



Pacific Conference on the Human Face of the Global Economic Crisis
10-12 February 2010
Port Vila

GEC/1
10 February 2010

THE IMPACT OF THE GLOBAL ECONOMIC CRISIS ON THE PEOPLE OF THE PACIFIC

(Item 2 of the provisional agenda)

This paper has been reproduced in the form in which they were received; only typographical errors and errors of fact or terminology have been corrected. A limited number of copies have been issued for use only by participants.

This paper was prepared by Mr Sakiusa R. Tuisolia, Consultant. The opinions, figures and estimates set forth in this paper are the responsibility of the author, and should not necessarily be considered as reflecting the views or carrying the endorsement of the United Nations.

The designations employed and the presentation of the material in this publication do not imply the expression of any opinion whatsoever on the part of the Secretariat of the United Nations concerning the legal status of any country, territory, city or area or of its authorities, or concerning the delimitation of its frontiers or boundaries.

TABLE OF CONTENTS

Executive summary.....	5
Chapter 1: Introduction.....	9
Chapter 2: Pacific island economies overview.....	10
Chapter 3: Macroeconomic impact of the global economic crisis.....	16
Chapter 4: Impact on the people of the Pacific.....	26
Chapter 5: Impact on the progress towards the Millennium Development Goals.....	37
Chapter 6: Surviving the global economic crisis: a platform for action.....	43
References.....	51

LIST OF BOXES, FIGURES & TABLES

Box 2.1:	Pacific is a diverse region.....	10
Box 3.1:	International response to the global economic crisis.....	18
Box 5.1:	The Millennium Development Goals (MDGs).....	37
Figure 2.1:	Trade in services is growing in importance	14
Figure 2.2:	Dependence on remittances is high in some Pacific countries.....	14
Figure 3.1:	Global real GDP trends and forecast.....	16
Figure 3.2:	Impacts of the global economic crisis varies between regions.....	17
Figure 3.3:	Fall in commodity prices has different impacts	20
Figure 3.4:	Foreign direct investments performance varies across regions.....	23
Figure 3.5:	Official development assistance (ODA) to PIDS is gradually increasing.....	23
Table 2.1:	PIDS key demographic indicators.....	11
Table 2.2:	PIDS economic indicators.....	12
Table 5.1:	Status of progress towards MDGs in the Pacific	38

ABBREVIATIONS

ADB	-	Asian Development Bank
EEZ	-	Exclusive Economic Zone
FDI	-	Foreign Direct Investment
FEMM	-	Forum Economic Ministers Meeting
GDP	-	Gross Domestic Product
HDI	-	Human Development Index
IFI	-	International Financial Institutions
IMF	-	International Monetary Fund
MDG	-	Millennium Development Goals
NGO	-	Non-Government Organisation
ODA	-	Overseas Development Assistance
OECD	-	Organisation for Economic Cooperation and Development
PIDS	-	Pacific Island Developing States
ROI	-	Return on Investment
SPC	-	Secretariat for the Pacific Community
UNCTAD	-	United Nations Conference on Trade and Development
UN ESCAP	-	United Nations Economic and Social Commission for Asia and the Pacific

Executive Summary

Introduction

The Pacific island developing states (PIDS) face daunting development challenges as they ride the storm of the current global economic crisis. Their economic growth performance over the last decade has been poor by international standards and so are their achievements in human development. None are on track to achieve the Millennium Development Goals (MDGs), the internationally agreed development targets for 2015. They are also slow in achieving the sustainable development goals that constitute the Mauritius Strategy. To make matters worse, the recent global economic crisis has caused a further set-back to the PIDS development achievements and progress, coming on top of the 2007-2008 food and fuel crisis and the recent natural disasters in the region.

In light of the above, this paper was commissioned by the United Nations Economic and Social Commission for Asia and the Pacific (UN ESCAP) Pacific Operations Centre based in Suva, Fiji Islands, to inform discussions at the Pacific Conference on the Human Face of the Global Economic Crisis in Port Vila, Vanuatu, on 10-12 February 2010. The paper assesses the impact of the global economic crisis on the PIDS and their peoples; and sets out policy options for effective national and regional responses. The paper is not intended to be an action plan; rather it is a call for coordinated national, regional and international action and partnership.

Pacific island economies overview

The Pacific islands is a very diverse region consisting of an interesting mix of island countries with open economies that vary enormously in size and structure; and have varying degrees of dependency on international trade and financial resource flows. Understanding these dynamics is crucial because it determines the level of vulnerabilities of PIDS and the extent of the impacts of the global economic crisis on their economies and peoples.

The PIDS do share some salient economic characteristics. A number of countries have improved their macroeconomic position since 2007 which provided them with some buffer from the impact of the global economic crisis and recent natural disasters. Most of the PIDS economies are dominated by large and expensive government sectors with underdeveloped private sectors. A number of PIDS, particularly Papua New Guinea, are heavily reliant on commodity exports. Most countries especially the small island states are import-dependent, especially on food and fuel. Trade in services, particularly tourism, has become increasingly important for a number of PIDS economies. Agriculture is generally a small contributor in GDP terms but remains a major source of employment and livelihoods for the region. Certain countries are heavily dependent on remittances, FDIs, offshore trust national funds and aid.

Macroeconomic impact of the global economic crisis

The PIDS are being hurt by the global economic crisis as demand, output and employment falls internationally. The World Bank estimated that the world economy contracted by 2.2 per cent in 2009, the first decline in world output since the 1930s. As the global economy contracts, Australia, China, Europe Union, Japan, New Zealand and the United States – the major markets for the Pacific region – have all experienced slower or negative growth in 2009.

The global economic meltdown has a direct flow-on effect on the Pacific islands region, primarily through the trade channel and financial flows. Most PIDS have experienced lower

economic growth in 2009 and 2010 as the global crisis started to bite. Its impacts are being felt through the following transmission mechanisms:

- a. Lower commodity prices and reduced demand for exports.
- b. Decline in tourism numbers and per capita spend.
- c. Fall in remittance flows and off-shore demand for labour.
- d. Decline in value of offshore national trust funds.
- e. Decline in FDI (private investment and capital flows).
- f. Decline in aid.
- g. Decline in terms of trade.

As a result, all PIDS are experiencing a worsening macroeconomic and fiscal outlook. The falling export receipts and net financial inflows are contributing to the deterioration in the balance of payments, weakening foreign reserves, low domestic economic activity and falling government revenues.

The extent and nature of the impact on individual countries depends on the structure of their economies and the extent of their integration with the global economy. Countries and areas that maintained positive but slow economic growth in 2009 are Federated States of Micronesia, Kiribati, Marshall Islands, Nauru, Papua New Guinea, Solomon Islands, Tonga, Tuvalu and Vanuatu while others faced economic contraction (Cook Islands, Fiji, Palau and Samoa).

Impact on people of the Pacific

Pacific Islanders are exposed to the adverse impact of the global economic crisis, especially through declining incomes, increasing unemployment, high cost of living and increasing poverty. The degree of impact, however, is relative to people's income level and resource endowment.

Lower cash incomes for families' means less money for food, education, health care, transportation and other basic needs, hence contributing to worsening social outcomes. Pacific peoples are also faced with high food prices and cost of living. Although the high food and fuel prices in 2008 have fallen internationally, this has not filtered down to the ground level in most PIDS. The real purchasing power of household incomes has fallen, reducing household consumption and corresponding domestic aggregate demand. Household savings, which are already generally low across the region, have been significantly constrained, especially for the poor.

The most vulnerable and severely affected are the poor who make up nearly a third of the Pacific island region's population (2.7 million people). These are people who live below and near national poverty lines and do not have the income to satisfy their basic needs. As the global economic crisis forced thousands of people into poverty, the poverty level in the Pacific is expected to rise. Children, women, rural people, urban poor and groups with special needs, such as the elderly and people with disabilities, have become worse-off.

PIDS governments are faced with fiscal challenges due to falling revenues, high debt levels and a corresponding shrinking in the fiscal space available for public investments. Reduced government financial capacity to fund crisis responses in infrastructure, economic services, health, education and pro-poor social programmes will constrain economic growth, employment and make the poor worse-off.

Impact on progress towards the Millennium Development Goals

The world is past the half-way mark towards achieving the MDGs by 2015. Indications are that achieving all the MDGs across the Pacific islands region by the deadline is unlikely.

While some countries have made some progress on some MDGs, no country is on track to achieve all the MDGs; and no MDG is on track to be achieved by all PIDS. Overall, some countries are doing better than others while a few countries have done very poorly. The overall tracking of their performance has been hindered by the lack of data, an area where the region is rated poorly by international standards.

The effects of the global economic crisis on human development in the Pacific islands region have eroded the gains and progress towards the MDGs, with serious implications for poor people. This set-back means that a special response is needed through the combined efforts of PIDS and development partners to get the Pacific region back on track.

A paradigm shift is needed that requires PIDS governments and development partners to mobilise and coordinate more financial and technical resources and effort towards the effective implementation of the MDGs. Pacific Leaders have responded to this call by adopting the *Cairns Compact on Strengthening Development Coordination in the Pacific* at the Pacific Forum meeting in Cairns in August 2009. The *Compact* aims to drive effective coordination among development partners to achieve real progress against national development goals, including the MDGs.

The onus is on PIDS governments to take greater ownership and responsibility in achieving the MDGs. They need to strengthen their governance and fiscal and budget management systems to improve the delivery of government services. The MDGs will also need to be integrated into their national plans and budget priorities.

Surviving the global economic crisis: a platform for action

The Cairns Pacific Islands Forum meeting in August 2009 provided the platform for decisive action by PIDS governments in responding to the global economic crisis and laid the foundation for promoting future broad based private sector-led growth consistent with the *Pacific Plan*.

First and foremost, it is important for PIDS governments to fully understand the impacts of the global economic crisis on their economies and peoples as articulated in this paper. The lack of quality statistical data is a serious issue that needs to be addressed to ensure the proper tracking of development outcomes, the design of evidence based policy responses to the global crisis and aid effectiveness.

With the knowledge of the impacts of the global economic crisis, PIDS governments could consider appropriate country, regional and international policy responses to the crisis. However, the challenge is to balance the urgent need to achieve accelerated economic recovery with measures that ensures the long-term sustainability of small island states and their resilience to future economic shocks – particularly ensuring protection for the poor. To achieve this, the following policy responses are considered appropriate:

- a. Maintain macroeconomic stability.
- b. Stronger governance and better fiscal management.
- c. Implement economic and public sector reforms for broad based private sector-led growth.
- d. Prioritise education and health investments.

- e. Invest in social protection programmes to insulate poor people from future economic shocks.
- f. Promote regional and national food security.
- g. Protect progress made towards the MDGs.
- h. Strengthen statistics and development tracking.
- i. Support regional cooperation and integration.
- j. Improve development partnership and coordination.

PIDS are unable to tackle these policy challenges on their own because they lack the necessary resources and capacity. They need the support of development partners. The two should integrate their combined resources and efforts within a framework of sound national policies and public expenditure systems that supports country-led responses and are consistent with regional and global aid effectiveness principles.

If the challenges of the future seem daunting, Pacific Leaders, policy makers and development partners ought to keep in mind that what the Pacific faces in the future is no worse or if not better than some of the experiences and crisis it has encountered in the past. It might also help to remember that old piece of wisdom: the reverse side of every challenge is an opportunity. The future policy options outlined above will offer the PIDS many advantages. The future is far from bleak. Now and in the years ahead, PIDS will continue to face rough seas in a global environment where a lot of factors are outside their control but they also have the opportunity to plot their own course and determine their own directions to ensure smoother sailing in the years ahead.

Chapter 1

Introduction

The Pacific Forum meeting in Cairns, Australia, in August 2009, gave a cold reminder to the Pacific island leaders that their countries face daunting challenges. The PIDS economic growth performance over the last decade has been poor by international standards and so is their achievement in human development. None are on track to achieve the MDGs by 2015. They are also slow in achieving the sustainable development goals that constitute the Mauritius Strategy. To make matters worse, the recent global economic crisis has caused a further set-back to the PIDS development achievements and progress, coming on top of the 2007-2008 food and fuel crisis and the recent natural disasters in the region¹.

The economic downturn in developed and emerging economies has had a flow-on-effect to the Pacific. All PIDS have faced a worsening economic, fiscal and human development outlook. Despite tentative signs of recent global recovery, the economic and human costs of the crisis have been considerable. The crisis has eroded the region's development gains and progress towards the MDGs. It has also undermined the PIDS progress in implementing the Mauritius Strategy and achieving sustainable development as small island states.

The extent of the impact of global economic crisis on PIDS and the ways in which they could recover from it is an issue of great importance to the region and Pacific island governments and is reflected in the outcomes of recent national, regional and international forums. How exactly have the PIDS been affected by the global economic crisis? What can be done today to mitigate these impacts? What policy options are there to improve their short and medium term prospects? This paper attempts to address these questions and issues in depth.

The paper seeks to promote a better understanding of the impact of the global economic recession on the Pacific island economies and its people. It will assess who have been most affected by the crisis; how they were affected, both economically and socially, and why they have been affected. The paper will identify financial, human and institutional constraints faced by PIDS, assess existing support measures to address these challenges and propose recommendations at national, regional and international levels on education, health, employment, social protection and legislation, to both government and development partners, to address the various impacts of the crisis.

The global economic crisis is a very significant policy challenge and requires creative policy responses. This paper provides a mix of immediate and medium-long term policy options. However, this paper is not an action plan. Rather it is a call to action, and a guide for governments and development partners to effectively respond to the global economic crisis and help lay a platform for future sustainable economic growth and prosperity. However, the lack of availability of data has hampered this effort, and any numerical data in the region should be viewed with some caution due to the limited capacity in the national statistical offices in most PIDS governments. This is a desk review relying primarily on secondary information. There are gaps and weaknesses in the information provided.

¹ The recent natural disasters in the Pacific include the 2009 - January floods and December cyclone in Fiji and September tsunami in Samoa and Tonga; and the January 2010 earthquake and tsunami in Solomon Islands.

Chapter 2

Pacific island economies overview

This chapter provides the context for PIDS economies which vary enormously in terms of structure, size and their level of integration in the global economy. It provides some background for those less familiar with the Pacific islands region, and shows why the impact of the global economic crisis on each country will be different.

The Pacific islands is a very diverse region in terms of land size, population, natural resource base, economy, distinct cultures and development constraints and prospects (Box 2.1). It consists of an interesting mix of large and small island countries with open economies that vary enormously in size and structure; and has varying degrees of dependency on international trade and financial resource flows.

Box 2.1 - The Pacific is a diverse region

The Pacific is an extremely diverse region in terms of land size, population, natural resources endowment, economic size and distinct cultures. Among them are some of the poorest and wealthiest developing countries in the world, and some of the very smallest states. The region consists of thousands of islands totalling approximately 551,483 sq km of land in a vast span of ocean (36 million sq km) – four times the size of China. Papua New Guinea, by far the largest country in the region, has a land area totalling 462,840 sq km (88 per cent of total land area) and the smallest being Nauru with 21 sq km².

The Pacific islands have a total population of 8.7 million people. Papua New Guinea has the largest population with 6.5 million people (74% of the region's population). The six next largest countries have populations ranging from 839,000 (Fiji) to 103,000 (Tonga). Just over half the countries have populations of less than 100,000, and of them, several have less than 10,000 residents with Niue being the smallest with 1,625 inhabitants. The population of the Pacific islands is predominantly young with a median age of 21.3. Over half the population is aged below 24 years and 20 per cent are between 14-20 years. The average life expectancy ranges between 60 and 70 years³.

The PIDS development is constrained by factors of scale, distance from markets, limited resources and the vicissitudes of global political economy. With the exception of the Melanesian countries to the West, which have abundant mineral and forest resource endowments, most of the countries lack ample natural resources except for an abundance of tuna and other commercial fishery in their Exclusive Economic Zone (EEZ). Most countries have a narrow export base and are heavily reliant on tourism, aid and remittances. Majority of the people in the region live in the rural areas and on a subsistence basis. Approximately a third of the region's population are living in poverty and do not have the income to satisfy their basic needs.

The contrasting size of the PIDS economies is evident in their share of the region's GDP which has a combined value of around US\$20 billion (excluding the French Pacific territories). Papua New Guinea has the largest economy (US\$8.2 billion GDP in 2009) which is more than twice the size of the second largest economy which is Fiji (US\$3.5 billion in 2009). Both these countries account for 80 per cent of the region's GDP⁴. The rest of the region, particularly the Polynesian and Micronesian countries, have very small economies

² Asian Development Bank, *Millennium development goals in the Pacific Island Countries: taking stock, emerging issues and way forward*, August 2009.

³ Asian Development Bank, *Millennium development goals in the Pacific Island Countries: taking stock, emerging issues and way forward*, August 2009.

⁴ AusAID, *Pacific Economic Survey 2009*, AusAID publications, Canberra, 2009.

with GDP's ranging from Samoa (US\$ 523 million in 2009) to the smallest being Tuvalu (US\$15 million in 2009) (Table 2.2).

Table 2.1: PIDS key demographic indicators

	Population	Median age	Land area	EEZ* area	Population density	Urban population	
	2009 mid-year estimate	2009 years	km ²	thousands of km ²	2009 people/ km ²	% of total	Year
UNESCAP Members							
Fiji	843 888	26.5	18 272	1 260	46	51	2007
Kiribati	98 989	21.8	811	3 600	122	44	2005
Marshall Islands	54 065	18.6	181	2 131	299	65	1999
Micronesia (Federated States of)	110 899	20.5	701	2 978	158	22	2000
Nauru	9 771	21.5	21	320	465	100	2006
Palau	20 397	34.1	444	629	46	77	2005
Papua New Guinea	6 609 745	20.5	462 840	3 120	14	13	2000
Samoa	182 578	20.2	2 935	120	62	21	2006
Solomon Islands	535 007	19.7	28 370	1 340	19	16	1999
Tonga	103 023	20.6	650	700	158	23	2006
Tuvalu	11 093	24.2	26	1 300	427	47	2002
Vanuatu	238 903	20.4	12 190	710	20	21	1999
UNESCAP Associate Members							
American Samoa	65 113	21.6	200	390	327	50	2000
Cook Islands	15 636	26.1	237	1 800	66	72	2006
French Polynesia	256 654	28.9	3521	503	75	51	2007
Guam	182 207	28.8	541	218	337	93	2000
New Caledonia	250 612	29.8	18 576	1740	13	63	2004
Niue	1 514	32.9	259	..	6	36	2006
Northern Mariana Islands	63 112	29.7	457	..	138	90	2000
Tokelau	1 167	22.8	12	290	97	0	2006

Sources: Secretariat of the Pacific Community (SPC) Estimates and projections of demographic indicators for specific years (October 2009), SOPEC

* Exclusive Economic Zone (EEZ)

.. Data not available

Pacific growth update

Economic growth has accelerated in the Pacific since the middle of this decade but remains low by international standards (Table 2.2). In 2008, the Pacific experienced its highest level of economic growth (5.2 per cent) which almost doubled that of 2007 (2.7 per cent). However, this growth was largely confined to Papua New Guinea, Solomon Islands and Vanuatu which benefited from the high prices for their commodity exports (gold, copper, oil, palm oil, timber and copra)⁵. Vanuatu also did well as a result of robust tourism growth that was propelled by market-friendly reforms combined with relative political stability.

Economic growth in the other PIDS which mainly relied on tourism, remittances, fishing and aid was below two per cent. These countries were also adversely affected by the food and fuel crisis in 2007-2008. Fiji because of its internal political problems and recent natural disasters (2009 flood and cyclone) has seen much reduced economic growth in recent years.

⁵ AusAID, *Tracking development and governance in the Pacific*, AusAID publication, Canberra, August 2009

Table 2.2: PIDS economic indicators

	Current GDP USD mil	GDP per capita 2008 US\$	Real GDP growth (percent)			Inflation ^a (percent)		
	2009e		2008	2009 ^e	2010 ^e	2008	2009 ^e	2010 ^e
Subregional total			5.2	2.8	3.1	9.5	6.1	5.2
Cook Islands	183	10 907	-1.2	-0.1	0.8	7.8	6.5	2.2
Fiji	3500	4 264	0.2	-2.5	1.2	7.8	5.0	7.0
Kiribati	114	804	3.4	1.5	1.1	11.0	9.1	2.8
Marshall Islands	161	2 737	-2.0	0.5	0.8	14.8	9.6	1.7
Micronesia (FS of)	238	2 154	-2.9	0.5	0.5	6.8	2.9	2.2
Nauru	22	2 396	1.0	1.0	0.0	4.5	1.8	1.8
Palau	164	8 812	-1.0	-3.0	-1.0	12.0	5.2	3.0
Papua New Guinea	8200	1 218	7.0	3.9	3.7	10.7	8.2	5.0
Samoa	523	2 988	4.8	-5.5	-1.0	10.9	5.7	3.2
Solomon Islands	668	1 284	6.9	0.4	2.4	17.2	8.0	7.0
Tonga	259	2 891	1.2	2.6	1.9	14.5	12.3	6.1
Tuvalu	15	3 213	1.5	1.0	1.0	5.3	3.8	2.3
Vanuatu	554	2 388	6.6	3.0	3.5	4.8	4.3	3.0

Sources: IMF, *World Economic Outlook October 2009 for Fiji, Kiribati, Papua New Guinea, Samoa, Solomon Islands, Tonga and Vanuatu*; and *Asian Development Outlook October 2009 for Subregional total, Cook Islands, Marshall Islands, Micronesia (Federated States of), Nauru, Palau and Tuvalu*.

Notes: a = changes in CPI; e = estimate

Salient economic characteristics

The volatile and high food and fuel prices experienced in 2007-2008 combined with the impacts of the global economic crisis provide a powerful case to support the economic vulnerabilities of PIDS to external economic shocks. The level of impacts depends on the individual countries economic structure and their level of integration into the global economy. Understanding these dynamics is crucial because it determines the level of vulnerabilities of PIDS and the extent of the impacts of the global economic crisis on their economies and peoples. For comparative purposes, the PIDS share some salient economic characteristics which are examined briefly below.

a. **Macroeconomic improvements** - In recent years, a number of PIDS, including Cook Islands, Papua New Guinea, Samoa, Tuvalu and Vanuatu, have improved their macroeconomic performance. From around 2007, most of these countries had low interest rates, relatively balanced budgets and comfortable levels of foreign reserves. These achievements were the result of improved economic management, implementation of economic reforms and improved economic performance. Responsible macroeconomic management have led to cut backs in government expenditure (mainly operating costs); and kept fiscal deficits in check and inflation low. The relative strong macroeconomic positions in most PIDS helped them cope with the fuel and food crisis in 2007- 2008 and provided them with some relief from the global economic crisis and recent natural disasters. The other countries with weak macroeconomic positions are more vulnerable to the global crisis.

b. **Public and private sectors** - PIDS economies have always been dominated by large public sectors where government play a broad role in economic development providing core public goods and services as well commercial activities through public enterprises. This is at least true for countries such Fiji, Kiribati, Marshall Islands, Micronesia (Federated States of)

Nauru, Palau, Samoa, and Tonga, whose governments account for 42 per cent, 51 per cent, 45 per cent, 63 per cent, 86 per cent, 60 per cent, 51 per cent and 42 per cent of their GDP respectively and is also the largest employer in the economy. The operation of governments especially through the provision of inefficient, unreliable and expensive public enterprises crowds out the private sector by absorbing large chunks of resources and places high cost burdens across these economies. With the exception of Fiji and Papua New Guinea, the private sector's contribution in PIDS economies is negligible since it is still under-developed. Governments have remained the dominant player in these economies controlling most of the key economic activities including agriculture, aviation, shipping, telecommunications, tourism and public utilities.

c. **Exports** – A number of PIDS are heavily reliant on exports as a major foreign exchange earner (Figure 2.1). Papua New Guinea is the region's exporting giant. Its exports is dominated by commodities including oil, gas, copper, gold, logs, palm oil, coffee, cocoa, copra and fishing and accounts for 48 per cent of GDP and 95 per cent of total good exports in 2008 (six times more than Fiji's exports). Fiji has the region's largest manufacturing sector and is the second major exporter. Exports including sugar, gold, timber, manufactured goods, agricultural produce and fisheries account for 41 percent of Fiji's GDP. Kiribati, Nauru, Samoa and Solomon Islands, Samoa also export timber, minerals, fisheries and manufactured products which account for 14 per cent, 17 per cent, 24 per cent and 35 per cent of their respective GDP. The exports of the other PIDS are relatively small and account for less than 10 per cent of their GDP. A major disadvantage for the region is their narrow export base and dependency on a small set of exports and a few trading partners. In 2007 for instance, mineral and oil exports accounted for more than half the region's good exports, and exports were directed to three main trading partners; Australia, China and Japan⁶. Any change in global prices can profoundly impact on employment, incomes and economic stability.

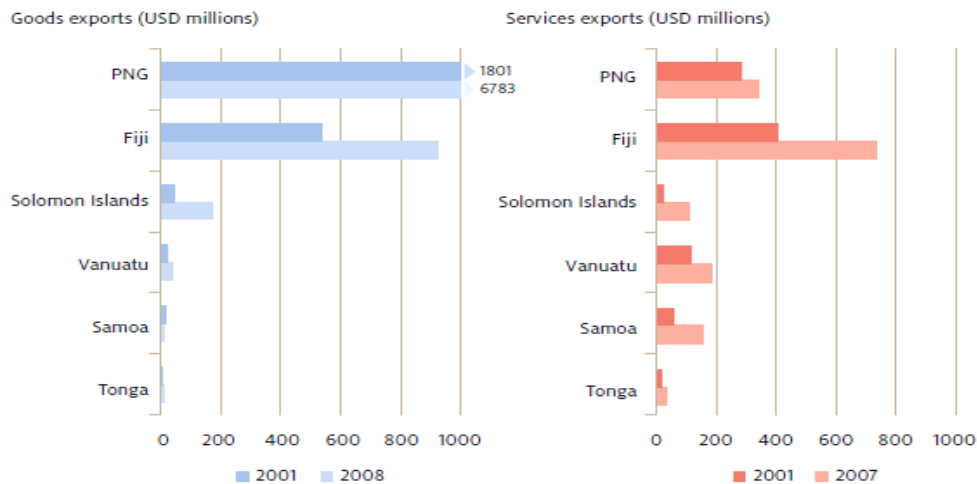
d. **Imports** - A number of PIDS are highly dependent on imports of food, manufactured goods and fuel. These countries will always require adequate foreign reserves to pay for their imports especially fuel which accounts for the largest chunk of their imports. This makes them vulnerable to external shocks and volatile movements in global prices for fuel and non-fuel commodities as such as the rise in food and commodity prices in 2007-2008. The most import-dependent countries are Fiji, Nauru, Palau, Samoa and Tuvalu whose exports equal 60 – 90 per cent of their GDP. The imports of Cook Islands, Kiribati, Marshall Islands, Micronesia (Federated States of) and Tonga is equal to 40 – 60 per cent of their GDP. The imports of Papua New Guinea, Solomon Islands and Vanuatu are less than 40 per cent of their GDP.

e. **Trade in services** - Trade in services, particularly tourism, is growing in importance across the Pacific region and is driving economic growth, investment and employment creation in a number of countries. Between 2001 and 2007, service exports have grown strongly at an average of nine per cent in Fiji, Papua New Guinea, Samoa, Solomon Islands, Tonga and Vanuatu (Table 2.1)⁷. Cook Islands, Fiji, Kiribati, Marshall Islands, Micronesia (Federated States of), Palau, Samoa Tonga, Tuvalu, and Vanuatu are heavily dependent on trade in services which account for 50 – 80 per cent of their GDP. Service exports, particularly the income from tourism, have contributed significantly to stabilising these countries balance of payments. Fiji continues to dominate the Pacific tourism market but tourism growth in the Cook Islands, Samoa and Vanuatu has been robust in recent years.

⁶ AusAID, *Pacific economic survey 2009*, AusAID publications, 2009.

⁷ AusAID, *Pacific economic survey 2009*, AusAID publications, 2009.

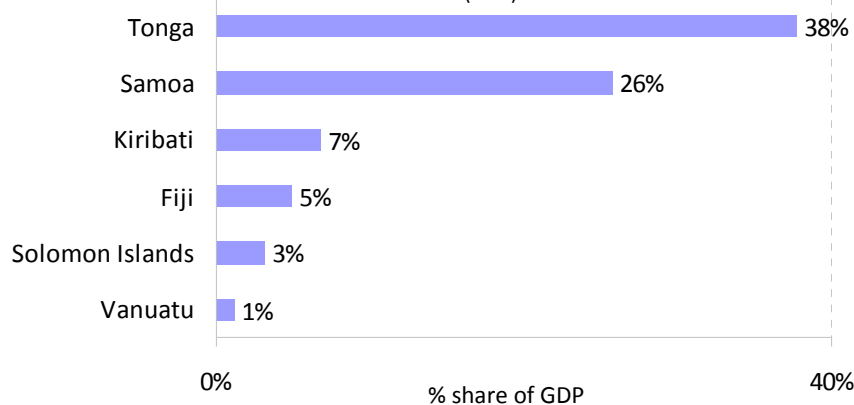
Figure 2.1: Trade in services is growing in importance



Source: AusAID, Pacific Economic Survey 2009

Figure 2.2: Dependence on remittances is high in some Pacific countries

Remittances as a share of Gross Domestic Product (GDP) in 2008



Source: World Bank staff estimates based on the International Monetary Fund's Balance of Payments Statistics Yearbook 2008.

f. **Remittances** – This is an important source of foreign exchange and household income for a number of PIDS (Figure 2.2). Since 2000, Pacific remittances have grown rapidly to US\$450 million in 2005⁸. Kiribati, Samoa, Tonga and Tuvalu are some of the most remittance-dependent economies in the region; their official remittance flows are equivalent to 7 percent, 26 percent, 38 per cent and 36 per cent of their GDP respectively. Fiji, since 2000, has become a remittance dependent economy with thousands of its citizens heading to work overseas. Its remittance income represented 5 percent of its GDP in 2008 and is now second only to tourism. Remittances, however, remain largely concentrated in Fiji, Kiribati, Samoa and Tonga which accounted for 90 per cent of all remittances in 2005. In contrast to conventionally recognised financial flows of ODA, FDIs and remittances represent a flow of income transferred directly to households. In Tonga and Fiji, approximately 90 and 43 per cent of households receive remittances, respectively⁹.

⁸ AusAID, *Pacific economic survey 2009*, AusAID publications, 2009.

⁹ AusAID, *Pacific economic survey 2009*, AusAID publications, 2009.

g. **Agriculture** - This is an important source of income and employment in majority of Pacific island countries. The larger land-rich countries such as Fiji, Papua New Guinea, Solomon Islands and Vanuatu are agrarian societies, with agriculture – both subsistence and commercial – being the major source of employment and livelihoods¹⁰. Agriculture provides a significant portion of net export earnings and employment for these countries and accounts for more than 25 per cent of their GDP. With the exception of Nauru, even the smaller countries depend to some extent on agriculture for subsistence and cash income from copra and niche export crops.

h. **Foreign direct investment (FDI)** – FDI is a critical financial flow that strengthens the balance of payments and is important for increasing economic production, employment creation and income generation in PIDS. FDI, however, is low in most Pacific island economies except for Fiji and Papua New Guinea which account for 75 per cent of FDI to the Pacific. These countries have the most developed private sectors and are strongly geared towards promoting private and foreign investment. The low level of FDI is the result of the underdevelopment of the private sector in the region, the lack of infrastructure, resources, enabling environment and investment opportunities; and recent political instability in Fiji, Solomon Islands and Tonga.

i **Offshore trust funds** - Five economies – Kiribati, Marshall Islands, Micronesia (Federated States of), Palau and Tuvalu – have substantial public savings invested in world stock markets. The income from these trust funds provides a significant financial buffer for these small economies and is used as supplement funds for their government budget. The trust funds are vulnerable to global economic shocks which could easily erode their market values.

j **Aid** - The Pacific receives some of the highest volumes of aid in the world relative to the size of the PIDS GDP and population. Since 2005, aid to the region has exceeded US\$1 billion annually but aid dependency varies between countries. For instance, Kiribati, Marshall Islands, Micronesia (Federated States of), Nauru, Niue, Palau and Tuvalu receive among the highest level of aid per capita in the world, which account for 20 – 54 per cent of their GDP. Papua New Guinea and Fiji receive considerably less at around 6 and 2 per cent of their GDP respectively. Aid is an important source of government revenue (especially for countries that seriously lack development resources) and community development funding in the Pacific¹¹. It is also an important source of official financial flows which helps strengthen the countries balance of payments.

¹⁰ AusAID, *Pacific economic survey 2009*, AusAID publications, 2009.

¹¹ AusAID, *Pacific economic survey 2009*, AusAID publications, 2009.

Chapter 3

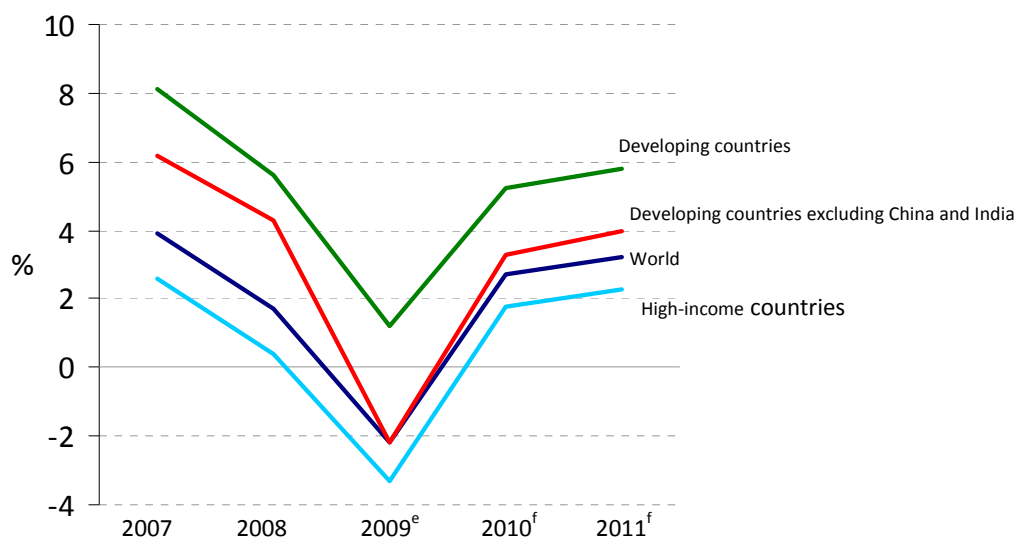
Macroeconomic impact of the global economic crisis

The global economic turbulence

The Pacific Island region's development challenges have become more daunting at a time when the global economy is facing the worst economic recession since the 1930's. What began as a financial crisis in the United States of America has turned into a global economic recession. This has resulted in a sharp slow down in global trade and investment leading to falling commodity prices, declining demand for services and manufactured goods and increasing unemployment and poverty.

The World Bank estimates that the world economy contracted by 2.2 per cent in 2009, the first decline in world output in six decades (Figure 3.1). High-income countries across the world were all in simultaneous recessions, with falling outputs at the end of 2008 and in early 2009. The investment banking collapse and the ensuing credit crunch followed by a sharp decline in industrial production across the world all took its toll in slowing down world output. Investment has become hard hit by the tough financial conditions. The decline in industrial output was followed by an immediate fall in commodity prices – more than 50 per cent drop in oil prices and more than 40 per cent drop in non-oil commodity prices. The World Bank estimates a 6.1 per cent contraction in the volume of world trade in goods and services in 2009. The value of world trade will collapse much more because of the fall in commodity prices¹².

Figure 3.1: Global real GDP growth trends and forecasts
(real GDP growth, % change over previous year)



Source: World Bank, Global Economic Prospects 2010

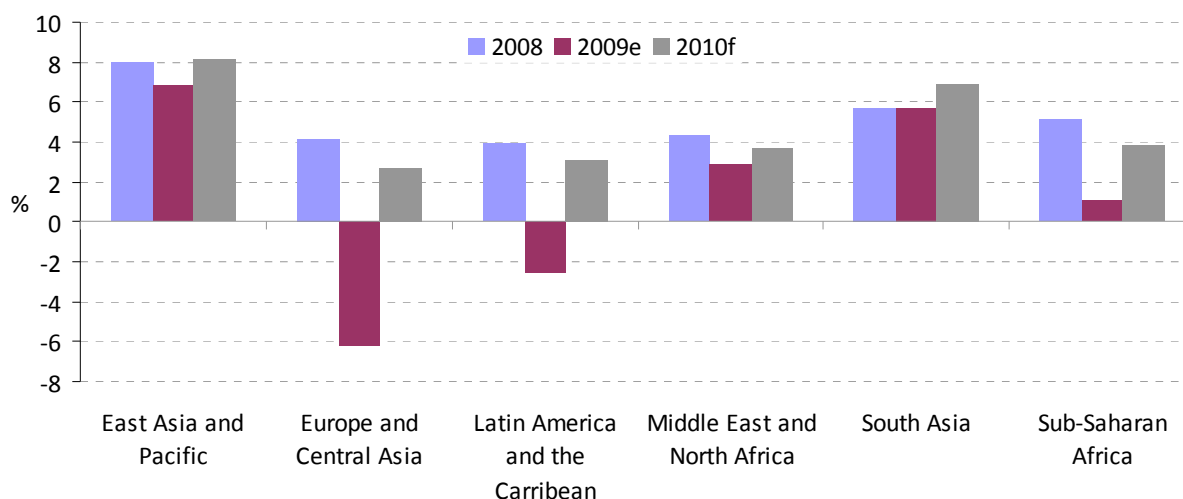
Notes: e = estimate; f = forecast; growth rates aggregated using real GDP in 2005 constant dollars

The impact of the global economic crisis on regions and individual countries across the world has varied markedly (Figure 3.2). While some regions faced recession in 2009, other regions

¹² World Bank, *World Bank updates economic forecasts*, World Bank Group, Washington DC, 2009.

are facing slower, but still positive growth. For instance, the World Bank estimates indicate that Europe and Central Asia have been worst affected with their GDP falling by 6.2 percent in 2009, compared with a 4.2 per cent increase in 2008. In Sub-Saharan Africa, GDP growth is expected to decline from 5.1 per cent in 2008 to 1.1 per cent in 2009. Real GDP growth for East Asia and the Pacific is expected to slow from eight per cent in 2008 to 6.8 per cent in 2009¹³.

Figure 3.2: Impacts of the global economic crisis varies between regions
(real GDP growth, % change over previous year)



Source: World Bank, Global Economic Prospects 2010

Notes: e = estimate; f = forecast; growth rates aggregated using real GDP in 2005 constant dollars

As the global economy contracts, Australia, China, Europe Union, Japan, New Zealand and the United States – the major markets for the Pacific region – have all experienced slower or negative growth in 2009. These countries are major markets for PIDS exports and imports, tourism services and capital investment flows. Australia, Europe, New Zealand and United States are also important sources of remittances. It is conceivable that a return to growth in the PIDS main trading partners will be important drivers for the region’s recovery (Box 3.1).

Impacts on Pacific island countries

The impact of the global economic crisis on the Pacific islands region has been significant, with most PIDS experiencing a downward revision to their growth outlook. A number of countries are projected to maintain positive but slowing economic growth in 2009, while others are facing an economic contraction¹⁴.

¹³ World Bank, *World Bank Updates Economic Forecasts*, World Bank Group, Washington DC, 2009.

¹⁴ AusAID, *Surviving the global recession: strengthening economic growth and resilience in the Pacific*, AusAID publications, Canberra, August 2009.

Box 3.1 - International response to the global economic recession

Coordinated action has been being taken at the international level to support economic recovery and address the root causes of the global recession. At the London Summit on 2 April 2009, G20¹⁵ Leaders committed to take all action necessary to restore growth and reduce the likelihood of future economic crisis.

G20 Leaders acknowledged that the global recession will impact disproportionately on the vulnerable in the poorest countries and that there is a collective responsibility to mitigate its impact. Leaders recognised that problems in accessing capital could further weaken economic activity in emerging markets and so agreed to commit \$1.1 trillion – mainly to International Financial Institutions (IFIs) - to help restore credit, growth and jobs. There was also an agreement to a 200 per cent general capital increase for the Asian Development Bank (ADB) to significantly expand its capacity to lend funds to developing countries in the region.

In the Pacific, Australia and New Zealand, will work closely with other development partners – in particular the World Bank, International Monetary Fund (IMF), ADB, the European Union, Japan, United Nations agencies and other international organisations - to monitor and analyse the regional impacts of the global recession and develop appropriate policy responses in partnership with PICs.

In terms of global outlook, the world economy is already showing signs of in 2010 with growth projected at 2.7 per cent by the World Bank. The rebound is due to the massive and to some extent concerted policy actions taken by the major economies, which effectively arrested a further erosion of confidence worldwide. The cut backs in industrial production that characterised the early stages of the recession have now been reversed. Indications are that the world economic situation has been on the mend since the second quarter of 2009. The global equity markets have rebounded and risk premiums on lending have fallen. International trade and global industrial production have also been recovering noticeably, with an increasing number of countries starting to register positive quarterly GDP.

However, the global economic recovery is expected to remain sluggish, unemployment rates will stay up and inflation will remain low. The immediate challenge for policy makers will be to determine how much longer the fiscal stimulus should continue which experts believe should continue at least until there are clearer signals of a more robust recovery of employment growth and private sector demand.

As reported by AusAID, a sharp contraction in growth rates is projected in 2009. Aggregate growth in the Pacific (including Timor-Leste) is set to slow to three percent in 2009 and 2.7 percent in 2010 (compared to 5.1 per cent in 2008); largely because of Papua New Guinea's expansion abate after two years of strong growth driven by the commodity boom. Countries that maintained positive but slow economic growth in 2009 are Kiribati, Marshall Islands, Micronesia (Federated States of), Nauru, Papua New Guinea, Solomon Islands, Tonga, Tuvalu and Vanuatu while others faced economic contraction (Cook Islands, Fiji, Palau and Samoa).

The transmission of the global economic downturn from rich to poor countries has occurred in several waves. At first, the immediate impacts were minimal as the PIDS economies were largely shielded as the region's banking and financial system had minimum leveraging in the global markets. The second wave was felt through the effects of the global economic recession on the trade channel and financial flows. The extent and nature of the impact on individual countries depends on the structure of their economies and the extent of their integration within the global economy as already examined in Chapter 2. In this connection, PIDS with the following characteristics are most likely to be at risk:

¹⁵ G20 or Group of Twenty is the economic council of the world's 20 most wealthy nations comprising their Ministers of Finance and Governor of Reserve Banks. It is a forum for cooperation and consultation on matters relating to the international financial system.

- a. Countries that rely heavily on commodity exports as their main source of foreign exchange earnings
- b. Countries with significant exports to the crisis affected countries including Australia, European Union, Japan, New Zealand and United States
- c. Countries that are dependent on export of tourism services
- d. Countries that heavily dependent on imports including food, manufactured goods and fuel
- e. Countries that are heavily dependent on remittances
- f. Countries that are dependent on FDIs and private investment
- g. Countries with financial and stock markets and banks that are highly integrated into the global markets
- h. Countries with high current account deficits, balance of payments problems and low foreign reserves
- i. Countries with high government deficits, debts and fiscal pressures
- j. Countries with high foreign debts
- k. Countries that heavily depend on foreign aid

The global economic crisis has put pressure on all important sources of external revenues for developing countries – exports, remittances, FDIs, portfolio equity flows and aid – with significant impacts on the real economy, which has further set backs between the real and financial sectors. In regard to the Pacific islands region, declining global demand for commodities, manufactured goods and tourism is affecting business profits and resulting in job losses and lower revenues to government. Tight credit condition and weak economic prospects are resulting in lower foreign and domestic direct investment and remittances. The precise effects on the PIDS have occurred through a number of channels which discussed in more detail below.

Falling commodity prices was the main immediate impact of the global economic crisis on the Pacific which by the collapse in world demand (Figure 3.3. Some PIDS are heavily reliant on commodity exports and all are dependent on commodity imports. The specific impacts are¹⁶:

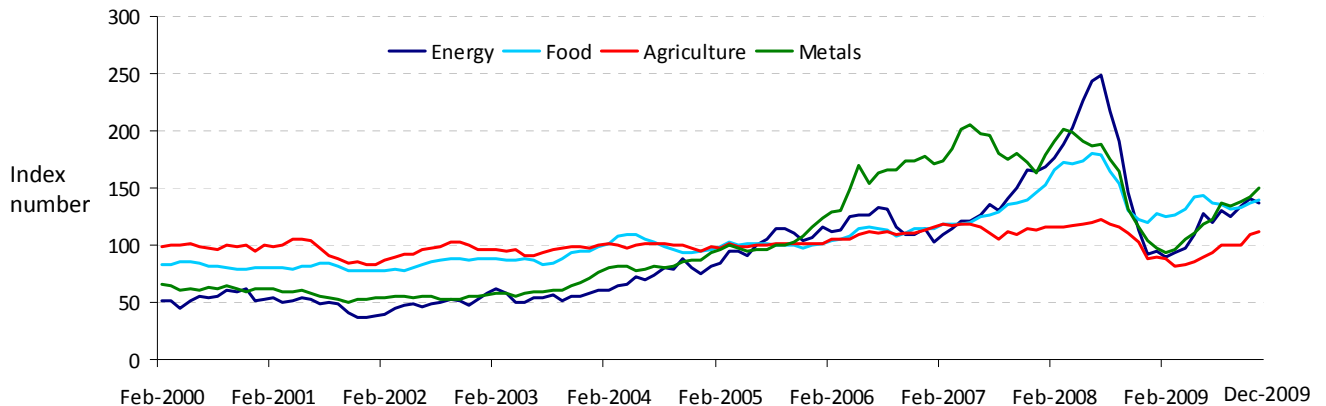
- a. Fiji, Nauru, Papua New Guinea and Solomon Islands have been adversely affected by falling commodity prices for exports. These countries have lost substantial revenues (albeit from a boom level) which will lower government revenues and levels of foreign reserves.
- b. All PIDS (apart from Papua New Guinea, which is a net oil exporter) have benefited from the lower international fuel and energy prices. This has reduced their fuel import bills substantially and lowers government revenues but it saves on foreign reserves.

¹⁶ AusAID, *Surviving the global recession: strengthening economic growth and resilience in the Pacific*, AusAID publications, Canberra, August 2009

- c. The PIDS that are heavily dependent on food imports such as Fiji, Nauru, Palau, Samoa and Tuvalu have benefited from the fall in world food prices but it is disappointing that savings are not being transmitted directly to consumers. This has lowered import bills and government revenues but it saves on foreign reserves.

Figure 3.3: Fall in commodity prices has different impacts

Index 2005=100



Source: International Monetary Fund

Notes: Energy index includes Crude oil (petroleum), Natural Gas, and Coal Price Indices; Food index includes Cereal, Vegetable Oils, Meat, Seafood, Sugar, Bananas, and Oranges Price Indices; Agriculture Raw Materials index includes Timber, Cotton, Wool, Rubber, and Hides Price Indices; Metals index includes Copper, Aluminum, Iron Ore, Tin, Nickel, Zinc, Lead, and Uranium Price Indices.

Tourism is a critical source foreign exchange, investment and household income in a number of PIDS. The impact of the global recession on tourism in the region has been mixed which obscures the underlying weakening of global tourism demand. The specific impacts for the region are:

- a. Fiji has suffered from falling visitor numbers and lower yields due to its reliance on heavily discounted holiday packages and the lower visitor spend. This has lowered tourism revenues and employment.
- b. Cook Islands, Samoa, Tonga and Vanuatu have enjoyed robust tourism revenues due to robust visitor arrivals especially from Australia and New Zealand. Both Samoa and Vanuatu have benefited from the recent aviation and communication reforms which improved their international competitiveness.
- c. Tourism numbers the northern Pacific countries have been heavily affected by decline in tourism numbers Asia, North America and Europe which are their major source markets.
- d. The tourism numbers from Japan and United States were already declining even before the global economic crisis but would be exacerbated as the tourism numbers from Australia and New Zealand fell in 2009.

- e. The fall in tourism numbers will stall planned tourism investments and force marginal tourism businesses to fail or incur heavy unsustainable losses. Any defaults on tourism business loans will increase the exposure of commercial banks.

Remittances are a very important source of income and foreign exchange and a safety net for the poor for a number of PIDS. The global economic slow down and increasing unemployment in the major remittance markets will lower incomes and offshore demand for PIDS labour leading to reduced remittances sent by Pacific Islanders back to the Islands. The specific impacts are:

- a. The ADB reports that remittances to PIDS have progressively in real terms since 2008 after growing significantly from US\$163 million in 2000 to US\$446 million in 2008¹⁷. Exchange rate movements, high inflation and declining overseas incomes were the main contributing factors.
- b. Remittances form a big part of capital flows for some of the countries including, Fiji, Kiribati, Samoa, Tonga and Tuvalu, which helps strengthen their balance of payments. The decline in remittances will erode their foreign reserves and balance of payments.
- c. Offshore demands for PIDS workers have been adversely affected by the global recession as economic growth in destination economies (Australia, New Zealand and United States) have declined.
- d. Demand by shipping companies for seafarers from Kiribati and Tuvalu has also fallen as global trade slows down. Many of the seafarers are now redundant back in their countries becoming dependent on the traditional subsistence economy.
- e. Growing cost of living and financial hardships overseas have reduced remittances as Fiji has realised from its foreign workers in Europe, Middle East and United States – the value of Fiji’s remittances has declined by 40 per cent between 2007 and 2008¹⁸.

Offshore national trust funds – invested in overseas share markets - have been severely depleted through a fall in their market values as world stock markets plunged. The same goes with national pension funds there were invested off-shore. The specific impacts are¹⁹:

- a. In 2008, Kiribati, Marshall Islands, Micronesia (Federated States of), Palau and Tuvalu all experienced a severe depletion in the value of their trust funds by between 20 and 30 per cent as world stock markets plunged. The same happened with the value of national pension funds that were invested offshore.
- b. The market value of these trust funds has grown considerably over the years. They will recover over time as the world stock markets recover.
- c. The trust funds are unlikely to have the capacity to support any funding of their government’s budget and activities at this stage. This is at least true in the case of Tuvalu.

¹⁷ Asian Development Bank, *Taking the Helm: A policy brief on response to the global economic crisis*, Pacific Studies Series, 2009

¹⁸ Ajay Chhibber, *The Global Economic Crisis and the Pacific Island Countries: The Human and Social Dimensions*, UNDP Paper presented at the Lowly Institute Conference for International Policy, Brisbane, August 2009

¹⁹ Asian Development Bank, *Taking the Helm: A policy brief on response to the global economic crisis*, Pacific Studies Series, ADB, 2009

- d. Kiribati and Palau have been drawing down their depleted trust funds to fund their consolidated government expenditure because of fiscal pressures. Their trust funds risks being drawn down at an excessive rate if no corrective action is taken in a timely manner to make adjustments to their public. This may even see national assets, accumulated with much effort to secure economic sustainability, set on a long term path toward depletion.

FDI inflows to the Pacific have fallen primarily due to the lack of affordable international debt finance and equity capital and the decline in foreign investments (Figure 3.4). The United Nations Conference on Trade and Development (UNCTAD) notes that global FDI inflows to developing countries have been severely affected by the economic crisis. Recovery in 2010 is expected to be slow²⁰. The specific impacts of falling FDIs are:

- a. FDI and equity investment flows to the Pacific has slowed down as liquidity tightens and investors consolidate their investments. UNCTAD figures show that FDI flows to Fiji, Papua New Guinea, Samoa, Solomon Islands, Tonga and Vanuatu have declined by 27 per cent in 2008 compared to 2007²¹
- b. The decline in FDIs and equity investment flows has slowed down private sector investment which is seen to be the real engine for economic growth²². As a result, PIDS economic growth, employment creation and aggregate domestic demand have all slowed down.
- c. New private and public investment projects will dry up and the ones currently implemented could face financial problems and risk non-completion because of failure to attract new capital. Projects that are export orientated are most at risk²³. In Fiji for example, a number of small and major tourism projects such as the Momi Bay Resort Development have encountered similar problems and can't attract new financing. The Fiji Trade and Investment Board (FTIB) had also reported a more than 75 per cent decline in approved investment projects in 2009 compared to 2006.
- d. Papua New Guinea currently has an abnormal flow of FDIs in relation to the anticipated launch of a multi-billion dollar liquefied gas project. This substantial capital inflow will drive up domestic aggregate demand and provide a major buffer against the damped external international market demand.

Foreign aid – The PIDS receives some of the highest volumes of aid in the world and are highly reliant on development assistance. The smaller countries of Micronesia and Polynesia are more aid dependent than the larger Melanesian countries (Figure 3.5). However, ODA flows to the Pacific are likely to be adversely affected as donor countries and organisations experience tighter fiscal positions. This means that the Pacific would be receiving less aid than normal. The specific impacts are:

- a. Between 2000 and 2007, the total aid to the region increased from US\$830 million to US\$1.2 billion annually. The reduction in aid flows to the PIDS will place fiscal pressures on their government budgets by reducing overall revenue and expenditure.

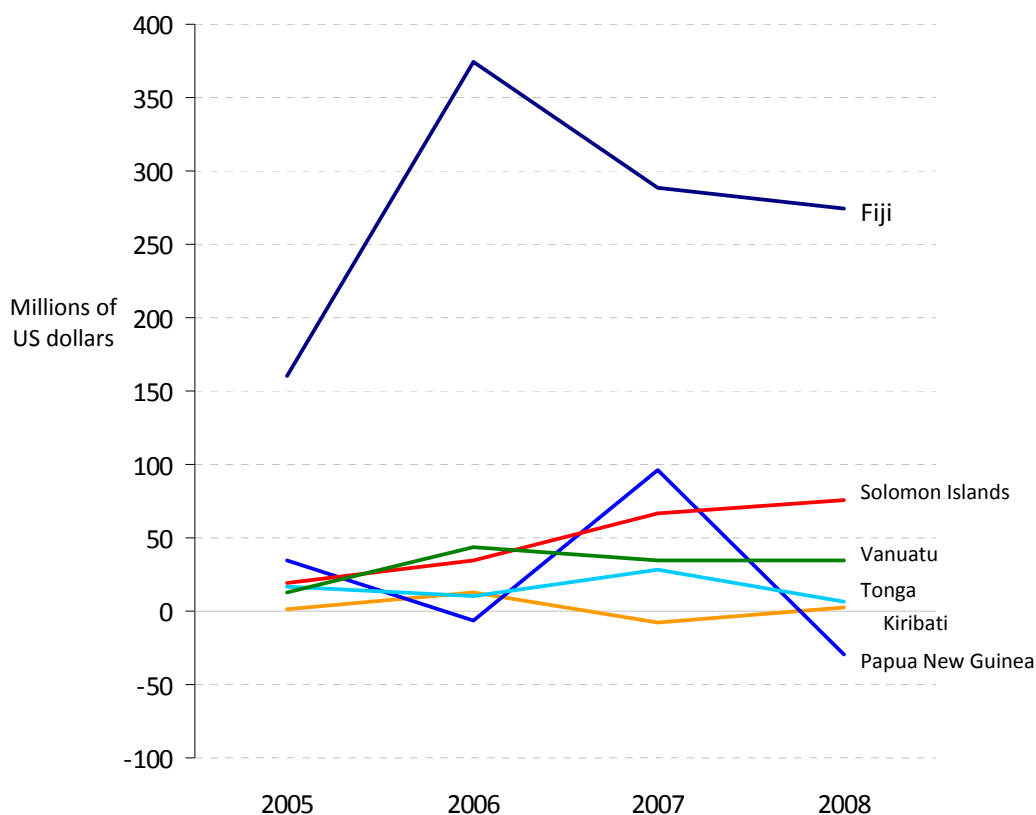
²⁰ UNCTAD, *World Investment Report*, 2009

²¹ UNCTAD, *World Investment Report*, 2009

²² Lowly Institute for International Policy, *The Pacific Islands and the world: the global economic crisis*, August 2009

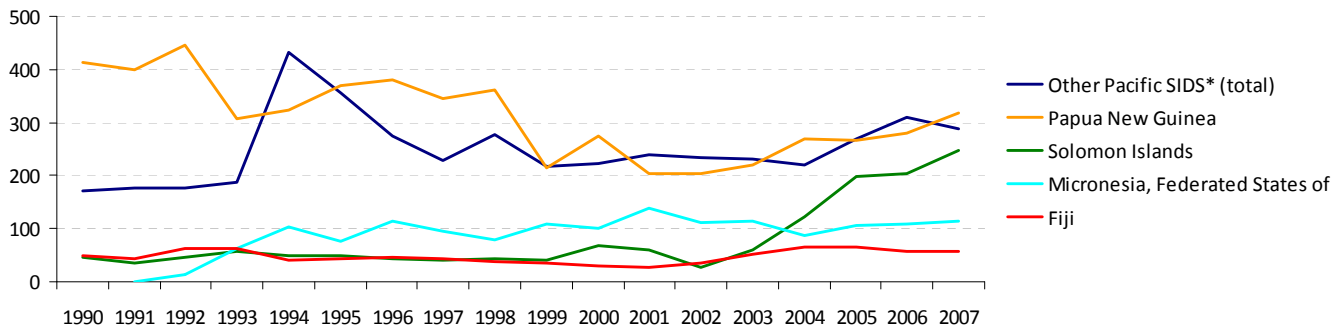
²³ *Taking the Helm: A policy brief on response to the global economic crisis*, Pacific Studies Series, ADB, 2009

Figure 3.4: Foreign direct investment performance varies across the region
Foreign Direct Investment (FDI) inflows in millions of US dollars



Source: United Nations Conference on Trade and Development (UNCTAD) World Investment Report 2009

Figure 3.5: Official development assistance (ODA) to PIDS is gradually increasing
Millions of US dollars



Source: United Nations Millennium Development Goal Database (last updated July 2009)

Notes: Based on OECD, DAC database, 2008. Disbursement basis.

* Other Pacific SIDS refers to Cook Islands, Tuvalu, Niue, Palau, Nauru, Kiribati, Tonga, Samoa, Marshall Islands and Vanuatu.

Balance of payments – All PIDS are facing disruptions to their balance of payments caused by their deteriorating external balance. The slow down in international trade and financial flows is putting pressure on their current accounts and balance of payments and eroding their foreign reserves. The specific impacts are:

- a. The fall in commodity prices for exports, and the high prices of food and fuel imports have contributed to a widening current account deficit and worsening balance of payments for most countries.
- b. The falling tourism numbers and visitor spend have reduced service receipts for the countries concerned hence lead to a deterioration in their balance of payments. On the other hand, countries that experienced robust tourism growth have enjoyed a boost in their service receipts
- c. The falling remittances, national trust fund income, foreign capital inflows and diminishing aid flows have collectively reduced net financial flows hence causing deterioration in the balance of payments of the countries concerned. With the exception of Papua New Guinea, the export and remittance dependent PIDS have all been affected to varying degrees.
- d. The widening current account deficit has eroded the import cover provided by foreign reserves in many PIDS, particularly Fiji and Solomon Islands (below acceptable levels) whose situation is more acute than others. The recent devaluation of the Fijian dollar has only provided a temporary bandage solution to what seems to be a more fundamental structural problem that exposes a non-performing and weakening manufacturing and commodities export sector.
- e. The nominal value of imports is declining in most of the large Pacific economies. While partly due to the effect of lower fuel prices, the decline also points to lower domestic demand. Notably, the value of imports from each country's major trading partner (fuel is normally from a minor trading partner for these countries) is now trending down in the tourism and remittance-dependent economies.

Government budgets - All PIDS are facing falling government revenues as a result of the contractions in their economies. The specific impacts are:

- a. The slow down in the economic activity dominated by the slow down in commodity exports and tourism has reduced tax revenues and other forms of government income including the market value of national trust funds causing widening budget deficits and tightening government cash flows. The PIDS under most pressure are those with high government deficits and debts, and little cash reserves. This has happened at a time when public services and government investments are needed most.
- b. Many governments are now assessing options for cutting expenditure or finding additional financing options for their 2009 and 2010 budgets, including support from development partners.
- c. The tightening fiscal situation has forced governments to reprioritize their expenditures and is shifting funds away from capital programmes into operating expenditures as well as cuts in the latter.
- d. Labour and businesses engaged in the provision of public services will face redundancies and be affected.
- e. The reduction in the quality and access to infrastructure and core public services such as education and health would constraint future development and has directly increased poverty.

- f. Conventional fiscal stimulus packages as those being implemented in developed countries and larger developing countries in Asia are not practical or applicable in many of the small PIDS because of their already weak fiscal positions. There is also little opportunity for small Pacific countries to mobilise additional domestic resources for investment, and virtually none have access to international capital markets. Running large deficits is not an option for PIDS.

Terms of trade – The impact of the global economic crisis on the terms of trade (ratio of export to import prices or the purchasing power of exports) of PIDS has in most cases been to their disadvantage. Most PIDS have suffered from a deteriorating terms of trade. For instance, the fall in the prices of major export commodities such as oil, copper, gold, palm oil, coffee and tourism services plus the high prices of imported goods (food, manufactured goods and fuel) has made the Pacific island countries worse off. Nevertheless, while the fall in food and fuel prices in 2009 did provide a critical buffer for most of the import-dependent economies, it adversely affected Papua New Guinea as an oil exporting country. The terms of trade decline represents a loss in real national income for a number PIDS. These economies will be affected in a number of ways:

- a. The loss in real national income will directly contribute to a contraction in the economy. It will also contribute to a real loss in household incomes and purchasing power.
- b. The relative increase in prices of imports especially fuel in the second half of 2009 has contributed to inflationary pressures and increases in cost of goods and cost of living.
- c. Pacific peoples, in particular the vulnerable communities, because of the loss in their purchasing power will be forced to switch their consumption to cheaper and inferior local products or reduce or eliminate consumption of selective imported products altogether.
- d. Papua New Guinea as an exporter of oil, gold and copper and a diverse range of agricultural cash crops has been severely affected by the significant fall in the prices of these commodities.
- e. The deteriorating terms of trade has put pressure on countries current accounts, balance of payments and foreign reserves.

Inflation in the region is expected to slow down substantially in 2009 and 2010 compared to the prices pressures experienced in 2008 following the food and fuel price hikes. While commodity prices have increased in the second half of 2009, weak global and domestic demand and continued rise in unemployment will keep price pressures at bay. Indications are that the savings from falling international food and fuel prices have not been fully transferred to consumers in the region and needs to be more carefully monitored and enforced by consumer protection institutions. The PIDS central bank's fears of deflation will likely to be offset by continued additions of liquidity to economies through stimulus programs and financial support measures.

Chapter 4

Impact on the people of the Pacific

This chapter seeks to assess how the global economic recession has affected Pacific Islanders, especially those with limited human and financial resources. These are mainly people who are living below and near the national poverty lines and generally those that are facing increasing hardships to satisfy their basic needs.

GDP per capita is relatively low and the proportion of the population below the poverty line is relatively high for several countries in the region. As noted earlier, approximately 2.7 million people in the region are living in poverty and do not have the income to satisfy their basic needs. More people in the Pacific will be forced into poverty as a result of the global economic recession which will raise the current level of poverty. However, although there are exceptions, there is limited evidence of widespread incidence of extreme poverty, in the form of hunger and destitution but the number may be growing as economies become increasingly urbanised with limited opportunities²⁴.

Poverty has emerged in the region as a significant problem and has been caused in part by the limited economic growth and under-investment in social services and basic infrastructure. The majority of poor people live in the rural areas on a subsistence basis yet the population of poor people in the cities and urban centres is the fastest growing²⁵. However, certain countries like Cook Islands and Palau are highly urbanised and majority of their poor people live in the urban centres. The poor are likely to be most severely affected by the global economic crisis. Lessons from past crisis show that it is the poor, women and children who are the hardest hit in economic downturns as real earnings slumped and jobs disappear. The poor take much longer to recover, as recovery in real wages and employment take much longer than recovery in GDP. A review of financial crisis in 80 countries found that real wages took an average of three years to pick up again. Employment growth did not regain pre-crisis levels for several years after that²⁶.

Perhaps the most compelling impact of the global economic recession on the PIDS is its direct and indirect links to unemployment, household incomes, consumption and savings. The impact of the global economic crisis is already being felt across the Pacific Islands through the lowering of economic growth for individual countries in 2009 and a forecast marginal growth in 2010. Combined with population increases this is expected to lead to five countries in the region to record negative GDP growth rates in 2009: Fiji, Micronesia (Federated States of), Palau, Samoa and Tonga²⁷. For the PIDS, the growth of their economies is essential and necessary to address poverty. Economic growth creates wealth which can be shared between the private and public sectors and citizens. The lack of economic growth on the other hand creates widespread unemployment, joblessness and declining household incomes – leading to poverty, frustration and potentially, social instability.

²⁴ AusAID, *Pacific economic survey*, AusAID publications, Canberra, 2009

²⁵ Asian Development Bank, *Millennium development goals in the Pacific Island countries: taking stock, emerging issues and way forward*, August 2009.

²⁶ ESCAP, *Responses to the economic crisis – women's economic security and rights* (November 2009).

²⁷ Asian Development Bank, *Asian Development Bank outlook*, March 2009.

The impacts of the lowering of economic growth in PIDS as a result of the global economic recession are being transmitted in several ways, some of which are discussed below.

Household incomes

In assessing the impact of the global economic crisis on household incomes, it is of concern that real GDP per capita is expected to decline in ten PIDS in 2009, after taking into account population growth rates²⁸. Negative GDP growth per capita is expected to directly contribute to a fall in average real household incomes in the countries concerned: Cook Islands, Fiji, Kiribati, Marshall Islands, Micronesia (Federated States of), Nauru, Palau, Samoa, Solomon Islands and Tonga. While the remainder of the PIDS may appear to have performed better and are more resilient to the global economic recession, indications are that the incomes of households in certain sectors will still be vulnerable, especially those dependent on commodity, manufacturing and tourism exports, FDIs and remittances - Papua New Guinea is a good example²⁹.

The negative impact of the global economic crisis on household incomes is being transmitted in several ways. The first round of impacts has been the result of employment losses in export orientated industries, tightening of financial sector lending, falls in remittances and the decline in domestic demand for good and services including primary sector produce. These impacts include:

- a. People who are employed in export orientated industries including high value agriculture have suffered direct employment losses as a result of the contraction in the industrial countries and overseas markets demand for Pacific island's exports. The loss of export revenue has troubled exporting businesses which have made workers redundant, reduced working hours or cut wages. In Fiji for example, over 1000 garment workers, who are predominantly women (80 per cent), were made redundant in 2009 following a 25 per cent drop in export revenue while those still in employment were forced to take pay cuts and work shorter hours.
- b. The decline in prices of agricultural commodities will quickly lower incomes for farmers, agro-exporters and labourers, and as logging prices fall, so will logging incomes. The impact is most profound for commodity exporting countries such as Papua New Guinea and Solomon Islands which have lost substantial export income (albeit from a boom level in 2007 and 2008).
- c. With the exception of Cook Islands, Samoa and Vanuatu, other countries in the region dependent on tourism such as Fiji, Solomon Islands and northern Pacific countries have suffered from lower visitor numbers and per capita spend which has caused job losses and declining incomes especially in rural areas where most of the tourism activities are based. This also had a negative fall out on the tourism industry value chain which includes local primary produce suppliers, transport, restaurants, entertainment and secondary tourism business operators.
- d. The banking crisis and the formal credit squeeze have directly impacted the incomes of investors who are users of financial services and are formal sector borrowers. These people have not been able to expand or refinance their businesses hence stalling new employment opportunities while troubled businesses face job redundancies and declining incomes. This will trouble the incomes of people that

²⁸ AusAID, *Tracking development and governance in the Pacific*, AusAID publication, Canberra, August 2009.

²⁹ See Dominic Patrick Mellor, *Social impact of commodity price volatility in Papua New Guinea*, Asian Development Bank, 2009.

work for such businesses. The micro-finance institutions where women are the majority borrowers will be similarly affected and as credit dries out their earnings from micro-businesses will drop.

- e. New jobs have dried up as private investments in the Pacific islands have slowed down in the affected sectors. Investors are either reluctant to take risk or are unable to raise debt and equity capital to finance investments. This means that the Pacific Island economies are unable to create jobs at a pace that matches their population growth hence reducing income per capita.
- f. The household incomes of Pacific Islanders will decline as remittances flow slows down. Remittances from Pacific Island families and workers abroad declined noticeably over 2008 in real terms and the impact is particularly serious in countries such as Fiji, Kiribati, Samoa, Solomon Islands and Tonga where remittances are a significant portion of families' income.

Household consumption

The global economic crisis has had a direct impact in reducing consumer spending and domestic consumption in PIDS. This in turn has subdued domestic demand and slowed down GDP growth in Pacific Island economies. This impact has been primarily caused by the reduction in household incomes and the real losses in wages and income per capita due to inflation and adverse terms of trade. In Samoa for example, consumption is expected to fall by 4.1 per cent due to falls in earned incomes and remittances³⁰. These impacts are further explained below.

Firstly, the impact of the global economic crisis on household consumption is a mirror of its impact on household incomes. The decline in household incomes has placed greater economic stress on the vulnerable population; especially the poor, rural people who have less to spend on food, education and health services and other basic needs hence worsen social outcomes. Interestingly, the rural population appear to be more resilient to the external shock because they have the traditional social system and informal subsistence sector to rely on. At best, however, this is still a limited safety net for various reasons.

However, the same cannot be said of the urban poor and population. They are fully exposed because they have no social protection and access to the traditional subsistence sector. Households and people on higher income brackets especially in urban centres are also faced with similar challenges as the poor but on a relative scale. It is common in the Pacific that urban people also look after bigger extended families who are dependent on them hence reducing the welfare mileage gained from their income. Increased mobility and rural-urban drift has further added to this pressure. These people are also facing difficulties to make financial ends meet and are spending less on basic needs.

Secondly, the inflationary impact of the global economic crisis on the prices of imported and domestic goods and services has also affected consumer spending in all PIDS. Although the high food and fuel prices in 2008 have fallen, the prices on the ground have not subsided in most countries and people are still paying high prices for imported and local goods and services. This impact has trickled right across most sectors of the economy including the wholesale and distribution, tourism, financial services, transportation, telecommunication, primary industries, utilities, manufacturing and construction. This means that people are now consuming less than they used to and are buying less on the dollar. This impact was compounded further in Fiji by the 20 per cent devaluation of the Fiji dollar in April 2009 - a

³⁰ Samoa, *Fiscal strategy statement: budget 2009/2010*, (Apia, Ministry of Finance, 2009).

Government move that was considered necessary to counter the country's weakening foreign reserves position.

The pass through of imported price shocks to domestic inflation has precipitated a substitution effect which has happened as relative price changes occur between imported and domestic goods that were triggered by the terms of trade shock. Invariably, imported goods have become more expensive than domestic goods. Consumers elastic demand response has led to a switching of Pacific Islanders consumption in favour of cheaper domestic products away from more expensive imported alternatives.

For all PIDS except Papua New Guinea, the fall in commodity prices including petroleum products (down by 50 per cent) did provide a timely and convenient cushion to the price shock caused by the rise in food and fuel prices in 2007 - 2008. Nevertheless, the adverse terms of trade and inflation have caused a loss in real income for Pacific Islanders hence leading to a significant slow down in consumer spending and consumption right across their economies. As a result, living standards have deteriorated – for example, poverty is on the rise, children are not attending school because of inability to pay school costs, health problems have increased because of reduced access to services and social problems such as crime and prostitution have increased.

Household Savings

The impact of the global economic crisis on household savings in the Pacific is an interesting one. Across countries saving rates tend to go hand in hand with economic growth and income growth – a fact that has been taken as proof of the existence of both the virtuous cycle of saving and prosperity and poverty traps of insufficient saving and stagnation³¹. This theory is sufficient prequalification for tracking the linkage between incomes, consumption and saving behaviour of consumers in the Pacific during the global economic crisis. Basically, declining incomes and the increase in cost of living is contributing to a decline in household savings in the Pacific. However, this impact while generalised does vary between different income groups.

Basically poor households in rural and urban areas have little or zero financial space to enable any form of savings. Their daily lives are a continuous struggle to make financial ends meet in light of their declining incomes and the increase in cost of living. These factors have led to more and more people falling into the poverty trap. The poor peoples' entrapment is clearly visible in every PIDS but more so in the large more populated Melanesian countries with a lower income per capita and standards of living. In Fiji for example, large numbers of people have sought to draw down their pension funds to pay for education, housing and other crisis-related costs. Furthermore, the number of school drop outs from poor families is a growing problem forcing government to introduce interim financial assistance in free bus fares and text books. This proves that the current financial state of poor people in the Pacific dictates that they have nothing to save at all or have no incentives to save.

For the middle and upper income households, their story is different. On the one hand, there are households that endure increased financial hardships because of declining incomes and mounting debts and personal expenses. These households have tried to survive either by cutting back their living expenses or incurring more debts to fund their lifestyle and short term financial commitments or getting other family members to look for employment and other forms of income (often forcing youths out of school and into the labour market), or a combination of these. Such households clearly have little or no income to save. On the other hand, there are households that have surplus income with an increased propensity to

³¹ *The World Bank Economic Review*, Vol. 14, No. 3: 393 – 414

save because of uncertainty in the market and through savings made by cutting back on their family living expenses.

People that have been affected, who are they and why?

The analysis contained in the earlier part of this chapter showed how the global economic recession has impacted household income, consumer spending and savings in the Pacific. The range of impacts has varied across the different economies, between the different income groups and regions but the most vulnerable and the most severely affected have been the poor people, those on low incomes, those that are debt ridden and those that have suffered job losses. However, the people most at risk are those that live in urban areas where people have less recourse to traditional food gardens and social support mechanisms. At the family level, lower incomes will translate into less money for food, children being withdrawn from school, reduced access to health services with consequences for long-term human and development prospects. Women and children are particularly vulnerable when poverty is increasing³². The specific impacts on different groups are further examined in more detail below.

Social impact on children

The global economic recession has plunged thousands of Pacific peoples into poverty, intensifying the misery of the already poor and endangering the lives, welfare and futures of the most vulnerable of all – the region's children. The Pacific islands 8.7 million total population is predominantly young with 37 per cent (3.3 million) below the age of 14 years indicating their high level exposure³³. Most PIDS have experienced slower economic growth since 2009 which has lowered government and household incomes. It has led to government and household expenditure cuts where children have had to bear the burden. Some of the impact on children includes³⁴:

- a. A growing number of young people and children have dropped out of school because of unpaid school fees and inability to pay other schooling costs (text books, uniforms, meals and transport). When earnings fall and prices rise, children's education often becomes a casualty.
- b. Children in poor families have been forced to work (usually in the informal sector and underpaid) in order to supplement their families incomes and in extreme cases are forced into prostitution. On rare occasions, children could be sold and the growing people trafficking problem in the Pacific makes this a growing threat.
- c. Children are exposed to malnutrition and hunger because households cannot afford to put adequate and balanced meals on the table.
- d. In extreme situations, young girls are being married off young to lessen the financial burden on their families. In some cases, this can involve underage girls.

³² AusAID, *Surviving the global recession: strengthening economic growth and resilience in the Pacific*, AusAID Publications, Canberra, August 2009

³³ Asian Development Bank, *The millennium development goals in the Pacific Island countries: taking stock, emerging issues and way forward*, Manila, August 2009

³⁴ UNICEF, *Impact of the economic crisis on children*, conference report accessed from: www.unicef.org/impact of economic crisis on children/conference report/on 12 January 2009

- e. Children are suffering from high mortality rates and other health problems including non-communicable diseases because of the lack of proper care and access to health services. With the exception of Solomon Islands and Vanuatu which have achieved major improvements in health care, the status of other island countries is modest and will suffer further due to the global economic recession.
- f. Government expenditure cuts has compromise the delivery of child care related services which undermined the socio-economic welfare of children. This will lead to long term problems for the region.

Gendered impact of the financial crisis

The impact of the global economic crisis will be felt by both men and women but not necessarily in the same manner. Women are the most vulnerable group because of their significantly disadvantaged overall status in the Pacific; they are therefore more likely to bear the brunt of the global economic crisis. The adverse impacts on women include:

- a. The growing job losses and unemployment in the region will mainly affect women as they constitute the majority of low-skilled, low salaried and temporary workers – the flexible workforce that can easily be drawn upon or withdrawn depending on market conditions. The female – dominated sectors such as tourism and services have been affected but job losses have been highest for women in labour intensive export manufacturing industries³⁵. In Fiji, 1000 workers were laid off in the ailing garment industry in 2009, 80 per cent of whom were women³⁶.
- b. Women are the first to lose jobs in downsizing because they are regarded as not being the main breadwinners, a fallacious stereotype.
- c. When there are few opportunities for wage work, men migrate out of the rural areas, leaving women as household heads, adding to their already significant burdens.
- d. There is a disproportionate impact on women because they have increased responsibility in home gardens for food security and caring for the sick, elderly and unemployed even when they are already in paid employment. This means longer-work hours and heavier work loads for women with consequences on their health and welfare.
- e. The cut back in government spending on social protection systems has hurt women especially single mothers with young children. In critical situations, Pacific Island girls and women are lured or forced into transactional sex work in order to survive, putting them at higher risk of HIV infection and sexual and gender based violence.
- f. Coping strategies of the poor in terms of cutting down on meals, health care spending, and withdrawing children from schools, invariably affect women and girls the most.
- g. Women in the Pacific are fairly active in operating small and micro businesses in the formal and informal sectors including cash crop farming. The slow down in

³⁵ ESCAP, *Responses to the economic crisis – women’s economic security and rights*, E/ESCAP/BPA/2009/3, November 2009

³⁶ Fiji Times, January 2010.

consumer spending and domestic demand has contributed to a fall in their income and threatens the viability of their enterprises.

- h. The tightening of the credit market including resources available for micro-finance has limited women's access to loans for businesses and other economic ventures. Their lack of recognised forms of collateral, such as property makes it more difficult³⁷. Women also have difficulty acquiring loans for other uses such as payment of school fees, housing and medical expenses.
- i. There has been a decline in the demand for migrant labour forcing workers to return home or work on reduced pay hence reducing remittances sent from abroad. This has had a disproportionate impact on women migrant workers who are mainly involved in informal and low-skilled work such as domestic work, care giver, nursing and sex work.
- j. The high food prices also affect women by limiting their ability to feed their families in light of their diminishing income.
- k. Domestic violence against women increases dramatically during times of crises along with many other forms of physical, sexual and emotional abuse.
- l. The crisis has worsened the status and conditions of women in the informal economy. Their plights include falling incomes due to falling prices for their goods and services, they work longer hours because of falling incomes, they face increasing costs in terms of overhead expenses and transport and increasing domestic burden and related stress.
- m. The political under-representation of women in Pacific Parliaments and governments; and other levels of national and community leadership remains a major disadvantage. This inferior position limits women's influence and say at the national and regional strategic decision making levels where critical policy decisions are made on measures to counter the global economic crisis which directly affect them.

Impact on rural people

Rural people are another group that is vulnerable and have been severely marginalised. They make up more than half the population of most countries in the region except for countries like Cook Islands, Palau and Kiribati which are highly urbanised. Rural people comprise mainly indigenous landowners, villagers, farmers and labourers. They usually depend on agriculture, forestry, fishing, tourism, remittances and mining for their livelihood. They also rely heavily on the non-cash traditional subsistence sector for their sustenance which helps cushion the impact of the global economic crisis on them. Rural people normally have low average incomes which are mostly seasonal depending on the type of economic activities they engage in and are more widespread. Their remoteness from urban centres, lack of quality infrastructure and public services, poor literacy and lack of economic opportunities are contributing factors to their marginalised status. As a result, poverty in the region is much higher for the rural population on the whole than for the urban population.

Due to their vulnerability, the global economic recession has forced thousands of rural people in the region into poverty while the lives of those that are already poor have worsened. The following are some ways in which the rural poor have been marginalised:

³⁷ AusAID, *Pacific economic survey 09*, AusAID Publications, Canberra, 2009

- a. The volatile fall in commodity prices especially for a range of agricultural commodities such as palm oil, copra and taro has seriously diminished the incomes of rural people in the regions where they are grown. This impact is particularly significant in Papua New Guinea following the boom in commodity prices in 2007 and 2008 followed by a general 30 per cent decline in prices.
- b. The economic crisis has threatened the social fabric of rural islanders by forcing young people and families to seek employment and social protection in urban centres in difficult times.
- c. The rise in rural to urban to overseas migration has led to other problems for those left behind. Rural villages and farming communities are being depleted of their young people, often leaving very young children in the care of aging parents and grandparents, which reduces food security in rural areas.
- d. The significant rise in food and fuel prices in 2008 may have subsided but it has reduced the purchasing power of rural households. High transportation cost has also constrained their mobility and access to public services and markets to sell their goods.
- e. The decline in consumer spending and domestic demand has reduced demand for rural agricultural products and thus reduced their incomes.
- f. Rural people are faced with a deteriorating terms of trade which increases the relative prices of external or urban goods. This has diminished their household purchasing power and welfare.
- g. Rural people have also suffered from loss of jobs in the tourism belt areas in some countries such as Fiji due to declining tourism numbers.
- h. The fall in remittances has also reduced rural people's incomes.
- i. The roll back of rural development programmes by governments has affected rural people in terms of loss of jobs and benefits. They have also been negatively affected in countries where government made expenditure cuts in programmes relating to social welfare, education and health, micro-finance and income creation.

Impact on the urban poor

Poor people in the urban areas although generally less than in the rural areas are also vulnerable to external shocks. Poverty is also considered to be most severe in the poorest parts of the urban areas. PIDS are generally urbanising at a rapid rate as people migrate to the major cities and towns in search of better opportunities. This is increasing the number of squatter settlements and demands for low cost housing, reducing access to subsistence production and creating pressures on urban infrastructure. Given their vulnerability, the global economic crisis has affected the urban poor as follows:

- a. The urban poor have suffered from increasing job losses in the informal sectors, small businesses and in low paying labour intensive industries where they are mostly employed in.
- b. The increase in price of goods and services has diminished the purchasing power of the urban poor who could only buy less from an already diminishing income. This leads to malnutrition and hunger.

- c. Their situation has worsened as relatives migrate from rural to urban areas and initially seek shelter with them adding to the number of mouths to feed.
- d. They are made more vulnerable because they lack access to the traditional subsistence agriculture system and social protection that rural people enjoy.
- e. With income pressures, other members of households including children and women have been forced to work to supplement the family income. It is common for women to reluctantly take up transactional sex work and be exposed to HIV and other diseases. Involvement in selling drugs is also common.
- f. They suffer as government health, education and social welfare budgets are cut and restrictive and they lack access because of lack of money.
- g. They are exposed to increase in criminal activities by criminal gangs who are based out of poor settlements.

Impact on elderly and people with disabilities

In the Pacific, the elderly and people with disabilities are also vulnerable to the impact of the global recession. The elderly in the Pacific generally don't have adequate financial protection for their retirement and many rely on their children and families for their livelihood. On the other hand, majority of the people with disabilities live below the poverty line. Poverty is both a major cause and consequence of disability. Poverty and disability reinforce each other contributing to increased vulnerability and exclusion. The impact on the elderly and disabled include:

- a. Most people with disabilities are employed in the informal sector and are treated as "reserve army of labour", last to be hired first to be fired' during economic crisis. The increasing job losses in the islands have impacted them directly.
- b. The rising food prices and cost of living means that the elderly and disabled have had to pay higher prices for their basic needs including transportation costs hence limiting their mobility and access to government services.
- c. Cuts in government expenditure on social welfare programme have reduced their social income support.
- d. The hard economic times means that they will receive less remittances and financial support from their families and carers.

In an ever globalising world, the Pacific region's level of integration and dependency on the rest of the world is increasing. This is because of its broader global opportunities for trade and the Pacific islands diseconomies of scale that makes them unable to support large scale domestic economic production. The reality is that it raises the Pacific Islanders level of exposure and vulnerability³⁸. Despite these challenges and vulnerabilities, Pacific island communities are strongly resilient to adverse internal and external shocks. They have traditional social systems and structures founded on extended family values and communalism that provides them with a coping mechanism which enables them to share their limited resources and help each during times of trouble. Sadly, this traditional social system of ensuring social safety for everyone is being slowly eroded due to the modern forces of social change.

³⁸ Vulnerability in this context is used in its broadest context whether it results from internal or external actions or whether it be economic, social, environmental or governance related

Impact on public sector programmes

All PIDS are facing falling government revenues as a result of the global recession. This could be confirmed in the 2009 budgets of PIDS governments. Most 2009 Budgets were formulated before the full extent of the global crisis was known, and it is very likely that their revenue forecasts will prove to be overestimates. Fiscal space is likely to shrink as the global crisis results in revenue collections falling below forecast. Budgets may move from surplus to deficit or projected deficit may widen further because of the fiscal shock³⁹. Prior to 2009, many PIDS were already experiencing a range of stresses, with some countries running unsustainable budget deficits even before the current economic downturn. More PIDS face potentially destabilising budget deficits without actions to manage expenditure in a manner consistent with a sustainable medium term fiscal position⁴⁰.

The policy responses of PIDS have been mixed. Some countries have opted to maintain fiscal discipline in an environment of declining revenues by taking action to strengthen budget management and to trim low priority expenditure, protect and prioritise expenditure on core development priorities, especially basic health, education and infrastructure, and improve revenue collections. The fiscal space created allows for the flow of resources into programmes that are necessary to counter the effects of the global economic crisis. Countries have also sought assistance from development partners to implement critical budgetary reforms, improve public sector capacity and maintain core services⁴¹. The Solomon Islands for example as a result of the sharp decline in its tax revenues has cut recurrent expenditure by 35 per cent, froze vacancies, reduced and reprioritized development expenditure. Tonga on the other hand has implemented tight spending control, particularly for non-staff expenditures such as operations and maintenance⁴².

On the other hand, a few countries such as Cook Islands, Fiji, Papua New Guinea and Vanuatu have opted for a fiscal stimulus package by increasing government expenditure through capital investment programmes covering especially infrastructure and reducing taxes. The primary role of such fiscal stimulus is to raise domestic aggregate demand to offset the decline in external demand. The fiscal stimulus package will require extra resources to fund the deficit, the options being external grants, where made available, and borrowing, where affordable.

Papua New Guinea because of its strong fiscal position decided to maintain a balanced budget despite its Government revenue falling by 25% in 2009 due primarily to the crash in commodities prices. The government drew down US\$227 million from its healthy cash reserve that was amassed during the commodities boom in 2007-2008 to finance the deficit. Its budget supported a massive 60 per cent increase in the capital budget⁴³. Vanuatu also did the same in implementing planned infrastructure programmes because of its strong fiscal position that was owed to improved economic management. Fiji, however, ran a large

³⁹ Asian Development Bank, *Taking the helm: a policy brief on response to the global economic crisis*, Pacific Studies Series, Manila, 2009.

⁴⁰ AusAID, *Surviving the global recession: strengthening economic growth and resilience in the Pacific*, AusAID publications, Canberra, 2009

⁴¹ AusAID, *Surviving the global recession: strengthening economic growth and resilience in the Pacific*, AusAID publications, Canberra, 2009

⁴² Asian Development Bank, *Pacific Economic Monitor*, August 2009.

⁴³ East Asia Forum 2009, accessed from: www.eastasiaforum.org/2010/01/08/papua-new-guineas-development-success-depends-on-learning-from-its-past/ on 6 January 2010.

expansionary budget but had to borrow US\$243 million domestically mainly at a concessional rates from the local pension fund to finance the deficit. This unfortunately pushed up the government's debt and exposure to exceed 50 per cent of GDP. As for Samoa, its government spending increased by 12.7 per cent, mainly as a result of higher development expenditure. This will result in a deficit of 5.9 percent which will be funded by tax revenue and external grants⁴⁴.

Despite the PIDS mixed fiscal policy responses to the global economic crisis, the effects on their public sector programmes has many parallels. Some of these are noted below:

- a. Some countries (e.g., the Cook Islands, Fiji, Papua New Guinea, Samoa and Vanuatu) have maintained or increased their level of capital expenditure in order to provide a fiscal stimulus for economic recovery. The targeted core investment areas have been public and social infrastructure, and job creation.
- b. Many of the PIDS that faced fiscal constraints recorded declines in their social sector budget allocations. Papua New Guinea for example, had a 17 per cent reduction in its health sector funding while its recurrent budget for education was below past levels⁴⁵. Samoa had cut back its allocation for social services including the allocations for health and education which fell back to 2006 levels⁴⁶. Fiji's health and education budgets had modest increases compared to the military budget⁴⁷.
- c. Countries that have cut their operating expenditure are likely to face adverse impacts on their service delivery. Such crude response has slowed down the implementation of capital projects in 2009 for many countries⁴⁸.
- d. The flow of ODAs to the Pacific especially in the form of external grants is commendable because it has provided a critical buffer for maintaining a reasonable level of investment in the social sectors. Fiji for example has a \$45.4 million grant in aid programme for education and \$14.9 million for health.
- e. Most countries have increased their poverty related allocations to help mitigate the impact of the crisis on poor. These included social welfare assistance, micro-finance schemes, gender programmes and creation of income opportunities. Another common pro-poor policy response was to reduce duties on basic food items to counter growing food prices.

⁴⁴ Samoa, *Fiscal strategy statement: budget 2009/2010*, Ministry of Finance (Apia, 2009).

⁴⁵ East Asia Forum, 2009. accessed from: www.eastasiaforum.org/2010/01/08/papua-new-guineas-development-success-depends-on-learning-from-its-past/ on 6 January 2010.

⁴⁶ Samoa, *Fiscal strategy statement: budget 2009/2010*, Ministry of Finance (Apia, 2009).

⁴⁷ Warden Narsey, *2010 budget: the great cover up*, University of the South Pacific, December 2010.

⁴⁸ Asian Development Bank, *Pacific Economic Report*, August 2009

Chapter 5

Impact on the progress towards the Millennium Development Goals

This chapter will review the individual PIDS progress towards the achievement of the MDGs (Box 5.1) in light of the impacts of the global economic recession on the Pacific island's economies and peoples. The underlying assumption is that the adverse impacts of the global economic recession will surely roll back or erode some of the hard gains that the PIDS have made towards the MDG. The analysis is mainly based on the review of recent papers and study reports produced mainly on this subject by the international multilateral and bilateral development agencies for the Pacific region.

Box 5.1: The Millennium Development Goals (MDGs)

The MDGs are a set of eight priority development goals, supported by time bound targets with quantifiable indicators to be reached by 2015 as listed below. There are currently 22 targets and a total of 60 indicators. The MDG addresses extreme poverty, hunger, disease, lack of adequate shelter and exclusion, while promoting gender equality, education and environmental sustainability. They also reflect basic human rights as pledged in the Universal Declaration on Human Rights and the Millennium Declaration⁴⁹.

- Goal 1 – Eradicating extreme poverty and hunger; (Targets 3, Indicators 9)
- Goal 2 – Achieve universal primary education; (Targets 1, Indicators 3)
- Goal 3 – Promote gender equality and empower women; (Target 1, Indicators 3)
- Goal 4 – Reduce child mortality; (Targets 1, Indicators 3)
- Goal 5 – Improve mental health; (Targets 2, Indicators 6)
- Goal 6 – Combat HIV/Aids, malaria and other diseases; (Targets 3, Indicators 10)
- Goal 7 – Ensure environmental sustainability; (Targets 4, Indicators 10)
- Goal 8 – Develop a global partnership for development; (Targets 6, Indicators 16)

Essentially, the first seven goals are measures which developing countries need to take to improve the well being of their citizens. The last goal is a social, political and economic compact between developed and developing countries, which sets down the commitment of developing countries to increase their share of ODA in order to assist developing countries reach the other seven goals.

Progress made towards Millennium Development Goals









The world is past the half-way mark for achieving the MDGs. Recent reports on the progress towards MDGs in the Pacific have showed that achieving all the MDG's across the Pacific region by the deadline is unlikely⁵⁰. While some progress has been made on some MDGs, no country is on track to achieve all the MDGs, and no MDG is on track to be achieved by all PIDS (Table 5.1). Overall, some countries are doing better than others while a few countries have done very poorly but the overall tracking of their performance has been hindered by the lack of data.


⁴⁹ ESCAP/ADB/UNDP, *The millennium development goals in the Pacific Island countries: taking stock, emerging issues and way forward*, August 2009

⁵⁰ Two reports on MDG have been done, namely: AusAID, *Tracking development and governance in the Pacific 2009* and a regional report by ESCAP/ADB/UNDP, *The millennium development goals (MDGs) in the Pacific Island countries: taking stock, emerging issues and way forward*, 2009.

In summary, the situation in the Pacific is one where poverty is rising, growth is insufficient and lacked equity, not enough children complete schooling and the basic health challenges are significant. There is also some positive news on the MDGs. The region is undertaking world-leading work on malaria education. There is good progress in some countries in primary education completion rates. Most countries are investing more of their own resources in health and education. The need to invest in women and children is also widely recognized⁵¹.

Table 5.1: Status of progress towards MDGs in the Pacific

	PACIFIC: MDG STATUS AT A GLANCE							
	 1	 2	 3	 4	 5	 6	 7	 8
PNG	X	X	?	X	X	X	X	?
Fiji		?	✓	?	?	X	?	?
Solomon Islands	✓	✓	X	?	✓		?	?
Vanuatu	✓	?	?	?	?		✓	?
FSM	✓	?	?	?	?		✓	?
Kiribati	✓	✓	✓	?	?	X	X	?
Marshall Islands	✓	✓	✓	✓	✓	?	?	?
Nauru		?	?	?	?		X	X
Palau	✓	✓	✓	✓	✓	✓	✓	✓
Cook Islands	✓	✓	✓	✓	✓	✓	✓	?
Niue	✓	✓	✓	✓	✓	✓	✓	?
Samoa	✓	✓	✓	✓	✓	✓	✓	?
Tokelau		✓		✓	✓			?
Tonga	✓	✓	✓	✓	✓	?	✓	?
Tuvalu	✓	✓	✓	?	✓	X	?	?

KEY: ✓ Mostly on track; ? Slightly off-track / some data gaps; X: Off-track;  Weak / No data SOURCE: National MDG Reports (2004-2008); UNDP estimates

Source: Ajay Chhibber, *Global economic crisis and the Pacific Island countries: the human and social dimensions*, UNDP Paper presented at the Lowy Institute Conference for International Policy, Brisbane, August 2009

Samoa and Tonga have made the most progress and are on track to achieve four MDGs. Fiji, Niue, Palau and Vanuatu are on track to achieve three MDGs. For many of these countries, substantial progress was made during the 1990's in the health and education MDGs. However, in recent years, progress has been slow (or in some cases reversed, as in the case of child and maternal health). Clearing the final hurdles to achieve universal primary education and mother and child care will often require more expensive interventions in remote areas and vulnerable groups. Kiribati, Marshall Islands, Nauru, Solomon Islands and Tuvalu are positioned to meet very few MDGs. Papua New Guinea is off-track on majority of the MDGs⁵².

Looking at the region overall, progress against the common development indicators reveal the scale and challenges faced by PIDS in meeting their MDGs. The global economic crisis has

⁵¹ Lowy Institute for International Policy, *The Pacific Island and the world: the global economic crisis*, August 2009

⁵² AusAID, *Tracking development and governance in the Pacific*, AusAID publication, Canberra, August 2009

further weakened the ability of many countries to achieve the targets without substantial further assistance. Equally important for the region is the need to develop and implement an effective system for tracking development indicators. Currently, there is no coordinated system to assist countries in tracking and measuring progress, and thus report their performance against internationally goals and indicators such as the MDGs. This is the root cause as to why the Pacific islands region has been identified as one that has fallen behind in meeting its MDG reporting obligations. The Secretariat for the Pacific Community (SPC) is working to address this problem.

Impact of the Global Economic Recession on the achievement of the MDGs

The global economic recession has thrown the Pacific islands region further-off course in achieving the MDGs. Some of its impacts in relation to the MDGs for the various countries are discussed below.

MDG 1: Poverty and hunger

Poverty is a significant and growing problem for many countries in the Pacific, with around one-third of the region's population, not having an income or access to subsistence production to meet their basic human needs. Of the eight MDGs' progress towards MGD 1 has been the slowest and is of most concern in the region. Only Vanuatu appeared to have made progress in reducing poverty⁵³. The global economic crisis has adversely impacted the already worsening poverty situation in the region by forcing more people into poverty. The rise in food prices and cost of living and slow economic growth have led to sharp reductions in the real incomes of the poor and has increased the incidences of basic needs poverty. The urban poor are likely to suffer more than the rural poor because they don't have the benefit of the traditional subsistence economy and social safety net to fall back on.

MDG 2: Universal education

Even though a number of countries (Fiji, Niue, Samoa, Tonga and Tuvalu) appeared to be on track to achieve universal primary education, a concern is that declining household incomes has led to declining school attendance and enrolment. The global recession has also placed pressure on education budgets as government revenues declined thereby restraining access and the quality of education. These factors have either stalled or reversed the progress already made towards MDG 2, unless investments (including development partner investments) in education budgets are safeguarded⁵⁴. For instance, in Fiji, the Government had to offer free bus fares and text books grants for underprivileged children in order to maintain school attendance in the last six months. In Samoa, many children have dropped out of school because of unpaid school fees.

MDG 3: Gender equality

Significant progress has been made towards promoting gender equality and empowerment of women in the region, in particular with access to education and employment, although inequalities remains in wages, work conditions, job opportunities and decision-making.

With the exception of Micronesia (Federated States of), Nauru, Solomon Islands and Vanuatu, the other PIDS are on track to meet this goal⁵⁵. Nonetheless, the gains made so far

⁵³ AusAID, *Tracking development and governance in the Pacific*, AusAID publication, Canberra, August 2009

⁵⁴ AusAID, *Tracking development and governance in the Pacific*, AusAID publication, Canberra, August 2009

⁵⁵ AusAID, *Tracking development and governance in the Pacific*, AusAID publication, Canberra, August 2009

have been eroded by the global recession. Women in the region have suffered from massive job losses, increased domestic responsibilities and burden, declining health standards, drop outs from school, engaging in prostitution and exposure to domestic violence.

With respect to participation in decision-making, women in PIDS are underrepresented at national and local levels of parliament and government. Women's political participation and representation in politics is vital to address the many factors that are impacting on the plight of women as a result of the global economic crisis. PIDS need to take active steps to including more women into decision making processes at all levels in order to meet the targets of the MDGs.

MDG 4: Child mortality

Significant progress has been made in improving the health status of children in the Pacific since the 1990s. The infant and under five mortality rates have shown improvements for a number of countries. With the exception of Papua New Guinea, the other PIDS are likely to achieve this goal. However, they are now faced with new layers of challenges due to the impact of the global recession. Declining real household incomes and government budget cuts have exposed children to poor nutrition and hunger, child labour, child abuse, poor health care and exposure to diseases.

MDG 5: Improve maternal health

A recent ADB report indicated that a number of countries appeared to be on track to achieving this goal but progress is uneven across the region⁵⁶. However, the global recession has put a dent to this achievement and could lead to worsening outcomes for health related MDGs. Declining household incomes, rising food prices and high transportation costs have adversely affected women's health and restrained their access to maternal health services while government health budgets cut has undermined the quality of the public health services provided.

MDG 6: Combat HIV/aids, malaria and other diseases

Infectious and life-style diseases pose significant health burdens on the region, marked by a high incidence of non-communicable diseases (e.g. diabetes) for most countries, a serious HIV/aids problem in Papua New Guinea while malaria is common to Papua New Guinea, Solomon Islands and Vanuatu. According to the ADB commissioned report, only the Marshal Islands, Niue, Palau, Samoa, Tonga are likely to achieve this goal. The global recession its economic and social ills will increase the Pacific Islander's vulnerabilities to these diseases.

MDG 7: Environmental Sustainability

The progress of environmental sustainability is essential for the attainment of all other MDGs in the Pacific, in particular managing the effects of climate change. The global recession has exacerbated pressures on the environment in several ways, including increased number of urban poor and squatter settlements and slums, which is already a concern for the Pacific; reverting to unsustainable subsistence farming and livelihood practices, increased exploitation of fisheries resources, and an inability to make domestic and ODA resources available for climate change adaptation and mitigation⁵⁷.

⁵⁶ ESCAP/ADB/UNDP. "The millennium development goals in the Pacific Island countries: taking stock, emerging issues and way forward", August 2009

⁵⁷ Ajay Chhibber, *The Global Economic Crisis and the Pacific Island Countries: The Human and Social Dimensions*, UNDP paper presented at the Lowly Institute Conference for International Policy, Brisbane, August 2009

Development partnership in the Pacific

Performance of PIDS governments

Recent studies have shown that the Pacific islands region has to date shown mixed progress towards the achievement of the MDGs, but on the whole it is seriously off track to achieve all the MDGs by 2015. Urgent action is required to ensure resources from both PIDS and their development partners are applied more effectively to make faster progress towards the MDGs in the region. An assessment of the progress made towards the MDGs in the region clearly shows the different levels of achievements by the different countries. The best progress towards the MDGs was achieved by countries that met the following criteria:

- a. Have sound economic growth supported by equitable development policies.
- b. Have a strong political commitment towards the MDGs.
- c. Committed higher levels of resources including substantial supplementary aid funds.
- d. Have strong capacity to implement programmes.
- e. Have a conducive internal environment.

Most PIDS continued to invest significant financial resources into human development. For instance, most PIDS governments spend more per person on health services than other countries with similar levels of income. This effort is complemented by the churches, civil society organisations and communities which all make important contributions as well. The levels of funding per capita however varied between countries. Despite large investments in service delivery, public spending by PIDS governments is generally not leading to better outcomes.

The reach and quality of government services remains poor in many countries, especially in Melanesia compared to Polynesia and Micronesia and this affects the quality of MDG outcomes. Small and dispersed populations and poor transport links means it is expensive to deliver services in the Pacific islands. Higher levels of spending will often be required to achieve the same level of services as in countries with lower cost structures. But in many cases expenditure is inadequately targeted and services often fail to reach the poor.

Experience from the region demonstrates that improved government effectiveness is achievable and critical for MDGs. The quality of services delivery and policy formulation and the capacity of the public service are important elements of government effectiveness. Improvements in each of the areas are associated with higher growth and higher growth is associated with greater progress towards the MDGs.

Development coordination and effectiveness

Domestic resources and aid resources together constitute the funding available to implement development policy in region. The two need to be integrated within sound national plans and public expenditure systems and applied to highest priority programs to achieve optimal results. The challenge for the Pacific islands is to achieve this within a practical framework that is built on international best practice.

Relative to the size of their economies and populations, PIDS receive some of the largest ODA amounts in the world on a per capita basis. For instance, in recent years, the Pacific

islands have received more than US\$ 1.0 billion annually in ODA from development partners⁵⁸. The total amount is much more when aid from China and Taiwan Province of China are also added on. However, aid fragmentation in much of the Pacific islands is high by international standards. Aid flows are often volatile and unpredictable and not well coordinated compared to other regions. Progress is also slow in implementing the *2005 Paris Declaration on Aid Effectiveness*. This is partially due to the prevalence of weak governance systems in the Pacific which development partners are often reluctant to use.

There is a school of thought that makes a compelling case for change – for a combined effort by PIDS and development partners to improve governance and development coordination⁵⁹. This will enable all development resources to be more effectively directed towards the Pacific island's highest priority development challenges. As a first step, more frequent and higher level dialogue is needed between countries and development partners on key challenges. Together PIDS and their development partners can turn ambition into reality and make faster progress towards the MDGs⁶⁰.

PIDS and development partners are mutually accountable for results and will be judged for the impact of their collective efforts have on the lives of Pacific Islanders. Transparent and accountable use of all development resources is necessary to achieve the MDGs. Clear and measurable commitments, reinforced by sustained dialogue, are required to improve coordination and accelerate progress towards mutually agreed development outcomes.

Domestic resources from PIDS and resources from development partners need to be better integrated within sound national plans and public expenditure systems and applied to the highest priority programmes. PIDS must lead improvements in development cooperation at the national level, to achieve faster progress towards the MDGs. Pacific Island governments are not managing aid well and should begin to take a proactive role in improving their policy planning and budget management systems to achieve better service deliveries and better development outcomes.

Pacific Leaders also need to closely track the outcomes of agreed actions on development coordination. The monitoring of the implementation of the *Cairns Compact on strengthening of development coordination* must be adhered to with close dialogue between PIDS and development partners at the national and regional levels.

⁵⁸ AusAID, *Tracking development and governance in the Pacific*, AusAID publications, Canberra, August 2009

⁵⁹ AusAID, *Tracking development and governance in the Pacific*, AusAID publications, Canberra, August 2009

⁶⁰ AusAID, *Tracking development and governance in the Pacific*, AusAID publication, Canberra, August 2009

Chapter 6

Surviving the global economic crisis: a platform for action

No developing country can or should isolate itself from the world economy, which is certainly true for PIDS. The analysis in this paper has proven that the PIDS engagement in the world economy is both a blessing and a risk. The benefits of having an open economy that takes advantage of the possibilities of international trade and capital flows are well understood in economic theory. This has also been demonstrated through the PIDS development experience. By linking themselves to the world economy, however, PIDS are also exposed to external shocks – that is, they can be adversely affected by economic disturbances that originate in events outside their countries. Coping with such external shocks such as the current global economic recession is often the most crucial test facing their policymakers.

The PIDS have been hit by the perverse effects of the global economic recession in 2009 which will flow on into 2010 and is still unfolding. Even if the global economy picks up in the second half of 2010, as the most recent forecasts suggest, it may take until 2011 for the Pacific economies to fully recover. This final chapter looks at the challenges created by the global economic recession and discusses the best policy options for PIDS to mitigate its impact. These policy options provide a mix of pragmatic solutions to help policymakers and Pacific Leaders find a way forward for their countries during these difficult times.

The Pacific Islands Forum meeting in Cairns in August 2009 has provided the platform for decisive action by PIDS governments in responding to the global economic recession and laying a foundation for future broad based growth consistent with the *Pacific Plan*. The challenge, however, is not to measure success by using accelerated economic recovery as the main yardstick or goal. Rather it should focus on using the opportunity presented by the global economic crisis to understand its impact on the Pacific island economies and to effectively address their development challenges in ways that will ensure their economic sustainability and long term resilience to future external economic shocks which protects the vulnerable communities and the poor. Some recent reports and papers on the impact of the global economic recession on PIDS have offered policy prescriptions for responding to the global recession. These have been taken into account in the mix of policies that is proposed below for the consideration of PIDS.

This is not an action plan but a call for action for PIDS governments (and development partners) that want to accelerate and better manage their growth and achieve a high level of resilience to future global economic shocks.

Maintaining macroeconomic stability

Most PIDS have suffered from a deteriorating external balance caused by lowering export receipts and financial in-flows. It is, therefore, imperative that they make the necessary adjustments in their policy responses to maintain macroeconomic stability, which is a pre-condition for ongoing growth and development. Some of the actions required for supporting macroeconomic stability are⁶¹:

- a. A sustainable fiscal policy and public sector debt position.

⁶¹ AusAID, *Tracking development and governance in the Pacific*, AusAID publication, Canberra, August 2009

- b. A sustainable balance of payments position and comfortable level of external reserves.
- c. A competitive exchange rate.
- d. Low inflation.
- e. Sustainable draw downs for PIDS dependent on offshore trust accounts for budgetary revenues.

In order to ensure macroeconomic stability, it is essential that the fiscal policy of PIDS is prudently managed especially for economies that are open and highly dependent on exports and imports⁶². It is also important for countries that are reaching unsustainable debt levels. Countries will need to make adjustments on their expenditures to reflect the fall in revenues due to fall in taxes and other incomes.

In adjusting to the global recession, and for PIDS with independent currency, the AusAID report titled “Surviving the global recession: strengthening economic growth and resilience in the Pacific”, emphasised that prudent fiscal policy will need to be supported by sound monetary and exchange rate policy. These policy levers will need to forge direct links to growth and focus on managing the impacts on the current account and foreign reserves. Monetary policy should focus on maintaining control of inflation and a competitive exchange rate that has come under pressure from falling export receipts and terms of trade⁶³.

Maintaining a well-functioning financial system is also important to enable PIDS to emerge healthily from the global recession. Although, banks were not excessively exposed to the global financial crisis, they have been placed under stress as borrowers are unable to service their loans on current terms (as confirmed by the ANZ Bank head office in Suva) as Pacific economies slow and incomes fall. Banking supervision should be stepped up so that any build up of bad loans is quickly identified and acted upon⁶⁴.

Stronger governance and better fiscal management

The lack of effective governance and public financial management is seen as a major obstacle which is contributing to the poor development performance of PIDS. Essentially, the level of government expenditures and aid in the region are not matched by the reach and quality of services provided. Expenditure is often poorly targeted and accounted for, the government bureaucracies are often inefficient and poorly managed, and the Pacific islands is an expensive region in which to deliver services. Given the importance of maintaining fiscal prudence in an environment of declining revenues, PIDS governments will need to improve their public financial management and prioritisation of core expenditure to support core services including health, education, infrastructure and core social services that support the vulnerable communities. Some of the key measures that could be taken are⁶⁵:

⁶² AusAID, *Surviving the global recession: strengthening economic growth and resilience in the Pacific*, AusAID publications, Canberra, August 2009

⁶³ AusAID, *Surviving the global recession: strengthening economic growth and resilience in the Pacific*, AusAID publications, Canberra, August 2009

⁶⁴ AusAID, *Surviving the global recession: strengthening economic growth and resilience in the Pacific*, AusAID publications, Canberra, August 2009

⁶⁵ AusAID, *Surviving the global recession: strengthening economic growth and resilience in the Pacific*, AusAID publications, Canberra, August 2009

- a. Cut back recurrent and capital expenditure on low priority items to reflect revenues and re-direct savings to prioritised expenditure with emphasis on core services in line with a sustainable fiscal position.
- b. Protect and strengthen core service delivery, particularly in health, education, basic economic services and social welfare support.
- c. Strengthen revenue collection.
- d. Strengthen efficiency and effectiveness of government services and capital expenditure programme.
- e. Introduce financial management reform to strengthen accountability and service delivery.

Conventional fiscal stimulus packages as those implemented in developing countries and larger developing countries of Asia have been implemented to varying degree by some PIDS (Cook Islands, Fiji, Papua New Guinea and Vanuatu) to stimulate domestic aggregate demand and create employment. This policy option may be appropriate for countries with large cash reserves such as Papua New Guinea or Tuvalu in terms of supplementary income from its trust fund or those that have fiscal space to borrow externally. It is also important that any expansionary investment programme is managed effectively to make sure that it generates a reasonable return on investment (ROI).

However, it may not be practical or applicable in many of the small PIDS whose budgets are already tight and pushing the upper limits of sustainable fiscal deficits because of a reduction in taxes and other revenues or if their debt is reaching unsustainable levels (e.g. Federated States of Micronesia, Fiji, Kiribati, Nauru, Samoa and Solomon Islands). There is also little opportunity for small PIDS to mobilise additional domestic resources for investment, and virtually none have access to international capital markets. Running large deficits and or printing currency to finance packages are not options and would be a risky policy contributing to deteriorating balance of payments, further declines in foreign exchange reserves, a weakening exchange rate, a rise in interest rates and increasing inflationary pressures.

Economic and public sector reforms and broad based pro-poor growth

While the global economic recession has shown the vulnerabilities of PIDS in the global economy, it also exposed the structural and governance problems, and narrow based growth that continue to plague these economies. However, there are enough success stories in the Pacific to indicate that many current constraints to growth can be overcome, if effective economic management and sound policies are followed.

Fundamentally, PIDS will need to improve their international competitiveness in order to maximise their export receipts and financial flows and achieve sustainable economic growth in the medium and longer term. This is critical to complement the gains achieved from short term macroeconomic or financial stabilisation policies. Economic reform and public sector reform policies will need to be pursued with a lot of perseverance, political will and with adequate resource support to address deeper structural and institutional weaknesses. This should be geared towards private sector-led growth.

In this regard, the *Pacific 2020 Report* makes sense in suggesting that a two pronged approach to reform: structural policy reforms and smart public investments to achieve quick

growth impacts (e.g. infrastructure), combined with more attention to the tough long-term growth constraints (such as political governance and land tenure)⁶⁶.

On this platform, PIDS particularly those with a narrow export base, will need to diversify their economies and develop new industries to create new jobs, new wealth and achieve broad-based growth. They also need mainstream pro-poor policies in the national development plans and priorities. This would be the best insurance against future global economic shocks. The specific policy actions required include:

- a. Opening up the economy for international trade through increased competition and appropriate regulation of monopolies.
- b. Reform public enterprises, reduce government involvement in economic activities and privatise activities better served by the private sector.
- c. Strengthen role of NGOs and private sector to deliver services in partnership with government.
- d. Improve the environment and cost of doing business.
- e. Promote pro-poor growth policies to ensure increased equity and broad based development.

Prioritise investment in education and health

Investments in education and health services have been a focal point of government effort and donor support in the Pacific and this is reflected in the improvements made in their education and health indicators since the 1990s. The reverse is noted for countries that have failed to maintain similar commitments.

Investment in education and health are basically investment in people in order to achieve long-term sustainable and equitable growth. A well educated and healthy population forms an invaluable human capital for stimulating sustainable economic growth.

However, the UNDP human development index (which integrates income, access to education, health services and gender equality) has shown that Asian countries such as China, India and Vietnam have made stronger gains in human development since the 1990s and have closed the gap over the advantage that Pacific Islanders enjoyed relative to many Asians⁶⁷. The lesson is that PIDS have not invested as much as they should in the health and education of their people. The message for PIDS is to take a precautionary approach and ensure that their education and health budgets are not disrupted in situations where budget cuts are imminent. They should always constitute the core of government expenditures and priorities.

A further point is that while many countries are making significant investments in these sectors, spending and service delivery is not always effective and fails to meet expectations. Improving services not only requires more resources, it requires these resources to be targeted well and used efficiently through better managed programmes. The involvement of communities in planning and service delivery can also help governments to be more

⁶⁶ AusAID, *Pacific 2020: challenges and opportunities for growth*, AusAID publications, Canberra, May 2006.

⁶⁷ Ajay Chhibber, "The Global Economic Crisis and the Pacific Island Countries: The Human and Social Dimensions" UNDP Paper presented at the Lowly Institute Conference for International Policy, Brisbane, August 2009

responsive to local needs and attract additional resources. Communities, NGOs, churches and the private sector can all play this role.

Social protection programmes and external shock adaptation

Social protection programs to assist the poor and vulnerable groups cope with risks and ensure adequate living standards are mostly non-existent in PIDS. This situation has made the region's poor people vulnerable and severely impacted by the global economic crisis. An important lesson learned from the post-1997 Asian crisis is that building or expanding social protection programmes have proven to be an effective and integral part of economic stimulus and recovery programmes. Conventional policy prescriptions subscribe to the theory that combating a recession requires governments to stimulate the economy by increasing investments in projects that will create jobs such as infrastructure development. This belief that the focus should be on economic growth and that social development will follow is a fallacy.

PIDS are experiencing slower growth as a result of the global economic recession which will impact on the poor, children, women, elderly, disabled and education and health standards. Investment in social protection programmes is needed to mitigate these impacts and they are affordable and not expensive. Social welfare and relief for those in distress were largely ignored during the crucial stages of the Asian crisis and the results were disastrous. All key human development indicators worsened and unemployment and political unrest increased. Therefore, not including social protection programmes as part of the global economic recession policy response can be severe. The specific policy actions required include:

- a. Maintaining the level of funding for social welfare programmes include support services for women, children, disabled, squatters and rural people.
- b. Initiate and strengthen micro-finance and employment creation schemes.
- c. Provide duty and tax relief on basic food items to counter high food prices.

Promote regional and national food security

A disturbing trend in the region is the increasing dependence of Pacific islanders on imported foods, especially staples and basic food items. Imported foods account for a substantial portion of the cost of the PIDS imports. This trend is common right across the Pacific particularly for coral atolls and populated urban centres where limited land, water and poor soils makes it people for people to grow their own food. The trend, however, is also growing in the bigger island countries where there is also a decline in commercial and traditional subsistence agriculture and food production. Reliance on imported foods makes Pacific islanders vulnerable to poor diets and health related problems and volatile movements in global food prices which poor people in particular cannot afford. Growing food locally to meet domestic demand also presents significant economic opportunities for income generation. In the context of the Pacific Plan and ensuring regional food security, PIDS governments need to actively promote local food production on a commercial and traditional subsistence scale to ensure self sufficiency and national food security. In this connection, intra-regional trade opportunities can also be explored between countries where food growing economies can export to food-dependence economies. Governments need to give such initiatives high policy and budgetary priorities as an appropriate investment for insulating future food price hikes and external shocks.

Protect progress towards the MDGs

The Pacific island region's mixed results in progressing towards the MDGs are duly noted. The impact of the global economic recession will mean that countries will fall behind and lose the gains they have made to date. Countries that are struggling with their MDGs will be worse off. More concerted efforts and resources will need to be committed by countries and development partners to progress the implementation of the MDGs.

The region's response to the global recession should also focus on the MDGs and give priority to supporting programs that generate employment and restore economic growth; support delivery of basic services, such as health care and education, and protect the vulnerable. Each country should adopt an MDG national action plan that should be integrated into their national plans and budget priorities.

Strengthening statistics and development tracking

The lack of availability of reliable and timely statistics is a major obstacle to tracking and understanding the impact of the global economic recession on PIDS, designing evidence-based policy responses and measuring aid effectiveness. The situation in the region is poor by international standards⁶⁸.

However, regional action is already underway to address this issue. A benchmark study on strengthening statistical services through regional approaches was undertaken in 2008-2009 in response to a decision by the Forum Economic Ministers Meeting (FEMM) in 2006. The study outlines the current limitations and proposed actions to bridge the gap. SPC is coordinating the implementation. PIDS governments will need to work with key development partners including Australia and New Zealand to establish a viable and reliable mechanism to meet the PIDS national, regional and international data needs.

Support regional cooperation and integration

To address their challenges, countries of the Pacific have committed themselves to the attainment of internationally agreed development goals, including those contained in the Millennium Declaration, the Brussels Declaration and the Programme of Action for the Less Developed Countries for the Decade 2001-2010 adopted by the Third United Nations Conference on the Least Developed Countries, Brussels, 14-20 May 2001 and the Mauritius Strategy for Implementation of the Programme of Action for the Sustainable Development of Small Island Developing States adopted by the International Meeting to Review the Implementation of the Programme of Action for the Sustainable Development of Small Island States, Port Louis, 10-14 January 2005. At the regional level, they have also resolved to address issues of concern to address the issues of common concern as outlined in the Bali Outcome of the Higher-level Regional Policy Dialogue on the food-fuel crisis and climate change: Reshaping the Development Agenda, Bali, Indonesia, 9-10 December 2008. Within the Pacific, the Communiqués of the Pacific Island Forum as well as the outcomes of their Ministerial Meetings.

Improve development partnership and coordination

The combined resources of PIDS and development partners constitute the funding available to implement the policies for mitigating the impact of the global economic recession and achieving future sustainable growth and development. The PIDS cannot do it alone because they lack the resources and capacity. This places a special responsibility on multilateral and

⁶⁸ AusAID, *Surviving the global recession: strengthening economic growth and resilience in the Pacific*, AusAID Publications, Canberra, August 2009.

bilateral donors to maintain their aid commitments and support PIDS to limit the scale of the human impacts. Their combined resources need to be integrated within sound national policies and public expenditure systems and applied to the highest priority programmes. The specific policy actions required include⁶⁹:

- a. Implementing the Cairns Compact and ensuring that responses are consistent with the established aid effectiveness principles and practices, as set out in the *Paris Declaration* and *Accra Agenda for Action*.
- b. PIDS governments to work closely with development partners to develop country frameworks for engaging development partners so development assistance is better coordinated and supports country-led responses to the global recession.
- c. PIDS governments and development partners to work together to improve public financial management and monitoring systems and to ensure their priorities are consistent with the host government playing a lead role to improve service delivery.

If the challenges of the future seem daunting, Pacific Leaders, policy makers and development partners ought to keep in mind that what they face in the future is no worse or if not better than some of the experiences and crisis they have encountered in the past. It might also help to remember that old piece of wisdom: the reverse side of every challenge is an opportunity. The future policy options outlined above will offer the PIDS many advantages. The future is far from bleak. Now and in the years ahead, the Pacific island countries will continue to face rough seas in a global environment where a lot of factors are outside their control but they also have the opportunity to plot their own course and determine their own directions to ensure smoother sailing in the years ahead.

⁶⁹ AusAID, *Surviving the global recession: strengthening economic growth and resilience in the Pacific*, AusAID Publications, Canberra, August 2009.

REFERENCES

Ajay Chhibber, *Global economic crisis and the Pacific Island countries: the human and social dimensions*, UNDP Paper presented at the Lowly Institute Conference for International Policy, Brisbane, August 2009.

Asian Development Bank, *Asian Development Bank outlook*, March 2009.

_____, *Notes on the vulnerability of the economic crisis*, Pacific Department, December 2008.

_____, *Taking the helm: A policy brief on response to the global economic crisis*, Pacific Studies Series, 2009a.

_____, *Millennium development goals in the Pacific Island Countries: taking stock, emerging issues and way forward*, August 2009b.

_____, *Pacific Economic Report*, August 2009c.

AusAID, *Pacific 2020: challenges and opportunities for growth*, AusAID Publication, Canberra, May 2006.

_____, *Pacific Economic Survey 2009*, AusAID publications, Canberra, 2009a.

_____, *Surviving the global recession: strengthening economic growth and resilience in the Pacific*, AusAID Publications, Canberra, August 2009b.

_____, *Tracking development and governance in the Pacific*, AusAID publication, Canberra, August 2009c.

Dominic Patrick Mellor, *Social impact of commodity price volatility in Papua New Guinea*, Asian Development Bank, Port Moresby, 2009.

East Asia Forum 2009, accessed from: www.eastasiaforum.org/2010/01/08/papua-new-guineas-development-success-depends-on-learning-from-its-past/ on 6 January 2010.

ESCAP, *Responses to the economic crisis – women's economic security and rights*, E/ESCAP/BPA/2009/3, November 2009.

ESCAP/ADB/UNDP, *Millennium development goals in the Pacific Island countries: taking stock, emerging issues and way forward*, August 2009.

Fiji Times, January 2010.

Lowy Institute for International Policy, *Pacific Island and the world: the global economic crisis*, August 2009.

Samoa, *Fiscal strategy statement: budget 2009/2010*, (Apia, Ministry of Finance, 2009).

UNICEF, *Impact of the Economic Crisis on Children*, conference report accessed from: www.unicef.org/impact of economic crisis on children/conference report/on 12 January 2009.

Warden Narsey, *2010 budget: the great cover up*", University of the South Pacific, December 2010.

World Bank, *World Bank economic review*, Vol. 14, No. 3: (September 2000) pp. 392-605.

_____, *World Bank updates: economic forecasts*, World Bank Group, Washington DC, 2009.

UNCTAD, *World Investment Report*, 2009