PACIFIC ISLAND DEVELOPING MEMBER COUNTRIES

Eight of the 11 Pacific developing member countries (PDMCs) discussed in this chapter are expected to maintain the generally improved economic performance of 1999. However, poor performance in Fiji and the Solomon Islands because of severe political problems will result in a marked decline in the 11 countries' overall growth. An early return to normalcy and political stability holds the key to future economic prospects.

Economic Indicator (percent)	1997	1998	1999	2000
GDP growth	-1.5	-1.0	4.2	-9.2
Inflation rate	4.0	5.8	2.5	4.4

Economic Assessment. Following a generally improved economic performance in these 11 PDMCs in 1999, political disturbances in Fiji (beginning in May 2000) and the Solomon Islands (starting in June 2000) drastically changed the prospects for the two countries in the subregion. As a result, total real GDP for these 11 PDMCs together is likely to contract by a weighted average of 9.2 percent in 2000.

Except for Fiji, Nauru, and Solomon Islands, eight countries are expected to record positive growth in 2000. In particular, growth in Vanuatu is expected to significantly improve to 4.0 percent in 2000 compared with a 2.2 percent contraction in 1999, largely reflecting an increase in construction activities, a rise in tourism, and a recovery in agriculture. Growth in the other seven countries together is expected to show only a minor variation over the 1999 level with construction and tourism remaining the main drivers of growth in 2000. The overall positive economic prospects in 2000 also reflect the impact of reforms undertaken since the mid-1990s and the positive effects of an improvement in the world economy.

Political instability and associated violence have led to a disruption of economic activities in Fiji and the Solomon Islands. As a result, real GDP is expected to decline by 15 percent in Fiji and by 15–20 percent in the Solomon Islands in 2000, doubling unemployment in Fiji and placing half the national government staff on leave without pay in the Solomon Islands. While tourism, garments, construction, and retail and wholesale business have been most severely affected in Fiji, the entire formal sector of the economy seems to have stopped functioning in the Solomon Islands. Sugar production, a major export earner in Fiji, has been relatively less affected because of a bumper crop, but delayed harvesting is reported to have reduced yields significantly. All major export-earning corporations in the Solomon Islands have suspended or closed their operations following ethnic trouble.

At the beginning of 2000, the macroeconomic environment in nine countries (i.e., excluding Fiji and the Solomon Islands) was stable and

Pacific developing member countries comprise Cook Islands, Fiji, Kiribati, Marshall Islands, Federated States of Micronesia, Nauru, Samoa, Solomon Islands, Tonga, Tuvalu, and Vanuatu. Papua New Guinea is discussed in a separate chapter.

improving. Fiscal and external balances as well as inflation levels are likely to vary only marginally in 2000 from 1999 levels in eight countries (Vanuatu is the exception, where the budget deficit is likely to increase substantially in 2000, due to a rollover of many development projects budgeted for 1999). The fiscal balances in Fiji and the Solomon Islands have significantly worsened, causing the governments to sharply revise budget estimates downward. The balance-of-payments account is under pressure in Fiji, but foreign exchange reserves were maintained around the pre-disturbance level to the end of July, largely due to the imposition of capital controls and a credit ceiling on commercial banks. In the Solomon Islands, the balance-of-payments position deteriorated sharply soon after the political disturbances, but showed signs of improvement by the end of July due to inflows of export earnings from logs, copra, and oil. Annual inflation rates in Fiji and the Solomon Islands are expected to be 5 percent and 6 percent, respectively, in 2000.

Structural Issues. The paradox of low rates of economic growth despite high foreign resource inflows and significant investment continues to be a major issue in these 11 PDMCs. It can be explained by the small size of factor and product markets that restricts the possibilities for economies of scale and diversification of production. The countries therefore remain vulnerable given their high dependence on external trade and financial support. Other structural issues include inefficient land markets, shortage of human resources, poor public sector performance, and weak private sector development. During the first half of 2000, nine countries (except for Kiribati and Nauru) continued the economic, public sector, and governance reforms started in the mid-1990s. The ongoing reforms include governance and transparency, public finance management, private sector development and privatization, public service delivery, and financial sector development. (Evidently, the political instability in Fiji and the Solomon Islands in mid-2000 severely disrupted the reform process there.)

A narrow export base and vulnerability to external economic shocks necessitate continuous maintenance of macroeconomic stability, with little room to maneuver. The first half of 2000 witnessed an overall consolidation of the broad macroeconomic stability achieved in 1999 in most of the 11 countries. However, the political disturbances and associated violence have seriously damaged tourism and investment prospects. Access to and cost of air transport as well as traveling time, particularly for Polynesian countries, has also been adversely affected by the instability in Fiji. Some tourist traffic from Fiji may therefore be diverted to Cook Islands, Samoa, Tonga, and Vanuatu in 2000, resulting in temporary income gains for these countries.

Forecast. Total real GDP for these 11 PDMCs is expected to contract by a weighted average of 9.2 percent in 2000, while the weighted-average annual inflation rate is estimated to be 4.4 percent. The overall macroeconomic environment is likely to worsen significantly in Fiji and the Solomon Islands this year. Nauru and Vanuatu face a significant risk of a deteriorating macroeconomic environment; the other seven countries are generally expected to remain stable in 2000. The overall economic prospects for the 11 countries largely depend on political stability, an early return to normalcy in Fiji and the Solomon Islands, and continued commitment to reforms.