PACIFIC ISLAND DEVELOPING MEMBER COUNTRIES

The growth forecast for 2001 has been revised downward due to continuing economic weakness in the Fiji Islands and Solomon Islands, and a sharper than expected slowdown in the world economy. Further delay in a return to normalcy in these two countries, and a general weakening of commitment to prudent economic management among governments, pose a risk to future economic prospects.

Economic Indicator (percent)	**1998**	**1999**	**2000**	**2001**		**2002**	
				Current	***ADO 2001***	**Current**	***ADO 2001***
GDP growth	0.7	5.6	-1.4	1.2	—	3.9	—
Inflation rate	5.1	2.5	2.1	3.7	—	3.2	—

— not available.

Economic Assessment. According to revised estimates, real GDP of the 11 Pacific island developing member countries contracted by a weighted average of 1.4 percent in 2000. This nevertheless represents a significant improvement over the *ADO 2001* estimate of a 1.8 percent contraction, due largely to the recent revision in the official figures for the Fiji Islands from a contraction of 9.3 percent to 2.8 percent growth in 2000. The overall decline in 2000 was a reflection mainly of crises in the two largest economies—Fiji Islands and Solomon Islands—arising from political instability and ethnic unrest. Other economies generally recorded positive growth during the year. In particular, the performances of Cook Islands, Samoa, and Tonga were robust.

Except for higher fish production, the two crisis-affected economies experienced weak demand and generally subdued or declining economic activity in the first half of 2001. During this period, both countries faced uncertainties due to pending elections. The other nine economies also recorded weak economic activity, largely reflecting the weakness of the world economy and depressed commodity prices. Positive developments were attributable primarily to a variety of country-specific factors, such as enhanced activity in construction, public investment, and fisheries.

Inflation generally rose during the first half of 2001 due to the lagged effect of higher global oil prices and increased costs of domestically produced food items. This has led to upward revisions of annual inflation projections for most countries as well as the group as a whole. The Fiji Islands recorded a rise in inflation, though this is expected to stabilize over the rest of this year due to significant excess capacity and weak wage growth. There was no official reporting of inflation in Solomon Islands for the first half of 2001. Across the

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

11 economies generally, money supply growth showed no discernable trend during the first quarter of 2001: there was a decline in the Fiji Islands and Solomon Islands, a rise in Samoa, and a modest decline in Vanuatu. However, an expansionary monetary stance is likely in most of these countries over the rest of 2001 due to the authorities' efforts to spur economic growth.

During the first half of 2001, sluggish external demand for the 11 economies' exports was only partially offset by a modest decline in imports stemming from weaker domestic demand. As a result, most economies experienced a deterioration in their trade account and a weaker overall balance of payments. There were, however, significant variations in individual country performance. For instance, while the Fiji Islands and Solomon Islands had worsening trade accounts during the first quarter of 2001, for the former this was due mainly to a sharp decline in traditional exports, while for the latter this was attributable to a steep rise in imports, leading to its highest quarterly trade deficit in 10 years. In Vanuatu, substantial capital account outflows were responsible for a deterioration in the balance of payments.

Most of the larger economies saw weakening fiscal balances during the first half of 2001 due to higher expenditures and lower revenues—though once again a certain amount of diversity can be seen. Deteriorating fiscal performance was attributable to tax breaks and expenditure measures to spur investment and growth in the Fiji Islands, and to an eroded tax base and high expenditures in Solomon Islands. In most of these larger economies, recurrent expenditures were on the rise, particularly in Vanuatu. No discernable trend was evident in Kiribati, Federated States of Micronesia, or Tuvalu, which have a large share of nontax revenues in total revenues.

Economic Management Issues. Deteriorating exports and tax revenues associated with the less hospitable external environment pose risks to fiscal and external balances. Thus the main economic management issues are (i) the maintenance of growth without creating macroeconomic instability and (ii) a continued commitment to reform despite current difficulties. Another major factor is the early return to normalcy and rehabilitation in the Fiji Islands and Solomon Islands, as several factors associated with political instability and ethnic conflict continue to plague these countries. This has kept business and investor confidence low and economic activity subdued. The stability of the new governments following elections, as well as their commitment to reform and good governance, is critical for the two countries' recovery prospects. However, unless economic management in Solomon Islands improves significantly, the country may face increased risk of another economic crisis, as suggested by the continued deterioration in its fiscal and external positions in recent months.

One of the constraints facing economic growth and private sector development in the Pacific island economies relates to property rights, in which some of the recent ethnic conflicts are rooted. It is important that this problem is addressed quickly in a manner acceptable to all parties. Diversification of production and exports is another important issue for the subregion, so as to reduce vulnerability to external economic shocks. Recent developments in Samoa and the general structure of the precrisis Fiji Islands economy serve as good models for this.

The June 2001 Forum Economic Ministers' Meeting addressed a range of crucial issues, including land matters, strengthening compilation and reporting of statistics, governance and accountability, finance sector reforms, commercial law, and dispute resolution. The Meeting's adoption of the Guidelines for Good Land Policy, which could form the basis for national consideration of issues such as land leasing, dispute resolution, and use of land as collateral, was a major step in addressing the issue of property rights. Further progress in these areas is needed. Another recent major development has been the signing of the Pacific Agreement on Closer Economic Relations (PACER) in Nauru in August 2001 by many Pacific island developing member countries. As an initial step under the PACER, a free trade agreement—the Pacific Island Countries Trade Agreement (PICTA)—was signed and will come into force next year.

Forecast. Near-term prospects remain weak because of a lack of rebound in the Fiji Islands and Solomon Islands, and a sharper than anticipated slowdown in the global economy. As a result, the forecast for the 11 economies in 2001 has been revised downward to a modest weighted average growth rate of 1.2 percent, reflecting small, but positive, growth in almost all the countries during the year. Projected weighted average inflation for 2001 has been marginally revised upward to 3.7 percent. A general deterioration in the balance-of-payments position is also expected during the rest of 2001, due to more subdued international demand for exports and low earnings from tourism resulting from heightened security concerns following the 11 September attacks on the US. While 2002 prospects remain uncertain, the weighted average of GDP growth is likely to pick up to 3.9 percent, reflecting a gradual recovery in the world economy and an economic rebound in the Fiji Islands and Solomon Islands. Inflation is likely to moderate as a result of lower food prices. The fallout from the events of 11 September has yet to settle and is adding uncertainty to these projections. Generally, the main areas of concern for the 11 economies are tourism, transport services, external trade, returns on official trust funds, and fiscal and external imbalances.