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

**Contents**

The economic setting  3  
Country updates  5  
Policy briefs  18  
- Realizing job needs across the Pacific  
- Informal sector growth and employment  22  
- The role of the public sector in meeting Pacific employment challenges  25  
- Timor-Leste: Highlights of 2013 Labor Force Survey  30  
- Incentives for labor adjustments: The case of the Federated States of Micronesia  33  
Economic indicators  36  

**Highlights**

- **Pacific growth outlook weakens.** Average growth in the Pacific region is now projected to increase to 5.2% in 2014, down from ADB's start of year forecast reported in Asian Development Outlook 2014. The downward revision is due to the impacts of flooding in Solomon Islands and weak private sector activity in Timor-Leste.

- **Modest growth in smaller islands seen to continue.** Regional growth is expected to soar to 13.2% in 2015, driven by very high growth in Papua New Guinea (PNG) resulting from the country's first full year of liquefied natural gas exports. However, the outlook for the Pacific region excluding PNG and Timor-Leste is expected to remain modest at average growth of 2.8%.

- **Inflation to remain steady.** Regional inflation is projected to remain stable at 4.5% through 2014 and 2015, the same rate seen last year, as declining global commodity prices are offset by stronger demand in some economies.

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**The Pacific’s employment challenge**

Emerging labor market issues and opportunities, and strategies to expand formal employment, are examined in this Monitor’s policy briefs.

![Graph showing workforce growth across the Pacific](image-url)

**Not Employed**

Subsistence only

Wage employment

*Most of these new workers will come from Papua New Guinea.*
Asian Development Bank projections

GDP growth

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Inflation

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Notes

This Monitor uses year-on-year (y-o-y) percentage changes to adjust for seasonality, and 3-month moving averages (m.a.) to reduce 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.
Improving global growth prospects

Boosted by recovery in developed economies, global GDP is projected to grow by 3.3% in 2014 from 2.6% in 2013, based on the average projections of three major forecasters (the Economist Intelligence Unit, the International Monetary Fund, and the Organisation for Economic Co-operation and Development). Economic growth is seen to accelerate further to 3.6% in 2015. Commodity prices are projected to hold steady or even decline over the next 2 years. However, optimism from the modest improvement in the growth outlook for leading global economies is tempered by concerns about rising risks as conflicts in Iraq, Syria, Ukraine, and the South China Sea, among others, could escalate and lead to disruptions in global trade and international commodity prices.

Stronger growth in the United States (US) economy, which is projected to grow by 2.3% in 2014 (up from 1.9% in 2013), leads the improvement in global outlook. Higher private demand and investment are expected to boost the economy. The eurozone is set to expand by 1.2% in 2014 (coming from 2 consecutive years of contraction) as domestic demand strengthens and exports continue to grow. Japan’s growth is expected to slow to 1.4% in 2014 and 1.2% in 2015 as stimulus impacts dissipate and an increase in the consumption tax rate lowers demand.

Developing Asia’s growth is expected to remain stable at 6.2% in 2014 (from 6.1% in the past 2 years) before inching up to 6.4% in 2015, according to Asian Development Outlook 2014. Growth in the People’s Republic of China (PRC) is expected to ease from 7.7% in 2013 to 7.5% in 2014. Growth in the rest of developing Asia is expected to increase slightly on the back of the improving global economy. The newly industrialized economies of East Asia all expect higher growth in 2014 and 2015.

Australia’s economy is expected to expand by 2.7% in 2014 and 2.9% in 2015, an increase over last year’s growth (2.4%) but significantly lower than 2012’s growth (3.3%). Although investment is expected to hold steady in 2014, rising commodity export revenues and increased private consumption are expected to fuel growth. In an effort to boost credit and aggregate demand, the Reserve Bank of Australia cut the benchmark interest rate to a historic low of 2.5% last August. Reduced demand for Australian exports from the PRC is expected to be offset by rising demand from other countries.

Economic growth in New Zealand is expected to accelerate to 3.3% in 2014, pushed by investment related to housing reconstruction and by strong dairy and other exports. To relieve inflationary pressures, the Reserve Bank of New Zealand raised its key policy rate to 3.0% in April 2014 (from 2.5%, which had been in place since March 2011).

Pacific trade deficits narrow as exports rise and imports fall

The value of Pacific exports to Australia and New Zealand increased in Q1 2014, reflecting strong growth in shipments from Papua New Guinea (PNG) and Fiji. Exports to Australia rose by 21.5% and those to New Zealand by 1.8% (both y-o-y) during the period. Gold and crude petroleum from PNG accounted for over 75.0% of regional exports to Australia. Timor-Leste’s coffee exports to Australia rose by 14.1% and to New Zealand by 20.6% (y-o-y), as both export volumes and international coffee prices increased.
The value of Pacific imports from New Zealand fell by 79.5% (y-o-y) in Q1 2014, led by declines in food and fuel imports to Fiji and PNG. With the winding down of construction related to the liquefied natural gas project, PNG’s iron and steel imports decreased compared with Q1 2013. Pacific imports from Australia remained stable during the same period. Nauru’s imports of food, chemical products, and other products have risen sharply due to the Regional Processing Centre’s expansion and broader improvement in the economy.

Driven by improving terms of trade, the Pacific economies recorded a trade surplus of A$121.4 million with Australia in Q1 2014, a reversal of the deficit incurred in the comparable period in 2013. The Pacific’s trade deficit with New Zealand narrowed by 23.8% (y-o-y) to NZ$171.2 million.

Strong start in tourism to the Pacific in 2014

Improving global economic conditions buoyed tourism to major South Pacific destinations over Q1 2014. Stronger currencies in Australia and New Zealand—the two main sources of tourists—also benefited South Pacific tourism destinations.

Australian tourism to South Pacific destinations increased by 6.4% in Q1 2014 (y-o-y). Fiji and Samoa recorded solid growth in the number of Australian visitors. Departures to the Cook Islands also grew, aided by government-underwritten Air New Zealand flights between Sydney and Rarotonga.

Likely spurred by appreciation in the country’s currency, New Zealand departures to the South Pacific surged by 13.4% (y-o-y) in Q1 2014. Fiji, Samoa, and Tonga each registered double-digit growth. The Cook Islands also saw a marked increase, while Vanuatu maintained the peak level of visitors from New Zealand achieved during the corresponding period of 2013.

Improving conditions in key overseas labor markets

Labor market conditions in some of the economies hosting the greatest number of workers from the Pacific improved in early 2014. US unemployment fell to 6.3% in April 2014—its lowest level since 2008—although concerns about the number of discouraged workers that have left the labor force remain. Australia’s unemployment rate eased to 5.8% in March and April 2014, following rises last year amid the country’s economic slowdown. Recent labor market indicators for the country have exceeded expectations, giving hope that unemployment may have peaked in early 2014. In New Zealand, the unemployment rate remained at 6.0% in Q1 2014. Unemployment among the Pacific labor force in New Zealand remains high, but has fallen to 13.0% from a peak of 16.3% in Q2 2013.

New Zealand’s Recognised Seasonal Employer scheme continues to provide the largest number of jobs to seasonal migrant workers from the South Pacific. Under the program, a total of 6,187 guest workers from the region worked in New Zealand in FY2013. About 90% of participants were from Vanuatu, Tonga, and Samoa. Australia’s much smaller seasonal worker program has hosted a total of over 1,600 workers from nine eligible countries over the past 4 years, with workers from Tonga taking up most (nearly 82%) of these posts.
Growth in tourist arrivals dropped to 1.2% over the first 3 quarters of FY2014 (ended June) compared with the same period the previous year. A contraction in the number of tourists from New Zealand—the largest source market—was offset by relatively strong growth from Australia and other markets. Australia, the second most important market, is expected to remain buoyant and should compensate for relative weakness in other markets.

Inflation slowed to 0.9% (y-o-y) in the third quarter of FY2014, mainly due to lower food price inflation. Transport and utility costs also continued to decline. These trends largely reflect softening international prices of food and fuel.

Growth is seen to moderate to 2.2% in FY2014 given a more modest tourism performance and a decline in infrastructure spending. In FY2015, growth is projected to accelerate to 2.5% assuming tourism reverts to long-term trends. Inflation is now seen to decline to 1.5% in FY2014 before rising to 2.5% in FY2015 with a stronger growth outlook.

Because government already exceeds its target of keeping personnel expenses below 40% of revenue, the economy will have to rely on the private sector to generate employment. Long-term growth will depend on raising labor productivity and wages to help stem the flow of skilled labor migrating overseas. Alternatively, the Cook Islands may need to continue to attract immigrants to fill current gaps in skilled and unskilled employment.

Recent developments

- Growth continues to be broad-based across sectors. The government upgraded its 2014 growth forecast to 3.8% (from 3.0%) due to the Fiji Bureau of Statistics’ rebasing of national accounts to account for structural changes in the economy, e.g., the contribution of emerging industries such as bauxite mining to the economy.

- Tourism and remittances are off to a strong start in 2014. In the first quarter, visitor arrivals from Australia were up by 6.4% (y-o-y) and from New Zealand by 10.4%—which together account for over 60% of total arrivals. This follows a record year for tourism receipts, which exceeded $650 million in 2013. Personal remittances, the second-highest foreign exchange earner after tourism, were up by 8.1% (y-o-y) in the first quarter of 2014. Foreign reserves in May 2014 were F$1.7 billion, sufficient to cover 4.6 months of imports.

- The government forecasts exports to grow by 5.0% in 2014 after declining by 5.5% in the previous year. All products are expected to contribute to the higher exports, with the exception of fish (where industry reports indicate there has been a steep decline in tuna catch) and gold (where production fell by 0.3% in the year to March). Imports are forecast to grow by 5% in 2014, down from 9% in 2013. The trade deficit (excluding aircraft) for 2014 is forecast at 31% of GDP, at about the same level as 2013.
Growth in net value-added tax collections slowed to 5% (y-o-y) in the first quarter of 2014, down from 17% in the same period last year. Consumption is expected to moderate further into the year as the effects of the stimulus provided by tax cuts in the 2013 budget wear off.

Investment activity is also seen to continue to grow, although more slowly than last year. New lending for investment purposes increased by 107% in 2013, led by lending to the construction and real estate sectors. Public investment increased by over 30% in 2013 as government proceeded with projects to upgrade the country’s road network. A similar increase is budgeted for 2014. Capital expenditure is expected to reach 36% of the total budget this year, pushing public investment above the government’s target of 25% of GDP.

Total government expenditure is projected to rise by 28% in 2014, while revenue is expected to increase by 33%. The sale of three state-owned enterprises underpins the expected rise in revenue. Should these sales not proceed, either the fiscal deficit would exceed the projected level of 1.9% of GDP or expenditure would need to be adjusted downward.

Inflation was low at just 0.8% (y-o-y) in the first quarter of 2014. A moderation in price inflation for food and nonalcoholic beverages reflects the decline in international food prices.

Outlook

ADB projects an expansion of 2.8% in 2014, which puts Fiji’s economy on track to achieve 5 consecutive years of growth. Consumption and investment activity is seen to continue to expand although at more moderate rates than were reported last year. Growth is then projected to rise to 3.0% in 2015 due to stronger investor confidence following the September 2014 elections.

Inflation is projected at 3.0% in 2014 and 3.5% in 2015. Growth of imports in recent months may heighten price pressures in coming months. A projected acceleration in growth is seen to drive inflation further in 2015.

Key issues

Despite recent improvements in Fiji’s growth performance, sustaining growth over the longer term and translating it into jobs remain a key challenge. The postelection government will likely need to focus on rebalancing growth to move from consumption and public investment-driven expansion toward increased private investment in the medium- to long-term. The recent ramping up of government spending on infrastructure projects is aimed at stimulating greater private investment. Achieving this goal will also require further structural reform to enhance the business environment. Increased private investment will be crucial in supporting broad-based and sustained growth moving forward. Employment creation in the medium term will likewise hinge on private sector development.

Fiji’s economy has struggled to generate enough jobs for the country’s 20,000 annual new workforce entrants. Women are also significantly less likely to participate in the formal labor force. Improving access to markets and services, and creating more job opportunities in rural areas, will be needed to promote inclusive growth.
Kiribati

- Higher-than-expected revenues from fishing license fees in 2013 resulted in a substantial budget surplus equivalent to 10.1% of GDP. The government deposited $16 million into the Revenue Equalization Reserve Fund, which helped in temporarily easing the rapid decline in the fund’s total assets.

- Food imports from Australia increased sharply over the first quarter of 2014, partly reflecting a recovery after weak demand in 2013. Stronger domestic demand is consistent with an expected acceleration in growth.

- Growth is projected to remain at 3.0% in 2014 as development-partner-financed projects are implemented. Following 2 years of deflation, inflation is expected to return as the Australian dollar (the official currency used in Kiribati) weakens. Inflation is projected at 2.5% in 2014 and 2015.

- The latest estimates show that more than 30% of the labor force is unemployed. Employment is largely in the public sector or subsistence activities, with limited private sector opportunities. These problems are expected to become more pronounced due to rapid population growth. Tourism and fisheries development (e.g., the planned development of Kiritimati Island) offer scope for employment expansion.

Food imports from Australia (3-month m.a.)

Marshall Islands

- The Republic of the Marshall Islands’ (RMI) imports from the US dropped by 70.2% (y-o-y) in the first half of FY2014 (ends 30 September). This was due to very low fuel imports likely associated with declines in fishery activity, which in turn arose from changes in fish migration patterns.

- Economic growth is still seen at 3.0% in FY2014 as development partner-funded infrastructure projects are implemented, and supported by recovery in fisheries output later in the fiscal year. The reemergence of El Niño in the Pacific poses a significant downside risk to this outlook because the increased likelihood of typhoons could hamper construction and fishery activities. Growth is expected to moderate to 1.5% in FY2015 as construction projects wind down.

- Although jobs in the public sector increased in recent years, private sector employment contracted during the same period. The RMI faces many challenges in promoting private sector business activity and job creation, ranging from the skill level of the workforce to economic disruptions arising from climate change. However, options to mitigate these risks must be explored in order to develop more sustainable drivers of growth and to revitalize and sustain job creation outside the public sector.

- In FY2012, fisheries accounted for 11% of total employment and was the leading private employer in the RMI, but job creation in this sector slowed. Apart from promoting investments, especially in higher-value fish processing, other actions are required to help expand the sector, e.g., improving working conditions and addressing the scarcity of fresh water.

Imports from the US (3-month m.a.)
Despite stronger food imports, the total value of the Federated States of Micronesia’s (FSM) imports from the US fell by 31.3% (y-o-y) in the first half of FY2014 (ends 30 September). This is due to the 50.1% decline in nonfood imports, mostly of machinery and transport equipment and manufactured goods, during the period.

Tepid GDP growth of 0.5% is still forecast for FY2014 and FY2015. Recovery from weak growth is unlikely in the near term, as the lack of private investment, sluggish business activities, and slowdown in major public infrastructure projects continue. Weak private sector growth is partly due to the delayed implementation and long overdue tax reform, which is necessary in improving the business environment and reviving growth. Inflation is projected to decline to 2.0% in FY2014 and 1.5% in FY2015 with expectations of lower international commodity prices.

Public sector jobs continue to dominate the employment structure, with private sector employment remaining at about 40% of total over the past decade. In this period, the FSM economy lost a net total of 1,159 jobs—467 of which were in the private sector.

The manufacturing sector recorded the largest employment decline, which is largely due to the collapse of garment exports after the 2004 expiration of the World Trade Organization’s Agreement on Textiles and Clothing. Development of drivers of growth, especially in the private sector (e.g., niche export or tourism activity), will be important in stimulating employment growth and sustaining it over the longer term.

Government revenues, excluding external grants, for FY2014 (ends 30 June) are estimated at A$99.5 million, more than three times the level prior to the reopening of the Regional Processing Centre (RPC) for asylum seekers in 2012. The A$6,000 annual business visa, introduced in February 2014, could raise revenues but discourage foreign investment. In recent years, recurrent expenditure tracked rising revenue collections, spurring higher growth. Payments to landowners with the liquidation of the Nauru Phosphates Royalties Trust are expected to increase incomes and raise inflation.

Inflation accelerated to 5.3% (y-o-y) in the first quarter of 2014, driven largely by higher alcohol and tobacco prices, which rose by 52.2% (y-o-y) in January 2014. Over the same period, transport and communications costs increased by 8.9%. These increases were partly offset by declines in prices of food (50% of the consumer price index basket) and clothing with rising competition in the retail sector.

RPC construction expanded employment opportunities in Nauru in 2012 and 2013. Additional job opportunities could arise if the RPC is scaled up.

Recent levels of recurrent expenditure may be unsustainable once RPC revenues slow. ADB is working with the government and development partners to establish a trust fund to absorb RPC-related and phosphate revenues. The government has set aside A$5 million in the revised FY2014 budget as an initial contribution.
Tourist arrivals declined by 1% in the first 7 months of FY2014 (ends 30 September) due to decreased arrivals from the Republic of Korea and Taipei, China. However, this is partially offset by stronger tourist spending. Tourism is seen to recover in the coming months, partly due to the resumption of Mega Global Maldives Air flights from Hong Kong, China.

Palau’s imports dropped by 8.5% (y-o-y) in the first half of FY2014, mainly due to softening fuel prices. However, the trade deficit is expected to persist as exports also declined over the same period.

The FY2014 growth forecast is revised downward to 2% due to weaker-than-expected construction activity and tourism performance. Growth is seen to remain at 2% in FY2015. Prices grew by 4.4% in the first half of FY2014, partly driven by higher tobacco taxes and medical fees. Inflation is now projected at 3.5% in FY2014, before falling to 2.0% in FY2015.

To secure its long-term fiscal standing, the government has adopted revenue-enhancing measures and is considering a comprehensive tax reform package including the introduction of a value-added tax.

Palau has one of the lowest unemployment rates in the Pacific; subsistence employment is also very low. The government plans to introduce reforms to simplify labor market regulations, increase fairness in worker compensation, improve safety at the workplace, and expedite the resolution of labor disputes.

Recent developments

The Provisional Final Budget Outcome Report for 2013 was released by the Treasury during March, updating information on 2013 budget performance. Total revenue collection was 6.2% lower than originally projected. This was mainly a result of the government receiving no dividends from its interests in mining and petroleum operations, and lower-than-expected development grants. Lower-than-expected government expenditure, which was 4.3% below target, partly offset underperforming revenues, resulting in a budget deficit equal to 7.6% of GDP, slightly larger than expected.

The aggregate expenditure figure masks significant differences across expenditure categories. The capital budget was underspent by approximately 19%, with 45% of this spending reportedly coming in the final quarter of 2013. This highlights the ongoing challenges that PNG’s bureaucracy is facing in delivering an ambitious list of public investments, particularly infrastructure projects. Further, there is a tendency for official expenditure figures to overstate real rates of project implementation because funds transferred to project trust accounts are typically recorded as expenditure.

In contrast, recurrent expenditure was 12% over budget. Continued weaknesses in payroll expenditure control at both national and subnational levels of government added to this outcome, as did what the final budget outcome report describes as overspending recorded by departments “without proper accounting treatment.”
The Treasury Department’s first quarter report for 2014 indicates that many of these expenditure trends continue. Total capital spending during this period was just 9% of the annual target. In particular, the Department of Works and Implementation was reported as recording zero expenditure against its 1.7 billion kina infrastructure program planned for this year (although this may partly reflect accounting delays in recording actual expenditures).

Outlook

- GDP growth is forecast at 6.0% in 2014, picking up to a record 21.0% in the following year, as liquefied natural gas (LNG) exports commence their first full year of production. Economic activity outside the mining and petroleum extraction sectors is expected to continue to slow, with growth of just 1.6% in 2014 as LNG construction spillovers dissipate. Construction is forecast to contract by 6.4% in 2014, while activity in transport and logistics, wholesale and retail trade, and financial services will ease from the highs recorded over the previous 3 years.

- The outlook for agriculture continues to improve, with international prices for key agricultural exports recording significant improvements in the first quarter of 2014. Coffee prices, in particular, jumped by 70% between December 2013 and March 2014. Prices for other exports like copra, cocoa, and palm oil have also consolidated on earlier gains, growing by 9.5%, 7.6%, and 5.4% during the first quarter of the year, respectively.

- Continuing weakness of the kina is also adding to rural cash crop export earnings. Following a large drop in late 2013, the kina has fallen a further 8% against the US dollar in the first half of 2014. Trading values of the kina against the US dollar have now dropped by 28% since their peak in February 2013.

- Inflationary pressures within the economy are reemerging with the drop in the value of the kina and rising government expenditures. Consumer prices rose by 2% in the last quarter of 2013 and are expected to increase by a further 6% in 2014.

- Over the past decade, the strong performance of PNG’s nonmineral economy has seen formal employment grow by an average of 6% per year. This has almost doubled the size of the private sector workforce and created new opportunities for an emerging middle class. However, as the construction phase of the LNG project winds down, and growth drivers shift toward mining and petroleum exports, efforts must be renewed to encourage new opportunities for formal sector employment.

Key issues

- The last decade highlights some important lessons for policies aimed at stimulating income-earning opportunities.

- First is the importance of fiscal prudence and macroeconomic stability for formal sector job creation. The mid-1990s recorded 4 successive years of economic growth in excess of 10% per annum, driven by investment in new mining and oil operations. However, political instability, fiscal indiscipline, and mounting public debt eroded private sector confidence, limiting investment outside of extractive industries. As a result, this period saw rapid economic growth but stagnation in formal job growth. By 2001, the share of the working-age population able to access formal employment had fallen to less than 10%.
In contrast, a defining feature of PNG's formal job growth between 2002 and 2013 has been the diversity of employment-generating sectors. Based on official statistics, agriculture accounted for the largest share of net job creation (30% of the total), followed by manufacturing (21%), building and construction (16%), wholesale and retail trade (15%), transport (8%), and finance and business (5%). A renewed commitment to fiscal discipline and macroeconomic stability, which saw a reduction in public debt, kick-started this employment growth. Favorable external conditions, and a series of structural reforms including financial sector and telecommunications liberalization, boosted private sector confidence and supported investment and job creation. Pursuing new opportunities to expand private sector involvement in previously monopolized industries will be a key component of ensuring that job creation continues as the economy again shifts toward growth based on resource exports.

PNG's formal labor market remains small by regional standards despite a decade of rapid growth—providing livelihoods to only 10%–15% of the working-age population. A much larger informal labor market, centered on semi-subsistence agriculture, forestry, and fisheries, generates livelihoods for most of the remaining working-age population. Even with sustained growth in formal sector job creation, it will take decades to move a majority of the population out of the informal sector. Raising the living standards of those that rely on informal livelihoods will require stronger institutions that can provide the essential infrastructure and social services necessary to expand their access to markets and their ability to participate in the country's growing economy.

Recent developments

The economy is starting to recover from the impacts of Tropical Cyclone Evan on the back of donor-financed reconstruction, a rebound in agriculture (particularly taro), and temporary stimulus from the preparations for the United Nations Third International Conference on Small Island Developing States. Consequently, ADB estimates growth of 2.0% in FY2014 (ended 30 June).

Prices are expected to fall further, by −1.3%, in FY2014, contrary to an initial forecast of 2.0% inflation. Declining international food and fuel prices, steady domestic food supply, and a stable exchange rate offset the 3.0% increase in public sector wages and public transport fares.

Latest employment data show that only 41.3% of Samoa’s working-age population is economically active. Of this, over a third are employed in subsistence farming. Also of concern is the youth unemployment rate, which at 16.1% is higher than the rest of Southeast Asia and the Pacific.

Outlook

Growth is projected to accelerate to 2.5% in FY2015. Postcylinder rehabilitation, improved remittances, construction and upgrading of hotels, and preparations for the 2015 Commonwealth Youth Games are seen to drive the faster growth.
Samoa

Key sources of foreign exchange (y-o-y % change, 3-month m.a.)

- A slight uptick in prices is expected in FY2015, in keeping with the improving growth outlook, especially for the construction and tourism sectors.
- Government commitment to achieving its medium term fiscal targets is reflected in the recently announced FY2015 National Budget, which projects a fiscal deficit of 4.2% of GDP, down from 4.8% in FY2014. Concerted efforts to reduce the debt overhang, create fiscal room, and reorient public expenditure to productive sectors of the economy will help open up opportunities for private investment.

Key issues

- Samoa’s economy remains narrowly based. Agriculture, which is still largely subsistence-based, provided employment for 37% of the labor force in 2011. Tourism receipts (equivalent to about 20% of GDP), remittances, and international assistance are key sources of income for Samoa.
- Promoting broad-based, sustainable growth is key to generating formal employment opportunities that would help raise living standards and reduce hardship. The government recognizes that private sector development is central to this, as reflected in each annual Strategy for the Development of Samoa since 2005.
- Samoa has made notable progress in reforming state-owned enterprises and improving the business environment. Continuation of structural reforms will help facilitate recovery and growth and generate more jobs. Further, the results of recent World Bank Doing Business surveys suggest that private sector access to credit, contract enforcement, and credit risk management are key constraints.

Solomon Islands

Recent developments

- In April 2014, Tropical Cyclone Ita hit Honiara, the entire Guadalcanal province, and the provinces of Isabel and Malaita. Major infrastructure, including roads, bridges, and the water and sewerage system, was severely damaged and agriculture was badly affected.
- Flooding cut off the only access road to the Gold Ridge mine and prevented fuel, food, and medical supplies from reaching the site. Gold Ridge evacuated all personnel and suspended operations. The mine operator also reported cases of vandalism and looting. Prior to the cyclone, gold production had increased by over 50% (y-o-y) in the first quarter of 2014.
- Production has yet to resume, and environmental concerns have emerged. A United Nations disaster assessment and coordination team noted an extremely high level of water contamination in the mine’s tailing dam. The Prime Minister banned foreign mining executives from returning to Solomon Islands, pending an independent review. Further, a major credit rating agency downgraded the mining operator’s credit rating in May. These developments raise the risk of prolonging the disruption in gold mining operations.
Logging output increased by 1% (y-o-y) in the first quarter of 2014, but a reduction in sawn timber exports is expected as a result of damage to road and bridge links. Exports of round logs are largely from provinces unaffected by the cyclone.

Palm oil exports grew strongly in the first quarter, with crude oil increasing by 21% and palm kernel oil by 25% compared with the same period in 2013. Copra output also increased by 38% (y-o-y). In contrast, cocoa production fell by 21% (y-o-y) over the same period. Declines in crop production are likely in coming months as a result of crop damage and limited road and port access.

Fish catch increased by 54% (y-o-y) in the first quarter of 2014, reflecting peak season (October to March) volumes. Minimal disruption to fishing is expected despite damage to roads and bridges near the port as fishing boats generally do not transfer their catch to land but instead to larger ships.

Inflation accelerated from 2.9% (y-o-y) in January to 3.7% in March. Further increases are likely with food prices expected to rise due to supply disruptions caused by cyclone damage.

Outlook

Given the cyclone’s impact on major sectors, the Solomon Islands economy is now projected to contract by 1.0% in 2014. This represents a significant reversal of the previous outlook (3.0% growth) presented in Asian Development Outlook 2014. A recovery to growth of 3.0% is expected in 2015, although potential long-term issues in the mining sector pose a key risk to the near-term outlook.

Supply bottlenecks also prompt an upward revision to the 2014 inflation projection to 6.0% (from 5.5% in Asian Development Outlook 2014). Restoration of supply links, along with declining international commodity prices, are expected to drive inflation lower to 5.0% in 2015.

Key issues

In contrast to previous natural disasters, the flooding has affected the country’s major economic and population center. Key export industries have been badly affected and thousands of people are still displaced. Rehabilitation of transport links will reconnect producers to markets and help restore livelihoods. Further assistance to subsistence workers, most recently estimated at almost 80% of those employed, will also be necessary as crop loss more directly affects their well-being.

Even prior to the cyclone, growth had already slowed in recent years due to flat forestry sector output. Restoring and expanding infrastructure links will be important to stimulate other potential growth sectors. This will also expand opportunities for subsistence workers to potentially engage in market activities and improve their livelihoods.

Reconstruction spending will further strain already tight government resources. This adds to existing concerns about the quality of expenditure amid growing spending on tertiary scholarships, public wages, and constituency funds. The urgency of response must be balanced with the need for proper management of emergency assistance inflows within a coherent strategy for reconstruction and rehabilitation.

Gold exports and prices (quarterly)

Inflation and fuel prices (monthly)

Foreign reserves (end of period, quarterly)
Recent developments

- Government spending in the first 5 months of 2014 was 24% higher than in the same period in 2013. All major components increased, with the most striking change in transfer payments, up 31% (y-o-y). This was driven by increased public grants while social spending was almost unchanged. Tax revenues were down 22% (y-o-y), raising questions about the level of business activity and the efficiency of tax collection.

- Petroleum royalties totaled $544 million in the first quarter, equivalent to 38% of the government’s forecast for the whole year. This, and income from past savings, brought the Petroleum Fund balance to $15.7 billion (or about $13,000 per capita). The reallocation of Petroleum Fund assets from bonds to equities continues, and is on track to reach the government’s target of 40% equity holdings by June 2014.

- Imports declined by 25% (y-o-y) in the first quarter, largely due to classification changes. Adjusting for these, imports actually rose by 0.5% (y-o-y). Fuel imports rose 31% (y-o-y), reflecting a 22% increase in electricity production during 2013. Food imports also rose by 13%, with imports of fruit and vegetables more than doubling, and grain imports up 25%. Export earnings were flat ahead of the June–October coffee harvest.

- The expansion of private sector credit stopped in the first quarter, as increased lending for agriculture and manufacturing was offset by lower lending for transportation, tourism, and other service providers. Businesses’ cash holdings increased in 2013 and were up 58% in the first quarter of 2014 (y-o-y), suggesting that retained earnings may be substituting for borrowed funds. With only 1.3% of total business lending going to the agriculture sector, lending to farms remains extremely low. Agricultural loans are almost exclusively provided by the government-owned Banco Nacional de Comércio de Timor-Leste, reflecting the challenges in lending to the sector.

- Following almost 3 years of double-digit inflation, consumer price growth slowed significantly by the last quarter of 2013 and was only 2.1% (y-o-y) over the first 4 months of 2014. Continuing appreciation of the US dollar against the currencies of Timor-Leste’s key trading partners, declining international rice and other food prices, and increased competition in a deregulated telecommunications sector contributed to this fall. Lower government spending in 2013 also eased demand pressures. Methodological changes also likely contributed to the reduction in inflation, as Statistics Timor-Leste updated the consumer price index basket and adjusted the way it calculates average prices.

Outlook

- Forecasts for non-oil GDP growth in 2014 and 2015 have been reduced to 8.0% in light of lower private sector credit growth.

- Inflation projections are cut to 3.0% in 2014 and 5.4% in 2015 in light of measurement adjustments and early-year inflation outcomes. Rising government spending is expected to put pressure on prices, particularly toward the end of 2014.

- Updated forecasts suggest that the Bayu–Undan field, which provides 95% of Timor-Leste’s petroleum royalties, will be exhausted by 2021, 4 years earlier than previously expected. Under conservative estimates, the net present value of
recent developments

the international monetary fund estimates that the economy grew by 1.5% in fy2014 (ended 30 june), up from 0.3% in fy2013. higher growth was due to recovery in agriculture (particularly squash, watermelon, and yam), tourism, and wholesale and retail trade.

- tourist receipts increased by 19.1% (y-o-y, adjusted for inflation) in the first half of fy2014 as visitor arrivals increased. private remittances grew by only 0.8% (y-o-y, adjusted for inflation) during the same period. however, remittance receipts are likely to pick up in the second half of the fiscal year with cyclone ian recovery efforts. experience suggests that remittances from tongans living abroad will increase in response to the loss of livelihoods and declines in incomes in ha’apai.

- inflation was 2.3% over the first 3 quarters of fy2014 despite continued declines in international commodity prices. this is mainly due to postcycnote supply disruptions and reconstruction on the ha’apai island group. inflation is estimated at 3.0% for full-year fy2014.

outlook

- the fy2015 growth outlook is upgraded to 2.5% to account for improving tourism, exports, and business activity, as well as the temporary boost from cyclone recovery efforts. development-partner-financed reconstruction is seen to boost related sectors.

- price inflation is expected to moderate to around 2.0% in fy2015. the supply of domestic crops and international fuel and food prices are seen to stabilize.
Tonga

Key issues

- According to the 2011 population census, only 52.3% of the working-age population is economically active, less than the average for ADB’s 14 Pacific developing member countries (around 60%). Slow economic growth has limited the expansion of job opportunities in urban and rural areas.

- The government recognizes that facilitating private investment is essential to providing employment opportunities for the labor force. Its structural reform agenda contains actions to progressively minimize public sector inefficiencies and private sector constraints. This entails improving public financial management, rationalizing state-owned enterprises, and streamlining onerous business regulations.

- The pace and extent of reforms in the agriculture, forestry, and fisheries sector, which accounted for an estimated 40% of employment in 2010 and 2011, needs to be sustained and deepened. Minimizing disruptions to the operations of heat and chemical treatment facilities, for example, will have an important bearing on export and employment growth in the sector.

- The operation of the Tonga–Fiji submarine cable, and the greater connectivity that it provides, have enormous potential to bring significant economic and social benefits. Not only will it help businesses expand and create more jobs, but the development of e-applications in health and education will also help boost Tonga’s human capital development.

Tuvalu

- In 2013, fishing license revenues more than doubled as a result concerted efforts by Tuvalu and other Pacific economies to raise fisheries access fees under the recently introduced Vessel Day Scheme. This led to a budget surplus of 25% of GDP in 2013. For 2014, the government projects an even larger surplus of 32% of GDP with expectations of continuing strong performance of fishing license revenues.

- After declining through most of 2013, imports from New Zealand increased sharply over the first quarter of 2014. Imports of food and other agriculture products, however, declined in the quarter, while imports of machinery and equipment increased. This suggests that the rise in total imports may be largely tied to the resumption in development-partner-funded infrastructure projects rather than stronger consumer demand.

- Construction work on the development-partner-financed airport upgrade, and increased retail activity, are seen to drive economic growth of 2.0% in 2014 and 2015. Inflation is projected to increase to 2.5% as economic activity strengthens in 2014, before continuing declines in international commodity prices push it down to 2.0% in 2015.

- With demand for seafarers at an all-time low, seasonal worker programs in Australia and New Zealand have provided overseas employment opportunities. To make workers more competitive, the government has made Nadi, instead of Funafuti, the hiring point for Tuvaluans. The government provides advances to cover workers’ return transportation between Funafuti and Nadi.
Recent developments

- In 2013, tourist arrivals exceeded 100,000 for the second year in a row. In the first quarter of 2014, departures from Australia and New Zealand to Vanuatu remained at about the same level as in the first quarter of last year—an early indication that strong tourism performance will be sustained this year.

- In May, following a vote of no confidence, Vanuatu changed its Prime Minister for the fourth time in 3 years. One area flagged for review by the new Prime Minister is the previous government’s airport funding deal. The deal grants a Singapore-based company rights to build a new international airport and upgrade several regional airports. It also guarantees reimbursement of the estimated $350 million project cost if the government breaches the agreement, but Parliament has yet to pass supporting legislation.

- The government targets a balanced budget for 2015. It aims for recurrent revenues of at least 18% of GDP and recurrent expenditure of no more than 17% of GDP. Public debt is targeted to remain below 40% of GDP in the long run.

Outlook

- The growth forecasts for Vanuatu are maintained at 3.5% in 2014 and 4.0% in 2015. Construction of major infrastructure projects have begun and will significantly boost growth over the next 3–5 years. Infrastructure spending is projected to quadruple from 2014 to 2016. ADB forecasts are slightly lower than the government’s projections due to a more conservative outlook for infrastructure spending given capacity constraints.

- ADB maintains its forecasts for inflation to pick up to 2.5% in 2014 and 3.0% in 2015. These are in line with the government’s forecasts of 2%–3% inflation over 2014 and 2015. Infrastructure spending is seen to fuel demand and price pressures in the near term.

Key issues

- Vanuatu has made significant strides toward reforming state-owned enterprises (SOEs) in the past year. In October 2013, the government approved a new SOE policy to serve as a blueprint for subsequent legislation. It aims to place SOEs on a firm commercial footing and enhance governance, monitoring, and accountability frameworks. Some SOEs have effectively ceased operations and have been marked for liquidation for several years. After liquidating one SOE in 2013, the previous government had planned to liquidate three more in 2014 and 2015. It is important that the new administration continue this reform momentum to reduce the fiscal burden of inefficient SOEs and improve service delivery and quality.

- A decade of uninterrupted growth has resulted in structural transformation of Vanuatu’s economy. The increasing importance of tourism led to some shift from agriculture employment toward services and industry. Sustaining growth is necessary to provide alternative employment to the large number of workers (about 60% of employed) still engaged in subsistence activities.
Realizing job needs across the Pacific

The Pacific region includes countries with high population growth rates as well as countries with declining populations. Labor market issues are therefore diverse, and efforts to address these issues are best developed in country-specific contexts. Nonetheless, this overview highlights some of the dominant labor market challenges faced in the region, considers underlying economic and labor market conditions, and discusses policy options for addressing these challenges.

Challenges faced across Pacific labor markets

Many countries in the Pacific share a number of common labor market characteristics and problems:

First, creating new opportunities for productive employment is arguably the most urgent labor market issue in the Pacific, especially in Papua New Guinea (PNG), Solomon Islands, Timor-Leste, which share an critical need to generate new jobs for their young and rapidly growing populations. These countries have recently achieved relatively high economic growth rates driven by resource export sectors. Other countries in the region share the need to generate new employment, although they generally have both lower rates of population growth and economic growth than the largest Pacific countries. Constraints to job growth in the region are daunting and interrelated.

Second, labor force participation rates—defined as the percentage of working-age persons in an economy who are employed or are unemployed but looking for a job—average 63% (Table 1). However, large proportions of the working-age populations in most Pacific countries continue to be engaged in subsistence-oriented and informal market activities, and have only marginal attachments to the formal labor market. Informal sector workers typically have lower and more unstable incomes, lack access to employment-related protection and other public services, and suffer from underemployment as they struggle to find adequate paid work.

Third, the low proportion of workers engaged in formal sector employment explains why the regional average unemployment rate appears moderate at 6.4%. For many people, even if they would like formal sector employment, they view the probability of securing a job so low that they do not actively participate in the formal labor market, which means they are not counted in the unemployment figures.

Fourth, large numbers of Pacific workers (especially more educated workers) seek employment overseas. This alleviates some of the pressure in the domestic labor markets but can constrain domestic growth by possibly creating shortages of skilled workers. Countries with strong links to more advanced and growing economies continue a long-standing pattern of migration, overseas employment, and repatriation of remittances that can make significant contributions.

### Table 1: Pacific labor market indicators (as of 2014 or latest available year)

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<tbody>
<tr>
<td>Cook Islands</td>
<td>15.2</td>
<td>62.4</td>
<td>77.0</td>
<td>65.0</td>
<td>31.0</td>
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<td>66.8</td>
<td>...</td>
<td>68.9</td>
<td>72.1</td>
<td>10.1</td>
<td>22.5</td>
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<tr>
<td>Kiribati</td>
<td>111.1</td>
<td>61.3</td>
<td>72.4</td>
<td>66.2</td>
<td>50.2</td>
<td>24.8</td>
<td>27.7</td>
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<td>Marshall Islands</td>
<td>54.5</td>
<td>57.4</td>
<td>66.3</td>
<td>53.4</td>
<td>66.7</td>
<td>38.0</td>
<td>3.5</td>
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<tr>
<td>FSM</td>
<td>102.9</td>
<td>63.2</td>
<td>66.1</td>
<td>48.4</td>
<td>39.9</td>
<td>24.4</td>
<td>52.4</td>
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<td>Nauru</td>
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<td>78.9</td>
<td>49.3</td>
<td>73.9</td>
<td>25.3</td>
<td>4.1</td>
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<td>Palau</td>
<td>17.9</td>
<td>72.4</td>
<td>...</td>
<td>68.1</td>
<td>94.0</td>
<td>34.9</td>
<td>2.0</td>
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<tr>
<td>PNG</td>
<td>7,570.7</td>
<td>58.2</td>
<td>62.0</td>
<td>63.6</td>
<td>55.2</td>
<td>22.8</td>
<td>41.0</td>
</tr>
<tr>
<td>Samoa</td>
<td>187.4</td>
<td>55.7</td>
<td>58.3</td>
<td>21.3</td>
<td>60.7</td>
<td>3.2</td>
<td>5.7</td>
</tr>
<tr>
<td>Solomon Islands</td>
<td>626.2</td>
<td>57.7</td>
<td>63.5</td>
<td>62.2</td>
<td>21.7</td>
<td>4.2</td>
<td>7.7</td>
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<tr>
<td>Timor-Leste</td>
<td>1,306.0</td>
<td>54.1</td>
<td>56.1</td>
<td>25.7</td>
<td>29.1</td>
<td>15.9</td>
<td>69.8</td>
</tr>
<tr>
<td>Tonga</td>
<td>103.3</td>
<td>56.5</td>
<td>62.7</td>
<td>42.3</td>
<td>70.6</td>
<td>17.6</td>
<td>28.6</td>
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<tr>
<td>Tuvalu</td>
<td>11.1</td>
<td>61.9</td>
<td>...</td>
<td>73.3</td>
<td>47.7</td>
<td>42.2</td>
<td>43.0</td>
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<tr>
<td>Vanuatu</td>
<td>271.1</td>
<td>59.4</td>
<td>80.4</td>
<td>61.4</td>
<td>38.5</td>
<td>7.7</td>
<td>59.6</td>
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<tr>
<td><strong>PACIFIC (total/average)</strong></td>
<td><strong>11,251.2</strong></td>
<td><strong>58.4</strong></td>
<td><strong>62.7</strong></td>
<td><strong>52.9</strong></td>
<td><strong>19.5</strong></td>
<td><strong>43.5</strong></td>
<td><strong>6.4</strong></td>
</tr>
<tr>
<td>Pacific excluding PNG</td>
<td>3,680.5</td>
<td>59.9</td>
<td>...</td>
<td>56.5</td>
<td>47.2</td>
<td>11.7</td>
<td>49.5</td>
</tr>
</tbody>
</table>

... = data not available; FSM = Federated States of Micronesia; PNG = Papua New Guinea.

Note: Working-age population standardized to ages 15–64; Regional averages are weighted averages.

to the families and economies back home. Migrant remittances contributed an estimated average of 22.8% of GDP in Tonga and 21.2% in Samoa from 2006 to 2012.

Fifth, for countries where data are available, women’s participation in the labor force is generally lower than men’s. In Samoa and Timor-Leste, women’s labor force participation rates are around 25%, which is about 30 percentage points lower than men’s. This is indicative of a much narrower range of employment opportunities for women in the region that reduces their contribution to the economy.

If these challenging labor market conditions persist and recent employment trends continue, the number of unemployed and underemployed persons in the Pacific is likely to rise sharply in coming decades. The region’s total population is projected to increase by about 4.1 million by 2030. The working-age population is seen to expand by 3.1 million, with about 2.1 million remaining outside wage employment, assuming there are no changes in labor force participation and formal employment rates. Just to maintain current rates of unemployment, nearly 1 million new formal sector jobs (or an expansion of current jobs by 44%) will be needed over the next 16 years. This does not take into account the need to provide formal employment for a nearly equal number of workers (about 830,000) that would otherwise be added to the subsistence sector.

Drivers of current labor market conditions

The challenges Pacific economies face in competing in global markets result in relatively small private sectors. Small and dispersed markets limit domestic demand, while remoteness constrains export opportunities for private enterprises in the region. Unable to achieve necessary economies of scale, businesses struggle to expand operations and extend employment opportunities. In addition to structural constraints, some policy choices have hindered the development of an enabling environment for private sector investment. Industries where private sector growth has tended to be highest in the region are in capital-intensive sectors, such as mineral and petroleum extraction in PNG and Timor-Leste. These industries make significant economic contributions but generate few direct employment opportunities. Further, these industries are characterized by high levels of leakage as a result of repatriation of profits by overseas investors and these industries’ reliance on imported skilled labor. The considerable growth generated by the resource sectors, however, does offer domestic opportunities through indirect employment in related retail, transport, and other industries.

Recent developments are opening up new opportunities in the Pacific. Significant investments in infrastructure and in information and communications technology are enabling the development and expansion of private investments in tourism and other services. Better roads and air and maritime services are enabling countries such as the Cook Islands, Fiji, and Palau to engage larger shares of the working-age population in formal, private sector employment. International demand for tourism has been growing and is forecast to continue to expand in the coming decades, which offers Pacific destinations a positive long-term growth outlook.

Given the relatively modest contribution of the private sector to overall employment, the public sector has tended to assume a dominant role in providing formal sector employment, often as an employer of last resort. But the public sector itself is limited in the extent to which it can provide employment opportunities and there is excess demand for public sector jobs.

Further, public sector jobs are frequently used for dual purposes. These are not only viewed as inputs into the provision of public services but also as a de facto social safety net. As more labor is employed than required, public sector productivity declines and could result in poor delivery of public services. Weak delivery of public education and health services produces poor education and health outcomes, which in turn, constrain growth and the expansion of new job opportunities—creating a vicious cycle. Use of public sector employment as a de facto social safety net also drives widening public–private wage gaps that hinder businesses in their efforts to attract skilled labor (Figure 1). This, in turn, contributes to the lackluster private sector growth outcomes observed in many Pacific developing member countries (DMCs).

**Figure 1: Public vs. private wages and salaries in the RMI ($’000 per annum)**

<table>
<thead>
<tr>
<th>FY 2000</th>
<th>FY 02</th>
<th>FY 04</th>
<th>FY 06</th>
<th>FY 08</th>
<th>FY 10</th>
<th>FY 12</th>
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<td>3</td>
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<td>3</td>
<td>6</td>
<td>9</td>
<td>12</td>
<td>15</td>
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</tbody>
</table>

Realizing job needs across the Pacific

The scope for expanding (or in many cases, merely sustaining) jobs in the public sector is very limited. Without significant resource revenues, most governments tend to rely on overseas development assistance to fund expenditure. Development partners generally share concern about the large and growing public wage bills in the region (Figure 2).

Options for generating employment opportunities

Despite challenges to generating needed employment opportunities, Pacific DMCs have a number of policy and program instruments at their disposal that, if used effectively, can be combined to address job growth constraints and boost regional employment prospects.

Expanding private sector opportunities. Generating more private sector employment opportunities requires policies to entice new investment in relatively labor-intensive businesses and to foster employment growth in existing businesses. Improved infrastructure is a key element in improving connectivity within and between Pacific DMCs, and to creating new business opportunities by lowering transaction costs. Better roads facilitate market access. More and better air and shipping services can help cut transportation costs. Improved information and communications technology can reduce the cost of doing business. Taken together, improved infrastructure can improve business competitiveness and expand markets.

At a sector level, given the variation in the structure of Pacific DMC economies, strategies for expanding private sector opportunities will need to be country specific. The larger resource-based economies could look to train more skilled workers through innovative partnerships between the public and private sectors—models from other Southeast Asian countries may provide useful lessons. Such public–private approaches could also look to expand opportunities for local businesses to provide services.

The relatively small size of many Pacific DMC economies and their labor markets means success in attracting one or two foreign investments can have a large impact on increasing formal sector employment. For example, tourism investments in Fiji, the FSM (particularly on Yap), and Vanuatu have demonstrated some success in generating new jobs. The tuna loining plant in Majuro, the RMI, and the Yazaki wiring factory in Samoa had initial success, but have recently struggled due to market changes. The RMI loining plant now employs far fewer Marshallese and is looking to Kiribati to provide workers. With the closure of Toyota car production in Australia by 2017 the future of the Yazaki wiring factory is now uncertain.

With the large numbers of people engaged in the informal sector, supporting private sector informal activity can also make an important contribution to employment opportunities. Increasing access to affordable financial services for small-scale entrepreneurs can expand the availability of capital at the community level. Fostering the development of micro, small, and medium-sized enterprises (MSME) can spur entrepreneurship and innovation.

In environments where formal sector jobs are scarce, policy makers need to carefully assess the implications of new labor market laws and regulations on employment generation. Regulation should take care to avoid inhibiting job creation. But it is also reasonable for Pacific DMCs to aspire to have the same level of legislative protection for their workers as other countries at a similar stage of development.

Reforming public sector employment. Enhancing the productivity of Pacific public sector workers is a long-term undertaking. It requires sustained efforts to professionalize the civil service, promote merit-based hiring and promotion, tie incentive-based remuneration to achievement of performance targets, and implement related reforms.

Unfortunately, slow private sector development has led some Pacific governments—often with the support of development partners—to seek to create jobs directly by establishing state-owned enterprises. Direct job-creating investments by Pacific governments have, at best, had mixed results. The region’s growth has suffered from failed government-directed investments in the commercial tuna industry, hotels, airlines, agriculture, and wholesale and retail sectors (ADB 1997; Gillett 2010).
To reduce pressure on the use of public sector employment as a social safety net, development of targeted transfer programs, widely used across the world, provide a better alternative. While costly, especially during the establishment phase, these transfer programs offer a fairer and more transparent way of providing social safety nets without distorting public sector performance. These can also help public sector employment processes become more merit based. Relieving public sector employment of its implicit social safety net role should enable real productivity growth in the public sector and promote a clearer focus on service delivery. State-owned enterprise reform to contract out delivery of public services to the private sector can also lead to efficiency gains and generate new opportunities for local businesses.

**Improving education and training systems.** The public sector has tended to take the lead role in skills development, especially through the delivery of technical and vocational education and training (TVET) services. Investments in basic education and TVET that equip a growing labor force with skills demanded by domestic, regional, and international markets have shown some success in creating more jobs for Pacific workers, both at home and abroad. However, the modest number of trainees graduating, the quality of the skills developed, and the low retention of postsecondary trainees all point to the need to do more to develop skills more effectively.

Since its establishment in 2007, the Australia-Pacific Technical College (APTC) has produced over 5,000 graduates from training campuses in Fiji, PNG, Solomon Islands, Samoa, and Vanuatu. APTC offers Australian-recognized credentials in fields such as construction and manufacturing, tourism and hospitality, and health and community services.

Expanding opportunities for female students to receive training for nontraditional occupations can address gender bias and help overcome gender-based job discrimination that has hampered the success of education and training efforts.

**Job growth through regional cooperation and integration.** Regional initiatives, such as the Melanesian Spearhead Group labor scheme, and seasonal employment schemes in Australia and New Zealand have expanded employment opportunities for islanders. Under its Recognised Seasonal Employer (RSE) scheme, New Zealand hosted a total of over 6,000 temporary workers from Pacific DMCs in FY2013. Almost half of these workers were from Vanuatu, where RSE participation is now a significant source of foreign exchange. Australia has likewise seen rapid growth in seasonal worker arrivals. Over 1,000 workers from Pacific DMCs found seasonal employment in Australia in FY2012, with a large majority coming from Tonga.

Regional trade agreements provide an important framework to formalize arrangements for labor mobility. The ongoing discussions around the Pacific Agreement on Closer Economic Relations suggest these issues are not straightforward, but have the potential to form an important part of expanding regional labor market opportunities in the Pacific.

While APTC has succeeded in skills creation, it has yet to achieve any significant progress in fostering labor mobility. Only about 1.5% of APTC graduates have found employment overseas. Graduates generally intend to migrate, particularly to Australia, but opportunities are hampered by administrative issues relating to skills assessment and certification. Mechanisms to match graduates with potential employers in Australia are also lacking (Clemens, Graham, and Howes 2014). Resolving these and other related issues will help facilitate the movement of APTC graduates, and also provide important lessons for the design of future programs targeting regional labor mobility.

**Conclusion**

To achieve more inclusive growth, Pacific economies will need to ensure that recent improvements in headline growth figures are translated into more and better employment opportunities. Creating enough decent, productive jobs for their citizens requires Pacific DMCs to adopt policy actions that take advantage of the opportunities resulting from a more interconnected regional and global economic system. This brief offers a preliminary analysis of some of the issues seen as defining labor markets in the Pacific. It presages additional research planned by ADB to explore these issues and options for improving job opportunities in the region in coming years.

Lead authors: Christopher Edmonds and Andrew Parker.

References:
ADB. 2009. *Support for Public Sector Reforms in the Pacific: Enhance Results through Ownership, Capacity, and Continuity.* Manila: ADB.
One of the Pacific economies’ distinctive characteristics is the informal sector’s significant contribution to growth and employment. The informal sector is broadly characterized as “unregistered and/or small unincorporated private enterprises engaged in the production of goods and services” (ILO 1993). Typically, informal business operations are small scale, without contractual arrangements and division between capital and labor, and generate income and employment exclusively for the persons concerned. In this analysis, the informal sector includes subsistence agriculture.

Subsistence workers account for a significant proportion of total employment in the Pacific developing member countries (DMCs) (Table 2). They constitute more than half of total employment in the Federated States of Micronesia, Solomon Islands, Timor-Leste, and Vanuatu.

The sheer size of subsistence employment has at least two implications. First, the informal sector essentially serves as a natural economic shock absorber. It allows workers to exit the formal sector temporarily and, rather than being unemployed, earn subsistence income. Therefore, low unemployment rates in some Pacific DMCs (e.g., Solomon Islands, Timor-Leste, Tonga, and Vanuatu) should be interpreted with caution because it may mask a high incidence of underemployment.

Secondly, the informal sector’s disproportionately large role in the labor market poses a pressing challenge to sustainable growth and development in Pacific DMCs. Subsistence workers have no access to employment protection and external credit, and are financially vulnerable to shocks. Except in Papua New Guinea, there is no legislation recognizing the informal sector’s contribution to subsistence employment in Pacific DMCs.

The absence of legislative and policy frameworks to systematically address subsistence labor development hampers improvements in overall labor productivity and business operations.

Declining importance of the informal sector

The contribution of the informal sector to total GDP generally declines as an economy develops. (UNESCAP 2007) Rising demand results in more economic opportunities, allowing more businesses and workers to move into formal market-based operations. Therefore, the formal sector’s crowding out of the informal sector is not surprising; it is part and parcel of economic development. Since formalization of an economy signifies more effective taxation, government regulations, and social security systems, it should be deemed as a step toward higher levels of economic development.

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In the Pacific, this is illustrated by the Cook Islands, where the informal sector accounted for approximately 3% of total GDP in 2012 (down from 6% in 2001) (Figure 3). Comparing informal sector and overall growth shows that the declining share of GDP could be attributed to the relatively faster growth in the formal sector. The informal sector generally underperformed vis-à-vis the overall economy by 0.4%, on average. As the formal economy grows, more labor is usually reallocated toward the formal and away from the informal sectors.

### Table 2: Contribution of informal sectors to employment

<table>
<thead>
<tr>
<th>Employment (‘000)</th>
<th>Unemployment (% of labor force)</th>
<th>Subsistence workers (‘000)</th>
<th>% employed</th>
<th>Year/Source</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cook Islands</td>
<td>6.2</td>
<td>8.2</td>
<td>0.1</td>
<td>1.8</td>
</tr>
<tr>
<td>Fiji</td>
<td>369.3</td>
<td>6.9</td>
<td>8.3</td>
<td>22.5</td>
</tr>
<tr>
<td>Kiribati</td>
<td>28.0</td>
<td>30.6</td>
<td>7.8</td>
<td>27.7</td>
</tr>
<tr>
<td>Marshall Islands</td>
<td>11.1</td>
<td>30.9</td>
<td>0.4</td>
<td>3.5</td>
</tr>
<tr>
<td>Micronesia, Fed. States of</td>
<td>31.3</td>
<td>16.2</td>
<td>16.4</td>
<td>52.4</td>
</tr>
<tr>
<td>Nauru</td>
<td>3.1</td>
<td>23.0</td>
<td>0.1</td>
<td>4.1</td>
</tr>
<tr>
<td>Palau</td>
<td>8.4</td>
<td>4.1</td>
<td>0.2</td>
<td>2.0</td>
</tr>
<tr>
<td>Papua New Guinea</td>
<td>2,713.1</td>
<td>6.4</td>
<td>1,112.4</td>
<td>41.0</td>
</tr>
<tr>
<td>Samoa</td>
<td>40.7</td>
<td>5.7</td>
<td>14.5</td>
<td>35.6</td>
</tr>
<tr>
<td>Solomon Islands</td>
<td>220.0</td>
<td>3.2</td>
<td>170.7</td>
<td>77.6</td>
</tr>
<tr>
<td>Timor-Leste</td>
<td>284.2</td>
<td>3.6</td>
<td>198.5</td>
<td>69.8</td>
</tr>
<tr>
<td>Tonga</td>
<td>30.2</td>
<td>1.1</td>
<td>8.6</td>
<td>28.6</td>
</tr>
<tr>
<td>Tuvalu</td>
<td>4.2</td>
<td>16.3</td>
<td>1.8</td>
<td>43.0</td>
</tr>
<tr>
<td>Vanuatu</td>
<td>108.9</td>
<td>4.6</td>
<td>65.0</td>
<td>59.6</td>
</tr>
</tbody>
</table>


Note: This policy brief adopts the International Labour Organization definition of subsistence workers as “workers who hold a self-employment job and in this capacity produce goods or services which are predominantly consumed by their own household and constitute an important basis for its livelihood.”

Source: ADB estimates based on latest population and housing censuses, household income and expenditure surveys, and labor force surveys.
Informal sector growth and employment

However, the decline in the informal sector can be stalled or reversed by adverse economic shocks. In the case of Tonga, civil disturbances in 2006 drove a temporary expansion in the informal sector. With a subdued formal economy, businesses and workers resorted to informal activities to generate income. The role of the informal sector as a hedge against economic shocks is illustrated by the steady growth in informal sector output while the overall economy contracted. More recently, the informal sector’s share in GDP has been declining as the economic situation in Tonga steadily improved.

The case of Fiji further highlights possible impacts of political and economic disruptions on the size of the informal sector. The 2006 military coup, the country’s second in a span of 6 years created significant uncertainty in the business and economic environment. Heightened uncertainty suppressed private investment, and likely pushed some businesses and workers toward the informal sector. The relative size of the informal sector increased slightly from 14.3% of GDP in 2005 to 15.4% in 2011. Comparing formal and informal contributions to GDP by sector further underscores the expansion in informal activities during the period of high market uncertainty (Figure 4). The largest increase was in agriculture, where the informal sector’s share of sector GDP increased from 23.6% in 2005 to 33.3% in 2011. Wholesale and retail trade (23.1% to 30.7%), personal and household services (24.6% to 29.0%), and manufacturing (21.9% to 26.0%) also saw notable shifts toward greater informal sector output. The economic disruption caused by the coup depressed domestic demand and may have caused smaller formal businesses to cease operations. Further, political and business uncertainties reduced private investment, including foreign investment, thereby limiting the opportunities for any large new business ventures.

The expansion in informal sector output is also mirrored in the labor market (Figure 5). Data from Fiji’s 2004–2005 and 2010–2011 employment and unemployment surveys allow for a crude measure of informal employment—the number of workers who are not paying Fiji National Provident Fund contributions. Using this simplified measure, the share of informal employment edged up slightly from 57.1% of the total in 2005 to 58.4% in 2011.

While informal sector shares in employment declined across subsectors, the rise in the number of subsistence workers in agriculture was substantial. The increase in informal agriculture employment is almost double the net decline across all other sectors. Thus, subsistence agriculture appears to have absorbed not only former industry and service workers but also the bulk of new labor market entrants during this period. This highlights the “natural economic shock absorber” role, in particular, of informal agriculture. Engaging in informal agriculture activities allows workers to support their livelihoods through subsistence or small-scale production for sale during times when employment opportunities in the formal sector are limited. Periods of economic crises or prolonged uncertainty can therefore push workers to the informal sector, at least temporarily, until they return to formal sector work when conditions normalize.

Conclusion

While informal sector output and employment can be expected to decline as an economy develops, episodes of economic uncertainty and stagnation can stunt the increasing formalization of economic activities. The case of Fiji highlights the importance of developing and maintaining a sound business environment to sustain a transition from informal to formal sector activities. As Fiji prepares for a return to representative government, policy transparency and predictability is seen to improve and this should reinvigorate private investment and formal sector activity in general.

GDP = gross domestic product, lhs = left-hand scale, rhs = right-hand scale.
Notes: (i) Informal sector includes subsistence GDP in agricultural sectors; (ii) GDP growth is measured at constant prices and on a year-on-year basis.
Sources: The Cook Islands’ Ministry of Finance and Economic Management and Tonga Department of Statistics.
The transition from informal to formal sector activities, in principle, is an encouraging sign of economic development. The formal sector is typically more productive than the informal. It is also subject to government taxation and social security contribution, thereby making the overall economy more conducive to sustainable growth. Nevertheless, this trend implies that the formal sector, particularly the private sector and small and medium-sized enterprises, will become much more crucial to job generation than ever before. To ensure that formal sector growth can be translated into job creation, it is essential that appropriate labor laws and regulations are implemented, sufficient social and employment provided, and private sector development in policy agendas advocated.

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Lead authors: Aekapol Chongvilaivan, Ruth Francisco, and Rommel Rabanal.

References:
Employment is a pressing concern in Pacific island countries (PICs) as youth populations expand and urbanization accelerates, yet economic growth typically remains low. While public sectors in the PICs are often viewed as constraints to private sector growth and employment creation, they actually offer important avenues for improved employment outcomes.

The employment challenge in the Pacific

The Pacific population is expected to double over the next 28 years, as high fertility rates drive rapid population growth in several PICs. All of these countries face a youth bulge, with 54% of the population below the age of 24—a higher proportion than in East Asia or the broader developing world. The number of people aged 0–14 substantially exceeds the number of those aged 14–25, so the number of working-age youth is expected to grow quickly over the next decade from an already high base (figures 6 and 7).

Formal employment opportunities are already limited relative to the labor force in most PICs. Recent estimates from the International Labour Organization (ILO) suggest that the percentage of men aged 20–24 who are not engaged in productive activities (defined as "paid or unpaid activity that contributes to their personal livelihood or that of their family and community as a whole") is as high as 58% in Kiribati, 44% in the Republic of the Marshall Islands (RMI), and 46% in Samoa (ILO 2013). At the same time, the spread of mass media and telecommunications has increased awareness of the wider world and fueled aspirations for higher living standards. Many people, particularly youth, have aspirations beyond village-based and family-oriented agricultural and fishing activities. The pressure associated with these growing aspirations is already spilling over into higher rates of urban migration in some PICs as young people seek cash incomes and broader opportunities, despite generally low rates of economic growth (Figure 8). For Pacific governments concerned with living standards, urbanization pressures, and social stability, improving the quantity and quality of employment opportunities is a key priority.

Figure 6: Population, by age group (% of total )

![Figure 6: Population, by age group (% of total )](image)

Source: United Nations Department of Economic and Social Affairs.

Figure 7: Expected growth in 15–24 year old population by 2020

![Figure 7: Expected growth in 15–24 year old population by 2020](image)

Source: Adapted from Bedford 2012.

Figure 8: Economic growth and urbanization

![Figure 8: Economic growth and urbanization](image)

Source: United Nations Development Programme and World Development Indicators.
Is the public sector part of the problem?

Reducing the size of public sectors in the PICs has often been cited as a priority to stimulate private sector growth and employment creation. Public expenditure and public sector wage bills in the PICs tend to be higher than in other small states and other middle-income countries (figures 9 and 10). The public sector also accounts for a very large share of formal employment (30 percent in Solomon Islands to nearly 80 percent in Kiribati). Large public sectors are often viewed as “crowding out” the private sector, with public sector employment thought to come at the cost of private sector employment. The public sector is viewed as imposing costs on the private sector by bidding up wages, inflating the tax burden, and tying up resources under inefficient public management. But it is not clear that these arguments apply particularly well in PICs, for several reasons.

First, it is not clear that wage or tax levels are binding constraints to profitability for the private sector in the PICs. Previous research has highlighted geographical constraints to private sector development in the PICs. The small size of their domestic markets makes it hard for firms to capture economies of scale. The relative dearth of firms makes it difficult for those that do exist to outsource upward and downward through the supply chain. They are also unable to observe the practices of other firms in the same industry and lack access to a pool of workers with experience in different firms, limiting their exposure to positive knowledge externalities.

In other small countries, firms can overcome some of these limitations by trading internationally. But the PICs are some of the most remote countries in the world (Figure 11). Extreme distance from markets increases the costs of domestic production and exports, because the costs of imported and non-tradable inputs are inflated (Figure 12). These costs have been demonstrated to be sufficient to undermine competitiveness across a wide variety of trading sectors (Tumbarello et al. 2013; Yang et al. 2012; Winters and Martins 2004). It is therefore not clear how much additional private sector activity and employment creation could be expected from marginal reductions in wages or taxes.
Second, it is not clear that relatively large public sectors inflate the tax burden on the private sectors in most PICs, because they are often financed by aid or natural resource rents. Of the nine PICs covered, the Doing Business indicators show that only the three US Compact states (Federated States of Micronesia, the RMI, and Palau) impose higher taxes than the average for East Asia and the Pacific (which is itself relatively low in global terms). To a large extent, the public sectors in PICs, through their expenditure, distribute the benefits of aid and natural resource rents across their populations. This additional public spending represents a vital source of demand in many PICs, with public sector employment and procurement supporting local businesses. (If aid and natural resource rents were instead distributed as private transfers, it is likely that the import content would be greater and the domestic economic multiplier smaller, with a negative impact on local employment and domestic private sector activity, relative to their distribution through public expenditure.) In several PICs, private sector activity and economy-wide output is driven by and strongly correlated with public spending (Figure 13). With private sector opportunities constrained by geography, Pacific governments have often become employers of last resort, offering broad employment opportunities to populations that would otherwise face even more limited employment prospects.

Third, reducing public expenditure may actually impose costs on the private sector that exceed any benefits from lower wages and taxation. A number of public goods and services are subject to indivisibilities, with many small states not large enough to take advantage of economies of scale in their provision. Many PICs face additional costs associated with delivering public goods and services to populations spread thinly across many different islands dispersed over large stretches of ocean. For the reasons outlined above, their remoteness also means that the inputs the PICs need are subject to inflated costs. As we have already seen, public expenditure in many PICs exceeds that in other small states and middle-income countries, but many of these PICs are either especially small (and therefore less able to capture economies of scale in the provision of public goods and services) or especially disadvantaged by dispersal, division, and remoteness (Figure 14).

This suggests that “large” public sectors may be a somewhat inevitable consequence of providing public goods and services in contexts like the PICs. Reducing the size of their public sectors, and the range and quality of goods and services they can provide to their private sectors, may hamper the growth of firms in PICs, where inadequate human capital and infrastructure are frequently cited as constraints to private sector growth.

Overall, while there are important differences among PICs, it is unlikely that simply reducing public sector expenditure and employment would help them address the employment challenges they currently face. Instead, the challenge is to ensure that public expenditures have the greatest possible impact in improving employment outcomes.

Can the public sector be part of the solution?

Several steps could be taken to improve employment outcomes from public expenditure in the PICs.

The role of the public sector
First, the primary focus should be on making the public sectors more efficient. That is, the emphasis should be on enabling the public sectors to deliver more and better services to their private sectors and populations at existing levels of expenditure. Fit-for-purpose tools for public sector management, performance, and accountability—including in the areas of public finances and human resources—that can be effective in thin-capacity contexts need to be developed and implemented. These might include, for instance, public financial management systems that encourage effective public dialogue on the use of public resources to help align public sector incentives with efficient service delivery. They might also include human resource management systems that effectively strengthen merit-based recruitment and promotions in small societies to help ensure that the distribution of these critical public sector employment opportunities is perceived to be fair, and to avoid undermining social cohesion and fueling conflict (World Bank 2010, 2012).

Second, outsourcing and privatization should be pursued selectively in contexts where a competitive market environment is feasible. This has the potential to improve service delivery and expand private sector employment opportunities (ADB 2011). In the absence of a competitive market environment, privatization can undermine service delivery and employment outcomes, with inadequately regulated private monopolies performing no better—and possibly worse—than public monopolies. Similarly, competition for contracts and effective monitoring of delivery by government agencies are necessary if outsourced services are to be delivered efficiently. Thus, opportunities for privatization and outsourcing need to be pursued carefully, taking account of (i) the economic significance of efficiency benefits expected from the introduction of private participation; (ii) the impact of any likely public sector employment losses on living standards and social cohesion, especially in the context of limited private sector employment opportunities; and (iii) the capacity of government to monitor and enforce regulatory or contractual arrangements effectively, in order for the potential benefits of private participation to be realized.

Finally, there are opportunities to increase the direct employment impact of public expenditure that should be pursued. Given limited prospects for private sector employment creation in the PICs, it is important that policy makers acknowledge that employment outcomes are a legitimate consideration in public expenditure. Explicit recognition could help to ensure that associated trade-offs are well managed and transparent.

**Figure 14: Public expenditure (% of GDP)**

Index of Remoteness and Dispersion

Note: The Index of Remoteness and Dispersion is comprised of four components that seek to capture population dispersion, internal division, remoteness from major markets, and spatial dispersion.
Source: World Bank staff calculations.
Possibilities for improving the employment impact of public expenditure include the following:

First, employment impacts should be treated as an important factor in the design of aid projects. Aid flows to PICs are often very significant, but donor spending sometimes has a lower domestic employment impact than it could, because inadequate attention is paid to (i) employment generation as—in itself—an important benefit of projects, (ii) the need to build the capacity of local firms to be able to provide inputs to those projects, and (iii) the need for broader awareness among local businesses of opportunities to supply inputs for donor projects. The outsourcing of road maintenance work in Samoa is a particularly successful example of a project that accepted short-term trade-offs on quality and cost and took a medium- to long-term view of the value of building capacity among local firms to supply the necessary quality of work competitively, with the result that better quality services are now provided at lower cost by local firms, with significant local employment benefits.

Second, make greater use of general and sector budget support. International evidence clearly shows that budget support has a much larger direct impact on local employment and private sector activity than aid that is channeled through project implementation units and parallel structures. Particularly where aid projects are recurrent in nature, greater reliance should be placed on budget support, because the recurrent expenditure it finances is more likely to generate public sector employment opportunities and small-scale procurement opportunities that are more accessible to local firms.

Third, plan for the role of public sectors as employers of last resort. Given both limited private sector employment opportunities and extreme vulnerability to shocks, governments in PICs have an important and legitimate role to play in providing social safety nets, including job creation schemes (World Bank 2014). Attempts at rightsizing in the PICs have typically led to only short-lived reductions in public sector employment, faced strong political opposition, and—in some cases—contributed to political-scale disruption and violence (ADB 2009; Collins and Warrington 1997). Instead, the important and ongoing role of public sectors in the PICs in providing employment needs to be explicitly recognized and accommodated. Increased and transparent use of job creation schemes could help achieve and accurately measure the costs of distinct policy goals of job creation and service delivery. Such schemes could be carefully targeted at providing low-wage jobs to the vulnerable. Separating “core” public sector jobs from job creation schemes for the vulnerable could help insulate the “core” public sector from otherwise irresistible political pressures to create jobs within it. This could also help support more efficiency-motivated management and staffing decisions within the “core” public sector.

Lead authors: Tobias Haque and Virginia Horscroft, World Bank.

References:
This article discusses the key findings from the 2013 Labor Force Survey in Timor-Leste. Although methodological changes limit comparisons with earlier surveys, the headline news is that unemployment is increasing. This does not necessarily indicate deteriorating labor market conditions, but may reflect rising labor force participation rates (LFPR). It is important, however, to note that the LFPR in Timor-Leste is still low relative to other comparable countries.

Growth, jobs, and labor force participation

Since Timor-Leste became independent in 2002, the economy has grown rapidly, mainly because of development of large oil and gas deposits. The non-oil sector grew by an average annual rate of 12.1% from 2007 to 2011 but it remains small. The 2013 Labor Force Survey shows that the number of subsistence food producers is 178,900, of which 166,600 are not considered to be in the labor force. The remainder have a secondary job or are searching for employment. Exclusion of subsistence food producers affects the LFPR, which was 30.6% in 2013, up from 24.8% in 2010.

The employment to population ratio, which shows the proportion of employed compared with the working-age population, is 27.3% (Figure 15). Almost a quarter (24.3%) of the youth population is not employed, in school, or receiving formal training. Many young people are either economically idle or end up working in subsistence agriculture which, as mentioned above, is excluded from the labor force.

Although the LFPR is highest among men aged 30–34 years (64.8%), for women it is highest among ages 20–29 and 50–54 (both 29.0%). The LFPR for women is low, especially among those aged 30–50, who are usually considered as an active cohort in the job market.

Unemployment rates: Should we be worried?

The unemployment rate increased by 3.3 percentage points from 2010 to 11.0% in 2013. It is slightly higher among men (11.3%) than women (10.4%), and more common among the youth (aged 15–24) and those with secondary school education (Figure 17). Youth unemployment has slightly increased from 20.3% in 2010 to 21.6% in 2013.

Despite rapid economic growth, it appears that the labor market is unable to absorb the increasing number of entrants into the labor force. Almost a quarter (24.5%) of unemployed have been looking for work for over 12 months.

In addition to the labor force (213,000), there is a “potential labor force” comprising 7,700 people of working age who are either seeking employment but currently unavailable, or available but not looking for employment. This, coupled with the underemployed, (less than 1% of the labor force), provides a composite measure of labor underutilization (14.7%).

The majority of the labor force have either a secondary, pre-secondary, or primary-level education (Figure 16). More than 40.0% of the labor force has completed secondary-level education. Close to 9.0% in the labor force have a university degree. A small percentage have a technical diploma (1.7%) or completed a vocational course (0.6%), while 5.7% have no formal education.
Nature of Employment

Over 70% of the employed are in agriculture and service-related occupations (Figure 18). Timor-Leste’s non-oil sector is predominantly agriculture-based, with a growing services sector (especially retail trade) in urban areas. Construction has also seen a major expansion on the back of increased public infrastructure financing. However, the lack of updated national accounts makes it difficult to identify fast-growing sectors of the economy and their impact on job creation.

The high concentration of workers in agriculture and certain services sectors suggests that job absorption in other sectors of the economy remains low. The vulnerable employment rate, which measures own-account workers and contributing family members, fell from 69% in 2010 to 54.5% in 2013. However, informal employment remains as high as 71% of total employment. Almost half of them are own-account workers.

On average, wage and salary workers earn around $530 a month, with men receiving higher earnings ($553) than females ($461). Interestingly, monthly average earnings are highest among those with a secondary education ($640), even compared with those with tertiary-level education ($578). Wage and salary workers aged 35–44 earn more ($598) than other age groups. Youth wage and salary workers have the lowest average earnings ($210).

Conclusion

Compared with 2010, the labor force participation rate has increased. Expectations of future economic prospects play an important role and can affect labor force participation. Growth and diversification of the economy can attract more workers, but that does not necessarily mean that there are jobs for everyone. As countries start to industrialize, urban migration, the informal economy, and unemployment tend to rise.
Active labor market policies, particularly targeting women and encouraging their participation in the labor force, should be a key priority. An industrial policy that encourages private sector growth and employment creation will undoubtedly play an important part in increasing labor force participation. However, potential gains can be further realized by investing in human capital. Although Timor-Leste has already taken steps to establish an accredited vocational and technical system, limited funds have constrained the building of an effective market-driven training system.

Although technically not considered part of the labor force, the large number of subsistence food producers is a reflection of limited job opportunities in the nonagriculture sector as well as low-productivity work in agriculture. Therefore, future policies should seek to reduce dependency on agriculture, both by achieving higher absorption of labor in other sectors of the economy and increasing agricultural productivity. It is important that agricultural productivity and labor allocation are managed effectively.

If agricultural development is not accompanied by growth in nonagriculture sectors, outward labor movements from agriculture could result in an expansion of the informal economy and turn into a perverse form of structural change.
Incentives for labor adjustments: The case of the Federated States of Micronesia

The Federated States of Micronesia (FSM) continues to have an economy driven largely by the public sector. Private sector growth has been hampered by problems with developing infrastructure, human capital, and competitiveness. Finin (2013) notes that “[b]y standard economic measures, the FSM’s conservative approach to development has brought little change in living standards compared with other economies in the North Pacific. GDP per capita income and levels of public debt are well below those of neighboring states.”

This article explores responses to past changes in economic conditions in the FSM, including emigration, and the implications these have on options in the future.

It is possible that the economy could become competitive in tourism and agriculture. This could convince educated and ambitious Micronesians who have migrated abroad to return. The FSM policy makers therefore need to decide where they want the country to be along a continuum from pure communal subsistence to a more capitalized society.

Historical context

Traditionally, Micronesians had few needs and even fewer “wants,” mainly because until the advent of longer-distance travel, they were not exposed to “things” and the desire to have them. The Japanese came between the two world wars and introduced relatively higher education, formal economic activities (in contrast to purely subsistence activities), and a public sector. Copra became an important cash crop, marketed in Japan and elsewhere. Micronesians became used to a money economy, and living conditions improved.

After World War II, this changed. Other oils supplanted coconut oil in global markets, and copra production provided lower returns. Unfortunately, while neighboring Pacific economies were able to develop other private sector sources of income, the FSM, for the most part, so far has not. The FSM has struggled for a variety of reasons, including demography and climate-influenced infrastructure, among others.

The United States (US) administered what became the FSM from 1947 to 1987. During this time, the US provided education and health facilities to enhance life spans, improve quality of life, and develop an economy for the islands. In 1987, the FSM and the US entered into a compact of free association to support development of the FSM. The current compact (Compact II) is due to expire in 2023. The results to date have been decidedly mixed.

The challenge of national connectivity

Whereas most of the population of Palau and the Republic of the Marshall Islands are concentrated in two major areas, the FSM’s population is spread across many islands, including the four islands hosting the state capitals, all of which require maintained infrastructure. Communication and transportation require integrated systems, and these systems must serve both the state and national levels.

As an example, the FSM has a long history of “field trip” ships to the outer islands. While Kosrae does not have any outer islands, the other three states (Chuuk, Pohnpei, and Yap) do. The field trips were originally intended to move copra and people. As a major contributor to the economy, copra was collected and prepared in the outer islands, then moved to Yap and out to where coconut oil would be extracted. The FSM no longer makes copra, and nothing has replaced it.

However, the field trip ships also served as people movers taking outer islanders to district centers (later state capitals) to seek health care, transporting students to high schools in late summer and back to their home islands in late spring, and moving visitors between islands. Even in the best years, costs of these ships were not covered by ticketing and copra, and so trips have always been subsidized.

If the state and national governments are unwilling to continue subsidizing the ships and new lifestyles in the outer islands, these islanders may find themselves with only two trips a year (to pick up and drop off the students). Further, with school consolidations, state governments may demand that all middle and high schools be located in the capitals. If this happens, outer islanders may be faced with a choice of either living at subsistence level or moving to the capital. Many have done so, and others are moving to Guam, Hawaii, and the United States mainland.

The field trips are one example of infrastructure problems. Materials for roads and buildings must be sufficiently strong to withstand the elements, and occasional typhoons and tidal waves. Often, these conditions are not taken into account when projects are approved and funded.

Most of the main islands—Kosrae, Pohnpei Island, Weno, and Yap proper—have roads around the islands. These roads must undergo constant maintenance to remain navigable and facilitate private sector economic development. The FSM government needs good infrastructure to promote private sector businesses and enterprises beyond the small retail stores supporting the government workers.
Incentives for labor adjustments

Similarly, the FSM has four major airports (one in each state) and several minor airports. The runways and the buildings must be maintained over time, and improved or expanded as necessary. All four capitals are also served by several commercial shipping companies. The docks and ports must be maintained, and, on occasion, enhanced as well.

Human capital development

When the US took over in the late 1940s, diets changed and healthcare improved resulting in higher fertility rates and lower infant and maternal mortality rates.

Unfortunately, job creation did not keep up with the population increase. Early on, high school and college graduates could take public sector jobs, especially as they replaced outgoing Peace Corps volunteers and other expatriates. However, these jobs were eventually filled, and the continued population increase in the 1980s and 1990s created an untenable economic situation. People had to go back to subsistence, wait for a job opening, or migrate.

One major issue in developing an economy in the FSM is the lack of progress in educational attainment. The percentage of high school graduates has remained steadily low, and this does not measure the quality of education. Large numbers of students going to the College of Micronesia—the main campus, which is supposed to be comparable to US standards, and the state subsidiary campuses—require remedial courses before they can even begin college work.

The number of college graduates also remains stubbornly low. Only the College of Micronesia provides undergraduate degrees, and only in a few areas in the FSM. Therefore, Micronesians must go at least to Guam for some degrees. Many stay in Guam, or go on to Hawaii or the mainland US for graduate work and employment.

In the early years of the FSM, all college graduates could find employment. That is no longer true, as those first jobs are now taken, and while many of the graduates who took those jobs are now beginning to retire, many of the jobs will disappear with them amid decrements in compact financial assistance. Further, the FSM’s “soft money” jobs, previously plentiful because of various federal programs, are also disappearing, as funding under the Compact II decreases.

Engines of employment growth

At one point, Yap had a garment factory, but manufacturing had many problems, particularly with getting materials and training and retaining personnel. The garment factory is now closed. Pohnpei grew pepper and harvested trochus shells, but government intervention stopped both of those.

Tourism is a potential income generator, as in many Pacific economies, but the capacity to accommodate tourists is limited, making planning for all-inclusive tours very difficult. Most local hotels are small and family-owned, which allows flexibility in response to the season and number of tourists, but is not really conducive to long-term expansion. Just getting to the islands takes considerable effort and time, and local tourism providers have not as yet developed services and activities adequately.

However, there are signs of increasing interest in tourism development as evidenced by proposals for resorts in Chuuk Lagoon and on Yap. Although these resorts might bring economic development, they are likely to introduce change in traditional ways of life.

Push and pull factors of migration

Given the problems the FSM has had in developing its domestic economy, it is not surprising that many Micronesians have taken advantage of the compact provisions allowing visa-free movement to the US and its territories. Some idea of the factors involved in decisions to migrate can be gleaned from a comparison of migrants and nonmigrants. For simple comparative purposes, this article looks at the 2010 statistics for the FSM population and FSM migrants in Guam.

Educational attainment. In 2010, about 60% of Micronesian migrants aged 25 and above were high school graduates, compared with only 25% in the FSM (Figure 19). This is not a good sign for future economic development in the FSM, and reflects the continuing problems with the local education system. Higher educational attainment makes one eligible for better jobs, and there are more, and more varied, jobs in Guam. The proportion of college graduates is less than 4% of the adults in both places. The FSM government needs to think about the importance of education for better economic development planning.

![Figure 19: High school graduates (% of population aged 25 and above, 2010)](image-url)

FSM = Federated States of Micronesia.
Source: 2010 censuses of Federated States of Micronesia and Guam.
Occupation. Occupations show some of the big differences in the two labor forces. With about half of the FSM workforce in the public sector, the percentage of managers, professionals, and clerks (about 10%) was much larger in the FSM than in Guam. Considerably more than half of the working Micronesians in Guam were in sales and services. According to the 2010 Guam Census, about one-third of Micronesian households in Guam sent an average of $2,400 in remittances over the year. Remittances totaled only $9 million, equivalent to about 3% of the FSM’s gross domestic product.

Conclusion

This paper considered some of the problems the FSM faces as it strives to develop a more self-sustaining economy as Compact II expires in 2023. The government has struggled to find its footing, both economically and politically, as it balances traditional society with a market-oriented economy.

Housing. Guam provides migrants with better housing, with more appliances and conveniences, than can be afforded in the FSM. For example, while 83% of Micronesian migrant homes in Guam had cement roofs in 2010, the same was true for only 21% of homes in the FSM (Figure 20). Micronesian migrant homes in Guam also had more appliances. Only 7% of FSM homes had air conditioning, compared with 70% for migrants in Guam, and 95% of the migrant homes in Guam had a refrigerator, compared with about 34% in the FSM. About a third of Micronesian migrant homes in Guam had a computer, compared with only a tenth in the FSM. Finally, about 75% of the migrant homes in Guam had at least one vehicle available, compared with only about one-third of the homes in the FSM.

Remittances. Some Pacific countries, like Samoa and Tonga, derive substantial income from migrant remittances. In comparison, Micronesian migrants, mostly in Guam, the Commonwealth of Northern Mariana Islands, Hawaii, and the US mainland, are much less likely to remit. This may be because they are recent migrants still establishing themselves. Further, many older migrants fund the transport costs of newer migrants rather than sending remittances.

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Conclusion

This paper considered some of the problems the FSM faces as it strives to develop a more self-sustaining economy as Compact II expires in 2023. The government has struggled to find its footing, both economically and politically, as it balances traditional society with a market-oriented economy.

The compact provision allowing Micronesians to move freely to the US and its territories opened the doors to wider employment opportunities. The pushes of a weaker local education system, problems in health care, and too few jobs—combined with the pull of more attractive education, health, and job situations in Guam and beyond—help perpetuate migration from the FSM.

Developing broader sources of private sector growth and employment in agriculture and tourism would help stem the outflow of human capital from the FSM. This can end the self-reinforcing cycle of low growth and outmigration of skilled labor that has held the economy back. Tourism and agriculture appear to offer the greatest potential as drivers of future growth. If such an economy does develop, and the islands’ cultural identities can also be maintained, the best of both worlds will ensue.

Lead authors: Michael Levin, senior adjunct fellow, East–West Center, Pacific Islands Development Program.

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

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

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.

fas = free alongside, fob = free on board, FSM = Federated States of Micronesia, m.a. = moving average, NZ$ = New Zealand dollar,
Sources: Statistics New Zealand and US Census Bureau.
Diesel exports from Singapore
(y-o-y % change, 3-month m.a.)

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

m.a. = moving average, y-o-y = year on year.
Source: International Enterprise Singapore.
Departures from Australia to the Pacific (monthly)

Cook Islands

Fiji

Samoa

Tonga

Vanuatu

Major destinations

<table>
<thead>
<tr>
<th>Country</th>
<th>Persons (’000)</th>
<th>y-o-y % change (rhs)</th>
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<tr>
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<td>Vanuatu</td>
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Major destinations

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<tr>
<th>Destination</th>
<th>Persons (’000)</th>
<th>y-o-y % change (rhs)</th>
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rhs = right-hand scale, y-o-y = year on year.
Source: Australian Bureau of Statistics.
Departures from New Zealand to the Pacific (monthly)

- **Cook Islands**
  - Persons ('000) y-o-y % change (rhs)
  - Sep12, Dec, Mar13, Jun, Sep, Dec, Mar14

- **Fiji**
  - Persons ('000) y-o-y % change (rhs)
  - Sep12, Dec, Mar13, Jun, Sep, Dec, Mar14

- **Samoa**
  - Persons ('000) y-o-y % change (rhs)
  - Sep12, Dec, Mar13, Jun, Sep, Dec, Mar14

- **Vanuatu**
  - Persons ('000) y-o-y % change (rhs)
  - Sep12, Dec, Mar13, Jun, Sep, Dec, Mar14

- **Tonga**
  - Persons ('000) y-o-y % change (rhs)
  - Sep12, Dec, Mar13, Jun, Sep, Dec, Mar14

- **Fiji**
  - Persons ('000) y-o-y % change (rhs)
  - Sep12, Dec, Mar13, Jun, Sep, Dec, Mar14

- **Vanuatu**
  - Persons ('000) y-o-y % change (rhs)
  - Sep12, Dec, Mar13, Jun, Sep, Dec, Mar14

- **Tonga**
  - Persons ('000) y-o-y % change (rhs)
  - Sep12, Dec, Mar13, Jun, Sep, Dec, Mar14

- **Major destinations**
  - Persons ('000) y-o-y % change (rhs)
  - Sep12, Dec, Mar13, Jun, Sep, Dec, Mar14

**rhs** = right-hand scale, **y-o-y** = year on year.
Source: Statistics New Zealand.
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 approximately two-thirds of the world’s poor: 1.6 billion people who live on less than $2 a day, with 733 million struggling on less than $1.25 a day. 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.

In this publication, “$” refers to US dollars.

Latest Economic Updates

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

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

* Timor-Leste GDP is exclusive of the offshore petroleum industry and the contribution of the United Nations.

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


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.