

Regional Context

Economic Performance and Challenges



Economic Growth and Poverty

Tables A1.1 and A1.2 in Appendix 1 show detailed social and economic profiles including the level of national income, external aid dependency, employment, and demographic trends of the PDMCs. PNG, Solomon Islands, and Timor-Leste have income levels that barely exceed the African average. Except for Fiji Islands, the remaining are middle-income, small island states with populations of 20,000 to 200,000 people, in many cases scattered over a large number of islands. The variation in performances by the PDMCs despite their similar natural conditions suggests that a significant constraint to development lies in the weaknesses of policies and institutions and that intervention to remedy them would be conducive to development.

The majority of the Pacific population relies on subsistence farming and fishing, government employment, servicing government employees, and work in the international maritime industry for their livelihoods. In addition, employment opportunities in the services sector, especially in tourism and international call centers are growing. With the exception of the poorest PDMCs, abject poverty may not be prevalent in many, but poverty of opportunity and hardship occurs in almost all (ADB 2003f). Hardship is characterized by limited access to

basic services, lack of opportunities to participate fully in socioeconomic life, and lack of cash to meet basic household needs and customary obligations to the extended family, the community, and the church. The United Nations Development Programme (UNDP) estimates suggest that about 43% of the total population lives close to the poverty line. Of this group, 95% live in Melanesia (PNG, Solomon Islands, and Vanuatu) (UNDP 1999).⁸ The tradition of mutual support in the extended family and the community often conceals the extent of poverty or deprivation. Indigenous cultures and traditions have remained strong in the Pacific and continue to play an important role in political, economic, and cultural life. These cultural and social values continue to contain the incidence of poverty, but there are clear indications that the systems and the values that support them are slowly eroding.

PDMCs have obtained strong support for their economic and social development from bilateral and multilateral development partners.⁹ Two features of aid to the Pacific are noteworthy: a per capita amount significantly higher than the global average and a high proportion of technical assistance. Bilateral assistance reflects colonial history and national interests. Among the bilateral agencies, Australia, Japan, New Zealand, and the United States (US) are major players. Australia is one of the biggest donors in the Pacific allocating around A\$480 million per annum of which roughly 75% is allocated to PNG (AusAID 2002). In its 2002/03–07/08 strategy, the Australian Agency for International Development (AusAID) responded to instability in the South Pacific, especially in Melanesia and Timor-Leste, with a sharper focus on establishing the foundations for stability, growth, and peaceful development to ensure law and order, accountable and democratic governments, more equitable growth, and enhanced service delivery. The US is the key donor in FSM, RMI, and Palau through compact funds that accounted for over 95% of bilateral assistance to these countries in 1998.¹⁰ The first compact allowed the government freedom in allocating funds to sectors. Compact II (2004–2024) continues to provide large, though reduced, amounts with a new emphasis on greater accountability and an outcome-based approach.

⁸ Please note that Timor-Leste is not a Pacific country under UNDP.

⁹ This subsection draws on ADB 2000c and ADB 2004d, Attachment 7.

¹⁰ World Bank 2000 provides 23.5% of total aid to the Pacific, mainly to FSM, Palau, and RMI (Pacific Islands Forum Secretariat 2002i).

New Zealand has a focus on poverty reduction through assistance in improving health, education, the environment, human resource development, and private sector growth. Its core geographical focus is the Pacific, especially the Polynesian countries. Through its official development assistance, Japan provides assistance in the Pacific with a focus on agriculture, forestry, fisheries, and basic infrastructure. Recently, Japan has started giving greater emphasis to institutional strengthening and human resource development. The United Kingdom focuses on education and on good governance.¹¹ The People's Republic of China and Taipei, China are active in the region and usually support stand-alone infrastructure projects.

Of the multilateral agencies, ADB and the European Union (EU) are main contributors while the various United Nations (UN) agencies have implemented significant, high-quality programs, especially in the social sectors. ADB is a key player in the region with approval of about \$50 million–\$100 million in loans and about \$15 million in technical assistance grants annually (ADB 2000c). Its assistance has focused on promoting good governance and macroeconomic stability. It has also promoted more efficient and effective institutions for infrastructure management in transport, energy, and water supply and sanitation. This has meant more business-like approaches for government departments and state-owned enterprises. An internal review of ADB's Pacific Strategy for 2000–2004 indicated a need for greater and longer-term focus in its programs and clearer and more specific objectives and performance indicators. The new Pacific strategy will provide clearer guidance on resource implications and implementation (ADB 2004d).

The EU primarily supports transport, communication, industry, construction (including schools), mining, and energy. The World Bank is involved in infrastructure, transport, agriculture, education, health, delivery of public services, macroeconomic stability, capital markets, trade and investment, and governance. The International Monetary Fund assists central banks and ministries of finance in the region and with UNDP jointly established the Pacific Financial Technical Assistance Centre in Suva, Fiji Islands. ADB, AusAID, and the New Zealand Agency for International Development (NZAID) support the

¹¹ Note that in recent years, the United Kingdom has officially closed its bilateral programs in the Pacific region.

center while the Pacific Islands Forum Secretariat (PIFS) sits on the review group. Its primary aim is to build the skills and institutional capacity in PDMCs for effective and sustainable economic and financial management. UNDP coordinates the activities of various UN agencies in employment, sustainable livelihood, gender issues, disadvantaged groups, environment, and governance.

The economic performance of PDMCs over the last decade has been mixed. While eight countries¹² witnessed rates of gross domestic product (GDP) growth varying from 0.8% (Vanuatu) to 4.6% (Kiribati) during 1995–2002,¹³ five countries¹⁴ had negative per capita growth. The weighted average of PDMCs for the period was as low as 0.9%. A positive turn is expected with a projected 2.9% growth in 2004 and 2.4% in 2005 (ADB 2004a). Nevertheless, the overall picture of PDMCs continues to present tremendous economic and social challenges. With a saturated or downsized public sector and a sluggish private sector, job creation has been minimal. The best prospects for job creation lie in tourism, small-scale manufacturing, financial services, and overseas employment. However, with few exceptions, the potential for developing these sectors has yet to be fulfilled.

Development Constraints

Three types of constraints on development confront PDMCs. The first is natural: smallness, remoteness and isolation, limited resources for economic diversification, and susceptibility to natural disasters. All of these contribute to their vulnerability and to their exposure to exogenous shocks over which they have little control and from which they have little capacity to withstand or to recover. Relative stability can turn into vulnerability when an existing resource is exhausted and an alternative source of revenue is elusive.¹⁵ The vast distances between communities combined with associated travel and communication

¹² Cook Islands, Fiji Islands, Kiribati, Samoa, Timor-Leste, Tonga, Tuvalu, and Vanuatu.

¹³ ADB Pacific Department database.

¹⁴ FSM, PNG, RMI, Solomon Islands, and Vanuatu.

¹⁵ A typical case is the imminent exhaustion of phosphate mining in Nauru that has been its mainstay of revenue since 1906. The economic downturn and ensuing lower incomes will present a major challenge to Nauruan people who have enjoyed relative affluence sustained by high phosphate earnings. The low priority attached to education and the resulting low profile in educational attainment has to be rectified urgently to prepare Nauruan people for alternative employment. See ADB 2000b.

constraints in most PDMCs create important challenges for governments in delivering services to remote communities and vulnerable populations.

Isolation and demographic pressures in others are exacerbating these problems. The total population in PDMCs is about 8.6 million living on hundreds of islands spread across thousands of square miles of ocean. At least a third of the population in the Pacific is in the 0–14 age group. About two-thirds of the populations live in rural areas, but migration to other countries as well as migration to small towns and cities has become a significant trend weakening societal and familial structures, boosting the demand for public services (including schooling), and increasing unemployment. The limited capacity of the rural economy has led many to move to urban areas that have great difficulty absorbing these newcomers. Without the social safety net that their extended families usually provide at home, they become a new urban underclass. This has become a pressing social problem and is described as a “time bomb” in Vanuatu where 43% of the population is under 15 years of age, most of them out of school by grade 6 or 10, and ill prepared for life. Population growth in Kiribati, PNG, RMI, and Solomon Islands is leading to similar situations. Improved access of outer island populations to basic social services, especially health and education, and income-generating opportunities may help to slow down the urban move.¹⁶

On the other hand, some PDMCs¹⁷ are experiencing very low population growth rates following considerable migration to the US, Australia, and New Zealand, attributed to disappointing economic performance and rising unemployment. The impact of emigration on these countries is complex.¹⁸ On one hand, most of those who leave tend to be skilled, qualified citizens, which means countries lose some of the benefits of investment in education and training and may face shortages in human resources especially in skilled and semiskilled occupations. The migration of skilled health personnel in particular is

¹⁶ PDMCs have been trying for decades to reverse urban drift, but they have failed because of continued unattractive economic prospects in rural areas.

¹⁷ Especially in Cook Islands, Samoa, Tonga, and Tuvalu, but increasingly in other countries too. The total population of Cook Islands remained at 18,400, but the resident population dropped from 14,800 in 2002 to 13,900 in 2003. (<http://www.spc.int/prism>). The population of FSM, Nauru, and Tonga, for example, increased by less than 0.5% during 2000-2003.

¹⁸ An important reason for emigrating from Fiji Islands and Solomon Islands is political factors and the resulting risk and uncertainty.

a major issue in the region. On the other hand, emigration reduces population pressure and contributes to the national economy through remittances. The returnees may also bring back capital, new skills, and knowledge. Ultimately the economic impact will be determined by the benefits from remittances.¹⁹ In some PDMCs, remittances are a large part of the economy (47.9% of GDP in Tonga, and 21.1% in Samoa in 2001).

The second constraint is historical. Most of the PDMCs were colonies or trust territories of Western powers from the 19th century through much of the 20th century. They are young nations that gained independence only in the second half of the 20th century, first is Samoa in 1962 and most recently FSM and RMI in 1986. Most countries comprise a group of islands many of which did not have a history of coexistence. Nation building is, therefore, a process of learning to work with each other as a political entity. Frequent changes of governments and ensuing political and economic instability in some Pacific countries are an unfortunate feature in the lengthy process of nation building.

The third type of constraint is institutional. The variation in performance by the PDMCs despite their similar natural conditions suggests that a significant constraint to development lies in the weaknesses of policies and institutions and that interventions to strengthen them would be conducive to development. For example, monopolistic policies have impeded the development of more efficient, open, and competitive telecommunications and transportation systems, which might have helped mitigate some consequences of geographical isolation. Incentives for private sector development may have mitigated unemployment. Perhaps the most important challenge in several PDMCs is to sustain progress toward strong inclusive leadership and public participation in support of a development strategy that responds to the priorities of the disadvantaged. There is no reason to doubt that with good policies, strong institutions, and effective leadership PDMCs will be able to overcome the constraints of geography and history.

¹⁹ In Fiji Islands, remittances are now the main foreign currency earner. For an interesting analysis of the positive impact of remittances on developing countries, see Ratha 2003.