supply chains, rather than horizontal, cross-cutting reforms aimed at transforming the entire business environment.

[The blue economy and sustainable tourism have considerable future potential.](#) Resilience-building is an urgent priority, given that export concentration has increased and that the Pacific island countries are so vulnerable to increasingly regular external shocks from the world economy. In the promotion of private-sector activity, linkages policies are important. Administrative institutional capacity assumes particular importance in countries where government takes up such a large part of the economy and major aid inflows have to be managed well. Appropriate institutional arrangements should also be considered,

such as cross-ministerial entities tasked with promoting development. Capacity development activities should also take into account the need to allow governments to make mistakes, so as to ensure ownership.

New, digitally technology-facilitated production and services may offer promising niches in years to come even if they are unlikely to become a mainstay of the economy or offer major prospects for structural transformation. The 'virtual' delivery of services may be less vulnerable to crises such as the COVID-19 pandemic, and it is even possible that

new, 'fourth-industrial revolution' technologies might improve resilience in the face of volatility in foreign markets and promote selected import substitution. Examples could include business process outsourcing (BPO), drone technology, 3D printing, microwork and virtual tours. Relevant policies include an increased emphasis on education and training, particularly in areas relevant to the digital economy; appropriate laws and regulations; strong, affordable infrastructure; and a working environment attractive to local people working in technology, as well as foreign investors and distance workers.

# 1. Background and introduction

Three of the Pacific small island developing States (SIDS) are LDCs and one, Vanuatu, graduated from the category in December 2020.<sup>2</sup> They experience major development challenges associated with their small size and remoteness from major markets, compounded by inadequate domestic infrastructure. Consequently, the Pacific LDCs continue to face structural bottlenecks that hamper the development of adequate productive capacities, making sustainable development difficult and expensive. Solomon Islands is scheduled to graduate in December 2024, while Kiribati and Tuvalu have met the criteria at several consecutive reviews of the CDP.

The Pacific LDCs will need to adjust their policies and development plans to prepare and implement an adequate transition strategy that will mitigate any potentially adverse impacts of graduation, even if these are limited, and to ensure a smooth transition that allows for further progress. Whilst graduation is likely to have little immediate material impact, it will remain important regardless for donors and national governments to put in place policies and strategies to mitigate volatility and vulnerability and to sustain progress in the years thereafter.

A shift towards higher productivity services-oriented activities will be important. For example, the *Asia-Pacific Countries with Special Needs Development Report: Leveraging Ocean Resources for Sustainable Development of Small Island Developing States* argues that this objective can be achieved through the blue economy and the development of a particular type of “local content intensive” tourism.

The situation has been further exacerbated by the pandemic and the associated economic downturns. The impact of COVID-19 has devastated the tourism sector on which most of these countries rely, through a sharp decline of international inbound visitors due to quarantine measures, travel bans and border closures both in tourist source countries and destinations. International tourist arrivals globally declined by 74 per cent in 2020 according to the World Tourism Organisation. In some Pacific LDCs this resulted in double-digit recession.

Resource mobilization in such a vulnerable environment is of major importance for the Pacific LDCs, especially for Kiribati and Tuvalu where structural transformation toward completely 'self-supporting' economic

<sup>2</sup> For the purposes of the analysis Vanuatu is still considered alongside the other three LDCs.

circumstances is unlikely in the near term. The role of international community and development cooperation, particularly

through official development assistance (ODA) and other forms of assistance, remains critical over the long term.

## 2. Key development challenges

### 2.1. UNIQUE CHARACTERISTICS

The Pacific LDCs feature a combination of special characteristics. These include extremely small size and associated lack of economies of scale, fragmentation, susceptibility to natural disasters, weak infrastructure and distance from major markets. Such challenges are in some cases so extreme that they constrain transformation. By population the Pacific LDCs are among the world's most diminutive. Out of 233 countries and territories Kiribati ranks 193<sup>rd</sup>, Solomon Islands 166<sup>th</sup>, Tuvalu 224<sup>th</sup> and Vanuatu 181<sup>st</sup>. The Pacific LDCs all fall within the smallest 15 economies in the world. According to the measure used in table 1 Tuvalu has the

smallest economy of any independent country, with a GDP of US\$46 million, around the same size as the US city of Albuquerque, or Edinburgh, Scotland's capital city. Collectively, with a GDP of US\$2.4 billion, the economy of all the Pacific LDCs put together would be around the same size as the economy of Central African Republic and slightly smaller than Lesotho, ranking around 168<sup>th</sup> in the world. Their collective population is only 1.1 million. The four countries also have land areas that are among the smallest in the world. Solomon Islands has the largest land area, at 27,986 km<sup>2</sup>, still making it the 139<sup>th</sup>-largest country or territory in the world.

**Table 1.** Pacific LDCs by population, GDP and geographic area

	Population*		GDP**		Exclusive economic zone (EEZ)***		Land area	
	Size	World rank/ 233	Size, US\$ million	World rank/ 193	Size, km <sup>2</sup>	World rank/ 152	Size, km <sup>2</sup>	World rank/ 194
<b>Kiribati</b>	117,606	193	189	191	3,441,810	12	811	171
<b>Solomon Islands</b>	669,823	166	1,271	178	1,589,477	22	27,986	139
<b>Tuvalu</b>	11,646	224	46	193	749,790	38	26	191
<b>Vanuatu</b>	299,882	181	889	182	663,251	39	12,189	157

Sources: \* Population: United Nations Statistics Division, 2019. NB. Includes all countries and territories.

\*\* GDP: United Nations Statistics Division, 2019.

\*\*\* EEZ: Sea Around Us. Available from [www.seaaroundus.org/data/#/eez](http://www.seaaroundus.org/data/#/eez), based on 152 known countries with an EEZ.

These countries are, however, also among the world's largest by Exclusive Economic Zone (EEZ). Kiribati, for example, covers the 12<sup>th</sup> biggest sea area of any country, 3.4 million km<sup>2</sup>. By comparison this is bigger than India's total land and water area, and considerably larger than the Caribbean Sea. Because the islands' small populations are spread across such a wide area the workforce is mostly very fragmented, raising the cost of domestic transport and limiting economies of scale. In Kiribati, an expanse of 33 atolls and coral islands, only one, Tarawa, has more than a few thousand people. These countries are so spread out that it is almost impossible to build up a producer or consumer base big enough to allow marginal costs for most products to fall, and isolation means that trade costs are extremely high, making import and export prohibitively costly. Table 2 shows that no Pacific island capital is within 2,000 km of Sydney or Auckland. Distance is compounded by the fact that shipping is broadly infrequent and sometimes irregular and air freight costly and infrequent. Trade costs can be up to double those in comparable or competitor countries.

All of the Pacific island LDCs are frequently at risk of natural disasters like cyclones and

flooding, which is a further need for government and other forms of support. Vanuatu is the country most at risk of natural disasters in the world, as measured by several international sources including the World Risk Report (ReliefWeb, 2020). Solomon Islands ranks 5<sup>th</sup> and Kiribati 18<sup>th</sup>.<sup>3</sup> Cyclone Pam, which led to a delay in Vanuatu's LDC graduation, affected more than 70 per cent of the population and required extensive development partner support, including US\$23.8 million from the International Monetary Fund. Vanuatu also faced volcanic eruptions on the islands of Ambae and Ambrym in 2018, leading to major expense as inhabitants were moved off the islands.

Nevertheless, Vanuatu has the lowest score on the Committee for Development Policy (CDP)'s Economic Vulnerability Index (EVI),<sup>4</sup> meaning that it is least vulnerable of the four countries. It has also made some advance in this regard over the last 20 years. The main drivers of change in Vanuatu were export concentration and export instability, the sub-index value for each of which experienced a near 50 per cent improvement over the 20-year period. The sub-index measuring the share of agriculture, forestry and fisheries in GDP improved by 25

**Table 2:** Distance to major export destinations

Country	Distance to Sydney, km	Distance to Auckland, km
Kiribati	4,536	4,258
Solomon Islands	2,858	3,389
Tuvalu	4,015	3,179
Vanuatu	2,472	2,216

Source: Google (distances from respective capitals).

3 Tuvalu was not included due to lack of data.

4 The EVI consists of the following sub-indices: Share of agriculture, fisheries and forestry in GDP; Remoteness and landlockedness; Export concentration; Export instability;

Share of population living in low elevated coastal zones; Population living in drylands; Agricultural instability; Victims of disasters. More information can be found at: [www.un.org/development/desa/dpad/least-developed-country-category/ldc-data-retrieval.html](http://www.un.org/development/desa/dpad/least-developed-country-category/ldc-data-retrieval.html).

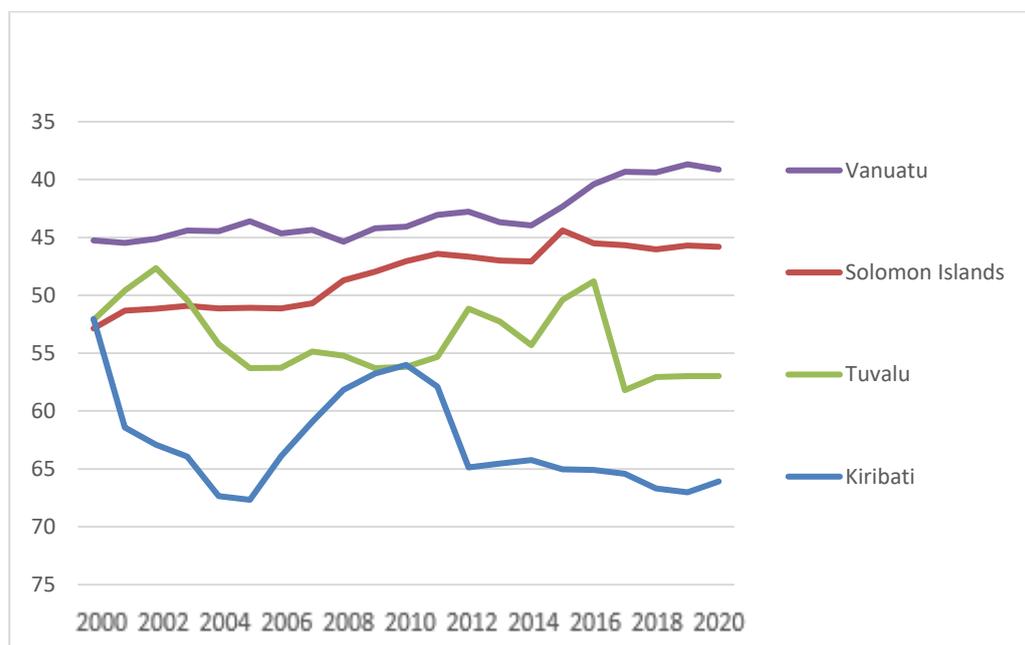
per cent. No other component of the EVI changed much over the period. Solomon Islands also made progress on the EVI from 2000 to 2015, mostly on the sub-indices measuring the share of agriculture, forestry and fisheries in GDP, export instability and agricultural instability. The export concentration sub-index worsened by 37 per cent between 2000 and 2020, however. Notably Tuvalu and Kiribati have become more vulnerable over the period according to the EVI, and as shown in figure 1. Of the four Pacific LDCs only, Vanuatu experienced a reduction in vulnerability between the 2015 and 2018 triennial reviews. The three other Pacific LDCs became *more* vulnerable (17 of the other 47 LDCs worldwide also became more vulnerable over the period). Other historic

shocks, not all of which are fully captured in the EVI, include fluctuations in international trade and financial markets, commodity cycles, climate breakdown, and the ongoing pandemic.

## 2.2. ECONOMIC GROWTH

Partly as a result of these challenges, performance on economic growth per capita in most of the Pacific LDCs has been mixed over the past 20 years, starting from a higher level but growing more slowly than the LDC average. Kiribati and Vanuatu experienced a decline in recent years. The COVID-19 pandemic devastated growth in 2020, disrupting domestic activity and tourism, lowering exports and reducing remittances.

Figure 1: Pacific LDCs Economic Vulnerability Index (EVI), 2000-2020



Source: CDP.

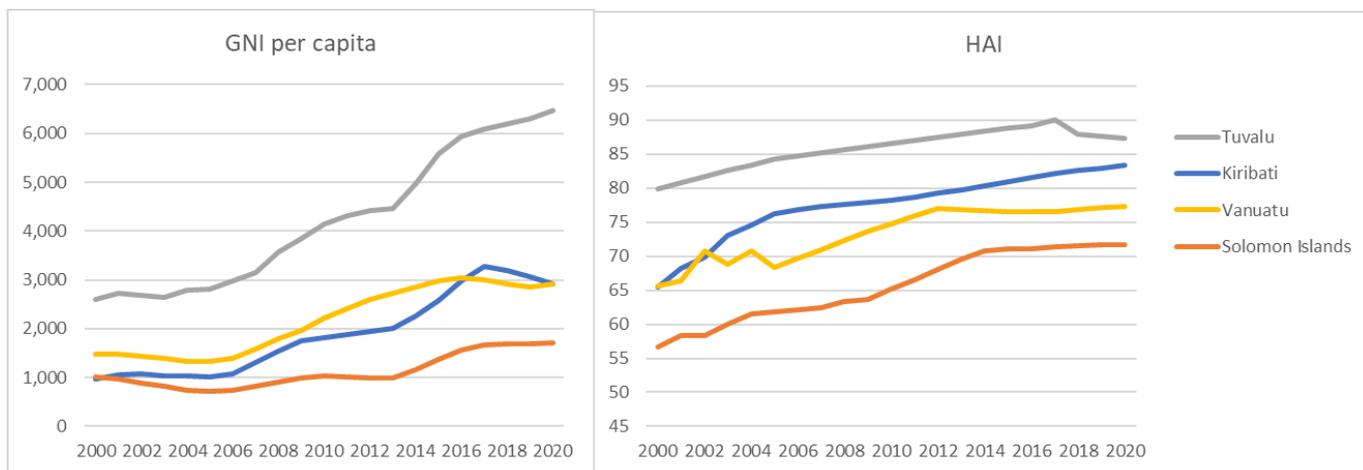
Note: Y-axis inverted. The lower the value, the less vulnerable, and vice versa.

Gross national income (GNI)<sup>5</sup> per capita in Tuvalu, Vanuatu and Kiribati roughly doubled between 2001 and 2019. Tuvalu passed into the upper-middle income category around a decade ago and now has a GNI per capita of US\$6,478 using the World Bank Atlas method adjusted for purchasing power parity. Income per head in Solomon Islands stagnated for nearly a decade following the civil unrest, locally referred to as the ‘Tensions’ in 2000, before rising quickly thereafter, but to a much lower level than in the other regional LDCs. Per capita income growth in every Pacific island LDC started and ended the period higher than other LDCs, although the LDC group on average made bigger proportionate gains, more than tripling over the period.

Whilst the Pacific Island LDC economies have grown on a per capita basis, helping make them eligible for LDC graduation, progress has not been as rapid as several other dynamic

developing regions either recently or historically. Conventional structural transformation has not driven growth, and many commentators and Pacific government officials have expressed dissatisfaction. There has been some disconnect between material gains and human assets, especially for the worst-off. Whilst the region started from a reasonably high level, and comparisons should be made with caution, especially since marginal gains become more difficult from an already high level, the average increase in the CDP Human Assets Index (HAI) over the last two decades was 20 per cent, compared with 130 per cent for GNI per capita. HAI improvements seem to be levelling off as time goes on, something which is particularly worrying in the two Melanesian countries, which lag Tuvalu and Kiribati.

**Figure 2:** Gross national income (GNI) per capita and Human Assets Index (HAI), 2000-2020



Source: CDP.

5 GNI calculated by the CDP Secretariat, based on United Nations Statistics Division National Accounts Main Aggregates Database (AMA) and the World Bank Atlas methodology for converting local currencies into US\$. Indicator values are three-year averages, e.g. the value for 2020 refers to the 2016-2018 average. The Human Assets

Index is composed of the under-five mortality rate; maternal mortality ratio; prevalence of stunting; gross secondary school enrolment ratio; adult literacy rate; and the gender parity index for gross secondary school enrolment.

The benefits from growth have largely accrued to people living in or near urban areas, often connected to tourism, hospitality or construction, raising questions over whether the aggregate economic gains benefit all of the population. Inequality remains very high, with a relatively rich urban middle class in Vanuatu and Solomon Islands enjoying many of the economic gains – particularly from tourism growth -- and an increasing urban poor in both countries, as well as Kiribati, remaining shut out of the apparent increase in material welfare. In Melanesia the lives of many subsistence or semi-subsistence rural dwellers in islands away from those of the capital remain largely unchanged, as is the case on islands away from Kiribati's capital south Tarawa, and to a lesser extent in Tuvalu.

### 2.3. STRUCTURAL TRANSFORMATION

In most developing regions and in LDCs the classical theory of progressive structural transformation is usually held to apply (e.g. Chenery, 1960, 1975, 1979; Hirschman, 1958; Lewis, 1954, 1979; Kaldor, 1957, 1978; Myrdal, 1957a, 1957b, 1968). Under the traditional structuralist theory, economic development involves the movement of labour and capital from low productivity activities, usually agriculture, to high-productivity areas like manufacturing, which has a unique role due to its potential for returns to scale. Production can also become more efficient within sectors, and government can play a role in stimulating the reallocation of production from low to high-returns activities. The importance of manufacturing growth lies in its ability to generate mass, unskilled employment which provides new jobs for subsistence or low-wage agricultural workers. Economic development consists of the process of increasing the share of manufacturing in economic output and increasing value-addition. In turn this raises living standards,

facilitating human development gains that act in a virtuous circle of broad-based improvement. Whilst there is debate about the practical applicability of such theories in the modern era, and the field is large and hotly contested, the East Asian experience is, by some accounts, held to confirm the broad perspective of scholars within this tradition (e.g. Schlogl and Sumner, 2020).<sup>6</sup>

Practical experience reveals the Pacific LDC experience to be different. Over the last two decades and more, despite the efforts of government and international entities, almost no manufacturing growth has taken place in the region's LDCs. What structural transformation has occurred has largely been in the direction of services, mostly tourism. Tourism accounts for more than a third of GDP in Vanuatu. It employs over 20 per cent of Solomon Islands' labour force, over 30 per cent of that of Kiribati and over 60 per cent of that of Vanuatu. Subsistence or semi-subsistence agriculture has remained important for many peoples' livelihoods, principally in Melanesia. Job creation and wage growth have been disappointing. Domestic production linkages also remain weak, particularly between agriculture and tourism. Tourism in the Pacific LDCs is an enclave with few linkages to local economies, resulting in high leakages and limited opportunities for learning.

A shift from agriculture to services is broadly considered less conducive to development than manufacturing-based structural transformation because services are inherently less productive. Services can inherently only deliver a certain level of productivity, or output per unit, beyond which further efficiencies are unattainable (e.g. Baumol and Bowen, 1966). A tour group, for example, can only reach a certain size – perhaps 20-30 people per guide – before it becomes unviable. The gains from mechanisation can, in contrast, potentially be extremely high as marginal unit costs fall toward zero. With a high level of automation, a

6 A separate question for other non-Pacific contexts is the extent to which conventional structural transformation is indeed occurring, and whether high-employment

industrialisation is still possible in an era of increased mechanisation.

machine can manufacture many more products per worker per hour. The rise in the informal services sector often experienced under this type of structural transformation is not only less productive but reduces resources available for redistributive policies and can end up locking workers into poverty. Women are more likely to be employed in the informal sector, worsening gender inequality.

Figure 3 shows that in Solomon Islands and Vanuatu, services employment has grown significantly over the past 20 years, almost entirely at the expense of agriculture. Growth in industrial employment in Vanuatu was close to zero. In Solomon Islands the employment share of industry grew slightly, from 7.2 per cent to 9.6 per cent. Agriculture employs an estimated 55 per cent of the population in Vanuatu versus 37 per cent in Solomon Islands and the shares of services employment are almost exactly inverse in either country. The LDC group, by comparison, has seen a slight, if still disappointing, increase in industrial employment.<sup>7</sup>

The composition of GDP shows a similar picture. All four economies remain services-orientated, with the agricultural and fisheries sectors comprising 23.5 per cent of GDP on average in 2018. The average share of manufacturing in GDP in the four countries was 4.4 per cent in 2018, slightly lower than in 2000. In contrast the LDC group as a whole experienced some change in economic structure, with a gradual reduction in the contribution of agriculture and a small upturn in industry. Figure 4, showing the composition of GDP by the main International Standard of Industrial Classification (ISIC) codes, confirms that there was very little structural change in Tuvalu, apart from a slight increase in construction. In Solomon Islands, after a turbulent period in the early 2000s, wholesale and retail slowly increased while agriculture,

forestry and fishing declined, as did 'other activities'. In Vanuatu there was very little discernible trend other than a slight increase in wholesale and retail and a small reduction in agriculture, forestry and fishing. In Kiribati the only real notable trend was that the share accounted for by 'other activities' increased over the period.

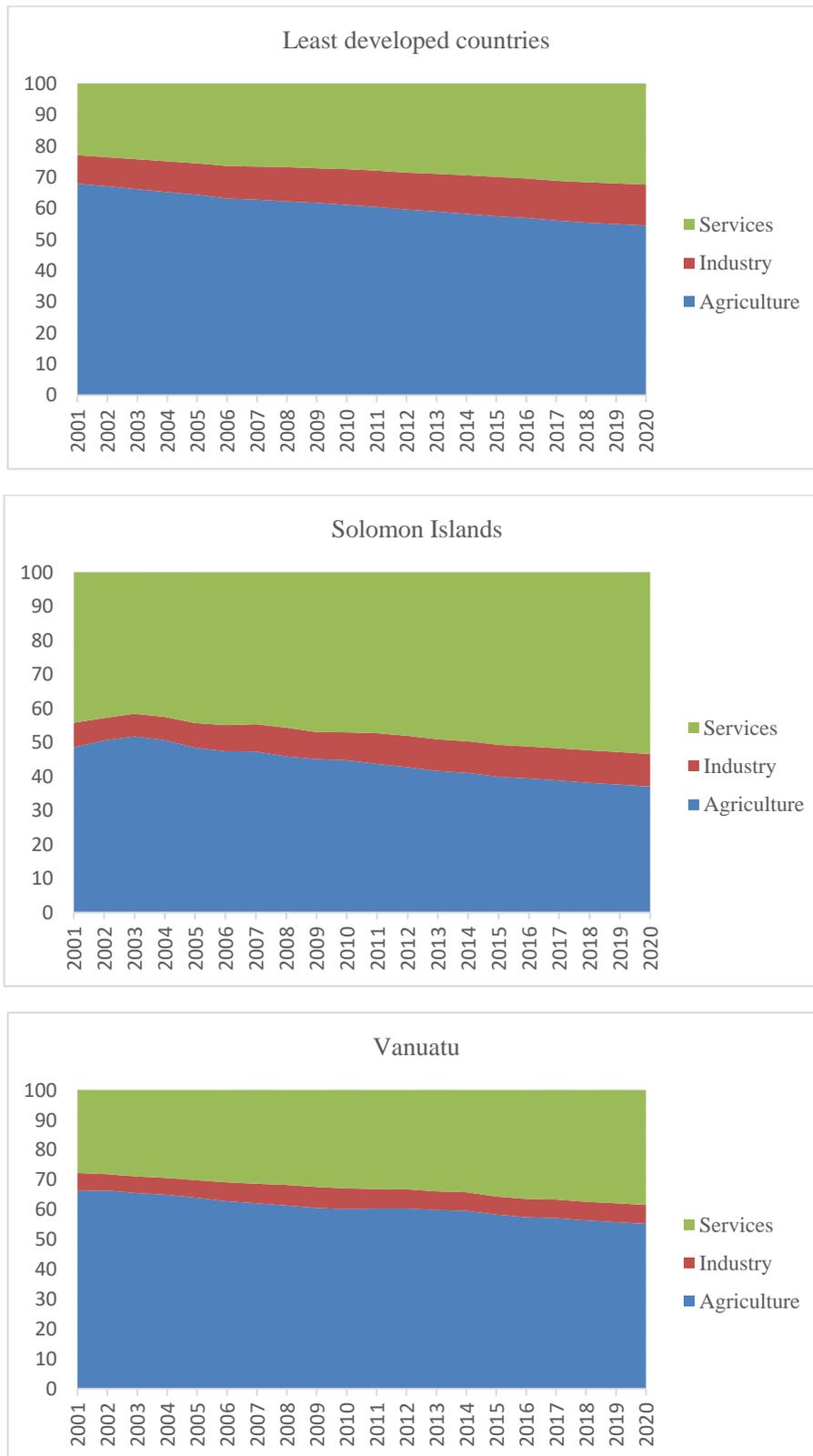
## 2.4. TRADE

Under some conventional theories, goods trade diversification is expected as developing economies industrialise and begin to develop product sophistication, becoming more closely integrated with world markets. Trade growth can be seen as a dimension of structural transformation. Global competition and exposure to market prices undistorted by tariffs, quotas or subsidies, is supposed to stimulate competition and the improvement of production.

In the Pacific islands, however, the opposite has occurred. Goods trade has mostly become less diversified and stayed small. Even the rise in tourism cannot be considered a major source of diversification. It has bypassed Tuvalu and Kiribati, and as the current crisis shows, the sector is highly vulnerable to international trends. In goods trade, increased external market access via multilateral and bilateral agreements such as the European Union Everything But Arms (EBA) scheme in place since 2001 and the South Pacific Area Regional Trade and Economic Cooperation (SPARTECA), originally signed in 1981, has not led to the desired dynamic gains. If anything, traditional preference-dependent colonial and regional relationships, under which such preference schemes were put in place, have gradually eroded. A higher proportion of goods trade, mostly import but some export, has taken place with China and

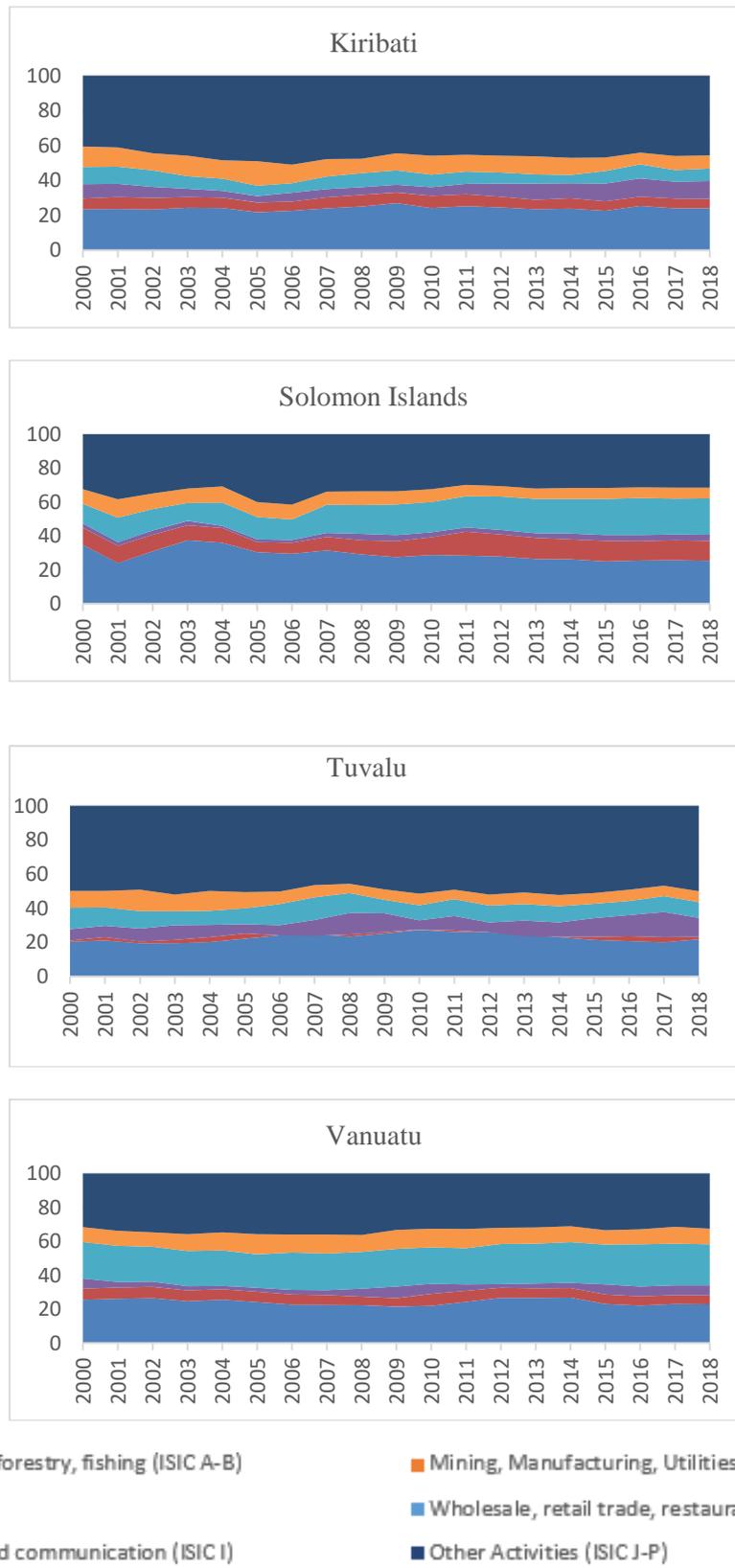
<sup>7</sup> There are no comparable World Bank data on Kiribati and Tuvalu.

Figure 3: Sectoral employment as a percentage of total employment



Source: World Bank.

Figure 4: Pacific LDCs, sectoral distribution of GDP, per cent



Source: United Nations Statistics Division.

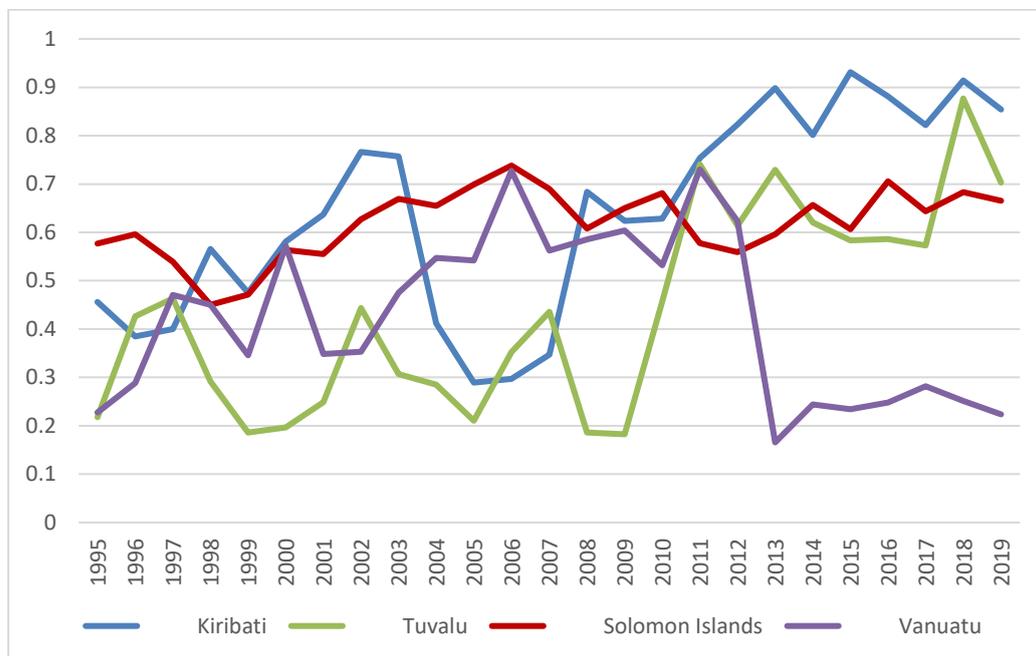
the rest of East Asia. On the export side this has mostly been in unprocessed commodities such as tropical hardwood (Solomon Islands), fish, kava (Vanuatu) and copra. Goods trade has also stagnated as a proportion of GDP in some countries, such as Vanuatu, where it comprised only around 14 per cent of GDP in 2018, little higher than the 10 per cent seen in 2000. In Solomon Islands the ratio increased to 47 per cent by 2012 before declining to 32 per cent in 2019, mostly the result of trends in the logging sector.

Figure 5 shows that exports have become progressively more concentrated by product in Kiribati, Tuvalu and Solomon Islands since 1995, with no apparent improvement as a result of trade liberalisation or the new trade agreements put in place from the 1990s to the

2000s. Vanuatu's export diversification appears to have increased dramatically after 2011, probably because of the relaxation of overseas restrictions on kava exports.

The lack of export diversification – indeed increased product concentration – can also be seen in the number of products exported at the three-digit Standard International Trade Classification (SITC) level. As of 2018 Vanuatu and Solomon Islands exported only 37 products, although each saw fast growth after around 2009-10, when a divergence with Tuvalu and Kiribati occurred. These latter countries only export five and four products respectively, much lower than in 1995. This is one area in which the divide between the Melanesian and the other two Pacific LDCs is revealed to be most stark.

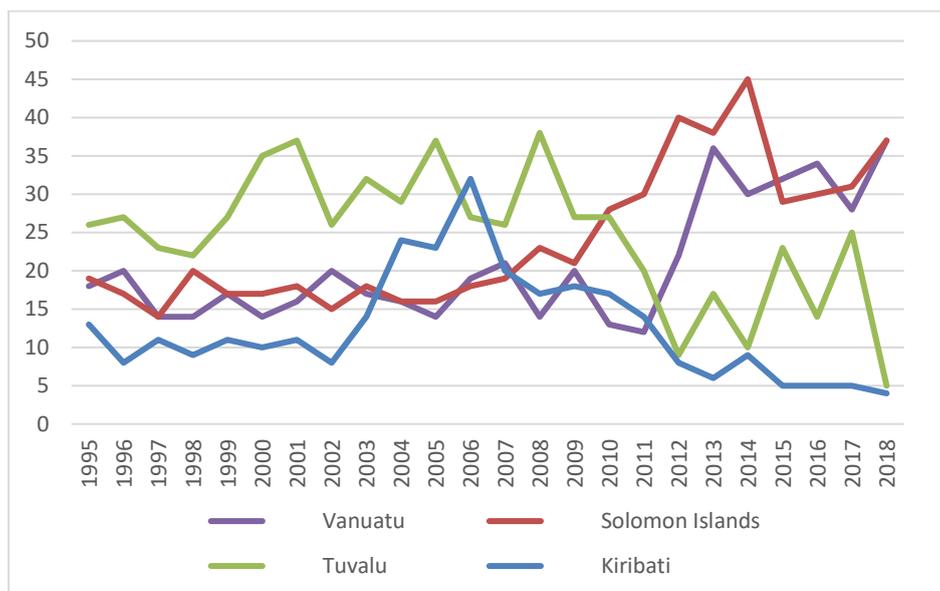
Figure 5: UNCTAD export product concentration index, 1995-2019<sup>a</sup>



Source: UNCTADStat.

Note: <sup>a</sup> This index measures, for each country, concentration of goods exported (services are excluded). The closer the score to 1, the more concentrated. It reveals whether a large share of a country's exports is accounted for by a small number of commodities or, on the contrary, if exports are well distributed among many products. It can be used as a warning sign of low export diversification, with ensuing economic vulnerabilities. Its evolution through time can also provide signals about the changing productive structure of a country.

Figure 6: Number of products exported at the three-digit SITC level, 1995-2018



Source: UNCTADStat.

## 2.5. TRANSFERS AND GOVERNMENT EXPENDITURE

It is well-known that the Pacific Island LDCs are highly transfer-dependent, with remittances, aid, and income from trust funds (in the case of Kiribati and Tuvalu) forming a large proportion of government income and economic output. Net secondary income (net current transfers from abroad) has formed a volatile but increasing and latterly very large share of the economy in Kiribati, reaching a sum worth as much as 36 per cent of GDP in 2018.<sup>8</sup> World Bank data for the other countries is incomplete or missing, but figure 7 shows that net transfers in Solomon Islands peaked at a quarter of GDP in 2008 before declining somewhat. In Tuvalu remittances from seafarers form around 10 per cent of GDP, although are in decline. Vanuatu is less transfer-dependent although remittances have become increasingly important in recent years with the regional labour mobility scheme.

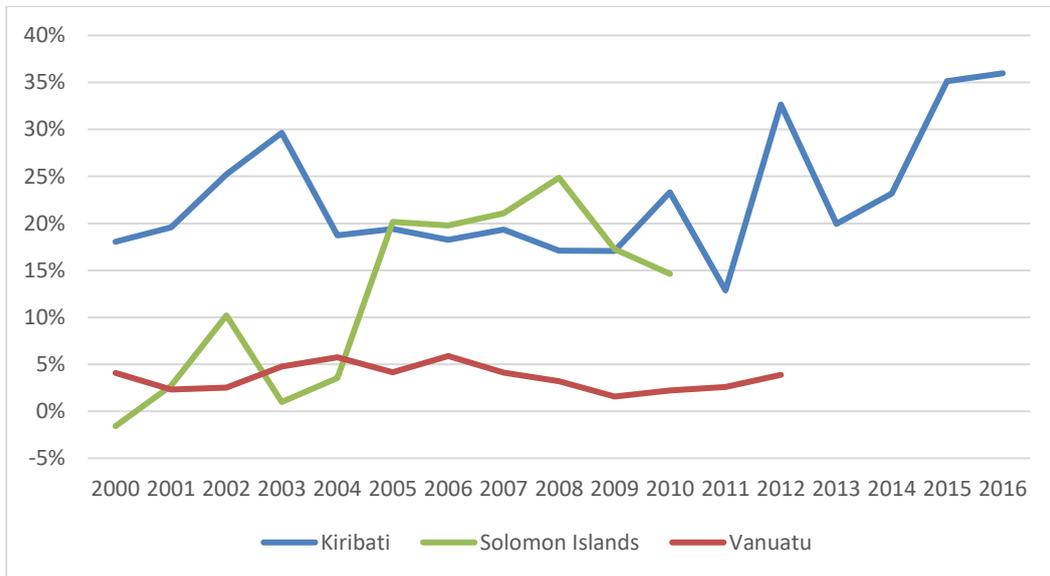
Other sources such as fishing licences, the Tuvalu and Kiribati trust funds and the .tv domain name in Tuvalu have formed valuable sources of income. In Vanuatu the sale of citizenship has in recent years grown to become a large part of government income, and indeed has helped the country weather the impact of COVID-19.

The fact that transfers and unconventional sources of income play such a prominent role and are in some cases increasing is connected with the high level of government spending, in that non-commercial activities form a necessary component of economic output. The government on average around eight-tenths the size of GDP in the Pacific LDCs, among the highest in the world. Government expenditure in Vanuatu averaged 33 per cent of GDP in the last seven years for which data was available, according to the IMF. This is the only Pacific LDC for which government expenditure might be considered within a 'normal' range. For comparison the LDC average is 11 per cent.

<sup>8</sup> Current transfers comprise transfers of income between residents of the reporting country and the rest of the world that carry no provisions for repayment. Net current transfers from

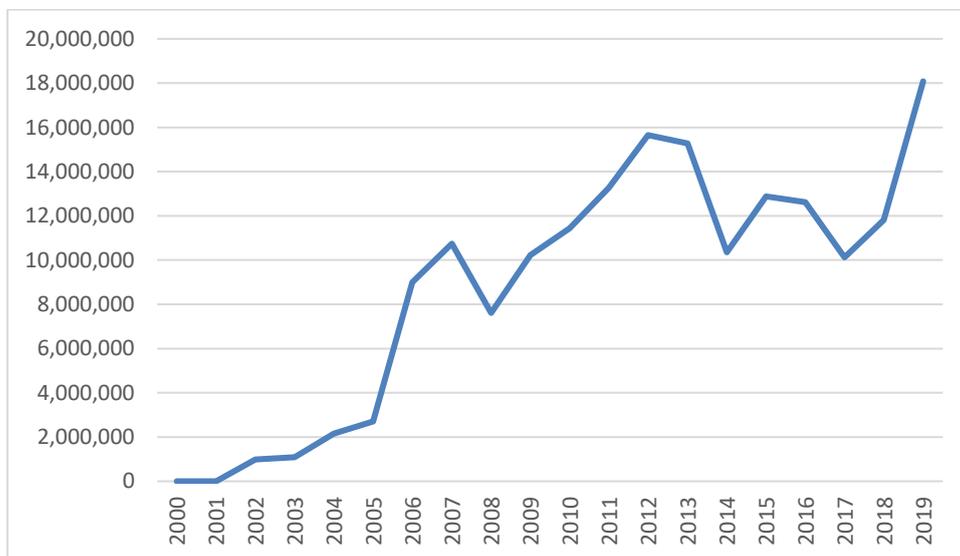
abroad is equal to the unrequited transfers of income from nonresidents to residents minus the unrequited transfers from residents to nonresidents.

**Figure 7:** Net secondary income (net current transfers from abroad) as a percentage of GDP



Source: World Bank/author's calculations.

**Figure 8:** Solomon Islands Personal transfers, receipts (BoP, current US\$)



Source: World Bank.

The proportion was 46 per cent in Solomon Islands. In Kiribati the figure rose from 91 per cent of GDP in 2013 to a projected 137 per cent of GDP in 2019, averaging 117 per cent. In Tuvalu the average was 130 per cent. The IMF's statement on Tuvalu is typical: "The country's remoteness, narrow production base, and weak banking sector constrain private sector activity, leaving public expenditure as the main source of growth."<sup>9</sup>

## 2.6. IMPLICATIONS

Some of the obstacles faced by the Pacific LDCs are so large and insurmountable that they provide further evidence of the difficulties of 'market-based' economic transformation based on a broad-based reaction to price incentives. Often these realities are underappreciated in commentaries from outside the region, and one-size-fits-all solutions are recommended from other contexts. This need not be a note of pessimism; more a recognition of the need to think creatively about analysis and policies.

Reducing the size of the state is unlikely to reduce 'crowding out' or promote private entrepreneurship because costs are too high, the consumer base and workforce too small and spending power always likely to be low. The market is too small in many areas for competition to occur, meaning that there is little downward impulse on prices – and therefore market-based activity is unlikely to directly compensate for a reduction in state activity in certain areas. Indeed, lowering government expenditure may often merely have the effect of reducing demand. It is better to think of state activity as a complement to the private sector rather than its opposite. Complementary activities should include more than just the rule of law and stability, and extend toward backstopping, the provision of absent services, the creation of linkages and demand

management. Indeed, the absence of domestic production linkages is one of the main obstacles to building productive capacity, and more should be done to explicitly promote linkages, as noted in section 5.

Many of the costs of conventional physical trade are inbuilt. Costs can be so elevated that many private sector activities are unviable. Regardless of the extent to which entrepreneurship or competition are promoted, small island archipelagos must still deal with the problem of fragmentation and distance from major markets. High prices make it difficult to produce products that are internationally competitive.

Because the private sector is hampered by prohibitive costs, the state must compensate. Commercial businesses simply would not provide some of the services currently offered by government, and privatisation has limited potential in most of the countries concerned. The government must stay involved in a range of areas – at least health, finance, education, and even retail. The state has also been obliged to perform a backstopping role for businesses in case they get into difficulty.

For instance, in Tuvalu the cost of keeping patients on dialysis machines overseas accounts for a large part of the health budget. Healthcare is far too small for privatisation, and the hospital has insufficient expertise or facilities for a machine of its own. Government has been compelled spend a large proportion of its budget on the service.

In small populations, the fixed costs of running a school for a tiny number of pupils are too high for it to be commercially viable. Private schools not only exclude the poor, but standards are difficult to enforce unless government takes direct ownership. Vanuatu took the enlightened step of removing fees, with the state for the first time offering free primary education.

9 [www.imf.org/en/Publications/CR/Issues/2018/07/05/Tuvalu-2018-Article-IV-Consultation-Press-Release-Staff-Report-and-Statement-by-the-46051](http://www.imf.org/en/Publications/CR/Issues/2018/07/05/Tuvalu-2018-Article-IV-Consultation-Press-Release-Staff-Report-and-Statement-by-the-46051).

Even private retailers in many remote islands need the state to step in when supplies dry up. In Kiritimati Island, for example, shops have periodically run out of supplies due to the irregularity and infrequency of shipping, prompting traditional import substitution in the form of coconuts and fish. The Ministry of Commerce has in the past chartered a ship to bring in supplies.

Even if it were a good idea to lower government service provision significantly, retrenching government workers can be problematic because there are a limited number of industries for workers to move into and because capital and know-how are in short supply. As part of the Cook Islands government reform programme in 1998, a large number of government workers were laid off. Most simply moved to Auckland, leaving a large skills gap.

This is not to say that the private sector cannot succeed in any area. It can, as shown by the many thriving small businesses across the region. Particular potential is evident in niche areas and in services industries with low start-up costs serving the international market. Neither is it to suggest that some government spending cannot be reprioritised or that governments cannot be more efficient. Government provision of services that complement the private sector, and where markets do not function as they might in a bigger, less isolated and more adaptable economy, such as infrastructure, credit, health, education and environmental services. Some commercial production may need to be carried out by the state in order to insure against severe volatility.

Winters and Martin (2004), on the cost of doing business in small island developing states write

that even if workers did their job for free, many businesses would still receive negative returns. That means they would effectively be paying the customer to receive their product. Winters and Martins conclude that “comparative advantage is not enough”. The implication is that the state must step in to perform a considerable proportion of economic activity. This is a radical critique which strongly undermines the conventional approach to trade and liberalisation – and partly explains why trade liberalisation in the Pacific, both internal and external, has underdelivered, as has the conventional idea approach to structural adjustment. The degree to which state activity is necessary is reflected in the data above – plainly government expenditure and transfers play a bigger role in Kiribati and Tuvalu – but the critique applies even to the Melanesian LDCs.

In order to deliver useful analysis and appropriate policy recommendations it is therefore necessary to put the conventional view aside and to recognise the fundamental necessity of large government and aid sectors, the prominence of transfer payments, both foreign and domestic, and these economies’ inherently inflexibility. In essence these are not economies as normally defined in the economic development literature, and it makes little sense to see them as behaving as such. Only seen from this position is it possible to begin to conceive of forward-looking and innovative policy directions with the potential to secure human development and future stability, in contrast to the standard prescriptions which have been tried, and which have often failed, in years gone by (e.g. Gay, 2004).

# 3. Impact of LDC graduation

LDC graduation is unlikely to make much material difference to the economies of any Pacific Island LDC other than Solomon Islands. This lack of impact is largely because goods exports are small, diminishing and mostly do not go to countries or regions which grant special preferences under LDC schemes. Official development assistance (ODA) appears stable and mostly increasing, despite graduation. Aid to Samoa increased after graduation, confirming donor partners' statements that they will remain committed for the long term. There is also little evidence of any change in the rate of structural transformation as a result of graduation.

It has been suggested in some quarters that graduation may also have potential benefits, including higher investment or the sense of national progress that comes with moving out of the LDC group. Achieving such an important development milestone can be celebrated as a key stage in a country's history and therefore may conceivably provide an unquantifiable boost to national and international sentiment. Standing in regional and international institutions may even increase. Some regional governments have identified graduation as a gauge of development progress and therefore may benefit from the perception of success. However, the emergence of COVID-19 and the broadly more pessimistic outlook for development in the region and elsewhere makes this speculative outcome less likely. Foreign investors and other external actors are likely to base decisions on the obvious material

setbacks experienced in the region rather than on perceptions resulting from graduation.

Nonetheless, the governments of Vanuatu and Solomon Islands have broadly accepted the eligibility and need to graduate, based on the need to acknowledge and reflect development progress and the importance of legitimising international processes. Tuvalu and Kiribati have each sought delays to graduation, signalling their reluctance to leave the category at appropriate forums such as ECOSOC. The former Prime Minister of Tuvalu said in 2013 that the CDP should reconsider the criteria for graduation from LDC status, suggesting that not enough weight was given to the environmental plight of small island states like Tuvalu.<sup>10</sup>

Any reluctance to graduate on the part of governments is largely an act of rational symbolism and part of their active maintenance of ongoing sources of income. The need to maintain aid flows as a source of foreign exchange, and a perspective which sees small island states as acting subjects constantly adapting to a changing and volatile world, further explains the reluctance to graduate. Continued LDC status sends a signal of these countries' need for continued international development support. It also enables them to collaborate in international negotiations alongside other countries, which is critical in mitigating the impact of climate breakdown. The visible effects of COVID-19, in the form of reduced tourism, investment, remittances and exports, further reinforce these signals.

10 Prime Minister Sopoaga said that: "The present application of those criteria we feel is totally unrealistic and perhaps very wrong. We need to address that. The application of the

current criteria - we have no problem with the criteria but the application - Environmental Vulnerability Index must be one of the two" (Pacific Islands Report 2013).

### 3.1. OFFICIAL DEVELOPMENT ASSISTANCE

Aid per head in the Pacific LDCs is among the highest in world, partly a result of the small denominators in each country and the fixed costs of aid programmes, alongside the large geographical spread of these countries. In Vanuatu ODA per capita was US\$423 in 2018, according to the latest OECD DAC figures; in Tuvalu it was \$1,635; in Solomon Islands US\$296; and in Kiribati US\$640. The global average was US\$21.80. One of the biggest concerns among Pacific Island governments is to maintain these high levels and avoid a possible decline in aid and ODA following graduation. However, aid trends and official communications from the main donor partners suggest that aid and ODA are unlikely to be significantly affected by graduation.

There has been little discernible trend in ODA to the current four Pacific LDCs over the last decade, with aid flows remaining more or less stable, although by 2018, the most recent year for which data is available, the total was slightly higher, at US\$543 million compared with US\$516 million at the start of the decade.

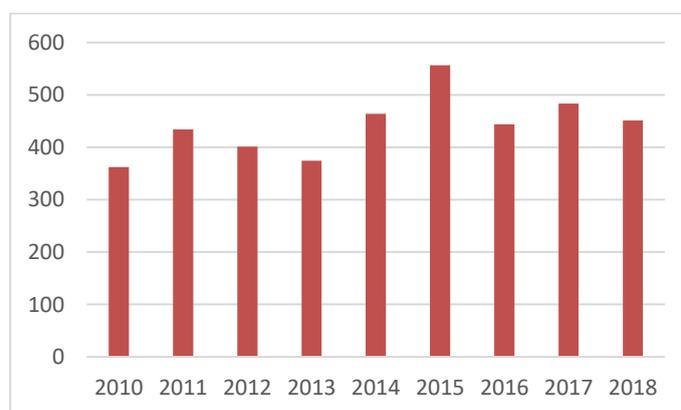
Figure 10 shows that only Solomon Islands experienced a decline in aid over the decade, although the totals were considerably higher than in any of the other countries, and are connected with the phasing out of the Regional

Assistance Mission to the Solomon Islands (RAMSI), in place since the 'Tensions'. Aid to Vanuatu reached a peak of US\$246.2 million in 2015, the year of cyclone Pam.

In most Pacific LDCs, ODA is comparable to government spending. In Vanuatu and Solomon Islands ODA has averaged 65.5 per cent of government expense over the last decade according to World Bank data, in Solomon Islands at times exceeding 100 per cent of the total. In Kiribati ODA has averaged 56 per cent of government expenditure. The cost of RAMSI alone was calculated at \$2.6 billion from 2003-13, a third of GDP and more than government expenditure (Gay, 2014) over the decade. This was the equivalent of 5,900 Solomon dollars a year per adult over the decade, enough to meet one person's entire basic needs.

Whilst some proportion of aid flows back out of the country, it makes sense to consider ODA in the Pacific LDCs as a component of aggregate demand rather than a periodic flow of assistance with a primarily technical or infrastructure function. This is not the case in most other developing countries and LDCs, where ODA tends to form a smaller part of expenditure and arguably has a more technical assistance, humanitarian or catalytic impact. In the Pacific donors are in effect distinct economic actors with a demand impact that goes beyond only the effect of projects.

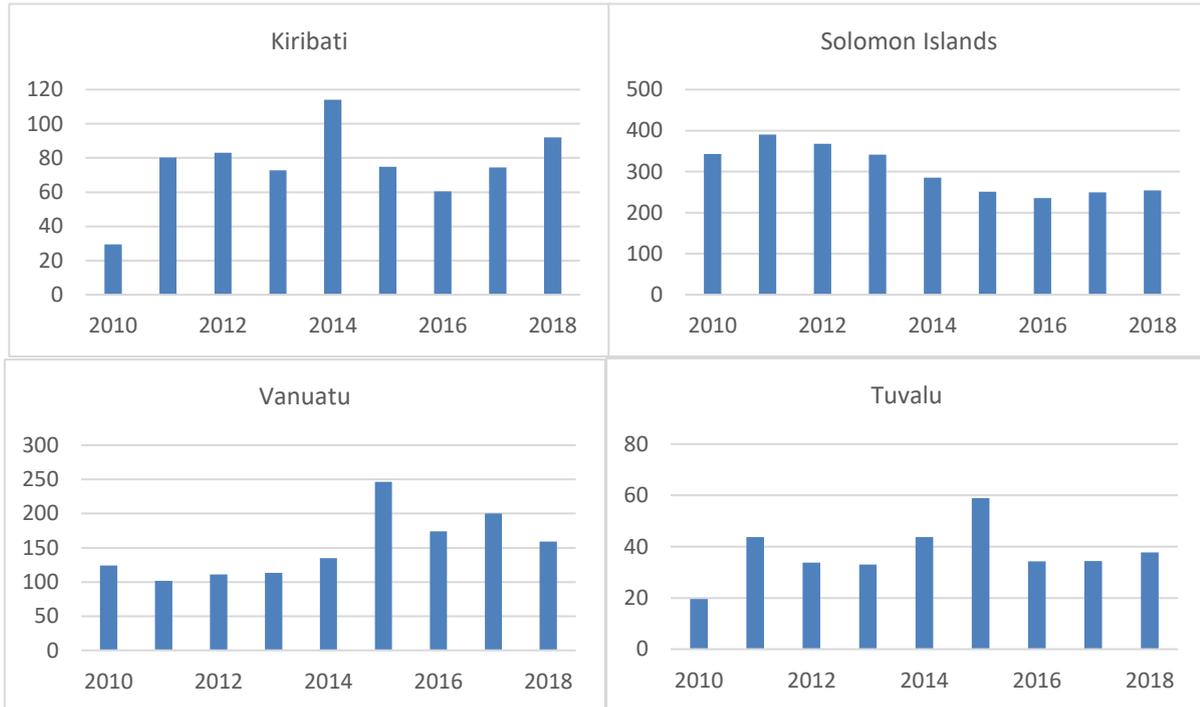
Figure 9: Aid to all current Pacific LDCs, US\$ million, 2010-2018



Source: Lowy institute.

Note: Data exclude Samoa, which graduated in 2014.

Figure 10: Aid to Pacific LDCs during 2010-2018, US\$ million



Source: Lowy institute.

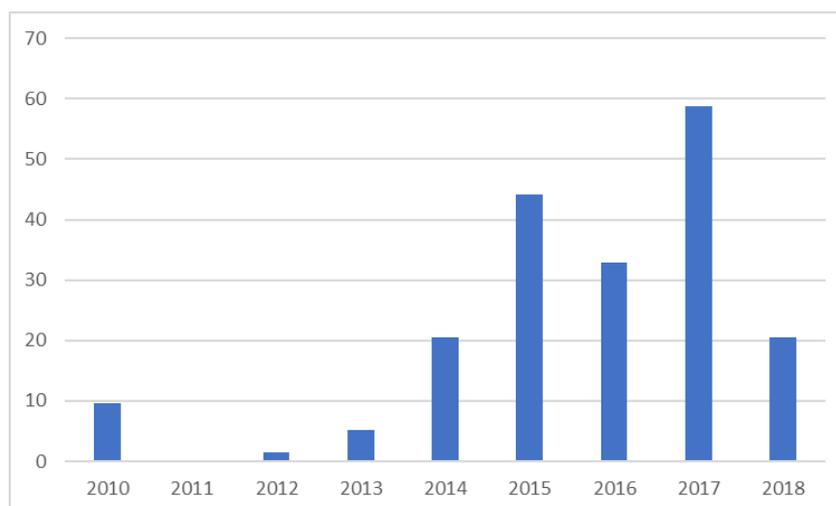
Note: Data exclude Samoa. Data encompass all sources of foreign aid, including China (not a DAC member).

Aid and ODA are part of the overall economic landscape. Historically, aid has been connected with the long-term strategic importance of the region (and the region has recently become more geo-strategically important) – and indeed several authors suggest that strategies for securing international assistance are inseparable from overall economic policy (e.g. Baldacchino and Bertram, 2009). Rather than seeing the Pacific island countries as inherently vulnerable and devoid of agency, these authors argue that the countries are “strategically flexible,” “seeking to exploit opportunities and maximize economic gains in the turbulent and dynamic external environment with which they must engage”. This can be seen in the emergence of new donors and actors, particularly China, which has become increasingly prominent in the region and forms a new source of donor funding to offset any possible decline in ODA.

Aid can be seen as but one source of foreign exchange opportunity accessible by governments and organisations, and as such it

can be considered comparable in type, and in some cases in magnitude, to other transfers such as remittances, trust fund payments or resource rental. Aid is higher and less volatile in the Pacific than in most other LDCs. In a sense governments face a ‘soft budget constraint,’ in that aid transfers appear likely to remain an important funding source for the long-term future and donors even channel major funding for current expenditure in response to unexpected events, such as the Tensions in the Solomon Islands, cyclone Pam and other challenges. The increasing geo-strategic importance of the Pacific island nations implies that they are even increasingly likely and able to attract foreign aid. As part of research for the recent LDC graduation impact assessments on the Pacific LDCs, the CDP received formal written confirmation from the main official donors that they were unlikely to reduce ODA on the basis of graduation. Indeed, the environmental challenges faced by the region combined with geo-political imperatives make the sums of aid involved a worthwhile investment.

Figure 11: Chinese aid to Vanuatu during 2010-2018, US\$ million



Source: Lowy Institute.

Whilst nothing is certain, aid and ODA are thus unlikely to decline after graduation and will continue to have a counter-cyclical economic impact. Indeed, any realistic assessment of the post-LDC experience must include a substantial transfer component. Seeing aid as a source of funding actively pursued and secured by governments, and donors as economic actors with an impact on demand, is a subtly different picture to the one that conceives of Pacific island economies in general, and LDCs in particular, as inherently vulnerable and subject to outside forces.

### 3.2. TRADE

After graduation the WTO members, Solomon Islands and Vanuatu, would no longer benefit from special and differential (S&D) treatment under the WTO agreements and decisions. The withdrawal of S&D is unlikely to have major economic implications although the two countries may face certain costs in implementing the Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPS). The main Aid for Trade instrument that is specifically geared at LDCs is the Enhanced Integrated Framework (EIF), which represents a relatively small share of Aid for Trade flows although has been catalytic across

the region in a number of areas. The country would be eligible for support from the EIF for a period of up to five years after graduation. Other components of Aid for Trade are generally not linked to LDC status.

#### (i) Services

The recently approved WTO services waiver allows members to grant special market access for services exports from LDCs. WTO members can in effect discriminate in favour of the services exports of LDCs. For example, the waiver would allow a host country receiving the exports of an LDC in an industry such as insurance services to deviate from normal WTO rules allowing the LDC company to establish business premises, invest, sell across borders or hire workers under conditions for which other countries are ineligible. However, since the services agreement has not yet been fully operationalized, and Pacific LDC services exports (other than tourism) and foreign investments are small, the loss of this preference will be very limited. Few LDCs have managed so far to make use of the waiver, even those with substantial services exports. The waiver is in any case less relevant to tourism. It is unlikely that graduation will have any significant impact on tourism.

## (ii) Goods

The main expected impact of graduation is via the loss of access to preferences for LDC exports under various developed and developing countries' Generalised System of Preference (GSP) schemes. However, the implications here, too, are expected to be small. With their small and volatile export bases, most of the Pacific LDCs export to a number of different destinations year by year. Many of the main preference-granting countries and regions, such as the EU, are not major export destinations. In the cases where the tariff increases, the margin is mostly not large and the value small. The impact on Kiribati and Tuvalu will be particularly limited, given the low value of exports in each country. Any such minor impacts can in principle be mitigated through trade agreements, extensions of existing arrangements or new arrangements.

In Solomon Islands graduation would have no impact on the main export, logs, most of which are destined for China, where logs do not face import tariffs. Domestic supply constraints and environmental sustainability are for Solomon Islands a bigger challenge than market access, particularly as the supply of tropical hardwood diminishes. Exports of minerals such as gold, bauxite, copper, nickel and cobalt to all destinations are similarly duty and quota-free (DFQF) and hence unaffected by LDC status. Solomon Islands can expect to maintain DFQF access for all products to Australia and New Zealand under the Pacific Agreement on Closer Economic Relations (PACER Plus). Graduation could have some impact on European market access for coconut oil and palm oil, each of which comprise a small share of exports but which are an important potential source of diversification and are vital to some local communities. The export of fish products is growing, mostly to Europe. To this end Solomon Islands signed an interim Economic Partnership Agreement with the European Union to compensate for the loss of fisheries preferences.

In Vanuatu, LDC graduation will affect tariffs on only exports of kava to China, beef to Japan and Noni juice to China. Coconut oil exports to Taiwan may incur a tariff increase from 0 per cent to 4 per cent but this is a minimal margin in a small market. For all other products and markets, graduation will have no impact either because another trade relationship is in place, the most favoured nation (MFN) rate is zero or because the destination market has no LDC scheme. The overall tariff-related impact of graduation on current exports is thus expected to be negligible. Multiplying tariff by product value and summing the total for the three products, the simple implied tariff value would amount to US\$405,329 (Enhanced Integrated Framework for Trade, 2019). However this is a very rough calculation with little real-world significance. It is likely that this sum would be divided between importer and exporter (the importer may in effect pay the difference), and it is possible that trade could be diverted to a lower- or tariff-free market.

## 3.3. OTHER INTERNATIONAL SUPPORT MEASURES

Graduation will result in higher mandatory contributions to United Nations system budgets, including the regular budget, peacekeeping, and the budgets of two of the three agencies that adopt class-based systems of contribution (International Telecommunications Union or ITU and World Intellectual Property Organization or WIPO). The largest impact would be in the ITU. In the past graduating countries have successfully requested an extension of the conditions applied to LDCs.

Graduating LDCs would no longer have access to LDC-specific support for travel to attend international meetings. Support for LDCs to attend the meetings of the General Assembly are available for a smooth transition period of 3 years, if requested. The country would still benefit from travel support extended to non-LDC developing countries.

The graduating LDCs would also no longer benefit from more flexible reporting requirements under the United Nations Framework Convention on Climate Change (UNFCCC). They would also no longer benefit from subsidies provided by the Canton of Geneva, Switzerland, for the operational costs of diplomatic offices, although concessions may be negotiable here.

Finally, it is worth referencing some of the foregone opportunities associated with graduation. While this is highly speculative, Tuvalu and Kiribati may be hesitant to graduate partly because they do not want to forego any possible future benefits, and thus there is a need to 'future proof' any graduation and to provide incentives for graduation. Discussion is taking place among international institutions on

how to provide more useful support to graduating LDCs, possibly as part of the Fifth United Nations Conference on the Least Developed Countries (LDC-V) to be held in January 2022. These may include opportunities to diversify exports, special access to new funding mechanisms and special and differential treatment under new trade agreements. To this end the CDP is piloting a graduation support facility in Vanuatu that includes measures to address the loss of international support; help with preparing and implementing the smooth transition strategy and negotiating better trade relationships; accessing non-LDC specific support; facilitating south-south dialogue and cooperation; and developing other new support measures and partnerships beyond graduation.

# 4. Lessons from graduating and graduated countries

Graduating governments can learn a number of lessons from previous graduates, including the need to plan early; to consider the broad range of impacts in ODA, trade and participation in multilateral processes; and to consult widely. As noted, development partners appear to be committed beyond graduation – especially in the post-COVID era. The most recent graduates have not experienced a reduction in ODA, unlike Cabo Verde and Maldives. Most previous graduates have integrated LDC graduation policy into their national development strategies and continued to pursue the development of productive capacities, particularly in tourism but also in other areas.<sup>11</sup>

## 4.1. VANUATU

Vanuatu graduated from the LDC category in December 2020. Extensive national consultations took place in the years before graduation, involving government, civil society, the private sector and development partners including the Enhanced Integrated Framework (EIF) for LDCs. The outcome of this process, Vanuatu's Smooth Transition Strategy, was a cross-ministerial strategy led by the Prime Minister's Office and linked to the 2030 national plan. A separate trade strategy for graduation was produced with EIF support, feeding into the overall strategy. Vanuatu learned from the earlier graduation cases, ensuring that preparations began early, were multi-stakeholder in nature and covered all possible impacts. With the assistance of the United

Nations Department of Economic and Social Affairs (DESA), a pilot graduation support facility was put in place for Vanuatu, aimed at supporting the country through and beyond graduation. As noted in the previous section the main impact of graduation was expected to be on exports of fisheries, kava and to China, and possibly beef to Japan, although sums involved were small relative to the size of the economy.

## 4.2. SAMOA

Samoa, the first Pacific island country to have graduated, has continued to develop sustainably since graduation in 2014. GNI per capita in 2019 was a projected \$4,057 using the CDP measure, well above the income graduation threshold, while the HAI and EVI have remained above the graduation threshold. These achievements reflect the implementation of effective policies, supported by the international community, and the strong government commitment to social development.

Samoa met the GNI and HAI criteria in 2003 and 2006. On this basis, the CDP recommended graduation for January 2010, but the Government of Samoa requested deferral after the tsunami of 2009. In accordance with UN resolutions, Samoa began working on a smooth transition strategy plan in that year. In 2011 it agreed on a Joint Policy Matrix with development partners, which became the basis for the delivery of aid after graduation. Multilateral financial institutions

<sup>11</sup> Information and analysis in this section draws from the Gradjet.org website, [www.gradjet.org/during-graduation/during-graduation-information](http://www.gradjet.org/during-graduation/during-graduation-information).

confirmed that there would be no change to Samoa's ability to access concessional financing provided it complied with the policy matrix. Likewise, bilateral partners indicated their commitment, and Samoa continued to see an increase in aid volumes from all sources after graduation, a higher proportion of which was in the form of grants. Loans decreased in absolute terms and as a share of the total, as shown in figure 12, which depicts all ODA and other official flows (OOF) to Samoa from 2010-18. Transport saw the biggest increase in aid after graduation in 2014, and was the main driver of the increase in the overall total, growing 14-fold from \$3.6 million in 2014 to \$51.8 million in 2018, more than a quarter of total aid during that year. Other types of aid which grew but by smaller amounts were multi-sector and cross-cutting aid, as well as other or unspecified; health; humanitarian; government and civil society. Aid to the energy sector was volatile but declined, while aid for education fell steadily over the period and for communication there was a big drop to low levels. Water and sanitation and industry, mining and construction remained at roughly the same levels. There thus seems to be no obvious impact of graduation on the sectoral composition of aid.

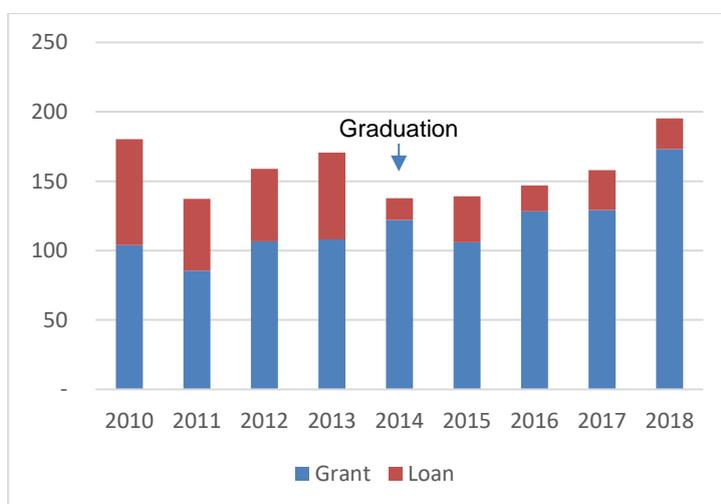
The United Nations assisted through the

conduct of impact assessments and a program for the accelerated achievement of the MDGs (Millennium Development Goals) through a policy review that contributed to the 2012-2016 national development strategy for sustainable development.

To prevent the abrupt loss of preferential market access under DFQF, the government negotiated with some of its export partners including the USA and Japan the continuation of DFQF schemes beyond graduation. Under EBA, a transitional period of three years was allowed after graduation for access of Samoa's exports to the EU market. In addition, Samoa continues to receive preferential bilateral market access to Australia and New Zealand.

As with most graduating LDCs concessional loan financing from the World Bank and Asian Development Bank (ADB) was unaffected. Because of Samoa's classification by the IMF as a country at high risk of debt distress, the government has continued with ongoing reforms including the implementation of a medium-term debt strategy. Given the high level of the public debt, the government was able to secure 100 percent grant financing for reconstruction after cyclones and other natural disasters. Considerable efforts have gone into improving revenue collection.

Figure 12: All aid to Samoa from 2010-2018, US\$ million

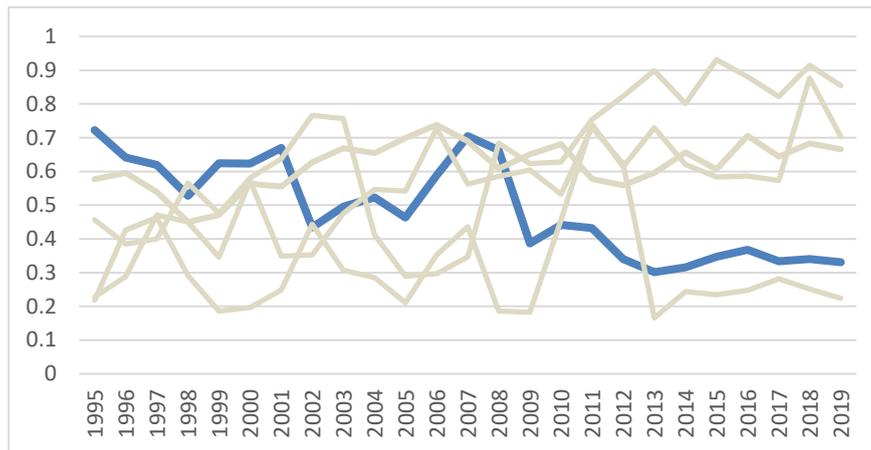


Source: Lowy Institute Pacific Aid Map.  
 Note: Data include all ODA and OOF.

Samoa is one of the few countries in the Pacific to have undergone consistent structural transformation in recent years, with the agriculture and fisheries share of the economy falling to low levels. Like in the other countries, however, the services share has risen. After graduation Samoa promoted economic

diversification by promoting agricultural and fisheries exports, although its export concentration index was already on a downward trend after 1995, as shown in Figure 13. Samoa has had some success with explicit linkages programmes aimed at the agriculture and tourism sectors.

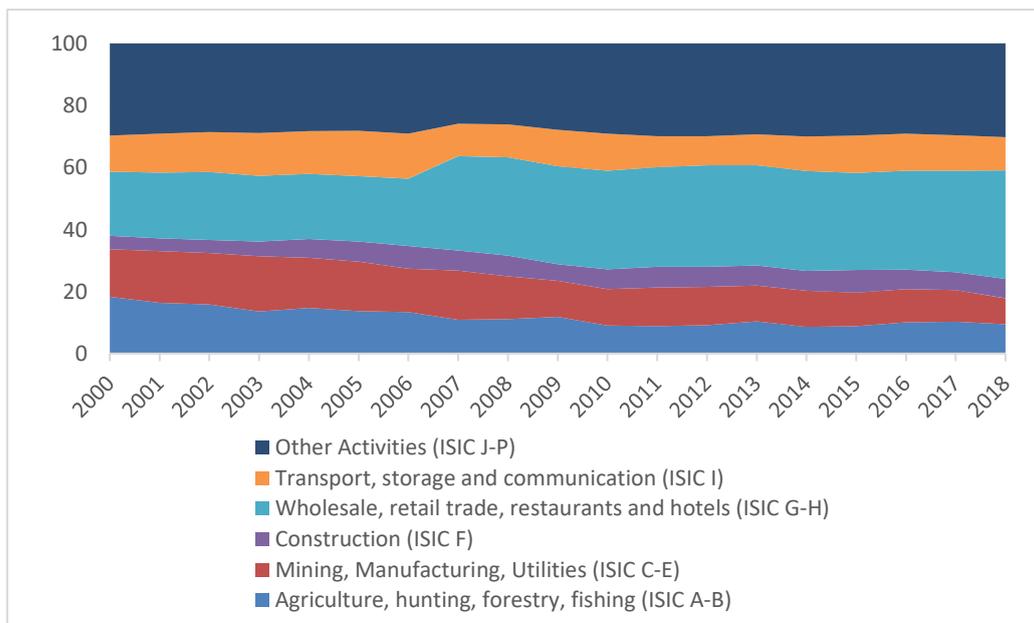
Figure 13: Samoa UNCTAD export product concentration index, 1995-2019



Source: UNCTADstat.

Note: Samoa is the blue line. For comparison the other Pacific LDCs are shown in grey.

Figure 14: Samoa, sectoral distribution of GDP, per cent



Source: United Nations Statistics Division.

### 4.3. THE MALDIVES

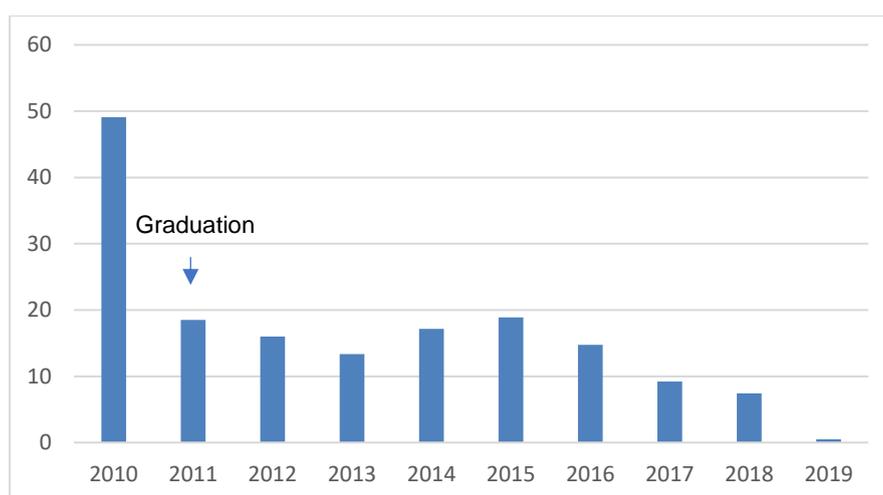
The Maldives graduated from the LDC category on 1 January 2011 after a longer than usual transition period. The country met graduation criteria in two successive triennial reviews (2001 and 2004) on the basis of its high GNI per capita and HAI. The CDP recommended graduation in 2004, and the recommendation was endorsed by ECOSOC. Graduation was originally scheduled to take place three years later. However, following the devastation caused by the Indian Ocean tsunami of 26 December 2004, the UN Assembly decided to defer the commencement of the three-year period preceding graduation to 1 January 2008, delaying the country's graduation to 2011.

In anticipation of the need to adjust to changes in development and trading partners' support, the UN recommended that the Government adopt several smooth transition policies to avoid any disruption in development progress. In this regard, the Maldives Donor Forum was held in March 2010, in which the Government

introduced the challenges it faces and the measures it has taken to its development partners. It also presented five priority areas—macroeconomic reform, public sector reform, social development, governance, and climate change—which requiring external resources. Maldives differed from most other recent graduates, however, in that ODA declined after graduation and continued to fall thereafter. Considerations other than LDC status may have driven donor decision-making, however, particularly the 2011-2012 political crisis. ODA was low during the year of graduation, at US\$18.51 million, which meant that its reduction probably made little overall difference to economic growth.

Although the Maldives has a high income per capita, at a projected US\$9,541 in 2019, structural vulnerability remains a challenge, as indicated by the country's high EVI, which is in turn due to its high exposure to shocks due to the small size of its population, the share of its population living in low elevated coastal zones (100 per cent), and high export concentration.

Figure 15: ODA to Maldives during 2010-2019, US\$ million



Source: OECD Creditor Reporting System.

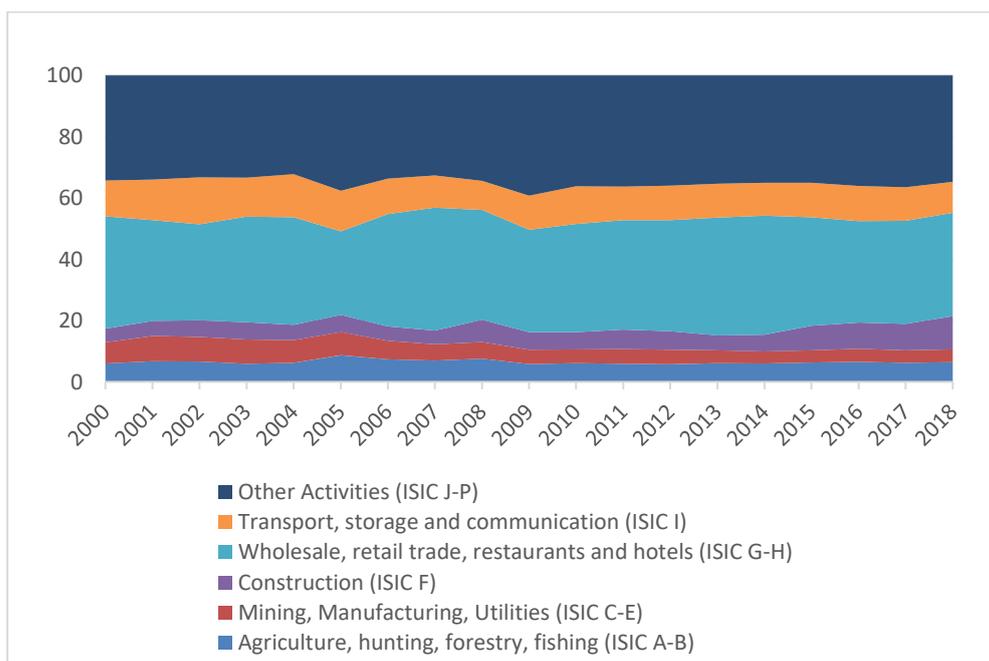
The international community adopted provisions to phase out some specific LDC-support measures in an orderly manner after graduation. These provisions included extensions of LDC benefits such as UN travel-related benefits and full EIF benefits, which the Maldives used to submit to the EIF board proposals for the approval of partial privatization of the international airport and the development of custom services. In addition, the EU extended DFQF access under the EBA, and Maldives continued to receive ODA, especially from Japan and the EU, for social infrastructure and humanitarian aid after the tsunami.

Analysis by the CDP Secretariat (Bruckner, 2018) suggests that any impact on the fisheries industry, an important export, has been limited as exports grew more value-adding in nature and shifted from Europe toward Thailand. Despite the initial fears, production and exports of fish products have been relatively stable. This finding confirms earlier assessments by the CDP in its monitoring report of graduated countries in 2015 that the tariff increase in the EU market did not have a major impact on the

Maldives' tuna industry. In its report within the 2016 WTO Trade Policy Review, the Government of the Maldives also highlighted that while the withdrawal of preferential market access created challenges, the country managed to maintain export volumes after graduation. This indicates that the loss of tariff preferences in a sector like fish products can indeed be mitigated and managed. The Government attributes the relative stability of exports after graduation to promotion activities by the Government and the private sector that enabled the country to enter new markets and to position Maldives fish as a niche premium product (for example through Marine Stewardship Council certification). The loss of preferences might even have a positive effect on product innovation and moving towards higher value-added activities.

As figure 16 shows, there was very little discernible trend in structural transformation from 2000 to 2018, although construction increased slightly toward the end of the period, mostly at the expense of other activities. Graduation appears to have had no impact on economic structure.

Figure 16: Maldives, sectoral distribution as a percentage of GDP



Source: United Nations Statistics Division.

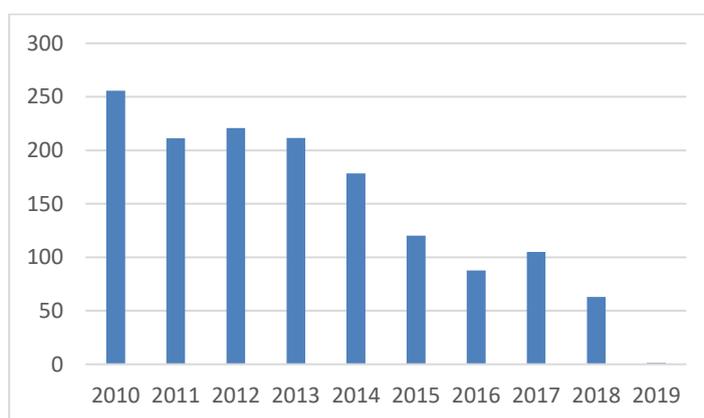
#### 4.4. CABO VERDE

Cabo Verde graduated from LDC status in December 2007. In preparation, the Government set up a donor support group, GAT, to prepare a transition strategy to adjust to the eventual phasing out of the support measures associated with LDC membership. In June 2007, GAT adopted a declaration supporting Cabo Verde's socioeconomic transformation agenda. Additionally, a budget support group put together by the Government and participating multilateral and bilateral donors was created in 2005 to align and harmonize donor support around the Growth

and Poverty Reduction Strategy. Continued preferential access to the important EU market was maintained via the Generalised System of Preferences Plus (GSP+) scheme. As in Maldives, ODA declined after graduation, although non-DAC sources may have increased.

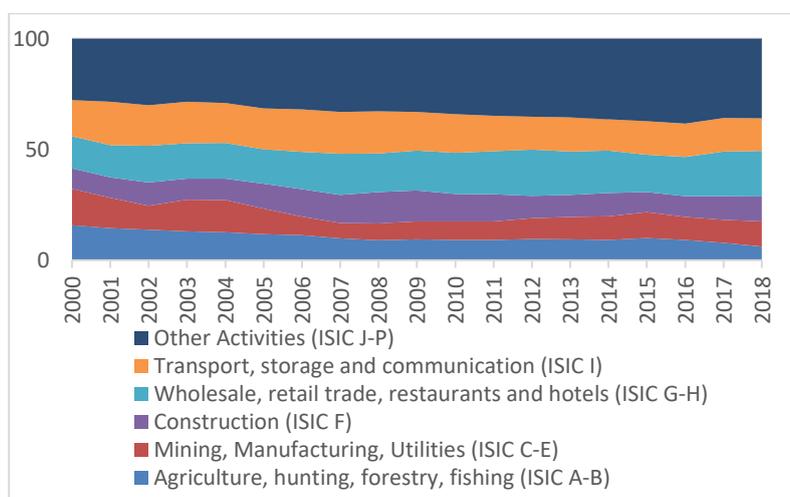
Unlike Maldives there is slight evidence of a change in economic structure, with the share taken up by 'other activities' increasing, alongside wholesale and retail, restaurants and hotels. Agriculture and fishing declined more or less steadily.

Figure 17: ODA to Cabo Verde, 2010-2019



Source: OECD Creditor Reporting System.

Figure 18: Cabo Verde, sectoral distribution as a percentage of GDP



Source: United Nations Statistics Division.

## 5. Possible future strategies, policies and sectors

The *Asia-Pacific Countries with Special Needs Development Report: Leveraging Ocean Resources for Sustainable Development of Small Island Developing States* (ESCAP, 2020) points out that the “blue economy”, “local content intensive” tourism and niche agriculture have considerable potential. The Pacific island economies, whilst managing their fisheries to the best of their abilities, could benefit more from their large EEZs. Several governments have already started to prioritise sustainable ocean management, programmes and policies. The blue economy focuses on the potential of the fishery sector for small-scale fisheries, urban fish markets and onshore tuna processing whilst continuing to serve the needs of local people, the natural environment and sustainability. Purposeful promotion of the blue economy could improve the revenues that the Pacific islands extract from EEZs. Partly due to difficulties in management and paucity of land-based facilities, fisheries revenues, mostly from licence fees, are only just over 10 per cent of the value of extracted tuna.

Environmentally sustainable tourism is an ongoing priority, despite the downturn seen in 2020 due to the COVID-19 pandemic. Vanuatu already benefits significantly from the industry, but in Solomon Islands tourism is still at a relatively early stage while in Kiribati and Tuvalu it remains very small. As pointed out in ESCAP (2020): “Structural transformation towards tourism as the main sectoral target must ensure productivity gains, hence the necessity to make the tourist industry a high-

value, high-end focused, and environmentally sustainable endeavour, similar to that in the landlocked and mountainous Bhutan.” Bhutan is also making efforts to improve linkages by promoting linkages between niche, organic agriculture and the hospitality industry.

In addition to the blue economy and sustainable tourism, there is the need also to recognise the need for aid and non-commercial sources of foreign exchange; linkages; and better institutional arrangements for structural transformation policy. Resilience-building is also an urgent priority, given that export concentration has increased in three of the four countries, the number of goods exports is diminishing, and that the Pacific island countries are so vulnerable to the increasingly regular external shocks from the world economy.

The international community, trade and development partners must take these realities into account. The existential threat posed to Pacific LDCs by climate change implies that the international community has an obligation to help, via carbon pricing and energy subsidy reforms, promoting low-carbon, climate-resilient infrastructure investments, and improving transboundary climate data collection. ODA itself is a source of resilience. The international community must also assist with climate adaptation and mitigation through disaster risk transfer and financing (ESCAP, 2020).

## 5.1. LINKAGES

Domestic linkages are critical to the development of productive capacity and structural transformation, as well as resilience-building. Many successful development experiences were partly a process of learning, via diversification of the domestic economy, rather than about the purchase of technology or capital from abroad or attracting FDI. It is important to develop linkages both between large and small domestic companies and between foreign and local companies.

Linkages include backward linkages with suppliers, linkages with technology partners, forward linkages with customers and other spillover effects. Linkages are often lacking because local firms cannot meet international production standards, as well as corporate requirements in terms of consistency, continuity and volumes of production.

Four areas of activity are relevant in the Pacific LDCs:

- a) Technological upgrading, including partnership with foreign affiliates and the promotion of suppliers' associations. This need not involve sophisticated technology but could just mean better equipment for processing food products aimed at tourism.
- b) Training, including collaboration with the private sector, support for private sector training programmes and collaboration with international agencies. The Australia Pacific Training Coalition based in Vanuatu is a good example, as is the Tourism and Hospitality School.
- c) Information and matchmaking, including the provision of relevant information, maintenance of updated electronic databases, acting as an honest broker in negotiations, support for suppliers' audits, the provision of advice on subcontracting, sponsorship of fairs, exhibitions and conferences, and the organization of meetings and visits to plants.

- d) Financial Assistance, including legal protection against unfair contractual arrangements and other unfair business practices; the guarantee of recovery of delayed payments; indirect financing to suppliers through their buyers; tax credits and other fiscal benefits to firms providing long-term funds to suppliers; co-financing for development programmes with the private sector; the direct provision of finance to local firms; loans and the use of ODA.

Explicit linkages development programmes may be the best way of achieving these objectives. Whilst in the Pacific islands the industries involved may be different to the norm, and the level of complexity considerably lower, a central entity tasked with promoting linkages may be helpful. One reason for recommending the use of a centralised agency is coordination failure. The private sector will struggle to coordinate activities along a single vertical supply chain, and each activity is unlikely to emerge spontaneously. This is especially the case in tiny, fragmented economies with poor communications. An independent institution can simultaneously address infrastructure, regulatory regimes, trade logistics and other challenges for a particular chain. This could be a particular product for sale to tourists or supermarkets. For instance, in Vanuatu for the first time a local producer recently began producing a tomato ragu for sale in local supermarkets using locally-grown tomatoes. This is an exception, however, and exists on a small scale. Many more such examples are possible.

Tackling all the apparent economic obstacles in the whole country – particularly one which is highly fragmented – may be overambitious. In many LDCs and particularly in the Pacific, nationwide 'horizontal' policy initiatives such as improvements to the entire business environment have a poor history. Overambition, copying from inappropriate contexts and geographical over-reach mean that such reforms have not delivered. For instance, 'one-stop shops' for investment, in place for around 20 years in some countries,

have often simply added a layer of bureaucracy and failed to make the investment process quicker or easier. Business registration is not the primary obstacle to attracting investment.

In a Pacific island country where hundreds of islands span thousands of kilometres, it may be impossible ever to achieve a high score on the basis of consistently spread commercial infrastructure, because there will always be areas of underperformance. Starting small and achieving a 'quick win' on linkages in a particular locale, industry or supply chain can provide encouragement and a sense of optimism, convincing government officials and private sector operatives that progress can be made.

A practical example is a UNDP initiative, the Supplier Development Programme, undertaken in the Dominican Republic and Haiti, which aims to identify a suitable large company which currently sources inputs from abroad, such as a large supermarket or food manufacturer, and to find and coach local suppliers to supply the company. A group of local consultants are selected for training and exams in supplier development. Two consultants are assigned to each supply chain. Eventually it is expected that the project would become self-sustaining. Under these programmes in other countries some local firms have subsequently developed into exporters themselves. In addition, the UNDP has established centres where entrepreneurs have access to business development services and inputs (i.e. entrepreneurship training, information, finance, quality control, networking and business counselling).

Thailand's Board of Investment Unit for Industrial Linkage Development (BUILD) is another example of a dedicated linkages programme in practice – and one from which Pacific island governments, particularly in Vanuatu and Solomon Islands, may wish to learn, even if in a much-simplified form. BUILD supplies a range of investment-related services, acting as a middleman to develop links between customers and suppliers. The

programme uses technology transfer to reduce imports of parts and components, linking Thai suppliers with large companies and strengthening domestic part makers, promoting industrial linkages and stimulating domestic subcontracting of parts and components. The unit analyzes parts and components needed by both Thai and foreign assemblers planning to start production in Thailand. BUILD then surveys existing supplier industries in order to identify companies that are capable of producing competitively. The program also collaborates with other government agencies and private firms to help these potential suppliers to upgrade.

ESCAP (2020) also suggests that linkages can be promoted sustainably by selectively promoting types of blue economy tourism alongside the countries' comparative advantages. Sustainability concerns imply development without degrading the environment, reducing environmental risks and considering ecological scarcities. Suggestions include leveraging marine-based tourism; improving onshore spending in the cruise ship sector; as well as promoting culture-based and sports tourism. Infrastructure is also highlighted as a mechanism for improving linkages, in that it is of benefit to a range of sectors, including tourism and agriculture, and that better physical communications between agriculture and tourism become possible. This is particularly the case in physically dispersed countries.

## 5.2. INSTITUTIONAL ARRANGEMENTS

Administrative capacity assumes particular importance in countries where government forms such a necessarily big share of the economy and large aid flows have to be managed well. New institutional arrangements should be considered, such as cross-ministerial entities tasked with promoting structural transformation and building productive capacity. These might take the form of Economic Development Boards (EDBs) in

the mould of the Rwandan Development Board, which is itself modelled on the Singaporean EDB. An EDB-type arrangement, or any dedicated cross-cutting institutional entity, is particularly appropriate in countries with low numbers of qualified civil servants and where there is less need for individuals to specialize. In many areas of economic development work, it would make sense for countries such as the Pacific LDCs to simply pool the best personnel in a single development organization and task them with promoting development in a variety of areas (given the small size of Tuvalu's government, this already more or less happens). Aid management, revenue collection and tax policy, trade and fisheries policy, for example, are all closely interlinked and need to be highly coordinated. It is important that the best personnel are in charge of these priority areas. The creation of well-designed, precisely mandated, cross-cutting development institutions would avoid the fragmentation and overlap that is common in some governments and would generate economies of scale as the most dynamic and qualified individuals worked together. Donor capacity-development activities should take into account the need to allow governments to make mistakes, so as to ensure ownership.

Singapore's EDB is an example that is perhaps too complex for the Pacific region, but lessons can be learned. The EDB is considered the locus of the city-state's development, forming a key platform of economic development since its establishment in 1961, two years before full independence. The EDB is the lead government agency aimed at enhancing the country's position as a global business centre. Its mission is to generate sustainable economic growth with vibrant business and good job opportunities, aiming to:

- Attract foreign investment via a one-stop agency which facilitates and supports local

and foreign investors in both manufacturing and services.

- Help existing industries explore new areas.
- Enhance the business environment by providing feedback to other government agencies to ensure that infrastructure and public services remain efficient and cost-competitive.<sup>12</sup>

The multi-faceted role of the EDB means that in effect it is one of the best examples of development mainstreaming in practice. Its cross-Ministerial authority means that it coordinates trade policy across the different government institutions involved with trade, overcoming the problem of policy fragmentation that often faces developing countries.

This type of arrangement may have particular relevance to Vanuatu and Solomon Islands in the generation and implementation of trade, business and investment policy, operating with direct authority over existing Ministries. The overall point of an EDB is to exert control over the development process and to overcome the fragmentation and diffusion of policy that sometimes emerges through the existence of several overlapping agencies. At the top should be a subset of the cabinet of ministers, chaired at the deputy prime minister level. Direct involvement from the top levels of political leadership will be needed to broker compromises across ministries and monitor their implementation. At the technical level, there also needs to be increased coordination in participation, commitments and servicing in trade agreements and broader structural transformation policy, including linkages development.

### 5.3. NEW TECHNOLOGIES

The likelihood of continued high government, donor and transfers presence in the economy is not to deny the possibility of *any* structural

<sup>12</sup> Source: [www.edb.gov.sg](http://www.edb.gov.sg).

change or economic policy aimed at stimulating more productive activities. The increasing services-orientation of the Pacific LDCs means that it would make sense to pursue further value-addition, diversification and productivity gains in other types of services – especially those with low start-up costs where physical location is less important, and which serve the international market. New activities are always possible, and digital technologies will become increasingly important for all countries, particularly with the increased use of remote working and the shortening of supply chains under COVID-19. Internet-enabled production, services and digitization more broadly can also bring new opportunities for LDCs, avoiding legacy technologies and speeding the process of leapfrogging and catch-up. Such technologies are particularly compatible with a zoning approach and need not rely on highly-sophisticated, cutting edge entrepreneurship. Some proven new technologies can simply be a valuable source of basic employment, often most suited to the growing young population most in need of jobs.

The long-term trend in the world economy has been toward a higher services content in economic output, one which has been further advanced by the pandemic. The global economy is becoming ever more virtual, and a considerable proportion of economic activity may never recover its physical dimension. For example, 53 per cent of American businesses are reported to be reducing office size, with distance working expected to take an increased future role.<sup>13</sup> Other aspects of production have long become closely integrated with services or automated. Unlike in many countries where automation looks likely to reduce employment, the Pacific LDCs are less at risk because they were never major manufacturing locations and their economies are less vulnerable to automation. In the new post-fourth industrial revolution world,

automation will mean that low wages are less of an advantage, which means that the Pacific, which has always been high cost, will be at less of a relative disadvantage than regions and countries that based their development strategies on mass, low-wage employment. The evolving ‘virtualisation’ of the world economy, together with the so-called fourth industrial revolution, may bring opportunities for physically distant, small or isolated countries such as the Pacific Island LDCs. With physical location less relevant, work can be done from anywhere in the world and production may be decentralised.

The economic implications of new, fourth-revolution technologies could be significant, cutting transport costs and possibly even reducing imports. Some have even predicted a future in which trade is in bits rather than physical items, and where the physical shipment of goods declines. Whilst few of these technologies are fully proven and they may not be scalable enough to constitute a significant component of future production, their potential is worth exploring, and governments should consider new approaches that allow progress in these new areas.

One such example from another LDC is Thimphu Techpark in Bhutan, a landlocked Himalayan country with a population about the same size as that of Solomon Islands. Thimphu Techpark was established in 2012 and by 2017 had grown to 19 mostly foreign companies, employing around 600 people in software, telecoms, business process outsourcing, and online data services. Its example shows that IT-related or technology zones are entirely feasible in a small, remote or isolated LDC – indeed they may be more viable than before with the improvement of internet connections and other relevant infrastructure, as well as the increasing receptivity of international audiences to digital provision of services.

The biggest investor in Bhutan’s Thimphu

13 Companies to Shrink Offices as Remote Work Becomes ‘New Normal’, available from [www.bloomberg.com/news/articles/](http://www.bloomberg.com/news/articles/)

2020-10-06/companies-to-shrink-offices-as-work-stays-remote-after-pandemic.

Techpark, the online US photo company Scan Café, creates photo albums from holiday snaps uploaded online. It is not a high-end, sophisticated operation requiring advanced skills, but instead provides valuable employment to mostly younger people at an early stage in their careers. Scan Café decided to scale up its initial 20-strong pilot project in May 2013 to 530 workers. It provided an example for other potential investors, showing that the country was a good place to do business. Other companies soon followed; Bangladesh's SouthTec Ltd, a software development outfit, and Secure Link Services from Switzerland. Firms specializing in telecoms, business process outsourcing, and online data services quickly followed (Bhutan DTIS Update, 2020).

Given the availability of intellectual property, products may even be 3D-printed at low cost using recycled materials produced in-country, avoiding the need to import some finished products or raw materials. Advances in renewable energy can lower the costs of running equipment.

Drone and surveillance technologies could benefit fisheries and the environment. For instance a New Zealand company is currently trialling an autonomous sea craft to police Pacific EEZs.<sup>14</sup> The sea-based drone can detect illegal fishing, assist with search and rescue by deploying life rafts; assess cyclone damage to remote islands by launching aerial drones; and collect scientific data, particularly on climate change. Energy comes from solar panels and a horizontal wind turbine, which power batteries that enable the craft to operate autonomously for long periods. Such technologies can address many of the challenges faced by LDCs simultaneously, including the enormous problems created by illegal fishing, safety at sea, and climate change.

Tailored, online virtual travel tours even exist, led by in-country guides. For example, in September 2020 Amazon launched a new service called Explore that allows customers to book live, virtual experiences led by local experts. The experiences include virtual tours of far-off places or cultural landmarks or shopping local boutiques. Such services already exist: a Berlin-based travel company provides virtual tours to people from around the world who were prevented from a physical visit due to COVID-19. In early 2020 the company quickly trained its guides on how to conduct online experiences, the use of gimbals and shooting with smartphones. Guides conduct tours on Zoom via their smartphone cameras, explaining the history and relevance of locations of interest. Tourists interact with guides, and can make private booking involving friends and family members from different locations.<sup>15</sup> Given good enough phone and Internet connections there is little reason why such a company could not offer similar services in the Pacific even without a physical corporate presence.

Some of the Pacific island LDCs may even be suitable for business-process outsourcing (BPO). This could range from the simpler type of operations of back office outsourcing, such as data entry, billing, payroll and benefits administration to more complicated matters such as accountancy, an industry which has long been prominent in Vanuatu. In addition, the level of education and language skills of Pacific islanders – including returnees from circular migration – provides a workforce trainable for front office outsourcing, including customer-related services such as marketing or technical support, usually through call centres.

Some other LDCs already host BPO. An Irish company, Taxback.com, opened an office in Haiti in 2009 and has created a few jobs in a

14 [www.nz.co.nz/international/pacific-news/420984/autonomous-sea-craft-to-police-pacific-fisheries#:~:text=New%20Zealand%20robotics%20firm%20X,islands%20by%20launching%20aerial%20drones.](http://www.nz.co.nz/international/pacific-news/420984/autonomous-sea-craft-to-police-pacific-fisheries#:~:text=New%20Zealand%20robotics%20firm%20X,islands%20by%20launching%20aerial%20drones.)

15 [www.livemint.com/news/india/virtual-tours-over-zoom-call-keep-tourists-guides-happy-amid-covid-disruption-11594382679649.html](http://www.livemint.com/news/india/virtual-tours-over-zoom-call-keep-tourists-guides-happy-amid-covid-disruption-11594382679649.html).

call centre to provide tax documentation assistance to international customers. Samasource, a non-profit organization based in San Francisco, started operations in Haiti after the earthquake, employing disadvantaged people to translate text messages related to the emergency. Digital workers have since been hired by Samasource for long-term microwork which is expected to range from creating digital handicrafts such as online greeting cards or flower bouquets, to data entry, Google-map analysis and transcriptions. These are relatively low-skilled operations which can create much-needed employment.

At least four sets of policies need to be put in place to take advantage of these trends and new technologies:

- a) Education and training need to keep improving. Although some types of low-skill work will continue to feature, many new fourth-industrial revolution technologies will require strong technical and communication skills. This is especially relevant to Solomon Islands and Vanuatu, which have bigger populations, can benefit more from new technologies and have lower average levels of human assets but a number of highly-skilled workers. New technologies should not be seen as the preserve of an elite, or of foreigners. All people should be computer and Internet-literate from a young age. Bhutan's schools, for instance, teach computer and internet literacy from primary school upwards. Curricula need to be kept up to date, including at primary level.
- b) Laws and regulations need to be updated in order to take advantage of new technologies and developments. Governments will need to be flexible and open to the possibilities associated with new technologies, tailoring legislation

and incentives appropriately. Some of the most common obstacles include access to communication infrastructure and movement of information across networks (for example in November 2020 the Solomon Islands government announced that it would attempt to ban Facebook). Electronic transactions and payments must be smooth, and governments must not oblige companies to establish a local presence before engaging in digital trade. The regulatory environment for digital trade should remain relatively unrestricted where possible, particularly for measures affecting infrastructure and connectivity, including the movement of data (Ferencz, 2019).

- c) Strong, affordable internet infrastructure is obviously critical. With the new undersea cables that have been laid in recent years both Vanuatu and Solomon Islands have made major advances here. The mobile phone revolution of the last decade has also brought enormous improvements in connectivity. The cost of Internet access, however, remains relatively high, excluding many people. To spread the benefits of new technologies and information, and to capture the skills and potential of all people, Internet access must be kept as low as possible.
- d) In attracting FDI and individual entrepreneurs or distance workers, improvements to the physical living environment will also be important, such as the EIF/ New Zealand project to upgrade the wharf area in Port Vila. Both Vanuatu and Solomon Islands have made progress in this regard. A liveable physical environment is more conducive to attracting and retaining overseas talent, as well as to discouraging brain drain.

## 6. Conclusions

Given the evidence that widespread structural transformation and industrialisation using horizontal policies may be more elusive than in some other developing countries and regions, large parts of the economy in the Pacific LDCs and former LDCs will continue to rely over the long term on transfers, aid, non-market activity, government service provision and backstopping. Only certain areas may ever be susceptible to industrial policies aimed at promoting value-addition. There will be no 'magic bullet' for structural transformation. The region's unique characteristics – small size, fragmentation, distance from markets and vulnerability to natural disasters – require nuanced and context-specific thinking.

New ideas about economic transformation must be put in place to promote the next phase of economic development, anchored in local realities and adapted to the very specific circumstances of the region, rather than taken unaltered from elsewhere. In no Pacific Island LDC is structural transformation likely to take the form of a 'spontaneous' transition to higher productivity led by market incentives. The state can catalyse private sector growth and support the private sector, with a particularly active role in linkage development. Aid and ODA are a long-term feature of the economic landscape and are unlikely to diminish substantially as a result of graduation. They are so large that they must be considered a major component of aggregate demand, unlike in many other developing countries. Transfers and other unconventional sources of foreign exchange will continue to form a large component of government revenues and economic output. It is important that outside entities such as multilateral agencies and

bilateral donors take these facts into consideration.

LDC graduation itself is unlikely to make much difference to the economies of any of the four countries, but this lack of impact does not mean that policies or strategy should remain the same. Even if the material impact of graduation is limited, its symbolic significance is not. To Kiribati and Tuvalu at least, the reluctance to graduate is partly due to those governments' unwillingness to send a signal to the international community that the development process has advanced to a high level and that therefore these countries can be left to their own devices. Governments are also concerned about foregoing future opportunities. The LDC group is particularly effective in the arena of climate negotiations, and the Pacific LDCs benefit via association with larger, more powerful climate-affected LDCs. In Vanuatu, which has graduated, and Solomon Islands, which will do so in 2024, the event is also symbolic, representing a milestone in development progress and a chance to take stock of developments so far, with the government enacting new strategies and policies for the next phase.

In an environment of extreme shortage of resources, physical and human, it is just as important for governments to prioritise what they will not do as what they will do. The emphasis on trade agreements takes up too much government time and resources, with little benefit. Trade liberalisation has not contributed to structural transformation. Most trade is by now fully liberalised, and in any case preference erosion reduces the impact of regional agreements with Australia and New Zealand. Pacific LDC governments should

commit more to developing productive capacity and less to trade negotiations. This means reassigning personnel and resources directly toward productive capacity-building activities and structural transformation.

Some fungibility in human resources exists – indeed a core principle of many civil services is that officials can be redeployed in a number of directions as circumstances change. Yet further flexibility is possible and desirable in such a rapidly changing and volatile situation, where adaptivity is at a premium. In most Pacific LDCs there are so few government personnel that they must work together on a range of assignments. The opportunity for specialisation is limited, and centralised entities or institutions should be created, tasked with multi-sectoral economic development initiatives. One of the jobs of these centralised institutions should be the promotion of linkages, concentrating on the blue economy and culturally and environmentally-sustainable tourism, as well as agriculture/ tourism linkages. External players such as donors should take a ‘hands-off’ approach, allowing governments to learn more by making mistakes.

Technology is no panacea, and the fourth industrial revolution will not provide all the answers for structural transformation. Yet it would be remiss of governments not to acknowledge the importance of new technologies and to put in place policies to take advantage. The Pacific island countries are services-orientated anyway, and may as well move further in this direction given that this is indeed the direction of structural transformation in recent decades. For the Pacific, digital trade makes sense since distance is less of a binding constraint than it is with physical trade. The pandemic is likely to have a lasting effect on business, with remote working and physically-distanced production becoming a permanent part of all economies. The Pacific is also less vulnerable to automation because it was never a mass employment, low-wage destination. New technologies such as drones, 3D printing and virtual tourism may have potential. Governments will need to enact the policies to accommodate and take advantage of new developments, including human resources and training, regulations, infrastructure and the physical environment.

# References

- Baldacchino, G., and G. Bertram (2009). The beak of the finch: insights into the economic development of small economies. *The Round Table*, Vol. 98, No. 401, pp. 141–160. Available from <https://core.ac.uk/download/pdf/83020805.pdf>.
- Baumol, W. J., and W. G. Bowen (1966). *Performing Arts, The Economic Dilemma: A Study of Problems Common to Theater, Opera, Music, and Dance*. Cambridge, Mass.: M.I.T. Press.
- Bruckner, M. (2018). Managing graduation from the LDC category: The case of the Maldives' fish exports. *UN LDC Portal*. Available from [www.un.org/ldcportal/managing-graduation-from-the-ldc-category-the-case-of-the-maldives-fish-exports/](http://www.un.org/ldcportal/managing-graduation-from-the-ldc-category-the-case-of-the-maldives-fish-exports/).
- Chenery, H. B. (1960). Patterns of industrial growth. *The American Economic Review*, vol. 50, No. 4, pp. 624–654.
- Chenery, H. B. (1975). The structuralist approach to development policy. *The American Economic Review*, vol. 65, No. 2, pp. 310–316.
- Chenery, H. B. (1979). *Structural change and development policy*. Washington, D.C.: World Bank; Oxford: Oxford University Press.
- Enhanced Integrated Framework for Trade (2019). Vanuatu Ministry of Tourism, Trade, Industry, Commerce and Ni-Vanuatu Business: Graduation Strategy, December 2019.
- Ferencz, J. (2019). The OECD Digital Services Trade Restrictiveness Index. *OECD Trade Policy Papers*, No. 221. Paris: OECD Publishing. Available from <https://doi.org/10.1787/16ed2d78-en>.
- Gay, D. (2004). The emperor's tailor: an assessment of Vanuatu's Comprehensive Reform Program. *Pacific Economic Bulletin* 19:3. Available from <https://openresearch-repository.anu.edu.au/handle/1885/157730>.
- Hirschman, A. O. (1958). *The Strategy of Economic Development*. New Haven, CT: Yale University Press.
- Kaldor, N. (1957). A model of economic growth. *The Economic Journal*, vol. 67, No. 268, pp. 591–624.
- Kaldor, N. (1978). *Causes of the Slow Rate of Economic Growth of the United Kingdom*. Cambridge: Cambridge University Press.
- Krugman, P. (1991). Increasing returns and economic geography. *Journal of Political Economy*, vol. 99, No. 3.
- Lewis, W. A. (1954). Economic development with unlimited supplies of labour. *The Manchester School of Economic and Social Studies*, vol. 22, No. 2, pp. 139–191.
- Lewis, W. A. (1979). The dual economy revisited. *The Manchester School of Economic and Social Studies*, vol. 47, No. 3, pp. 211–229.
- Myrdal, G. (1957a). *Rich Lands and Poor: the Road to World Prosperity*. New York: Harper & Brothers.
- \_\_\_\_\_ (1957b). *Economic Theory and Underdeveloped Regions*. London: Gerald Duckworth.
- \_\_\_\_\_ (1968). *Asian Drama: An Inquiry into the Poverty of Nations*. New York: Pantheon Books.

- Pacific Islands Report (2013). Tuvalu pushes UN to reconsider 'least developed' status. Available from [www.pireport.org/articles/2013/09/24/tuvalu-pushes-un-reconsider-'least-developed'-status](http://www.pireport.org/articles/2013/09/24/tuvalu-pushes-un-reconsider-'least-developed'-status).
- ReliefWeb (2020). *WorldRiskReport 2020 - Focus: Forced Displacement and Migration*. Available from <https://reliefweb.int/report/world/worldriskreport-2020-focus-forced-displacement-and-migration>.
- Schlögl L., and A. Sumner (2020). Economic development and structural transformation. In *Disrupted Development and the Future of Inequality in the Age of Automation*, Rethinking International Development Series. Palgrave Pivot, Cham. Available from [https://doi.org/10.1007/978-3-030-30131-6\\_2](https://doi.org/10.1007/978-3-030-30131-6_2).
- United Nations, Economic and Social Commission for Asia and Pacific (ESCAP) (2020). *Asia-Pacific Countries with Special Needs Development Report 2020: Leveraging Ocean Resources for Sustainable Development of Small Island Developing States*. Bangkok.
- Winters, A., and P. Martins (2004). When comparative advantage is not enough: business costs in small remote economies. *World Trade Review*, vol. 3, No. 3, pp. 347-383.

Get connected. Follow us.



[www.unescap.org](http://www.unescap.org)



[facebook.com/unescap](https://facebook.com/unescap)



[twitter.com/unescap](https://twitter.com/unescap)



[instagram.com/unitednationses](https://instagram.com/unitednationses)



[capyoutube.com/unescap](https://capyoutube.com/unescap)



[linkedin.com/company/united-nations-escap](https://linkedin.com/company/united-nations-escap)