

INCLUSIVE AND SUSTAINABLE GROWTH ASSESSMENT

A. Recent Growth, Poverty, Inequality, and Environmental Dynamics

1. This assessment focuses on the Asian Development Bank (ADB) small developing member countries (DMCs) in the Pacific.¹ The 12 small Pacific island countries (PIC-12)—the Cook Islands, the Federated States of Micronesia (FSM), Kiribati, the Marshall Islands (RMI), Nauru, Niue, Palau, Samoa, Solomon Islands, Tonga, Tuvalu, and Vanuatu—share common features: (i) vulnerability to shocks, (ii) weak service delivery, and (iii) economic underperformance. The interplay between these factors impacts the development performance and prospects of the PIC-12. In 2020, ADB classified six of the PIC-12 as fragile and conflict-affected situations (FCAS) and all as small island developing states (SIDS).² The assessment, along with the annual country strategic analyses included in rolling country operations business plans, informs detailed programming of country support to the PIC-12 and the broader strategic direction of the Pacific Approach, 2021–2025.

2. The coronavirus disease (COVID-19) pandemic is the most severe economic shock faced by the PIC-12. As SIDS, the PIC-12 are highly vulnerable to shocks and fragility or near-fragility—since each country exhibits at least some aspect or dimension of fragility—and COVID-19 doubles their burden. Although most PIC-12 managed to remain free of the virus through timely border closures, the socioeconomic cost is high. COVID-19 travel restrictions pushed the PIC-12 to an unprecedented economic contraction during 2020, rolling back per capita income by several years and placing hard-won gains in poverty reduction at serious risk. With tourism at a standstill during the last three quarters of 2020, the previous strong momentum in visitor arrivals has been lost. Weak tourism performance could linger over the medium term through supply-side constraints stemming from business closures. Remittance inflows, particularly from seasonal workers, have declined, with prospects for near-term recovery contingent on the resumption of international travel. Delays in project construction caused by constraints on mobility of labor and capital equipment have impeded productivity gains from infrastructure upgrades. The rising debt burden from increased borrowing to finance COVID-19 response packages in some countries may constrict the fiscal space for infrastructure projects,

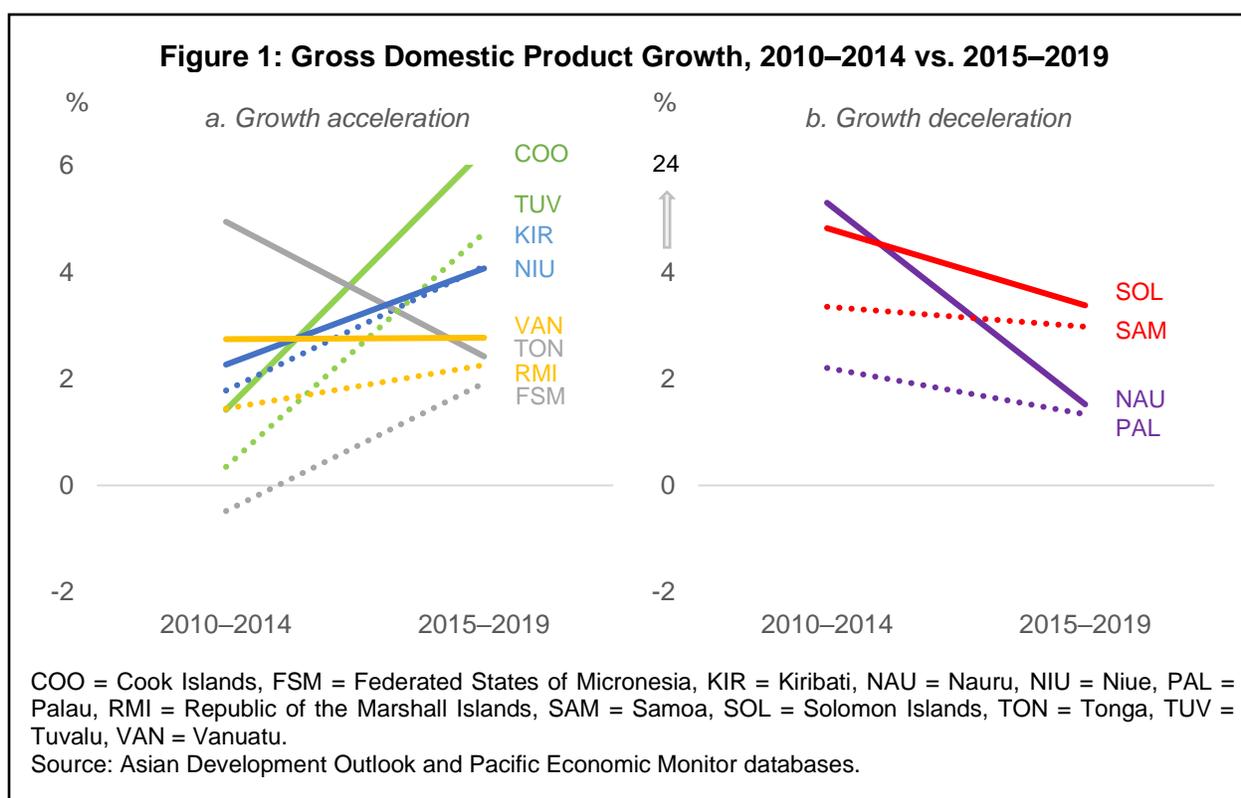
3. The severe impacts and challenges posed by COVID-19 necessitate an adaptive and flexible strategy to put growth back on a more inclusive and sustainable path over the medium term. Just as the Pacific economies were among the first to fully close their borders, they are likely to be the last to open them to safeguard their fragile health systems. Thus, COVID-19 response and recovery will feature heavily in implementing the Pacific Approach, 2021–2025. ADB's country partnership strategies (CPSs) will prioritize differentiated approaches to support sustainable recovery from COVID-19 across the PIC-12. The focus will be on (i) supporting previous drivers of economic growth—including tourism; trade and transport (e.g., fisheries transshipment); and infrastructure construction—to reclaim losses in potential output and eventually revert to positive pre-pandemic trends; and (ii) continuing to build resilience to shocks, including disasters, climate change, and potential future health emergencies similar to the COVID-19 pandemic, to safeguard long-term economic growth and human development.

¹ Given their substantially larger project portfolios and investment pipelines, specific country partnership strategies (CPSs) are in place for the two largest Pacific DMCs—Fiji and Papua New Guinea.

² The FSM, Kiribati, Nauru, the RMI, Solomon Islands, and Tuvalu were classified as FCAS in 2020. SIDS are recognized by the United Nations as a distinct group of developing countries facing specific social, economic, and environmental vulnerabilities.

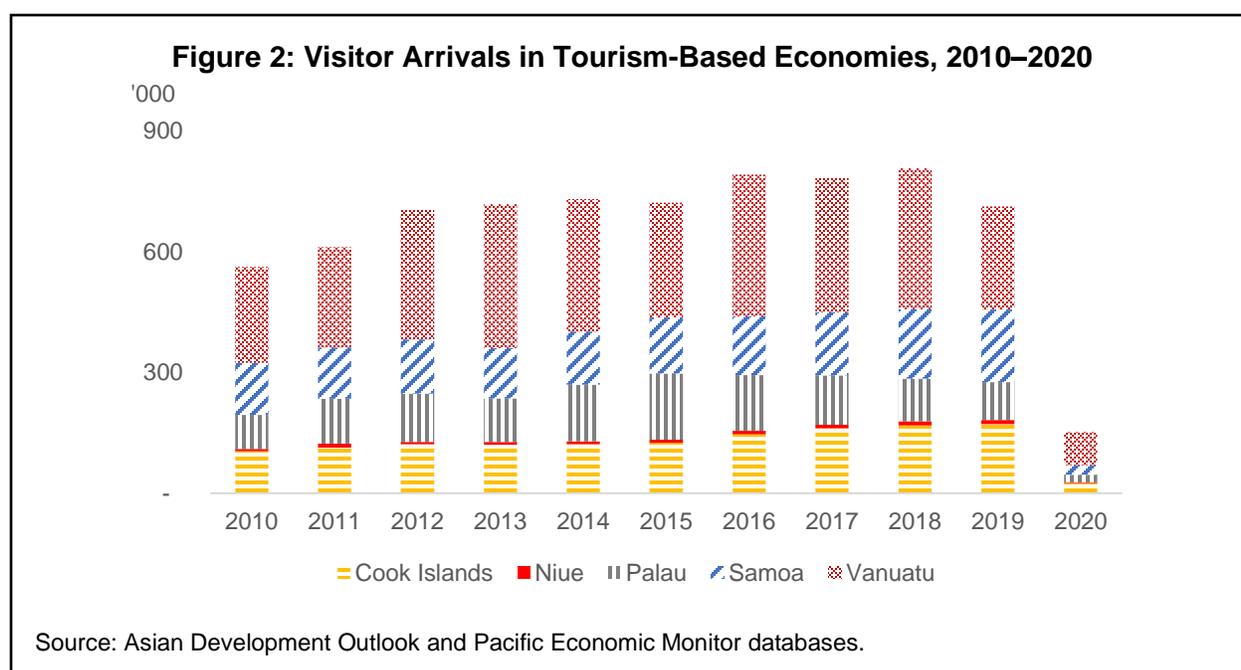
4. Although the PIC-12 face common development challenges, they are not a homogenous group. Their populations range from just 1,800 in Niue to less than 15,000 in Nauru and Tuvalu to about 685,000 in Solomon Islands. While the FSM, Kiribati, Samoa, Solomon Islands, and Vanuatu are lower-middle-income economies, the RMI, Maldives, Nauru, Palau, Tonga, and Tuvalu are considered upper-middle-income economies based on nominal per capita gross national income (GNI). Only the Cook Islands and Niue are classified as high income. Based on population size and drivers of growth, the PIC-12 can be divided into three economic subgroupings: (i) small island and atoll economies, comprising the FSM, Kiribati, the RMI, Nauru, Tonga, and Tuvalu; (ii) tourism-based economies, comprising the Cook Islands, Niue, Palau, Samoa, and Vanuatu; and (iii) a larger export economy, Solomon Islands.³ These groupings are neither deterministic nor exclusive, and some small islands and atolls could conceivably become tourism-based economies following recovery from COVID-19.

5. **Stronger economic growth in most of the PIC-12 during 2015–2019.** Annual average growth in gross domestic product (GDP) accelerated in eight of the 12 smaller Pacific DMCs, driven by stronger fiscal stimulus backed by sharp increases in domestic revenue collection—most notably of fishing license fees collected from foreign fishing fleets—and rising tourist arrivals in the South Pacific. Median economic growth among the PIC-12 rose to an average of 3.3% during 2015–2019 compared with 2.0% in 2010–2014. Key economic drivers that had pushed growth to previous highs were immobilized by cutbacks in public spending in Nauru, the tourism downturn in Palau, the closure of the largest private employer in Samoa, and the drop in log exports from Solomon Islands.



³ These subgroupings and their implications for ADB's CPSs are further discussed in the Pacific Approach 2021–2025.

6. **A favorable external environment underpinned solid tourism performance.** In the five tourism-based economies in the PIC-12—the Cook Islands, Niue, Palau, Samoa, and Vanuatu—average annual visitor arrivals were higher by 5%–33% in 2015–2019 than in 2010–2014 (Figure 2). The increase was supported by (i) income growth among major sources of tourists, particularly with sustained strong growth in Australia plus acceleration in New Zealand and the United States; (ii) expanding flight connections; and (iii) muted international crude oil prices, which helped reduce air travel costs. Momentum was strongest in the Cook Islands and Samoa, with each setting successive record highs in visitor arrivals from 2015 to 2019. Visitor arrival growth in Vanuatu could have been higher if not for constraints on air and sea transport infrastructure. Arrivals in Palau peaked in 2015, but the surge in tourism driven by visitors from the People’s Republic of China has since reversed rapidly. Tourism growth seen during 2016–2019 has been slashed by global travel restrictions in 2020, the severe contraction of the aviation industry, and the lack of client confidence in tourism. Post–COVID-19 recovery is likely to depend on rebuilding tourism as a growth driver.

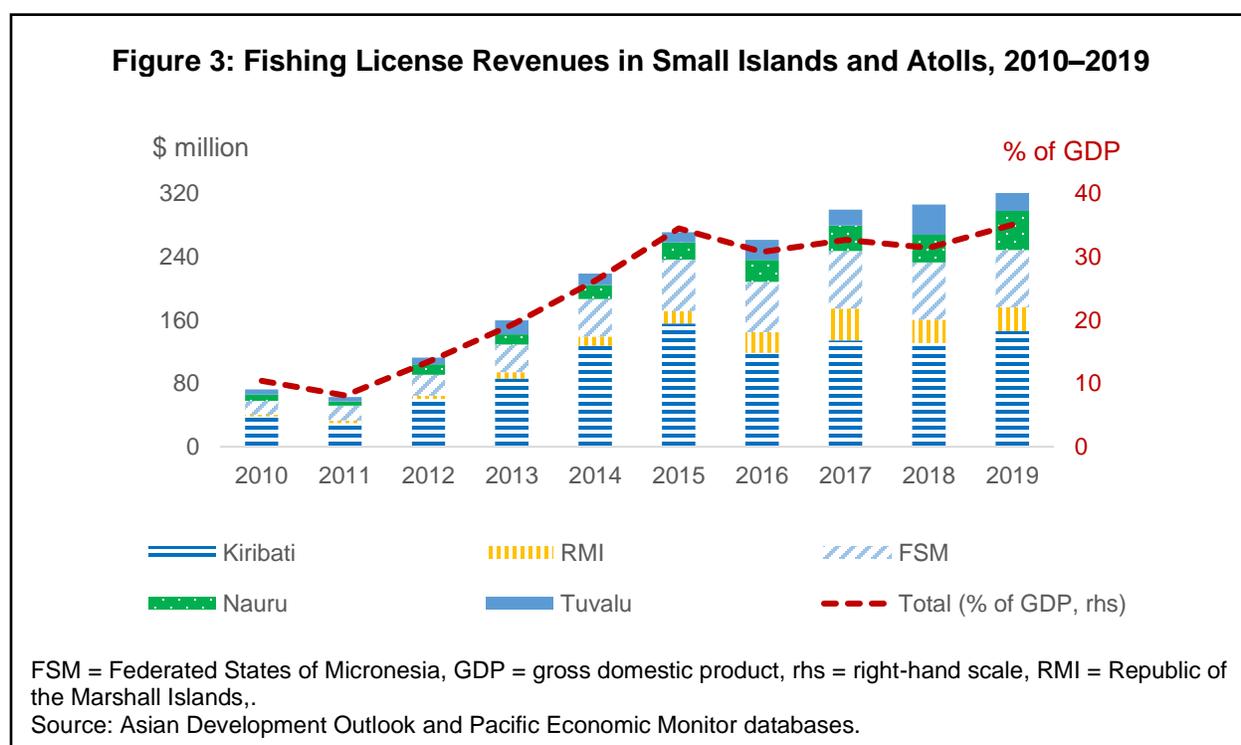


7. **Structurally higher fishing license revenues through regional cooperation.** The Parties to the Nauru Agreement’s vessel day scheme (VDS) is a foremost example of successful regional cooperation and integration in the Pacific developed by the countries themselves for their collective benefit.⁴ Building on the success of the VDS, the Regional Roadmap for Sustainable Pacific Fisheries was developed by the Parties to the Nauru Agreement, the Pacific Islands Forum Secretariat, and the Forum Fisheries Agency to further increase economic returns from fisheries through strengthened regional cooperation. Since its full implementation in 2012, the VDS for collecting fishing license fees from foreign fleets has resulted in a surge in revenues, particularly for the small islands and atolls.⁵ A steadily rising minimum

⁴ The Parties to the Nauru Agreement comprise Kiribati, the FSM, the RMI, the FSM, Nauru, Palau, Solomon Islands, and Tuvalu among the PIC-12, plus the subregion’s largest economy, Papua New Guinea.

⁵ The VDS shifted the metric for regulating fishing activity from the limit on catch levels to the total number of (tradable) fishing days to be allocated among all foreign fishing vessels. The VDS promotes longer-term sustainability of fisheries stocks by linking effort limits to total vessel days per year. The limits are based on regular assessments by

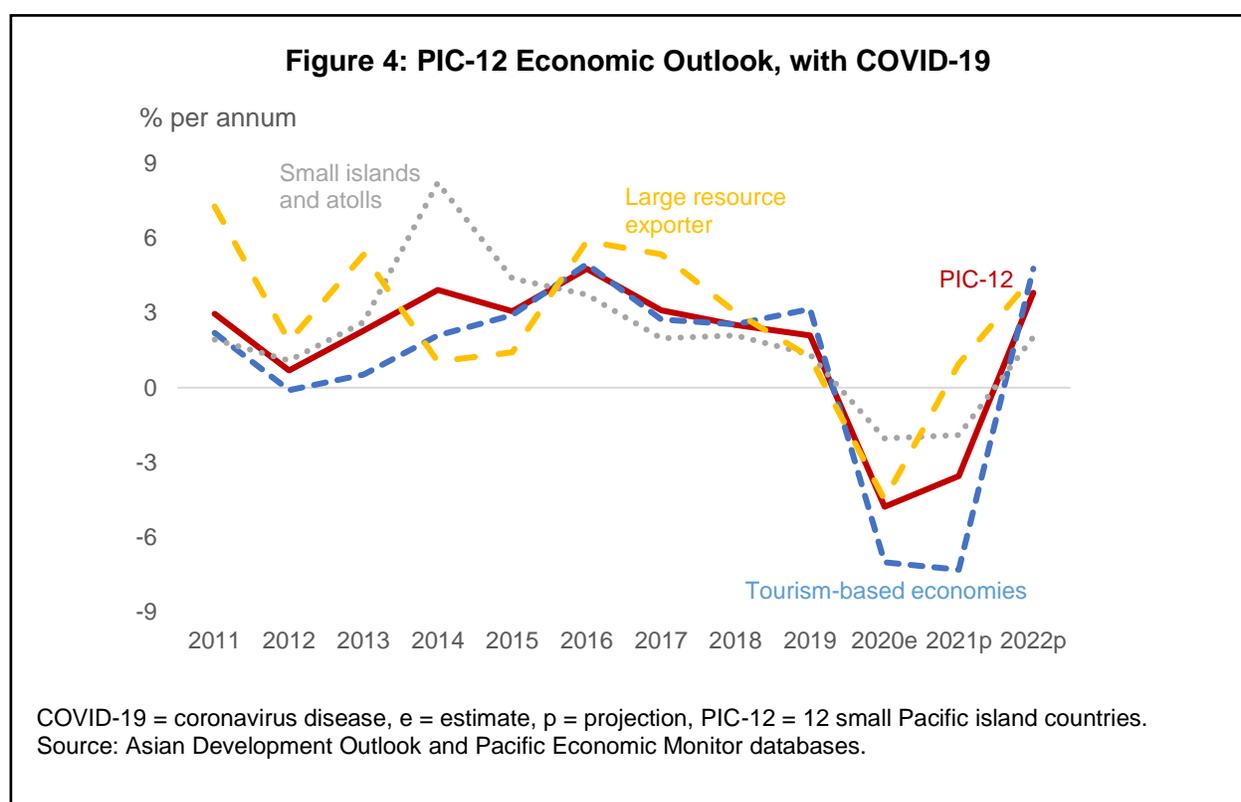
benchmark fee, which stabilized at \$8,000 per fishing day by 2015, pushed fishing license revenues up in five PIC-12 economies 2–5 times more in 2015–2019 than in the preceding 5 years (Figure 3). Total fishing license revenues in Kiribati, the RMI, the FSM, Nauru, and Tuvalu reached \$292 million in 2015–2019, up from \$125 million in 2010–2014. In proportion to economic output, the increase was from the equivalent of 15% of aggregate GDP to more than double at 33%. Stronger fishing license revenues, along with inflows of overseas development assistance for infrastructure, supported concurrent large increases in public spending. On average, annual government expenditure more than doubled in Tuvalu and was higher in Kiribati by 58% in 2015–2019 than in 2010–2014. Large fiscal stimuli backed by a structural increase in fishing license revenues, in turn, boosted economic growth. Fishing license revenues generally held up against pre-pandemic projections during 2020 largely because of increased demand for canned tuna during the crisis. However, COVID-19 restrictions have disrupted other fisheries-related activities, particularly transshipment of tuna caught by foreign fishing vessels in PIC-12 ports, including in Majuro, Pohnpei, and Tarawa, among others.



8. COVID-19 impacts severely constrain short- and medium-term prospects. COVID-19 travel restrictions are seen to push the PIC-12 to a weighted average economic contraction of 4.8% in 2020 and a further 3.5% in 2021 (Figure 4). With 99% year-on-year declines in visitor arrivals since April 2020, the tourism-based economies are expected to be the heaviest hit, resulting in projected contractions of 7.0% in 2020 and 7.3% in 2021. Impacts on the small islands and atolls are mostly caused by delayed infrastructure construction and disrupted fisheries activities, including transshipment of tuna caught by foreign fishing vessels. On average, economic contraction among the small islands and atolls is seen to reach 2.0% in 2020 and 1.9% in 2021. As a large resource exporter, Solomon Islands is experiencing the effects of COVID-19 restrictions mostly through trade. Subdued exports, including of logs, are projected to lead to

the world's top tuna biologists at the Secretariat of the Pacific Community to maintain a minimum sustainable size of spawning tuna biomass in the western and central Pacific Ocean.

economic contraction of 4.5% in 2020, with cautious recovery to 1.0% growth seen in 2021 but with heavy downside risks. A June–September 2020 World Bank survey of Pacific workers employed in Australia’s Seasonal Worker Programme and New Zealand’s Recognised Seasonal Employer scheme found that (i) 68% of workers reported lower earnings and 47% reduced their remittances; (ii) remitting became less frequent, from mostly biweekly before to monthly after the pandemic; and (iii) substantial numbers of potential workers from Kiribati, Tonga, and Vanuatu were unable to participate because of travel restrictions.⁶ The resulting reductions in overall remittances adversely affect household consumption in workers’ home countries. The PIC-12 are implementing COVID-19 response packages, equivalent to 3.1%–47.3% of GDP, to counter the pandemic’s socioeconomic impacts, including support for the unemployed and the vulnerable as shown in the table. As some PIC-12 governments have had to borrow from development partners to partly finance their response packages, public debt–GDP ratios are seen to rise in the near term. External debt is projected to increase from the equivalent of 16.7% in FY2019 to 42.2% in FY2021 in the Cook Islands and from 31.5% in FY2019 to 68.5% in FY2021 in Palau.



9. Despite structural constraints, most PIC-12 economies exhibit advanced social development outcomes. Most PIC-12 have already achieved medium to high levels of human development. Based on the United Nations (UN) Human Development Index (HDI)—which covers multidimensional aspects of social development, including income levels and health and education outcomes—five of the PIC-12 are in the medium human development category, two in

⁶ D. Doan et.al. 2020. [Pacific Labor Mobility and Remittances in Times of COVID-19](#). Development Policy Centre, Australian National University; and the World Bank.

high, and Palau in very high.⁷ Among the eight PIC-12 economies with calculated indexes, the average HDI as of 2018 was 0.666, which falls within the medium human development category. By subgrouping, the tourism-based economies' average HDI was 0.706, just above the cutoff to be in the high human development category, while the small islands and atolls average was 0.663.

Fiscal Impacts of the COVID-19 Crisis

PIC-12	COVID-19		Fiscal Balance			External Debt		
	Response Package		% of GDP			% of GDP		
	\$ million	% of GDP	2019	2020e	2021p	2019	2020e	2021p
Cook Islands	39.0	11.6	4.9	-6.0	(33.1)	16.7	16.3	42.2
FSM*	29.8	8.8	17.6	0.0	0.2	20.2	19.0	17.3
Kiribati*	22.1	11.7	15.5	(0.7)	1.1	25.5	0.0	0.0
Nauru*	11.7	10.8	32.7	32.2	16.7	28.6	28.4	47.5
Niue	12.4	37.6	(1.2)	(4.6)	(11.0)	0.0	0.0	0.0
Palau	20.0	7.9	0.3	(11.2)	(15.7)	31.1	54.1	68.5
RMI*	42.3	20.0	(2.3)	(4.9)	(15.4)	29.9	29.0	26.6
Samoa*	25.1	3.1	2.7	6.2	(9.8)	46.8	46.5	62.8
Solomon Islands	37.6	2.5	(2.0)	(2.5)	(2.0)	6.3	8.6	8.4
Tonga*	25.7	5.2	3.1	5.3	(4.7)	36.9	32.6	32.8
Tuvalu*	20.0	47.3	24.1	9.1	0.0	22.0	17.0	8.0
Vanuatu	38.0	4.4	1.7	2.5	(2.0)	40.1	43.9	45.2

() = negative, COVID-19 = coronavirus disease, e = estimate, FSM = Federated States of Micronesia, GDP = gross domestic product, p = projection, PIC-12 = 12 small Pacific island countries, RMI = Republic of the Marshall Islands.

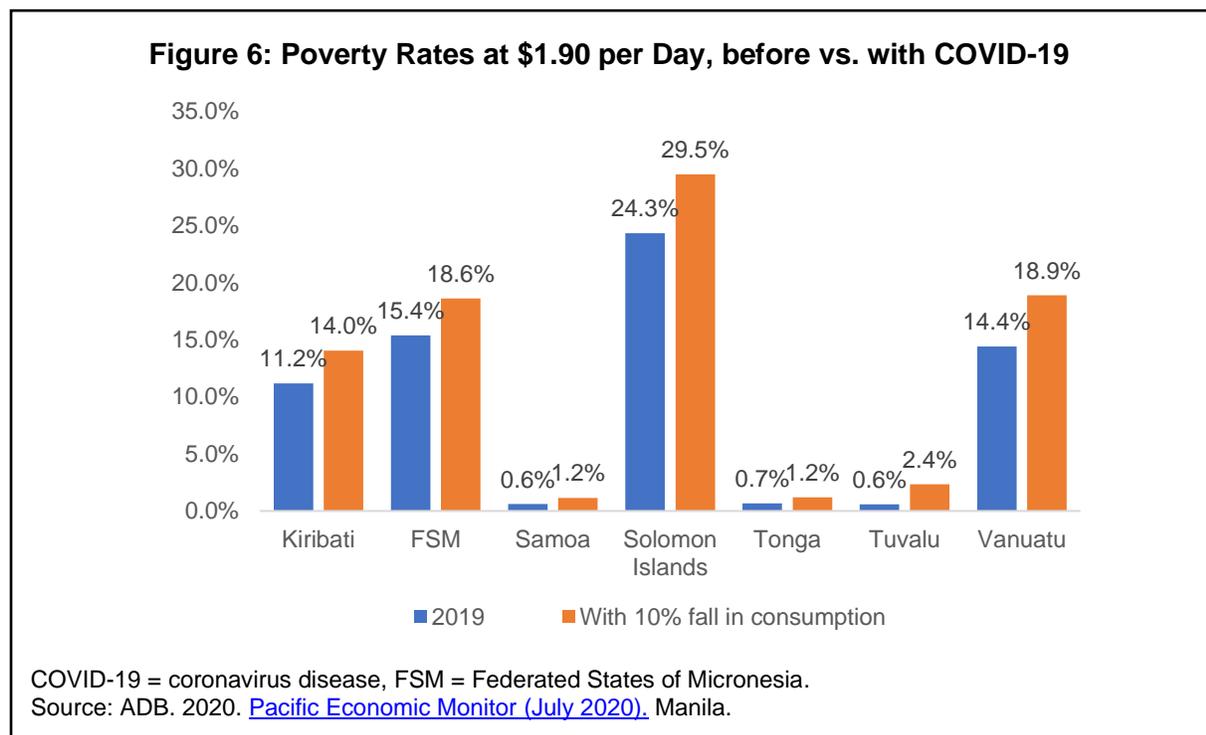
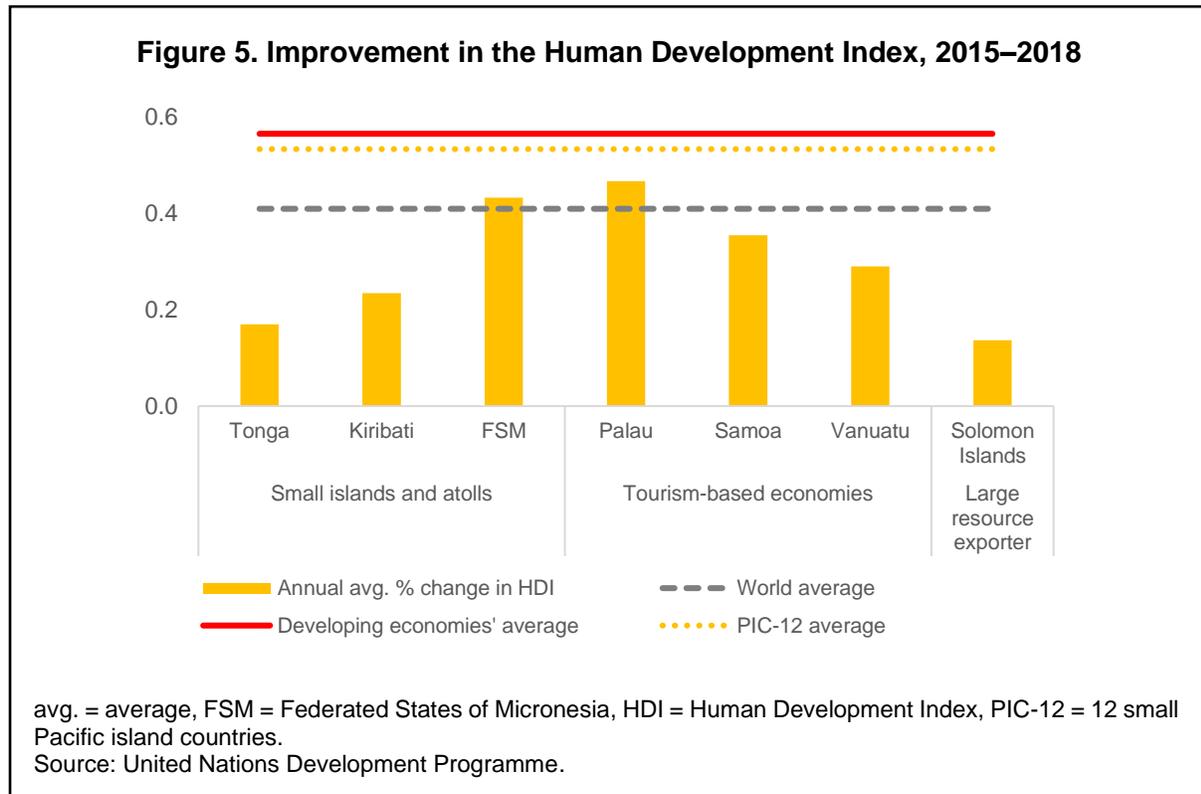
* Rated at high risk of debt distress according to the latest debt sustainability analysis of the International Monetary Fund and the World Bank. For Nauru, ADB's own debt sustainability analysis yields a high-risk rating.

Source: Asian Development Outlook and Pacific Economic Monitor databases.

10. **Recent strong growth was slow to translate to social development gains.** The gains are now at risk because of COVID-19. Despite the acceleration of GDP growth during 2015–2019, improvement in the HDI of PIC-12 economies has fallen well short of the progress seen in comparator developing economies. The tourism-based economies, on average, have outpaced progress in other PIC-12 subgroupings. The most notable case is Kiribati, where improvement in HDI has been one of the slowest among the PIC-12 despite more than double GDP growth during the period (Figure 5). PIC-12 economies can ill afford such stagnation, particularly because a still substantial social development agenda remains unfinished. Although extreme poverty is rare in most PIC-12 economies, rural and outer island communities are still exposed to episodes of hardship and vulnerability. Room for progress is apparent in remaining gaps in access to basic services. To illustrate, access to electricity services is only about 48.1% among PIC-12 economies, compared with 87.4% globally. Although access to water supply is high (85.8% vs. 88.5% globally), a notable gap remains in the provision of sanitation services (52.6% vs. 68.0%). Capacity constraints continue to hamper the pace of progress in social development, with a thinly spread public administration struggling with high staff turnover to sustain implementation of targeted interventions. Six of the PIC-12—the Cook Islands, Nauru, Palau, the RMI, Samoa, and

⁷ The 2019 *Human Development Report update* classifies Samoa and Tonga in the high human development category; and the FSM, Kiribati, the RMI, Solomon Islands, and Vanuatu in the medium. Because of data limitations, the index was not calculated for the Cook Islands (estimated to have achieved high human development) or for Nauru, Niue, and Tuvalu (medium to high).

Tonga—are among the 10 with the highest shares of overweight or obese people in the world, highlighting an ongoing major challenge in preventing noncommunicable diseases.



11. **COVID-19 exacerbates poverty and inequality.** COVID-19 impacts have the potential to push per capita incomes back by at least 3 years to about a decade, which will reverse recent hard-won gains in poverty reduction across the PIC-12. Based on an internationally accepted definition of extreme poverty of \$1.90 per day for comparability, simulations suggest that the impacts of the COVID-19 pandemic on household incomes and consumption have the potential to increase poverty incidence among the PIC-12 by 0.5% in Samoa and Tonga and by as much as 4.5% in Vanuatu and 5.1% in Solomon Islands (Figure 6). As Vanuatu and Solomon Islands have the largest populations and among the highest pre-pandemic poverty rates in the Pacific, the increase in number of people experiencing hardship is potentially substantial. Although internationally comparable poverty rates appear to be low in some PIC-12 economies, the incidence of poverty based on national poverty lines that capture basic needs and other broader dimensions remains high in Samoa (18.8% in 2013), Tonga (22.1% in 2015), and Tuvalu (26.3% in 2010). Unequal access to basic services exacerbates hardship in the even more remote and mostly rural, subsistence-based communities in the outer islands. For example, in Solomon Islands and Vanuatu, access to basic handwashing facilities—essential for hygiene and disease prevention, especially critical during the COVID-19 pandemic—is far from universal in urban areas (58.9% in Solomon Islands and 48.2% in Vanuatu), but plummets to exceptionally low rates in rural communities (28.9% in Solomon Islands and 17.5% in Vanuatu).

12. **Urgent action needed to fulfill achieve the Sustainable Development Goals.** Like other developing economies, the PIC-12 have set ambitious Sustainable Development Goal (SDG) targets. Available assessments show that PIC-12 economies have made good progress on the SDGs related to maternal mortality (3.1), infant deaths (3.2), and narcotics abuse (3.5), educational facilities (4.a), access to energy services (7.1), resilience to disasters (13.1), and birth registration (16.9). However, progress is weak on other SDGs, including those relating to the Pacific’s critical development challenges, such as noncommunicable diseases (3.4), violence against and active participation of women (5.2 and 5.5), share of renewable energy (7.2), sustainable tourism development (8.9), reduced inequalities in income (10.1 and 10.4), conservation of coastal and marine areas (14.5), and use of information and communication technology (ICT) for development (17.8). Specific challenges include the following:

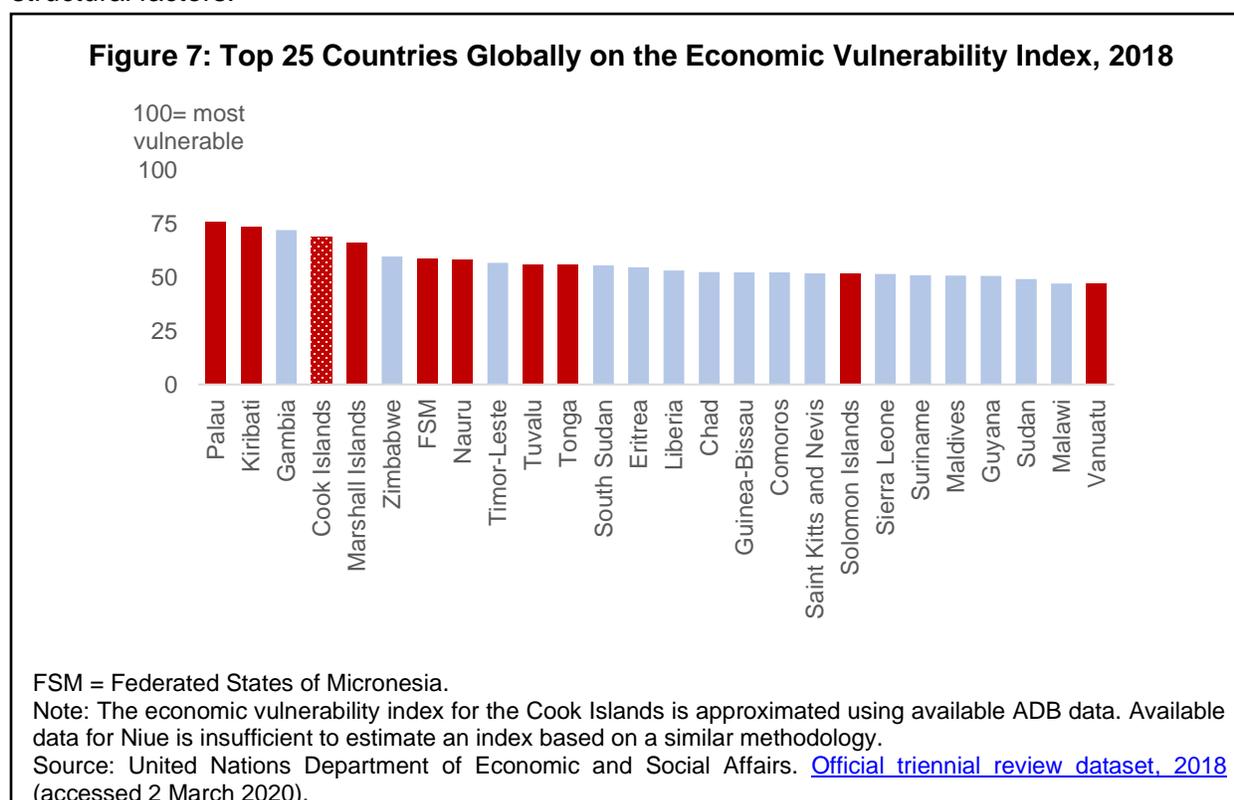
- (i) **Gender inequality.** Wide gender disparities persist across the Pacific, particularly in economic empowerment, human development, decision-making and leadership, time poverty, gender-based violence, and vulnerability to climate hazards. For example, women representation in Parliament is lower in the Pacific than in any other global region, while women’s participation in paid employment is low (14%–35% across the region), except in the Cook Islands (59%).⁸ Further progress in promoting gender equity will not only ensure that the welfare of women and girls is protected but also underpin stronger achievement of broader development results by expanding economic opportunities and unlocking the potential of women entrepreneurs and leaders.
- (ii) **Environmental sustainability.** The PIC-12 have been leveraging their natural resources to earn rents through tourism and fishing license fees. To derive lasting value, the PIC-12 will need to manage ecosystems sustainably, while leveraging revenue to expand their economic bases.
- (iii) **Harnessing information and communication technology.** Access to improved and lower-cost internet introduces new opportunities for the PIC-12 to participate in the growing digital services industry, from digital marketing to language instruction.

⁸ Pacific Women in Politics. [National Women MPs.](#)

B. Key Impediments to Inclusive and Sustainable Growth

13. Stylized facts concerning constraints on inclusive and sustainable growth in the Pacific commonly focus on the region's small populations and markets, geographic isolation and dispersion, and increasing exposure to natural hazards and climate change impacts, among other structural factors. The overall impacts of a complex interplay among these factors manifest in three impediments to inclusive and sustainable growth: (i) vulnerability to shocks, (ii) weak service delivery, and (iii) economic underperformance. Although vulnerability to shocks and climate change impacts is a core challenge, weak service delivery stemming from elevated cost structures and capacity constraints, along with large swings in year-to-year economic performance, ultimately hinders efforts to sustain inclusive growth and development over the longer term.

14. **Vulnerability to shocks.** The PIC-12 are highly vulnerable to the impacts of climate change, natural disasters, and health emergencies caused by epidemics and pandemics. Adverse impacts are further exacerbated because of the PIC-12's narrow economic and revenue bases, particularly during prolonged shocks that expose further fragilities. The combination of the structural impediments is captured by the broad concept of economic vulnerability, which reflects the risk that a country's development will be hampered by natural or external shocks. Among a wide range of available cross-country measures, the United Nations' Economic Vulnerability Index (EVI) is the most comprehensive attempt to measure vulnerability based on physical and structural factors.⁹



⁹ The EVI scale is 0–100 (a high index indicating elevated vulnerability), based on a simple average of two subindexes: (i) the exposure subindex, which is the weighted average of five component indexes: population size (25.0%); remoteness from world markets (25.0%); export concentration (12.5%); share of agriculture, forestry, and fishery in GDP (12.5%); and share of population living in a low-elevation coastal zone (25.0%); and (ii) the shocks subindex, which is the weighted average of three component indexes: victims of natural disasters (25%), instability in agricultural production (25%), and instability in export of goods and services (50%).

15. As of 2018, seven of the top 10 economies with the highest EVI scores globally belonged to the PIC-12 (Figure 7). Among the PIC-12, the most economically vulnerable are Palau, which is highly exposed to volatile international travel trends, and Kiribati, which is extremely sensitive to climate change impacts. The average EVI among the PIC-12 economies is 59.3—nearly double the 31.4 average for ADB’s other 29 DMCs—highlighting heightened vulnerabilities. Among the PIC-12, narrow economic bases and exposure to climate change impacts result in an average EVI of 61.4 for the small islands and atolls, the highest among the three subgroups. The tourism-based economies are exposed to volatility in international travel trends, resulting in an average EVI of 57.9, close to the PIC-12 average. Solomon Islands, as a larger resource exporter, is somewhat less vulnerable than the other PIC-12, with an EVI of 51.9.

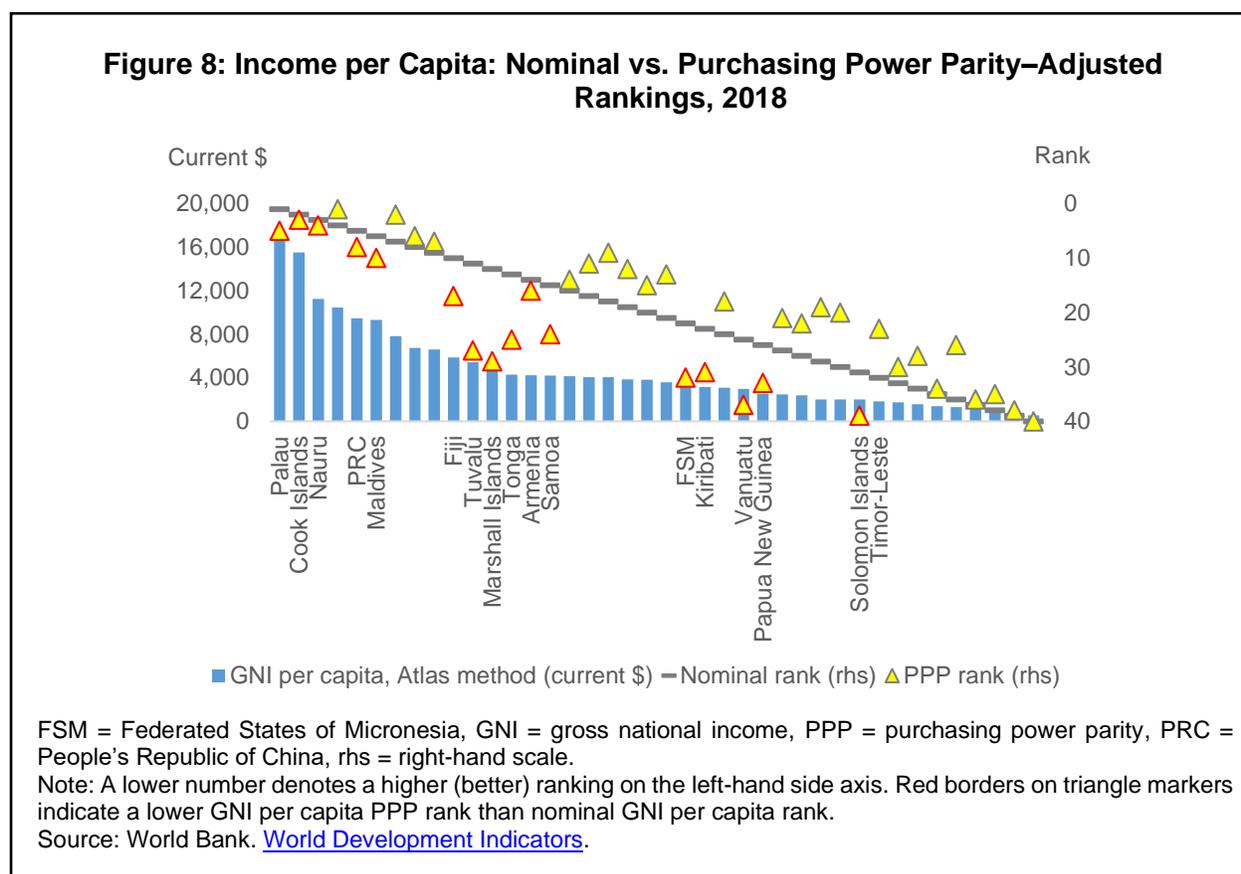
16. **Weak service delivery.** The quality of basic services across the PIC-12 is constrained by elevated cost structures and institutional capacity constraints. Small markets translate into difficulties in achieving economies of scale and limited competition, resulting in elevated prices for locally produced goods, while high transport costs raise the prices of imported commodities. Diseconomies of scale in production, limited competition, and remoteness raise the cost and the risk of doing business and delivering services. Although nominal per capita income may appear to be substantial, the narrow economic bases are insufficient to cover the minimum cost of running a government, particularly when the high cost of service delivery is exacerbated by geographic dispersion and remoteness. Living costs in the PIC-12 are, therefore, significantly higher than in other DMCs.

17. Higher living costs in the PIC-12 can be illustrated using purchasing power parity (PPP)–adjusted GNI. Although each PIC-12 is classified as at least a lower-middle-income country based on nominal GNI per capita, high-cost structures restrict purchasing power. When comparing the 40 ADB DMCs by nominal per capita GNI, the PIC-12 tend to rank better than the 29 other ADB DMCs. However, PPP adjustment leads to lower ranks compared with nominal GNI rankings for the PIC-12, in sharp contrast to the other DMCs—all but six of which (and only three outside of the Pacific: Armenia, Maldives, and the People’s Republic of China) improve their rankings on a PPP-adjusted basis—reflecting lower living costs compared with the PIC-12 (Figure 8). On average, nominal GNI per capita for the PIC-12 is more than 77% higher than that of the 29 other ADB DMCs, but PPP-adjusted GNI per capita among the PIC-12 is about 13% lower than that of other ADB DMCs. This starkly illustrates the much higher-cost structures in the PIC-12.

18. The average ranking of PIC-12 economies among ADB DMCs by PPP-adjusted GNI per capita is about nine notches lower than their ranking by nominal GNI per capita. Reflecting extreme price margins stemming from acute remoteness and small markets, the small islands and atolls register the largest gap, averaging 11 notches lower than average PPP-adjusted rankings relative to nominal GNI per capita rankings.

19. Most Pacific economies have weak institutional capacities, human resource pools, and economic bases, constraining effective governance, service delivery, and the staffing and resourcing of government systems. These constraints are heightened in the smaller economies. The major sources of fragility in the Pacific are acute challenges to effective governance and service delivery, as opposed to conflict in other ADB DMCs. ADB defines as fragile a state that has weak capacity to carry out the basic functions of governing a population and territory; lacks the ability or political will to develop mutually constructive and reinforcing relations with society; or is affected by other specific vulnerabilities, such as small states are. Based on ADB’s most recent country performance assessment (CPA), in 2020, six of the 11 DMCs classified as FCAS

belong to the PIC-12:¹⁰ Kiribati, the FSM, Nauru, the RMI, Solomon Islands, and Tuvalu.¹¹ A country is classified as FCAS if it has an average rating of 3.2 or less in the CPA. Although ADB operationally classifies only half of the PIC-12 as fragile, they are all fragile in varying degrees. For the PIC-12, fragility mainly stems from geographic constraints and shallow human resource pools, but potential flashpoints for social tensions and unrest remain. To identify and respond to capacity constraints and political economy challenges unique to each PIC-12, ADB has committed to conducting fragility assessments in each PIC-12. The assessments will inform ongoing programming and help ADB respond to fragility in each PIC-12.

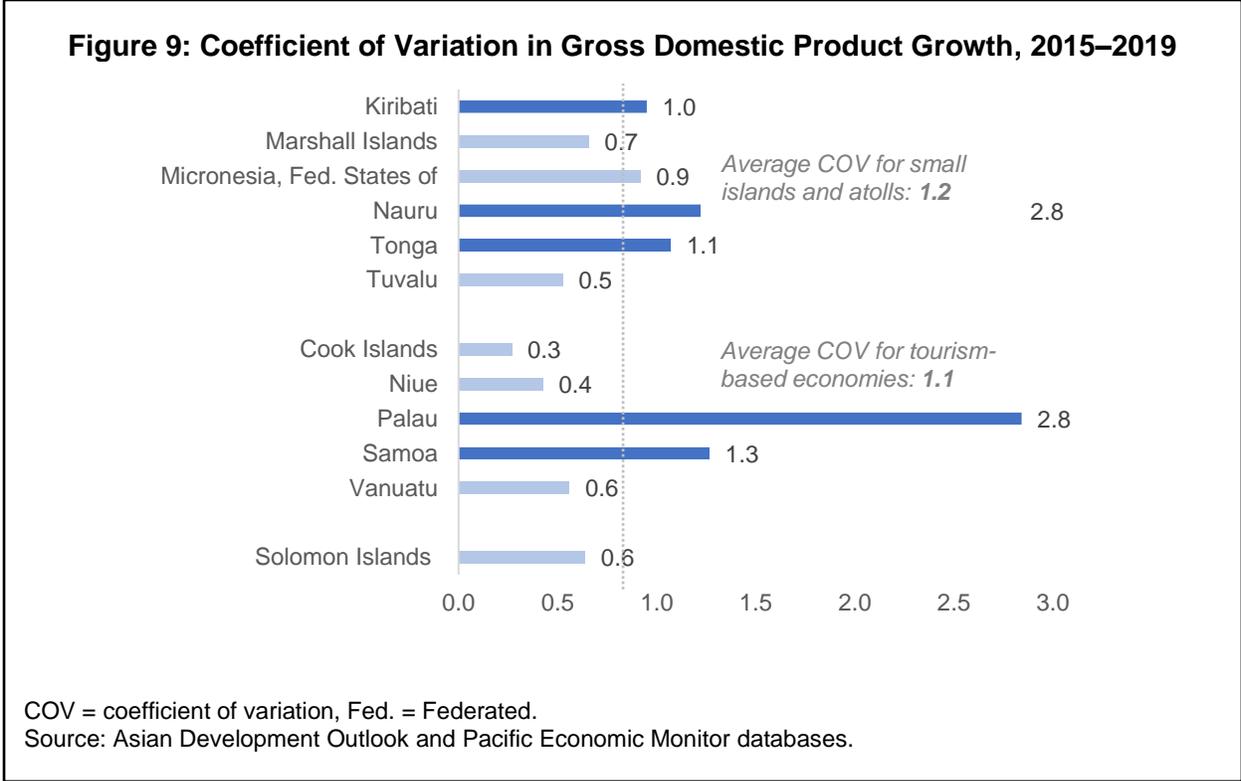


20. The scope for strengthening institutions and developing capacities for effective governance and improved service delivery, particularly in the fragile PIC-12, remains extensive. However, sustainable capacity development and institutional strengthening are possible across all the PIC-12, as evidenced by the experience of Samoa among the tourism-based economies and Tonga among the small islands and atolls—the two PIC-12 with the highest CPA ratings—in reforming public sector management. Knowledge and experience from their recent reform paths can help guide efforts to strengthen capacities for effective governance in the fragile PIC-12. Further public sector management interventions will apply lessons learned from the COVID-19 crisis to build stronger government institutions, systems, and capacities that can support sustainable recovery.

¹⁰ The CPA rates ADB DMCs with access to concessional resources based on the quality of (i) economic management; (ii) structural policies; (iii) policies for social inclusion and equity; and (iv) public sector management and institutions, plus the performance of concessional assistance project portfolios, on a scale of 1 to 6, where a higher score indicates better performance.

¹¹ The other FCAS countries are Afghanistan, Myanmar, Papua New Guinea, and Timor-Leste.

21. **Economic underperformance.** Significant year-to-year fluctuations in economic performance are common across the PIC-12, resulting in perennial difficulties in building momentum toward steady and sustained development gains. Hard-won progress toward inclusive growth during economic upswings can be rolled back quickly during downturns, requiring restarts that ultimately delay achieving desired development outcomes. During 2015–2019, the average coefficient of variation—or the ratio of the standard deviation to the mean—in real GDP growth remained at 1.0 or higher in Nauru, Palau, Samoa, and Tonga, indicating high variance (Figure 9). Economic performance in these countries fluctuated from solid rates of growth to substantial economic contractions, all within 5 years.



22. Large year-to-year swings in business cycles are common among the PIC-12, stemming from domestic factors—including the schedule and pace of large public infrastructure construction in small economies—and external shocks. Narrowly based formal private sector activity, which, for example, accounts for only about 20% of annual GDP in the FSM and 30% in the RMI, contributes to economic volatility. Although underdeveloped private sectors are largely the result of structural constraints, weak enabling environments discourage business activity, including for micro, small, and medium-sized enterprises (MSMEs). External sources of volatility include (i) fluctuations in international commodity prices for key export items and for imported food, fuel, and other necessities; (ii) international travel and tourism trends; and, most significantly, (iii) the frequency and severity of disasters. The acute downturn brought on by COVID-19 will significantly add to volatility in economic performance over the near to medium term.

23. Disasters have not only contributed to extreme volatility but also reduced average trend growth in GDP in the Pacific, from an estimated potential of up to 3.3% with no disasters to an

actual outcome of just 2.6% over 1980–2014.¹² During 2014–2018 alone, the Pacific experienced at least six major cyclones that directly affected about half the PIC-12. The most destructive was Cyclone Pam, which directly hit Vanuatu and caused tide swells and strong winds that damaged Kiribati and Tuvalu in March 2015. Economic damage and losses in Vanuatu reached about \$450 million, equivalent to a staggering 64% of annual GDP. Reconstruction of damaged infrastructure took more than 3 years to complete. The most recent cyclone to heavily impact the PIC-12 was Cyclone Harold, which struck Solomon Islands, Tonga, and Vanuatu, as well as Fiji, in April 2020. Damage was particularly severe in Vanuatu, in the order of 57% of GDP. Other notable storms included Cyclone Ian (January 2014), which damaged schools and the electricity grids in Tonga’s Ha’apai islands; Cyclone Ita (April 2014) in Solomon Islands, causing flooding in the capital, Honiara, and resulting in the closure of Gold Ridge mine; Typhoon Maysak (April 2015), which destroyed homes and agricultural produce in Chuuk and Yap states of the FSM; and Cyclone Gita in Tonga (February 2018), which struck Tongatapu and ‘Eua, damaging homes, government buildings, and infrastructure for basic services. COVID-19 will substantially reduce potential growth in the PIC-12, particularly if the prolonged downturn causes widespread business closures (e.g., of tourism-related enterprises) and it takes years for output and employment to revert to pre-pandemic levels.

C. Implications for ADB Country Engagement

24. **Supporting a resilient Pacific.** The overarching goal of the Pacific Approach, 2021–2025 is to support an inclusive and resilient Pacific. The strategy has three pillars: (i) preparing for and responding to shocks, (ii) delivering sustainable services, and (iii) supporting inclusive growth. The three pillars are mutually supportive and designed to provide crosscutting support as development challenges are closely interrelated. Assistance will leverage the One-ADB approach, drawing on interdepartmental resources within ADB and from its development partners.

25. **Preparing for and responding to shocks.** Recognizing their heightened exposure to external shocks and limited coping capacity, ADB will work with the PIC-12 on physical, economic, and knowledge-based tools that strengthen resilience to disasters such as COVID-19 and the effects of climate change. ADB will support disaster risk mitigation and economic recovery efforts, using tools that include contingent financing and disaster insurance, budget support, and immediate recovery assistance.

26. To reinforce economic resilience and public financial management (PFM), assistance will support fiscal and debt management, improvement of revenue collection and monetary policy, state-owned enterprise (SOE) reforms, and revenue mobilization. Support for PFM will increase resilience to climatic and economic shocks while strengthening macro-fiscal management and safeguarding debt sustainability. ADB will continue to deepen collaboration with PIC-12 governments through its growing field presence, recognizing that PFM improvements require long-term commitment and ongoing support.

27. ADB will help the PIC-12 respond to severe impacts of health crises such as COVID-19 by continuing to invest in health systems. The effort will include helping Samoa, Tonga, Tuvalu, and Vanuatu safely introduce a COVID-19 vaccine. More broadly, ADB will strengthen rural health service delivery, upskill health workers, strengthen digital information systems in health, and improve governance and management of health services.

¹² E. Cabezon et al. 2015. *Enhancing Macroeconomic Resilience to Natural Disasters and Climate Change in the Small States of the Pacific*. International Monetary Fund Working Paper Series. WP/15/125. Washington DC: International Monetary Fund.

28. ADB will increasingly work with the PIC-12 to harness ICT to improve learning outcomes, leverage new e-education resources, and furnish the population with the knowledge and skills they need to engage meaningfully in the workforce. ADB will explore opportunities to engage with nongovernment organizations and civil society to boost education outcomes.

29. Climate and disaster resilience are at the core of ADB's work in the Pacific. ADB will take a more comprehensive approach to tackling the underlying causes of vulnerability and fragility. Key features of ADB's support will include (i) climate-proofing all investments; (ii) helping countries collect and analyze risk data and use them to inform policy decisions and long-term planning; (iii) delivering quick-disbursing assistance in the wake of disasters; (iv) providing contingent finance and insurance mechanisms; (v) enabling the PIC-12 to access international climate finance, including the Green Climate Fund; and (vi) expanding ADB's support for climate change from the project to the country and regional levels for a holistic approach to resilience. ADB will expand its use of contingent disaster financing to help the PIC-12 set aside financial resources they may need to respond to crises. ADB will explore opportunities to support civil society engagement in community-based disaster risk management and emergency response.

30. COVID-19 will have lasting impacts on the PIC-12. ADB is committed to supporting economic recovery by helping design and implement policies to restore tourism and to operate safely and profitably under the "new normal" (e.g., travel bubbles). ADB's infrastructure investments will continue to be critical in supporting economic recovery and growth by injecting capital into the PIC-12. ADB will help identify and expand new growth areas, including by leveraging ICT to strengthen e-governance, e-education, e-health, and remote digital work.

31. **Delivering sustainable services.** Access to basic infrastructure and services underpins inclusive development. High-quality infrastructure and adequate provisions for operation and maintenance are key to delivering the services efficiently and sustainably in the long term. ADB will draw on the G20 principle of using quality infrastructure to maximize the positive economic, environmental, social, and development impacts of investments. ADB will continue to provide regional support for infrastructure through the Pacific Regional Infrastructure Facility, a community of local and international experts that guide infrastructure development and coordination in the PIC-12 and among their development partners.

32. Increasing the use of renewable energy can lower power generation costs and emissions across the PIC-12. ADB will help increase the share of renewable energy used for power generation by investing in solar, wind, and hydropower. ADB will help the PIC-12 implement crosscutting solutions to support the urban and water sectors with renewable energy and energy efficiency. These activities will lower the costs of generating and consuming electricity by transitioning from costly imported diesel to indigenous renewable energy, strengthen fuel security, reduce emissions, and improve service delivery and coverage.

33. Strengthening intermodal transport links and the use of ICT can reduce the cost of goods, services, and trade to increase access to productive opportunities. ADB will continue to focus on roads, ports, and airports in rural and urban areas, while providing loans to support long-term operation and maintenance to ensure that the PIC-12 have the resources and capacity to manage transport assets sustainably. ADB will scale up assistance and partnerships to improve transport safety and security. Grants and loans for ICT will help the PIC-12 integrate digital solutions through e-governance, e-health, and e-education.

34. Urban sector projects will promote inclusive and equitable access to water supply, sanitation, solid-waste disposal systems, transport, and electricity to develop more vibrant and

resilient cities. ADB will support governments with long-term urban planning to ensure that service levels meet people's needs now and in the future.

35. SOEs primarily deliver essential services such as water, electricity, and connectivity in the PIC-12. However, public utilities in the region are often not commercially self-sufficient and require heavy subsidies. Improving management practices, reforming institutions, and restructuring tariffs to enable cost recovery are essential to improve service levels and reduce the need for subsidies. Support for SOE reforms will be of particular importance for building institutional resilience and managing state resources during COVID-19, when utilities may be increasingly fiscally constrained by, for example, reduced demand for services and the associated slowdown in revenue collection. ADB will use loans to integrate reforms into infrastructure works and to support institutions.

36. **Supporting inclusive growth.** ADB will support more robust and inclusive growth in the PIC-12 by helping strengthen the business environment and engaging directly with the private sector. ADB's Private Sector Development Initiative will increase opportunities for the private sector to grow. ADB will establish partnerships with domestic financial institutions to increase access to finance for MSMEs, while working with civil society and nongovernment organizations to strengthen the financial literacy of vulnerable groups. ADB's Trade Finance Program will serve as a key resource to fill MSME financing gaps to help businesses grow. The program will provide credit guarantees and loans to local banks to increase trade and access to finance among MSMEs.

37. ADB will provide direct debt finance to and invest equity in commercially viable, private sector projects across the PIC-12. ADB's Private Sector Operations Department is implementing a new strategy for the Pacific, which focuses on renewable energy, financial institutions, tourism, and fisheries. The Asian Development Fund will pilot a new approach to increasing private sector activity through the Private Sector Window. It will encourage investment in markets that experience disproportionate barriers to growth, by way of co-investment and partnerships with commercial lenders and investors. The Private Sector Window will target sectors with high potential for social and environmental impacts, such as renewable energy; social sectors (e.g., health, education, and elderly care); agribusiness; and local finance.

38. ADB will support ecosystem management to protect the Pacific's valuable marine and terrestrial resources. The PIC-12 are spread across 3.5 million square kilometers of ocean and have successfully begun leveraging their marine resources to expand tourism and to generate revenue through fishing licenses. The PIC-12 must develop and implement strategies to sustainably manage their ocean territories. ADB will help PIC-12 governments strengthen marine conservation and restoration through its Healthy Oceans program, which focuses on (i) blue economies, (ii) ecosystem management, (iii) pollution control, and (iv) sustainable infrastructure. ADB will help PIC-12 governments sustainably manage revenue from fishing licenses. Overall support for ecosystem management will enable the PIC-12 to leverage their vast marine resources more effectively, while ensuring that they are available for generations to come. Support for fisheries and ecosystem management will foster deeper regional cooperation and integration to accomplish shared goals for healthy and productive oceans.