

Pacific Economic Monitor

BUDGET ANALYSIS

December 2015

www.adb.org/pacmonitor

The *Monitor* provides an update of developments in Pacific economies and explores topical policy issues.

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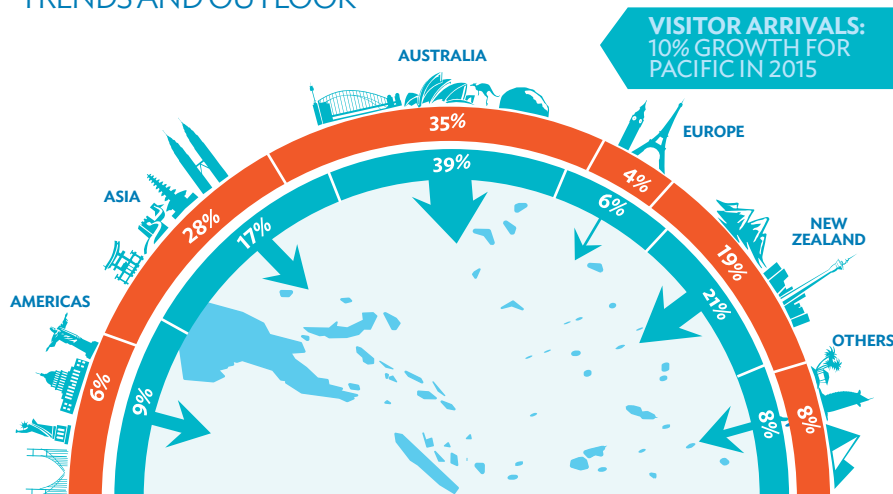
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Highlights

- Larger Pacific economies experiencing fiscal crunch.** Weak energy export revenues in Papua New Guinea (PNG), and delays in Fiji's public asset sales restrain planned expenditures in the near term. Petroleum revenues are steadily declining in Timor-Leste, requiring medium-term adjustment to a sustainable fiscal path. In Fiji, PNG, Solomon Islands, Tonga, and Vanuatu, extreme weather conditions related to El Niño are exerting economic and fiscal pressures.
- Windfall-financed increases in public spending for smaller economies.** Continued rises in fishing license fees have boosted fiscal resources of smaller island economies, including Kiribati, Nauru, Palau, and Tuvalu. El Niño is expected to lead to transitory increases in tuna stocks, and any additional revenues will need to be managed carefully to safeguard long term fiscal sustainability.
- Tourism trends and opportunities.** Policy briefs in this issue discuss the drivers of strong demand for tourism in the Pacific and the challenges to growth (e.g., lack of infrastructure, human resources, destination development, airline links, and visa restrictions). Measures to ensure tourism develops in an inclusive and environmentally sustainable manner are also explored.

TOURISM TO THE PACIFIC

TRENDS AND OUTLOOK



FROM 1.3 M IN 2014 TO 1.9 M BY 2019^a

NEED TO LOOK BEYOND INTERNATIONAL ARRIVAL NUMBERS

Recommended alternative measures:

- Receipts per visitor (spending per day)
- Duration of stay
- Number of repeat visitors
- Arrivals outside peak periods
- Jobs linked to tourist sector

IMPORTANCE OF TOURISM TO THE REGION



^a Pacific Asia Tourism Association. 2015. *Asia Pacific Visitor Forecasts 2015–19*. Bangkok.

^b ADB calculations using data from the World Bank and national sources.

2 Highlights



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This edition of the *Monitor* was prepared by Yurendra Basnett, Robert Boumphrey, Prince Cruz, Caroline Currie, Christopher Edmonds (editor-in-chief), David Freedman, Malie Lototele, Rommel Rabanal, Bing Radoc, Roland Rajah, Shiu Raj Singh, Cara Tinio, Laisiasa Tora, and Johannes Wolff of the Pacific Department. Publishing production assistance was provided by Cecil Caparas.

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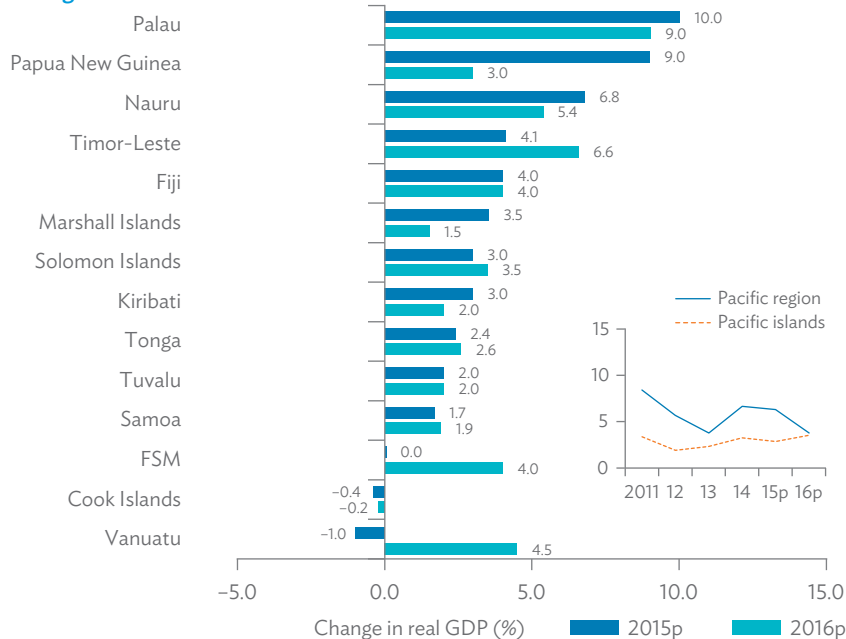
Note: ADB recognizes “China” as the People’s Republic of China.

Abbreviations

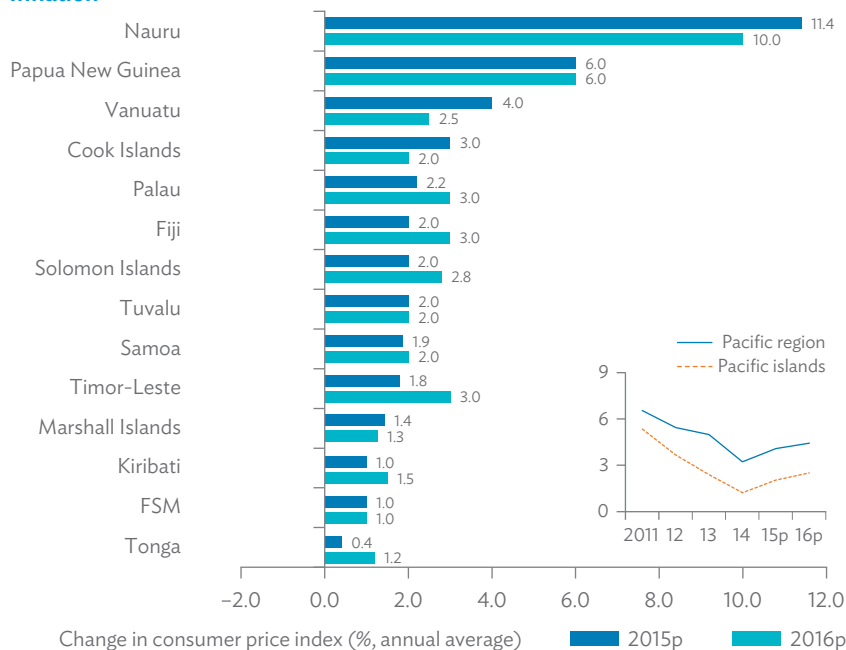
\$	US dollar, unless otherwise stated
A\$	Australian dollar
ADB	Asian Development Bank
F\$	Fiji dollar
FSM	Federated States of Micronesia
FY	fiscal year
GDP	gross domestic product
JICA	Japan International Cooperation Agency
K	PNG kina
lhs	left-hand scale
LNG	liquefied natural gas
m.a.	moving average
NZ\$	New Zealand dollar
PNG	Papua New Guinea
PRC	People’s Republic of China
rhs	right-hand scale
US	United States
Vt	Vanuatu vatu
y-o-y	year-on-year

Asian Development Bank projections

GDP growth



Inflation



e = estimate, FSM = Federated States of Micronesia, GDP = gross domestic product, p = projection.

Note: Projections are as of November 2015 and refer to fiscal years. Regional averages of GDP growth and inflation are computed using weights derived from levels of gross national income in current US dollars following the World Bank Atlas method. Averages for the Pacific islands exclude Papua New Guinea and Timor-Leste. Timor-Leste’s GDP is exclusive of the offshore petroleum industry and the contribution of the United Nations.

Source: ADB estimates.

Notes

This *Monitor* uses year-on-year (y-o-y) percentage changes to reduce the impact of seasonality, and 3-month moving averages (m.a.) to reduce the impact of volatility in monthly data.

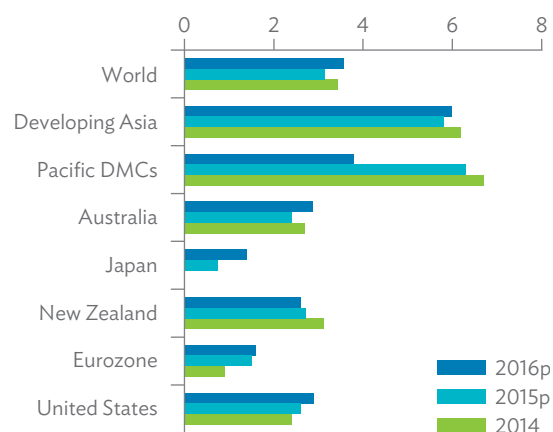
Fiscal years end on 30 June for the Cook Islands, Nauru, Samoa, and Tonga; 30 September in the Marshall Islands, the Federated States of Micronesia, and Palau; and 31 December elsewhere.

International and regional developments

2015 global economic growth disappoints

- Expectations of faster global growth in 2015 failed to materialize due to lower-than-projected expansion in the People's Republic of China (PRC), Japan, and the United States (US). The consensus global growth forecast is now at 3.1% in 2015—down from 3.7%. This is projected to strengthen to 3.6% in 2016—below the start of year forecast (4.0%). Risks to this outlook include possible oil price shocks from conflicts in Syria and financial disruptions that may be triggered by monetary tightening in the US.
- US growth rebounded in Q2 2015 to a seasonally adjusted annualized rate of 3.9%, after low growth in Q1 (0.6%) due to a severe winter in most of the country. Personal consumption expenditure made the largest contribution to Q2 growth. Consumption was boosted by rising employment, which reached its highest rate since Q2 2008. Growth in Q3 was at 2.1%, full-year growth is projected at 2.6%. The US Federal Reserve has signaled that it will begin raising interest rates in December.
- In Japan, the economy entered recession in Q3 as exports and capital expenditure contracted. With this recession—the fifth since 2008—growth for 2015 is now expected at 0.7%.
- Growth in the Eurozone is now projected at 1.5% (from 1.3%) for 2015 due to stronger consumer confidence and sales in Q3. Boosted by the weak euro and low commodity prices, exports strengthened. The European Central Bank is expected to continue its accommodative monetary policy, especially with the continuing concerns about Greece's debt and wide variation in economic performance across Eurozone countries.
- Developing Asia's growth is projected to slow to 5.8% in 2015 (from an earlier projection of 6.3%) on the back of moderating growth in its biggest economies, as reported in the *Asian Development Outlook 2015 Update*. In the PRC, growth in Q3 was 6.9%, the lowest since 2008, led by slowdowns in construction and real estate. Weaker growth in the PRC appears to have slowed growth in other Asian economies, Australia, and New Zealand. In India, the growth forecast was reduced to 7.4% from 7.8% due to weak exports, government spending, and investment as hoped-for economic reforms stalled.
- Australia's economy is seen to grow more slowly in 2015, with the forecast revised from 2.7% to 2.4% due to lower export revenues and falling investment—especially in the mining sector. Private consumption growth was lackluster as unemployment inched back to 6.2% in Q3 2015. The New Zealand GDP growth forecast for 2015 was adjusted downward to 2.7% from 2.9%, due to weaker export performance and lower-than-expected growth in investment and private consumption. The Reserve Bank of New Zealand reduced its key interest rate by 25 basis points to 2.75% in September—its third rate cut this year. The unemployment rate rose to 5.9% in Q2 2015 from 5.5% in Q3 2014.
- Average crude oil prices dropped to \$45.7 per barrel in August—the lowest level since February 2009—before rising to \$46.3 in September. Prices of food and other major commodities were also down from a year earlier and are expected to remain low until 2016. Oil prices are seen to remain low for the next few years as major economies slow down, affecting demand, while supply may rise as trade relations with Iran improve.

GDP growth (% annual)

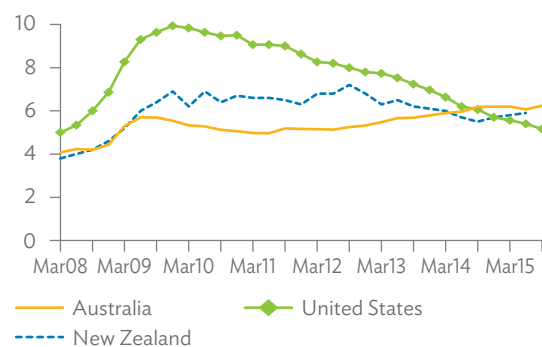


DMC = developing member country, GDP = gross domestic product, p = projection.

Notes: Developing Asia and Pacific DMCs as defined by ADB. Figures for 2014 are based on ADB estimates for developing Asia and Pacific DMCs.

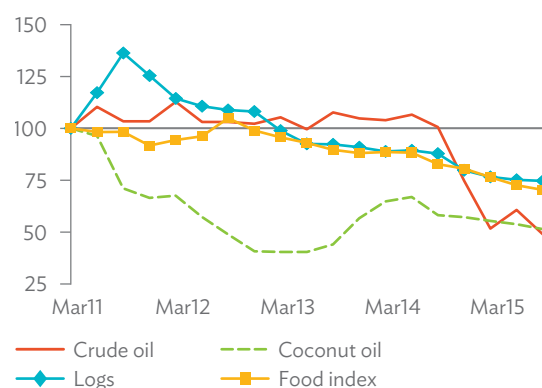
Sources: ADB. 2015. *Asian Development Outlook 2015 Update*. Manila; CEIC; Economist Intelligence Unit; International Monetary Fund; Organisation for Economic Co-operation and Development.

Unemployment rates (% of labor force, quarterly)



Source: CEIC.

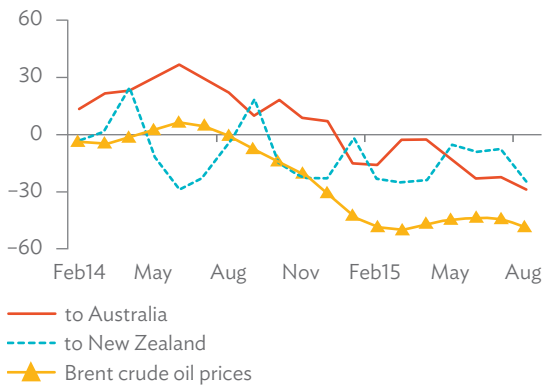
Commodity prices (March 2011 = 100, quarterly)



Source: ADB calculations using data from World Bank Commodity Price Data (Pink Sheets).

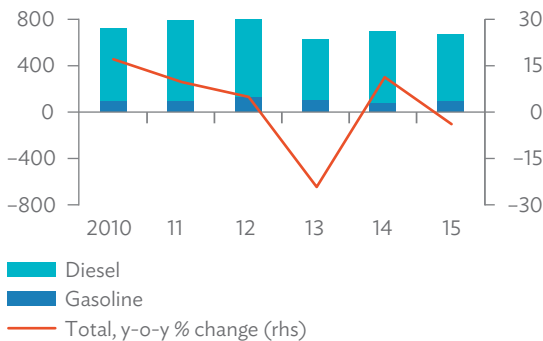
International and regional developments

Pacific exports to Australia and New Zealand (y-o-y % change, 3-month m.a.)



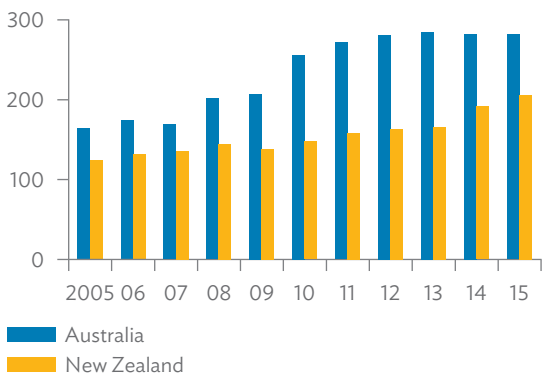
m.a. = moving average, y-o-y = year-on-year.
Sources: Australian Bureau of Statistics, Statistics New Zealand, and World Bank Commodity Price Data (Pink Sheets).

Singapore fuel exports to the Pacific ('000 tons, January–September totals)



rhs = right-hand scale, y-o-y = year-on-year.
Source: International Enterprise Singapore.

Tourist departures to Pacific destinations ('000, January–August totals)



Sources: Australian Bureau of Statistics and Statistics New Zealand.

Lead authors: Prince Cruz, Christopher Edmonds, Rommel Rabanal, and Cara Tinio.

El Niño strikes the region

- The Pacific is seeing widespread effects from an unfolding El Niño, which is expected to be more severe than in 1997–1998. Across the Pacific, particularly in Melanesia, countries are experiencing significant variations in weather and rainfall. Droughts are expected to cause significant losses in agricultural output. Other impacts include changing migration patterns of commercial fish species, increasing risks of cyclones, freshwater shortages, and waterborne diseases. Papua New Guinea (PNG) has been one of the most severely affected, with heavy rains in March causing an estimated \$36 million in damages to infrastructure and agriculture. The early season rainfall has been followed by prolonged drought. Fiji, Solomon Islands, Tonga, and Vanuatu have faced similar impacts from El Niño.

Regional exports continue decline, trade balances worsen

- Exports from Pacific countries to Australia fell by 21.0% (y-o-y) in January–August 2015, largely due to lower crude oil exports from PNG. PNG's gold export volume increased by 9.5% during the same period. Pacific nonfuel imports from Australia declined by 0.8% (y-o-y) in January–August 2015 as increased imports by Fiji (mostly food and machinery) offset lower imports by PNG. The resulting Pacific trade surplus of A\$500 million during this period was 52.1% of the surplus registered from January to August 2014.
- Pacific exports to New Zealand fell by 21.7% (y-o-y) in January–August 2015. Lower agricultural exports—particularly vegetables from Fiji, and coffee and peanut by-products from PNG—led the decline. Nonfuel imports from New Zealand rose by 10.5% (y-o-y) during the same period. The resulting trade deficit grew by 14.2% to NZ\$582 million.
- Fuel imports from Singapore to the Pacific fell by 3.7% (y-o-y) in January–September 2015. Imports by Fiji and Solomon Islands were about 50% of the previous year's level as they partly shifted toward Australian and New Zealand suppliers. A 31.8% increase in fuel imports by PNG, which accounted for 71.9% of the total during the period, partly offset this decline.

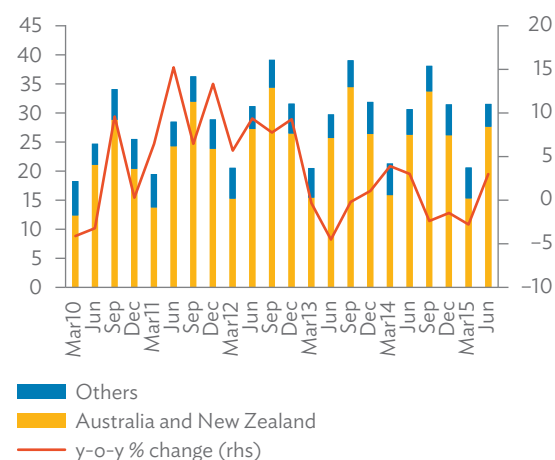
Strong growth in tourism to Pacific destinations continues

- Australian visitors to Fiji—the most-visited South Pacific destination with a market share of over 70%—increased by 3.4% (y-o-y) over the first 8 months of 2015. This reflects an established pattern of substitution by Australian tourists choosing between vacations in Fiji and Vanuatu. When Fiji was struck by severe flooding in 2009 and 2012, Vanuatu saw increased visitors from Australia. This year, after Cyclone Pam hit Vanuatu, the number of Australian visitors has fallen by 27.3% (y-o-y). In this case, however, diversion of visitors appears more widespread, with Samoa and Tonga also registering double-digit growth over the same period.
- Departures from New Zealand rose by 7.7% (y-o-y) in the first 8 months of 2015. Fiji sustained double-digit growth in visitors from New Zealand, and the Cook Islands, Samoa, and Tonga also recorded solid rates of growth. Visitor departures to Vanuatu, however, declined by 16.6% (y-o-y) over the same period.
- In the North Pacific, visitor arrivals in Palau rose by 26.8% (y-o-y) in the first 8 months of 2015, as the number of tourists from the PRC continues to swell. However, the numbers of visitors from Japan; the Republic of Korea; and Taipei, China are all dropping sharply. This suggests a crowding out of traditional source markets, and rising accommodation and capacity constraints.

Cook Islands

- A net operating surplus equivalent to 5.6% of GDP is estimated in FY2015 (ended 30 June). This reflects higher revenues from fishing license sales and fines for illegal fishing and increased grants. Further, overall expenditure fell due to delayed implementation of capital projects.
- Nonetheless, the government had increased borrowing in pursuit of an expansionary fiscal stance. This has pushed gross debt to the equivalent of 27.8% of GDP as of end-FY2015. However, debt service reserves resulted in net debt equivalent to 23.5% of GDP.
- Despite increased appropriations for capital investments, budget execution rates have remained low and reliance on foreign contractors blunts economic stimulus from construction of large capital projects.
- The government projects a fiscal deficit equivalent to 10.5% of GDP for FY2016. This largely results from planned capital investments equivalent to 21.4% of GDP on projects including investments in renewable energy, water and sanitation, and education infrastructure.
- Tourist arrivals declined slightly in FY2015, reflecting accommodation shortages in peak periods. Investments in accommodation facilities are constrained by issues related to land tenure and the cost of meeting sanitation requirements. Tourism growth can be facilitated by reforms to the land tenure system and planned investments in infrastructure.

Visitor arrivals, by source ('000, quarterly)



rhs = right-hand side, y-o-y = year-on-year.

Source: Ministry of Finance and Economic Management.

Lead author: Shiu Raj Singh.

Fiji

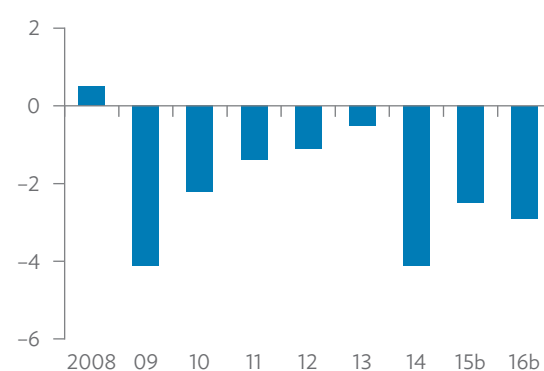
Budget performance 2015

- The government projected a net budget deficit equivalent to 2.5% of GDP in 2015, compared with 4.1% in 2014. The lower deficit reflected increasing revenues and sales of assets (although asset sales have proceeded more slowly than anticipated).
- Overall public debt has fallen from the equivalent of 55.0% of GDP in 2010 to an estimated 49.5% in 2015. In September, the government issued \$200 million in bonds to roll over a bond maturing in March 2016. The 6.6% interest rate on the new bonds compares favorably with the 9.0% for the original bond.
- The government forecasts expansion of 4.0% for this year. Growth has been led by expansion in the transport, construction, and tourism sectors, supported by low oil prices and public infrastructure investment.

Budget 2016

- The 2016 budget released in early November seeks to keep expenditures relatively flat and targets a net fiscal deficit equivalent to 2.9% of GDP. This follows several years of expenditure increases to fund free primary and secondary education, and significant infrastructure investments.

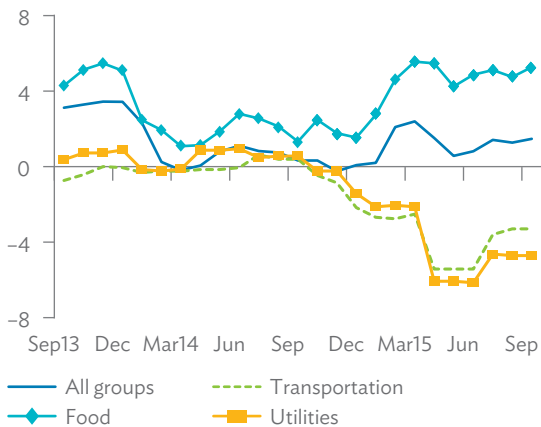
Fiscal balance (% of GDP, annual)



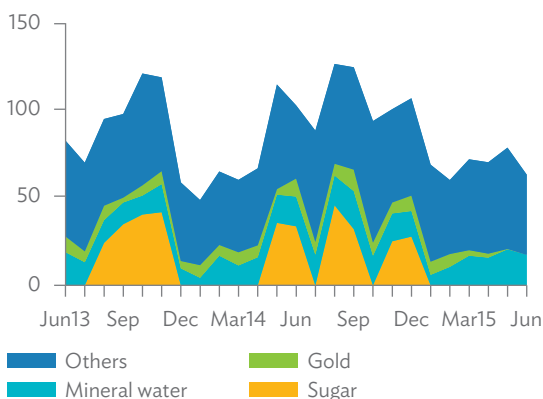
b = budget.

Source: Fiji Ministry of Finance.

Fiji

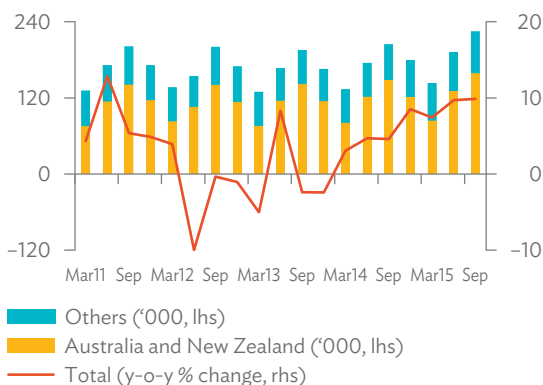
Consumer price index, by commodity group
(y-o-y % change, monthly)

Source: Fiji Bureau of Statistics.

Merchandise exports
(F\$'000, monthly)

F\$ = Fiji dollar.

Source: Fiji Bureau of Statistics.

Visitor arrivals, by source country
(quarterly)

lhs = left-hand scale, rhs = right-hand scale, y-o-y = year-on-year.

Source: Fiji Bureau of Statistics.

Lead author: Caroline Currie.

- Revenue is projected to increase modestly, through new duties and excise taxes on tobacco, alcohol, and soft drinks; additional levies on hotel room rates; and anticipated improvements in tax compliance. A reduction in the value-added tax rate, from 15% to 9%, is expected to be offset by the removal of exemptions for food, kerosene, and medicine.
- Capital investments, primarily for continuing works on roads and water and sanitation infrastructure, is projected to remain at around 40% of the budget.

Recent developments

- Visitor arrivals increased by 9.2% (y-o-y) over the first 3 quarters of 2015. Arrivals from Asia continue to expand rapidly, and now account for around 9% of total visitors. In particular, arrivals from the People's Republic of China (PRC) rose by 48% compared with the same period last year. The number of visitors from the largest source markets—Australia and New Zealand—increased by 4.1% and 13.3% (y-o-y), respectively. Over the first half of 2015, tourism receipts were 10.6% higher than in the same period in 2014.
- Export performance was weak in the first half of the year, with the total value of exports falling by 10% from a year earlier. The value of gold exports was 50% (y-o-y) lower, but bottled water exports registered a 7% (y-o-y) increase. The Fiji Sugar Corporation expects exports to decline by 38% in 2015 compared with 2014. The decline in sugar production is largely from dry conditions due to a severe El Niño event. Despite lower export receipts, foreign exchange reserves remain adequate at the equivalent of 6.1 months of imports as of October 2015, supported by high tourism receipts.
- Inflation remains low, averaging 1.3% over the first 3 quarters of 2015, mainly due to soft international commodity prices. Transportation and electricity costs continue to decline, reflecting low oil prices; however, food price inflation has increased steadily and averaged 5.0% (y-o-y) in Q3. This likely reflects supply pressures due to El Niño effects on local food production. Average inflation for 2015 is now forecast at 2.0%.
- Fiji's growth momentum has continued through 2015. Higher remittances and improved private investment also contributed to the strong performance, which is expected to continue in 2016. Growth is expected to remain at 4.0% in 2016.

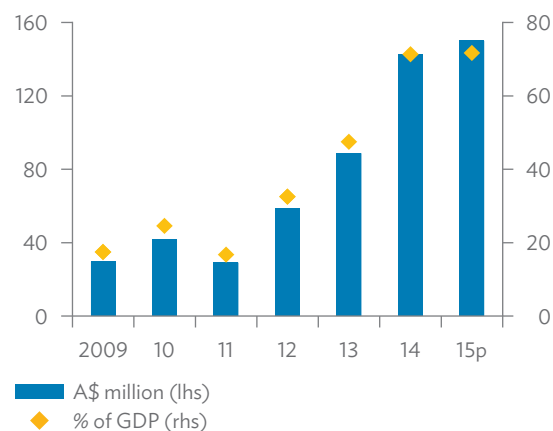
Key issues

- Downside risks to the economy remain from slowing growth in the PRC, leading to weaker trade in Asia and the Pacific. The effects of a slowdown in the PRC economy is expected to be indirect through impacts on the economies of Fiji's leading trading partners (Australia and New Zealand). To sustain current growth levels, the government needs to continue its structural reform program, as highlighted by the October International Monetary Fund Article IV mission.
- Tourism has performed well recently, achieving record high visitor arrivals of just under 700,000 in 2014, and has maintained strong growth so far this year. This has been underpinned by expanding air links, but also reflects the benefit of tourists shifting away from Vanuatu in the wake of Cyclone Pam. Expanding private sector investment to develop new tourism facilities and attractions, continuing upgrades in public infrastructure that supports tourism, and sustaining successful marketing efforts will all be essential in maintaining this strong growth.

Kiribati

- A period of strong fiscal performance commenced in 2013 when fishing license revenues jumped with the introduction of a vessel day scheme. High license revenues in 2013 and 2014 contributed to large fiscal surpluses—the first since 1998. In 2014, revenues were estimated around A\$140 million, equivalent to roughly 70% of GDP. Fishing license revenues continue to rise, and appear likely to reach A\$150 million—about twice the amount projected at the start of the year. A fiscal surplus of A\$57.7 million (equivalent to 27.6% of GDP) is expected again in 2015.
- Achieving fiscal sustainability remains a key challenge. Current levels of government expenditure could see Kiribati's Revenue Equalization Reserve Fund (RERF) depleted within 20 years if fishing license revenues fall significantly. Recognizing this, the government has injected A\$10 million from its fiscal surplus into the RERF this year. The remainder has been placed in a new deposit account to meet future funding needs, such as costs arising from the effects of climate change and operation and maintenance of new infrastructure. Other fiscal challenges facing the government include limiting VAT exemptions and controlling growth in nonessential expenditures.
- As an isolated atoll nation, Kiribati's growth opportunities are constrained. Attempts to attract tourism have been hampered by limited air links and expensive access to potential attractions in the outer islands, such as Kiritimati's surfing sites, and . Perceptions of weak customer orientation at tourist facilities further constrain tourism development. Prudent use of recent windfall incomes, along with ongoing development partner-financed infrastructure upgrades, could provide some of the resources needed to stimulate tourism and growth.

Fishing license revenues (annual)



lhs = left-hand scale, p = projection, rhs = right-hand scale.
 Source: International Monetary Fund. 2015. *Kiribati: 2015 Article IV Consultation—Staff Report*. July. Washington, DC; and Kiribati Ministry of Finance and Economic Development.

Lead author: Malie Lototele.

Marshall Islands

- A fiscal surplus equivalent to 1.7% of GDP is expected for FY2015 (ended 30 September). The FY2016 budget projects a 1.4% increase in revenues (to \$177.2 million) over the FY2015 budget due to higher income tax collections and fishing license and ship registry fees. These are seen to offset a drop in grant inflows.
- The FY2016 budget raises recurrent expenditures by 35.3%, led by an 81.3% spike in special appropriations (accounting for 46.6% of total recurrent spending). Totalling \$28.8 million, these included additional trust fund contributions (\$3.3 million) and expenditures on a range of discretionary spending priorities. The budget also includes higher expenditures on health and education, which combine to account for 17.9% of recurrent expenditures.
- Despite its potential as a diving and sportfishing destination, the Republic of the Marshall Islands averaged just over 5,000 visitors a year from 2004 to 2014. Visitors need to take costly, low-capacity flights mostly from Guam or Hawaii—both of which require US visas. Once in the country, visitors contend with scarce tourism facilities and difficult domestic flights.
- Improving air links with international markets—particularly the fast-growing economies in Asia—and enhancing efficiency at state-owned Air Marshall Islands could improve accessibility and stimulate travel demand. These efforts should be complemented with improvements to domestic infrastructure and the business regulatory environment, both of which are integral to supporting tourist facilities and services.

Fiscal accounts (annual)

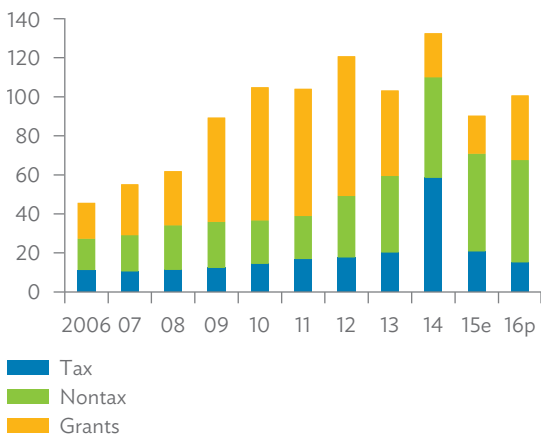


FY = fiscal year, lhs = left-hand scale, rhs = right-hand scale.
 Source: www.econmap.org

Lead author: Cara Tinio.

Micronesia, Federated States of

Government revenues, by source
(\$ million, annual)



e = estimate, p = projection.

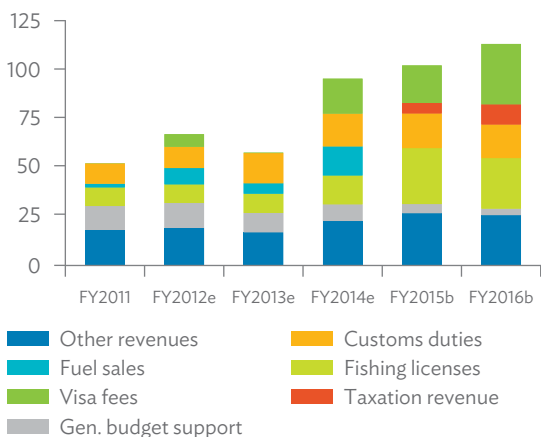
Source: Office of Statistics, Budget and Economic Management, Overseas Development Assistance and Compact Management.

Lead author: Bing Radoc.

- The government estimates it achieved a fiscal surplus of \$19.8 million (equivalent to 6.9% of GDP) in FY2015 (ended 30 September). The government plans to increase current expenditures by 2% in FY2016 and capital expenditures by 65% amid an expected 70% increase in external grants. Planned capital spending on infrastructure and tourism development, and contributions into the Federated States of Micronesia (FSM) Trust Fund, are aligned with the 2023 Action Plan. Total revenues are expected to be 11% higher in FY2016, likely to be driven by external grants and increased collections from fishing licenses. This would result in a fiscal surplus equivalent to about 5% of GDP.
- The FSM faces long-term fiscal challenges in building revenue to replace declining US grants under the Compact of Free Association (amounting to about 25% of GDP and 40% of revenues), which will expire in FY2023. Returns from the Compact Trust Fund and the FSM Trust Fund look likely to be insufficient to sustain existing expenditure. In an effort to achieve fiscal self-reliance, the government has adopted the 2023 Action Plan, which aims to facilitate private sector development, generate additional revenues through tax reforms.
- Tax collections are equivalent to 12%–13% of GDP, lower than the 20% Pacific average. The government intends to increase the tax effort to 16% over the next 3 years through administrative reforms, but this hinges on the commitment of the four state governments.

Nauru

Revenues
(A\$ million, annual)



b = budgeted, e = estimated, FY = fiscal year.

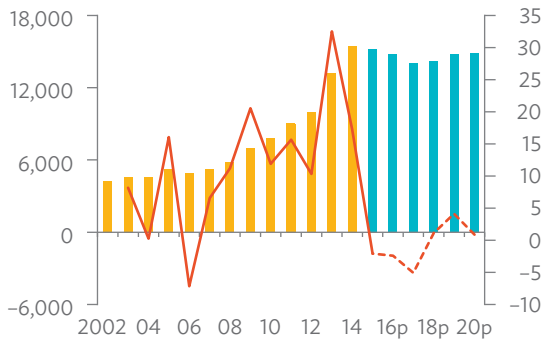
Sources: Republic of Nauru budget documents (various years).

Lead author: Roland Rajah.

- The budget swung into deficit in FY2015 (ended 30 June) against expectations of a small surplus. Revenues underperformed owing to weak customs and phosphate revenue. Expenses were also lower than expected, although higher than in FY2014, which helped to contain the cash deficit. However, these figures mask improvement in the government's balance sheet as debt repayments and other financing transactions are reported as expenses. Excluding these items, Nauru recorded a fiscal surplus in FY2015.
- The FY2016 budget targets continued fiscal expansion. A supplemental budget was passed in October increasing revenue to A\$117.8 million with a matching increase in planned expenditures. The higher spending will be financed by greater revenues from fishing licenses, taxes, and visas, more than offsetting lower revenue in other areas.
- The government announced it would accelerate the processing of asylum seekers at the Regional Processing Centre. The move is expected to result in higher revenues from visa fees while activity at the center is expected to remain steady. Phosphate exports continue to disappoint due to damage at the port and mining delays. In common with several other Pacific economies, fishing license fees remain uncertain and could prove a point of vulnerability within the budget.
- Fiscal policy is becoming increasingly unsustainable and vulnerable to potential shocks. The budget is becoming more reliant on revenue derived from finite and uncertain sources. Efforts to repair the government's balance sheet have been commendable, although progress is slowing as a greater share of windfall revenues are directed toward recurrent expenditure.

Papua New Guinea

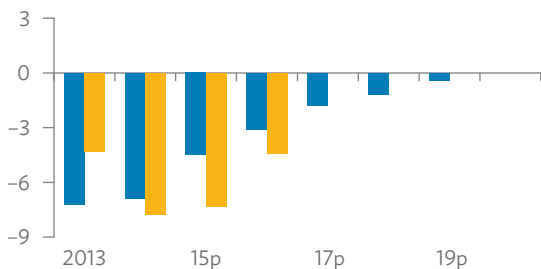
Government expenditure (annual)



■ Total expenditure and net lending (million kina, lhs)
 — Expenditure growth (% change p.a., rhs)

lhs = left-hand scale, p = projection, rhs = right-hand scale.
 Sources: National budget documents (various years);
 ADB calculations.

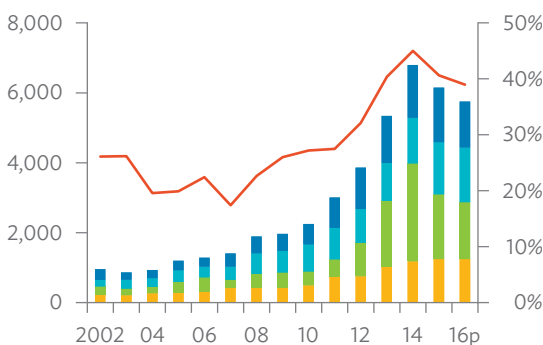
Fiscal balance—planned vs. actual (% of GDP, annual)



■ Planned
 ■ Actual

p = projection.
 Sources: National budget documents (various years);
 ADB calculations.

Budget priorities (annual)



■ Education
 ■ Health
 ■ Transport and utilities
 ■ Law and justice
 — % Total expenditure (rhs)

p = projection, rhs = right-hand scale.
 Sources: National budget documents (various years);
 ADB calculations.

Budget performance 2015

- The government faced mounting fiscal challenges in 2015 due to falling commodity prices. A shortfall of K2.5 billion (equivalent to 4.9% of GDP) was estimated in the midyear fiscal and economic outlook, with lower-than-expected revenues from the mineral sector. The supplementary budget identifies expenditure cuts of about K1.4 billion. The supplementary budget identifies K1.1 billion in additional revenues from the Inland Revenue Commission, customs, and state-owned enterprises. However, it is unclear whether receipts from state-owned enterprises are loans or dividends.
- Fiscal adjustment to overly optimistic assumptions on global oil prices and inflows related to liquefied natural gas (LNG) has been slow. The 2015 budget projected K1.7 billion in revenues from the mining and petroleum sector—18.0% higher than in 2014—assuming an oil price of \$89.70 per barrel (versus a long-run average of \$50 per barrel). Sustained falls in oil prices in 2015 and tax incentives granted to LNG investors sharply reduced sector revenue to K300 million. Although the 2016 budget revises commodity price assumptions, these still remain optimistic. Using long-run average prices for commodities—particularly oil and gold—would have reduced the risk from negative commodity price shocks.

Budget 2016

- The 2016 budget positions fiscal policy on more realistic grounds. Responding to the economic slowdown and weak external outlook, the government's fiscal strategy postpones the achievement of a balanced budget from 2017 to 2020. Net borrowing in 2016 is projected to be equivalent to 3.8% of GDP, falling steadily to 0.2% in 2019. The 2016 budget forecasts that PNG's debt-to-GDP ratio will increase to 36% by 2017 before gradually reducing to 31% in 2020. Achieving these targets will require greater fiscal discipline, and the debt-to-GDP ratio now becoming an even more important anchor.
- Adjusting to lower revenue expectations (projected at K12.0 billion), total public expenditure will be reduced to K14.8 billion, a reduction equivalent to 2.5% of GDP from the 2015 supplementary budget. Of this, K5.0 billion is allocated for capital investment and K8.8 billion for operational expenditure. Direct government financing accounts for 60% of capital expenditure, while the remainder will come from concessional loans (20%) and grants (20%).
- The 2016 budget aligns expenditures with the medium-term development priorities of education, health, transport, law and order, agriculture, and subnational growth. The government is prioritizing completion of ongoing projects, preparations for hosting several large gatherings (e.g., the African, Caribbean, and Pacific states meeting in 2016, and the Asia-Pacific Economic Cooperation summit in 2018), and conduct of national elections in 2017. Expenditures associated with these events could challenge fiscal discipline. The budget allocation to tourism was increased from K1 million in 2015 to K50 million in 2016, which aims to leverage underutilized potential, contribute to inclusive growth, and generate employment.

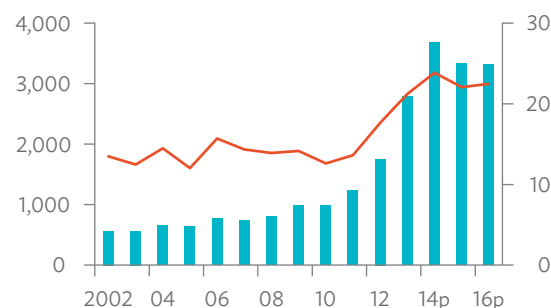
Key issues

- PNG may find it difficult to finance the 2016 budget deficit. The domestic sources of finance have dried up as commercial banks have reached their limit for exposure to Treasury bills. PNG is exploring options to float a sovereign bond of \$1.0 billion in 2016 to refinance its borrowing. PNG may face high financing costs, and exchange rate movements could raise nominal debt.

Papua New Guinea

- Debt service costs are increasing and are now estimated at K1.5 billion, or 10% of the 2016 budget. The stock of domestic debt is shifting toward shorter-term maturity with banks unable to purchase any more Treasury bills, further raising interest rate risks. Thus, more severe cash flow constraints are likely in 2016, placing a premium on improving cash flow management through regular reconciliation of checks issued against warrants and through monitoring delays in budget execution.
- More efficient public spending could yield large savings. It is estimated that up to K700 million could be saved by weeding out nonperforming workers and spurious posts. Each year, the government places a sizable part of the budget in commercial bank trust accounts. Not only are these subject to service fees, banks also use the cash to purchase Treasury Bills when the government faces cash flow problems. This reportedly costs the Treasury over K1 billion, which could be avoided through better planning and budget implementation.
- The tight fiscal situation is exerting downward pressure on the kina. A sizable part of the budget is spent on imports. After the completion of construction on the LNG pipeline, imports were expected to decline, but this has occurred more slowly than anticipated with upscaling of government capital investment. Foreign exchange reserves are likely to continue falling (from \$2 billion in September 2015), and further measures may be needed to arrest this decline.

Subnational government funding (annual)



■ million kina, lhs
— % of total expenditure and net lending, rhs

lhs = left-hand scale, rhs = right-hand scale.

Sources: National budget documents (various years); ADB calculations.

Lead author: Yurendra Basnett.

Samoa

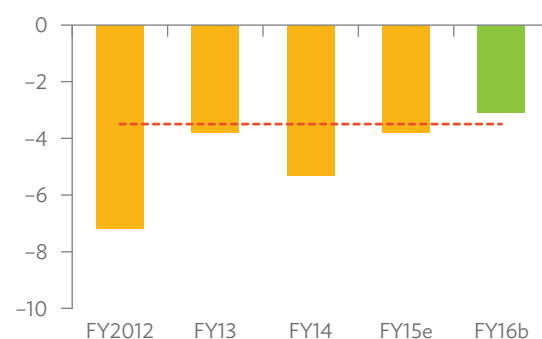
Budget performance FY2015

- Completion of postdisaster projects drove a reduction in the fiscal deficit in FY2015 (ended 30 June). The deficit fell to the equivalent of 3.8% of GDP, slightly lower than planned but still above the medium-term target of 3.5%. Completion of public works enabled a 6.2% decline in total government spending. Total government receipts declined by 3.7% due to a large drop in grant inflows that was partly offset by increased domestic revenue collections.

Budget FY2016

- The government forecasts a fiscal deficit equivalent to 3.1% of GDP to be financed by concessionary loans. Grants are expected to drop by 28.0% (y-o-y), leading to a 5.8% decline in overall fiscal inflows. This follows completion of postdisaster reconstruction and rehabilitation projects, as well as reduced grant assistance with Samoa's reclassification as a country at "medium" risk of debt distress according to the July 2015 International Monetary Fund–World Bank debt sustainability analysis.
- Overall expenditures are also seen to decline by 6.9% (y-o-y). The government also plans to tighten recurrent spending and adhere to its commitment to keep the deficit at acceptable levels.

Fiscal balance (% of GDP, annual)



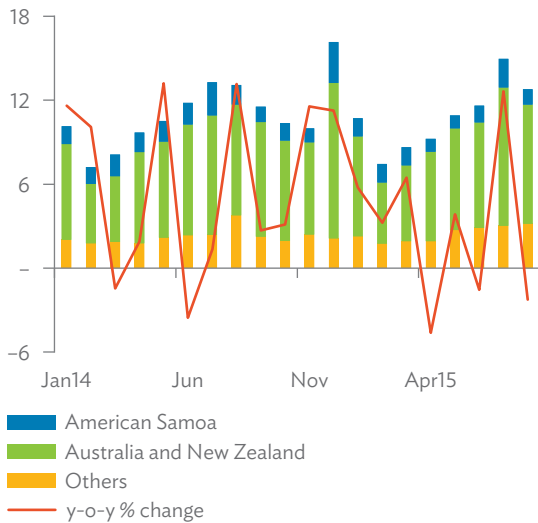
■ Fiscal balance
--- Target, SDS 2012–2016

b = budget, e = estimate, FY = fiscal year, GDP = gross domestic product, SDS = Strategy for the Development of Samoa.

Sources: Samoa Bureau of Statistics, Samoa Budget Address 2015/2016, and the Strategy for the Development of Samoa, 2012–2016.

Samoa

Visitor arrivals by source
(‘000, monthly)



y-o-y = year-on-year.
Source: Central Bank of Samoa.

Lead author: Shiu Raj Singh.

Recent developments

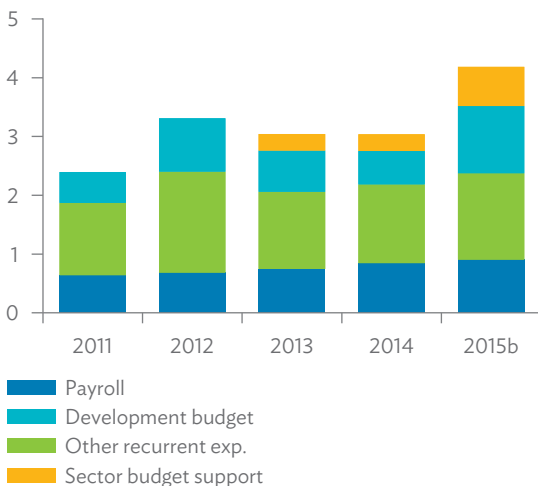
- GDP grew by 1.7% in FY2015, with growth in tourism, transport, electricity and water, and fishing offsetting declines in nonfood manufacturing, agriculture, and construction. Low fuel prices helped reduce operating costs in the transport and energy sectors. Weak output from Samoa's largest employer, Yazaki Enterprise, contributed to the decline in nonfood manufacturing activity. Construction activity, which had been stimulated by disaster response and preparations for hosting international events, has now wound down.
- Visitor arrivals rose by 4.8% (y-o-y) during FY2015. With little change in the estimated tourism price index, tourism earnings are estimated to have grown by 4.9%. Remittances also increased by 6.7% (y-o-y) during the year due to higher inflows from Australia and New Zealand.
- Although the current account balance for FY2015 is in line with historical trends, lower-than-usual capital transfers have contributed to declining foreign reserves. At the end of FY2015, gross foreign reserves were equivalent to 4.3 months of goods and services imports.

Key issues

- Growth is expected to remain moderate at 1.9% with the absence of new large infrastructure projects, and further declines in output from Yazaki Enterprise. The positive performance in tourism and remittances is seen to continue, but will likely depend upon continued growth in the Australian and New Zealand economies.

Solomon Islands

Government expenditure
(SI\$ billion, annual)



b = budget.
Source: Ministry of Finance and Treasury.

Budget performance 2015

- The government no longer expects to run a budget deficit in 2015. Late approval of the budget in April has delayed implementation of the development budget, which is expected to be only 60% spent this year. The recurrent budget has largely avoided similar delays and is expected to be fully spent.
- Domestic revenue collection has been underperforming. As of midyear, tax revenues were tracking 4% below budget—reflecting weak performance in taxes on goods and services and income tax. Lower oil prices, subdued inflation, and closure of the Gold Ridge mine have been driving factors. Strong nontax revenues (mostly fishing license fees) and export and import duties have provided a partial offset.

Budget 2016

- The 2016 budget is still being prepared. The fiscal deficit target is expected to be similar to that in the 2015 budget (equivalent to about 5% of GDP), with continued focus on major infrastructure projects. Delayed development projects from 2015, such as the JICA Kukum Highway and the ADB Transport Sector Flood Recovery Project, will be rolled over into next year's budget.

Solomon Islands

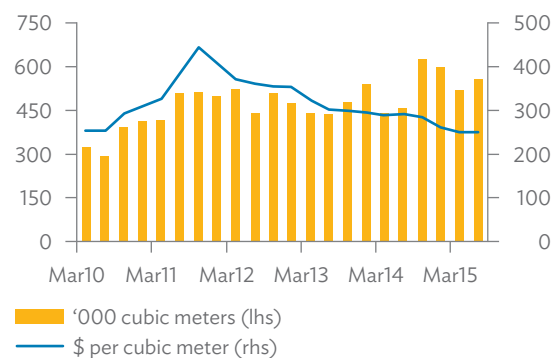
Recent developments

- Construction and logging are supporting the recovery from severe floods last year. Logging volumes have been higher than expected despite concerns about sustainability and illegal activity. However, other major exports have performed poorly this year: earnings from palm oil, coconuts, and minerals have contracted significantly; international prices for Solomon Islands' major commodity exports have been dropping; and export volumes are generally down with the exception of timber and cocoa.
- Monetary policy remains accommodative. Foreign exchange reserves are high while domestic inflation is subdued as prices subside from flood-related rises last year. Lower international food and fuel prices have also helped contain inflation and the import bill. Private sector credit growth accelerated to around 20% amid continued rapid increases in personal loans.
- Low rainfall from El Niño conditions is expected to continue until April 2016, leading to decreased domestic food production and increasing hardship, particularly among poor subsistence farming families. Low supplies of potable water raise risks of outbreaks of diarrhea and infectious and respiratory illnesses.

Key issues

- The near-term outlook has become more uncertain. Severe El Niño conditions are seen to hurt agricultural production and exports outside of timber, while underspending of the budget would exert further downward pressure on the economy. Weak revenue performance is also a concern. Future sources of growth and revenue remain uncertain with logging expected to eventually decline.
- Policy action is required to prepare for the eventual dissipation of existing drivers of growth. Despite progress in some areas, many pronounced policies lack detail (e.g., establishing special economic zones and a national development bank), while others await proper implementation (e.g., tackling illegal logging).
- Fiscal expansion remains a government priority but care is warranted. Infrastructure needs are substantial, but should be balanced with maintaining macroeconomic buffers and scaling up implementation capacity. Cash and foreign exchange reserves are relatively large, but high exposure to negative shocks mean these need to be maintained. Progress in reforms to improve the business environment remains critical to realizing sustainable growth dividends from planned infrastructure investment. A proposed submarine cable that will provide high-speed internet access would open up business opportunities, and analysis suggests this would yield substantial return on investment.
- The new Land Board was established in April to improve transparency and management of land allocations amid perceptions of corruption and rent-seeking under the previous arrangement. Board membership consists mostly of technocrats plus representatives of women and the business community. The reform includes increased disclosure requirements on land transactions to Parliament and the public.
- The government's new tourism strategy for 2015–2019 aims to position the country as an adventure travel destination. The initial focus will be on marketing existing products before developing new ones and building tourism infrastructure and human resources. Developing the cruise ship industry is also a focus. A task force chaired by the Prime Minister is expected to coordinate across portfolios.

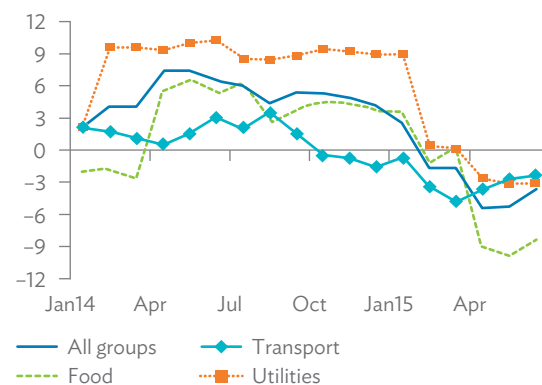
Log exports and prices (annual)



lhs = left-hand scale, rhs = right-hand scale.

Sources: Central Bank of Solomon Islands and World Bank Commodity Price Data (Pink Sheets).

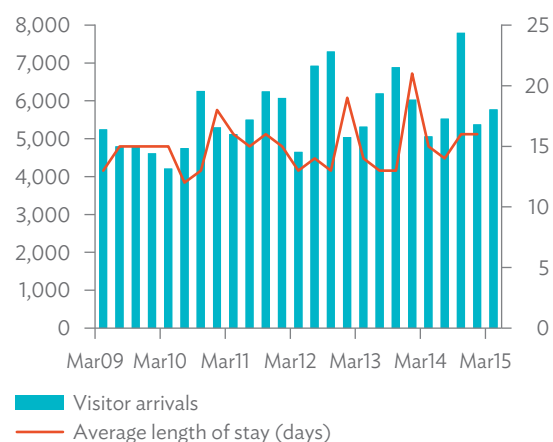
Consumer price index, by commodity groups (y-o-y % change, monthly)



y-o-y = year-on-year.

Source: Central Bank of Solomon Islands.

Visitor arrivals (quarterly)

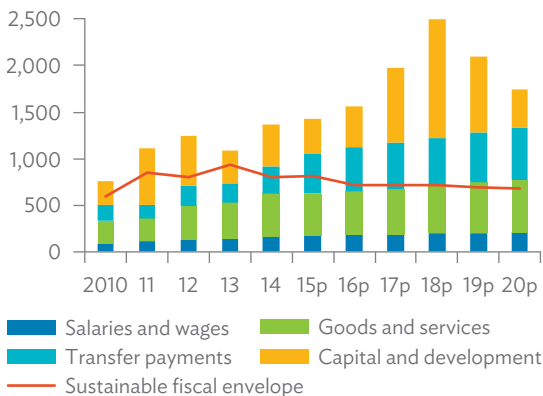


Source: Central Bank of Solomon Islands.

Lead author: Roland Rajah.

Timor-Leste

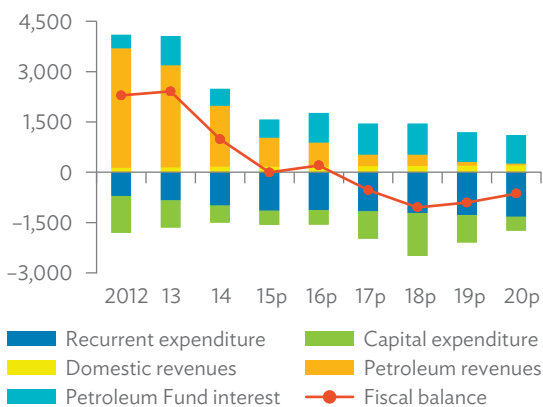
Government expenditures, by category (\$ million, annual)



p = projection.

Sources: Government of Timor-Leste Transparency Portal and draft 2015 State Budget.

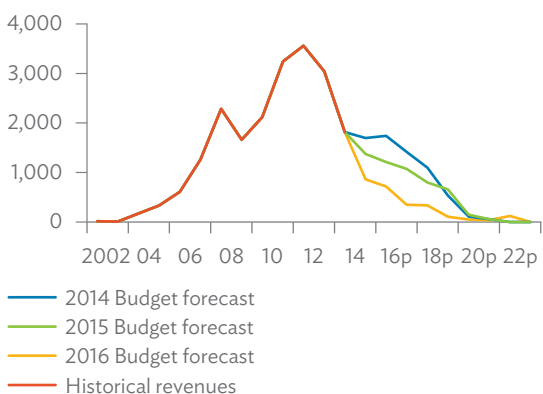
Fiscal accounts (\$ million, annual)



p = projection.

Sources: Government of Timor-Leste Transparency Portal and draft 2015 State Budget.

Petroleum revenue projections (\$ million, annual)



p = projection.

Source: Timor-Leste national budget documents (various years).

Budget performance 2015

- Total government expenditure increased by 4.5% (y-o-y) in the first 10 months of 2015 with spending on salaries and wages up 6.3% and transfer payments up by 58.0%. These increases offset a 10.9% decline in government purchases of goods and services and a 35.3% reduction in capital investment. The large shifts in capital expenditures and transfer payments are partly due to changes in how the government records its expenditures. A \$133 million transfer to the Special Administrative Region of Oecusse Ambeno accounted for 35.4% of transfers during the first 10 months of the year. Approximately 85% of transferred funds have been allocated to capital investment, but actual disbursements on projects are unclear.
- Total budget execution reached 59% at the end of October. As in recent years, disbursements are expected to be significantly higher in November and December. Capital spending is expected to pick up in the final quarter, with the government projecting full execution of its Infrastructure Fund budget despite low implementation during the first three quarters. Projections suggest that final 2015 expenditures could be 3%–5% higher than in 2014—easing spending growth from 2013–2014 rates.
- Royalties from offshore petroleum operations, a major source of government revenues, were 51% lower (y-o-y) in the first three quarters of 2015 due to weak international prices and declining output from the main oil field. Petroleum Fund investments have performed below long-term targets due to unfavorable conditions in international financial markets. Returns on investment averaged –0.4% in the first three quarters and the value of the equity holdings fell by 8.3% in Q3. As of September, the Fund's balance was \$16.4 billion—about \$13,200 per capita. Domestic revenues—accounting for 6.2% of total government receipts in 2014—grew by less than 1% (y-o-y) in the first 9 months of 2015.

Budget 2016

- The proposed 2016 budget submitted to Parliament plans total expenditure of \$1.56 billion in 2016 and projects large spending increases from 2017 to 2020 to complete major capital investments. The planned spending is significantly above the previous targets of \$1.3 billion in 2016 and \$1.2 billion in 2017, and excludes expenditures supported by development partner grants.
- The draft budget highlights Timor-Leste's reliance on the Petroleum Fund and the challenges to long-term fiscal sustainability. Lower oil prices contributed to a 56% reduction in forecast petroleum revenues for 2016–2022 and a 15% reduction in both the country's estimated total petroleum wealth and the Petroleum Fund's estimated sustainable income (ESI). The ESI now stands at \$545 million and excess withdrawals will be needed to finance planned expenditures in 2016–2020, which are projected to erode the Petroleum Fund's balance.
- Despite being identified as priority sectors during budget planning, allocations were reduced for agriculture (by 28.1%), education (6.3%), and health (17.5%). Allocations for maintenance of the electricity system and other public assets are seen to be below the level required in the medium term.
- A total of \$376.7 million was allocated for major capital investments through the Infrastructure Fund, with 52.0% for road and bridge upgrades and 21.7% for development of the south coast. Appropriations to develop special economic zones in Oecusse Ambeno and Atauro have been increased 63.3% to \$218 million, mostly for upgrading transport and other infrastructure in Oecusse Ambeno.

Timor-Leste

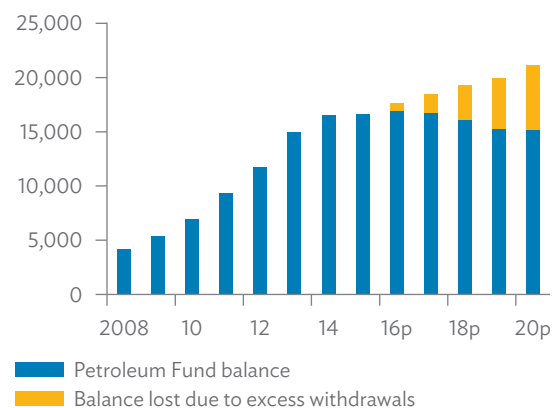
Recent developments

- A range of indicators suggests strong demand in the first half of 2015. Credit to the private sector expanded by 8.5% (y-o-y) in Q2, with sharp increases in lending to the agriculture, tourism, and construction sectors. Private electricity consumption rose by 20.0% (y-o-y) over the first half of 2015, and vehicle registrations almost doubled over the same period. However, several large private investment projects have been delayed and the Ministry of Finance has reduced its forecast for 2015 non-oil GDP growth from 7.0% to 4.1%.

Key issues

- Declining oil revenues highlight the importance of fiscal sustainability. Timor-Leste does not face immediate fiscal pressure, but the success of the government's frontloading strategy will depend on the quality of public expenditures. A rebalancing of spending toward the priority sectors of agriculture, health, and education would help Timor-Leste to make growth more inclusive while leveraging the impact of improved physical infrastructure.
- Timor-Leste has identified tourism as a strategic sector that can drive growth of the non-oil economy. The sector is at a very early stage of development and the government has an important role to play in encouraging private investment and providing coordination and supporting infrastructure. One immediate priority is improving the evidence base for tourism policy. International arrivals have risen steadily in recent years, but no system is in place to monitor tourist arrivals and capture data to guide development of the sector.

Petroleum Fund balance (\$ million, annual)



p = projection.
Source: Timor-Leste national budget documents (various years).

Lead author: David Freedman.

Tonga

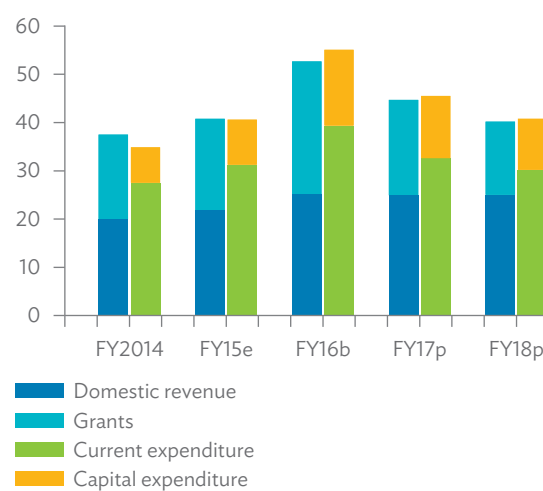
Budget performance FY2015

- The government recorded a fiscal surplus equivalent to 0.2% of GDP in FY2015 (ended 30 June). Growth in public spending was much lower than planned, as general budget support and infrastructure projects were postponed. Total government expenditure increased by 13% in FY2015, with non-wage operational spending growing by 17% and capital spending rising by 31%. Spending on public wages grew by 7% from FY2014, driven by new government hiring, but remained below the budgeted allocation.
- Total revenues, including grants, were 12% higher in FY2015 than in FY2014 despite deferral of \$7.5 million in planned budget support pending an agreed reform framework. Domestic revenue performance was strong, with collections of tax arrears at \$2.0 million above target and excise tax on tobacco and alcohol at \$2.5 million above target.

Budget FY2016

- The FY2016 budget plans another large increase in public spending, with capital expenditure set to increase by 75% in FY2016, driven by the expected start of delayed projects. However, capacity constraints could further delay some projects. Recurrent expenses are budgeted to rise by 30%, including a 17% expansion in the public wage bill.
- Revenues are expected to rise with higher excise taxes on unhealthy food and beverages, and royalties from broadband cable operations. Higher departure taxes and a controversial new foreign exchange levy are being implemented with the stated purpose of funding preparations to host the 2017 Pacific Games. Grant inflows to date are above target with the receipt of

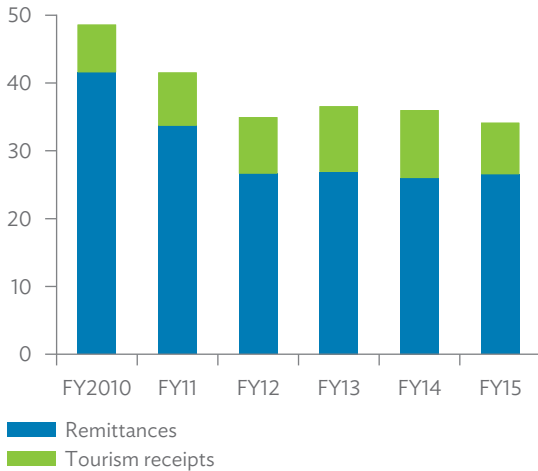
Government revenue and expenditure (% of GDP, annual)



b = budget, e = estimate, p = projection.
Sources: Tonga Budget Statement 2015/2016; ADB estimates.

Tonga

Key sources of foreign exchange (% of GDP, annual)



Source: National Reserve Bank of Tonga.

the \$4.3 million EU grant, originally scheduled for FY2015. The planned fiscal expansion for FY2016 is expected to result in an overall deficit equivalent to 3.6% of GDP, to be financed from a combination of domestic borrowing, budget support, and project loans.

Recent developments

- Private remittances increased slightly, to the equivalent of 26.5% of GDP in FY2015 (from 26.0% in FY2014). In contrast, tourism receipts declined to the equivalent of 7.6% of GDP in FY2015, from 10.0% in the previous fiscal year.

Key issues

- Although economic growth has remained modest at around 2% in recent years, government commitment to reform has been waning. Expenditure has continued to increase, and is expected to rise even further because of preparations for hosting the 2019 Pacific Games. However, despite new taxes, revenue streams have struggled to keep pace with spending. The waning commitment to reform has prompted delays in grants for budget support. These factors raise concerns regarding long-term fiscal sustainability.
- To strengthen Tonga's resilience to climatic events, the government is establishing a climate change trust fund, through a grant from ADB. The trust fund will provide \$5 million in grants for community-based investments.
- Sustaining the recent positive performance in the tourism sector in early FY2016 will largely depend on economic growth in Australia and New Zealand, despite uncertainties in the global environment. Possible factors behind the upturn in tourism include the recent coronation and other events, and a temporary diversion of travelers away from cyclone-hit Vanuatu.

Lead author: Saia Faletau.

Tuvalu

Domestic revenues (% of GDP, annual)



p = projection.

Sources: Government of Tuvalu. 2015 National Budget; International Monetary Fund. 2014. *Tuvalu: 2014 Article IV Consultation—Staff Report*. August. Washington, DC; and Ministry of Finance and Economic Development.

- Following consecutive years of budget surplus, the government projected a deficit of A\$0.3 million (equivalent to 0.8% of GDP) in 2015. However, as of September, the government is running a surplus of A\$14.3 million as fishing license revenues were 39.4% above budget estimates. The revenue boost stems from a payment received by Tuvalu as a signatory to the US Tuna Treaty. The government confirmed that windfalls from fisheries licenses in excess of A\$16 million will be saved in the Consolidated Investment Fund.
- Expenditures are projected to be below budget estimates, with the exception of education-related travel (25% above budget) and the Tuvalu Medical Treatment Scheme (61%). Even with special development expenditures increasing from A\$3.8 million in 2014 to a projected A\$13.8 million in 2015, government spending will likely be 24.0% below target for the full year.
- Achieving fiscal sustainability remains an important challenge. Prudent management of volatile and often unpredictable revenue streams, including earnings from fishing license fees and “.tv” internet domain sales, is required. Even if revenues are high in the short term, expenditure restraint will be necessary for fiscal and economic sustainability, as will management of fiscal risks from external economic shocks and climatic events and disasters.
- Remoteness, inefficient international and domestic transportation, and weak infrastructure are among the challenges faced in attracting tourists. Stronger coordination of marketing efforts with Fiji—the sole gateway to Tuvalu—could boost onward travel to Tuvalu for niche tourism.

Lead author: Malie Lototele.

Vanuatu

Budget performance 2015

- Recurrent expenditure remains largely on track. Spending is running slightly higher than expected, but the government is carefully managing this to ensure an operating surplus by year end. Development partners have contributed \$5.8 million for disaster recovery, but this amounts to only to 19% of the estimated funds required for recovery from Cyclone Pam.
- The government's new national recovery plan, Strengthening Ni-Vanuatu Resilience, focuses on infrastructure reconstruction and restoring social services and livelihoods. The bulk of reconstruction is expected to be financed by development partners. However, these projects have been affected by delays in the government's approval process.

Budget 2016

- Next year's budget has been delayed amid the ongoing government corruption scandal and is likely to be presented to Parliament in only March 2016. The government is considering passing a supplementary budget in the interim. The 2016 budget will likely continue to focus on recovery, reconstruction, and new infrastructure investment financed by concessional borrowing.

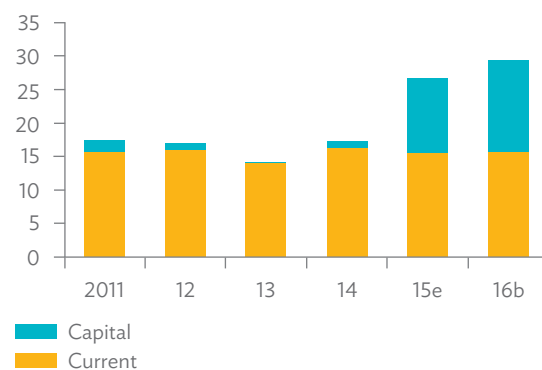
Recent developments

- Tourism is showing signs of nascent recovery following Cyclone Pam in March. Arrivals by air in July had recovered to 12.4% below the same period a year ago. There was also strong recovery in cruise ship arrivals.
- Export earnings have provided crucial support to the economy, rising by nearly 40% (y-o-y) over the year to July. Strong coconut and timber exports, and the depreciation of the vatu against the US dollar, have boosted local currency export earnings. However, the high levels of coconut exports may not be sustained due to significant crop damage from Cyclone Pam.
- Dry conditions due to El Niño are causing food and water shortages. Subsistence crop production has suffered from low rainfall in recent months, and dry conditions are expected to continue until early 2016. There are already increasing reports of malnutrition, dehydration, and rising hardship.

Key issues

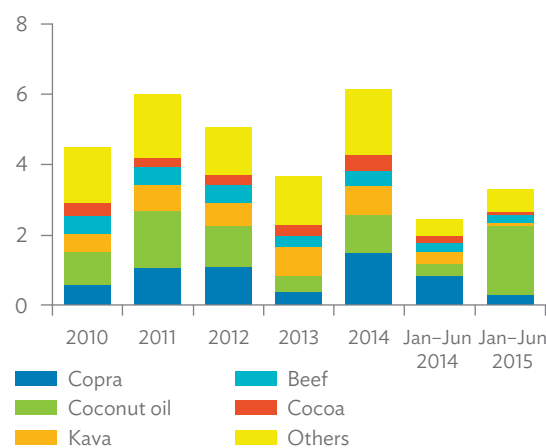
- Recovery in agriculture will be hampered by severe El Niño conditions. Reconstruction projects that were expected to boost activity will now commence early next year at best. The outlook is also dampened by subdued prospects in Australia—Vanuatu's largest tourist source market and trading partner. However, if recent trends in tourist arrivals are sustained, this would strengthen the outlook considerably.
- Political instability continues, with a large number of parliamentarians convicted for corruption. This may negatively impact the economy if it leads to government indecision or affects business confidence. Planned infrastructure projects must be completed to regain the high economic growth enjoyed during the 2000s, and this needs to be complemented by an improved business environment.

Government expenditure (Vt billion, annual)



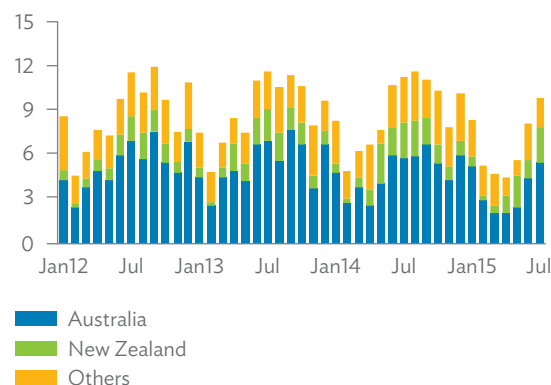
b = budget, e = estimate, Vt = vatu.
Source: Vanuatu Department of Finance and Treasury.

Principal exports (Vt billion, annual)



Vt = vatu.
Source: Vanuatu National Statistics Office.

Visitor arrivals, by source ('000, monthly)



Source: Vanuatu National Statistics Office.

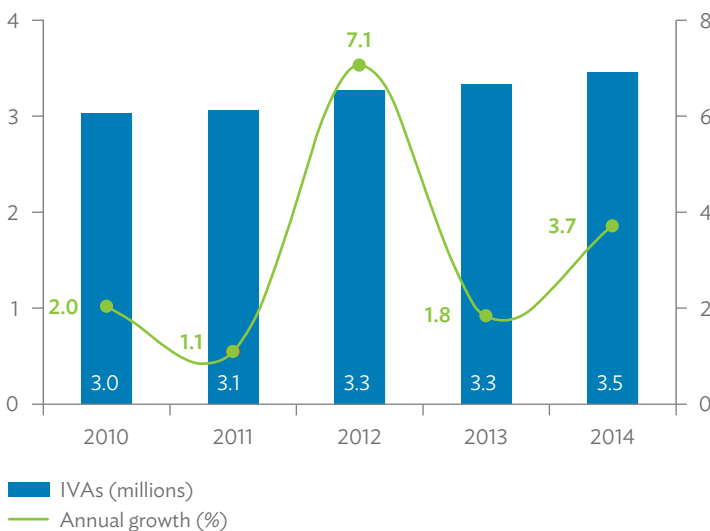
Lead author: Roland Rajah.

Tourism trends and forecasts for the Pacific

International tourism has grown steadily at an average annual rate of almost 4% over the past decade, from 674 million in 2000 to 1.13 billion in 2014 (UNWTO 2015). It is expected that growth will continue between 3% and 4% in 2015. In addition, arrivals growth in Asia and the Pacific (based on United Nations World Tourism Organization [UNWTO] classifications) is seen to exceed the global average, with full-year expansion of between 4% and 5%.

Within that context, the Pacific (excluding Australia and New Zealand) is performing reasonably well. International tourist numbers increased steadily from 2010 to 2014, at about the global average rate (Figure 1).

Figure 1: International visitor arrivals to Pacific destinations, 2010–2014



Source: Pacific Asia Tourism Association.

Further, the UNWTO predicts that tourism to Oceania (which includes Australia and New Zealand), an important gateway into the Pacific, will grow at an average of 2.4% per annum to 2030. This translates into an additional 400,000 foreign tourists arriving between 2010 and 2030, with an annual foreign inbound count of 19 million by the end of the period (UNWTO 2012).

The Boeing Company is also bullish on growth, with 20-year projections of its revenue passenger kilometers (RPK) for Oceania ranging from 3.5% to 6.3% per annum. This would push RPKs for Oceania on four major routes from almost 200 billion in 2014 to over 490 billion by 2034 (Boeing 2015).

Rising outbound tourism in the People's Republic of China

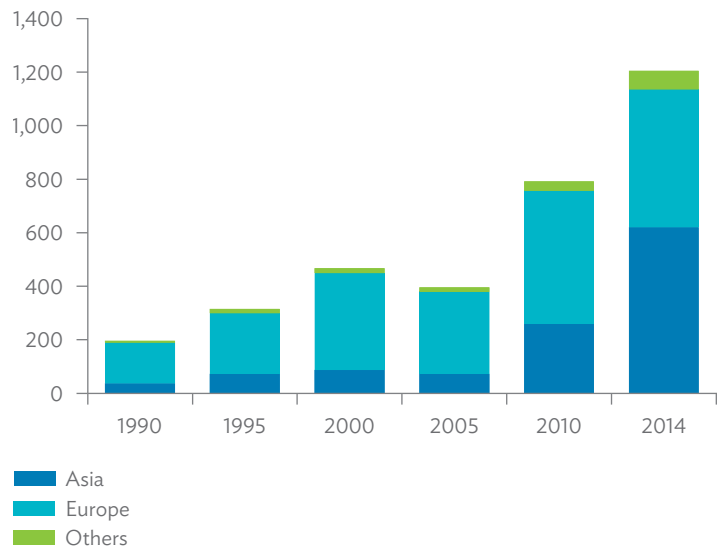
However, there are some significant movements in structure, with Asian source markets increasing their share in total visitor arrivals in many destinations.

The China National Tourism Authority projects that outbound international trips from the People's Republic of China (PRC) will increase from about 100 million in 2014 to 500 million by 2020 (Zheng 2014). A more conservative forecast suggests this figure will be closer to 200 million (Economist 2014), which would represent a doubling of travel propensity—or the ratio of international trips to total population—from the PRC. In either case, outbound Chinese tourism will have a major impact on destinations across the globe.

Travelers from the PRC spent \$3.7 billion abroad—excluding international transport—in 1995. By 2010, expenditure had risen to \$54.9 billion, and by 2014 had grown to \$164.9 billion. Since 2012, the PRC has ranked first in the world in terms of expenditure by its international travelers (UNWTO 2015).

The case of the Maldives illustrates how a foreign inbound market mix can change quickly (Figure 2). In 1990, Europeans dominated tourist arrivals, but by 2014 Asians accounted for over half of arrivals.

Figure 2: Foreign arrivals into the Maldives, by origin ('000)



Source: Maldives Ministry of Tourism, Arts & Culture.

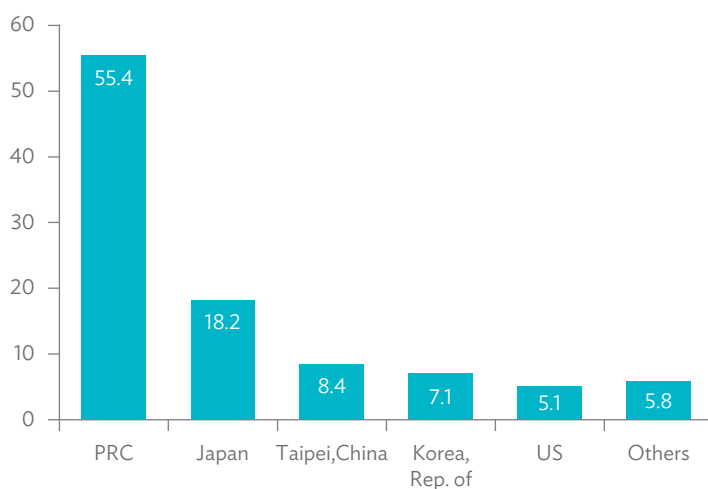
The increase in travelers from Asia to the Maldives is also reflected in other metrics. For example, average duration of stay in resorts and hotels was 8.8 days in 1998, but had dropped to 6.1 days by 2013 (Maldives Ministry of Tourism 2014). This could partly be explained by workers from Asia having fewer vacation entitlements than their western counterparts.

The reduction in average length of stay may be either offset by increased expenditure, or exacerbated by an associated drop in expenditure patterns. In any case, this highlights the need for a multidimensional perspective covering a wide variety of tourism indicators not limited to numbers, length of stay, and expenditures.

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There are also changes in the mix of tourists from Asia. For example, Palau, which has traditionally had a strong mix of Asian visitors among its total arrivals—71% of total visitors in 1998 to 87% in 2014—has seen a significant shift within the Asian source markets. In 1998, Japan and Taipei,China dominated the Asian inbound mix with relative shares of 48% and 42%, respectively, while the PRC (including Hong Kong, China and Macau, China) accounted for less than 2%. These shares held steady until 2012, when the PRC exceeded 4% of Asian arrivals. In 2013, the PRC accounted for a 10.7% share and in 2014, a 32.0% share of Asian arrivals—surpassing both Japan (30.9%) and Taipei,China (24.4%).

Figure 3: Foreign arrivals into Palau, by origin
(% share, January–September 2015)



PRC = People's Republic of China, US = United States.
Source: South Pacific Tourism Organisation, 2015.

The rapid expansion in arrivals from the PRC continues. Palau reported almost 70,000 arrivals from the PRC in January to September 2015. This translated to 62% of arrivals from Asia, and 55% of all foreign arrivals for that period.

The ratio of visitors to the resident population in Palau was about 6:1 in the first 9 months of 2015. This has exerted pressure on the supply of water and energy, and strained waste treatment and basic carrying capacity. Clearly, as elsewhere in the Pacific, tourism management is a fundamental issue.

The current wave of growth in travelers from the PRC and the rest of Asia is not expected to diminish any time soon, given a ballooning middle-income population and corresponding rises in disposable incomes (World Economic Forum 2013). Further, Boeing (2015) projects that Asia will add 100 million new air travelers every year.

Not only does the “hardware” for hosting larger numbers of tourists (e.g., public infrastructure and private investments) need to be in place, but also the “software” (e.g., trained tourism professionals). In combination, these would ensure delivery of a superior tourism

experience to both foreign and domestic visitors. Tourism management is particularly important in the Pacific, where the impacts of rapid tourism growth are more readily evident because of the relatively small size of their populations, land areas, and economies.

Trends in the Pacific

Foreign arrivals to Pacific destinations reached a total of 3.5 million in 2014 and are projected to increase by 10.2% this year (Table 1). These are seen to grow further by 6% to 7% per annum through 2019, leading to increased GDP growth particularly in economies that are heavily dependent on tourism. These include the Cook Islands (where the tourism receipts-to-GDP ratio is about 60%), Palau (54%), Vanuatu (36%), and Fiji (20%).

Visitor arrivals could be further increased by reducing constraints through liberalizing visa requirements, simplifying customs and immigration procedures, and expanding air links. However, in a number of economies growth in visitor arrivals must be balanced against considerations of limited carrying capacity. The economic benefit of increased visitor arrivals could be raised through various measures, including strengthening domestic value-addition (these and other measures as applied in Southeast Asia are discussed in pp. 28–31).

Within the Pacific, Micronesia (Guam, Commonwealth of the Northern Mariana Islands, and Palau) is showing the strongest performance so far in 2015, and is seen to record 11.6% growth in international visitor arrivals. Foreign arrivals in Melanesia (Fiji, New Caledonia, Papua New Guinea, and Vanuatu) and Polynesia (the Cook Islands, French Polynesia, and Samoa) are also expected to perform well. Even when considering a longer period, Micronesia remains the strongest performer with annual average growth in foreign arrivals at 5.6% between 2011 and 2015.

Micronesia

Medium-term projections indicate that Micronesian destinations will continue to lead growth in international visitor arrivals in 2016–2019. The recent boom in demand for tourism to Palau is seen to continue, but actual growth in arrivals may be limited by capacity constraints that are already becoming apparent. Arrivals from Asia are expected to maintain dominance of the source market mix, with the rapid rise in visitor numbers from the PRC pushing Asia's share from 87% in 2014 to 95% by 2019.

Data limitations preclude projections of visitor arrivals growth in other economies, but some destinations such as the Federated States of Micronesia could increase their tourism market share with adequate reforms and investments in coming years.

Melanesia

Prior to 2014, Melanesia saw only marginal growth in international visitors. In 2015, the number of international arrivals in Melanesia is expected to increase by 9.0%, building on last year's solid growth.

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Table 1: Foreign arrivals in Pacific destinations ('000)

	2010	2011	2012	2013	2014	2015p	2016p	2017p	2018p	2019p
Melanesia	975	1,044	1,045	1,046	1,085	1,182	1,239	1,289	1,337	1,382
Fiji	632	675	661	658	693	764	796	826	853	879
Papua New Guinea	99	112	112	108	107	106	109	109	110	110
<i>New Caledonia</i>	<i>147</i>	<i>163</i>	<i>164</i>	<i>171</i>	<i>176</i>	<i>203</i>	<i>221</i>	<i>239</i>	<i>257</i>	<i>275</i>
Vanuatu	97	94	108	110	109	110	113	115	117	118
Micronesia	1,662	1,610	1,803	1,878	1,939	2,163	2,308	2,477	2,649	2,818
<i>CNMI</i>	<i>379</i>	<i>341</i>	<i>401</i>	<i>439</i>	<i>460</i>	<i>486</i>	<i>536</i>	<i>578</i>	<i>614</i>	<i>642</i>
<i>Guam</i>	<i>1,197</i>	<i>1,160</i>	<i>1,283</i>	<i>1,334</i>	<i>1,339</i>	<i>1,501</i>	<i>1,558</i>	<i>1,616</i>	<i>1,675</i>	<i>1,734</i>
Palau	86	109	119	105	141	176	214	283	360	441
Polynesia	388	403	425	410	433	466	479	491	502	512
Cook Islands	104	113	122	121	121	129	133	137	141	145
<i>French Polynesia</i>	<i>154</i>	<i>163</i>	<i>169</i>	<i>164</i>	<i>181</i>	<i>185</i>	<i>188</i>	<i>191</i>	<i>194</i>	<i>197</i>
Samoa	130	128	135	124	131	152	158	162	167	171
PACIFIC	3,024	3,057	3,273	3,334	3,457	3,811	4,026	4,257	4,488	4,713
% change	...	1.1	7.1	1.8	3.7	10.2	5.6	5.7	5.4	5.0
ADB Pacific DMCs	1,147	1,231	1,256	1,226	1,302	1,436	1,523	1,632	1,748	1,865
% change	...	7.3	2.1	-2.4	6.2	10.3	6.0	7.2	7.1	6.7

... = data not available, Melanesia = Fiji, New Caledonia, Papua New Guinea, and Vanuatu; Micronesia = Guam, Commonwealth of the Northern Mariana Islands, and Palau; Polynesia = Cook Islands, French Polynesia, and Samoa.

Note: Countries in *italics* are not ADB Pacific developing member countries (DMCs).

Source: Pacific Asia Tourism Association.

International arrivals are seen to exceed 1.1 million foreign arrivals in total, mostly to Fiji (65%).

Tourism in Fiji has been regaining strength recently, benefiting from at least some temporary destination switching away from disaster-hit Vanuatu. Growth in foreign arrivals had been slowing in Vanuatu even before Cyclone Pam struck in March 2015, and tourist numbers declined sharply thereafter. A similar, although reverse, substitution between Fiji and Vanuatu was observed during severe flooding in Fiji in 2009 and 2012. Visitor arrivals growth in Fiji exceeded 9% in the first 9 months of 2015.

In contrast to Micronesia, arrivals from Asia only comprise a small market share in Melanesia. Foreign arrivals into Melanesia have shown little change in source markets, mainly from Australia and New Zealand. Over the medium term, travelers from Oceania are still expected to account for almost 80% total foreign arrivals into Melanesia.

According to forecasts of tourism demand by the Pacific Asia Travel Association (PATA), foreign arrivals in Fiji will likely continue to grow at solid rates through 2019. Arrivals growth in Fiji is projected to average 3.6%, second only to New Caledonia. Slower growth averaging less than 2% between 2016 and 2019 is projected for international arrivals in PNG and Vanuatu.

Polynesia

Arrivals in Polynesia (the Cook Islands, French Polynesia, and Samoa) showed a 7.5% growth for 2015. Medium-term, annual average growth from 2016 to 2019 may reach 2.4%.

Asia remains an even smaller market for Polynesia, comprising less than 6% of total international arrivals. This is not expected to increase by any significant amount over the next few years to 2019, primarily due to distance and limited air links between Asia and these destinations. Oceania and Pacific source markets, in contrast, are expected to maintain their majority share in total visitor arrivals,

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rising slightly to 59% by 2019 (PATA 2015). The Cook Islands and Samoa are seen to record growth at annual average rates of about 3% through 2019.

Constraints and opportunities

Island nations generally are heavily reliant on air connectivity and that to a large degree dictates the possible volume of foreign arrivals. The growth of international flights into the Pacific was unsteady between 2012 and 2015. There are 48,215 scheduled international flights into the region in 2015 (Table 2). Micronesia captures 45% of these flights, followed by Melanesia and Polynesia.

However, total available inbound seats are lower in 2015 than in 2012 and 2013. There was a marginal increase of around 1% relative to 2014. The loss of seat capacity has been on flights to Micronesia.

Other aviation issues relate to flight frequency and average aircraft size. Average seats per scheduled international inbound flight are generally diminishing, which suggests that some operators may have moved to smaller aircraft but offer more frequent flights. That is certainly an issue worth exploring as it relates to airport structure and the capacity of some airports to handle bigger aircraft.

Regional differences certainly need to be taken into account.

Another constraint relates to visa requirements for entry into Pacific destinations. The Cook Islands and Niue scored a maximum 100 on the UNWTO visa openness table. The Federated States of Micronesia also nominally scored 100, but most visitors would have to comply with strict US customs and immigration regulations while transiting through either Hawaii or Guam.

Fiji scored 78, followed by Vanuatu with a score of 75. The rest of the Pacific destinations could benefit from reviewing their visa requirements. In many cases, this is already being done. For example, Tonga has introduced 64 improvements to the visa policy process between 2010 and 2014.

Experiences elsewhere in the world show that the results of such improvements have been swift and significant. Japan recently lifted or eased visa requirements for a number of Asian markets. In 2013, visitors from Thailand were granted visa-free entry for 15 days, albeit still subject to standard customs and security regulations. The resulting rise in Thai visitors to Japan was immediate and has sustained its momentum.

Across Asia and the Pacific, India, Indonesia, and Thailand have already initiated positive changes to their visa policies.

Policy reforms and investments

Apart from issues dealing with visas, there are a number of areas that need to be addressed for responsible and sustainable tourism development. A number of immediate improvements, many of them requiring significant investment in infrastructure and training, can be considered.

Table 2: Foreign arrivals in Pacific destinations ('000)

Destination	2015		
	Flights	Seats	Seats/Flight
Melanesia			
Fiji	7,019	1,220,217	174
<i>New Caledonia</i>	1,900	345,582	182
Papua New Guinea	3,466	466,014	134
Solomon Islands	980	140,505	143
Vanuatu	1,691	232,852	138
Micronesia			
<i>Guam</i>	13,057	2,167,264	166
Kiribati	370	52,514	142
Marshall Islands	936	151,394	162
FSM	1,122	171,118	153
Nauru	338	47,715	141
<i>CNMI</i>	4,788	756,682	158
Palau	1,135	178,042	157
Polynesia			
<i>American Samoa</i>	3,289	89,056	27
Cook Islands	774	161,581	209
<i>French Polynesia</i>	1,759	477,763	272
<i>Niue</i>	85	14,535	171
Samoa	4,445	253,301	57
Tonga	815	117,627	144
<i>Wallis and Futuna Islands</i>	246	39,120	159
Total	48,215	7,082,882	147

FSM = Federated States of Micronesia, CNMI = Commonwealth of Northern Mariana Islands.

Note: Countries in *italics* are not ADB Pacific developing member countries (DMCs).

Source: Pacific Asia Tourism Association.

Are Pacific destinations adequately prepared to receive significantly higher visitor numbers? This includes determining if destination attributes are of sufficiently high quality in terms of both physical product and service ethos. Perhaps more significantly, are there methods for balancing mass market and niche tourism together, or is one favored over another?

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There are a number of strategies that can be initiated in either case, including sustaining growth in arrivals, reducing seasonality through product development and marketing, and encouraging visitors to spend more by lengthening their stay and/or exploring more local attractions.

Can accommodation capacity and the environment deal with the current and forthcoming demand? The impacts of increased tourism include higher demands on public goods, and it is essential to identify current and impending bottlenecks to efficiently manage tourist flows.

Are existing metrics adequate to measure tourism performance? All destinations would benefit by expanding and refining the metrics used to currently assess benefits from tourism. This should go beyond a simple headcount of arrivals.

Visitor metrics also need to be measured against other indicators, e.g., the number of small and medium-sized enterprises, employment in the tourism sector, private investment, and local tax revenues derived from tourism.

The findings from more refined data could be shared with the industry to guide the private sector's marketing strategies. Further, appropriate metrics can help determine whether tourism is benefiting local households and firms.

How can locals benefit from tourism? Ensuring the welfare of locals is just as important as the satisfaction of visitors. Striking a balance between the two is the ultimate target of a responsible and sustainable tourism sector strategy. Encouraging tourism facilities to maximize their employment of local labor and inputs would accelerate community development. This, however, would require parallel interventions to raise the capacities of local suppliers to meet quantity and quality standards that would be demanded by an influx of foreign visitors (see Jamieson, Goodwin, and Edmonds 2004).

Lead author: John Koldowski, advisor, Strategic Intelligence Centre, Pacific Asia Travel Association (PATA) and head, Service Innovation and Development Unit, College of Innovation, Thammasat University; with contributions from the *Pacific Economic Monitor* team in Manila.

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The determinants of visitor arrivals in the Pacific: A gravity model analysis

International tourist arrivals in 2014 reached about 1.14 billion worldwide, up by 4.7% from 2013. Of this, the Pacific received a 5.9% share. Tourist arrivals are forecast to grow by 5% in 2015—equivalent to an additional 547,000 international visitors (Pacific Asia Travel Association 2015). About 3% of these additional trips, or roughly 16,500 additional international arrivals, are forecast for Pacific destinations. This growth is seen to continue in the long run.

Tourism represents a dominant economic sector for a few Pacific countries (e.g., the Cook Islands and Palau), and the list of countries with the highest ratios of tourism receipts to GDP includes Vanuatu, Samoa, and Fiji (Culiuc 2014). Given the importance of tourism to many Pacific economies, it is useful to try to assess the factors driving visitor flows. In a number of recent journal articles, the gravity model, a commonly used analytical approach applied in empirical studies of trade flows, has been adapted to study visitor arrival flows. This brief offers an initial examination of tourism flows to selected Pacific ADB developing member countries, using an adapted version of a simple gravity model based on the estimation approach of Anderson and Wincoop (2004). It begins with an overview of the estimation model used to assess drivers of visitor flows into the Pacific. It then discusses the data used in the analysis, and concludes with a discussion of the estimation results and their implications.

Estimation model and data analyzed

This exploratory analysis considers visitor arrivals to selected Pacific DMCs—namely, the Cook Islands, Fiji, the Republic of the Marshall Islands (RMI), the Federated States of Micronesia (FSM), Papua New Guinea (PNG), Palau, Samoa, Tonga, and Vanuatu—in

1990–2014. Visitors include tourists (both overnight and longer-stay visitors, and same-day visitors, i.e., cruise ship passengers), business travelers, and individuals visiting relatives. The database includes arrivals from the list of countries, divided by geographic region (see endnote). The study generated origin–destination country pairs, which represent the unit of analysis in the estimation model to analyze the factors accounting for changes in bilateral inbound visitor arrivals to the selected Pacific destinations.

Table 1 summarizes the data on annual visitor arrivals across the Pacific DMCs studied, and shows a clear rise in average annual visitor arrivals over time. From 1990 to 2014, arrivals to the Cook Islands, Fiji, Samoa, and Tonga grew at average annual rates of 4%–6%, while those to Palau, PNG, and Vanuatu averaged growth of over 6% a year. The sharp increase in visitors to Vanuatu is notable, as strong growth in cruise ship arrivals accounted for much of the increase and represented about 70% of total visitor arrivals to the country.

Applying a gravity model suggests that visitor arrivals between country of origin and destination country are positively related to the size of their economies, and inversely related to the distance between them (Morley et al. 2014). Size is measured by the levels of economic activity in the two countries (Anderson 2011). To also account for the role of population size in driving economic exchanges between the two countries, which is particularly important in the case of visitor flows, GDP is considered in per capita terms. As in the law of gravity, the other key factor driving the force of attraction between two countries is the distance between them. Greater distance suggests higher travel cost between the countries, which should discourage visitor arrivals. The gravity

Table 1: International visitor arrivals by destination (1990–2014)

Destination	Visitor arrivals			Population		Tourism receipts (% of GDP), 2014		
	Annual average 1990–2000 (A)	Annual average 2001–2014 (B)	(B) / (A)	Min ('000)	Max ('000)		1990 ('000)	2014 ('000)
Cook Islands	50.9	97.5	1.9	34.2	121.6	17.0	18.6	59.9
FSM*	23.3	25.7	1.1	13.4	43.2	98.1	103.6	10.4
Fiji	319.6	554.2	1.7	259.4	692.6	737	866	19.7
Papua New Guinea	51.7	109.6	2.1	33.6	176.5	3,690	7,600	...
Palau*	58.7	87.6	1.5	54.1	140.8	15.1	17.7	53.8
RMI	5.5	6.0	1.1	4.6	9.0	44.5	53.8	6.4
Samoa	63.6	114.7	1.8	37.5	134.6	160.3	192.1	17.5
Tonga	26.8	40.3	1.5	20.9	50.4	96.4	103.8	10.0
Vanuatu*	91.4	197.0	2.2	77.2	352.8	147.3	271.1	36.4

... = not available, FSM = Federated States of Micronesia, RMI = Republic of the Marshall Islands.

Note: The database records cruise ship arrivals only for Vanuatu without information on country of origin. Accordingly, cruise ship arrivals are excluded from the analysis.

* Data for FSM begins in 1997, Palau in 1998, and Vanuatu in 1993.

Source: Pacific Asia Travel Association.

The determinants of visitor arrivals in the Pacific

model also includes characteristics of the destination country that are expected to influence visitor inflows, such as GDP per capita, land area, shared language, and colonial history, airline connectivity, disruptive events (e.g., cyclones), and major regional events. See endnote for technical details on the estimated equation.

Estimation results

The regression results reveal that the GDP per capita of a destination country does not significantly influence visitor flows, but GDP per capita of a country of origin has a significant positive effect on visitor flows (Table 2). Consistent with the literature, higher average incomes in source markets for tourists to Pacific destinations increase the likelihood of more tourist arrivals. Visitor flows are not as sensitive as merchandise trade to changes in GDP per capita of the country of origin (Culiuc 2014).

Findings also show that greater distance tends to inhibit visitor flows, presumably because farther destinations are correlated with higher travel costs, and increase the likelihood that travelers would forgo visiting a Pacific destination in favor of competing destinations closer to home. Further, the results suggest that in difficult economic times, Australia and New Zealand travelers—who comprise the majority of visitors to the South Pacific—may increase visits to these destinations as an alternative to more expensive destinations.

Land area has a positive impact on visitor flows, suggesting that larger land area may expand the variety of activities available to tourists. Origin countries sharing colonial ties with Pacific

destinations had significantly more visitors to those destinations than countries without shared history, but common language had only a slightly significant effect (Chen et al. 2014, Culiuc 2014). A common cultural heritage, shared institutional framework, as well as past commercial, family, or official ties, could positively influence levels of travel to the Pacific. It may also reflect the continued relevance of international groupings, e.g., the British Commonwealth, in driving visitor flows, such as through visa liberalization for travelers from member countries. The positive effect of shared colonial ties illustrates the way in which market interactions expand and intensify over time. The fact that history affects current visitor flows, by extension, may justify special short-term measures to develop new markets for visitors in the hope that these would grow over time.

Other variables have mixed results on visitor flows: (i) flight availability, which implies stronger competition among airlines and cheaper fares, has a positive effect; (ii) one-time events in the destination country have no significant impacts; (iii) a common language between the countries of origin and destination has little impact; and (iv) severe cyclones (category two or higher) in a Pacific destination tend not to impact significantly, likely because falls in visitor arrivals are not large enough to significantly affect annual data.

Implications of estimation results

The results yield important insights into the drivers and constraints to visitor inflows, which have important implications for Pacific countries trying to encourage more visitors.

Improving transport connectivity, especially the availability of flight options, lowers travel costs and entices more visitors. Stimulating demand for flights to the Pacific requires complementary efforts to improve the domestic infrastructure and the enabling environment for sustainable tourism in the region (ADB 2015).

The impact of strong historic ties between countries implies that efforts to develop new source markets can yield increasing visitor numbers over time, giving impetus for short-term measures to encourage visitors from countries outside the region.

This analysis used a fairly limited set of variables to explore the determinants of visitor flows into the Pacific, and many additional variables merit further study. Firstly, it would be useful to study the impact of the quality of public infrastructure and private facilities available to visitors. Common wisdom notes the importance of addressing capacity and infrastructure constraints in destination countries to meet higher demand from prospective visitors (World Travel & Tourism Council 2015). Secondly, because cruise ship arrivals to the Pacific have grown nearly fivefold since 2004, it would also be useful to explore the impact of port facilities. Thirdly, the role of ICT infrastructure in driving visitor flows could also be examined. Access to online booking systems and social media platforms highlighting various sites and activities available in a country of destination appear to be vital in present-day efforts to promote and develop tourism services (ADB and ADBI 2015).

Table 2: Maximum likelihood random-effects panel regression results

Variables	1	2	3	4
constant	7.3226***	6.2663***	6.0282***	6.0804***
log(GDP/popn_ destination)	0.0588	0.0746	0.0681	0.0645
log(GDP/popn_ origin)	0.7621***	0.7276***	0.7030***	0.6929***
log(distance)	-1.1648***	-1.0669***	-1.0740***	-1.1845***
log(land area)	0.2650***	0.2707***	0.2627***	0.3538***
colonial ties		1.2878***	1.2477***	1.2989***
common language		0.3882	0.5037*	0.5054
number of airlines			0.1382***	
≥3 airlines (dummy)				1.4250***
hosted events (dummy)			-0.0401	-0.0411
cyclones			-0.0284	-0.0312
Number observations	2,187	2,187	2,187	2,187
R ²	0.29	0.37	0.44	0.50
Wald chi ²	184.47***	201.33***	223.46***	234.65***

* p<0.05, ** p<0.01, *** p<0.001.

Source: Authors' estimates.

The determinants of visitor arrivals in the Pacific

Endnotes:

The estimated gravity equation is $\log(\text{visitor arrivals})_{ijt} = \alpha_0 + \beta_1 \text{GDP/popn}_{jt} + \beta_2 \text{GDP/popn}_{it} + \beta_3 D_{ij} + \beta_4 X_j + \beta_5 X_{jt} + \varepsilon_{ijt}$

GDP/popn_{jt} serves as a proxy for the variety of products in country j (Chen et al. 2014), and is derived from each country's real GDP at constant 2005 US dollars and the midyear population, and allows the model to measure the income elasticity of visitor inflows to the Pacific. D_{ij} refers to geographic distance and serves as proxy for the cost of travel from country i to country j . Head and Mayer (2002) provide detailed information on the methodology used to calculate geographic distance.

The estimation model also includes vectors of the host country's time-invariant (X_j) and time-varying (X_{jt}) characteristics expected to influence visitor inflows. Time-invariant characteristics of the destination country j (X_j) considered are land area, shared language, and common colonial history. Additional time-varying characteristics of country (X_{jt}) considered in the model measure connectivity (flight availability), disruptive events (e.g., cyclones), and instances of countries hosting major regional games.

There is considerable room to add other variables of interest to the estimation equation. Similarly, more precise measures of travel cost, supply of tourism facilities, infrastructure quality, and ease of doing business—particularly ease of entry and exit—are other factors that would be worthwhile to assess in a gravity model. These are left for future research efforts due to time constraints in the initial analysis being presented in this brief. Refinements to the estimation approach are also available to address endogeneity in the model, but results from this introductory analysis are nonetheless illustrative.

Economies included in the dataset: American Samoa; Australia; Austria; Bangladesh; Belgium; Canada; Chile; the People's Republic of China; Cook Islands; Denmark; Fiji; Finland; France; French Polynesia; Germany; Guam; Hong Kong, China; India; Indonesia; Israel; Italy; Japan; Kiribati; The Netherlands; Malaysia; Federated States of Micronesia; Nauru; Nepal; New Caledonia; New Zealand; Northern Mariana Islands; Norway; Pakistan; Palau; Papua New Guinea; the Philippines; the Republic of Korea; the Russian Federation; Samoa; Singapore; Slovenia; Solomon Islands; South Africa; Spain; Sri Lanka; Sweden; Switzerland; Taipei, China; Thailand; Tuvalu; the United Kingdom; the United States; Vanuatu; and Viet Nam.

Lead authors: Christopher Edmonds and Bing Radoc.

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Hosting major Pacific events: Boon or bane?

Hosting of events, such as international or regional conventions, conferences, or sporting competitions, is advocated as a tourism promotion mechanism by showcasing countries' attractions to the international market. This is also seen as prompting investment in public facilities, and stimulating demand for private enterprises' goods and services. Countries often spend heavily on events and incur significant debt in pursuit of strengthened regional ties, goodwill between neighboring countries, and international cooperation.

For most countries—especially those with smaller, less developed economies—hosting an event requires investments in new venues (e.g., stadiums, convention halls, and hotels), roads, airports, and other public infrastructure. In addition, expenditures are required for security, transportation, communications, and other needs of participants. The general public bears some of the costs, in the form of higher prices during events, displacement of local residents, crowding out of regular tourists and businesspeople, congestion, and productivity losses due to closures of schools, government offices, and even private sector facilities.

While most costs are easy to quantify, the benefits of event hosting are generally more difficult to measure. What is readily quantifiable is the additional spending by tourists on accommodation and food. The pay-off from new investments and tourism flows may not be immediately seen. Some benefits, such as enhanced confidence, solidarity, and sense of community, are largely non-monetary. Benefits to events tend to be bigger if they attract large numbers of spectators.

A simple framework is useful in assessing the net economic benefits of hosting large events. This would help policy makers understand how events-related investments can be mobilized, financed, and harnessed to generate net benefits over time.

International experience

The main direct economic impact of hosting events centers on increased demand for construction, transportation and communication, and tourism-related services (e.g., food and retail sales). Before the event, construction of facilities and stadiums tends to boost the construction and transportation and communication sectors. During the event, tourism-related services (hotels and restaurants), transportation, and communication benefit from additional demand from participants and spectators. After the event, significant drops in construction and tourism activity are expected.

The Olympics has been extensively analyzed, and studies suggest that hosting the Olympics has a minimal impact on the overall level of economic activity in the host country. Preuss (2004) found that among Olympic organizing committees for games held from 1972 to 2000, only Los Angeles in 1984 and Seoul in 1988 generated some financial surplus (Table 1). Further, a survey by PricewaterhouseCoopers (2004) found that host cities derived direct benefits equivalent to no more than 3% of local GDP during Olympic Games held from 1984 to 2000. Zimbalist (2012) suggests that only host cities with sufficient existing sporting venues, accommodations, and transport infrastructure are likely to turn a profit. The Olympic Games in Los Angeles in 1984, and seemingly London in 2012, are the most illustrative cases.

There is also little evidence that hosting large events raises tourist arrivals or attracts new investment. For example, Beijing and London reportedly each attracted fewer visitors when they hosted the summer Olympics than during the comparable period in the previous year (Economist 2015).

The cost of new facilities tends to significantly outweigh the resulting benefits. The construction of costly venues often results in higher public debt that must be serviced for years, and higher

Table 1: Financial balance of Olympic organizing committees (\$ million PPP, 1995 prices)

Host/year	Investment costs (estimated)	Operational costs	Revenues	Balance, excluding investments	Overall balance
Munich 1972	1,231	546	1,090	544	-687
Montreal 1976	1,765	399	936	537	-1,228
Los Angeles 1984	321	467	1,123	656	335
Seoul 1988	251	512	1,319	807	556
Barcelona 1992	236	1,611	1,850	239	3
Atlanta 1996	484	1,202	1,686	484	0
Sydney 2000	239	1,700	1,900	239	0

PPP = purchasing power parity.

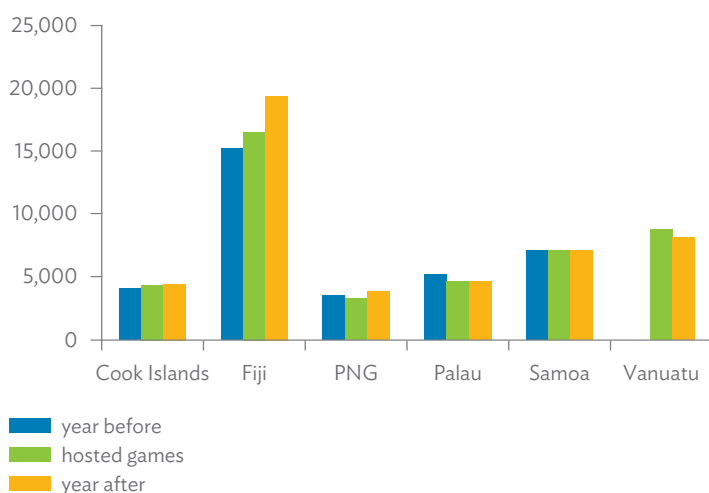
Source: ADB calculations using data from H. Preuss, 2004. *The Economics of Staging the Olympics: A Comparison of the Games 1972–2008*. Edward Elgar: London.

Hosting major Pacific events

government outlays to operate and maintain venues following the event. Or, as is frequently seen, the lack of use of these facilities after the event and their rapid deterioration commonly turns them into “white elephants”. This places heavy fiscal pressures on small economies with limited revenues. Hosting the Athens 2004 Olympics cost an estimated \$11.2 billion—twice the original budget and equivalent to 4.7% of Greece’s GDP during that year (Karamichas 2012). This increased debt and saddled the country with the burden of maintaining facilities that were left unused or underutilized after the games.

Further, due to the often rushed nature of building new venues and facilities, there is a tendency to rely on imported construction materials and skilled workers from abroad. This limits the stimulus to the local economy.

Figure 1: Visitor arrivals in the year of hosting the Pacific (Mini) Games



PNG = Papua New Guinea.

Note: Years of hosting are as follows: Cook Islands (2009), Fiji (2003), Palau (2005), PNG (1991), Samoa (2007), and Vanuatu (1993).

Source: Pacific Asia Tourism Association.

Applying the same analysis to the Pacific is difficult due to a lack of detailed data on investment, expenditures, and receipts (including grants) by the government and the private sector before, during, and after events. Extensive data on tourism, including length of stay, average spending, and country of origin, is typically not available. Annual data on visitor arrivals may seem inconclusive (Figure 1). For instance, the increase in arrivals during Fiji’s hosting of the 2003 Pacific Games may be part of a general trend of rising arrivals as it continued even after the event.

Policy implications

Evidence from hosting large events suggests that the net impact on the economy tends to be limited, as the costs—for construction and security, in particular—are often higher than expected while benefits frequently fall short. In the context of small economies with limited

facilities and capacity, hosting large events strains public utilities and other basic services.

In terms of benefits, events often fail to attract many nonlocal spectators. Facilities developed for big events in the Pacific are also usually not well suited for frequent use after the event. Increasing the global visibility of the destination does not appear to lead to significant increases in visitors following events. The stimulus from hosting on local businesses also tends to be limited.

International experience suggests that countries need to carefully consider fiscal priorities, and weigh the overall costs and benefits, when considering whether to host a major event. Economies where appropriate facilities and supporting infrastructure are already present are more likely to benefit from hosting such events. In contrast, economies with significant debt should approach prospects for hosting new events—and using events as a rationale for ramping up public capital spending—with caution.

Clearly, more complete accounting, and open reporting, of costs and benefits of hosting large events is needed, as a lack of consistent data hampers impact assessment efforts. Noneconomic reasons for hosting events—such as promotion of international ties—must be balanced with realistic expectations of direct and indirect economic impacts. Further studies could also explore opportunities to rationalize and better coordinate regional events.

Lead authors: Prince Cruz, Christopher Edmonds, and Rommel Rabanal.

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Tourism facilitation: What can the Pacific learn from Southeast Asia?

Visitor arrivals to the Pacific, especially from the People's Republic of China (PRC), are forecast to rise considerably both in absolute and relative terms over the medium term (see pp. 18–22). Connectivity (e.g., availability of flights, ease of entry) was found to be an important determinant of visitor flows to the region (see pp. 23–25).

Although there are significant differences between the Association of Southeast Asian Nations (ASEAN) and the Pacific—for example, distances are not as great between ASEAN countries—there have historically been major impediments to movement of individuals within the region (e.g., visa restrictions). The development of a regional ASEAN tourism strategy and the elimination of a number of these impediments in recent years offers important lessons for the development of the sector in the Pacific and the formulation of supporting government policies.

Traditionally, most ASEAN countries focused on increasing visitor numbers, without much concern for the social, cultural, and economic consequences. However, using international arrivals as the basis of measuring performance, and for guiding planning and policy development, is problematic. Most experts now agree that rising tourism does not necessarily serve national goals and objectives, and responsible and sustainable tourism is now being adopted as a development goal in the region. This is especially true in areas with historic sites (e.g., Angkor Wat in Cambodia).

The need for responsible and sustainable tourism is even more important for the Pacific's small and fragile island environments. An appropriate tourism development strategy can increase foreign exchange levels and job opportunities, alleviate poverty, ensure that women and minorities benefit from the activities of the tourism sector, and help improve a country's image.

Following this understanding, this briefing note explores the ASEAN community's efforts in developing responsible and sustainable tourism policies, plans, and strategies. The paper then identifies lessons applicable to Pacific tourism development.

While commercial and industry groups may be able to absorb more visitors, the carrying capacity of the hard and soft public infrastructure, and the need to maintain quality standards in the face of constant calls for increased tourism, must be an ongoing concern. The ability of small island environments to scale up tourism while maintaining the visitor experience and addressing the needs and concerns of local communities must be paramount in planning and decision making. Island destinations must assess their ability to absorb increases in arrivals resulting from the growing middle class in Asia. Length of stay, consumer expectations, and spending patterns will require careful examination.

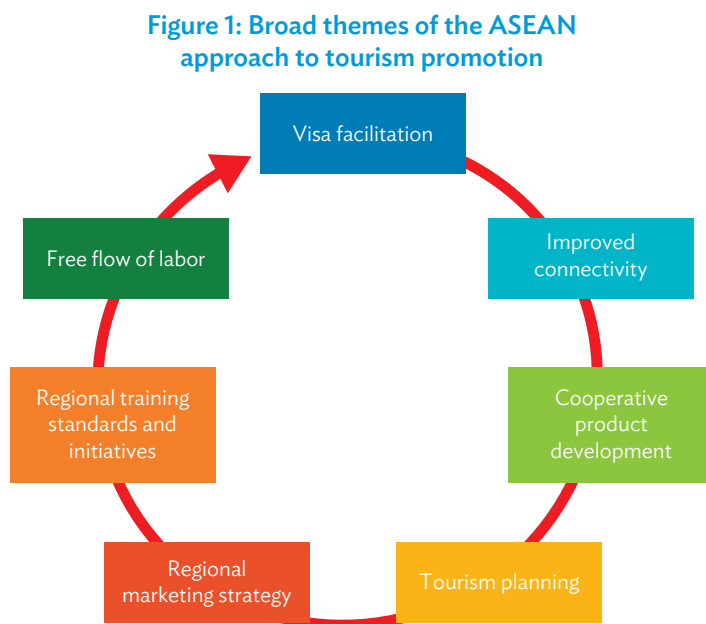
Tourism planners and policy makers are aware that while some dimensions of increasing arrival levels are within the purview of national governments, there are other areas of decision making that are not. For example, while governments can create an

enabling environment to facilitate air connectivity, airlines make the decisions about the allocation of resources. Planners must also bear in mind that tourism activity is determined by global events, as well as conditions in the host country, and changing economic conditions and geopolitical situations abroad can lead to rapid changes in visitor numbers, expectations, and interests.

Tourism planners must also understand that facilitation and improved connectivity efforts often depend on government departments and industry groups that may not fully understand tourism's potential as a tool for economic and regional development. Obtaining the full cooperation of stakeholders is a challenge for those involved in setting responsible goals and objectives for destinations.

Tourism facilitation in ASEAN

Although regional efforts to increase tourism within ASEAN have been modest compared with the resources that individual members allocate for national initiatives, there have been comprehensive approaches to increasing not only tourism numbers, but also the nature and quality of visitors (Figure 1). In addition, many of the countries in the region work together at the bilateral and subregional levels (e.g., the Greater Mekong Subregion).



Source: ASEAN. 2012. *ASEAN Tourism Marketing Strategy 2012–2015*. Jakarta.

There have been many tourism- and travel-related policies and plans, but these will be fully implemented only upon the official launch of the ASEAN Economic Community (AEC) in January 2016. It may take time for ASEAN to meet its overall objectives.

Tourism facilitation

While individual countries have implemented many of these approaches and strategies, ASEAN has considered tourism-related concerns within a much larger set of policy and political discussions.

Planning and coordination. The ASEAN Tourism Strategic Plan 2011–2015 covers a wide range of issues, including connectivity and facilitation, which are often the function of other subcommittees. The plan was an important regional initiative among the 10 member economies and their development partners (Jamieson and Jamieson 2012), and was built around the following guiding principles (i) integrated and structured tourism development, (ii) sustainable and responsible development, (iii) wide ranging stakeholder collaboration, (iv) quality tourism products, (v) service excellence, and (vi) distinctive and interactive experiences.

Strategic directions adopted in the plan as the pillars of policy development are: (i) product development, (ii) quality of services, and (iii) facilitation and connectivity.

Marketing and destination development. The ASEAN tourism marketing strategy was built around shared understanding about the need to develop regional products and experiences to market the region as a multination destination with a wide range of attractions (ASEAN 2012).

Based on market analysis and the need to identify regional experiences, the strategy focused on the six travel market segments: experiential, creative, adventure, extended or long stay, generic and mass, and business-related. Six themes were then developed to differentiate the ASEAN region: (i) Tastes of Southeast Asia, (ii) Tropical paradise, (iii) World-class cities, (iv) Diverse traditions and ways of life, (v) Sports and relaxation, and (vi) Contemporary creativity.

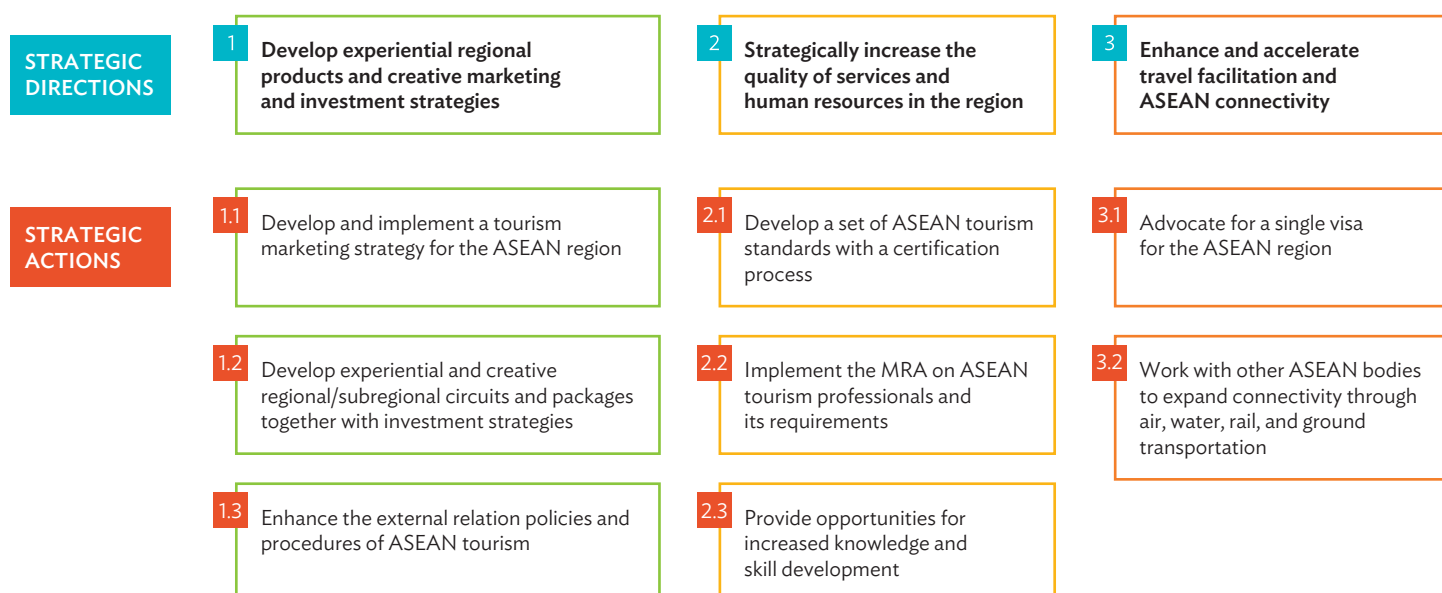
Enhancing connectivity and other facilitation measures. The Master Plan on ASEAN Connectivity comprises a three-prong strategy centered on improving physical (e.g., roads, airports), institutional (e.g., visa harmonization), and person-to-person linkages. It is supported by financial mechanisms and institutions (ASEAN Secretariat 2010). This plan establishes an important context for connectivity issues that are essential in creating a single social, cultural, and economic community. ASEAN, like the Pacific, is geographically dispersed and the plan seeks to address this disadvantage by engendering “a more cohesive, competitive, investment attractive, resilient and dynamic economic community.”

An important part of the plan is the ASEAN Single Aviation Market, which recognizes the importance of air transportation to global tourism. Although the emergence of low-cost carriers has increased travel opportunities, this can impose pressure on destinations with limited capacity to absorb increased tourists. The plan also calls for the Multilateral Agreement on Air Services and its various protocols and air transport agreements between the PRC, India, and the Republic of Korea.

Finally, the plan recognizes the importance of strengthening institutional capacity in order to implement and coordinate various policies, programs, and projects, and the role of subregional initiatives—e.g., the Greater Mekong Subregion, BIMP-EAGA (Brunei Darussalam–Indonesia–Malaysia–Philippines East ASEAN Growth Area), IMT-GT (Indonesia–Malaysia–Thailand Growth Triangle), and Heart of Borneo—in achieving these objectives.

The United Nations World Tourism Organization (UNWTO) identifies 164 instruments regarding facilitation and other related subjects, including tourism safety and security, travel documents, visas, transport, health, monetary and taxation issues, and free

Figure 2: Pillars of ASEAN tourism policy and action priorities



Tourism facilitation

movement of services (ASEAN 2002). This forms the basis for the facilitation strategies in the ASEAN Tourism Strategic Plan.

A joint study by the UNWTO and the World Travel and Tourism Council identified the percentage of growth attributable to visa facilitation and the contribution of visa liberalization to tourism industry competitiveness. It identifies opportunities in the following areas: information delivery, processes for obtaining a visa, treatment of different types of visitors, e-visa programs, and regional agreements (UNWTO/WTTC 2014).

There is now visa-free travel within ASEAN for citizens of member countries but full implementation of a single visa scheme, such as the Schengen Agreement in Europe, is likely some time away. Recognizing the need to continue to develop planning and coordination to facilitate tourism, ASEAN member countries are developing an updated regional tourism strategy for 2016–2025 scheduled for launch in January 2016.

Applying lessons to the Pacific

Important lessons for the Pacific economies from the ASEAN experience are that connectivity and visa facilitation are important in expanding tourism. Reducing transactions costs associated with tourism are likely to prove particularly beneficial in the Pacific where distances are large and transport costs correspondingly high. But the ASEAN example also makes it clear that the process of responsible tourism development extends well beyond increased numbers. A sustainable and responsible future for tourism can only be achieved with a comprehensive and integrated set of strategies and policies comprising (i) well-designed carrying capacities, (ii) integrated experience development, (iii) targeted marketing and establishing realistic arrival numbers, (iv) increased air capacity, and (v) visa facilitation.

Planning and coordination for sustainable tourism growth

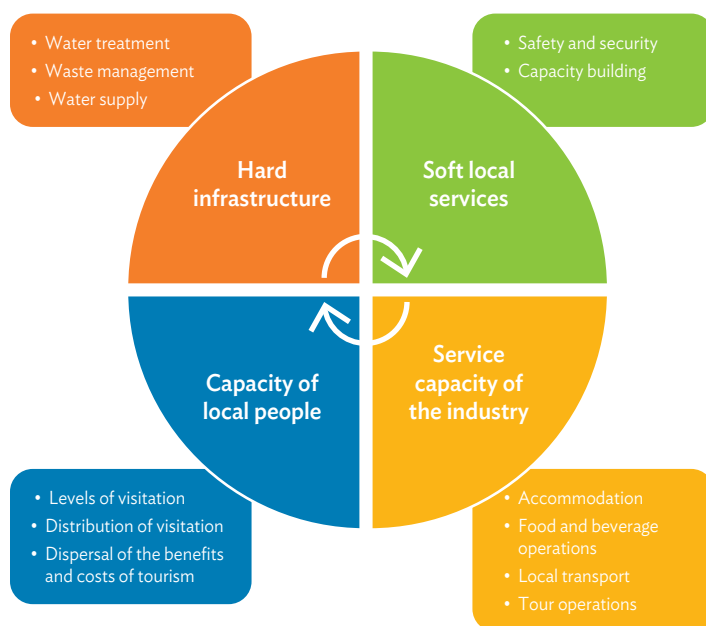
Carrying capacities. Although ASEAN countries may have the capacity to absorb large numbers of tourists, some major tourist attractions in the region are already experiencing difficulties related to the numbers of visitors. These include historic sites (e.g., Angkor Wat, Bagan, Borobudur), resorts (e.g., Boracay, Pattaya) and other ecologically sensitive areas (e.g., Tonle Sap). The Pacific economies, particularly island economies, have more limited capacity, and at certain times of year, especially in the peak seasons, overall systems may be operating at or above capacity. Nonetheless, the experience of ASEAN in addressing these issues is relevant to the Pacific.

As argued earlier in this brief, encouraging more visitors without regard to the pressures on social, cultural, and economic systems can be counterproductive. Any expansion of tourism must therefore be done within a well-defined set of plans and policies that deal with the ability of these economies to absorb more tourists. This requires a nuanced approach that looks at the distribution of arrivals over a year, the allocation of benefits and the impact on the poor, the increase in opportunities for women, the growth of small and medium-sized enterprises owned by local people, etc. These

factors, rather than international visitor arrivals, should constitute the key performance indicators for tourism development policies.

Capacity is not limited to number of rooms, food and beverage outlets, and tour operations. It also includes hard infrastructure, soft local services, the service capacity of the industry, and most importantly, the capacity of local people to absorb increased numbers of tourists (Figure 3).

Figure 3: Components of tourism carrying capacity



Source: ASEAN. 2012. *ASEAN Tourism Marketing Strategy 2012–2015*. Jakarta.

Regional approaches: As in the ASEAN context, there should be recognition of the importance of regional cooperation to cater to the tastes of sophisticated visitors looking for unique or unusual experiences. Developing regional opportunities for such tourists will help overcome connectivity issues related to distance and remoteness. It is incumbent upon Pacific island economies to move beyond the “sea, sun, and sand” syndrome if they are to ensure that tourism provides benefits to local communities without relying on increasing visitor numbers. ASEAN countries have developed targeted campaigns and product development strategies and programs for specific market segments. A promising area is experiential and creative tourism (ASEAN 2012).

Marketing and destination development: A targeted marketing strategy based on longer staying and higher spending may place less stress on island systems and achieve national social, economic, and cultural goals more efficaciously than one based on increased visitor numbers. Further, island destinations can develop regional strategies to take advantage of additional capacity at off-peak times by, for example, focusing on older travelers who tend to have flexible schedules.

Tourism facilitation

Enhancing connectivity and other facilitation measures

Increased air capacity: Although, there are numerous examples of, predominantly publicly-owned, airlines in the Pacific that have collapsed and of routes underwritten by governments there appears to be scope for reducing the fragility of air services. Possible ways of improving the viability of airlines include: (i) pooling resources, (ii) flight codesharing, (iii) developing regional air services offices to streamline security and aviation compliance, (iv) increasing foreign investments in tourism facilities, and (v) professionalizing commercial management of tourism facilities by facilitating entry of skilled people (e.g., Taumoepeau and Kissling 2008).

As discussed earlier, island nation states that can develop clear objectives and targets to inform their policymaking in relation to tourism will be in a better position to align their objectives with the capacities of airlines. In fact, an integrated approach with two or more countries working together may aggregate market power and enable them to make a stronger case for expanded service with the airlines.

Visa facilitation: Based on the ASEAN experience, it is evident that any country that does not facilitate the visa process will be less competitive and may not be able to attract the visitor segment that fits with its overall national goals. Visitors who want to enjoy more than one country require straightforward and consistent visa policies. Where necessary, e-visas together with integrated data systems can prevent problems with implementing visitor-friendly visa processes. Island nations could consider cooperating to facilitate the visa process for countries that require more scrutiny or more sophisticated processes.

Concluding remarks

Given the connectivity challenges faced by Pacific island nations, innovative and creative approaches should be adopted that consider strategies and policies described in this report. Coordination of government and private sector efforts related to innovative packaging and scheduling of tourism presents opportunities to begin to tailor flight schedules and experiences in order to meet the needs of well-targeted visitors. Island nations that focused primarily on visitor arrivals will not only be unable to achieve responsible tourism, but are also more susceptible to the whims of airline operators. Finally, issues of visas and air connectivity can be better addressed if a wider set of issues—including policies aimed at fostering innovation, creativity, and local engagement—are introduced into decision making related to tourism policy.

Lead author: Walter Jamieson, director, Service Information Program, College of Innovation, Thammasat University; with contributions from the *Pacific Economic Monitor* team in Manila.

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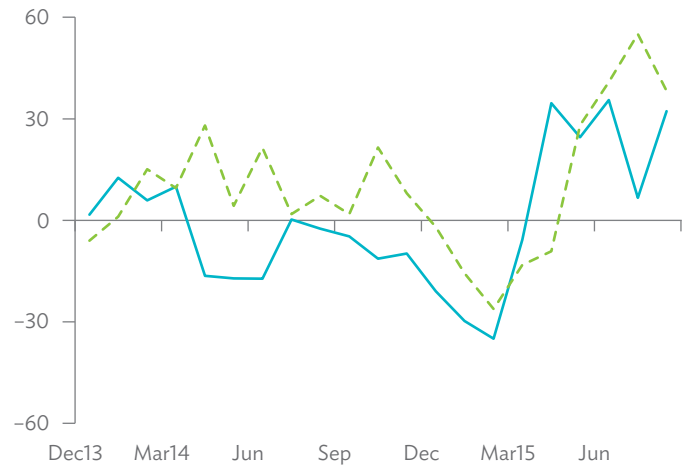
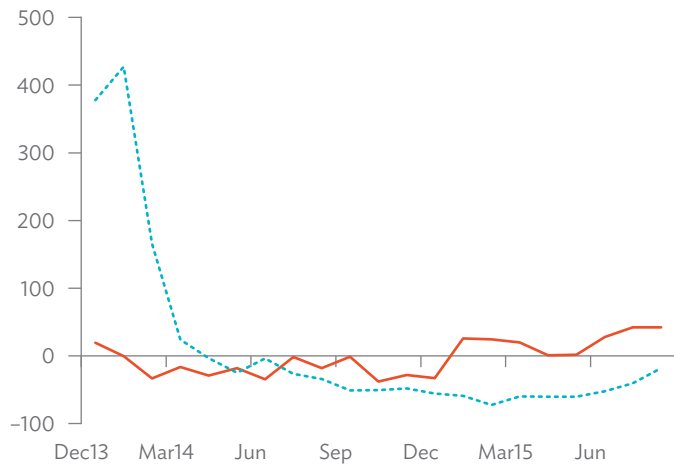
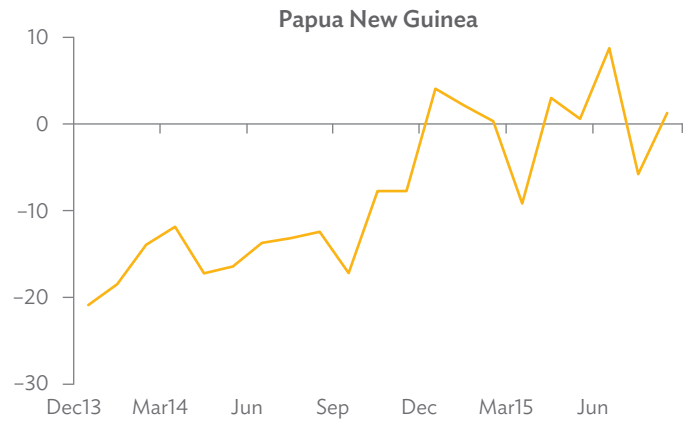
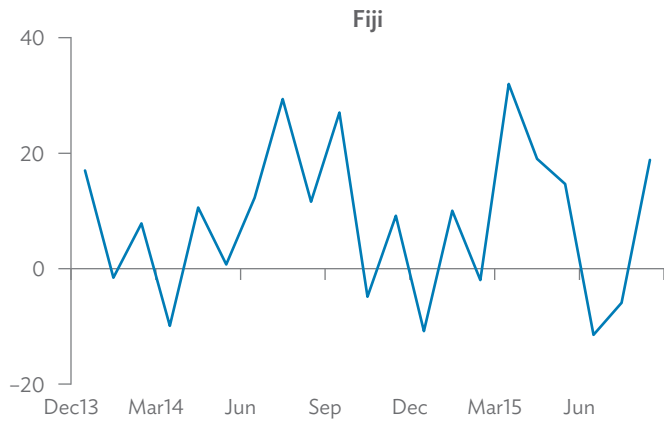
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Nonfuel merchandise exports from Australia
(A\$; y-o-y % change, 3-month m.a.)

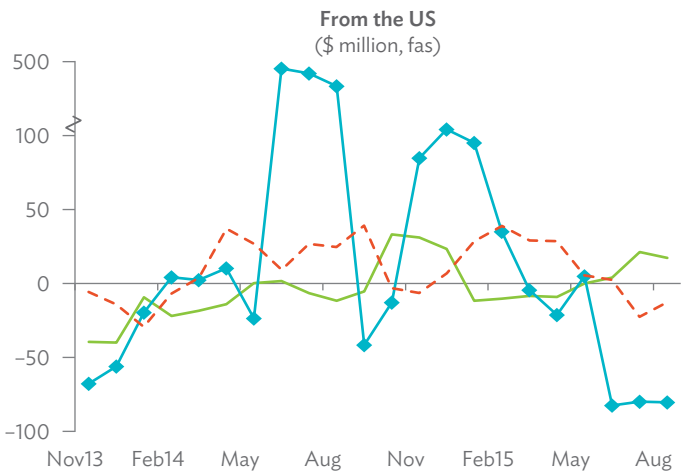
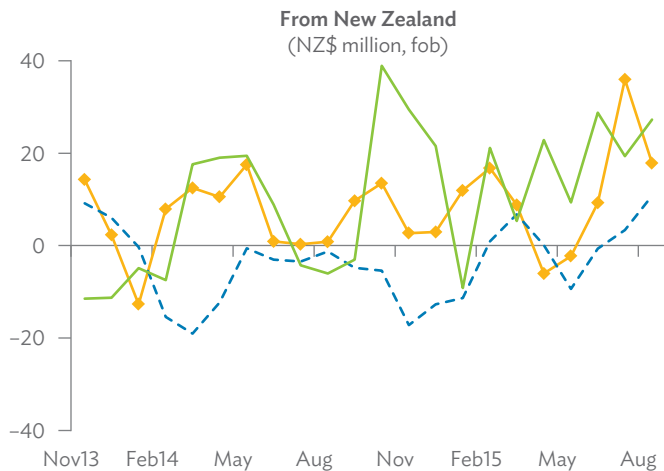


— Kiribati - - - Nauru

— Solomon Islands - - - Vanuatu

A\$ = Australian dollars, lhs = left-hand scale, m.a. = moving average, rhs = right-hand scale, y-o-y = year-on-year.
Source: Australian Bureau of Statistics.

Nonfuel merchandise exports from New Zealand and the United States
(y-o-y % change, 3-month m.a.)

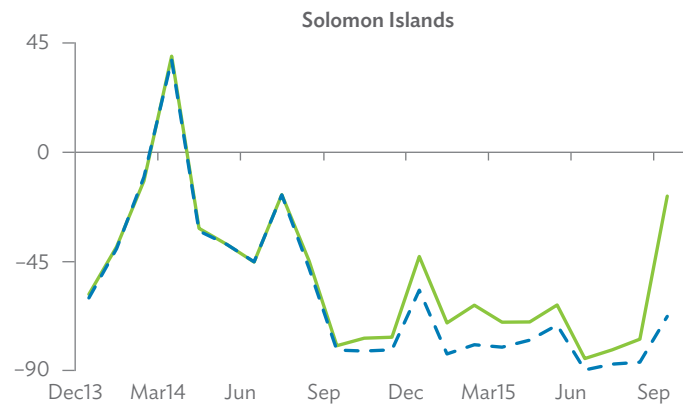
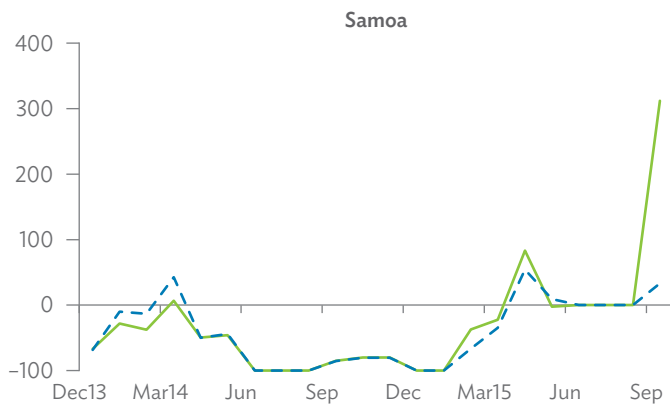
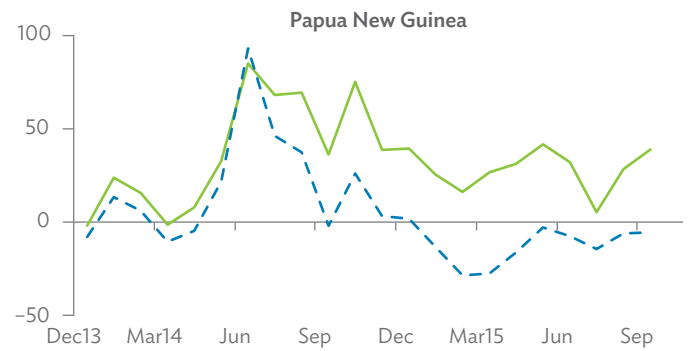
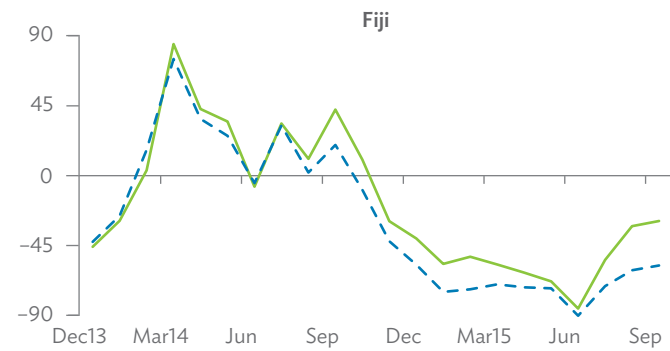


◆ Cook Islands - - - Samoa — Tonga

— FSM ◆ RMI - - - Palau

fas = free alongside, fob = free on board, FSM = Federated States of Micronesia, m.a. = moving average, NZ\$ = New Zealand dollar, RMI = Republic of the Marshall Islands, US = United States, y-o-y = year on year.
Sources: Statistics New Zealand and US Census Bureau.

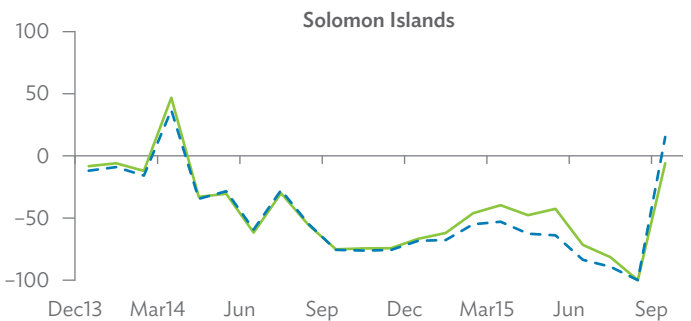
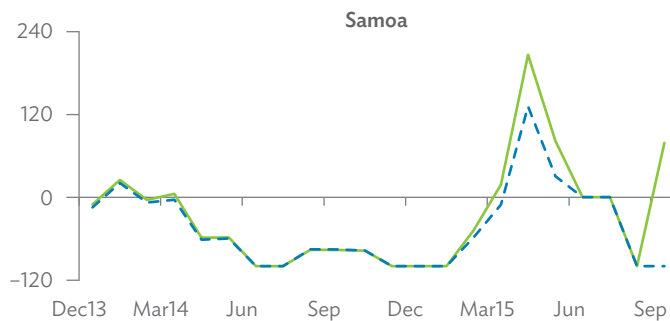
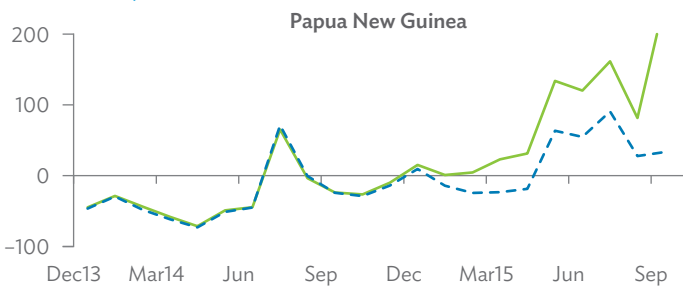
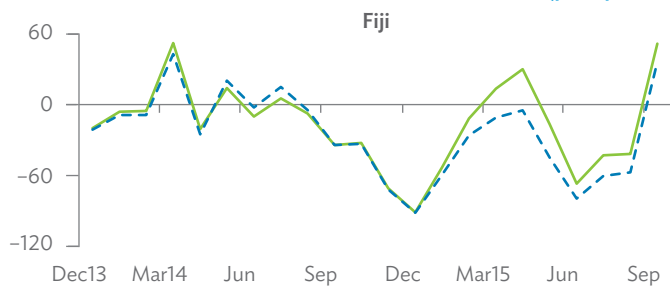
Diesel exports from Singapore
(y-o-y % change, 3-month m.a.)



— Volumes - - - Values

m.a. = moving average, y-o-y = year-on-year.
Source: International Enterprise Singapore.

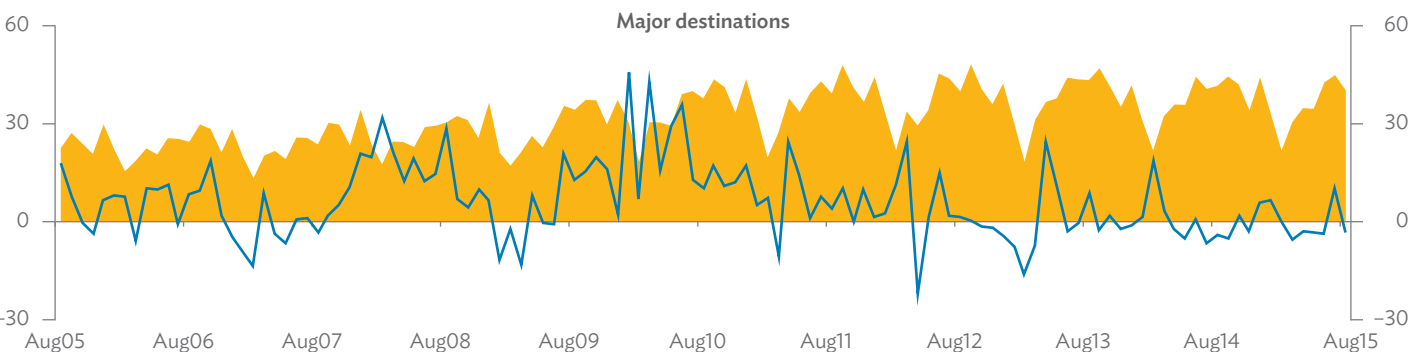
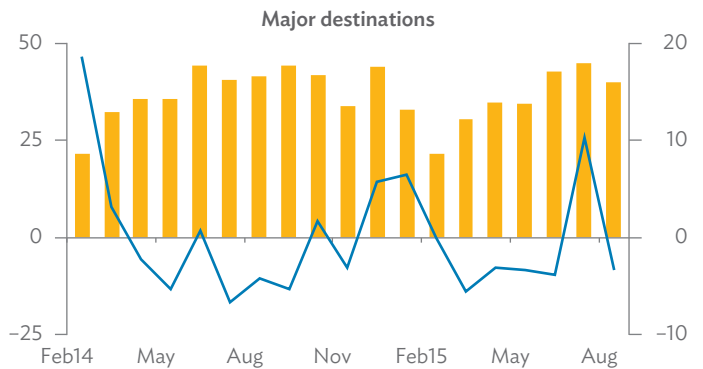
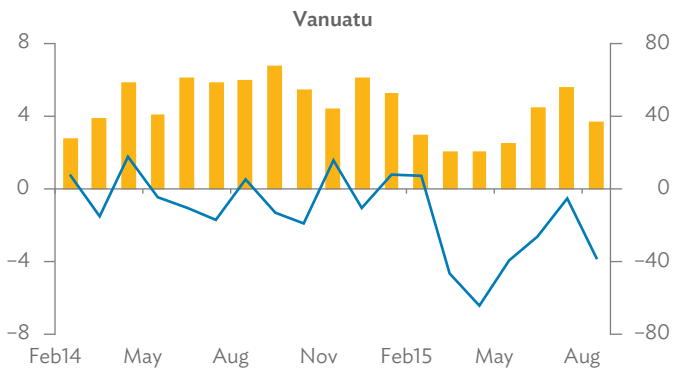
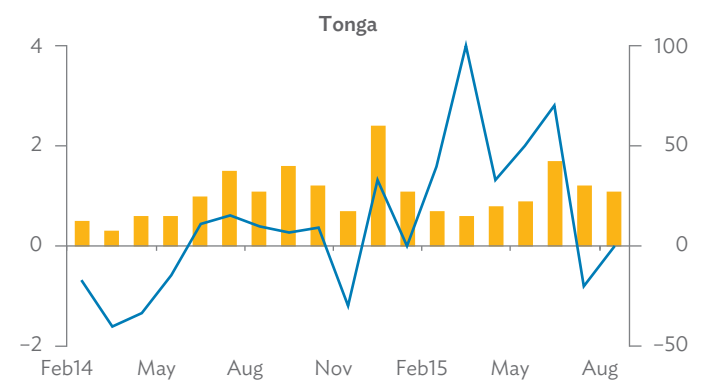
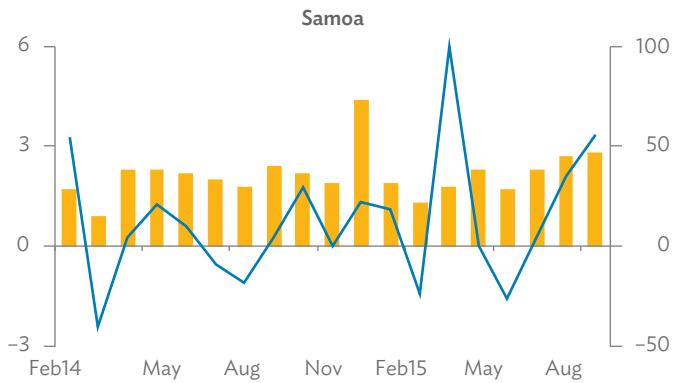
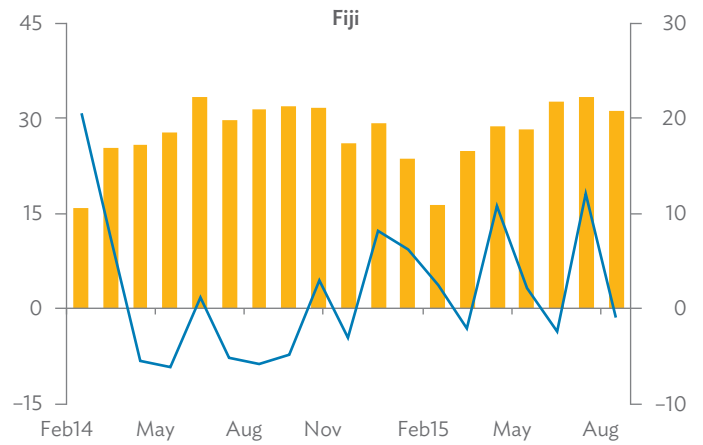
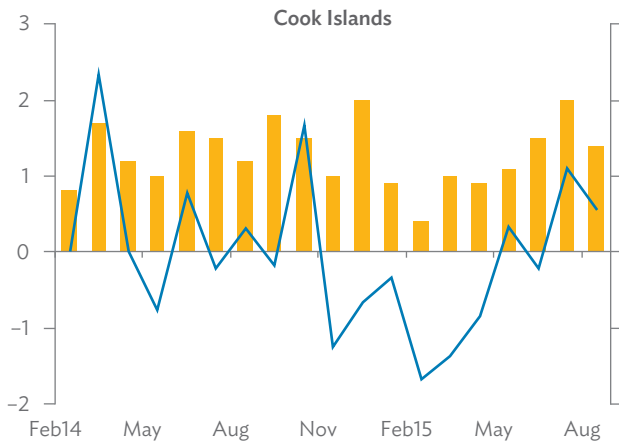
Gasoline exports from Singapore
(y-o-y % change, 3-month m.a.)



— Volumes - - - Values

m.a. = moving average, y-o-y = year-on-year.
Source: International Enterprise Singapore.

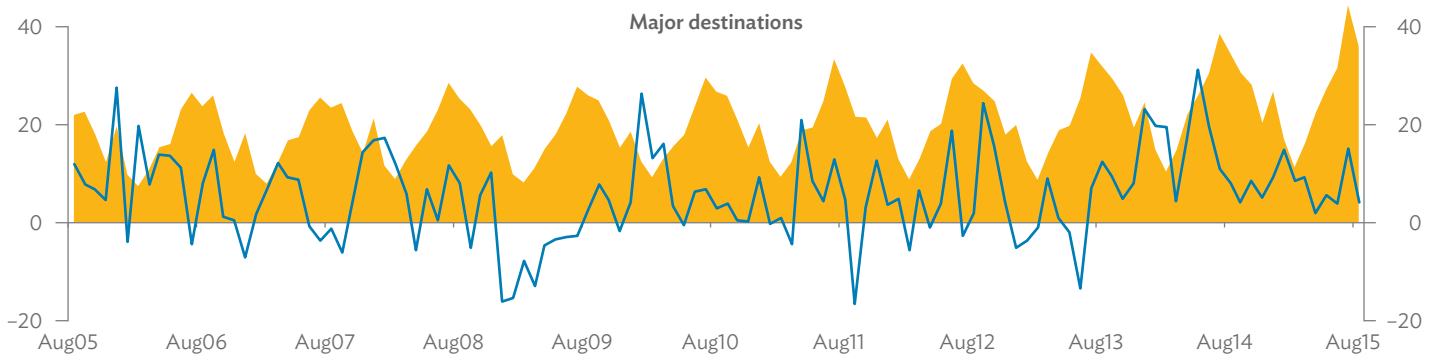
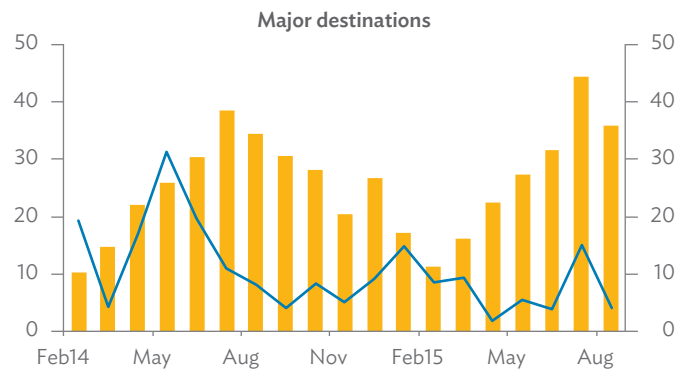
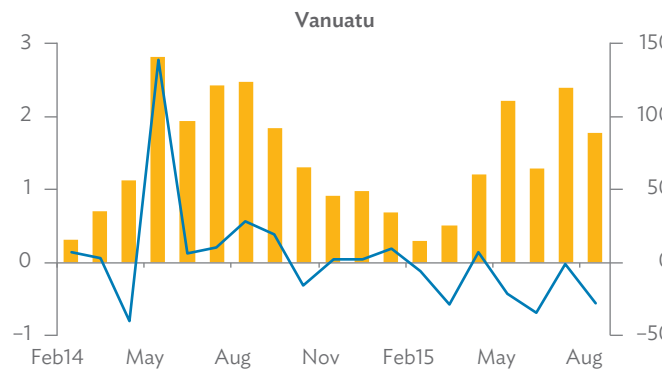
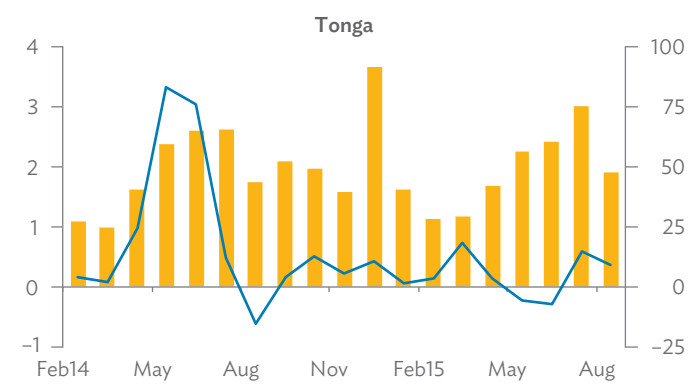
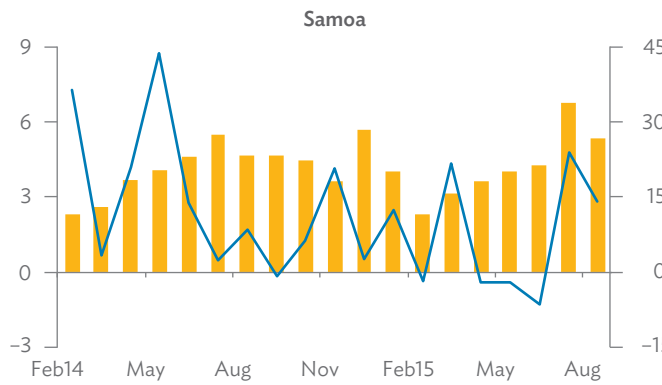
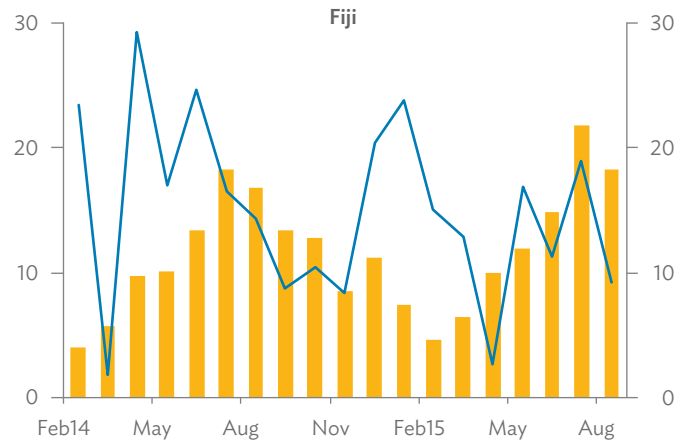
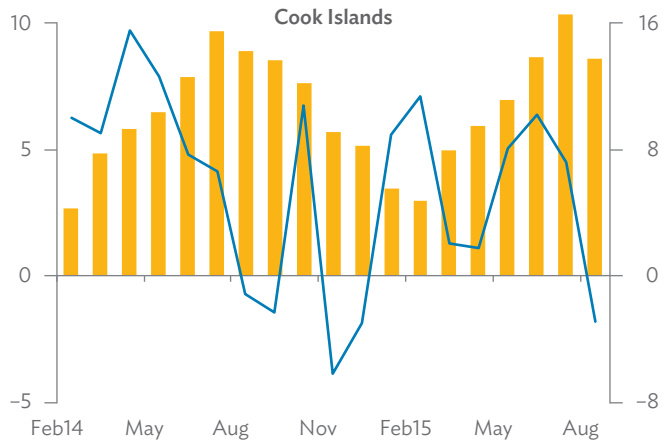
Departures from Australia to the Pacific (monthly)



persons ('000) y-o-y % change (rhs)

rhs = right-hand scale, y-o-y = year on year.
Source: Australian Bureau of Statistics.

Departures from New Zealand to the Pacific (monthly)



persons ('000) y-o-y % change (rhs)

rhs = right-hand scale, y-o-y = year-on-year.
Source: Statistics New Zealand.

Latest Pacific Economic Updates

	GDP Growth (%, 2015p)	Inflation (%, 2015p)	Credit Growth ^a (%)	Trade Balance (% of GDP)	Import Cover (months)	Fiscal Balance (% of GDP)
Cook Islands	-0.4	3.0	0.7 (Mar 2015)	-31.1 (FY2015e)	—	5.6 (FY2015e)
Fiji	4.0	2.0	12.1 (Aug 2015)	-25.4 (2015p)	6.1 (Oct 2015)	-2.5 (2015b)
Kiribati	3.0	1.0	—	-50.1 (2015p)	—	27.6 (2015p)
Marshall Islands	3.5	1.4	-0.1 (FY2015e)	-37.0 (FY2015e)	—	1.7 (FY2015e)
FSM	0.0	1.0	-4.8 (FY2013)	-42.1 (FY2015e)	—	6.9 (FY2015e)
Nauru	6.8	11.4	—	—	—	0.1 (FY2015e)
Palau	10.0	2.2	—	-49.1 (FY2015e)	—	4.4 (FY2015e)
PNG	9.0	6.0	7.4 (Jun 2015)	12.9 (2015p)	9.5 (Sep 2015)	-4.9 (2015p)
Samoa	1.7	1.9	16.2 (Jul 2015)	-30.8 (FY2015e)	4.3 (Jun 2015)	-3.8 (FY2015e)
Solomon Islands	3.0	2.0	17.2 (Mar 2015)	-2.2 (2015p)	11.1 (Jun 2015)	-4.8 (2015p)
Timor-Leste ^b	4.1	1.8	8.5 (Jun 2015)	-51.0 (2015p)	—	37.2 (2015p)
Tonga	2.4	0.4	2.2 (Jun 2015)	-45.2 (FY2015e)	9.1 (Oct 2015)	0.2 (FY2014e)
Tuvalu	2.0	2.0	0.8 (2014e)	-31.7 (2015p)	7.9 (2014e)	-0.7 (2015b)
Vanuatu	-1.0	4.0	4.0 (Dec 2014)	-25.9 (2015p)	8.5 (Jun 2015)	1.6 (2015p)

— = not available, b = budget, e = estimate, GDP = gross domestic product, FSM = Federated States of Micronesia, p = projection, PNG = Papua New Guinea, Q = quarter.

^a Credit growth refers to growth in total loans and advances to the private sector.

^b Timor-Leste GDP is exclusive of the offshore petroleum industry.

Notes: Period of latest data shown in parentheses; import cover for PNG is months of nonmining and oil imports.

Sources: ADB. 2015. *Asian Development Outlook 2015 Update*. Manila; and statistical releases of the region's central banks, finance ministries and treasuries, and statistical bureaus.

Key data sources:

Data used in the *Pacific Economic Monitor* are in the ADB PacMonitor database, which is available in spreadsheet form at www.adb.org/pacmonitor

How to reach us: pacmonitor@adb.org

**Asian Development Bank
Pacific Department**

Apia
Level 6 Central Bank of Samoa Building
Apia, Samoa
Tel: +685 34332

Dili
ADB Building
Rua Alferes Duarte Arbiro, Farol
Dili, Timor-Leste
Tel: +670 332 4801

Honiara
Mud Alley
Honiara, Solomon Islands
Tel: +677 21444

Koror
P.O. Box 6011, Koror, PW 96940, Palau
Fax: +680 775-1990

Majuro
P.O. Box 3279, Miec Beach Front
Amata Kabua Boulevard
Majuro, MH 96960, Marshall Islands
Tel: +692 625-2525

Manila
6 ADB Avenue, Mandaluyong City
1550 Metro Manila, Philippines
Tel: +63 2 632 4444

Nuku'alofa
Fatafehi Street
Tonga Development Bank Building
Nuku'alofa, Tonga
Tel: +676 28290

Palikir
P.O. Box PS-158, Palikir, Pohnpei 96941
Federated States of Micronesia
Tel: +691 320 2639

Port Moresby
Level 13 Deloitte Tower
Port Moresby, Papua New Guinea
Tel: +675 321 0400/0408

Port Vila
Level 5 Reserve Bank of Vanuatu Building
Port Vila, Vanuatu
Tel: +678 23610

Rarotonga
Ministry of Finance and Economic Management
P.O. Box 120, Rarotonga, Cook Islands
Tel: + 682 29521

Suva
5th Floor, Ra Marama Building
91 Gordon Street, Suva, Fiji
Tel: +679 331 8101

Sydney
Level 20, 45 Clarence Street
Sydney, NSW Australia 2000
Tel: +612 8270 9444

Tarawa
Kiribati Adaptation Project-
Phase III Office
P.O. Box 68, Bairiki
Tarawa, Kiribati
Tel: +686 22040/22041

About the Asian Development Bank

ADB's vision is an Asia and Pacific region free of poverty. Its mission is to help its developing member countries reduce poverty and improve the quality of life of their people. Despite the region's many successes, it remains home to the majority of the world's poor. ADB is committed to reducing poverty through inclusive economic growth, environmentally sustainable growth, and regional integration.

Based in Manila, ADB is owned by 67 members, including 48 from the region. Its main instruments for helping its developing member countries are policy dialogue, loans, equity investments, guarantees, grants, and technical assistance.

Asian Development Bank
6 ADB Avenue, Mandaluyong City
1550 Metro Manila, Philippines
Tel +63 2 632 4444
Fax +63 2 636 2444
pacmonitor@adb.org
www.adb.org/pacmonitor

In this publication, "\$" refers to US dollars.