Economic Growth and Sustainable Development in the Pacific Island Countries

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Overview of the economies of Pacific island countries

The Pacific island countries (PICs) have benefited from the growth in Asia and the Pacific in the last 2 decades, strengthening their economic links while loosening ties with the Americas and Europe in most cases, although not all. Still, more needs to be done to deepen their integration with Asia, but the islands’ diverse demographics make integration difficult to accomplish. For instance, Table 1 shows that Papua New Guinea (PNG) (with a population of 7.6 million), Fiji (850,000), and Solomon Islands (611,500) together account for about 90% of the population of all 15 PICs while 6 PICs have populations of less than 20,000. The relatively small population sizes discount the economies of scale in the PICs as industrialization remains minimal. High transportation and raw material costs make entrepreneurship difficult to sustain, leaving the islanders to survive at subsistence levels with family, clan, and community ties providing the social safety net (UNFPA 2014).

Fiji, with its sizable garment industry, is an exception because of its unfettered trade access to Australia and New Zealand through the nonreciprocal South Pacific Regional Trade and Economic Co-operation Agreement (SPARTECA) and the establishment of tax-free factories and tax-free zones. Its tourism industry is well developed, attracting around 500,000 people annually because of its proximity to Australia and New Zealand compared with other PICs and a well-functioning airline, Air Pacific (Duncan and Nakagawa 2006).

Endowed with natural resources—but unfit for large-scale manufacturing owing to their small economies—agriculture and forestry account for about 20%–30% of the PICs’ gross domestic product (GDP) with products such as copra, coconut oil, cocoa, fruit, kava, fresh and canned fish, pearls, seaweed, timber, and mining gold forming the bulk of their exports (Duncan and Nakagawa 2006). PNG, for instance, exported gold, crude petroleum, petroleum gas, wood, and copper worth $7.39 billion in 2014. The top export destinations were Australia ($3.23 billion), Japan ($2.29 billion), and the People’s Republic of China ($1.31 billion), followed by Germany ($366 million) and the United Kingdom ($196 million) (OEC web page). Figure 1 illustrates the most and least competitive PIC “export” industries.
Table 1  Demographic Composition of the Pacific Island Countries

<table>
<thead>
<tr>
<th>Country</th>
<th>Population Size ('000)</th>
<th>Land Area (sq km)</th>
<th>Population Density (per sq km)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Papua New Guinea</td>
<td>7,587.2</td>
<td>462,840</td>
<td>16</td>
</tr>
<tr>
<td>Fiji</td>
<td>847.6</td>
<td>18,273</td>
<td>46</td>
</tr>
<tr>
<td>Solomon Islands</td>
<td>611.5</td>
<td>30,407</td>
<td>20</td>
</tr>
<tr>
<td>Vanuatu</td>
<td>271.1</td>
<td>12,281</td>
<td>22</td>
</tr>
<tr>
<td>Samoa</td>
<td>190.7</td>
<td>2,935</td>
<td>65</td>
</tr>
<tr>
<td>Kiribati</td>
<td>111.2</td>
<td>811</td>
<td>137</td>
</tr>
<tr>
<td>Tonga</td>
<td>104.2</td>
<td>650</td>
<td>160</td>
</tr>
<tr>
<td>FSM</td>
<td>102.8</td>
<td>701</td>
<td>147</td>
</tr>
<tr>
<td>Marshall Islands</td>
<td>53.8</td>
<td>181</td>
<td>297</td>
</tr>
<tr>
<td>Palau</td>
<td>17.7</td>
<td>444</td>
<td>40</td>
</tr>
<tr>
<td>Cook Islands</td>
<td>15.0</td>
<td>237</td>
<td>63</td>
</tr>
<tr>
<td>Tuvalu</td>
<td>11.0</td>
<td>26</td>
<td>424</td>
</tr>
<tr>
<td>Nauru</td>
<td>10.6</td>
<td>21</td>
<td>504</td>
</tr>
<tr>
<td>Niue</td>
<td>1.6</td>
<td>259</td>
<td>6</td>
</tr>
<tr>
<td>Tokelau</td>
<td>1.2</td>
<td>12</td>
<td>100</td>
</tr>
<tr>
<td>Total</td>
<td>9,937</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

FSM = Federated States of Micronesia, sq km = square kilometer.

Fig. 1  Comparative Advantage of Pacific Island Countries (in Exports)

In general, PIC exports have increased by 169% over the past 20 years, reaching $9.6 billion in 2013. Food and live animals accounted for 17% of exports while crude and mineral oils comprised the bulk of export earnings between 1993 and 2013 (see Figure 2; Radoc 2016). Foreign direct investments have also surged to around 3.5% of the combined GDP of the PICs, with many Asian countries investing in fisheries, mining, and agriculture. These statistics combined with the relative macroeconomic stability and open trade regimes have led the economic development of the PICs.

However, not all of the PICs have performed consistently well. As Figure 3 shows, there are significant variations in exports among 14 PICs with Kiribati, Timor-Leste, and Tuvalu outperforming others.

The strong gains for Kiribati can be partially attributed to the newly released licenses for fisheries under the vessel day scheme, which widened the current account surplus from 44.7% of the country’s GDP in 2014 to 77.2% of GDP in 2015. For Timor-Leste, exports of coffee, which is chief among its merchandise exports, increased by 219% in 2015 coupled with the 28.7% above expected oil production in 2015 and $125.3 million (17.9% of its 2016 budget forecast) in petroleum taxes and royalties in the first quarter of 2016. For Tuvalu, government revenues are slated to be 25% higher in 2016 than in 2015 owing to a 2% increase in tax revenues, 49% increase in collection of government charges, and 88% increase in revenues from fishing licenses coinciding with fiscal expansion boosting growth in 2016 (ADB 2016).

Despite the intermittent gains, the PICs face numerous challenges in forging sustainable economic growth.

**Key challenges to sustainable economic growth**

**Improving tourism infrastructure**

The tourism industry has been one of the key niche markets for the PICs, owing to their pristine beaches, clear skies, and marine life. At least 1.5 million people visit the region each year. The industry has
developed significantly since the 1980s from large-scale resort development to ecotourism in the 1990s and 2000s. Palau, for example, has gradually advertised itself to the Japanese market as a popular diving and ecotourism destination starting in the 1980s before expanding its promotions to Taipei, China, and the Republic of Korea in the 2000s. Palau has strategically advertised itself as a high-end resort country luring high-income visitors from the three Asian economies over the years (Pacific Islands Centre 2013). Fiji’s tourism industry has also been flourishing, bolstered by its internationally competitive airline developed over a long period by competing in other sectors (Duncan and Nakagawa 2006). However, aggressive competition among travel companies, resorts, and hotels has led to a price war cutting down on luxury travel and quality services, leading to a general dissatisfaction among tourists. Palau, Fiji, and other PICs must therefore upgrade their tourism infrastructure and services while maintaining a healthy competition to ensure tourist satisfaction and domestic economic growth.

**Encouraging private sector involvement**

The PICs need to involve the private sector to bridge the knowledge and capital deficit required to develop their niche markets for products and services. For instance, instead of severely regulating and protecting markets, the government should provide the private sector with logistical support and practical market information on Asia, connecting them with buyers and distributors in the region. Prohibitive costs of transportation...
“Even though unilateral liberalization may be easy for the Pacific island countries to enforce, without the reciprocal arrangements from other countries, it would be difficult to gain concessions, making it politically disastrous for governments as well.”

and of setting up manufacturing units severely undermine industry growth. The transportation of raw materials also suffers from lack of efficient airports and seaports. According to an Asian Development Bank study, these constraints restrain the growth of niche markets for high-end products like pearls, vanilla, and cocoa. Since exuberant transportation costs downgrade export competitiveness by increasing the time and costs involved in manufacturing these goods, the PIC governments must pursue substantial investments to improve their transport infrastructure.

For the smaller countries with scarce resources for investing in transport infrastructure, Fiji and PNG could be regional hubs for exporting products (Duncan 2008).

Trade liberalization

The PICs need to redress technical barriers to trade—including customs, quarantine, and registration procedures—to decrease the costs of doing business. Trade liberalization, however, must be managed proactively to minimize its baneful environmental, social, and economic effects. Since most of their exports, consisting of natural resource-based products, are extractive in nature, the PICs must stringently regulate industries that could adversely affect their environment. So far, only six PICs have joined the World Trade Organization (WTO), which allows “most-favored nation” trade access to all member countries. For smaller countries with limited resources, the administrative and human resources costs for engaging with the WTO could be prohibitive and, hence, day-to-day communication with the WTO is routed through the Pacific Islands Forum Secretariat. More importantly, trade in the PICs is conducted through regional and multilateral agreements with Australia, New Zealand, and the European Union. For instance, SPARTECA—signed in 1981 between the PICs (excluding Palau and Tokelau) and Australia and New Zealand—helped Fiji and Samoa develop garment and automotive harness industries, respectively creating 23,000 jobs for Fiji and 3,600 jobs for Samoa at one time, by allowing duty-free access of specific PIC exports to Australia and New Zealand. However, as Australia and New Zealand have reduced tariffs on imports over time, the intended benefit of SPARTECA to the PICs has diminished considerably. More recently, the PICs have negotiated the Pacific Island Countries Trade Agreement to reduce tariffs on selected services and products, but only Nauru and Samoa have ratified it. The agreement awaits ratification by the other PICs to become fully operational. The Melanesian Spearhead Group Trade Agreement between Fiji, Vanuatu, PNG, Solomon Islands, and the Kanak and Socialist National Liberation Front of New Caledonia includes 180 duty-free products, but sporadic conflicts of interest between the member countries have marred its success.

The benefits of trade liberalization for the PICs, while potent, are difficult to ascertain. Even though unilateral liberalization may be easy for the PICs to enforce, without the reciprocal arrangements from other countries, it would be difficult to gain concessions, making it politically disastrous for
governments as well. Further, a potential agreement between a small country and a large country would be a likely better deal than any intraregional trade agreement since the effects of trade diversion as compared with trade creation would be less likely with greater benefits accruing from integration into vibrant supply chains (ADB and ADBI 2015).

**Human capital development**

The PICs should focus on developing skilled human capital to cater to the needs of a wealthier Asia. About 1.4 million people in the PICs—13% of the population—are either unemployed or underemployed, prompting them to seek work abroad in Australia, New Zealand, and the neighboring countries and send remittances, which form a critical slice of their GDPs. However, unchecked and steady migration of semiskilled and skilled workers to neighboring countries will only drain human capital from the PICs, worsening their capacity to provide essential services to their citizens and sustain economic growth (Centre for International Economics 2007). Moreover, with the number of people over 60 years old increasing by 400 million in the next 15 years in Asia, the demand for skilled care workers is slated to increase, making the PICs a possible location for tropical retirement homes for Asia’s burgeoning middle class. A skilled workforce could therefore become one of the major sources of revenue for the PICs.

**Conclusion**

The PIC economies have diversified greatly over the past few decades and increased their exports to the neighboring countries. While crystal clear seas, pristine beaches, and abundant natural resources fuel their economic growth, their peculiar geography also limits their economic potential. A lack of interconnectivity amid inefficient transport and communication infrastructure has led to sluggish development of its natural resource-based primary industries. Regional trade agreements have also been partly successful with their relatively high negotiation and operational costs. Therefore, to foster a sustained economic development, the PICs need to improve their outdated infrastructure, increase regional coordination with each other, and refocus on developing niche markets. Finally, because their small economies heavily depend on ecotourism, the PICs must closely monitor any potential negative economic, social, and environmental impacts of their trade links with the rest of Asia to avoid adverse effects on the livelihoods of their people.

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References