Small island economies

Higher fishing revenues helped boost GDP growth and fiscal positions in the otherwise import- and aid-dependent small Pacific island economies of Kiribati, Nauru, and Tuvalu. Australia's reopened Regional Processing Centre in Nauru and externally funded projects in Kiribati and Tuvalu are expected to boost growth in 2013. Inflation is seen reappearing after a 3-year absence as growth accelerates and the impact of the stronger Australian dollar wanes. Paramount concerns are the longer-term sustainability of growth and intergenerational equity.

Economic performance

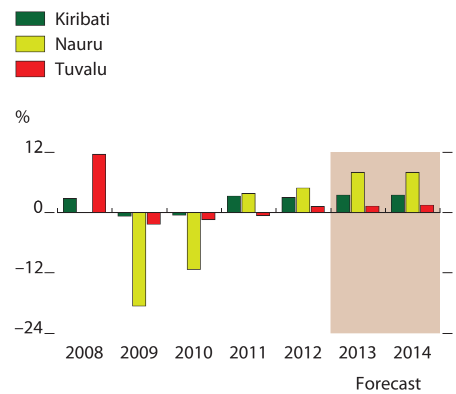
In 2012, inflows of development partner assistance, the positive effect of the El Niño weather pattern on fish stocks near the equator, and the introduction of a new fishing licensing scheme boosted government revenues and bolstered economic growth in Kiribati, Nauru, and Tuvalu. Conversely, continuing declines in seafarers' remittances stemming from weak global trade weighed down growth in Kiribati and Tuvalu.

Looking ashore, phosphate exports from Nauru reached 519,000 tons, the highest annual figure since the country recommenced production in 2007, and contributed strongly to economic growth of 4.9% in FY2012 (ended 30 June 2012). Expanded education and private retail services in Tuvalu helped restore growth of 1.2% in 2012 after 3 consecutive years of economic contraction. In Kiribati, development partner-funded seaport reconstruction and roadwork projects contributed to growth of 3.0% in 2012 (Figure 3.38.1).

All three countries use the Australian dollar as legal tender. None has its own central bank or an independent monetary policy or exchange rate flexibility. In recent years, the appreciation of the Australian dollar vis-à-vis the US dollar has effectively reduced the price of imports on average, greatly constraining consumer inflation (Figure 3.38.2). In Kiribati, consumer prices are estimated to have fallen by 1.8% in 2012, the second year of deflation in the past 3 years. Deflation has persisted in Nauru since FY2010. Tuvalu recorded inflation of 0.5% in 2011 and 1.4% in 2012. These low rates were held down by shifting trade patterns and stiffened retail competition (Figure 3.38.3).

Kiribati, Nauru, and Tuvalu are party to the Nauru Agreement, which recently implemented the Vessel Day Scheme, wherein fishing access and license fees are calculated using the number of days a foreign fishing vessel operates within a country's waters. This new policy combined with transitory catch improvement caused by El Niño to garner governments additional domestic revenue that improved the small island economies' fiscal positions.

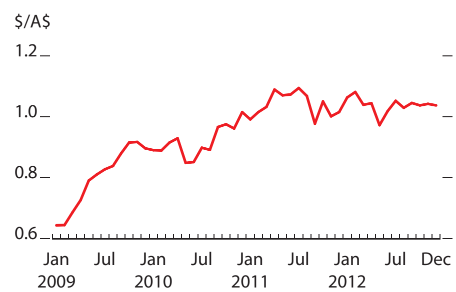
3.38.1 GDP growth



Sources: Kiribati National Statistics Office; Pacific Financial Technical Assistance Centre; Tuvalu Central Statistics Division; ADB estimates.

Click here for figure data

3.38.2 Australian dollar appreciation



Source: Reserve Bank of Australia.

Click here for figure data

This chapter was written by Milovan Lucich of the Pacific Liaison and Coordination Office, ADB, Sydney; Malie Lototele of the South Pacific Subregional Office, ADB, Suva; and Rommel Rabanal of the Pacific Department, ADB, Manila.

Higher fishing fees and fish catches overturned original budget estimates that anticipated deteriorating fiscal balances in all three economies in 2012 (FY2012 for Nauru). Tuvalu posted a fiscal surplus, and the Kiribati and Nauru deficits were much smaller than expected, which at least temporarily eased perennial fiscal strains. It remains to be seen if higher fishing license revenues will become a permanent feature of government budgets. If the revenue increases are mostly attributable to licensing, higher collections may become permanent, but if they largely reflect El Niño-induced bumper catches, they can be expected to revert to historical levels.

Economic prospects

Infrastructure upgrades will likely be the primary drivers of growth over the next 2 years. The September 2012 reopening of the Regional Processing Centre (RPC) in Nauru for asylum seekers attempting to enter Australia without authorization is projected to boost economic growth to 8% in FY2013 and FY2014 through its impact on construction, hotels and accommodation, restaurants, and retail trade, as well as on government finances. The RPC, which currently holds around 400 refugees and directly employs 200 Nauruans in a population of 10,086, is expanding to a capacity of 1,500 asylum seekers. Partial repayment of government salaries in arrears, equivalent to 1.3% of GDP and funded by RPC-related revenues, will likely boost domestic consumption.

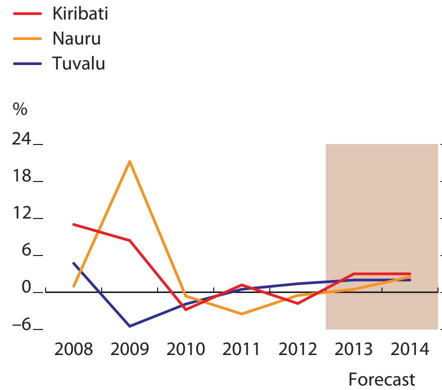
Meanwhile, the government expects phosphate production to slow from 519,000 tons in FY2012 to 450,000 tons in FY2013 because of poor weather and disruptions caused by the RPC's commandeering of mining equipment to clear land for construction (Figure 3.38.4). The phosphate industry employs about 700 Nauruans.

Kiribati's economy is projected to grow by 3.5% in 2013 and 2014 as construction picks up to implement projects funded by development partners: upgrading airports at Tarawa and Kiritimati, upgrading the South Tarawa Road, and extending Betio Port. In Tuvalu the airport upgrade, also funded by development partners, and continued retail expansion will drive economic growth of 1.3% in 2013 and 1.5% in 2014.

The recent trend of low inflation is expected to continue. Although the impact of a strengthening Australian dollar has probably ended, international food and fuel prices are expected to decline. Over 2013 and 2014, inflation is projected to remain at about 3% in Kiribati and 2% in Tuvalu. For Nauru, inflation is projected at a low 0.5% in FY2013, before rising to 2.5% in FY2014.

Island governments plan fiscal expansion to help support economic growth in the near term. In Nauru, the FY2013 budget already incorporates an expansionary stance supported by higher-than-expected revenues from fishing licenses and continued aid flows. As the reopening of the RPC will mean higher visa fees, fuel sales, and customs duty collections, the expansionary fiscal stance has been further amplified, and domestic expenditure will be almost double in FY2013. Fiscal expansion is also expected in Kiribati and Tuvalu, driven by planned increases in recurrent expenditures and by capital spending associated with ongoing infrastructure projects.

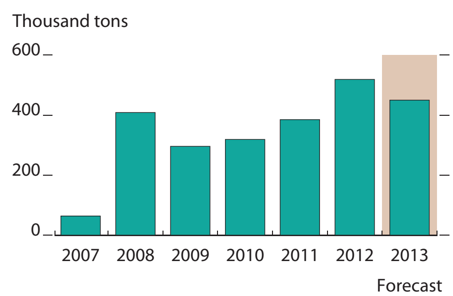
3.38.3 Inflation



Sources: Kiribati National Statistics Office; Pacific Financial Technical Assistance Centre; Tuvalu Central Statistics Division; ADB estimates.

Click here for figure data

3.38.4 Phosphate exports from Nauru



Sources: Republic of Nauru Phosphate Company; Nauru Bureau of Statistics.

Click here for figure data

3.38.1 Selected economic indicators (%)

Kiribati	2013	2014
GDP growth	3.5	3.5
Inflation	3.0	3.0
Current account balance (share of GDP)	–23.9	–20.0
Nauru		
GDP growth	8.0	8.0
Inflation	0.5	2.5
Current account balance (share of GDP)	...	...
Tuvalu		
GDP growth	1.3	1.5
Inflation	2.0	2.0
Current account balance (share of GDP)	–3.3	...

... = data not available.
Source: ADB estimates.

Policy challenge—sustainability and intergenerational equity

Limited resources and narrow economic bases give rise to reliance on aid flows, which account for as much as half of GDP in some of these small island economies. The pace of resource exploitation, the sustainability of growth, and intergenerational equity are therefore major issues. Financial resources from sovereign investment funds in Kiribati and Tuvalu, and phosphate reserves in Nauru, are being depleted at unsustainable rates to fund current expenditures, raising concerns regarding the tradeoff between supporting growth now versus ensuring that future generations share the benefits provided by finite and exhaustible resources.

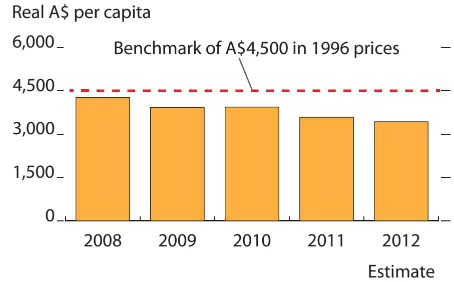
The Government of Kiribati's target for drawing down the Revenue Equalization Reserve Fund is A$15.0 million annually from 2013 to 2015. The 2012 drawdown of an estimated A$37.5 million raises concerns about the fund's long-term sustainability. The real value of the fund per capita has been trending downward in recent years to well below the benchmark of A$4,500 (Figure 3.38.5).

The Tuvalu Trust Fund has languished below its target maintenance value since 2008 and been unable since then to transfer resources to the Consolidated Investment Fund, through which budget deficits are financed. The investment fund neared utter depletion in 2012, prompting an A$4 million contribution from Australia (Figure 3.38.6).

Nauru has recently ramped up its exploitation of secondary phosphate reserves, digging deeper to reach a production high in FY2012. The proper management of phosphate wealth and of revenues from the reopening of the RPC will largely determine Nauru's fiscal and economic sustainability over the long run. In addition to effects on local employment and construction, the RPC has the potential to increase visa fee revenues by as much as A$16 million per year when operating at full capacity. However, full scaling up depends on the government and landowners reaching agreement on the terms of the land lease for two of the three RPC sites. Like phosphate revenues, RPC earnings may be transitory, so the government could consider saving RPC-related revenues for future generations and investing in priority infrastructure projects and human capital development.

Prioritizing investments and building up savings will allow future generations to benefit from the current use of resources. In addition to equity concerns, such adjustments to fiscal policy would address issues affecting the sustainability of growth. Broadening the economic bases of these small islands through private sector development, the reform of state-owned enterprises, and other improvements to the business environment will help reduce reliance on foreign assistance and promote more inclusive growth over the longer term.

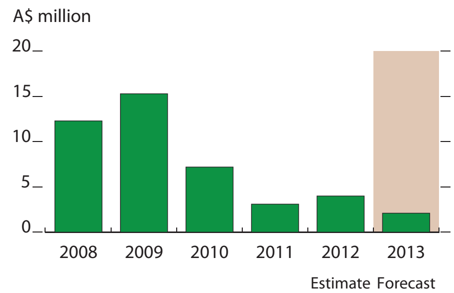
3.38.5 Revenue Equalization Reserve Fund of Kiribati, closing balance



Source: ADB estimates using data from the Kiribati 2012 national budget.

Click here for figure data

3.38.6 Consolidated Investment Fund balance of Tuvalu



Source: International Monetary Fund. 2012. *Tuvalu, Country Report* No. 12/259. September.

Click here for figure data