Pacific Performance and Outlook

Background Paper for *Pacific Economic Survey 2008*

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Introduction

The world economy continues to enjoy vigorous growth, expanding by 5.4 percent in 2006. Growth in Asia is even higher, with East Asia and South Asia both growing rapidly. At the centre of this success story is China and India with economies growing at 10 per cent and 8 per cent respectively. Other countries in the region are also growing at rates of around 5–7 per cent.

The Pacific though is generally missing out on the global boom. On a per capita basis real GDP growth over the past decade has barely kept pace with the rate of population increase. Closer integration with regional and world markets offers the Pacific the best opportunity for accelerating growth. This will require reforms to improve communication and transport links to the rest of the world, liberalization of foreign investment regulations, improved access to local land and, if real progress is to be made, improved access to foreign labour markets.

Some progress has been made, with various Pacific island countries taking steps to lower trade barriers, invest in infrastructure and liberalize the aviation and mobile telephony sectors. The results obtained, for example in Samoa (telecom and aviation) and Vanuatu (aviation) show the potential benefits from competition in these areas. However, progress is halting, uneven, and undermined in several countries by political instability and a mix of natural, institutional and policy constraints. Timor-Leste, Tonga, Solomon Islands and PNG have all suffered from social unrest in recent years and the Fijian economy has been battered by successive coups. Many countries in the region have limited resources and continue to be disadvantaged by the distance from major centres of economic activity and the small size of local markets. Economic integration and other institutional and economic policy changes could make a big difference but in several countries the binding constraint of remoteness will continue to restrict local economic development irrespective of the public policies that are implemented.

1 Growth has picked up, but the Pacific is missing out on the global boom

The overall growth performance in the Pacific improved in 2007 with annual growth increasing to around 3 per cent compared to an average of about 2.2 per cent for the 2002–2005 period (Table 1). Vanuatu, Palau, Solomon Islands and Papua New Guinea grew at above average rates in 2007. Economic growth picked up in Fiji in 2006 but declined in 2007 following the coup in early December 2006. The Cook Islands, Marshall Islands and Samoa also experienced a pick up in growth. For the region as a whole the strong performers in 2007 and 2008 are Papua New Guinea, Timor-Leste, Palau, Solomon Islands and Vanuatu. The strong recovery in Timor-Leste in 2007 reflects the restoration of civil order following the civil unrest in 2006, a sharp increase in government expenditure and the re-establishment of a UN Integrated Mission to support recovery and improved governance.

Table 1: Real GDP growth in the Pacific, 2002–2008

	2002	2003	2004	2005	2006	2007	2008
Cook Islands	2.6	8.2	4.3	0.1	0.8	2.5	3.5
Fiji Islands	3.2	1.02	5.3	0.7	3.4	-3.1	1.5
Kiribati	2.7	-1.5	2.3	2.5	1.1	1.0	1.0
Marshall Islands	3.8	3.4	5.6	1.7	1.3	2.5	3.0
Micronesia, Fed States	1.4	3.3	-4.3	1.5	-0.7	1.0	1.5
Palau	-3.5	-1.3	4.9	5.5	5.7	5.5	4.8
Papua New Guinea	-0.2	2.2	2.9	3.4	2.6	5.2	4.5
Samoa	1.0	3.1	3.4	5.2	2.6	3.1	2.5
Solomon Islands	-1.6	6.4	8.0	5.0	6.1	6.3	4.0
Timor-Leste	-6.7	-6.2	0.3	2.3	-1.6	22.0	3.5
Tonga	3.0	3.2	1.4	2.3	0.7	-3.5	0.1
Tuvalu	5.5	4.0	4.0	2.0	3.0	2.5	2.5
Vanuatu	-7.4	3.2	5.5	6.5	7.2	4.7	4.6
Melanesia	0.6	2.0	4.0	2.7	3.2	2.5	3.5
Micronesia	1.0	1.7	0.9	2.6	1.4	2.4	2.6
Polynesia	2.0	4.2	3.1	3.3	1.7	1.2	2.1
The Pacific, PNG and Timor-Leste	0.5	1.9	3.6	2.7	2.8	3.0	3.3
South Asia	4.4	5.0	5.7	6.7	6.7	6.2	6.1
Emerging Asia		8.8	9.2	9.8	9.0	8.5	8.1

Source: ADB (2007a), IMF (2007a) and authors estimates. Note: South Asia comprises Bangladesh, Bhutan, Maldives, Myanmar, Nepal and Sri Lanka. Emerging Asia comprises China, India, Hong Kong, Korea, Singapore, Taiwan, Indonesia, Malaysia, the Philippines, Thailand and Vietnam.

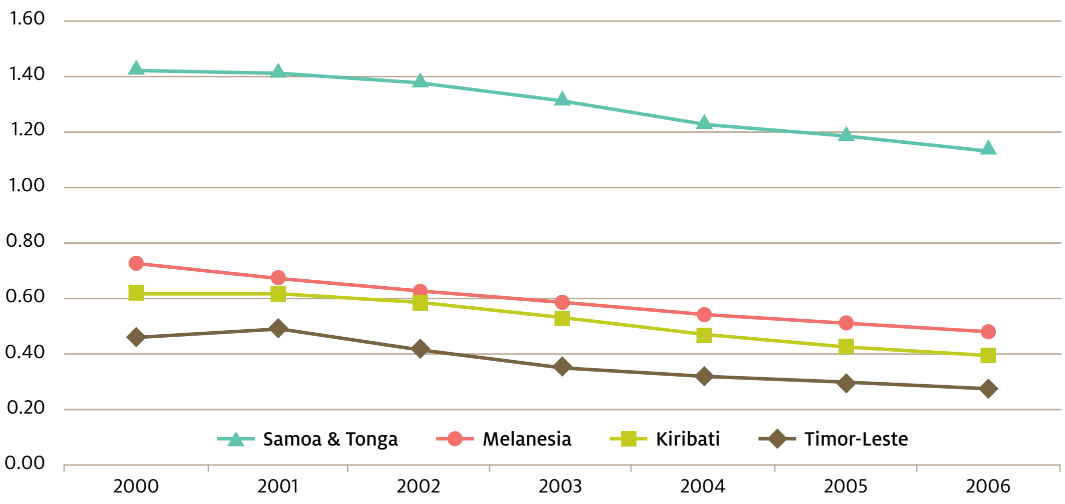
For the region as a whole the main factors supporting growth are the commodities boom, tourism, remittances, income from trusts and aid-funded government expenditure and development projects. Some of these factors are not beneficial or not important for some countries. Micronesia is heavily reliant on aid funding while remittances are a major source of income for Polynesia, Tuvalu and Kiribati and tourism provides substantial income for Fiji, Palau and most of Polynesia. Income from trust funds is important for Kiribati, Timor-Leste and Tuvalu. Commodity exports make a relatively small contribution to GDP in many Pacific island countries given these other income sources. Commodity exports including oil are important for Papua New Guinea and Timor-Leste but these countries receive minimal income from tourism and remittances.

The commodities boom clearly benefits Papua New Guinea which produces half of the GDP of the region and Timor-Leste with its large oil resources. However, as shown later in this chapter, the recent commodities boom has had adverse overall impacts for many smaller countries in the Pacific because the impact from high oil prices has more than offset any boost from higher non-oil commodity prices. Some countries have adjusted to higher oil prices with the support of aid and remittances and in some cases by running down foreign asset reserves which is creating pressures on external accounts.

The improved growth performance in 2006 occurred mainly in Melanesia. The strong performance in Vanuatu represents the third consecutive year of strong growth and all sectors of the economy are growing. The Solomon Islands has also experienced several years of strong growth and stronger growth is now occurring in Papua New Guinea. The overall contraction of the economy in Fiji in 2007, following the military coup in December 2006, was the main reason why growth was lower in 2007 in Melanesia than a year earlier and also held back overall growth in the Pacific region in 2007.

Although it is clear that Papua New Guinea and Timor-Leste are benefiting from the global mining resources boom, the growth performance of the Pacific region as a whole continues to be well below that of Emerging Asia and the low income countries of South Asia (Table 1). The low economic growth in Pacific island countries has been a longstanding feature of the region, despite the relatively large aid and economic development programs that have been in place over a long time frame. When GDP per capita is adjusted for the purchasing power of different currencies, countries in the Pacific and Timor-Leste[1] have fallen behind in terms of the outcomes achieved in Emerging Asia (Chart 1). The increase in social and civil tensions that has also been a recent feature of the region may be reflecting underlying dissatisfaction that the region is missing out on the general improvements that are being made in Asia and elsewhere.

Chart 1: Purchasing Power Parity GDP per capita—The Pacific Relative to Emerging Asia



Source: IMF World Economic Outlook Data Base

1 The GDP figures for Timor-Leste refer to non-oil GDP as this is considered to be a more meaningful measure of economic development in that country at this stage.

Part of the explanation for relatively weak economic growth can be related to the natural constraints of small domestic markets, geographic isolation from major centres of economic activity and vulnerability to natural disasters. However, institutional arrangements and public policies also play a role and these can be changed and improved in many countries in the region so that they provide a better economic and social environment to support an improved growth performance. There are a number of very positive recent changes in institutional arrangements and public policies that have been important in crystallizing better performance in specific sectors or laying the foundations for general improvements in living standards. However, generally limited progress has been made in addressing the key binding constraints to economic development and growth.

2 Recent growth developments in selected countries

Melanesia

Economic growth has been picking up in **Papua New Guinea** as the economy responds to the commodity price boom and macroeconomic and political stability. There has been increased production of copra, logs and palm oil and oil in response to higher world prices, however non-oil mining production contracted in 2006 as the result of a landslide at the Porgera gold mine. The stimulus provided by the commodities boom led to a further pick-up in growth in 2007 and the election in mid-year did not appear to disrupt the economy.

Despite civil unrest following the election in April, the **Solomon Islands** economy grew strongly in 2006 as a result of continuing and unsustainable high log production, a resumption of palm oil exports from Guadalcanal, higher fish exports, refurbishment of the Gold ridge and aid-funded development projects. A tsunami on 2 April 2007 killed 52 people and displaced thousands in the country's western provinces, generating a supply of emergency aid from international donors alongside reconstruction programs. Continued growth is expected as the economy benefits from significant aid and the commodities boom and recovers to levels of economic activity similar to what was achieved ten years ago before the breakdown in law and order. It is also worth noting that Taiwan has agreed in principle to accept hundreds of guest workers each year, potentially constituting a valuable source of remittance income.

Fiji recorded moderate growth in 2006, despite a small decline in tourism as a result of the military coup in early December, the closure of the Emperor gold mine and a substantial decline in the clothing industry as a result of the loss of preferential access to the US market. The economy contracted in 2007 as tourism and the construction sectors suffered in the uncertain security and political environment and sugar production declined. Although sugar production increased in 2006, the industry continues to struggle to be competitive given the reduction in preferential prices that are in prospect in the near and medium term. The balance of payments continues to be under pressure and this has led to a focus of monetary policy on restricting credit and foreign exchange transactions. Foreign investors are now required to refinance up to 50 per cent of capital expenditure from overseas sources by the end of 2008 and property investment to be entirely funded from overseas by the start of 2008. The political scene is very uncertain, business confidence has plummeted and sustainable economic growth is not likely to occur without a return to more democratic and stable governance. The state of emergency that was in force was formally ended on 31 May but the military government has proposed that elections will not be held until 2010 but there is pressure from donors to hold elections in early 2009.

Vanuatu has achieved several years of strong growth with relatively strong performances in construction and tourism. There has also been considerable foreign investment in local real estate. With the exception of 2005 there has also been strong growth in export crops in recent years. The operation of Pacific Blue since October 2004 has boosted tourism, especially from Australia, and visitor arrivals by ships have also increased. The government's fiscal position has also improved and private sector credit has also been buoyant, growing by more than 10 per cent a year. Vanuatu is also benefiting as the first Pacific island country to receive funding from the Millennium Challenge Account (MCA) which was established in 2002 by the United States government for provision of foreign aid to countries meeting a set of established criteria. In Vanuatu the funding will support development in poor rural areas. New Zealand's Recognised Seasonal Employer Scheme will allow around 1,000 ni-Vanuatu workers to work there for a short period beginning in October 2007. Political stability has been a feature of Vanuatu in recent years, however, 2008 is an election year and this could entail some downside risk in terms of effective public policy design and implementation.

Timor-Leste

The contraction of the economy in Timor-Leste in 2006 occurred as a result of civil unrest and armed conflict between the National Defence Force and the National police that lasted from April to September. Order was restored with the help of international forces. The conflict led to the burning of over 2000 houses and about 50 per cent of the population leaving Dili. Coffee and other agricultural production also suffered. However, rapid recovery was underway in 2007 with the support of substantial external aid and the presence of more than 2,000 international personnel, a resumption of agricultural activity and continuing income from oil production. There was some violence in the run-up to the elections held in mid-2007 but the elections occurred without any major incident. All the parties contesting the parliamentary election agreed to a code of conduct that dealt primarily with their conduct during the campaign but also held them to a post-election commitment to good governance. However, continuing political tensions are likely as a coalition government will be in place which may make it difficult to reach agreement on effective public policies.

Micronesia

In **FSM** recent growth has been constrained by the need to adjust to lower external aid, particularly for current spending, and delays in implementing a substantial aid-funded infrastructure program. Economic growth slowed in **Kiribati** in 2006 as construction activity has levelled off and only modest growth is expected in the near and longer term. Economic production in **Nauru** remains stagnant despite the substantial injection of aid funds for a range of projects. However, the resumption of phosphate mining should lead to some modest growth in near and medium term. In the **Marshall Islands** economic growth has picked up driven largely by aid-funded capital expenditures.

Palau continues to record the best economic growth in Micronesia, with real GDP growth averaging about 5.5 per cent in the 2004-2007 period. The recent growth performance has been supported by tourism and aid-funded infrastructure projects and on a per capita basis, Palau is the most prosperous of the Pacific island economies. However, there are strong concerns, as is the case for the rest of Micronesia, regarding the country's economic sustainability and long-term future. Key issues to be faced are fiscal consolidation to prepare for a possible decline in US Compact aid and reforms to make it easier to attract foreign investment and mobilise land resources.

Polynesia

The **Cook Islands** economic growth performance has been good since a fiscal and associated economic crisis in the mid-1990s. However, growth has slowed in recent years reflecting a decline in exports of pearls and fish although the tourism sector has continued to grow. Business confidence is high and growth is expected to pick up in the near term led by the tourism sector and supported by recovery of commodity exports. The main risk in the business sector is the prospect that restrictions on foreign investment will be tightened.

In **Samoa** growth has slowed reflecting cyclone damage in the agricultural sector and an easing of construction growth. Expansion of tourism is expected to continue to be the main contributor to economic growth in the near and medium term. Improving access to land is considered to be important for Samoa to realise its growth potential. Applications far outnumbered placements for short term work opportunities in New Zealand's new Seasonal Employer Scheme for Pacific Islanders.

Economic growth has slowed in **Tonga** reflecting a decline in agricultural production in 2006, lower construction activity and a reduction in economic activity in the wake of the demonstration that led to the burning and looting of the capital in November 2006. Modest recovery is occurring with a pick up in tourism and remittances and aid funded reconstruction activity but there are significant risks to the outlook as a result of the government's fiscal position and ongoing uncertainties about governance and how those involved in the looting will be treated. Interest in New Zealand's Seasonal Employer Scheme has been considerable in Tonga. The US-based Warwick International Hotel Group signed an unprecedented agreement with the government of Tonga in March 2007 to lease 11.5 ha of land in the Vavau group of islands on which it plans to build a luxury resort. In addition the Tongan authorities have been working with the assistance of FIAS to review and reform the regulatory environment for business since early 2005 and there has been good progress on contract enforcement and conflict resolution. However, revisions to business licensing processes are seen as a backward step as all business activities except handicrafts have to be licensed, multiple licenses are often needed and administrative costs are still high.

Tuvalu continues to record modest growth largely reflecting increases in government expenditure supported by trust fund income and aid funded projects.

3 Macroeconomic stability is being achieved in most countries but several face significant fiscal pressures

Macroeconomic stability is important for providing a platform for growth as it reduces uncertainty and enables the private and public sectors to focus on initiatives to improve performance across a wide range of activities and functions. Fiscal and monetary policies are the main policies that are relevant for helping to ensure macroeconomic stability but in most Pacific Island countries fiscal policy dominates monetary policy given the nature and state of the monetary arrangements and the depth of financial markets. Effective fiscal policy is also important given the government sector is a relatively large part of the formal economy in most Pacific Island countries and is, in many cases, heavily reliant on aid.

Generally **fiscal** stability has been a long term feature for most of the region, although at times there have been important exceptions where a fiscal crisis has emerged creating a combination of inflationary and recessionary pressures. In 2006 and 2007 most Pacific island countries had fiscal policies in place that were both conducive to macroeconomic stability and sustainable over the longer term. The main exceptions were Kiribati, Federated States of Micronesia, Marshall Islands and Tonga. Some countries also experienced macroeconomic instability or the prospect of instability as a result of internal security or political crises, particularly Fiji, Timor-Leste and Tonga.

Kiribati has been running very large deficits of well over 20 per cent of GDP in the past four years. The deficits have been financed by drawdowns from the Revenue Equalisation Fund which was created to provide a long term sustainable income source and funding in times of temporary fiscal shortfalls. A tradition of sound fiscal management and prudent investment allowed Kiribati to increase the financial assets in this fund to a peak of approximately 8 times GDP in 2000. The government's revenue base is one of the most volatile in the world reflecting high dependence on non-tax (particularly fishing fees) and grant revenues and the fund provides a valuable cushion when there are temporary fiscal shortfalls. However, increased government expenditure since 2001 and a subsequent weakening in revenues have been reflected in a series of very large fiscal deficits. The per capita value of the Fund has declined from its peak in 2000, although it remains above the informal benchmark of maintaining it at the 1996 real per capita value. The Fund has provided a valuable income source in recent years but if recent policies continue the fund risks being depleted.

The **Federated States of Micronesia** is facing fiscal pressures as it tries to transition to lower levels of Compact grant funding and requirements for expenditure in sectors designated as priorities under the Compact arrangements, as well as requirements to invest in a trust fund. Recent weakness in the economy largely reflects lower levels of grant funding as well as an inability to spend substantial Compact funds designated for infrastructure. In the past fiscal discipline has been uneven across States and, in particular, Chuuk State, which is the most populous State, has experienced severe fiscal problems over a long time frame. Reserves have been completely depleted and government arrears were over 40 per cent of GDP in 2006 leading to significant operational difficulties for government and economic development programs. A fiscal adjustment and transition plan has been developed for the country with the central feature being tax reform. However, it is apparent that tax reform by itself will not be enough and in addition will take several years to implement effectively.

Tonga has been experiencing a period of macroeconomic instability and weak growth reflecting fiscal pressures and political and social unrest. A pro-democracy demonstration in November 2006 led to the burning and looting of many businesses in the capital, Nuku'alofa, and the loss of life. The fiscal deficit deteriorated alarmingly in 2006 following a 2005 public service strike and subsequent action to raise civil service salaries by 60-80 per cent and provide payout packages from a consequent reduction in the civil service by 18.5 per cent in mid-2006. The 2006 fiscal deficit had to be financed by the sale of state assets as well as foreign borrowings. Fiscal pressures were evident before these recent developments and are expected to continue, reflecting the strain of higher salaries as well as the need to support economic recovery and the reconstruction of the capital.

Some countries have recently or are currently experiencing some macroeconomic instability as a result of some combination of civil unrest, public security and political problems. **Timor-Leste** does not have a fiscal stability problem but it has suffered economic instability as a result of civil unrest. Inflation increased in 2007 but is forecast to decrease in 2008. The use of the US dollar has served as an inflation anchor. The security crisis in 2006 led to the closure of some government departments and disrupted private sector activity. Timor-Leste also faces fiscal and economic development problems in terms of budget execution and the optimal use of petroleum trust funds from an intergenerational perspective.

Fiji also faces a period of macroeconomic instability reflecting general uncertainty following the coup in December 2006, subsequent difficulties in re-engaging effectively with the international community and weaknesses in key sectors. Maintaining fiscal stability is a priority for the interim administration and the 2007 budget contains a number of measures that will help to reduce the fiscal deficit including a reduction in civil service wages and rationalisation of government departments.

In **Solomon Islands** macroeconomic stability and economic recovery have been achieved with the help of the Regional Assistance Mission to Solomon Island (RAMSI)[2], significant aid funded financial resources and improvements in public security. Economic growth has rebounded and macroeconomic stability has been achieved with the benefit of substantial external aid.

In **Nauru** a reformist government that was elected in 2004 has made good progress in restoring fiscal stability with the help of substantial external funding and technical assistance. The return of fiscal stability follows many years of fiscal mis-management and the depletion of public trust fund assets. In 2007–08 the government is maintaining a surplus for the third consecutive year. This is important in order to commence repaying the large public debt that is owed to both Nauruans and foreign creditors. Total public debt owed outside the public sector is estimated to $A 635 million which is equivalent to about 2,500 per cent of Nauru's annual GDP (Republic of Nauru 2007). Given the enormous size of the debt the government is developing a debt management strategy that will aim to negotiate a substantial write-down in debt and commit to a credible, sustainable repayment schedule. Legislation is being planed for introduction in 2007–08, aimed at cementing in place principles of good financial management and reporting. However, considerable progress will be needed in ensuring secondary phosphate production is successful and other revenue streams are developed if reliance on aid is to be reduced over the long term.

Tuvalu has been experiencing a period of high fiscal deficits but these have been financed by funds drawn from the Tuvalu Trust Fund which is considered to be the most successful public fund in the Pacific.

2 RAMSI is a partnership between the citizens and the government of the Solomon Islands and 15 regional countries.

In **Vanuatu**, fiscal stability has been achieved in recent years but a decision to increase civil servants salaries by 20–25 per cent that was implemented in 2006 has meant a reduction in other expenditures important for economic development and will contribute to future fiscal pressures.

Turning to **monetary policy**, the success of the monetary arrangements that are in place is primarily reflected in inflation outcomes and the avoidance of recessionary conditions. For those countries without an independent currency, inflation should tend to reflect inflation outcomes in their main trading partners. The lack of an independent currency in small countries has the advantage that inflation cannot be generated by deficit spending within the country and also leads to a saving in terms of the institutional costs of establishing and maintaining a central bank.

In most Pacific island countries, inflation is currently at moderate and manageable levels. However, inflation for the region increased to average 4.7 per cent in 2007 reflecting the flow on effects of higher oil prices and in some cases local inflationary pressures. Solomon Islands, Timor-Leste and Tonga have been experiencing inflationary pressures in recent years and inflation picked up in Fiji, Papua New Guinea and Samoa in 2007. Solomon Islands has a long history of relatively high inflation, however the central bank adjusts the exchange rate, when it considers it is appropriate, to help maintain international competitiveness. The inflation outcomes in Tonga in recent years are symptomatic of macroeconomic instability arising from fiscal deterioration and recent disruption to economic activity.

In some countries private sector credit has been growing rapidly with the potential for contributing to inflationary pressures and raising concerns about capacity to meet higher interest payments which may be in prospect. This is particularly the case for Solomon Islands and Tonga. Inflationary pressures are building in Papua New Guinea, as a result of the stimulus provided by the commodities boom.

A positive feature of the financial systems in the Pacific as a whole is that the regulatory authorities appear to be doing a good job in terms of financial supervision and there have been no instances of major crises in the finance sectors of the region for several years now.

Exchange rate policy is only relevant for those countries with their own currencies. Exchange rate policy and monetary policy are inextricably linked, however the exchange rate provides an important means of macroeconomic adjustment when there is a balance of payments crisis and the exchange rate is also important for helping to ensure that international competitiveness is maintained.

The most relevant indicator of international competitiveness when assessing exchange rate policy is the real effective exchange rate (REER) which takes account of exchange rates for major trading partners as well as differences in inflation between the home country and its trading partners. If the exchange rate is held fixed and a country has a persistently higher inflation rate than its main trading partners, this will be reflected in a rise in the real effective exchange rate and imply a loss of international competitiveness.

Fiji, Samoa, Tonga and Vanuatu have experienced a loss of international competitiveness in recent years based on the REER (See Charts in Annex 1). The effect in Fiji has been relatively small but it is much larger in Samoa and Tonga. In Samoa most of the loss occurred in 2004 as a result of a sharp increase in inflation in that year. In Tonga the deterioration in competitiveness occurred in the 2004-06 period and further deterioration is likely reflecting the flow-on effects of the substantial increase in public sector wages in 2006. The loss in competitiveness in these countries is to some extent reflected in the sizeable and, with the exception of Vanuatu, growing current account deficits that have been realised in recent years.

To be effective exchange rate policy needs to be supported by complementary fiscal and structural economic policies and current account deficits per se are not necessarily a problem, particularly if they are supported by sustainable balances on the capital account. In addition, adjustment of the exchange rate targeted at reducing the current account may well be counter productive if there are large capital inflows that are leading to either a build up of reserves or appreciation of the nominal exchange rate. In the case of Vanuatu private sector capital inflows have meant that the capital account has recorded strong surpluses in recent years and gross official reserves have built up to cover 7 months of imports by mid-2007 when a comfortable level is about 4 months of import cover.

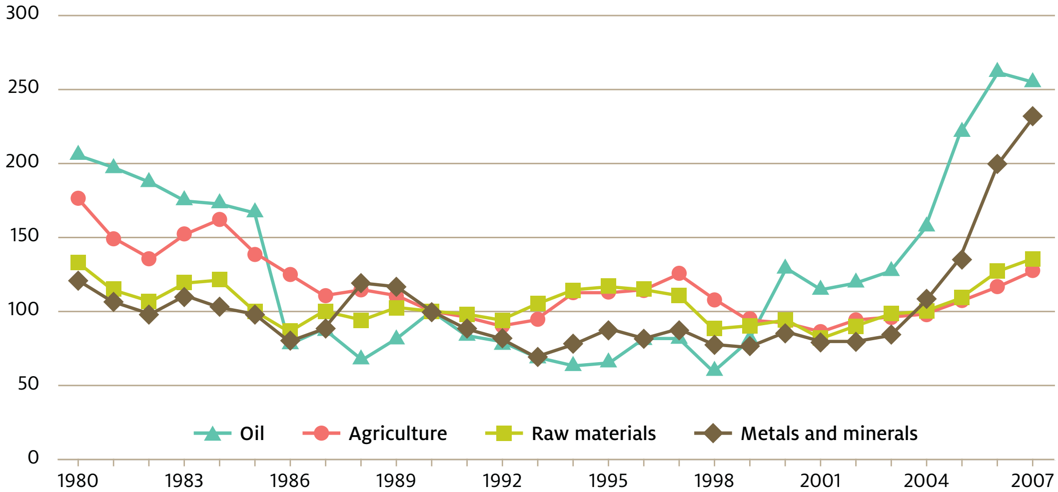
However, some of the countries in the South Pacific may need to adjust their exchange rates over the next few years to help restore international competitiveness. Relatively low foreign reserves in Fiji and Tonga may create pressures for exchange rate adjustment. For Vanuatu, a key issue for the medium term is the sustainability of the surplus on the capital account, however, it does have a strong reserve position in the event that substantial private capital inflows were suddenly reduced and the policy environment has been contributing to business confidence.

4 High commodity prices have had a dramatic impact

There has been a big increase in commodity prices

Rising commodity prices have been an important force affecting global and regional economic activity in recent years. Broad averages of real commodity prices (relative to world manufactured export unit values) have increased markedly since 2001 and continued to increase in 2006 and up to mid-2007 (Chart 2). However, the most dramatic increases have occurred for oil and metals and minerals. Real agricultural prices are still below levels recorded in the early 1980s, while real raw material prices have recently risen to levels just above those recorded in 1980. Nevertheless, the recent strengthening of non-oil commodity prices is longer lasting than for other cyclical upturns since 1980.

Chart 2: Real commodity prices—oil, agriculture, raw materials, metals and minerals



Source: World Bank, Commodity Price Data Base

Commodity prices are expected to stabilize but not weaken in the near term consistent with slowing world economic growth and uncertainty in financial markets. For Pacific Island countries key issues are the extent to which commodity prices have increased for particular commodities that they export, the extent to which volume responses have occurred following the price increases and the extent to which oil price increases have offset or reduced the benefits from the price and volume effects of the commodity price boom.

Oil, gold and copper are important exports for Papua New Guinea. Oil production makes a dominant contribution to GDP in Timor-Leste and gold mining makes a small and growing contribution in the Solomon Islands. Gold production has recently stopped in Fiji while phosphate production is resuming in Nauru, with the life being extended by secondary mining of the underground and less accessible phosphate in Nauru. Real copper prices have almost quadrupled in real terms since 2001, providing a significant benefit to Papua New Guinea. Recent increases in phosphate prices would also benefit Nauru.

Agricultural commodity exports are important for Fiji (sugar) Papua New Guinea (coffee, cocoa, copra and palm oil), Solomon Islands (cocoa and palm oil) Vanuatu (coffee, cocoa, copra and beef) and Tonga (squash). Fish and marine exports and log exports are also important for some countries. However, for many countries in the region (FSM, Kiribati, Marshall Islands, Palau, Samoa, Tuvalu) agricultural commodity exports make a relatively small contribution to the economy, especially in comparison to incomes provided by aid, remittances, trust fund income and tourism, depending on the country. Log exports are important for the Solomon Islands and Papua New Guinea.

Real prices for coffee and cocoa, palm oil and copra have also increased since 2001, boosting export values in several Pacific Island countries. In the case of copra, real prices in the first half of 2007 were higher than they had been since a peak in the mid-1980s and similarly for palm oil compared to the last peak in 1998. However, in many countries production levels for commodities continued to be well below peak levels recorded in the past. Real prices for logs have also increased significantly since 2001, but nowhere near as much as for copper.

The supply response has generally been sluggish[3]

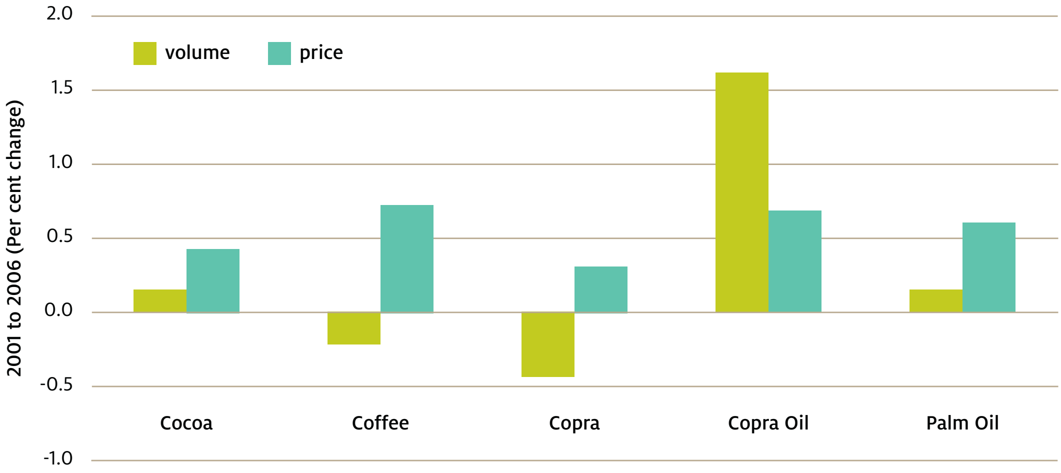
Despite the sustained high prices for commodities, the supply response in some countries for traditional agricultural exports has been sluggish. In Papua New Guinea coffee and copra export volumes were lower in 2006 than in 2001 (Chart 3). However, copra oil increased substantially in this period as processing facilities were developed.

Cocoa and palm oil volumes have increased since 2001 but volume responses are far less than price increases. Weak coffee volumes in 2006 were associated with the biennial production cycle, however coffee volumes in 2005 were only 10 per cent higher than in 2001 despite a nominal price increase of over 70 per cent in this period and volumes in the first quarter of 2007 were 25 per cent less than for the same period a year earlier. This was partly due to lower yields from the prolonged rainy season but also the lack of rehabilitation of aging coffee trees.

Copra production declined substantially in 2006 as a result of poor infrastructure and rainy conditions but production in 2005 was about the same as in 2006 despite an increase in nominal prices of around 55 per cent between 2001 and 2005. Cocoa volumes also declined marginally in 2006 due to unfavourable weather conditions as well as infrastructure and logistic problems in getting produce to markets. Unfavourable weather conditions also affected tea and rubber production in 2006 but rubber production has increased noticeably since 2001 as the result of better road infrastructure, particularly in the Cape Rodney area of the Central Province.

3 This section draws on quarterly and annual economic reports of various Central Banks in the region.

Chart 3 Agricultural commodity volume response in Papua New Guinea



Source: Bank of Papua New Guinea QEB Statistical Tables, Export Volume and Price Indices

In **Solomon Islands** it is difficult to determine the extent to which increased production of copra and cocoa in recent years is due to recovery from the collapse of industries in 2001 and 2002, as a result of the civil war, and the substantial increase in prices since 2001. Copra production in 2005 was about 38 per cent higher than in 2000 before production collapsed in 2001. Production declined in 2006 by 19 per cent, although prices declined by only about 3 per cent in $US terms. Cocoa export volumes also declined substantially in 2006, although prices did not weaken and declined further in the first quarter of 2007 when prices strengthened. A positive development is the resumption of palm oil exports in 2006 after 5 years of no activity. In addition, production of palm oil and palm kernels expanded massively in the first quarter of 2007, by around 50 and 38 per cent respectively compared to the previous quarter. Further expansion is expected in palm oil and kernel production as investments are put in place. The fish catch which was not as affected by the crisis in 2001 and 2002 has increased by 39 per cent since 2000 and prices have increased in $US terms by 84 per cent.

In **Vanuatu** agricultural exports declined in 2005 with falls in coconut oil, cocoa and copra output. Although Vanuatu has the largest coconut production and processing capacity among Pacific island countries, its output declined because of an industrial dispute that forced the closure of its main processing mill. Cocoa exports also fell as a result of a decline in export prices. However, there was evidence of a volume response in 2006 for beef, cocoa, coffee and kava which led to an increase in real production of export crops of 6.5 per cent.

In **Samoa**, agriculture has been in decline for more than a decade falling by an average of 2.4 per cent per annum in the 1994–2006 period. Agricultural exports have dwindled to next to nothing in this time period. The binding constraint is difficulties in accessing land and ineffective leasing arrangements for public land. There is a substantial amount of unused arable land but customary land (80 per cent of all land) cannot be leased to people who are not matai (chiefs) for intensive agricultural use. Around 15 per cent of land is government land that can be leased but this land has generally been poorly utilized and managed. In addition, the approvals process for leasing land is cumbersome and prolonged, taking in excess of 12 months and the status of leases as collateral for securing loans is unclear. The result is that investment in commercial agriculture is discouraged.

The offshore long line tuna fisheries sector in Samoa does not face this constraint and expanded rapidly from 1995 to peak at export income of around SAT $33.5 million in 1999, accounting for 60 per cent of merchandise exports. However production declined rapidly after 2002 to realize export income of SAT $12.7

million in 2006, although this was still about 43 per cent of total exports in that year. The decline was due to a combination of lower tuna stocks, rising fuel costs and appreciation of the currency relative to the US dollar.

In **Fiji** commodity exports in value terms are similar or less than what they were in the mid-1990s with only fish exports being a success in that time frame[4]. In **Tonga** fish and squash exports typically account for 80 per cent or more of merchandise exports. However, the value of both has declined by over 40 per cent since 2003-04, reflecting lower prices and rising costs and for fishing unfavourable weather patterns, highlighting that the commodities price boom is not widespread across primary production. In the **Cook Islands** pearls and fish are the main commodity exports but both have declined in value terms substantially in recent years. In **Timor-Leste** coffee exports have some potential, although in recent years they have only constituted about 2 per cent of GDP and in 2006 the crop was damaged as a result of the civil unrest. In **other Pacific Islands** agricultural commodity exports are relatively small and generally stagnant.

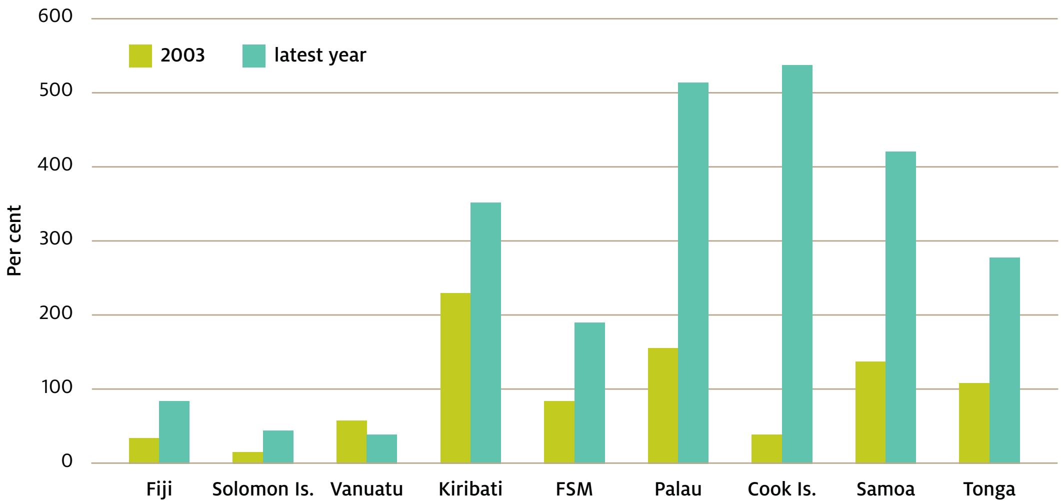
For the region as a whole the weak performance of commodity exports, both recently and over a longer time frame, largely reflects a combination of property rights, transport and marketing constraints and at times disruptions associated with civil and political crises and weather conditions.

High oil prices are hurting the fuel importers

Overall income in Papua and New Guinea and Timor-Leste has been boosted by the commodities boom that has occurred in recent years. But for other Pacific island countries, oil prices have increased by more than other commodity prices, leading to a deterioration in their trade and current account balances and contributing to inflationary pressures.

A useful measure of the impact of higher oil prices is the ratio of the value of fuel imports relative to the value of merchandise exports as the measure effectively incorporate volume responses. As shown in Chart 4 the ratio of oil imports to merchandise exports has increased for eight of nine Pacific island countries for which data are available between 2003 and 2006. Vanuatu is the sole exception where the value of fuel imports relative to merchandise exports was lower in the most recent year.

Chart 4: Oil imports/merchandise exports—Pacific Islands



Source: ADB Key Indicators 2007

Note latest year is 2006 for all except Kiribati, FSM and Tonga (2005) and Palau (2004)

4 However exports of bottled water have been a success.

The other striking feature of Chart 4 is the very high oil import to merchandise export ratios for the Micronesian and Polynesian countries, highlighting the relatively small contribution from merchandise exports in these countries. For these countries a mix of aid, remittances, trust fund and tourism income (depending on the country) help to offset the impact of higher oil prices. However, in the case of tourism high oil prices increase the cost of international travel and tourist activity has been disrupted in Fiji and Tonga as a result of the civil turmoil. In addition, as explained above, real exchange rates have appreciated in several countries in the South Pacific reducing the scope for relative price changes to stimulate exports. Fiji, Samoa and Tonga have absorbed the fuel price increase by reducing their foreign exchange reserves and tightening monetary policy. Aid inflows have helped Solomon Islands to meet the cost of higher oil. Vanuatu has been less affected because it is relatively less reliant on oil, its exports have increased in value and it has also benefited from aid inflows.

To reduce their dependence on oil Pacific island countries have begun to focus on alternative sources of energy, such as biofuels, solar and wind power and hydropower. A World Bank (2005) study that assumed oil prices around half of current levels found that there are several renewable energy options that would cost less than diesel electricity generation, including wind, solar/wind hybrids, biomass and mini-hydro. Hydro generation is already being used in Fiji and there is scope for expansion. A coconut oil-diesel fuel blend is being promoted as a biofuel substitute for electricity generation in Samoa and Vanuatu, while bagasse, a by-product of sugar production, is being used to generate electricity in Fiji. Coconut oil can also be used in diesel-powered motor vehicles and in some countries, such as FSM, the coconut oil is particularly viscous and suitable for this purpose. Wind and solar power could substitute for imported oil in smaller and more remote Pacific islands.

PNG and Timor-Leste face different challenges managing the mineral boom

Papua and New Guinea and Timor-Leste are fortunate to have large resource sectors and the resources will generate a large income stream over a long time frame. More importantly this income stream will provide the opportunity to invest in infrastructure, social services and human resources development that should enable broad-based economic development and a significant general improvement in living standards.

However, experiences from many low and high income countries suggest that resource booms often give rise to difficult economic management and governance problems. Resource booms can lead to unproductive government spending, higher wages and a higher exchange rate with adverse impacts on the competitiveness of the non-resource sector. The focus of a resource boom can also turn to being on the distribution of wealth rather than on policies that develop the economy, alleviate poverty on a widespread basis and improve general living standards on a sustainable basis. In addition, policies need to be designed that provide scope for adjustment when resource booms turn out to be transitory.

In the case of Papua New Guinea, revenue windfalls from earlier commodity booms were seldom well managed, with recurrent expenditures rising to unsustainable levels. In this cycle, however, Papua New Guinea is devoting most of its revenue— beyond those amounts allocated in the 2006 budget—to investments in transport infrastructure, education, health, law and justice. In the 2007 budget, the windfall revenues expected from high copper and oil prices will be spent on equity injections into State owned enterprises and natural gas pipeline projects, and repayments of public debt.

In the case of Timor-Leste the oil revenues are so large they have led to current account surpluses projected to average about 150 per cent of non-oil GDP in 2007–08 and official foreign exchange reserves of around 6 years of import cover. Timor-Leste has adopted a long-term expenditure and saving policy with the objective of ensuring that oil revenues are used consistent with the concept of intergenerational equity. Annual 'sustainable' fiscal spending is set equal to the sum of the estimated permanent (interest) income from the oil-and-gas wealth and domestic non-oil revenue. The concept of insulating the economy from volatile income flows is sound. However, the oil and gas resources represent considerable wealth and there is also the prospect of new discoveries supplementing the savings carried forward in the fund and increasing the benefits for future generations. This raises the issue of whether the intergenerational equity balance is too much in favour of future generations given the low level of development and widespread poverty of the current generation. There is scope for Parliament to authorize spending in a particular year to exceed the target defined by sustainable income. However, Timor-Leste is continuing to experience significant budget execution problems and there are concerns about how effective increased development expenditure would be given the state of social unrest in the country. The framework that has been established has the potential to be very effective. However, in order to ensure success in terms of broad-based economic development and the alleviation of poverty on an equitable basis, the Government will need to continue to improve its planning and budget execution capacity and give due emphasis to improving the standards of living of the current generation.

5 Improving the business environment

Reducing business regulation and creating more secure property rights

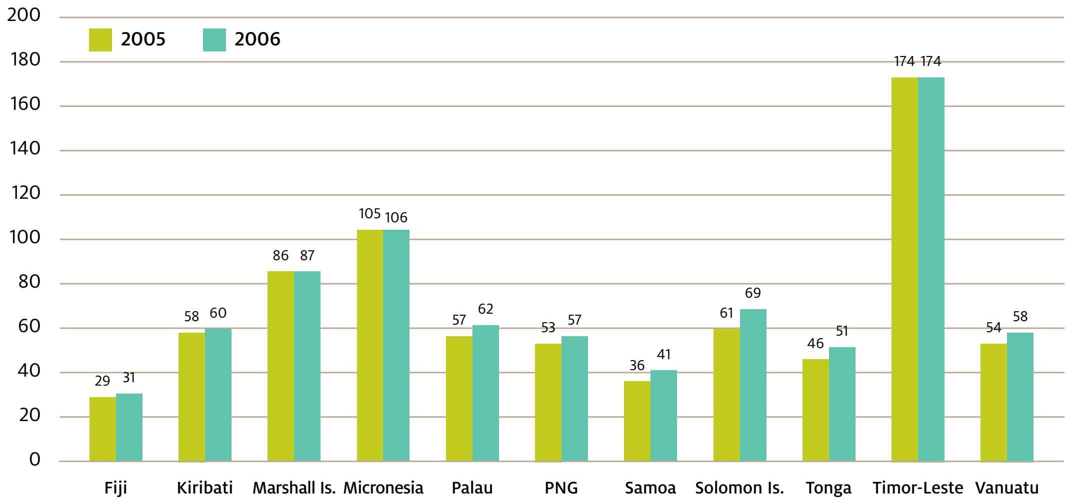
Improving the business environment has been a focal point of recommendations and plans for reform in many Pacific island countries. However, the economic policy and institutional environment in many countries in the region still makes it difficult to invest and operate businesses profitably. Businesses are affected by a wide range of public policies including macroeconomic management, structural policies, social polices and governance policies and institutions.

Both the Asian Development Bank and the World Bank assess the public policy and institutional performance of Pacific island countries across a wide range of criteria on an annual basis. The World Bank's (2007) Country Policy and Institutional Assessment was undertaken for 77 low income developing countries six Pacific island countries[5] and Timor-Leste (see Table 6 of Annex 1). The assessment found that only Samoa ranks highly as it has in previous assessments and it is notable that it has performed the best in terms of economic growth over the past 15 years. The individual criteria used for the rankings indicate that Solomon Islands and Timor-Leste perform very poorly in terms of the business regulatory environment and property rights and rule-based governance. Another feature is that Papua New Guinea performs reasonably well on economic management but poorly on property rights and rule-based governance reflecting continuing problems with law and order and land tenure issues.

In relation to the business regulatory environment, the results of the World Bank's Doing Business 2007 Survey indicate that Fiji and Samoa are in the top quartile of 175 country rankings while the Marshall islands, Federated States of Micronesia and Timor-Leste are in the bottom half of the rankings, with Timor-Leste ranked second last (Chart 5). A disappointing feature of the recent rankings is that the ranking for every country in the Pacific worsened between the surveys undertaken in 2006 and 2005 and Timor-Leste still ranked second last out of 175 countries.

5 The six Pacific Island countries were Kiribati, Papua New Guinea, Samoa, Solomon Islands, Tonga and Vanuatu.

Chart 5: Ease of doing business rankings, 2005 & 2006



Source: World Bank (2007)

Notes: The ease of doing business index ranks economies from 1 to 175, with lower values indicating greater ease in doing business. The data for all indicators are for April 2006 and January 2005.

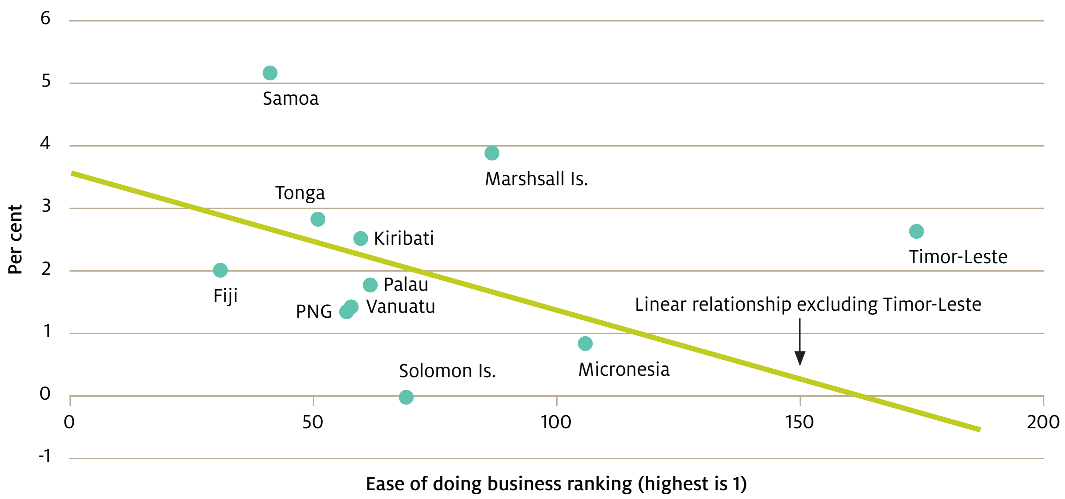
Reviewing the more detailed categories that are part of the overall ranking, with the exception of Timor-Leste, countries in the region generally score relatively well in terms of employing workers, starting a business, paying taxes and trading across borders but poorly on other criteria such as enforcing a contract, protecting investors and access to finance (except Fiji) (Table 6 in Annex 1 and World Bank 2007). The difficulties in access to finance are in turn likely to be related to land tenure arrangements as well as gaps in the law for using property as collateral.

There is evidence that the implementation of 'business-friendly' policies is an important determinant of economic growth. At a broad level, Douglas North (1990) shared a nobel prize in economics for his contribution on the importance of institutions and regulatory and legal frameworks for promoting investment and economic growth. More recently, in a World Bank research paper Djankov et al (2006) estimated the impact of business regulations on economic growth per capita from 1993 to 2002 for a data set of 135 countries. They find that countries with less burdensome regulation grow faster and that moving from the worst quartile of business regulations to the best implies a 2.3 percentage point increase in annual growth. This is a large effect and the results are robust to the inclusion of various control variables and different data sets. They also find that their measure of the ease of doing business, which is based on the World Bank's Doing Business data base, is highly correlated with other measures of corruption, the rule of law and democratic accountability.

In the Pacific there are three key regulatory and institutional weaknesses, namely: regulations that increase the costs of doing business; policies and regulatory arrangements that restrict foreign investment; and problems with land administration that make it difficult to use land for different economic purposes. Most Pacific island countries have relatively open markets with respect to trade but relatively closed markets with respect to investment and the use of land. These characteristics together with cumbersome business regulations, poor infrastructure, small local markets and isolation mean that the overall environment for business is difficult and costly, particularly for small businesses trying to develop agriculture and tourism related activities.

In the Pacific, although a separate detailed econometric study has not been undertaken, there is evidence that improving the environment for doing business has been associated with higher growth (Chart 6). However, there is clearly room for further progress in many countries, as in particular, most are still characterised by policies and institutions that restrict the economic use of land, particularly for foreign investors.

Chart 6: Real GDP Growth vs Business Climate



Source: IMF 2007a, World Bank 2007a

Positive features and developments in individual countries

In **Cook Islands**, a substantial improvement in the quality of economic and public sector management since the financial crisis of the mid-1990s, the tourist potential of the country, and a commercial and legal environment closely resembling that of New Zealand have combined to produce relatively strong economic growth in the 2000-06 period. Foreigners cannot own land but they can lease it for up to 60 years and the legal system for leasing land works well and does not appear to have been a deterrent to foreign investment. Business confidence in the policy and institutional environment appears to be very high.

FSM has taken some positive steps to address many of the regulatory and institutional constraints that contribute to a difficult and costly business environment. Secure transactions legislation was enacted at the National level in 2005 with legal opinion that it is not needed at the State level and an electronic filing office for secured transactions opened in October 2006. This will make it a relatively simple matter to record a charge by financiers over property for collateral. In addition, information systems for registering and providing access to information on land registration, leases, sales and related transactions established in each state are being worked on with ADB technical assistance. Progress has also been made in improving access to land with all States changing their laws to allow leases of over 50 years. However, there are still numerous disputes over land ownership and use.

Fiji has a relatively high overall ranking in terms of the ease of doing business and has in the past attracted considerable foreign involvement in the economy. However, business confidence has plummeted in the wake of the military coup in early December 2006 and lack of credible policies to restore investor confidence. Private investment as a proportion of GDP languished at a relatively low level of around 5 per cent of GDP in the 1988 to 1994 period but then increased to average around 12 per cent of GDP from 1995 to 1997 and to 12.7 per cent of GDP from 2003 to 2005. This improved investment performance following the successful implementation of a range of economic reforms and greater investment in tourism. Fiji has also made greater progress than other countries in the region in developing economic property rights with the traditional land system but the property rights system is still an important constraint on private investment, particularly given the legislation that determines administrative rents for agricultural land. Another development that will deter foreign investment is the introduction by the Reserve Bank of Fiji of significant restrictions on local borrowing by foreign investors.

Kiribati performs reasonably well in terms of most policy and institutional measures for facilitating business development. A major exception is the time taken to enforce a contract. However, the prospects for profitable private sector development in Kiribati are extremely limited and little can be done without the government taking a major leadership role. Recently, the government has begun focussing on Christmas Island which has some potential for tourism as a growth centre. A long-term strategic development plan is being developed that considers land-use planning and zoning for residential and economic development. The plan will also include transportation, expanded water and sewer systems, protection of freshwater lenses, solid waste management, and necessary supporting infrastructure. The Government has also reached an agreement with Air Pacific to add a stop on Christmas Island to its Nadi–Honolulu round-trip service, which should increase tourist numbers.

In the **Marshall Islands**, there has been some progress in mobilizing land with the establishment of a land registration authority in 2003 and ongoing efforts to further strengthen land registration, and ease administrative barriers for accessing land. A secure transactions law was also passed in March 2007.

The prospects for meaningful business development in **Nauru** are very limited, given its limited size and resources and its remoteness. The main prospects would be in relation to providing some services to government, the Nauru Phosphate Corporation and aid projects and the possible development of locally based long line fishing operations provided regular, competitively priced air freight services to Brisbane can be established. To help address constraints with respect to access to finance and basic business skills, in 2007–08, AusAID and UNDP are funding and providing administrative support for a small business development fund that will provide seed funding to new small businesses on a microfinance basis. A Small Business Incubator will also be established to provide technical and advisory support to new business start-ups.

A feature that distinguishes **Palau** from other Pacific island countries is that there is considerable individual ownership of land. Palau is also a top performer in terms of the time and cost for registering property. Individual ownership of land should help to ensure that land can be used where it is of most value to the economy as a whole. The Government also owns a significant portion of the land in Palau, but because much of this ownership is derived from the colonial past, a large portion of land in government possession is being disputed. Currently, the Land Court is creating a new system of land recording and registration, and there is an ongoing program to register all land in the country. New foreign investment legislation has also been introduced to Parliament that would represent a substantial improvement.

Papua New Guinea's overall ranking in the World Bank's ease-of-doing-business database compares relatively favourably with others in the region. In addition, the economy and the business sector are currently benefiting from the macroeconomic stability that has occurred as a result of the mining boom and more effective fiscal policy. Papua New Guinea has made progress in the past in improving the business environment, for example, five years after the financial sector reforms of 1999-2002, PNG has one of the strongest banking sectors in the Pacific. In addition the Independent Consumer & Competition Commission (ICCC) which is a statutory authority that has been given responsibility for the promotion of competition and price regulation for certain goods and services, has proven to be an effective institution in an environment where there has been a long history of governance problems. It has recently completed reviews on coastal shipping and ports, stevedoring, telecommunications and taxi fares. However, it does rely on government to empower it to undertake reviews and to implement its recommendations. One area where the recently re-elected government may make progress is on land reform where the Cabinet endorsed a report on this matter by the National Land Development Taskforce in March of 2007. The National Land Development Taskforce prepared a 'Land Development Program' following a National Land Summit in 2005. The Land Development Program includes numerous recommendations to improve land administration and also a recommendation to establish a single Land Court to deal with all disputes relating to land.

Samoa has recorded the highest growth in the Pacific in the past 15 years and continues to record relatively good performance although growth is slowing. Strong economic growth can be associated with a number of reforms undertaken in Samoa including trade and tax reform, financial deregulation, public enterprise reform, improved budgeting and planning as well as growth of the tourism sector and good governance. More recently competition has been introduced into utility markets and the joint venture of Polynesian airlines with the low-cost Australian-based Virgin Blue airline has resulted in a substantial reduction in airfares. The benefits of this have been dramatic with visitor arrivals increasing by around 20 per cent following a reduction in airfares of about 50 per cent between Australia and New Zealand and Samoa. Similar significant benefits have followed the recent introduction of competition in the mobile telecommunications sector where the costs of international mobile calls declined by over 50 per cent. In 2007 a Task Force was established to examine means of streamlining the leasing of customary land. Access to land presently managed by Samoa Trust Estates Corporation and the Samoa Land Corporation could be improved by issuing long-term transferable leases.

In **Solomon Islands** growth has rebounded and financial stability has been maintained with the help of the Regional Assistance Mission to Solomon Islands (RAMSI). Improvements have been made in the machinery of government and law and justice sectors, for example in relation to cabinet and parliamentary processes, management and accountability mechanisms and institutions, and the capacity of police and the courts. In terms of economic governance, the Economic Reform Unit, in the Ministry of Finance has taken a leadership role in coordinating economic reform and encouraging investment through addressing key regulatory, tax, infrastructure and finance impediments. Recent examples of success include: a revised Foreign Investment Act implemented in June 2006, streamlining of business regulation procedures in 2006, particularly those related to foreign investment (where approval times have fallen from 3 months to just a few days) and work and residency permit rules; a tax reform discussion paper released in December 2005 with subsequent consultations undertaken in 2006; and the removal of import duties on all business inputs for shipping and boating.

In **Timor-Leste**, the overriding issue for the private sector and the people as a whole is maintaining public security. However, assuming public security is maintained, improving the business environment in Timor-Leste will need to be given priority as it is close to being the most difficult in the World. Along with poor infrastructure, incomplete legal institutions are critical constraints to private sector investment and economic development. The Government is facing this challenge with an ambitious program to improve the enabling business environment with laws being passed or developed on domestic and foreign investment, bankruptcy and leasing of government and private property.

Tonga's performance is comparable to the average performance of countries in the region and there have been a few examples of successful reform in some sectors, for example, the deregulation of the telecommunications sector in 2002. More recently trade and tax reform have been complemented by new foreign investment legislation which came into effect in April 2007, with a view to facilitating investment. There has also been some progress in reviewing and reforming business regulation and in particular contract enforcement and conflict resolution. In addition, consideration is being given to extending work permits for foreign investors from two to ten years. There have also been some positive developments in relation to governance reforms, in particular with a proposed greater role for community representatives in the Parliament. Improving governance in Tonga is a critical aspect of improving the business environment.

Tuvalu has limited scope for private sector development, given remoteness, the small local market and the limited potential for tourism. However, the Government has committed to aligning the country's commercial legal environment with modern international practices to attract foreign investment.

In **Vanuatu** the government has taken steps in recent years to substantially improve supervision of domestic banks and the offshore financial sector including legislation that complies with all OECD Financial Action Task Force requirements to combat money laundering. Reductions in tariff rates since 2004, liberalization of marketing arrangements for commodity exports, the prospective Economic Partnership Agreement with the EU and the government announcement to sell 46 per cent of the international airline with IFC assistance are also positive developments. In addition progress is being made in relation to improving administration and the settlement of disputes in relation to land tenure, similar to developments and proposals in Papua New Guinea.

6 Poverty, Social Services and Human Development

It is difficult to measure progress in improving social services and the standard of living for disadvantaged people in the Pacific and other developing countries. There is limited suitable up-to-date data and there are also issues of how best to determine if progress is being made. However, an important perspective to keep in mind is that sustained high rates of economic growth and poverty reduction generally go hand in hand[6] and so it could be expected that the relatively low rates of economic growth in the Pacific have not been conducive to making significant progress in reducing poverty and improving general standards of living.

Economic growth and poverty reduction

GDP per capita on a PPP basis is relatively low and the proportion of the population below the poverty line is relatively high for several countries in the region compared to major developing countries in Asia (Table 8 in Annex 1). However, although there are exceptions, there is limited evidence of widespread incidence of extreme poverty, in the form of hunger and destitution, in the Pacific (ADB 2004). But the incidence of hardship and extreme poverty may be growing as economies become increasingly urbanized and traditional employment opportunities no longer exist.

The ADB completed a major study of poverty, involving participatory assessments in nine countries in the Pacific in 2004 (ADB 2004). The study defined poverty not as meaning starvation and destitution but rather as hardship due to lack of basic infrastructure and social services, lack of opportunities to participate fully in the socio-economic community and lack of resources to meet the basic needs of the household. Key findings of the study were as follows:

- The highest rates of poverty were recorded in Kiribati, the Federated States of Micronesia, Papua New Guinea and Timor-Leste and tended to be lower in the Polynesian countries.
- Although a growing incidence of hardship was associated with the gradual erosion of traditional skills and culture, subsistence production and traditional social systems still play a very important role in mitigating the extremes of hardship and poverty.

It is suggested that these findings would still be relevant today (see Table 8, Annex 1). However, in Fiji there is evidence that the stagnation of its traditional sugar and clothing industries and the limits of other opportunities relative to the size of the population appear to be increasing hardship and poverty for many people there. Estimates based on the 2002-03 household and income expenditure have only been recently compiled (Abbott 2006). The results suggest that approximately 34 per cent of people in the country (Table 9 in Annex 1) have incomes below the basic needs poverty line (BNPL).[7] This is considerably higher than the

6 See Ravallion and Chen 1997, Dollar and Kray 2000. Dollar and Kray found that an increase in per capita growth of one percentage point *causes* a 1 per cent rise in the incomes of the poor.

7 The BNPL is the amount required to meet all basic needs, including food and non-food items such as housing/shelter, utilities, education, health, transport and community obligations. It is calculated by estimating a Food Poverty Line (FPL)—the amount required to purchase the minimally nutritious, low-cost diet developed and approved in 1996 by the National Nutrition Committee—and multipliers to take account of essential non-food expenditure.

estimate of approximately 25 per cent of the population with incomes below the BNPL in 1990-91. The results also indicate that: the incidence of poverty has increased for both Fijian and Indo-Fijian families and there has been a relatively larger increase in rural areas than in urban areas. However, the results also indicate that the income distribution has become significantly more equal since 1990–91 for both races and in both urban and rural regions.

In Fiji, patterns of poverty differ widely between urban and rural areas: In towns, where incomes are higher, pockets of deep poverty exist in the midst of generally more prosperous households. In rural areas, on the other hand, average incomes are substantially lower and poverty is more widespread and as a result the incidence of poverty is much higher for the rural population on the whole than for the urban population. Much of this poverty reflects poor housing and limited access to health and education services. The Fiji Islands still has a very low incidence of hunger and malnutrition. The incidence of poverty is also higher for Indo-Fijian families than for Fijian families both in urban and rural areas.

The severity of poverty in the Fiji Islands is also somewhat higher than that in other countries in the Pacific region. The poverty gap index (PGI)[8] for the Fiji Islands is 11.2, compared to 9.8 in the Federated States of Micronesia 9.8, 7.7 in Tonga 7.7, and 6.5 in Samoa 6.5 (Abbott 2006). Poverty was also found to be most severe in the poorest parts of the urban areas.

The findings of the 2002–03 household income and expenditure survey in Fiji are of concern given the poor prospects for sugar and textiles and the disruption to tourism and other economic activity following the coup in late 2006.

It is also important to recognise that Pacific island countries are generally urbanizing at a rapid rate as people migrate to the major cities towns in search of better opportunities. As highlighted by the situation in Fiji, this is increasing the number of people in squatter settlements, reducing access to subsistence production and creating pressures on urban infrastructure.

Achieving high rates of economic growth on a sustained basis is an important pre-condition for making significant progress in reducing poverty for all countries in the region. This will require improving the environment for doing business but also investments and policy reforms in relation to human resource development as well as more meaningful progress with economic integration of labour and capital markets in the region.

Investment in people for sustainable and widespread growth

Education and health services have been a focal point for government effort and donor support for many years in the Pacific and various educational and health care indicators have improved considerably since the 1970s. Primary and secondary school enrolment rates have generally improved, mortality rates have declined and childhood diseases have been better controlled.

However, the human development index which is a composite index measuring three basic dimensions of human development – longevity, knowledge and income for the five counties in the region for which data are available was below that of China, Indonesia and the Philippines in 2006, largely reflecting outcomes in Papua New Guinea, the Solomon Islands and Timor-Leste (see Table 8, Annex 1). In addition there are growing concerns about the quality of education, emerging communicable diseases, the increasing incidence of diabetes and other lifestyle diseases, inequity of service provision, employment prospects for youth, the welfare of the aged and the disabled as traditional cultures and obligations change, and the pressures associated with growing urbanization.

8 The Poverty Gap Index measures how far incomes fall short of the BNPL as a proportion of the poverty line.

In a recent comprehensive assessment of social services and human development in the Pacific Islands the World Bank (2007b) found that Pacific countries are better resourced than other small island countries and low income countries with abundant aid. However, the study also found that the effectiveness of resources for education and health in delivering strong performance has lost momentum in key areas. The main recommendation of the report was that generally performance problems in the social sectors will be more effectively addressed by improving service management and multi-stakeholder governance rather than by service expansion. Some key examples of successful initiatives that have been taken in various countries, consistent with this recommendation are outlined in Box 1:

Box 1: Examples of successful initiatives to improve service management and multi-stakeholder governance in education and health in the Pacific.

In education:

- Increasing pupil teacher ratios through clustering of lower grade schools with senior schools as in Papua New Guinea to reduce the total salary cost of teachers.
- Enlisting community help in constructing high schools as was done in Solomon Islands.
- The introduction of teacher testing and the publication of results in public schools as has occurred in the Marshall Islands.
- The management of teacher absenteeism by using team teaching and extending the school year as in Kosrae in the Federated States of Micronesia.
- Training of all teachers in special needs education as in Samoa.
- The use of household characteristics to better target the needs of the poor as in Fiji and Kiribati.
- The development of a common sector strategy and plan and unified financing strategy as in Tonga and the Solomon Islands but with more attention to performance monitoring.

In health:

- Greater delegation of accountability to those delivering services as Fiji has succeeded in doing for divisional directors.
- Increasing the involvement of communities in primary health care through community health councils and committees as in the Marshall Islands, Solomon Islands and Samoa.
- Linking remuneration to performance as has been done with five year performance contracts in Fiji, Samoa, Vanuatu and the Solomon Islands.

Source World Bank 2007

Gender inequality means lower economic growth and living standards

In all countries improving the gender balance is not only important as a social issue but also in terms of increasing the growth of the economy as a whole and contributing to rising living standards. Greater participation by women in formal employment has the potential to increase the output of an economy. In addition empirical studies have tended to find a positive relationship between female education and growth, although taken as a whole the results are not conclusive. ESCAP (2007, p. 106) estimates that a 1 per cent increase in female secondary school enrolment rates would lead to a 0.23 per cent increase growth rates in the Asia-Pacific region based on study of 27 countries in the Asia-Pacific region. A study of the Pacific has not been undertaken using this methodology but the estimates are indicative of the potential impact of the economic benefits of higher schooling for girls in those countries where secondary school enrolment rates are relatively low. However, the real challenge to be addressed is how formal employment opportunities can be increased in the region.

Data on gender equity education indicators are relatively sparse in the Pacific. Based on the available data (see Table 11 in Annex 1), the main features of education indicators are the high rates of literacy for both girls and boys in Polynesia, the high enrolment rates for both girls and boys in Fiji and the relatively low enrolment and literacy rates for both girls and boys in PNG and the Solomon Islands. A particular concern is the decline in the enrolment rate in primary education for both girls and boys in PNG and the widening gap between girls and boys. The indicators for Fiji and Polynesian countries compare favourably to major Asian countries. However, there are major inequities in education, health and employment in Timor-Leste.

There is also relatively limited data on female participation in the workforce. However, the available data indicate that the proportion of women in formal employment in the non-agricultural sector has increased on average by about 5 percentage points since 1990 and particularly in Papua New Guinea (Table 12 in Annex 1). This improvement was larger than in several major Asian countries in the region. However, it is important to recognise that this indicator does not take into account the fact that the agricultural sector is a major employer in Papua New Guinea and most other Pacific island countries as well as in Timor-Leste. In addition, it is clear that further improvements are needed to achieve equity in terms of employment outcomes and provide benefits to the economy.

In terms of political participation, women are considered to be clearly disadvantaged relative to men. In five Pacific island countries there are no women representatives in national parliament and it is only Timor-Leste where the representation of women in national parliament compares favourably to other developing countries (Table 12 in Annex 1).

However, in Timor-Leste a recent ADB (2005) gender assessment concluded that women continue to be particularly vulnerable to living in poverty. On the positive side, the principles of gender equality are embedded in the Constitution in Timor-Leste and as the nation is in the early stages of building there should be an opportunity to make significant progress in improving gender equity.

7 Growth Determinants and Prospects

Constraints on economic growth and policy performance

The overall performance of the region has improved in recent years. Some countries have achieved much better growth relative to historical averages, reflecting the benefits of economic reform, macroeconomic and political stability, substantial aid for reconstruction and tourism growth. However, generally the economic growth performance is still relatively low compared to outcomes in both the low income countries of South Asia and rapidly expanding group of countries in Emerging Asia.

In addition, the performance has been uneven. Countries with mining resources have benefited from the commodities boom but those with high imports of oil relative to commodity exports have suffered from the commodities boom; although most have still grown with the support of a mix of aid, remittances, trust fund income and tourism. Economic growth in some countries has also been disrupted by civil and political crises.

Most countries have been reasonably successful in achieving macroeconomic stability characterised by manageable fiscal positions and low to moderate inflation and most have relatively open trade markets. However, few have made meaningful progress with structural reforms designed to address the key binding constraints for economic development.

Pacific Island countries face a wide range of constraints to economic development and typically are faced with a long list of recommendations to improve performance. But in trying to understand why performance over a long time frame has been relatively poor, even though many countries have implemented a wide range of recommended reform programs, it is important to recognise that addressing some constraints will have little noticeable impact unless the key binding constraints are addressed. This issue has been recently highlighted by Hausmann et al (2006) who recommend that countries need to figure out the one or two most binding constraints on their economies and focus on lifting those constraints. The point is that the binding constraints need to be addressed as a priority if meaningful progress is to be made.

For the Pacific as a whole, it is suggested that the key binding constraints relate to the fact that most countries do not have in place the legal and administrative frameworks needed to mobilize land under customary tenure; the transport and marketing costs to access international markets; and the regulatory and administrative constraints on foreign investment. Although countries in the region are continuing to develop and implement policies to help mobilize land not enough has been done to have a catalytic impact on economic growth. Investment in local transport infrastructure is a key aspect of many development plans and there are a few signs that this is making a difference in improving access to local markets. However, countries with significant land resources need to make more progress in facilitating intensive use of their land and on a large scale, as for example with the expansion of oil palm plantations in Papua New Guinea and the revival of this sector in the Solomon Islands. This will require easier access to land and easier entry of foreign investment to take advantage of scale and scope economies, knowledge in production and superior marketing systems and networks. There are many countries in the region that are land rich but are not maximising the value of the land for the benefit of the population as a whole.

Constraints in relation to the use of arable land and poor infrastructure are key reasons why many countries in the region have not been able to take much greater advantage of the commodity price boom that has occurred since about 2001. Furthermore, addressing these constraints is important for ensuring that the growth gains that some countries have made can be sustained by more effective institutional arrangements. Countries with good land resources that are not fully utilizing the land because of these constraints include Federated States of Micronesia, Fiji, Palau, Papua New Guinea, Samoa, Solomon Islands, Tonga and Vanuatu.

For some countries, the most important binding constraint more recently relates to law and order and governance problems. A breakdown of law and order greatly restricts economic activity and creates strong dis-incentives for investment and foreign involvement in an economy. Political instability has similar effects on business confidence and investment. The economies of Fiji, Timor-Leste and Tonga have suffered in the recent past as a result of civil tension and political instability as did the Solomon Islands in 2001 and 2002. In addition, economic development in Papua New Guinea has long been restricted by law and order problems that continue to be an important and costly issue for business.

For some countries the binding constraints are remoteness and a lack of natural resources, particularly land resources. These countries include Kiribati, Nauru, Tuvalu and to a lesser extent the Marshall Islands. Although there is some modest scope for development in some of these countries, prospects are very limited given the limited and costly linkages to international markets that are not likely to be easily overcome. The key factors in supporting growth of these economies are likely to continue to be a mix of aid, trust fund income, foreign fishing licence fees and remittances supplemented in some cases by a small amount of income from commodity exports.

Recognising the nature and extent of key binding constraints is important for interpreting recent growth outcomes and assessing short and long term prospects.

Short term prospects

Growth for the region as a whole is projected to be around 3.3 per cent in 2008. Such an outcome would be slightly higher than the average annual growth in the 2004 to 2007 period. Above average growth is expected in the Cook Islands, Palau, Papua New Guinea, Solomon Islands, Timor-Leste and Vanuatu.

Growth in Papua New Guinea will be underpinned by continued expansion of the mining sector and growth in cash crop production as new investments and transport infrastructure improvements are made. Growth in non-oil GDP in Timor-Leste will be driven by infrastructure investment and the flow-on effects of substantial aid to the fledgling private sector. Coffee production is also expected to recover making a small contribution to economic growth. Cook Islands growth will be driven by expansion of the tourist sector and recovery of pearl production. Tourism and aid funded projects are expected to support continuing growth in Palau. In the Solomon Islands aid-funded projects, palm oil production and gold mining are expected to be the main contributors to growth. In Vanuatu relatively strong growth is expected to continue as a result of aid-funded construction, expansion of tourism and continued growth of agricultural exports. In Palau tourism and aid-funded infrastructure projects will continue to be the main growth drivers.

High public expenditures are expected to support average growth in the Marshall Islands. Modest growth is also expected in Tuvalu driven by aid-funded investment projects. Recovery in Tonga is predicated on the maintenance of civil order and significant donor assistance to aid in reconstruction. Growth of tourism and recovery of the local long line tuna fishing industry are expected to support growth in Samoa.

Weak growth is expected in Fiji reflecting low private investment, fiscal pressures, tight monetary policy, stagnation of the tourist sector and modest growth of merchandise exports. Growth is expected to remain low in FSM as the economy adjusts to lower levels of aid funding for current spending and infrastructure investments are slow to be put in place. The economy is expected to contract in Nauru as the public sector reduces expenditure to meet debt obligations, despite the expected recovery of phosphate production. Lower returns from Trust Fund investments, fiscal pressures and weak economic development prospects are expected to lead to lower growth in Kiribati.

Long term prospects

In the absence of fundamental and sustained public policy and institutional reforms, the long term prospects for the region as a whole are likely to continue to be disappointing despite the good prospects of a few countries.

The mineral rich countries of Papua New Guinea and Timor-Leste will continue to benefit if the resources boom generated by the growth of China and India and other Emerging Asian economies continues at a good pace, as is expected to occur. However, both these countries face considerable challenges in ensuring that the income from the mining resources is invested to achieve widespread and sustainable improvements in the standard of living, particularly for the current generation of people who face relative hardship. Solomon Islands is also land rich and has the potential to benefit form strong demand for agricultural commodities. These countries have formulated effective development plans but effective execution of plans, political stability, public security, property rights and infrastructure development will need to be given priority and constant attention to ensure success.

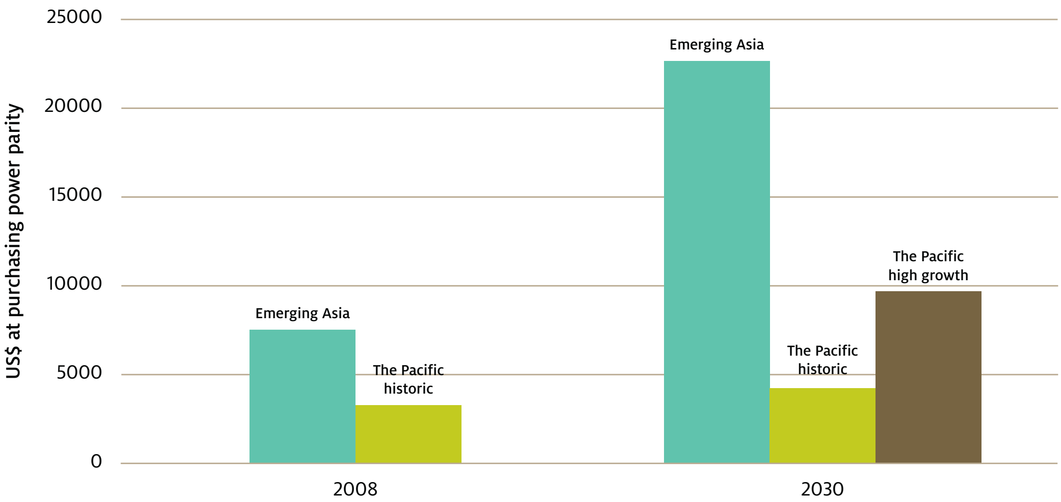
Some countries also face good prospects because of their potential for tourism and in most cases more effective use of arable land for agriculture. The development of tourism is more likely occur in those countries that are closer to major markets and that are likely to be able to promote relatively cheap airline access and ensure a more friendly business environment for foreign investment. This group includes the Cook Islands, Fiji, Palau, Samoa, Tonga and Vanuatu. FSM, Solomon Islands and Papua New Guinea also have the natural resources to attract tourists but face other constraints such as the limited availability or high cost of transport, inadequate infrastructure or law and order problems that will limit prospects until they are effectively addressed. However, each of these three countries also has ample arable land which has the potential to be better utilised for intensive agriculture. As noted the key constraint to be addressed there is problems with land administration that inhibits commercial agriculture relative to what it could be.

Those countries that are both land-poor and also isolated from major markets face greater challenges, although modest economic development is possible in some cases. For example the development of Christmas Island as a tourist attraction in Kiribati and the development of long line fishing in Nauru.

As highlighted in this chapter, the Pacific region is generally missing out on the global economic boom that has been occurring for several years now. However, better outcomes are possible for the region as a whole and some countries in particular if better progress can be made in addressing the binding constraints that have been identified as well as in ensuring macroeconomic stability and in investing in people to support sustained growth and achieve more equitable outcomes.

The AusAID (2006) Pacific 2020 report highlighted the implications for incomes of a ‘high growth’ scenario, predicated on better policy and institutional performance, versus a ‘muddling through’ scenario where growth continues at historical averages. Similar scenarios are depicted in Chart 7 which compares projected performance of the Pacific region as a whole and Emerging Asia in 2008 and 2030.

Chart 7: Real GDP per capita—The Pacific and Emerging Asia in 2008 and 2030



Source: IMF World Economic Outlook Data Base. Note: The Pacific historic growth scenario assumes per capita growth of 1.25 per cent per annum and the Pacific high growth scenario assumes per capita growth of 5.1 per cent per annum as does the Emerging Asia forecast.

To ensure comparability of average living standards, the data in Chart 6 are provided in terms of per capita real GDP on a purchasing power parity basis[9]. Based on IMF World economic outlook data, growth of per capita incomes is projected at annual average rates of 5.1 per cent to 2030. For the Pacific, two scenarios are shown. The first scenario for the Pacific is one where per capita growth is 1.25 per cent per annum based on the performance estimated for the period 2003–08, which is a period when there was a relatively good performance. The second assumes the same growth performance of 5.1 per cent per annum as predicted for emerging Asia for the period from 2008 to 2030.

As Chart 6 highlights, even if the Pacific as a whole continues to record growth consistent with that realised (and predicted) in the 2003 to 2008 period it will clearly continue to fall far behind with respect to outcomes realised in Emerging Asia. In contrast, the high growth scenario would mean that real incomes more than double by 2020 compared with recent historic performance but would still be less than half of those predicted for emerging Asia. Some countries in the region might be able to do better than this if they addressed the key binding constraints, particularly those with large natural resources but it would still be an extremely good outcome to achieve per capita growth of 5.1 per cent per annum for over 20 years. However, it is also important to recognise that in some cases, inability to remove or ease the key binding constraints will mean that little improvement in incomes per capita can be realised. For those countries aid, trust fund income and remittances would offer the best scope of improving and sustaining living standards.

Finally, it is important to recognise that many countries in the region are highly vulnerable to environmental risks. Three key environmental issues are: the depletion of fishing stocks in the Pacific, the risks of extreme weather and possible rises in the sea level associated with climate change over the longer term, and local waste management in crowded urban centres that could impact adversely on health and tourism.

9 The purchasing power parity estimate of real GDP adjusts for the different purchasing power of the national currency in each country for a standard basket of consumption goods and services.

Annex 1 DATA

Table 1. Growth rate of real GDP (% per year)

	2002	2003	2004	2005	2006	2007	2008
The Pacific	0.4	1.8	3.6	2.7	2,8	3.0	3.3
Cook Islands	2.6	8.2	4.3	0.1	0.8	2.5	3.5
Fiji Islands	3.2	1.0	5.3	0.7	3.4	-3.1	1.5
Kiribati	2.7	-1.5	2.3	2.5	1.1	1.0	1.0
Marshall Islands, Rep. of	3.8	3.4	5.6	1.7	1.3	2.5	3.0-
Micronesia, Fed. States of	1.4	3.3	-4.3	1.5	-0.7	1.0	1.5
Nauru	-	-	-	-	-	-	-
Palau, Rep. of	-3.5	-1.3	4.9	5.5	5.7	5.5	4.8
Papua New Guinea	-0.2	2.2	2.9	3.4	2.6	5.2	4.5
Samoa	1.0	3.1	3.4	5.2	2.6	3.1	3.5
Solomon Islands	-1.6	6.4	8.0	5.0	6.1	6.3	4.0
Timor-Leste	-6.7	-6.2	0.3	2.3	-1.6	22.0	3.5
Tonga	3.0	3.2	1.4	2.3	0.7	-3.5	0.1
Tuvalu	5.5	4.0	4.0	2.0	3.0	2.5	2.5
Vanuatu	-7.4	3.2	5.5	6.5	7.2	4.7	4.6

Source ADB 2007a and revisions. Notes: Data are on a calendar year basis except for Marshall Islands, Micronesia, Palau and Tonga which are on a fiscal year basis. The average is based on 2006 GDP in $US.

Table 2. Inflation (% per year)

	2002	2003	2004	2005	2006	2007	2008
The Pacific	6.2	8.0	3.3	2.4	3.2	4.7	3.2
Cook Islands	3.4	2.0	0.9	2.4	3.4	2.8	2.0
Fiji Islands	0.7	4.2	2.8	2.4	2.5	4.1	3.0
Kiribati	3.2	1.9	-1.0	-0.3	-1.5	-	-
Marshall Islands, Rep. of	0.4	1.2	2.2	4.4	4.3	3.1	2.4
Micronesia, Fed. States of	-0.1	0.1	2.3	4.2	3.0	3.0	-
Nauru	-	-	-	-	-	-	-
Palau, Rep. of	-1.3	0.9	5.0	3.9	4.4	3.9	-
Papua New Guinea	11.8	14.7	2.2	1.7	2.9	4.8	2.9
Samoa	8.1	0.1	16.3	1.9	3.8	5.0	-
Solomon Islands	9.4	10.1	6.9	7.2	8.0	8.0	7.5
Timor-Leste	-0.4	0.1	0.8	1.8	4.2	8.0	4.0
Tonga	10.0	10.7	11.8	10.0	7.2	5.0	5.0
Tuvalu	5.1	3.3	2.8	3.2	3.8	3.0	3.0
Vanuatu	2.0	3.0	3.2	0.6	2.6	2.5	2.5

Source ADB 2007a and revisions. Notes: Data are on a calendar year basis except for Marshall Islands, Micronesia, Palau and Tonga which are on a fiscal year basis

Table 3. Fiscal balance of central government (% of GDP)

	2002	2003	2004	2005	2006	2007	2008
The Pacific							
Cook Islands	0.2	-0.8	-1.0	2.1	3.2		
Fiji Islands	-8.5	-8.7	-6.5	-3.3	-2.9	-2.0	
Kiribati	-0.7	-28.1	-37.1	-23.3	-24.7		
Marshall Islands, Rep. of	-9.4	-1.8	-1.3	-2.9	0.1		
Micronesia, Fed. States of	6.8	0.3	-6.4	-5.7	-1.6	-2.5	
Nauru	-	-	-	-	-	-	-
Palau, Rep. of	-28.3	-2.4	-6.9	-3.9	-0.4		
Papua New Guinea	-3.9	-1.0	1.6	0.0	0.0	-0.2	1.2
Samoa	-2.0	-0.6	-0.8	0.3	-0.4	-0.5	-0.3
Solomon Islands	-10.9	-0.2	8.0	2.3	0.6	1.0	1.2
Timor-Leste	-59.0	-56.9	-48.6	75.2	102.5	153	156
Tonga	0.7	-2.9	1.7	2.4	-6.1	-4.5	-4.6
Tuvalu	30.8	-11.0	-9.0	-6.8	-6.4		
Vanuatu	-2.3	-1.9	1.3	0.9	-0.5	-0.5	

Source ADB 2007a and revisions. Source ADB 2007a and revisions. Notes: Data are on a calendar year basis except for Marshall Islands, Micronesia, Palau and Tonga which are on a fiscal year basis.

Table 4. Fiscal balance of central government (% of GDP)

	2002	2003	2004	2005	2006
The Pacific					
Cook Islands	36.0	33.0	32.5	32.5	27.5
Fiji Islands	34.3	33.1	31.3	27.4	28.8
Kiribati	146.1	139.4	105.5	86.7	89.4
Marshall Islands, Rep. of	79.0	71.0	60.9	65.2	-
Micronesia, Fed. States of	64.9	68.3	65.8	62.3	-
Nauru	-	-	-	-	-
Palau, Rep. of	66.3	62.6	61.7	54.2	61.7
Papua New Guinea	32.1	30.0	32.8	34.7	35.7
Samoa	34.9	32.5	31.1	45.2	31.8
Solomon Islands	29.6	39.0	39.5	52.2	53.1
Timor-Leste, Dem. Rep. of	69.4	72.9	71.1	21.1	33.7
Tonga	29.9	31.3	28.1	26.7	-
Tuvalu	136.6	-	-	85.8	98.2
Vanuatu	26.3	23.7	21.9	21.7	-

Source ADB 2007a and revisions. Source ADB 2007a and revisions. Notes: Data are on a calendar year basis except for Marshall Islands, Micronesia, Palau and Tonga which are on a fiscal year basis.

Table 5. Current account balance (% of GDP)

	2004	2005	2006	2007	2008
The Pacific	-0.9	6.2	4.9	7.3	2.3
Cook Islands	6.6	14.6	21.9	23.4	23.6
Fiji Islands	-13.1	-12.3	-20.2	-24.0	-
Kiribati	-58.0	-62.4		-	-
Marshall Islands, Rep. of	-3.1	-5.0	-3.8	-	-
Micronesia, Fed. States of	-18.1	-15.4	-12.7	-	-
Nauru	-	-	-	-	-
Palau, Rep. of	9.6	10.6	2.5	-	-
Papua New Guinea	3.1	12.3	7.3	7.9	2.3
Samoa	-5.6	-5.6	-5.9	-5.1	-
Solomon Islands	25.3	0.8	3.2	-15.9	-10.4
Timor-Leste	30.4	83.5	115.5	139.6	-
Tonga	4.0	-2.9	-6.8	-5.0	-
Tuvalu	-	-	-	-	-
Vanuatu	-4.7	-10.9	-	-	-

Source ADB 2007a and revisions. Notes: Data are on a calendar year basis except for Marshall Islands, Micronesia, Palau and Tonga which are on a fiscal year basis.

Table 6. Country Policy and Institutional Assessment 2006 Rankings for Pacific Island Countries

Rank	Country	Economic Manage-ment	Bus. Reg. Env.	Structural Policies	Social Inclusion & Equity	Property Rights & Rule-based Governance	Public Sector Manage-ment & Ins.	Ave.
7	Samoa	3.8	3.5	4.0	3.9	4.0	3.9	3.9
50	PNG	3.8	3.0	3.3	2.5	2.0	2.9	3.1
	Vanuatu	3.5	3.0	3.2	2.8	3.0	3.1	3.1
55	Kiribati	3.2	3.0	3.0	2.9	3.5	3.2	3.1
61	Tonga	2.7	3.0	3.0	3.2	3.5	2.7	2.9
64	Solomon Is.	3.2	2.5	2.8	2.6	2.5	2.5	2.8
67	Timor-Leste	3.0	1.5	2.5	2.6	1.5	2.6	2.7

Note: the business regulatory environment is a sub-set of structural policies and property rights and rule-based governance is a sub-set of public sector management and institutions.

World Bank Country Performance and Institutional Assessment, IDA Resource Allocation Index (IRAI) 2006.

Table 7. Selected business climate indicators

	Fiji	Kiribati	Marshall Is.	Micro-nesia	Palau	Papua New Guinea	Samoa	Solomon Is.	Timor-Leste	Tonga	Vanuatu	Pacific Av. Excluding Timor-Leste
Ease of doing business												
2006	31	60	87	106	62	57	41	69	174	51	58	62
2005	29	58	86	105	57	53	36	61	174	46	54	59
Starting a business—time (days)												
2006	46	21	17	16	28	56	35	57	92	32	39	35
2005	46	21	22	36	33	56	68	35	92	32	39	39
Employing workers—rigidity of employment index												
2006	21	17	11	11	4	10	10	21	46	7	33	15
2005	21	17	11	11	0	21	17	17	46	13	30	16
Paying taxes—time (hours per year)												
2006	145	120	128	128	128	198	224	80	640	164	120	144
2005	140	..	160	128	128	198	224	80	640	156	120	148
Enforcing a contract—time (days)												
2006	397	660	432	775	622	440	455	455	1170	510	430	518
2005	420	440	440	410	465	440	505	455	990	510	430	452

Source: World Bank (2007, 2006)

Notes: The data for all indicators are for April 2006 and January 2005. The ease of doing business index ranks economies from 1 to 175, with lower values indicating greater ease in doing business. It is calculated as the ranking on the simple average of country percentile rankings on each of the 10 topics covered in the World Bank report Doing Business 2007. The rigidity of employment index is an average of three sub-indices: a difficulty of hiring index; a rigidity of hours index; and a difficulty of firing index. The index ranges from 0 to 100, with higher values indicating more rigid regulation. The time to pay taxes measures the time to prepare, file and pay three major types of taxes. The time to enforce a contract is measured from the time the plaintiff files a lawsuit in court until the time of payment.

Table 8. Poverty Indicators in the Pacific and Selected Asian Countries

	GDP per capita (PPP basis) 2006	Population in poverty per cent	Gini co-efficient	Year for poverty and gini estimate	Human development index 1975	Human development index 2004
Cook Islands		12.0	..	1998		
Fiji Islands	6137	34.4	0.34	2002	0.663	0.758
Kiribati	2504	50.0	..	1996		
Marshall Islands		...	..			
Micronesia, Fed. States of		27.9	0.41	1998		
Nauru		...	..			
Palau		59.2	..	2004		
Papua New Guinea	2673	37.5	0.48	1996	0.424	0.523
Samoa	6545	20.3	0.43	2002	0.705 (1985)	0.778
Solomon Islands	2082	...	..			0.592
Timor-Leste	1727	39.7	0.35	2001		0.512
Tonga	8255	22.3	0.42	2002		0.815
Tuvalu		29.3	0.43	1994		
Vanuatu	3315	40.0	..	1998		0.670
Average of Pacific	**4155**	**33.9**	**0.41**			**0.664**
China	7598	2.5	0.47	2005	0.527	0.768
India	3737	27.5	0.36	2004	0.413	0.611
Indonesia	4322	16.7	0.34	2004	0.469	0.711
Philippines	5414	30.0	0.44	2003	0.655	0.763

Source: IMF World Economic Outlook data base for GDP per capita, UNDP Human Development data base for human development index and ADB (2007) for population in poverty and gini coefficient.

Notes: **PPPs** are the rates of currency conversion that equalize the purchasing power of different currencies in their home countries for a given basket of goods. The Gini coefficient is a measure of inequality of income distribution. The **Gini coefficient** is defined to be between 0 and 1, with 0 representing complete equality in the income distribution and 1 representing complete inequality. The **human development index** is a composite index measuring average achievement in three basic dimensions of human development—longevity, knowledge and income (GDP per capita on a PPP basis). GDP is non-oil GDP for Timor-Leste. The average for the Pacific is a simple average.

Table 9. Incidence of Poverty and income distribution in Fiji

	1990–91	2002	1990–91	2002
	Per cent below basic needs poverty line		Gini coefficient	
National average	**25.5**	**34.4**	**0.49**	**0.34**
Fijian family	27.7	34.2	0.42	0.31
Indo-Fijian family	31.0	34.9	0.53	0.36
Urban average	**27.6**	**31.8**	**0.54**	**0.35**
Fijian family	na	29.9	na	0.31
Indo-Fijian family	na	33.9	na	0.36
Rural Average	**24.3**	**38.1**	**0.43**	**0.31**
Fijian family	na	37.3	na	0.29
Indo-Fijian family	na	39.2	na	0.34

Source: Abbott 2006.

Table 10. Health indicators

	Under 5 mortality rate 2000	Under 5 mortality rate 2005	Death rate associated with tuberculosis 2000	Death rate associated with tuberculosis 2004
Cook Islands	24	20	12	5
Fiji Islands	18	18	9	5
Kiribati	70	65	30	4
Marshall Islands	68	58	30	4
Micronesia, Fed. States of	47	42	23	4
Nauru	30	30	12	4
Palau	14	11	12	7
Papua New Guinea	80	74	73	42
Samoa	34	29	9	5
Solomon Islands	32	29	28	4
Timor-Leste	107	61	126	85
Tonga	26	24	10	5
Tuvalu	43	38	8	5
Vanuatu	48	38	30	5
Average of Pacific	46	38	29	13
China	41	27	25	17
India	48	36	43	30
Indonesia	94	74	93	46
Philippines	40	33	79	48

Source: ADB Millennium Development Goals Data Base

Table 11. Gender education indicators

	Net enrolment rate in primary education Girls		Net enrolment rate in primary education Boys		Literacy rate 15–24 years Girls		Literacy rate 15–24 years Boys	
	2000	Latest	2000	Latest	1990	2000–04	1990	2000–04
Cook Islands	...	...	...	...	...	...	...	...
Fiji Islands	98	96	98	97	98	...	98	...
Kiribati	...	...	...	...	...	...	...	...
Marshall Islands	88	89	88	90	...	...	...	...
Micronesia, Fed. States of	...	...	...	...	...	...	...	...
Nauru	82	...	80	...	...	...	...	...
Palau	95	...	98	...	...	...	...	...
Papua New Guinea	74	69	82	79	62	64	74	69
Samoa	91	91	90	90	99	99	99	99
Solomon Islands	...	79	...	80	...	...	...	...
Timor-Leste	...	...	...	...	...	...	...	...
Tonga	89	93	92	97	...	99	...	99
Tuvalu	...	100	...	100	...	...	...	...
Vanuatu	92	93	94	95	...	...	...	...
Average of Pacific	**88.6**	**88.8**	**90.3**	**91.0**	**86.3**	**87.6**	**90.3**	**89.2**
China	95	..	99	..	91	99	97	99
India	73	86	89	92	49	68	74	84
Indonesia	92	94	96	97	95	99	97	99
Philippines	93	95	92	93	97	97	96	94

Source: ADB Millennium Development Goals Statistical Tables

Note: The latest year varies from 2002 to 2005 and is shown in Table 7 in the Annex. For China the net enrolment rates are for 1991.

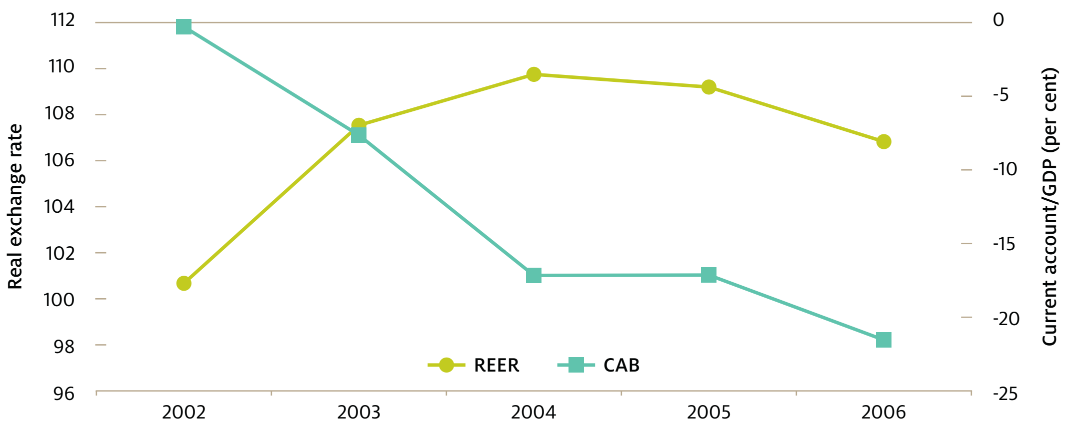
Table 12. Gender employment and political participation indicators

	Share of women in wage employment in the non-agricultural sector		Proportion of seats held by women in national parliament	
	1990	2004 or latest year	2000	2006
Cook Islands	38.4	39.4	8	...
Fiji Islands	29.9	35.9	11	9
Kiribati	34.0	38.0	5	5
Marshall Islands	...	30.9	3	3
Micronesia, Fed. States of	34.0	34.0	0	0
Nauru	...	...	0	0
Palau	39.0	40	0	0
Papua New Guinea	20.3	35.4	2	1
Samoa	31.0	43.0	8	6
Solomon Islands	...	30.8	2	0
Timor-Leste	19.0	35.0	26	25
Tonga	36.0	...	0	3
Tuvalu	38.0	44.0	0	0
Vanuatu	38.0	44.0	0	4
Average of Pacific	32.5	37.5	4.6	4.3
China	37.7	40.9	22	20
India	12.7	17.3	9	8
Indonesia	29.2	31.1	8	11
Philippines	39.7	40.4	12	16

Source: ADB Millennium Development Goals Statistical Tables

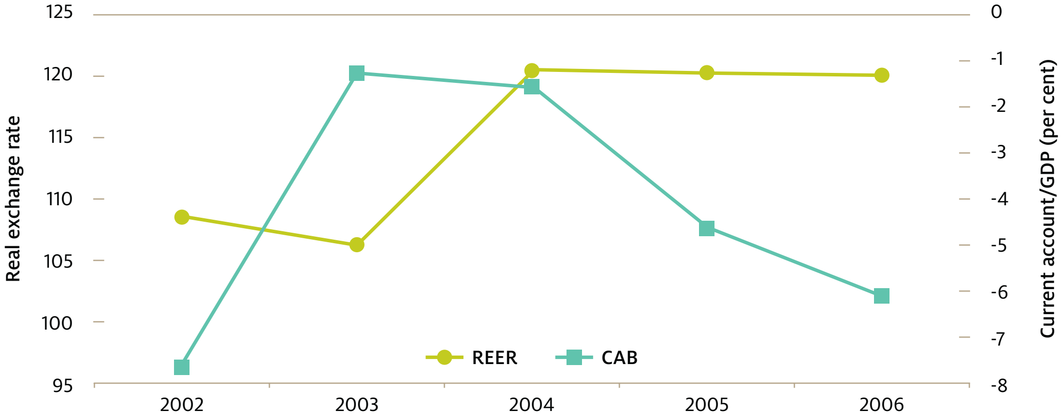
Note: The latest year varies from 2002 to 2005 and is shown in Table 7 in the Annex. For China the net enrolment rates are for 1991.

Chart 1. Competitiveness and the current account—Fiji



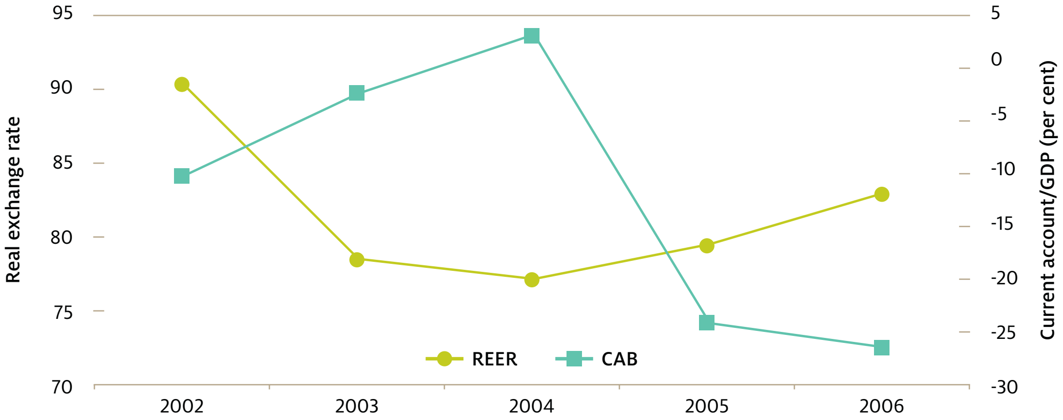
Source: ADB 2007a, IMF 2007a

Chart 2. Competitiveness and the current account—Samoa



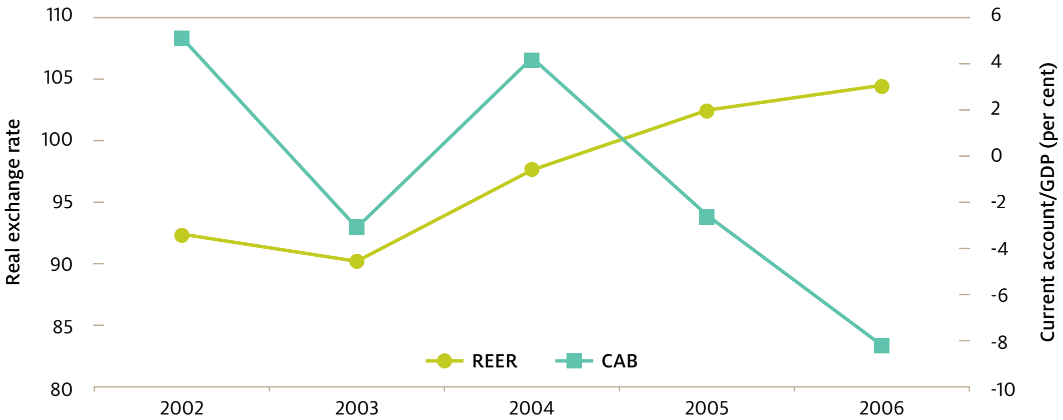
Source: ADB 2007a, IMF 2007a

Chart 3. Competitiveness and the current account—Solomon Islands



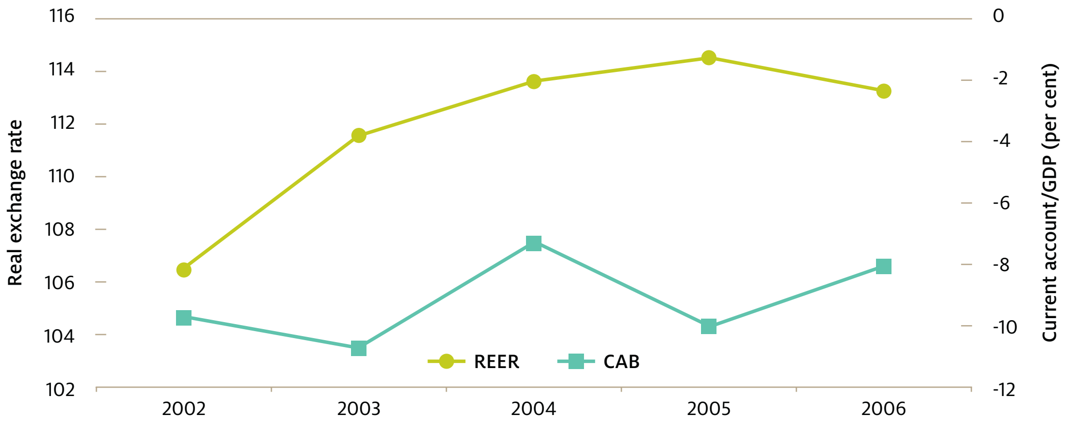
Source: ADB 2007a, IMF 2007a

Chart 4. Competitiveness and the current account—Tonga



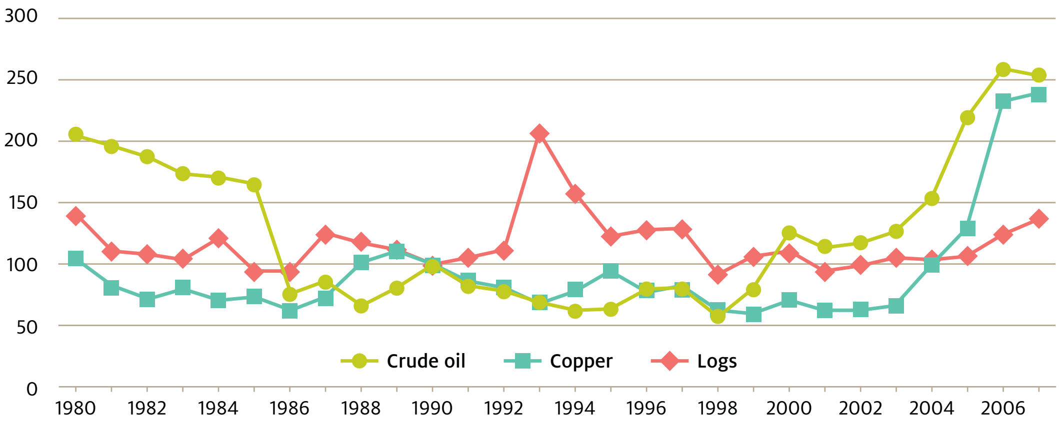
Source: ADB 2007a, IMF 2007a

Chart 5. Competitiveness and the current account—Vanuatu



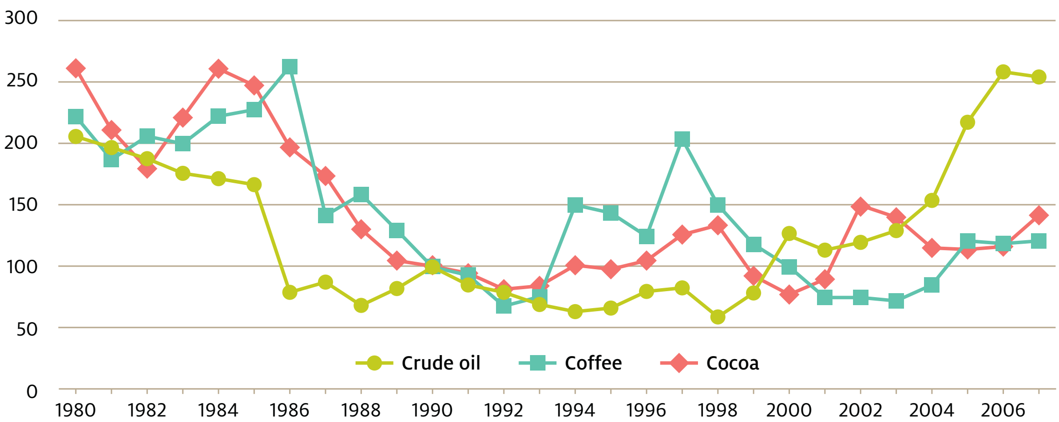
Source: ADB 2007a, IMF 2007a

Chart 6. Real commodity prices—logs, copper and crude oil



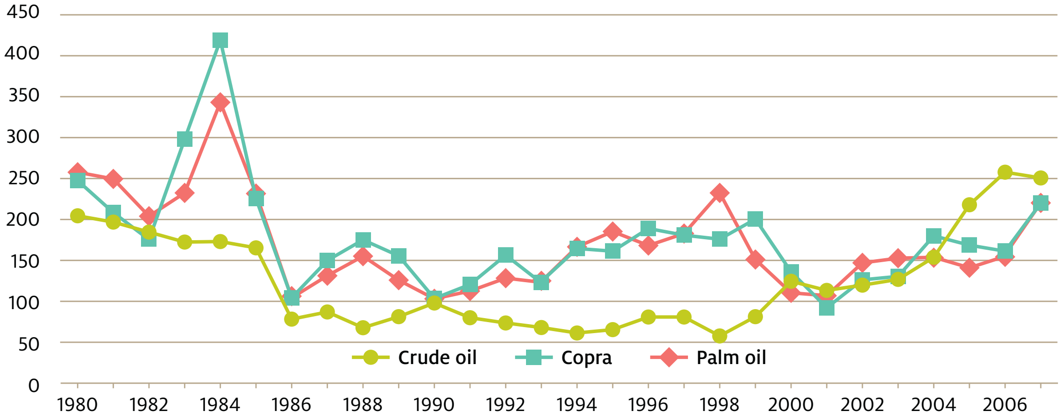
Source: World Bank, Commodity Price Data Base

Chart 7. Real commodity prices—cocoa, coffee and crude oil



Source: World Bank, Commodity Price Data Base

Chart 8. Real commodity prices—palm oil copra and crude oil



Source: World Bank, Commodity Price Data Base

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