09

PACIFIC ECONOMIC SURVEY

engaging with the world

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For further information contact:
AusAID Communications
GPO Box 887
Canberra ACT 2601
Phone: +61 2 6206 4000

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Contents

Acronyms

ADB	Asian Development Bank
ASEAN	Association of South-East Asian Nations
AusAID	Australian Agency for International Development
DfID	Department for International Development
FAO	Food and Agriculture Organization
FDI	foreign direct investment
FSM	Federated States of Micronesia
GDP	Gross Domestic Product
GNI	Gross National Income
HIES	Household Income and Expenditure Survey
IFC	International Finance Corporation
ILO	International Labour Organization
IMF	International Monetary Fund
MDGs	Millennium Development Goals
MDR TB	multi-drug resistant tuberculosis
NGOS	Non-Government Organisations
NCDs	non-communicable diseases
ODA	Official Development Assistance
ODI	Overseas Development Institute
OECD	Organisation for Economic Co-operation and Development
PACER Plus	Pacific Agreement on Closer Economic Relations
PICTA	Pacific Island Countries Trade Agreement
PNG	Papua New Guinea

PSWPS	Pacific Seasonal Worker Pilot Scheme
RSE	Recognised Seasonal Employer
SPC	Secretariat of the Pacific Community
SOPAC	Pacific Islands Applied Geoscience Commission
STIs	sexually transmitted infections
TB	tuberculosis
UN	United Nations
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Programme
UNICEF	United Nations Children's Fund
UNESCAP	United Nations Economic and Social Commission for Asia and the Pacific
WHO	World Health Organization
WIBDI	Women in Business Development Inc.
WTO	World Trade Organization

Preface

Welcome to the *Pacific Economic Survey 2009*. First launched in 2008, the *Survey* is an annual publication that provides an overview and update of growth and development in Pacific island countries and Timor-Leste. *Pacific Economic Surveys* also provide a detailed analysis of themes relating to particular driver or drivers of economic growth. *Pacific Economic Surveys* cover the 14 island member countries of the Pacific Islands Forum, as well as Timor-Leste due to its proximity to the Pacific and the similarity of many of its development challenges.

The theme addressed by the *Pacific Economic Survey 2008* was 'Connecting the Region'. As such it was concerned with communication, shipping and aviation. Improvements in these areas are vital if the Pacific island countries and Timor-Leste are to achieve and sustain high rates of economic growth and, in turn, progress towards the Millennium Development Goals (MDGs).

A key lesson from the spike in food and fuel prices in 2008 and the global recession is that Timor-Leste and Pacific island countries need to strengthen their resilience to external economic shocks by better engaging with the world. Such engagement has many dimensions. They include responding more effectively to global trade opportunities, taking greater advantage of labour mobility and dealing better with changes in food and fuel prices. Each of these issues is examined in this survey. The analytical theme of the *Pacific Economic Survey 2009* is, therefore, 'Engaging with the World'.

Part 1 of this *Survey* contains the growth and development update and has three chapters. Chapter 1 examines recent trends in economic growth and macro-economic developments in the Pacific region and Timor-Leste over the past twelve months. It also examines sectoral developments in agriculture, forestry and fisheries, extractive industries and tourism. Chapter 2 reviews recent political developments, improvements in various areas of governance, and progress made by Pacific island countries and Timor-Leste with microeconomic and structural reforms. Chapter 3 examines the progress towards meeting the Millennium Development Goals (MDGs). The chapter also provides an analysis of why governance matters for progress towards the MDGs in the Pacific and Timor-Leste.

Part 2 provides an analysis of this year's theme, 'Engaging with the World'. It has three further chapters. Chapter 4 looks at expanding opportunities to trade, examining ways that governments could benefit from innovative strategies and new approaches to trade, particularly in services trade, to support economic growth and drive their economies forward. Chapter 5 focuses on labour mobility. It examines some of the benefits arising from and challenges relating to labour mobility for Pacific island countries and Timor-Leste. Chapter 6 looks at global shocks, focussing specifically on how to deal with food and fuel supply and price volatilities. It examines ways that imports of food and fuel affect the economies in the region and identifies practical responses to deal with volatility in these imports in order to build more resilient economies.

Pacific Economic Survey 2009 was guided by a regional steering committee. The committee comprises experts in economics and related topics from across the Pacific region and Timor-Leste. The *Survey* is one of three analytical reports produced in 2009 by AusAID and various collaborating agencies that look at development issues in the Pacific and Timor-Leste. The other reports are *Tracking Development and Governance in the Pacific: 2009 Report* and *Surviving the Global Recession: Strengthening Economic Growth and Resilience in the Pacific*.

Key Messages

A number of key messages emerge from the *Pacific Economic Survey 2009*. They include the following.

Despite the challenges imposed by high food and fuel prices and the global recession, economic growth in the Pacific and Timor-Leste has remained strong overall. **Some countries achieved growth rates in excess of 6 percent and have good potential for strong future growth, although others struggled and will continue to do so throughout 2009 and beyond.** While economic growth in 2008 was still reasonably high in a number of countries, lower growth is expected in 2009 as **the global recession started to bite, owing to its impacts on trade, tourism, remittances, investment and trust fund revenues.**

Remittances have grown substantially this decade, although they have slowed over the past year due to recent economic events. They remain an important source of income for the Pacific as a whole and in Fiji, Kiribati, Samoa and Tonga in particular. **Official development assistance is still larger in volume than remittances** for the region, but in Tonga, Samoa and Fiji remittances were more than double aid flows in 2007.

The quality of governance varies across the Pacific and Timor-Leste. Some countries perform quite well in assessments of government effectiveness, others do not. Control of corruption remains a major challenge for some countries.

Sustaining progress towards the achievement of the MDGs is a major challenge for most developing countries, including the Pacific island countries and Timor-Leste. Countries have shown progress on a number of MDG fronts since the 1990s, but achieving the majority of MDG targets in each country by 2015 is unlikely based on current trends. Progress towards reducing poverty (MDG 1) has been the slowest and is of most concern in the region, with rising poverty being evident in some countries.

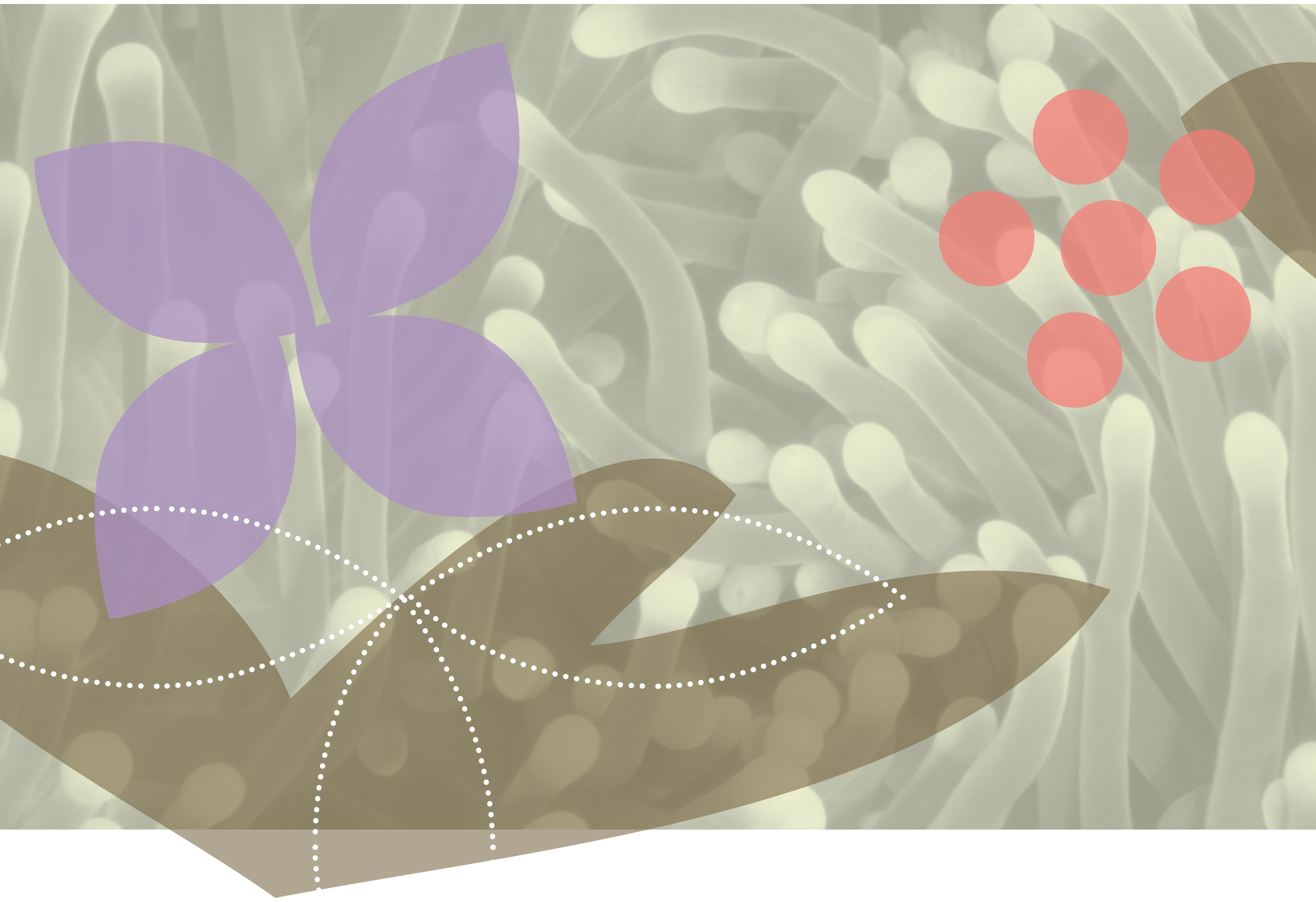
Better governance means better progress towards the MDGs for Pacific island countries and Timor-Leste. Increased government effectiveness (defined in terms of the quality and capacity of public services and quality of its policy formulation) is associated with higher per capita incomes, and higher per capita income is associated with more primary school enrolments and lower child mortality. The *Survey* shows evidence that an achievable 10 per cent increase in government effectiveness in each of the 14 Pacific island countries in 2008 alone would have resulted in around 1870 fewer children dying before their fifth birthdays.

The spike in food and fuel prices in 2008 and the global recession made it abundantly clear that the Pacific island countries and Timor-Leste need to strengthen and strategically diversify their economies to build resilience to external economic shocks. Macroeconomic stability is also essential to building resilience to these shocks. More generally, **policy settings need to treat shocks as the rule, rather than the exception.**

Trade liberalisation is crucial for economic growth and development but alone does not guarantee that these benefits will flow immediately. **Trade liberalisation must be accompanied by efforts to improve domestic competiveness through improving domestic human resources, investing in productive infrastructure and improving the business-enabling environment**, including access to finance. Improving governance, more generally, is also essential to reap dividends from trade liberalisation.

Labour mobility increases opportunities to build closer regional ties, develop skills, create economic benefits and facilitate higher levels of remittances. To benefit most from migration opportunities, countries need to improve the availability and quality of education and training. Improving the skills base of Pacific island countries and Timor-Leste to meet changing labour demand requires **long-term investments in basic education and tertiary education and vocational training.**

Further increases in food and fuel prices are on the horizon. Improving food security in Pacific island countries and Timor-Leste depends on both the ability to produce food and the ability to export goods and services in order to import food. **Greater diversity in domestic food production** will help achieve both outcomes. **Better energy policies and strategies are needed in the Pacific.** This will improve energy management, and better management of oil supplies can help countries manage volatile global prices.



Executive summary

Growth and development update

Despite the global challenges faced in 2008, economic growth in Pacific island countries and Timor-Leste was strong, but confined to a few countries and sectors

The combined real Gross Domestic Product (GDP) of Pacific island countries and Timor-Leste grew during 2008 by 5.1 per cent, almost double the 2007 rate (2.8 per cent) and the highest level of economic growth this decade. This regional average, however, was largely due to strong economic performance in Timor-Leste, Papua New Guinea (PNG), Solomon Islands and Vanuatu. Most other countries grew at less than two per cent.

In late 2008 and throughout 2009 the global recession started to bite, reducing growth through its impact on trade, remittances and investment

The impact of the global recession on the region has been significant, with many countries experiencing downward revisions of their growth outlook. Countries projected to maintain positive but slowing economic growth in 2009 are the Federated States of Micronesia (FSM), Kiribati, the Marshall Islands, Nauru, PNG, Timor-Leste, Tonga, Tuvalu and Vanuatu while others are facing economic contraction (Cook Islands, Fiji, Palau and Samoa).

The global recession is having an impact on Pacific island countries through the following transmission channels: lower prices and reduced demand for commodity exports; slower growth in tourism; declines in remittances; significant falls in the value of offshore national trust funds; and lower levels of foreign direct investment (FDI).

Remittances have grown substantially this decade, although they have slowed over the past year due to recent economic events

Remittances are a major source of income and a safety net for the poor in some Pacific island countries. In Tonga, Samoa and Kiribati, officially recorded remittance flows are equivalent to 39 per cent, 23 per cent and nine per cent of these countries' GDP, respectively. The volume of remittances to the region steadily increased from US$163 million in 2000 to US$446 million in 2008. Remittances, however, remain largely concentrated in Fiji, Samoa and Tonga. In 2008, these three countries accounted for 89 per cent of all remittances to the region. Aid is still more important than remittances for the region as a whole, but in Tonga, Samoa and Fiji remittances were more than double aid flows in 2007.

Tourism appears to be steady despite the global downturn

While tourist numbers from northern hemisphere countries to the Pacific appear to be falling, tourists from Australia and New Zealand are choosing to holiday closer to home and certain Pacific island countries are benefitting. In Australia, departures in the first five months of 2009 were approximately the same as those in 2008, albeit with a 17 per cent fall in visitor numbers to Fiji. Falling energy prices and increased competition on many air routes have also ensured that the Pacific remains an attractive holiday destination. In addition, cruise boat lines such as P&O are expanding their activities in the region. In Vanuatu, total visitor arrivals in April 2009 were 24 per cent higher than for the same period in 2008. Fiji is suffering, and the tangible decline in visitor numbers to the country can in part be attributed to the uncertain political environment.

The quality of governance varies across Pacific island countries and Timor-Leste

Government effectiveness can be assessed on the basis of the quality of public services and infrastructure, the capacity of the civil service and its independence from political pressures and the quality of policy formulation. In general, Vanuatu and the Polynesian countries perform relatively well in these areas while the Marshall Islands, Timor-Leste and some Melanesian countries perform poorly. Control of corruption is a major challenge for a number of countries.

Despite some progress, Pacific island countries and Timor-Leste are unlikely to achieve many of the Millennium Development Goals by 2015

Countries have improved on a number of MDGs since the 1990s. For instance, 13 out of 15 countries in the region have increased the proportion of children enrolling in primary school; the likelihood of a child dying before his or her fifth birthday has reduced in many countries, as has the chance of a mother dying while giving birth. More households now have access to a clean and safe water supply and sanitation facilities. Despite this progress, meeting the MDGs by 2015 will be a challenging task for many Pacific island countries and Timor-Leste. Many are unlikely to meet the targets of halving poverty, achieving universal primary education, reducing child and maternal mortality by two-thirds, and improving access to safe water supply and sanitation. Particularly in the poorest countries, infectious diseases such as malaria, HIV and tuberculosis continue to spread at alarming rates and rising incidences of lifestyle diseases is placing additional burden on fragile public health systems.

At one end of the spectrum, Polynesian countries—particularly Samoa and Tonga—have made the most progress and are on track to achieve a number of MDGs. At the other end of the spectrum, PNG and Timor-Leste, the two most populous countries, face a number of different development challenges and both are unlikely to meet any MDG by 2015.

Rising poverty is evident, with one-third of people living below national poverty lines

Of all MDGs, progress towards MDG 1—reducing poverty and hunger—has been the slowest and is of most concern in the region. While monitoring and understanding poverty in the Pacific is hampered by poor quality and out-of-date data, indications are that the number of people living in poverty continues to rise and was doing so even before the food and fuel crisis and the onset of the global recession. The number of people living below national basic needs poverty lines has increased in Fiji, PNG, FSM, Samoa and Timor-Leste. Only Vanuatu appears to have made progress in reducing poverty and is on track to reducing poverty by half by 2015.

Governance is good for growth … and growth is good for the Millennium Development Goals in the Pacific and Timor-Leste

It is widely accepted that good governance matters for growth and that growth, in turn, matters for progress towards the MDGs. This also holds true for Pacific island countries and Timor-Leste, where greater government effectiveness is associated with higher per capita incomes. Higher per capita incomes are, in turn, associated with lower child mortality rates in the region.

Engaging with the world

The spike in food and fuel prices in 2008 and the global recession made it clear that Pacific island countries and Timor-Leste need to build resilience to international shocks. This does not mean they should insulate themselves by turning their backs on the international economy. To do so would be an error as the structural characteristics of their economies dictate they must look to the world as a driver of national prosperity. In short, they must position themselves to successfully engage with the world. Alongside improving governance, exploiting comparative advantages, prudently managing public finances, increasing the ease of doing business and so on, they must position themselves to take advantage of international trade, take advantage of increased labour mobility and position themselves so they can deal with changes in international food and fuel prices.

Countries need policies that treat shocks as the rule, rather than the exception

While Pacific island countries and Timor-Leste cannot change their geographies, they can manage for risk. Countries can strengthen institutions and implement policies to improve their resilience and enable them to prepare for, and deal with, economic shocks. Given their vulnerability to commodity price shocks—in particular energy price shocks—governments in the region have been exploring ways to make their economies more resilient to changes in global prices. Some countries are leading the way in better managing energy imports, but there is still more the region can do to improve policy development around energy and food security.

Despite access to markets, goods trade remains poorly diversified by both partner and product

Diversifying trade can help reduce the impact of shocks. Pacific island countries and Timor-Leste continue to export primarily to Australia, making them highly dependent on the strength of the Australian economy for their economic growth. The exports or goods is narrowly focused on mineral and energy commodities and low value-added agricultural products, logging and fisheries. By identifying export opportunities where countries have a comparative advantage, they can gain more benefits from trade liberalisation. Diversification will only add value if countries are truly competitive in these exports. Trading behind subsidies and other distortions will likely lead to slower rather than stronger growth and distract the private sector from investing in more efficient industries.

Trade liberalisation needs to be accompanied by trade development and facilitation if countries are going to make the most of new opportunities

No country in the world has generated sustained economic growth and poverty reduction by closing itself off to international trade. Trade provides access to a wider range of goods and services, technologies and knowledge. It creates entrepreneurial activity and jobs, and provides opportunities for skills transfer and knowledge development. It also attracts private capital and increases foreign exchange earnings.

Trade liberalisation is not an end in itself, however, and does not guarantee that the benefits of trade will flow immediately. Trade liberalisation must be accompanied by efforts to improve domestic competitiveness through improving domestic human resources, investing in productive infrastructure, and improving the business-enabling environment, including access to finance. Countries that address these three areas, while also progressing with trade liberalisation, find it easier to benefit from international trade. Domestic policy settings form the foundation of a growing export base.

Niche markets can provide valuable opportunities

Product differentiation is increasingly important for commodity exporters. Identifiable, high-quality commodities attract higher prices at market. Product differentiation, through branding, certification programs and value-adding, offers potential for improving returns to farming communities. Exporters are also finding success by using agricultural products in new and innovative ways. Beauty products are a growing industry, and successful exporting companies include Vanuatu’s Volcanic Earth.

Labour mobility increases opportunities to build closer regional ties, develop skills and create economic benefits

To realise the benefits of labour mobility, both host and sending country governments need to work together to develop mutually beneficial labour schemes. This requires careful policy development that is well integrated with country development plans. Sending country governments need to efficiently manage the movement of workers, find ways to harness the benefits of remittances, and ensure diaspora remain well connected with communities at home. Host country governments can assist by introducing temporary and circular migration schemes, thereby helping workers stay connected to family and encouraging workers and employers to build the skill base for work in future years. Both host and sending country governments can cooperate to ensure remittances are sent cheaply and effectively, and that there is a ready supply of well-trained, work-ready labour with the skills to benefit from employment opportunities at home and abroad.

Skills development is a key to increasing employment opportunities both at home and abroad

To maximise benefits from labour migration opportunities, countries need to improve the availability and quality of education and training, so as to build the capacity of all—those who remain to work in their country of origin, as well as those who take up temporary employment elsewhere. Skills development is central to improving productivity, living standards and economic growth. With a high demand for technical and vocational skills both at home and abroad, investments in technical education have the potential to pay dividends to Pacific communities. Improving the skills base of Pacific island countries and Timor-Leste to meet changing labour needs across the region requires long-term investment in basic education and tertiary education and training.

Successful labour mobility requires policy coordination and extensive stakeholder management in both sending and receiving countries

A successful labour mobility program starts in the host country. Labour mobility may only succeed if driven by labour demand in the host country, so migrants are not perceived to be driving down wages or taking job opportunities from domestic workers. An effective program provides flexible working arrangements, involves consultation with all stakeholders, close supervision of recruitment procedures, clear admission criteria, and protection of all labour and associated social rights. Countries need to consider how social security and similar provisions can be transferred back to home countries simply and cost-effectively. They also need to determine how workers can improve their skill base through additional training and education.

2008 and 2009 has been a turbulent time for world food and fuel prices and there is little change on the horizon

Soaring food and energy prices during 2008 highlighted the vulnerability of Pacific island countries and Timor-Leste to external economic shocks. Food and fuel prices peaked between May and July 2008, but fell to around half these levels by December 2008. The impact of the subsequent global recession has lowered prices in 2009, but despite the Food and Agriculture Organization’s (FAO) forecasts of strong production in 2009, prices are rising again.

Food security for Pacific island countries and Timor-Leste depends on both the ability to produce food and the ability to export goods and services in order to import food

A country can be a substantial importer of food and enjoy a high level of food security provided it has more than sufficient foreign exchange earnings to pay for those imports. Both improved agricultural productivity and freer trade in agriculture are necessary to ensure regional food security. The future food security for Pacific island countries and Timor-Leste therefore depends on both the capacity to produce food and the capacity to export goods and services to pay for food imports.

Improving food security in Pacific island countries and Timor-Leste will require policies that promote domestic production

In an increasingly liberalised and deregulated global market, agriculture, livestock and fisheries industries need to be internationally competitive. Helping farmers increase both agricultural production and productivity is a long-standing policy objective which is made more pressing in the face of price shocks. Investments in infrastructure, agricultural research, and institutions that provide farmers with access to finance, inputs and information can help improve production and productivity.

Better energy policies and strategies can improve energy management

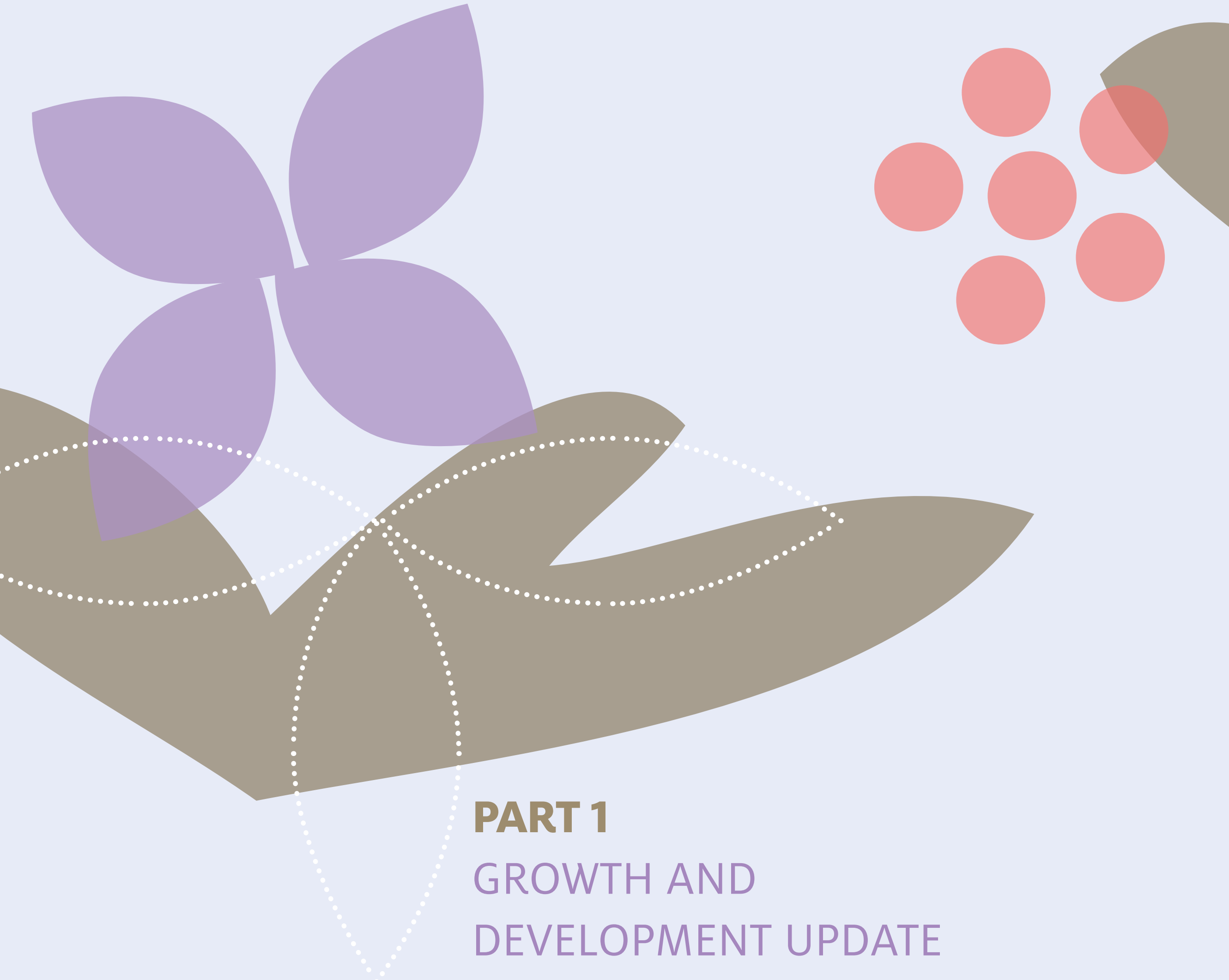
While 10 of the 14 Forum island countries include energy in their national sustainable development strategies, the sector could be better integrated into national priority areas and budgets. In most countries, governments play a key role in the development of the energy sector, but to best manage energy, considerable resources need to be provided to oversee energy supply development. National energy offices need to be well integrated with other government departments to influence national development priorities, decisions and budget allocations.

Better management of oil supplies can help countries manage volatile global prices

Inefficient fuel procurement arrangements, weak regulatory frameworks and the poor state of fuel-related infrastructure (including ports and storage) combine to push the cost of fuel in the region above global prices. While privatisation of energy utilities has proven controversial in many countries, Samoa has successfully introduced the best elements of competition while retaining strong oversight of the sector. Samoa's approach is now being considered by Forum Economic Ministers for application in the wider region.

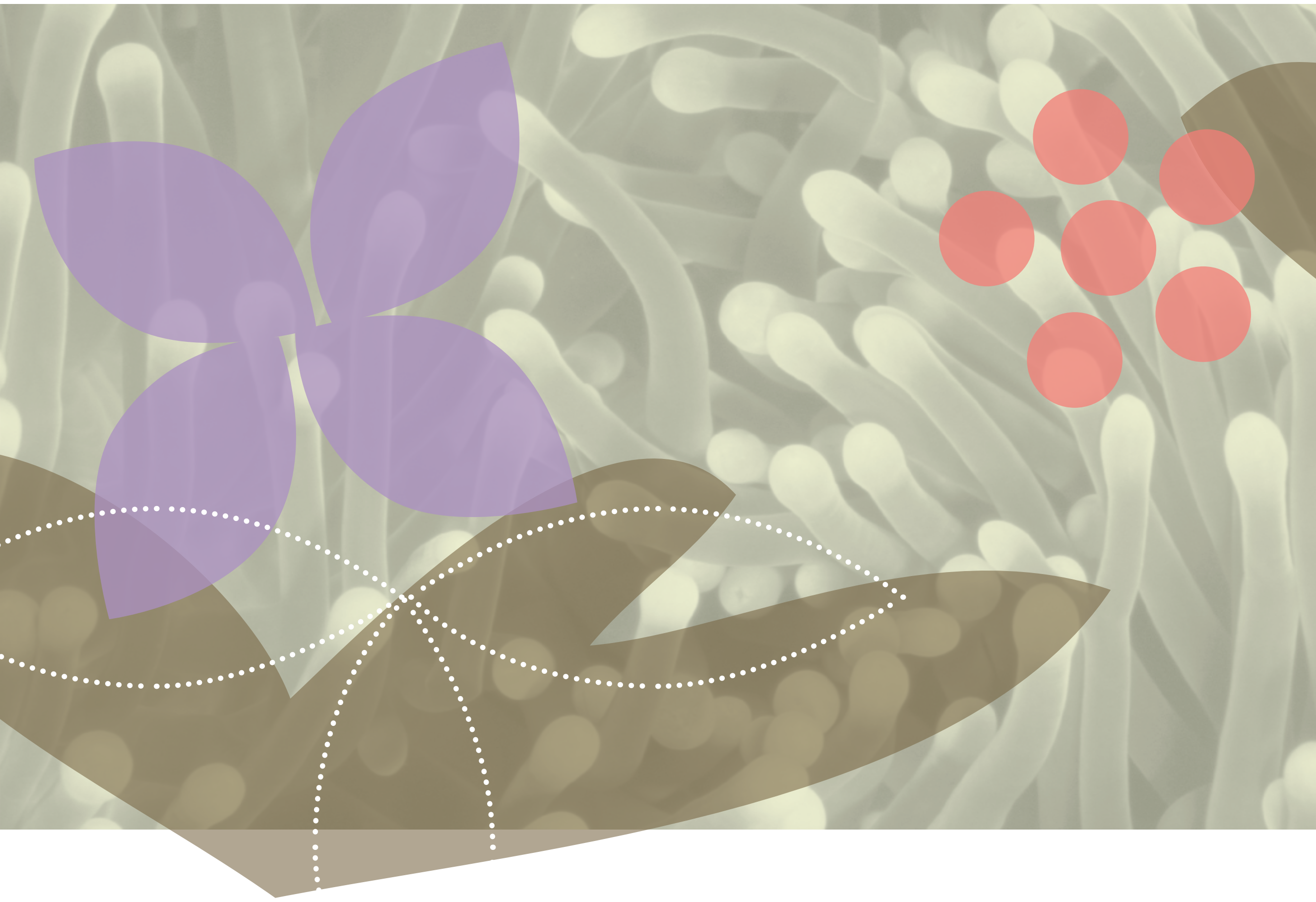
Renewable energy offers potential, but requires a strong policy framework

Solar energy and biofuels are being used in limited quantities throughout the region. Wider use of renewable energy technologies in Pacific island countries and Timor-Leste requires strong government policy setting and implementation of innovative, low-oversight solutions. Use of renewable energies needs to be linked to national planning efforts and well integrated into national budgeting processes.



PART 1

GROWTH AND DEVELOPMENT UPDATE



1 Pacific growth performance

This chapter examines recent trends in economic growth and macroeconomic developments in the Pacific region and Timor-Leste. It also reports on sectoral developments in agriculture, forestry and fisheries, extractive industries and tourism.

1.1 Economic growth

The global economy was reshaped by three major events in 2008: soaring commodity prices, the collapse of global financial markets and a contraction in global economic demand

The global economy is very different now than it was 18 months ago. In the early part of 2008, the price of oil skyrocketed. This was accompanied by the doubling of some food prices, including rice and wheat. During the latter half of 2008, the financial crisis resulted in falling asset prices and tightening of global credit.

As a result, the global economy in 2009 is contracting. Japan, the United States, Australia and New Zealand—the major markets for the Pacific region—are all experiencing slower or negative growth in 2009. The latest International Monetary Fund (IMF) economic growth data shows that developed economies are forecast to experience a decline in GDP of -3.8 per cent in 2009.[1] Emerging and developing economies are forecast to grow by 1.5 per cent, which is significantly slower than in previous years (8.3 per cent in 2007 and 6 per cent in 2008).[2]

As the financial crisis evolved into a broader global recession, developing countries were impacted primarily through the trade channel and a reduction in private capital flows. Declining global demand for commodities, manufactured goods and tourism is affecting business profits and resulting in job losses and lower revenue to governments. Tight credit conditions and weak economic prospects are resulting in lower foreign and domestic direct investment.

1 International Monetary Fund (IMF) (2009)
2 ibid

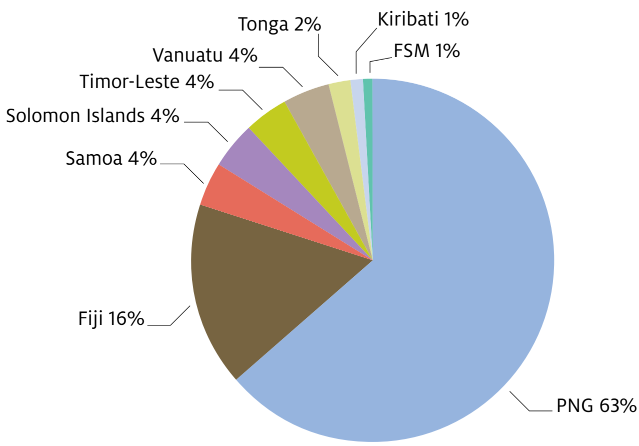
The global recession is impacting on Pacific island countries and Timor-Leste through lower prices and reduced demand for commodity exports, pressure on tourism, falls in remittance flows, significant falls in the value of offshore national trust funds and downward pressure on other public revenue streams, pressure on foreign direct investment and the availability of credit.

Despite the global challenges faced in 2008, economic growth in Pacific island countries and Timor-Leste was strong, but confined to a few countries and sectors

The combined GDP of Pacific island countries and Timor-Leste in 2007 was approximately $21 billion (in purchasing power parity terms). Figure 1.1 shows that PNG and Fiji are the two largest economies, accounting for 79 per cent of the region's economic output.

Figure 1.1: The two largest economies—Papua New Guinea and Fiji—account for 79 per cent of the region's Gross Domestic Product in 2007

Distribution of GDP (current international dollars) in selected Pacific island countries and Timor-Leste (2007)



Source: Asian Development Bank (ADB) (2009b)

Note: GDP data is not available for Cook Islands, the Marshall Islands, Tuvalu, Palau, Niue and Nauru.

The combined real GDP of Pacific island countries and Timor-Leste grew by 5.1 per cent in 2008, almost double what it was in 2007 (2.8 per cent) and the highest level of economic growth this decade. This regional average, however, was largely due to strong economic growth in Timor-Leste, PNG, Solomon Islands and Vanuatu. Most other countries grew at less than two per cent.

Higher economic growth in 2008 was driven by the mineral and oil boom and logging ...

PNG, Solomon Islands and Timor-Leste each experienced economic growth of above five per cent in 2008. This was primarily driven by high global prices for minerals, timber and oil. Recent declines in commodity prices, however, and the depletion of these resources (particularly forestry resources in Solomon Islands), have underscored the need to strengthen non-resource sectors and the sustainable management of existing natural resources.

... and by improved policies towards the private sector ...

Improved policies towards the private sector, coupled with political and macroeconomic stability, have facilitated strong economic growth in Vanuatu. In 2008, Vanuatu's economy grew by 6.3 per cent. In addition to rapid growth in the tourism sector (tourists arriving by air rose by 16 per cent in 2008), Vanuatu has also seen strong growth in its industrial sector (13.7 per cent in 2008), particularly in construction and property development.

Samoa's reforms, including encouraging new entrants into the telecommunications and aviation sectors, reduced the cost of doing business and lowered prices for consumers. This contributed to an average economic growth rate of 4.4 per cent between 2004 and 2007. While economic growth in 2008 was negative, this was due to particularly strong growth in 2007 (6.4 per cent) arising from hosting the South Pacific Games.

... but other countries continue to experience volatile, flat or declining growth

Fiji, the Marshall Islands, Nauru, Tonga and Tuvalu all recorded GDP growth of less than two per cent in 2008, while the economies of Cook Islands, FSM, Palau and Samoa contracted. In Fiji, flooding, rising inflation and ongoing political uncertainty since the 2006 military coup have continued to erode business confidence and hurt the tourism industry, and remittances from Fijians abroad fell from 4.8 per cent of GDP in 2007 to around 3.3 per cent in 2008.

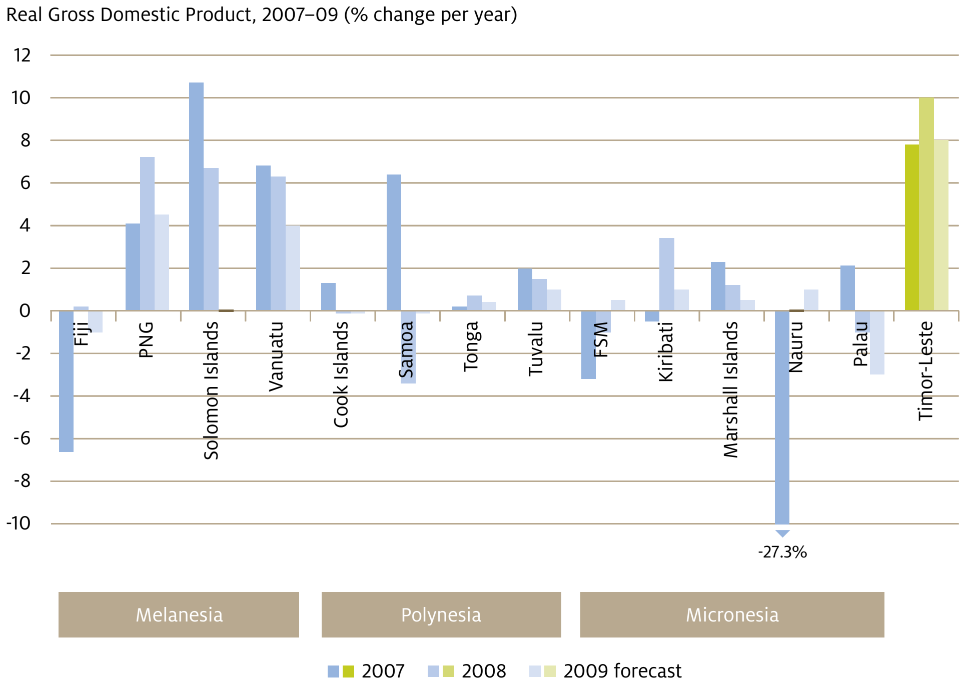
Several economies were likewise affected by a decline in tourism. Visitors to Cook Islands fell by three per cent in 2008, while in Palau arrivals fell by 10 per cent. This, combined with higher inflation, led to an overall contraction in Palau's economy of around one per cent.

Other countries weathered the economic storms a little better. Economic growth in Tonga in 2008 was boosted by the King's Coronation in mid-2008, which saw the temporary return of many Tongans residing overseas as well as visiting dignitaries. For the small island economies of Kiribati, Tuvalu and the Marshall Islands, modest economic growth was underpinned by high levels of government expenditure, which in certain cases has not been consistent with a sustainable medium-term fiscal position. In contrast, delays in disbursement for public works contributed to an overall contraction in the FSM economy in 2008.

In late 2008 and throughout 2009 the global recession started to bite, reducing growth through its impact on trade, remittances and investment

The impact of the global recession on the Pacific has been significant, with many countries experiencing downward revisions of their growth outlook (Figure 1.2). While some countries are projected to maintain positive but slowing economic growth in 2009 (FSM, Kiribati, Nauru, the Marshall Islands, PNG, Timor-Leste, Tonga, Tuvalu and Vanuatu) others are facing an economic contraction (Cook Islands, Fiji, Palau and Samoa).

Figure 1.2: Growth was stronger in 2008, but is likely to fall in 2009 as the impact of the global recession is felt



Source: ADB (2009b, 2009c)

Note: No data is available for Niue. Timor-Leste GDP data excludes the value added of activities of United Nations organisations.

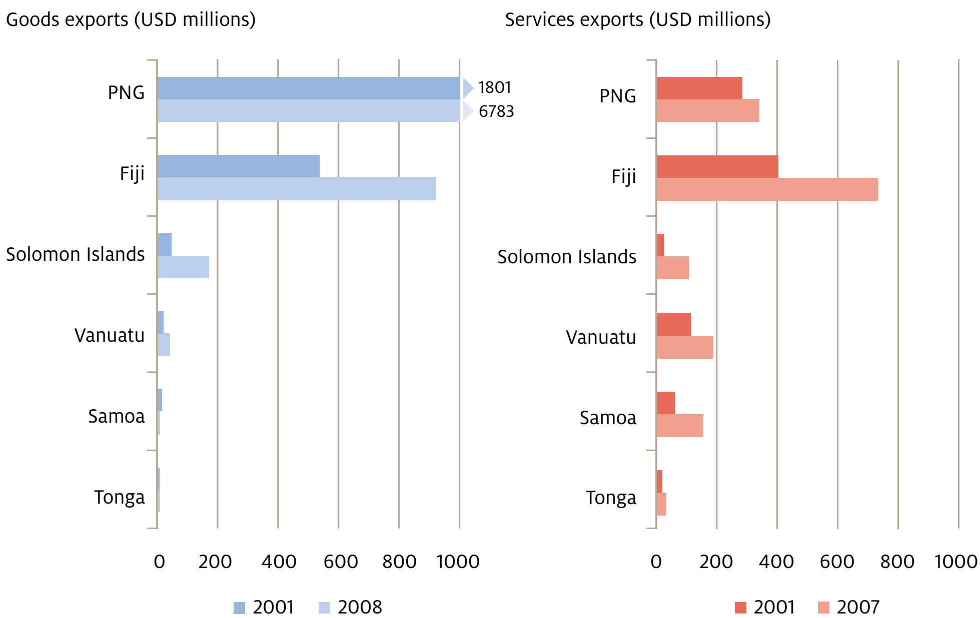
Trade in services is growing across the region, and trade in goods is important for a few countries

Many Pacific island countries earn more money from trade in services, than in goods (Figure 1.3). Between 2001 and 2007, service exports grew annually by an average of nine per cent for the six countries for which data is available. Samoa's performance stands out, with growth averaging at 17 per cent per annum. Growth in service exports is largely driven by the tourism sector. The global recession has impacted adversely on tourism in some Pacific island countries while others have been less affected.

Between 2001 and 2008, goods exports from the Pacific region grew annually by 16 per cent, two percentage points faster than the Asia-Pacific average. After excluding PNG, growth was nine per cent per year. PNG is the region's exporting giant, followed by Fiji. In 2008 the value of its goods exports totalled US$6.8 billion, more than six times larger than Fiji. Aside from PNG, Fiji, Solomon Islands and Timor-Leste, all other countries have a relatively small goods exporting sector.

The global recession has depressed demand for commodities and led to a sharp decline in world prices for minerals and energy since the record highs of mid-2008. Lower prices and reduced demand for commodity exports are especially hurting PNG, Solomon Islands and Timor-Leste.

Figure 1.3: Trade in services is increasingly important for many Pacific economies



Source: ADB (2009b); United Nations (UN) Trade in Services database.

Note: Goods and service exports are in current USD and are therefore affected by inflation and fluctuations in exchange rates.

The trade structure of many Pacific island countries and Timor-Leste is narrowly focused on a few sectors and by trading partner. In 2007, mineral and oil exports accounted for more than half the region's goods exports, and exports were directed to three main trading partners: Australia (33 per cent), Japan (14 per cent) and China (nine per cent). Chapter 4 examines ways countries are innovating to broaden their trading base.

Remittances have grown substantially this decade, although have slowed over the past year due to recent economic events

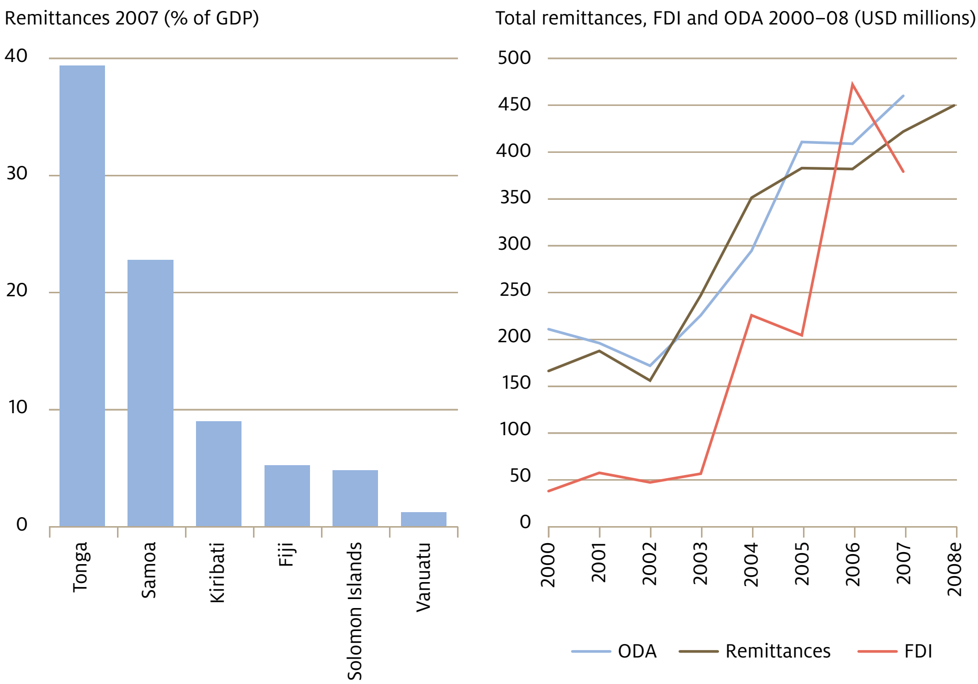
Labour mobility is one topic of this year's Pacific Economic Survey. Remittances are a major source of income and a safety net for the poor in some Pacific island countries. In Tonga, Samoa and Kiribati, officially recorded remittance flows are equivalent to 39 per cent, 23 per cent and nine per cent of these countries' GDP, respectively (Figure 1.4). In contrast to conventionally recognised financial flows of Official Development Assistance (ODA) and FDI, remittances represent a flow of income transferred directly to households. In Tonga and Fiji, approximately 90 and 43 per cent of households receive remittances, respectively.

Figure 1.4 shows that the volume of remittances to the region has steadily increased from US$163 million in 2000 to US$446 million in 2008. Remittances, however, remain largely concentrated in Fiji, Samoa and Tonga. In 2008, these three countries accounted for 89 per cent of all remittances received by the six countries for which data is available. Aid is still more important than remittances for these six countries as a whole, but in Tonga, Samoa and Fiji remittances were more than double aid flows in 2007.

While the region has experienced substantial growth in remittances this decade, between 2007 and 2008 remittances to most Pacific island countries slowed, as economic growth and employment opportunities in destination economies declined due to the global recession. In Samoa, for example, remittances declined by nine per cent in the fourth quarter of 2008. Church and community organisations were hardest hit (experiencing a decline of 35 per cent), while remittances to households remained relatively buoyant.[3] In many countries, churches and other community-based organisations play an important role in providing social services to local communities and many of these organisations rely on remittances for their funding. They, as a result, will become more reliant on grants from governments and international organisations to maintain service delivery. As the global recession continues, a decline in demand for labour from Pacific island countries and Timor-Leste is expected to reduce remittances further.

3 Central Bank of Samoa (2008)

Figure 1.4: Remittances continue to grow, but are unevenly spread across the Pacific



Source: World Bank (2009c,g)

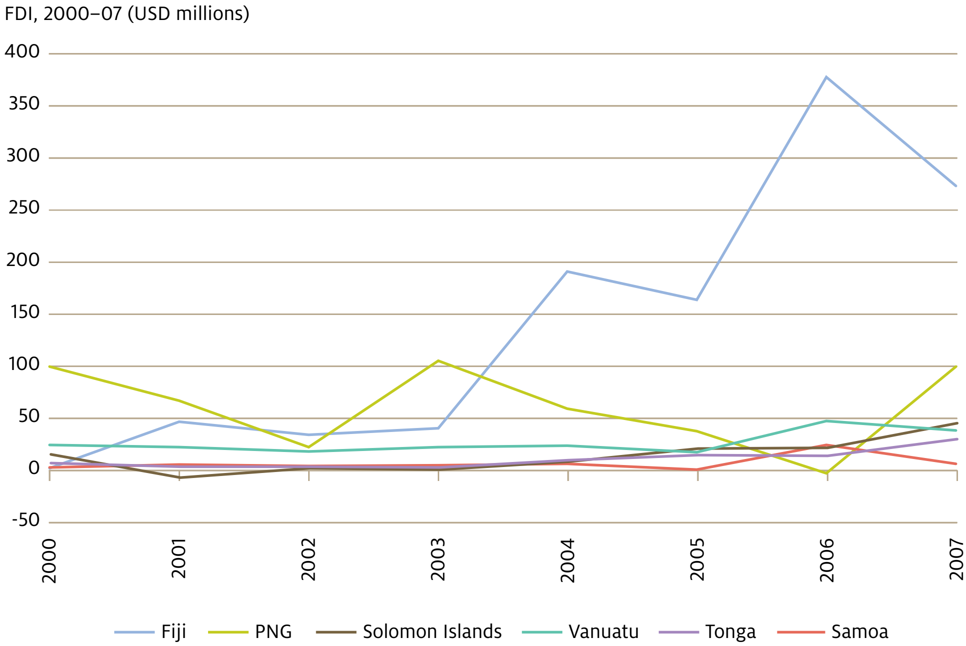
Note: Remittances (received), FDI (net flows) and ODA data are in current USD and are therefore affected by inflation and fluctuations in exchange rates. The aggregated data in the right-hand graph are for countries in the left-hand graph. Remittance data for 2008 is estimated.

Foreign direct investment increases economic productivity in Pacific island countries and Timor-Leste but goes to just a handful of countries

Foreign direct investment can be used to build infrastructure and improve the level of technology used in the region. Just as importantly, it can provide additional benefits such as knowledge transfer and skills development, and access to global supply chains. Fiji and PNG capture more than 75 per cent of FDI to the Pacific (Figure 1.5). Attracting FDI to the Pacific is not easy due to the high cost of doing business in many countries. Some of these costs are fixed, while many others can be reduced through regulatory reform, improvements in infrastructure and investment in human resource development. These are examined in Chapter 2. Political uncertainty also affects FDI, as can be seen from the fall in Fiji's inflows after 2006.

Tighter credit conditions and lower company profits have negatively affected the capacity of many companies to invest, while weak economic prospects mean many firms have chosen not to invest in new business or to expand existing business.[4] FDI to developed countries fell in 2008 by 15 per cent. In developing countries, the recession took a little longer to be felt but initial data suggests that FDI in 2009 has fallen by around 45 per cent compared to the first quarter of 2008.[5] Figures are not yet available for Pacific island countries and Timor-Leste, but these global trends may negatively affect economic activity during 2009 and 2010.

Figure 1.5: Foreign direct investment performance varies across the region



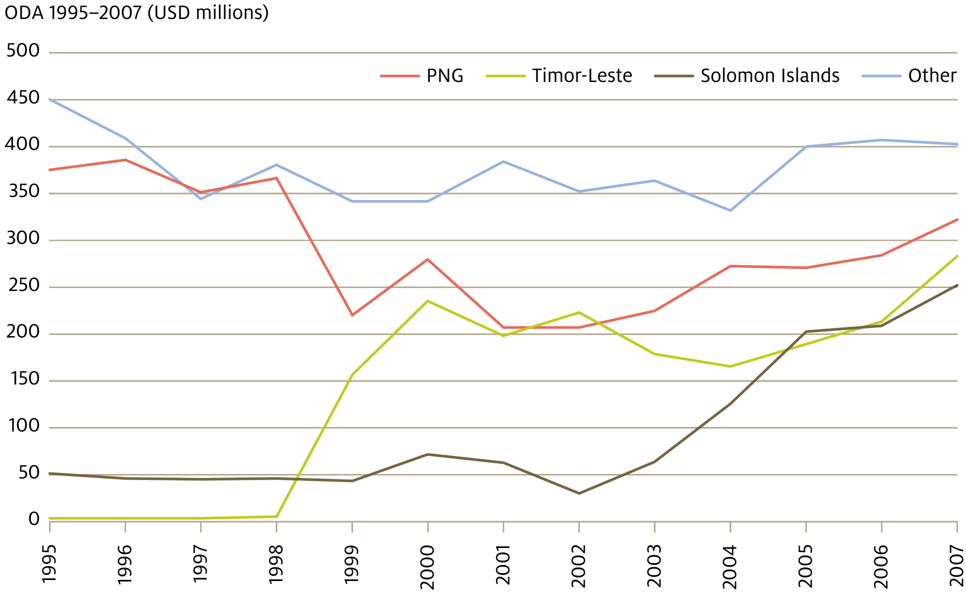
Source: World Bank (2009g)

Different parts of the Pacific show different trends in aid volume

Pacific island countries and Timor-Leste receive some of the highest volumes of aid in the world, relative to the size of their GDP and population. The smaller countries of Micronesia and Polynesia rely much more on aid than the larger Melanesian countries. For instance, FSM, Niue, Tuvalu, Palau and Nauru receive among the highest level of aid per capita in the world, ranging from more than US$1000 per person to nearly US$5500 in 2007. PNG and Fiji receive considerably less at approximately US$50 per person.

4 United Nations Conference on Trade and Development (UNCTAD) (2009)
5 UNCTAD (2009b)

Figure 1.6: Official development assistance is growing in some countries



Source: World Bank (2009g)

Between 2001 and 2007, total aid to the region increased from US$830 million to US$1.2 billion. This largely reflected increased allocations to Solomon Islands and more recently to PNG and Timor-Leste. For other countries, aid levels remained stable.

1.2 Macroeconomic developments

Macroeconomic stability is an essential pre-condition for ongoing growth and development. It underpins business confidence and the investment plans needed for sustainable economic growth. It allows households and businesses to save and plan. Macroeconomic stability is also essential for governments to plan, finance and implement programs that deliver core services and invest in infrastructure.[6]

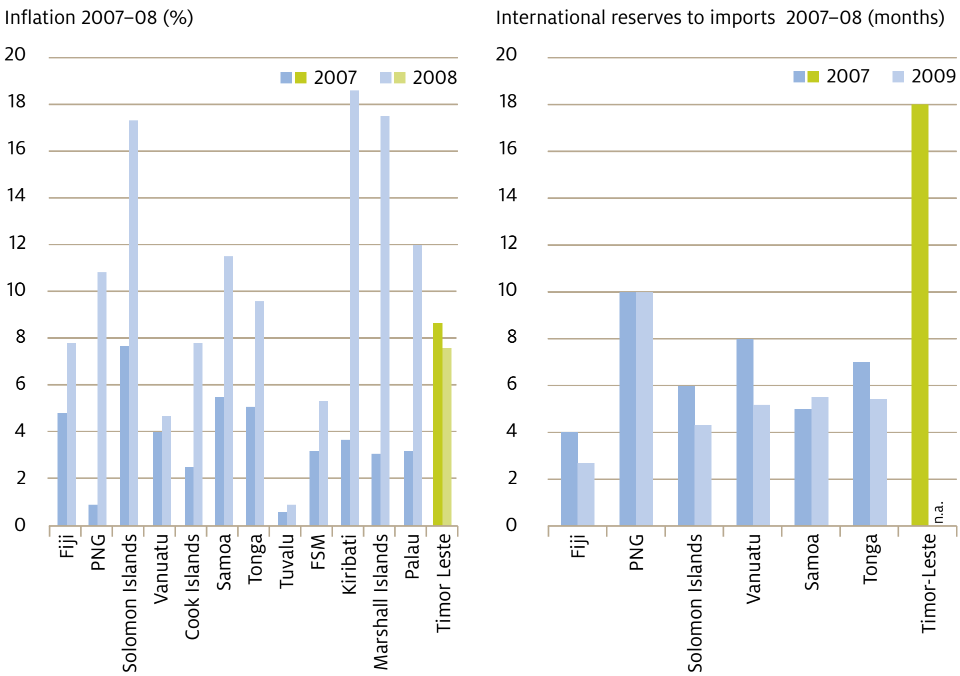
Most governments ended 2007 with low rates of inflation, relatively balanced budgets and comfortable levels of international reserves

Relatively strong macroeconomic positions in most Pacific island countries and Timor-Leste in 2007 helped them cope with the fuel and food price hikes and the inflationary pressures and squeeze on international reserves which followed.

6 Australian Government and New Zealand Government (2009)

Figure 1.7 shows that in 2007 most countries, except Samoa, Solomon Islands and Timor-Leste, kept inflation below five per cent. All countries also had a relatively comfortable level of international reserves valued at more than four months worth of imports. In 2007, six (out of 11) countries were in fiscal surplus, compared to one in 2000 (Annex 3: Pacific Statistics).

Figure 1.7: The region entered 2008 in a relatively strong overall macroeconomic position



Source: ADB (2009 b,c); various central banks.

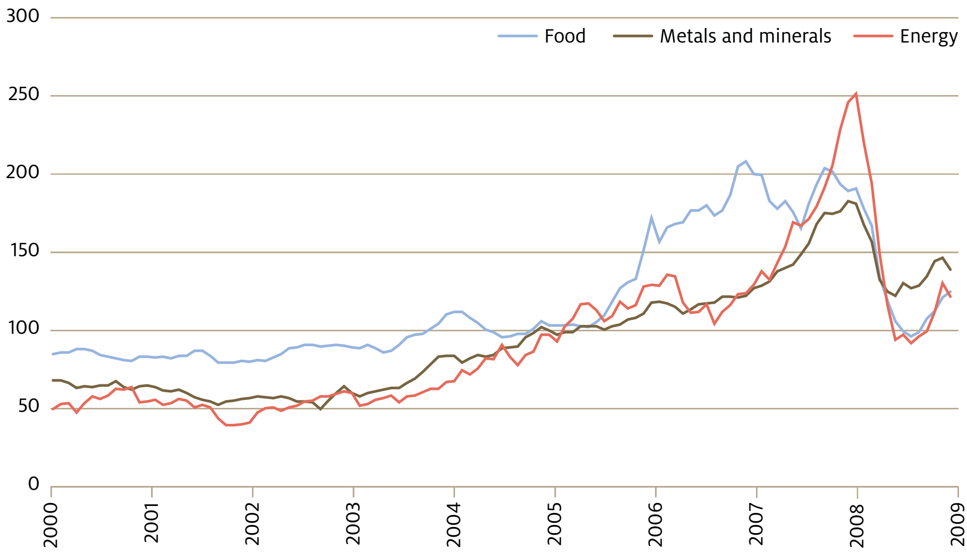
Fluctuating commodity prices in 2008 had a profound impact on the region …

In 2007 and 2008 global commodity prices soared, peaking in mid-2008 before sharply dropping. In such a diverse region, the rapid rise in commodity prices had mixed effects.

PNG and Timor-Leste enjoyed windfall gains and a boost to their terms of trade from the fuel and mineral commodity price boom. In 2008 there were also increases in prices for agricultural goods commonly exported from Pacific island countries and Timor-Leste, including palm oil, coconut oil, copra, hardwood, cocoa beans, coffee and gold. However, in many countries these increases were more than offset by large price hikes for imported oil and food.

Figure 1.8: Commodity price changes have affected countries in different ways

Commodity Price Index, 2000–09 (2000=base year)

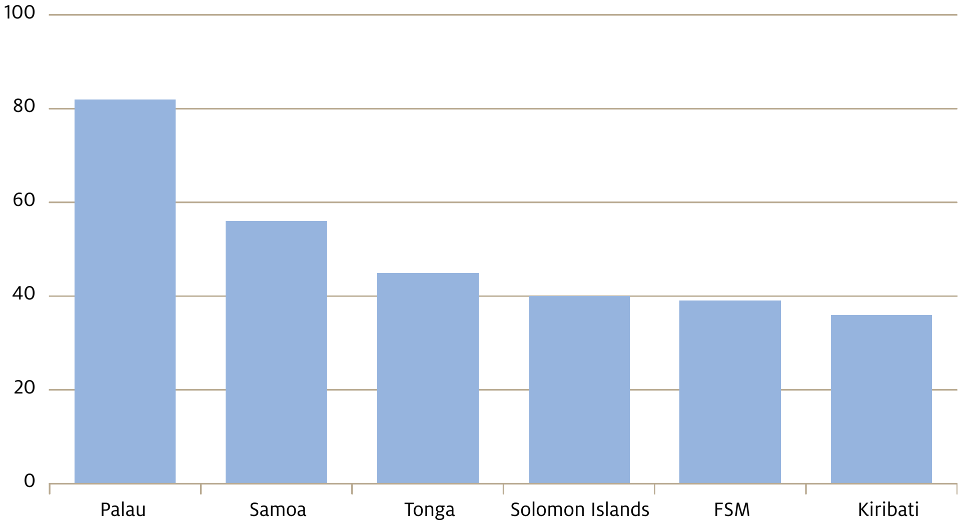


Source: IMF Commodity Price Database

Pacific island countries and Timor-Leste are vulnerable to shocks in global fuel prices, in part because the distance many imports and exports must travel means their economic activities are vulnerable to increased transport costs. With the exception of Fiji, these countries are also net food importers and several import more than 30 per cent of their food, as illustrated in Figure 1.9. The high global prices for food and fuel exerted tremendous pressure on inflation across all countries in 2008, with inflation reaching 18 per cent in Kiribati, the Marshall Islands and Solomon Islands.

Figure 1.9: Some countries are highly dependent on imported food

Food imports as a share of total food expenditure, various years (%)



Source: McGregor A et al. (2009)

Many Pacific island governments responded quickly to the most recent round of price shocks. For example, the Government of Solomon Islands removed import duties and sales tax on rice to reduce the retail cost of rice. Similarly, import duties on fuel products were reduced in Fiji to alleviate some price pressures. Fiji also delayed a planned increase in the tariff on electricity. Timor-Leste reduced import duties and sales taxes on certain food imports and also introduced the Economic Stabilisation Fund to insulate consumers from price shocks. The Marshall Islands exempted selected food staples from import duties and introduced measures to reduce electricity and fuel consumption in government offices.

These measures however, require financing (for subsidies) or they result in loss of revenue (reducing taxes), resulting in reduced fiscal space for government expenditure in other areas. While well intended, such measures can distort price signals and act as a disincentive for investment in the domestic agricultural sector and alternative energy sources. Different options for improving the region's energy and food security in the short- and long-run are examined in Chapter 6.

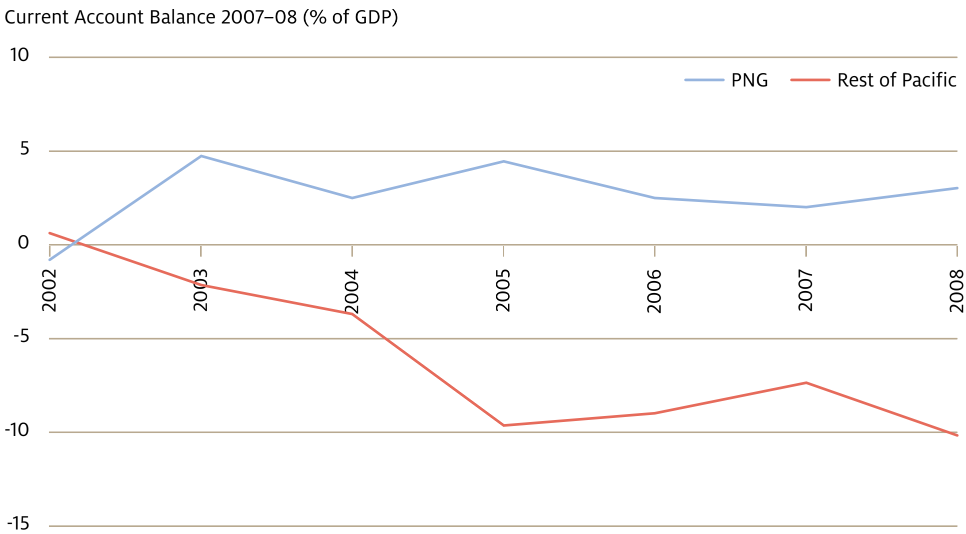
Many countries have benefited from lower international energy and food prices from the highs of 2008 and this is assisting in offsetting some of the impacts of the global recession through a reduction in input and transport costs. Lower prices are also freeing up government revenue for countries that spend a large share of their expenditure on oil. Prices on the ground, however, have often not mirrored global trends and have not declined to pre-peak levels. In Tuvalu, for instance, in early 2009 consumers were still paying two-thirds more for rice and around one-third more for flour and biscuits than they were in late 2007.

… and combined with the global recession, this has increased external vulnerability and reduced fiscal flexibility for 2009

Since 2008 external vulnerability and macroeconomic instability has increased in much of the region. Current account deficits widened in most Pacific island countries (Figure 1.10) and the import cover provided by reserves fell (Figure 1.7). This is largely a result of high import bills in the early half of 2008 caused by high fuel and food prices. It also reflects the economic downturn in the fourth quarter of 2008 caused by weakening demand for Pacific exports.

While PNG maintained a current account surplus since 2002—as a result of the commodity price boom—it moved into deficit during the first quarter of 2009.

Figure 1.10: The economic downturn is putting pressure on current accounts

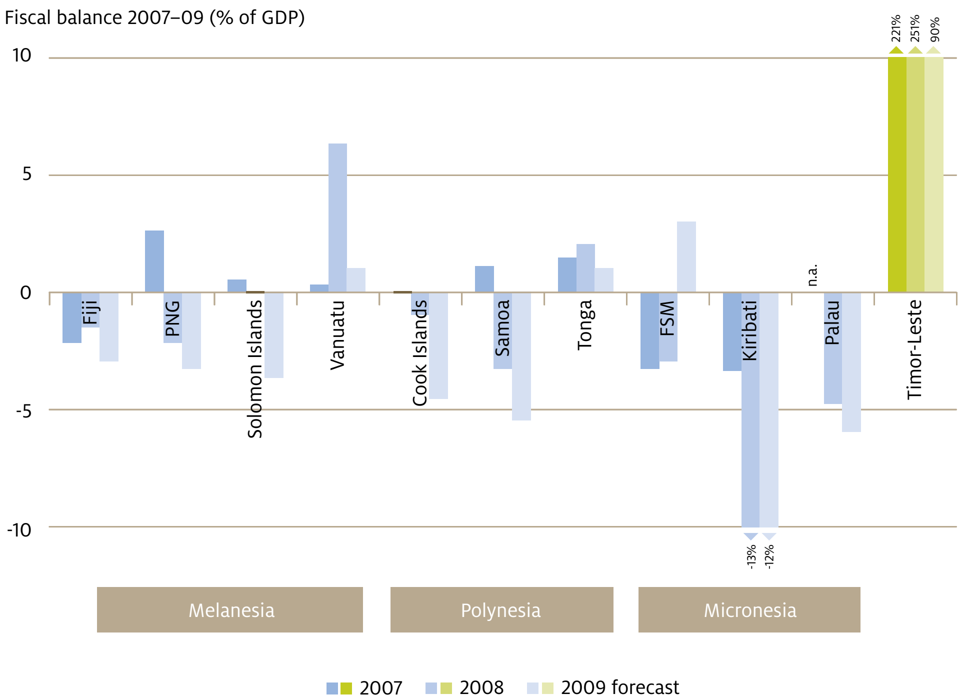


Source: IMF (2009)

Note: Countries included in the 'Rest of Pacific' are those for which data is available: Fiji, Kiribati, Samoa, Solomon Islands, Tonga and Vanuatu. Unweighted average taken. Timor-Leste's Current Account Balance increased from 20 per cent in 2004 to more than 400 per cent of GDP by 2008.

With the global recession reducing the market value of national trust funds and reducing taxes and other revenue streams, many Pacific island countries are facing potentially destabilising budgets at a time when demand for public services and government investment is needed most (Figure 1.11). This shrinking fiscal space emphasises the need for well prioritised and executed expenditure, and continuing reforms to improve capacity for public revenue generation. Box 1.1 identifies some of the actions needed for supporting macroeconomic stability—including that of managing public expenditures in a manner consistent with a sustainable medium-term fiscal position.

Figure 1.11: These economic shocks have weakened the fiscal outlook for 2009 in some countries



Source: ADB (2009b,c); various Central Bank and Government sources.

In PNG, revenue generation forecasts for 2009 have been revised downwards by one-third. The Government has been reluctant to cut budgets in the current economic climate, however, and will finance the budget deficit through borrowing. Financing this shortfall will see public debt increase to 34 per cent by the end of 2009.[7]

7 Government of PNG (2009)

The fiscal outlook for Cook Islands has also worsened for 2009. But unlike in other countries, the budget deficit in Cook Islands is in response to an increase in government expenditure to address shortcomings in port, water and road infrastructure which are needed to strengthen and diversify the economy. Much of this investment is being financed through concessional loans from donor agencies, and while government debt is expected to increase from 15 per cent of GDP in 2009 to 37 per cent of GDP in 2010, the debt is expected to be temporary, and debt servicing is manageable (accounting for one per cent of government revenues).[8]

Box 1.1: Actions to safeguard macroeconomic stability

- a sustainable fiscal policy and public-sector debt position
- a sustainable balance of payments position and comfortable level of external reserves
- a competitive exchange rate
- low inflation
- sustainable draw downs for Pacific island countries dependent on offshore trust accounts for budgetary revenues

Source: Australian Government and New Zealand Government, 2009 *Surviving the global recession: strengthening economic growth and resilience in the Pacific*, August

1.3 Sectoral developments

The *Pacific Economic Survey 2008* focused on five sectors: agriculture, fisheries, forestry, mining and tourism. This section revisits progress in each.

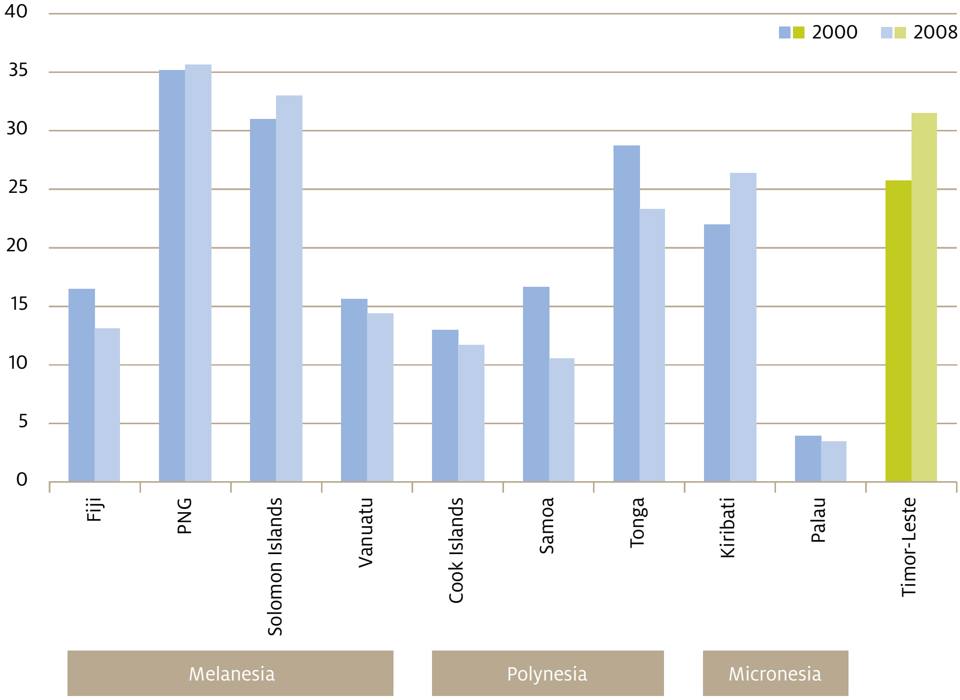
Agriculture and fisheries remain important to Pacific island countries and Timor-Leste

With the exception of Nauru, the agriculture and fisheries sectors—both commercial and subsistence—form a critical component of private sector activity, providing income, employment and livelihoods to Pacific islanders and East Timorese people. In PNG and Timor-Leste, more than 80 per cent of the population lives in rural areas and engages in subsistence or smallholder agriculture. These sectors accounted for more than one-fifth of GDP in PNG, Solomon Islands, Timor-Leste, Kiribati and Tonga in 2008 (Figure 1.12). Agriculture and fisheries are also important export sectors, accounting for around 17 per cent of goods exported from Pacific island countries and Timor-Leste in 2007.

8 Standard & Poor's (2009)

Figure 1.12: Agriculture, forestry and fisheries remain important in many Pacific island economies and Timor-Leste

Size of agriculture, forestry and fisheries sectors, 2000 and 2008 (% share of GDP)



Source: ADB (2009b)

PNG's agricultural sector has recorded impressive economic growth in 2008, largely driven by growth in the export-orientated commercial agricultural plantations sector. In 2008 agricultural exports increased by 19 per cent with strong performances recorded in palm oil (up 44 per cent), coffee (up 37 per cent), cocoa (up 139 per cent) and copra (up 98 per cent).[9] However, the majority of Papua New Guineans are subsistence and smallholder crop and livestock farmers and fishers, and therefore efforts to improve productivity of smallholder farmers is important for poverty reduction and broad-based economic growth. Measures to boost productivity and increase the commercialisation of smallholder farmers include: improving the road transport network; continuing with land and financial sector reforms; and investing in agricultural research, extension services and training.[10]

9 Bank of PNG (2008b)
10 ADB (2008)

There are opportunities to expand the agriculture sector through developing competitive niche markets and higher value-added products

The market for organic and fair trade health food and cosmetic products is growing in Europe, North America and Australia. This growing market is providing some Pacific island countries with opportunities to expand their incomes through producing and exporting competitive niche agricultural products. For example, in Solomon Islands virgin coconut oil is now making a substantial contribution to incomes in rural communities whose only coconut crop, until now, has been the low-value copra. Locating simple, labour-intensive, oil-extraction technologies close to the point of production has allowed an entrepreneur, Kokonut Pacific (Australia), to gain an early foothold in the specialised food and cosmetics market. At the same time, this sustainable village-based industry provides much needed incomes to subsistence farmers in some of Solomon Islands' poorest communities.

Although the recent oil wealth has changed the economic fundamentals of Timor-Leste, the agriculture sector still dominates the livelihoods of the majority of East Timorese. For the foreseeable future, the country is likely to remain a highly rural economy, with more than 80 per cent of the population residing in rural areas. However, the sector's performance has been poor and food insecurity remains widespread. The expansion of commercial agriculture, especially coffee however, has good growth prospects. Coffee is the major cash crop in Timor-Leste and a quarter of households earn an income from it. Despite a 20 per cent fall in coffee production in 2008, it remains a major export of Timor-Leste, generating more than 90 per cent of non-oil export income. Other crops with good export prospects include sandalwood and vanilla.

Sustainable management of the Pacific's fisheries resources is critical to safeguarding national incomes, household incomes and food security

Fisheries are one of the Pacific's largest resources and are vitally important as a source of food for subsistence fishers, as well as a source of employment, economic growth and government revenue. However, over-fishing and illegal, unregulated and unreported fishing are threatening this valuable resource. To address these issues, regional- and country-level initiatives are underway. Through the Western and Central Pacific Fisheries Commission, for example, Pacific island countries have been effective in their push to establish a satellite vessel monitoring system, a regional observer program for the tuna fishery and conservation and management measures for bigeye and yellowfin tuna. Coastal fisheries are a mainstay of food security in Pacific island countries and Timor-Leste and will need careful management to avoid over-fishing and subsequent stock depletion.

Falling demand and unsustainable logging is affecting the forestry sector in Solomon Islands and Papua New Guinea

Future economic growth in Solomon Islands requires developing the economy's non-logging sectors. In 2008, logging accounted for 13 per cent of government revenue and almost two-thirds of exports.[11] But logging rates are well beyond the sustainable yield of 200 000 cubic metres, and if continued at this pace natural forests will be exhausted by 2015. Data released in early 2009 indicates that the logging rate is slowing in response to weakening demand and rainy weather conditions. Between November 2008 and February 2009 logging volumes were 23 per cent lower compared with the same period in the previous year. Indeed, it is estimated that production will fall by 30 per cent in 2009. Future economic growth in Solomon Islands requires developing non-logging sectors of the economy, which will build a broader base for economic growth.

In PNG, export volumes of logs doubled between 2001 and 2007, but the sector has also been hit hard by the global recession. The volume of logs for the first quarter of 2009 was down by 74 per cent when compared to the corresponding 2008 quarter. Similar to Solomon Islands, poor weather conditions and lower demand have hindered exports. There are reports that up to 3000 jobs have already been lost in the sector, which will badly affect heavily log-dependent provinces such as Sandaun, West New Britain and Gulf Province. Reduced reliance on log exports from natural forests and a move to plantation forests and downstream processing would be more sustainable for the economy.

Mining and gas is expanding in Papua New Guinea and is financing development in Timor-Leste

PNG's mining and petroleum sector continues to be a major export and a significant revenue earner for the government, contributing 36 per cent to total revenues in 2008. Exploration activities increased in 2008 and a number of new mines (including Ramu Nickel and Hidden Valley) are expected to come on stream in late 2009. Despite the recent fall in some commodity prices, the sector as a whole shows potential for growth.

The PNG Liquefied Natural Gas Project, led by ExxonMobil, is in its final design phase and production is expected to commence in 2013. The project has an expected life of 30 years and is the largest private-sector investment (US$12.5 billion) ever considered in PNG. The project is expected to yield large economic benefits, including an increase of around K10 billion in real GDP each year during the operational phase. However, the Government of PNG faces considerable capacity challenges in managing the project (including providing a skilled workforce) and in ensuring its revenue stream will lead to broad-based economic growth. A number of other liquid natural gas opportunities are at various stages of exploration throughout PNG.

Timor-Leste's Petroleum Fund continues to grow, totalling US$5 billion at the end of July 2009. Petroleum continues to be the major driver of Timor-Leste's economy, representing 97 per cent of central government revenue in 2008. The Fund's governance and investment arrangements are prudent. Over the medium term, the arrangements surrounding the proposed Greater Sunrise Field will be a major issue for Timor-Leste.

11 Central Bank of Solomon Islands (2008b)

Phosphate and gold mining has recommenced in Nauru and Fiji

Nauru's phosphate industry recommenced in 2007 to access approximately 30 years of secondary phosphate deposits. Outside of the public service, the phosphate industry is the country's main employer and provides a significant revenue stream to the community and Government of Nauru through royalty payments and dividends. Aside from generating jobs and other economic benefits, the process of secondary mining will enable the rehabilitation of previously mined lands for small-scale agriculture, sport and cultural uses. Nauru is looking to new export opportunities for selling crushed rock and cut stone tiles which are by-products of phosphate mining. While the global recession has recently weakened demand for phosphate, a strong recovery is expected in 2009 and 2010.

Box 1.2: Natural resource management in PNG ... then and now

In the early 1990s PNG experienced an extractives boom, principally in crude oil, timber harvesting and gold. During the boom, the PNG Government significantly increased its level of public expenditure. Unfortunately, as is often the case in resource-rich developing countries, the boom revenue was generally not reinvested into other appropriate and diversified forms of economic capital. Instead it was used to finance items such as increased public service salaries and benefits.

Because the boom revenue proved insufficient to finance the increased public spending, the Government was forced to increase its external borrowing by 70 per cent. Consequently, public debt levels rose from 44 per cent of GDP in 1991 to 54 per cent in 1994. Finally, in October 1994, as a result of a series of expansionary budgets, the country's external currency reserves were exhausted and conversion of the kina suspended. In an attempt to bring the budget back into surplus, the Government adopted a policy of only paying wages and debt, resulting in a decline in the quality of service delivery and a large number of unpaid invoices. Even with this strategy, the Government was on the brink of being called in default on external loan repayments to creditors such as the IMF and Australian and Japanese banks, until Australia agreed to provide emergency bridging loans.

Recently there have been some encouraging developments. Over the last six years, PNG has experienced robust economic growth, averaging around four per cent each year. Although mineral exports have remained the principal driver of growth, the PNG Government is now focusing on developing non-mineral sectors such as agriculture, construction, tourism and other service industries. Increased macroeconomic stability, together with the flow-on effects of structural reforms in 2000 and 2002, have facilitated broader-based economic growth which has in turn led to a large Balance of Payment surplus and windfall revenue gains for the Government.
By 2008 public debt had been reduced to 30 per cent of GDP and around K3 billion (A$1.5 billion) of revenues from commodity revenues were held in government trust accounts. Ongoing prudent fiscal management will help PNG deal with the global recession.

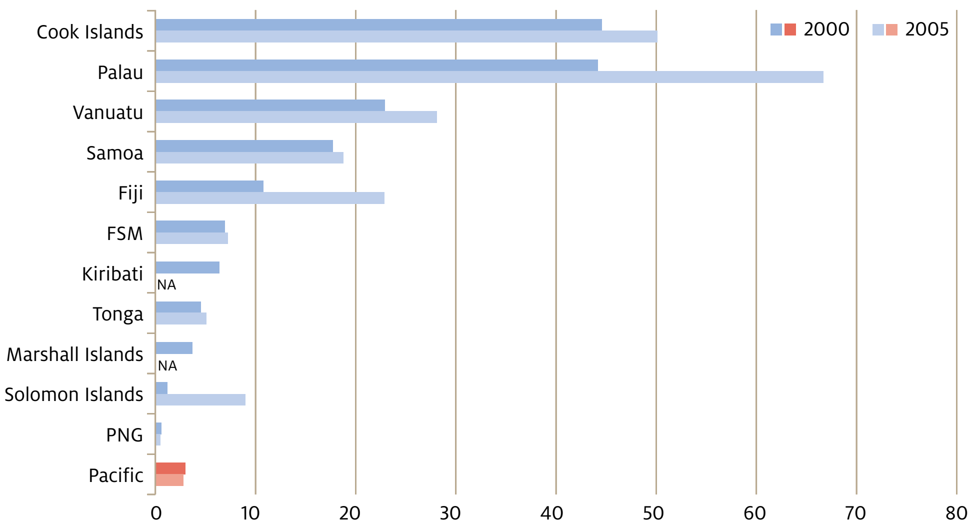
Fiji's main gold mine, Vatukoula, reopened in 2008 after closing in 2006 and the intention is to restore production to 110 000 ounces per year (in the nine months leading up to May 2009 production stood at 27 000 ounces). In June 2009, the gold mine announced a partnership with the Fiji Sugar Corporation to purchase electricity from the planned Rarawai Mill bagasse project.[12] Previously the mine operated on imported diesel. Meanwhile, commercial production of 150 000 ounces of gold per annum is planned at Solomon Islands Gold Ridge mine. Although progress in opening the mine has been delayed, it is now scheduled for late 2010, subject to the availability of financing.

Tourism is driving growth in many Pacific island economies

According to most recent data, tourism contributes approximately three per cent to the region's GDP, with international tourism receipts totalling US$1 billion in 2005. In 2008, more than 1.2 million tourists visited the region, with approximately half visiting Fiji. The majority of tourists were from Australia and New Zealand, but visitors from the United States, Europe and Asia were also important markets, particularly for the northern Pacific island countries.

Figure 1.13: Tourism has outpaced growth in other sectors

Tourism exports 2000 and 2005 (% of GDP)



Source: United Nations Economic and Social Commission for Asia and the Pacific (UNESCAP) (2009)

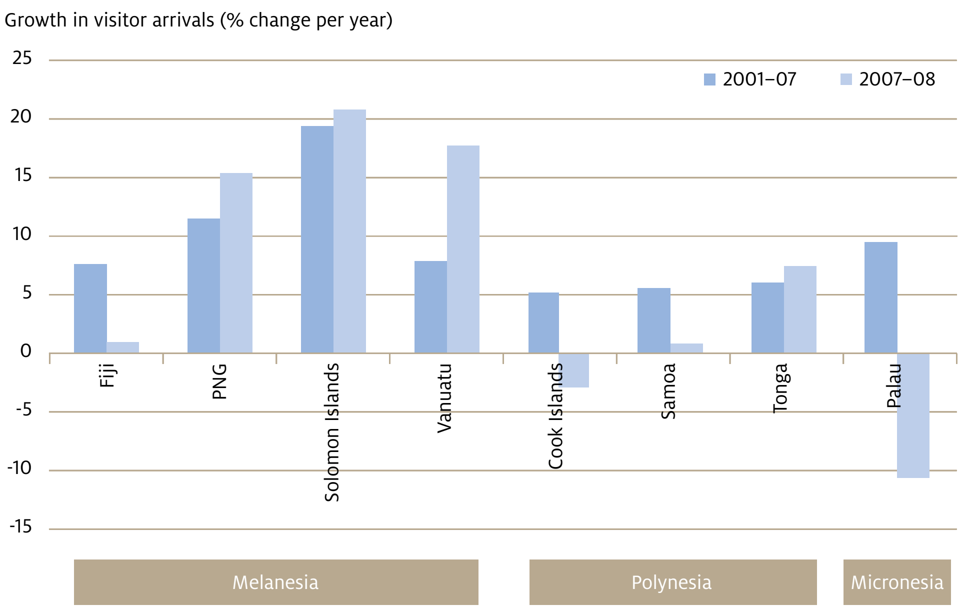
Note: PNG data is for 2000 and 2004

12 Bagasse is the residue from sugar milling and can be burned to generate electricity.

The size of the tourism sector varies across Pacific island countries. Cook Islands and Palau have built their economies around tourism. Both countries are small island states but attract visitor numbers more than four times their population. In 2008, more than 94 000 people visited Cook Islands, and Palau received more than 79 000 visitors, and tourism accounted for more than 50 per cent of GDP in both countries (Figure 1.13).

Tourism has grown rapidly in several Pacific island countries as governments and the private sector have addressed constraints impeding the sector's growth, including high transport costs, security issues and lack of appropriate infrastructure. Figure 1.13 shows that between 2000 and 2005, tourism's contribution to GDP has grown rapidly in Cook Islands, Fiji, Palau, Solomon Islands and Vanuatu. Growth in visitor numbers to Vanuatu and PNG has been particularly healthy in recent years, with average annual growth between 2001 and 2007 of six and nine per cent respectively (Figure 1.14). This has been driven by increased competition in air travel, bringing costs down, as well as an increased focus by these governments on tourism development. Visitor growth in Vanuatu can also be attributed to a substantial increase in cruise ship tourism.

Figure 1.14: Airline competition means more visitors to regional destinations



Sources: Cook Islands Statistics Office (2009), Reserve Bank of Fiji (2009), Palau Visitors Authority (2009), National Reserve Bank of Tonga (2008), Reserve Bank of Vanuatu (2009c), Central Bank of Solomon Islands (2008b), PNG Tourism (2009).

Notes: Data for Cook Islands is for 2004–2007. Data for Solomon Islands is for 2005–07.

The impact of the changed global economy on tourism is not yet fully known

Tourism in the Pacific region is different to many other regions of the world as international, not domestic, visitors dominate the sector. Pacific island countries, which receive a large proportion of their visitors from the Asian, American and European markets, experienced a decline in visitor numbers in 2008. For example, Palau experienced a 10 per cent drop in tourist arrivals in 2008. In Cook Islands, visitor arrivals were down three per cent in 2008, with a large decline from high-spending market segments such as the United States, Canada and Europe. The higher fuel prices and resulting increase in the cost of airfares in 2008, combined with the start of the global recession late in the year, have influenced these trends.

Countries such as Vanuatu, Samoa and Tonga receive a higher proportion of visitors from Australia and New Zealand. These countries are still experiencing positive growth in visitor arrivals. This is likely due to a reorientation in travel plans by Australians and New Zealanders from more expensive European destinations to relatively less expensive Pacific destinations. Vanuatu in particular is benefiting from the reorientation with visitor arrivals increasing by 18 per cent in 2008; this is largely attributable to reforms in the aviation sector (see Chapter 2). In Samoa, tourism earnings for March 2009 were 27 per cent higher compared to March 2008. In Tonga, visitor arrivals grew by seven per cent in 2008. Tourists are also diverting their travel from Fiji to other Pacific island countries such as Vanuatu, Tonga and Samoa due to Fiji's current political situation.

2 Governance and structural reforms

This chapter reviews recent political developments, governance performance and progress made by Pacific island countries and Timor-Leste with microeconomic and structural reforms.

In conjunction with macroeconomic stability, political stability, effective governance and microeconomic and structural reforms are necessary for sustained growth and development. They are all needed to improve national competitiveness and provide a platform for stronger, more resilient growth and progress towards achieving the MDGs. Governance, however, includes more than institutions of state and political stability. Effective governance occurs when government, the private sector, civil-society organisations and citizens work together to identify needs, find solutions and deliver services.

2.1 Political developments

It is widely accepted that political and social stability support economic growth through creating a stable environment for business investment and freeing up public resources to be spent on improving infrastructure, health and education. Pacific island countries and Timor-Leste are no exception to this reality.

Economic growth has followed stability in the region

Vanuatu held an election in 2008. Following a period of negotiation immediately after the poll, a coalition government was established, led by Prime Minister Natapei. It remains relatively stable despite four no-confidence motions. However, Vanuatu's political system is fragmented. Substantial numbers of Members of Parliament are independents which can work against the passing of potential reforms that threaten individual Member interests.

With the exception of the riots in November 2006, **Tonga** is a relatively peaceful country with few law and order problems. Even so, the country continues to operate under emergency powers, with the Government yet to return full responsibility for internal security to the national police force. Following the 2006 riots, which impacted negatively on the economy (GDP growth in 2007 was 0.2 per cent), the economy received a boost in 2008 by an increase in tourism numbers largely associated with events surrounding King George Tupou V's Coronation. Political reform remains one of Tonga's biggest challenges as the country moves towards a more representative form of government by 2010.

The last year has seen relative political stability in **Solomon Islands**, following the change of government in December 2007. Prime Minister Dr Sikua was elected on a platform of rural development, reconciliation and re-engagement with donors. In August 2008, he defeated a no-confidence motion brought forward by the Opposition. National elections are due to be held in mid 2010.

Since the attacks on President Ramos Horta and Prime Minister Gusmao in February 2008, **Timor-Leste** has enjoyed relative stability. Most camps for internally displaced people are now closed and good progress has been made in helping people return to their homes. During the April to May 2006 crisis, an estimated 150 000 people were displaced and as of July 2009 approximately 230 families remain in three small camps. However the country continues to rely on international security forces to maintain stability. So far during 2009 the Government has used its petroleum revenue to stimulate the economy and support vulnerable and disadvantaged groups.

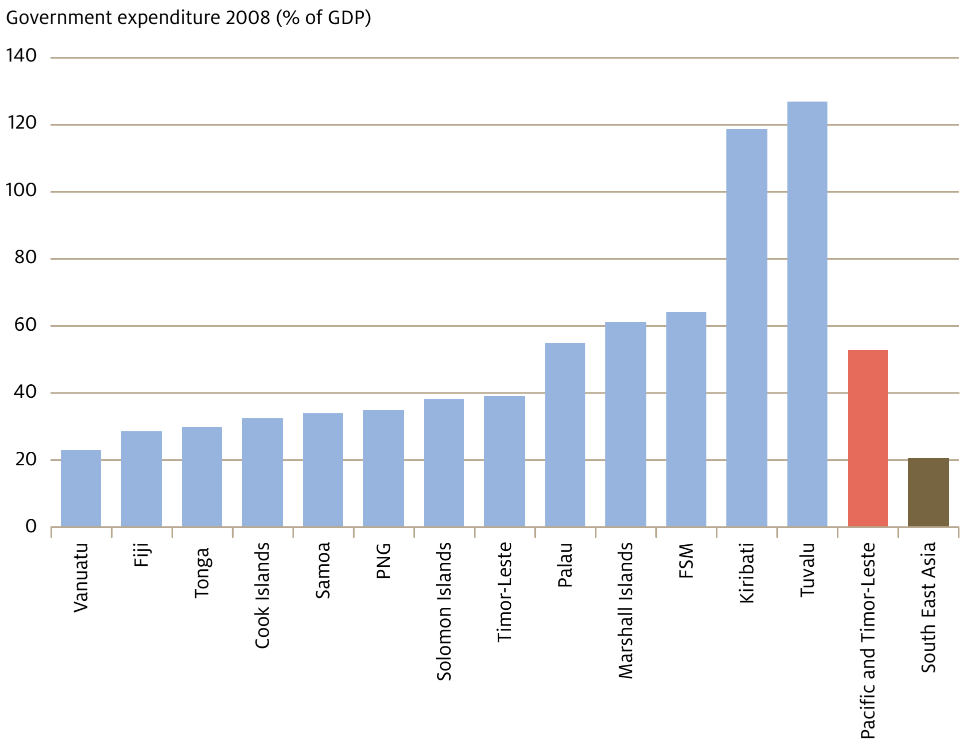
The political situation in **Fiji** has considerably worsened since the abrogation of the Constitution on 10 April 2009, and the announcement by the former President of Fiji that the country would be ruled under a 'new legal order'. Under the order, all constitutional appointments were revoked pending new appointments for all judges, magistrates and other judicial officers. Fiji is currently ruled under Public Emergency Regulations which prohibit public assembly, restrict media freedom and confer extensive power to the military and police. The response from within the region and internationally has been strong, with the Pacific Islands Forum suspending the military regime from Forum meetings and regional cooperation initiatives in response to its recent actions.
The European Union announced in May 2009 that it will suspend its AU$43 million-a-year support to Fiji's sugar industry due to '... the absence of any indications that a legitimate government will be in place in 2009.' Sugar is Fiji's second largest export behind tourism and provides income and employment to around one-quarter of the labour force. From 1 September 2009, the Commonwealth suspended Fiji in response to the regime's continued failure to return the country to democracy and the rule of law. As a result of the uncertain political environment and exacerbated by the global recession, Fiji has experienced much reduced economic growth in recent years (–6.6 per cent in 2007 and 0.2 per cent in 2008) compared to previous years (2.7 per cent per year between 2001 and 2006).

2.2 Governance performance

Governments affect the daily life of citizens and businesses in several ways, but most notably through their powers to tax and spend. The quality and the quantity of government spending on health, education, and infrastructure has a significant bearing on economic growth—including the nature of that growth—and a country's progress towards meeting the MDGs and other national priorities.

While governments in the region are also increasingly looking at new ways of engaging with civil society, the private sector and international aid organisations to more cost-effectively deliver social services and infrastructure, the public sector remains the main deliverer of social services and utilities. Figure 2.1 shows that, in 2008, total government expenditure averaged at 53 per cent of GDP for the Pacific region and Timor-Leste—more than double the average for South East Asia (21 per cent).

Figure 2.1: Total government expenditure



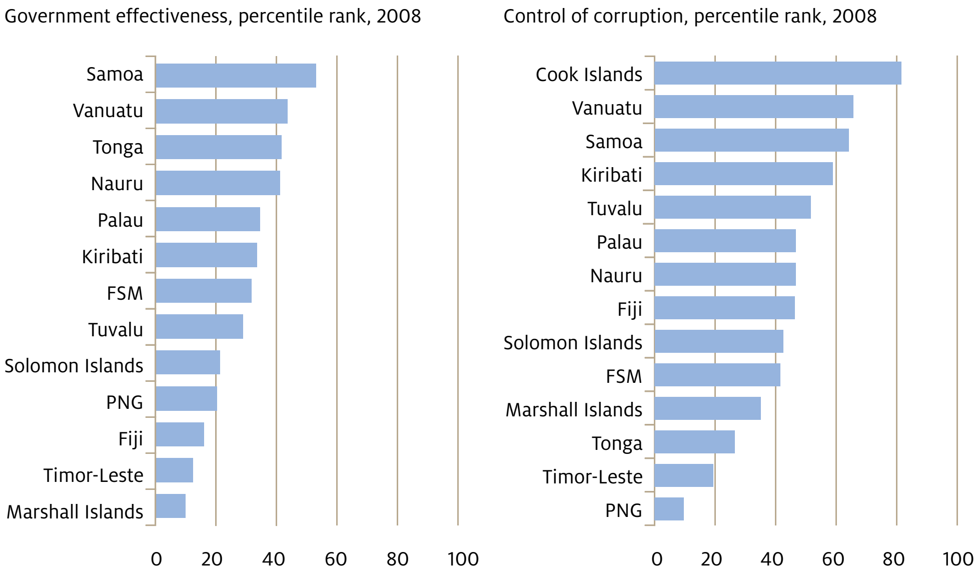
Source: ABD (2009d)

Note: unweighted average for Pacific and Timor-Leste and South East Asia.

The quality of governance varies across the region

Figure 2.2 shows scores for 'government effectiveness' across the Pacific and Timor-Leste in 2008. The World Bank's measure of government effectiveness includes: the quality of public services and infrastructure; the capacity of the civil service and its independence from political pressures; and the quality of policy formulation. In general, Vanuatu and the Polynesian countries perform relatively well in these areas while the Marshall Islands, Timor-Leste and some Melanesian countries perform poorly.

Figure 2.2: Government effectiveness and control of corruption varies across the region



Source: World Bank (2009f)

Note: Government effectiveness chart: Cook Islands and Niue are not included because their rankings are based on the performance against one indicator. Corruption chart: data for Cook Islands is for 2007. Data for Niue is not available.

A comparison of statistically significant changes between 2002 and 2008 of the World Bank's governance indicators show that Vanuatu has improved in both rule of law and control of corruption indicators. On corruption, Vanuatu moved from a percentile ranking of 29 to 66, largely due to reforms to the business enabling environment which reduced the amount of red tape likely to be encountered by businesses thereby reducing opportunities for corruption.

Solomon Islands has also improved in indicators of 'government effectiveness', 'rule of law 'and 'control over corruption'. Data from the ADB's Country Policy and Institutional Assessments indicates that the improvement in Solomon Islands 'rule of law' indicator between 2002 and 2008 is due to a marked increase in the level of property rights and rule-based governance particularly since 2007.

On the other hand, Fiji's performance has deteriorated in three areas: voice and accountability; government effectiveness; and regulatory quality. World Bank indicators suggest that the rapid decline in 'voice and accountability' is due to a decline in press freedom, political rights and civil liberties. Such falls have been most evident since 2006.

Corruption remains a serious challenge for some Pacific island countries and Timor-Leste

When governance is weak, opportunities for corruption increase. Corruption has a substantial negative impact on economic growth as it raises the cost of doing business and is a disincentive for investment. It may also lead to an under-investment in public goods and impact on service delivery.

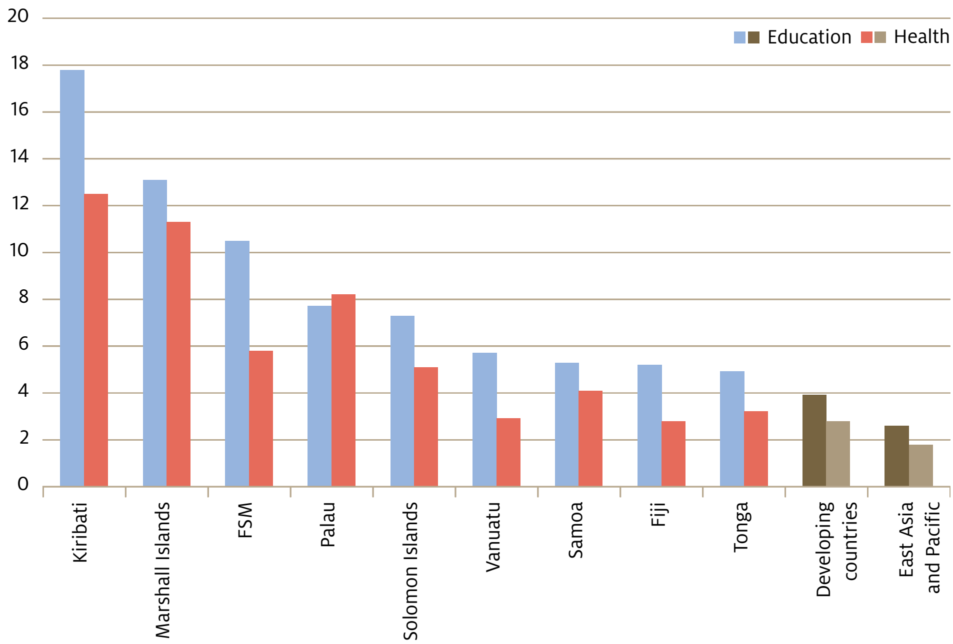
The corruption challenge faced by a number of Pacific island countries and Timor-Leste is reflected in the World Bank's 2008 control of corruption indicator (Figure 2.2). Of the 15 countries in the region, PNG and Timor-Leste are in the bottom 25 per cent, and nine countries are ranked in the bottom half. Tonga's score improved between 2007 and 2008 due to the introduction of an anti-corruption law and the establishment of an anti-corruption commission which helped bolster public perceptions of a more systematic approach to anti-corruption. In Timor-Leste, the Government is looking to strengthen anti-corruption activities by introducing a new Civil Service Commission and an Anti-Corruption Commission.

Pacific island countries are investing more in service delivery than other regions but spending is not always effective

Pacific island countries continue to invest significant resources into human development, relative to other developing countries and the East Asia and Pacific regions as a whole (Figure 2.3). Governments, churches, civil society organisations and communities all make important contributions to service delivery in the Pacific.

Figure 2.3: Human development is a priority of governments

Government expenditure on health and education 1997–2003 (% of GDP)



Source: World Bank (2007)

Note: PNG and Timor-Leste were not included in this study. Expenditure excludes the United States Compact capital funds for FSM, the Marshall Islands and Palau; government capital expenditure and donor funds for Kiribati, Solomon Islands and Vanuatu; and donor funds for Fiji, Samoa and Tonga.

While government spending is high, it often fails to result in overall improvements in service delivery and development outcomes. Chapter 3's Development Update shows that many Pacific island countries and Timor-Leste face serious challenges in meeting many of the MDGs by 2015.

Pacific island countries and Timor-Leste face a number of challenges in improving the quality and reach of public services. Small and dispersed populations and poor transport links mean it is more expensive to deliver public services compared to other regions. Population growth also continues to add to the demand for public services in much of the region. While migration patterns keep overall population growth rates low in most Polynesian and Micronesian countries, high birth rates means many Pacific island countries and Timor-Leste have very young populations: in 2008, 10 out of these 15 countries had more than 35 per cent of their population aged below 15, while the average for Asia and the Pacific is 26 per cent (Annex 3, Table A3.1). This increases the demand on public health and education systems.

Improving service delivery not only requires more resources, it requires that these resources be well targeted and used efficiently. In many countries, sub-national levels of government are responsible for delivering basic services such as education and health; however, organisational capacities and financing capabilities can vary significantly. PNG has recently introduced reforms to improve the quality of the basic services delivered by provincial and district governments (Box 2.1).

Box 2.1: Reforms are underway to improve local service delivery in Papua New Guinea

A major constraint to effective delivery of rural infrastructure and essential services in PNG has been the level of funding available to the provinces and districts responsible for delivering these services. In real terms funding for rural services has declined substantially over the past 30 years. Significant fiscal reforms have been made in 2009 to help address this.

Following reforms to the Organic Law on Provincial and Local level Governments in July 2008, the Intergovernmental (Financing and Functions) Act 2009 was passed unanimously through Parliament in March 2009. The reforms introduce measures to reduce the gap between each provincial government's ability to raise revenue and the estimated costs of service delivery within the province (the 'needs gap'). The central government will distribute available funding to provincial governments on the basis of their needs gap, to help them meet the recurrent cost of their assigned service delivery functions and responsibilities. Before these reforms, seven out of the 19 provinces in PNG had less than 40 per cent of the budget required for delivering basic services such as education, health and transport infrastructure. When combined with improved accountability mechanisms, these reforms aim to bring all provinces to a similar level of financial capacity to meet the costs of delivering a comparable set of basic services to their residents.

The reforms are also designed to improve the quality of service delivery through two key measures. The first measure is introducing expenditure guidelines to ensure local expenditures are directed towards the priority areas of health, education, transport, law and order, and rural development. The second measure is introducing better transparency and accountability arrangements for service delivery grants.

While it is anticipated the reforms will start impacting on service delivery from 2009, further efforts will be required to address low individual and organisational capacity and ensure the decentralised system of government is able to deliver quality services to PNG's rural population.

Low-cost, reliable infrastructure services support economic activity and progress towards the Millennium Development Goals

Many factors contribute to broad-based economic growth and poverty reduction. But provision of low cost, reliable infrastructure services—transport, telecommunications, electricity, water and waste water—provides a platform for most economic activities. It also enables the delivery of, and access to, basic social services and helps improve the health and education status of families.

While data on access and quality of infrastructure provision in the region is poor and the situation may have since improved, Table 2.1 illustrates the significant challenges still facing Pacific island countries and Timor-Leste:

› **Road** density in urban centres is generally considered adequate for the population and traffic flows in most Pacific countries.[13] However, access to rural and remote areas is inadequate, particularly in larger dispersed Melanesian countries and Timor-Leste. Road quality can be measured by reviewing the number of paved or all weather roads. Paved roads account for a far lower proportion of the total road network in the Pacific than in other comparator countries.

› Access to **electricity** in Pacific island countries and Timor-Leste is relatively low with only six countries providing electricity to 80 per cent or more of households.

› Access to **water and sanitation** services varies substantially between urban and rural areas within each Pacific country, with rural access levels being lower.

Table 2.1: Poor quality infrastructure reduces economic productivity and impacts on progress towards the Millennium Development Goals

	Paved roads	Road density	Household electrification rate	Households with improved water supply	
	(%)	(km of road per 1000 sqkm)	(%)	Urban (%)	Rural (%)
Melanesia					
Fiji	49*	188.3*	67*	97.5*	88.5*
PNG	3.5*	43.3*	11*	70*	30*
Solomon Islands	2.4*	49.7*	16*	80.9*	43.6*
Vanuatu	24*	87.8*	19*	90.5*	70.8*
Polynesia					
Cook Islands			94*	99.2*	87.3*
Samoa	14.2*	825.5*	92	96.3	97.6
Tonga	27*	944.4*	89	99	97
Tuvalu			92*	93.9*	97.6*
Micronesia					
FSM		342.9*	56*	94.4*	92.1*
Kiribati		827.2*	39	70.1	37.4
Marshall Islands	18*		63*	97.8	99.7
Nauru			99*		
Palau			99	100	100
Comparators					
Timor-Leste			27*		
Indonesia	55.4	215.8	91.1	89	71
Philippines	9.9*	670.9	76.6*	96	88

Source: ADB (2009b); AusAID (2009)

Note: Latest available data is used; * denotes that data is from 2004 or earlier.

13 World Bank (2006c)

Clearly, the high cost of serving thinly populated and dispersed rural areas affects the ability of Pacific island countries and Timor-Leste to provide access to infrastructure in these areas. Indeed, low provision of certain infrastructure services may in part be due to sensible prioritising. Reticulated water systems, for instance, are not always necessary in remote parts of PNG or Vanuatu where there is adequate rainfall. However, some underperformance can be addressed through better policy, institutions and management. Some examples of best practise in the region include:

- developing long-term infrastructure plans, which enable governments and donors to more effectively coordinate and prioritise infrastructure development and maintenance
- establishing policies which recognise the importance of infrastructure operation and maintenance, and linking maintenance with infrastructure design contracts
- undertaking structural reforms to facilitate increased competition in the construction, maintenance and supply of infrastructure services.[14]

Box 2.2: Cook Islands is taking a long-term vision for infrastructure development

In 2007, the Cook Islands Government adopted the 20-year Preventive Infrastructure Master Plan with technical assistance from the ADB. The Plan concluded that lack of investment in maintenance, rehabilitation and upgrading of basic infrastructure had resulted in ageing systems that were not capable of providing appropriate levels of service to meet current demand or support sustained growth. Importantly, the Plan assessed both the condition and management of existing infrastructure, and the need for new infrastructure.

Based on this assessment, proposals to upgrade or build new infrastructure were ranked using a multi-criteria analysis, the end product being a list of prioritised infrastructure projects needed for sustainable economic growth in the immediate, medium and longer terms.

One such high priority infrastructure project identified in the Plan is the upgrade and expansion of Cook Islands Avatiu Port. The wharf is ageing, vulnerable to damage from storms, and unable to accommodate larger vessels and cruise ships. Construction will commence on improving the port in 2010.

Better quality information and public access to information can help governments improve service delivery and infrastructure provision

Public access to information is important in allowing communities to check whether resources are reaching the local level and to compare service access and quality. In particular, the media helps to inform public opinion and provides a channel for citizens, non-government organisations (NGOs)

14 World Bank (2006c)

and governments to engage on issues of public importance. Well-informed communities, their civil-society representatives and the media, can play an important role in demanding higher standards of governance and accountability from public officials.

More effective service delivery also requires better quality information on community and household needs and the ability to track the provision and quality of services. Several Pacific island governments have established information management systems within service-delivery agencies. For example, Solomon Islands—with assistance from New Zealand—is implementing a system in the education sector to track service delivery at school level. Significant progress has also been made in improving the reliability and accuracy of statistics: 11 countries have completed a Household Income and Expenditure Survey in the last five years and a further six are planned by 2012, including PNG (2009)—its first since 1996.

Social accountability initiatives are beginning to take hold in Pacific island countries. For example, Oxfam and the Solomon Islands Christian Association have partnered to establish a community-based education tracking and monitoring system in several communities in Malaita Province. The objective is to empower communities to demand accountability from national and provincial education authorities. The project has been able to facilitate direct feedback from communities to national education policy-making bodies and enhance upward accountability. The Ministry of Education has shown strong support for the project and is keen to see it expanded into other provinces.

2.3 Structural reforms

The *Pacific Economic Survey 2008* discussed the benefits and opportunities resulting from the introduction of competition and other regulatory reforms to the telecommunications and transport sectors in some Pacific island countries. These reforms are proving effective in lowering the cost and improving access and efficiency of key infrastructure services. Progress in these sectors is revisited in this section, as well as developments in improving the business-enabling environment.

Government reforms are reducing costs and improving access to telecommunications … facilitating economic growth

Competition in the telecommunications sector has reduced costs and improved access. In 2002, Tonga introduced competition in mobile telecommunications. Samoa and Palau followed in 2006. This resulted in dramatic increases in the number of mobile phone subscribers as well as large decreases in the cost of handsets and calls. Use of mobile phones continues to grow quickly in these countries (Figure 2.4).

PNG and Vanuatu have had similar experiences. PNG introduced competition in late 2007 and Vanuatu in early 2008. In PNG, there has been a large and rapid overall improvement in market penetration of mobile services, particularly in remote and rural areas. Mobile subscribers have grown rapidly from 100 000 in 2006 to an estimated one million in 2008. The cost of handsets and calls has also fallen. In Vanuatu, the liberalisation of telecommunications expanded coverage from

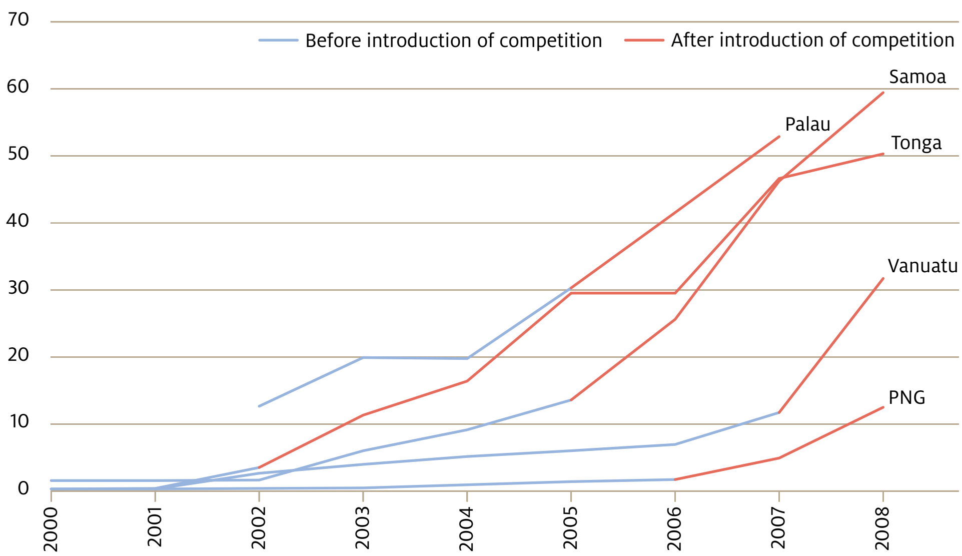
20 per cent of the population in 2007 to 75 per cent in 2008. It is estimated that the coverage rate will reach 85 per cent by the end of 2009. The cost to consumers has also dramatically decreased with the price of SIM cards dropping from A$60 to zero and the price of handsets dropping from A$100 to A$25.

Bringing telecommunications services to rural and remote areas is important but difficult in many Pacific island countries. In Vanuatu, the telecommunications regulator administers the Universal Access Fund, which subsidises telephony and Internet operations in loss-making, predominantly rural, areas. The Fund is financed by international donors and a licensing levy payable by the two service providers. The PNG Department of Communications and Information is working with the World Bank to assess the feasibility of a 'rural connectivity scheme' similar to Vanuatu's Universal Access Fund. To ensure viability, issues of land tenure, law and justice, provision of basic services (e.g. power) and financing need to be addressed.

Timor-Leste is taking steps to restructure its telecommunications sector including through developing and implementing a new telecommunications policy, establishing a new legal framework and strengthening the capacity of the regulatory authority as an independent regulating body in the sector. The Government is also considering ways to liberalise telecommunications in the country to increase competition.

Figure 2.4: Countries with competition are improving communications

Mobile phone subscribers per 100 people, 2000–08



Source: International Telecommunications Union (2009)

Lessons from other developing countries suggest information and communication asymmetries are among the prime causes of market failure and the under-development of small businesses. Improved access to telecommunications can reduce business and transaction costs; provide access to new markets; and overcome obstacles to accessing information about markets, prices and consumers.[15] This potential is also noted in the 2005 *Pacific Regional Digital Strategy*.[16] In Vanuatu, competition is reducing the costs of doing business (incremental benefits) and expanding business opportunities (transformational benefits), particularly for small business. Preliminary estimates by the Vanuatu Ministry of Finance and Economic Management suggest that telecommunications reform has contributed approximately one per cent to GDP growth. In PNG, it is estimated that competition in the mobile telecommunications sector has contributed approximately 2.5 per cent to the nation's GDP.[17]

Investment in port infrastructure will help reduce the cost of importing and exporting

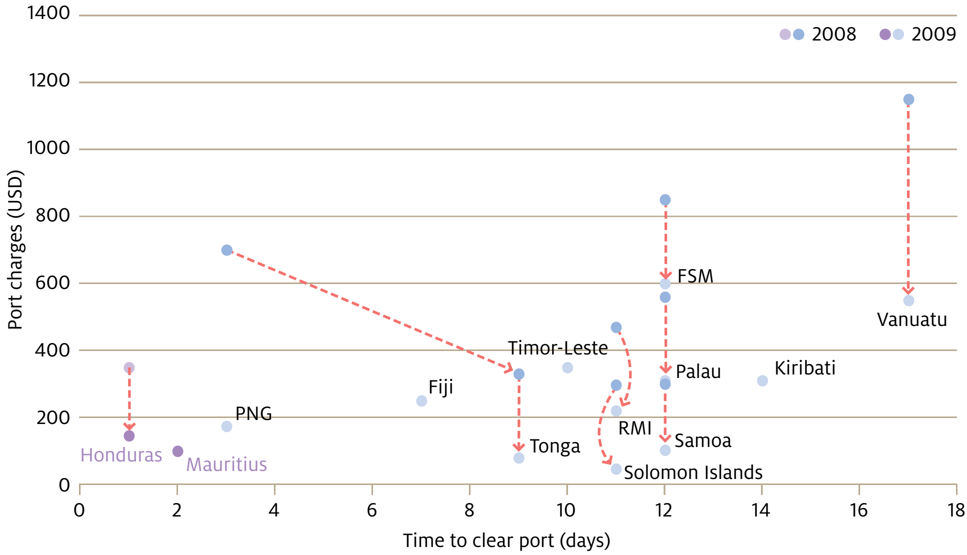
Shipping costs remain high in many Pacific island countries due to large fixed costs. These high costs limit opportunities for economic growth and the expansion of major industries. Vanuatu is the poorest performing Pacific island country in terms of the 'Trading Across Borders' rankings in the World Bank's *Doing Business* indicators. It takes 21 days and costs US$1467 to import a container to Vanuatu, while exporting a container takes 30 days and costs US$1392. These high costs can be considered a tax on the rest of the population as they raise the price of all goods. In addition, they do not include intra-country trade and transport costs which are a substantial additional cost on the end price of goods in rural communities.

Despite some progress in reducing port charges in the last year (Vanuatu, FSM, Palau, Samoa, Solomon Islands, Tonga and Timor-Leste), the inefficiency and the cost of ports remains high in many Pacific island countries, in comparison with other small island developing states such as Honduras and Mauritius (Figure 2.5). Although some countries in the region have been able to reduce the cost of clearing items through ports they have not been able to reduce the time it takes.

PNG and Cook Islands are currently investing in ports to reduce the cost of importing and exporting. The PNG Ports Corporation has secured around US$100 million from the ADB to finance the extension of Lae Port, the main shipping port in PNG which processes more than 80 per cent of exports and 95 per cent of imports. However, the project is on hold due to complications in implementation, including: lack of qualified engineers and technical staff; cash-flow difficulties; delays in procurement and approval processes of government; and competition from the mining sector for resources, particularly human resources. Cook Islands, with a concessionary loan from the ADB (US$18.2 million), will rehabilitate and expand capacity of the Aviatu Port.

15 World Bank (2008)
16 Pacific Island Forum Secretariat (2004)
17 Government of PNG (2009)

Figure 2.5: Some ports have made improvements in reducing port charges, but not port efficiency



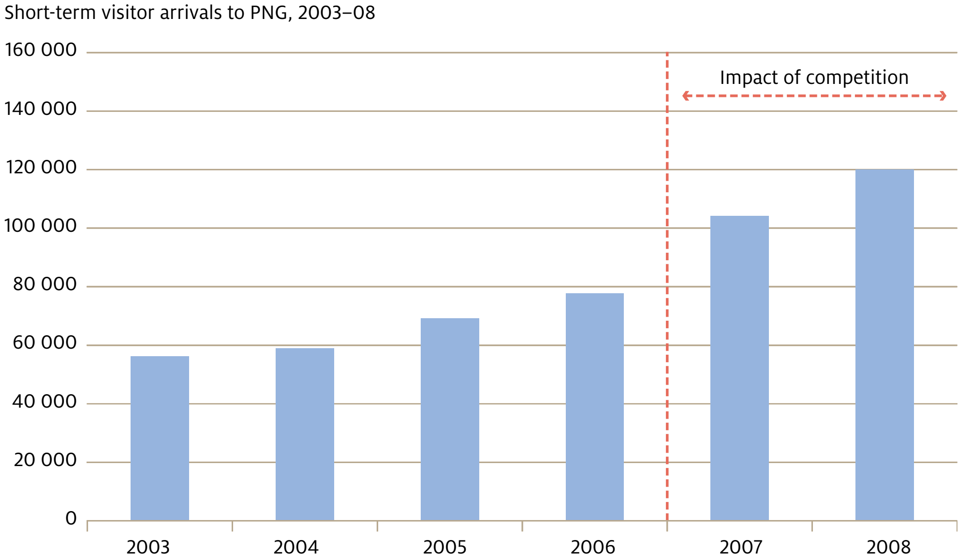
Source: World Bank (2009b)
Notes: RMI = the Marshall Islands. Mauritius, PNG, Fiji and Kiribati recorded no change between 2008 and 2009.

Aviation reforms are continuing

The *Pacific Islands Air Service Agreement* is a regional agreement providing a framework for liberalising air services between Pacific island countries. There are 10 signatories: Cook Islands, Kiribati, Nauru, Niue, PNG, Samoa, Solomon Islands, Tonga, Tuvalu and Vanuatu. The agreement came into effect in October 2007 and has contributed to increased services and new routes. For example, Air Pacific now flies into Solomon Islands, and Pacific Blue, Air New Zealand and Solomon Airlines fly to Vanuatu.

In recent years, PNG's aviation sector has witnessed improvements to its regulatory environment and an expansion of routes and seat capacity on domestic and international routes. These developments are largely attributable to reforms to the Civil Aviation Authority and from introducing greater competition into the aviation industry. Airlines PNG began operating in early 2007 and commenced a code-sharing arrangement with Pacific Blue in late 2008. This arrangement is expected to produce benefits for the tourism sector and will hopefully generate additional income-earning opportunities for Papua New Guineans. The total number of short-term international visitor arrivals to PNG grew by 15 per cent from 2007 to 2008 (Figure 2.6).

Figure 2.6: Airline competition has contributed to growth in visitors to Papua New Guinea



Source: PNG Tourism Authority

But, the overall ease of doing business is declining compared to other countries, restricting private sector and overall economic growth

Doing business in the region remains difficult and costly. In addition to the natural disadvantages of geography and size that Pacific island countries and Timor-Leste face, the policy and regulatory environment hinders private sector growth.

The World Bank produces Ease of Doing Business rankings for 183 countries on 10 areas such as ease of starting a business, access to credit, trading across borders and registering property. Countries are ranked from best (1) to worst (183) based on their combined rankings across all 10 areas. A decline in a country's ranking from one year to the next indicates that the ease of doing business in that country has declined relative to other countries.

Timor-Leste and Samoa improved on their rankings from 2009, implementing change and keeping pace with global reforms to make it easier to do business:

- **Timor-Leste** revised corporate tax laws to make payments quarterly and abolished withholding tax on interest.
- **Samoa** introduced a new company act that cut 26 days from the time taken to start a new business, and moved up 111 ranks within the category Starting a Business.

Table 2.2: Timor-Leste and Samoa improved on the ease of doing business, but other Pacific island countries have slipped.

Country	Ease of doing business, global ranking		Change
	2009	2010	
Tonga	46	52	↓
Fiji	43	54	↓
Samoa	68	57	Improved ↑
Vanuatu	58	59	↓
Kiribati	79	79	-
Palau	92	97	↓
Marshall Islands	93	98	↓
PNG	95	102	↓
Solomon Islands	96	104	↓
FSM	125	127	↓
Timor-Leste	173	164	Improved ↑

Source: World Bank (2009b)

Other Pacific island countries' rankings fell according to the 2010 survey. This comes on top of falls in most rankings between 2008 and 2009. This does not mean that all areas of doing business have necessarily changed for the worse. Some countries with an overall fall in rankings, such as Vanuatu and Tonga, still improved on individual indicators:

- **Vanuatu** gained 13 places in the ranking for Getting Credit
- **Tonga** gained two places in the ranking for Trading Across Borders

Fiji, on the other hand, recently introduced legislative changes that made it more difficult to do business. The City Council of Suva now requires builders to obtain pre-approval from the Occupation Department, the Health and Safety Department, the National Fire Authority and the Water and Sewerage Authority. These additional procedures added 35 extra days to the time it takes to obtain a construction permit in Suva.

Businesswomen in the region face additional constraints to participating in the private sector. Lack of access to credit, justice systems, contract enforcement and the traditionally lower status of women have translated to fewer opportunities for women to start or grow their own business. Lack of access to finance is particularly difficult for women in Pacific island countries and few microfinance schemes are aimed at women. Rural women especially have problems accessing credit as they tend to lack recognised forms of collateral, such as property.

Two organisations in Samoa are working together to give greater access to finance and provide business development advice to Samoan businesswomen. Women in Business Development Inc mentors microenterprises and provides them with financing. When these businesses are ready to 'graduate' from microfinance, the Small Business Enterprise Centre supports them by serving as a broker and guarantor for bank loans. The collegial relationship between Women in Business Development Inc and the Small Business Enterprise Centre has backed several successful and notable business ventures in Samoa including an exclusive contract for virgin coconut oil producers with The Body Shop, and *Levaii*, a female entrepreneur-owned bottled water company which supplies to major hotels.

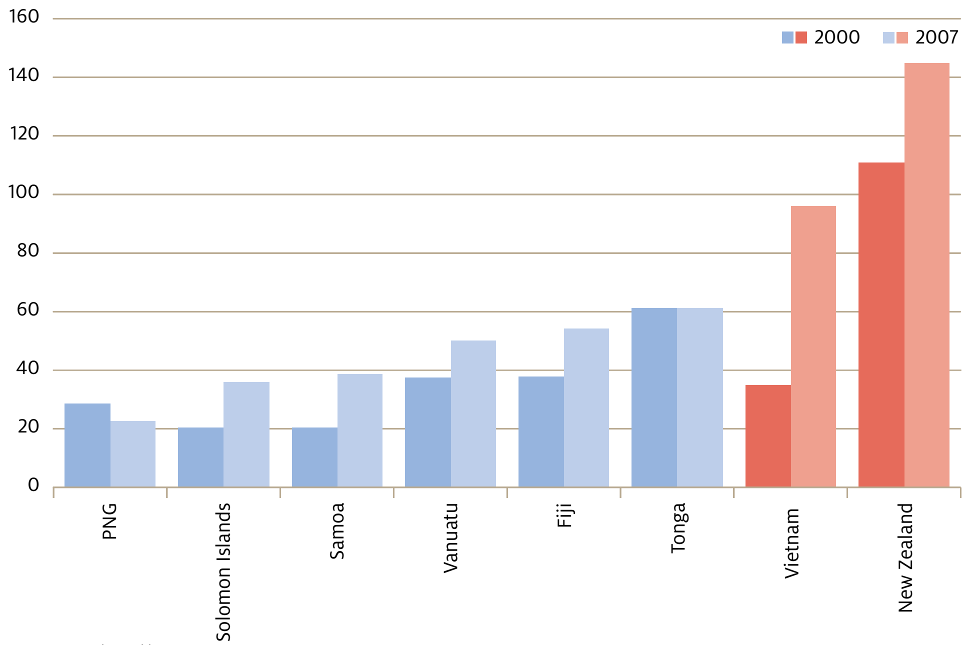
Financial services are important for economic growth

Well-functioning financial markets are essential for promoting economic growth. Access to credit enables entrepreneurship, while deposit and saving services provide safe channels for households and businesses to save, and money and remittance transfer services allow for funds to be cost-efficiently transferred within and across borders.

One measure of a country's access to financial services is the ratio of domestic credit to GDP (Figure 2.7). Many Pacific island countries have experienced a sustained expansion of credit to the private sector reflecting increased confidence in the region's macroeconomic environment and the outcome of financial sector reforms, both of which have contributed to lowering interest rates and improving the outreach of financial services. However, overall penetration of financial services remains low and many are still far from the ratios of 100 per cent that typify developed and some developing economies.

Figure 2.7: Loans from the domestic banking sector are increasing

Domestic credit provided by the banking sector, 2000 and 2007 (% of GDP)



Source: ADB (2009b)

Provision of financial services is often narrowly focused by geography, sector and company size. Little formal credit is extended to the agricultural and forestry sectors, despite their sizeable contributions to GDP and employment. In 2008, the agriculture and fishing sector accounted for two per cent and five per cent of all loans in Solomon Islands and Vanuatu respectively.[18]

Large segments of the population remain 'unbanked', that is, they do not have any savings accounts or taken loans with commercial banks or microfinance insitutions. Broadening the accessibility of financial services is a priority for many Pacific island countries and Timor-Leste. This is being achieved by:

- reforming the **regulatory environment** for the financial sector
- improving the **outreach** of financial services to rural areas through levering new technologies, introducing innovating banking models and improving financial literacy

Land reform programs, as well as expanded rural banking services by larger commercial and national banks and microfinance institutions and international organisations, are also addressing this need (Box 2.3).

Many governments in the region have recently introduced new financial laws and regulations to enable the financial sector to expand. Reforms to collateral laws (for instance, secured transaction laws) are making it possible for potential borrowers to put up 'moveable assets' (such as crops, equipment and consumer goods) as collateral. The Marshall Islands, FSM, Solomon Islands and Vanuatu have recently passed such laws, and Palau, Tonga and Samoa are in the process of doing so. In the absence of well-defined property rights, these reforms are making it considerably easier for people to obtain a loan. They also make borrowing cheaper as the rights and duties of borrowers and lenders are clearly established and enforced, therefore lowering the overall risk and enforcement costs faced by lenders.

The introduction of competition in the telecommunications sector, combined with the availability of new technology and regulatory reform, has brought new opportunities for improving the outreach of financial services to underserved areas. Bank South Pacific, for example, launched a new SMS mobile phone banking service in partnership with Digicel and B Mobile in April 2009. This will make it possible for Papua New Guineans to use their mobile phones to handle a number of day-to-day banking transactions, without having to travel to their nearest bank branch. Tonga and Samoa, with the assistance of the ADB, are also moving in this direction and have assessed potential branchless banking models and the regulatory reforms (such as electronic transaction laws) required to support such initiatives. Rural banking and microfinance is taking off in many countries (Box 2.3).

18 Central Bank Solomon Islands (2009), Reserve Bank of Vanuatu (2008)

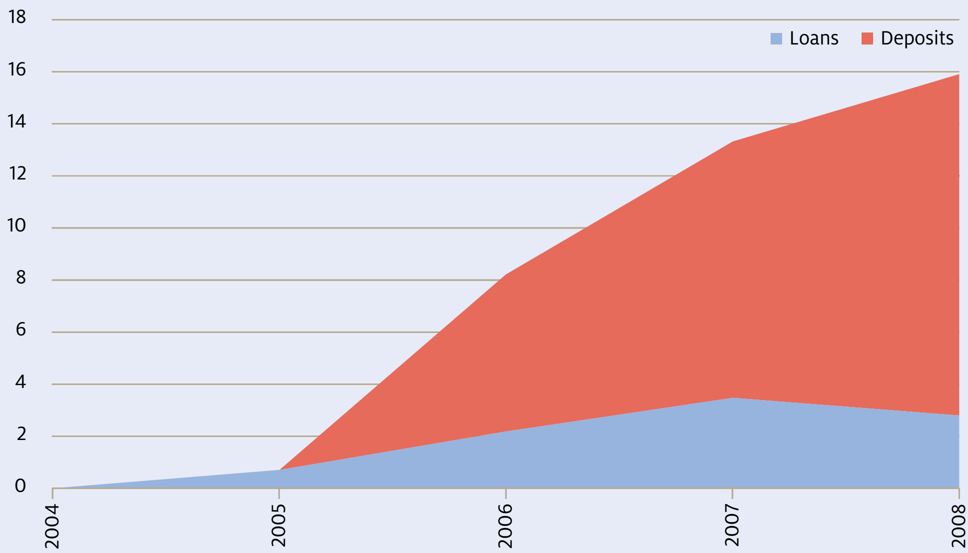
Box 2.3: Improving access to microfinance

Vanuatu: the National Bank of Vanuatu is operating a mobile banking program to deliver microfinance services to a number of outer islands. The initiative involves around 130 National Bank of Vanuatu staff, many of whom tour rural areas on motorbikes. Operations have expanded quickly and as of April 2008 the bank had approved 1600 loans ranging from VT25 000 to VT50 000. Most loans (73 per cent) go to small trade and investment in agriculture, livestock and fishing activities. No formal collateral is required. Instead, the initiative uses 'character-based' lending where village chiefs recommend who should receive finance. Repayment rates have been high.

Source: World Bank, *Women in Vanuatu: Analyzing Challenges to Economic Participation*, April 2009

PNG: PNG Microfinance Limited (PNG MFL) has grown rapidly since it was established in 2004—by the end of 2008 it had 120 000 depositors, with average savings of US$120. Its long-term vision is to achieve one million active clients by 2015. In 2008, PNG Microfinance Limited opened its fifth western province branch at Obo and is planning to open new full-time branches at Lake Murray, Suki, and Morehead.

Value of loans and deposits at PNG MFL, 2004–08 (USD millions)



Source: *PNG Sustainable Development Program Ltd: Annual Report 2008* and the Microfinance Information Exchange: http://www.mixmarket.org/

Land reform is on the agenda in many Pacific island countries

Land reform remains on the agenda in the Pacific region. PNG, Vanuatu, Solomon Islands, Samoa, the Marshall Islands and Tonga, for example, are either undertaking or considering land policy reforms to ensure land contributes to community and national social and economic development.

Land forms the economic basis of Pacific island communities and is central to each country's social, cultural and spiritual make-up. Customary ownership is the dominant form of land ownership in the Pacific region, accounting for more than 80 per cent of total land area in most countries. National land reform programs are underway in a number of countries. While each country is adopting its own approach, all are aiming to strengthen the customary landownership framework and allow for development to occur within a clear legal framework. Land reform programs are also increasingly considering gender impacts. Such measures include joint titling, reform of laws restricting women's right to inherit and own land, ensuring women's participation in resolving land disputes and ensuring women's involvement in negotiations with external interest groups.

In Solomon Islands new legislation has been drafted for the creation of Tribal Lands Dispute Resolution Panels. If accepted the resulting reforms will simplify the process for resolving disputes over customary land and will reduce the backlog of cases in the formal court system. The panels will use alternative dispute resolution mechanisms to encourage agreements between parties. Each three-person panel must also have at least one female member. In addition to women's membership, the informality of proceedings, reconciliation of custom and constitutional rights and recognition of use of land will potentially deliver benefits and promote women's inclusion in land administration.[19]

PNG recently passed amendments to the Incorporated Land Groups Act and the Land Registration Act (March 2009). These new laws improve the system by which customary land-owning groups can be legally recognised as land owners and introduce a more effective procedure for customary landholders wanting to register their interests in land. They also provide customary landholders with a simplified process to voluntarily lease out parts of their land for commercial development. PNG is also strengthening the management of its urban land and undertaking pilot projects to release customary land for formal residential housing and commercial development. This is, in turn, easing the pressure on the urban land market.

The Government of Vanuatu is also moving forward with its land reform agenda. This includes improving the management of land records and regulation of leases over customary land, planning and zoning. The Government is also developing a Land Sector Framework to establish priorities for land reform and help coordinate the work of government, civil society, donors and the local community.

19 International Finance Corporation (IFC) and AusAID (2009)

The governments of Samoa and Tonga are each undertaking a formal review of their land tenure laws and procedures. They are seeking to consult widely before making changes, given the sensitivities associated with land.

In May 2009 the Government of Timor-Leste introduced a draft transitional land law which is undergoing a wide community consultation process before being submitted to Parliament. A revised version of the draft law is expected to be presented to Parliament before the end of 2009.

3 Pacific development update

This chapter examines progress towards meeting the MDGs in Pacific island countries and Timor-Leste.[20] It tracks country progress against each target for MDG1 though to MDG7, indicating which countries are on track or off track to meeting the targets.

The chapter also reports on the analysis of links between governance, economic growth and child mortality. This analysis shows that better governance is associated with higher growth and that higher growth is, in turn, associated with lower child mortality. Overall, it shows that better governance can mean greater progress towards the MDGs.

3.1 Overview of progress towards the Millennium Development Goals

Many Millennium Development Goals in Pacific island countries and Timor-Leste will not be met by 2015

Many Pacific island countries are unlikely to meet a number of MDGs by the agreed timeframe of 2015. As Table 3.1 shows, many are unlikely to meet the targets of halving poverty, achieving universal primary education, reducing child and maternal mortality by two-thirds, and improving access to safe water supply and sanitation. Particularly in the poorest countries, infectious diseases such as malaria, HIV and tuberculosis (TB) continue to spread at alarming rates and rising incidences of lifestyle diseases is placing additional burden on fragile public health systems.

At one end of the spectrum, Polynesian countries—particularly Samoa and Tonga—have made the most progress and are on track to achieving a number of MDGs. At the other end of the spectrum, PNG and Timor-Leste, two populous countries, face a number of different development challenges and are both are unlikely to meet any MDG by 2015. Further information, on which Table 3.1 is based, is in Annex 2.

20 This chapter draws on AusAID's 'Tracking Development and Governance in the Pacific 2009'.

Table 3.1: Many Pacific island countries and Timor-Leste are unlikely to meet a number of Millennium Development Goals by 2015

	On Track	Of Concern	Off Track
MDG1: Eradicate Extreme Hunger and Poverty			
Halve, between 1990 and 2015, the proportion of people whose income is less than $1 a day and the proportion of people who suffer from hunger. (Incidence of Basic Needs Poverty)	Vanuatu	Solomon Islands, Cook Islands, Niue, Tonga, Kiribati, Marshall Islands, Nauru, Palau	Fiji, PNG, Samoa, Tuvalu, FSM, Timor-Leste
MDG2: Achieve Universal Primary Education			
Ensure that, by 2015, children everywhere, boys and girls alike, will be able to complete a full course of primary schooling. (Primary Completion Rate)	Fiji, Niue, Samoa, Tonga, Tuvalu	Solomon Islands, Cook Islands, FSM, Kiribati, Marshall Islands, Palau	PNG, Vanuatu, Nauru, Timor-Leste
MDG 3: Promote Gender Equality and Empower Women			
Eliminate gender disparity in primary and secondary education, preferably by 2005, and in all levels of education no later than 2015. (Gender equality in primary and secondary schools)	Fiji, Vanuatu, Samoa, Tonga, FSM, Kiribati, Marshall Islands, Nauru, Palau	Cook Islands, Niue, Tuvalu, Timor-Leste	PNG, Solomon Islands
MDG4: Reduce Child Mortality			
Reduce by two-thirds, between 1990 and 2015, the under-five mortality rate.	Solomon Islands, Vanuatu	Niue, Samoa, Tonga, FSM, Marshall Islands, Nauru	Fiji, PNG, Cook Islands, Tuvalu, Kiribati, Palau, Timor-Leste
MDG5: Improve Maternal Health			
Reduce by three-quarters, between 1990 and 2015, the maternal mortality rate.	Solomon Islands, Samoa, Tuvalu	Cook Islands, Niue, FSM, Marshall Islands, Palau	Fiji, PNG, Vanuatu, Tonga, Kiribati, Timor-Leste
MDG6: Combat HIV/AIDS, malaria and other diseases			
Have halted and begun to reverse the spread of HIV/AIDS, malaria and other major diseases.	Cook Islands, Niue, Tonga, FSM, Marshall Islands, Nauru, Palau	Solomon Islands, Vanuatu, Samoa, Tuvalu, Kiribati	Fiji, PNG, Timor-Leste
MDG7: Ensure Environmental Sustainability			
Integrate the principles of sustainable development into country policies and programs and reverse the loss of environmental resources. (Household access to improved water supply and sanitation)	Fiji, Cook Islands, Niue, Samoa, Tonga, Palau	Vanuatu, FSM, Marshall Islands, Nauru	PNG, Solomon Islands, Tuvalu, Kiribati, Timor-Leste

Source: Refer Annex 2

Note: Countries on track to meet the target are shaded in green. Countries progressing slowly but with extra resources could meet the target are shaded in yellow. These are also countries which have limited data. Countries highly unlikely to meet the target are shaded in red. Data is drawn from different years.

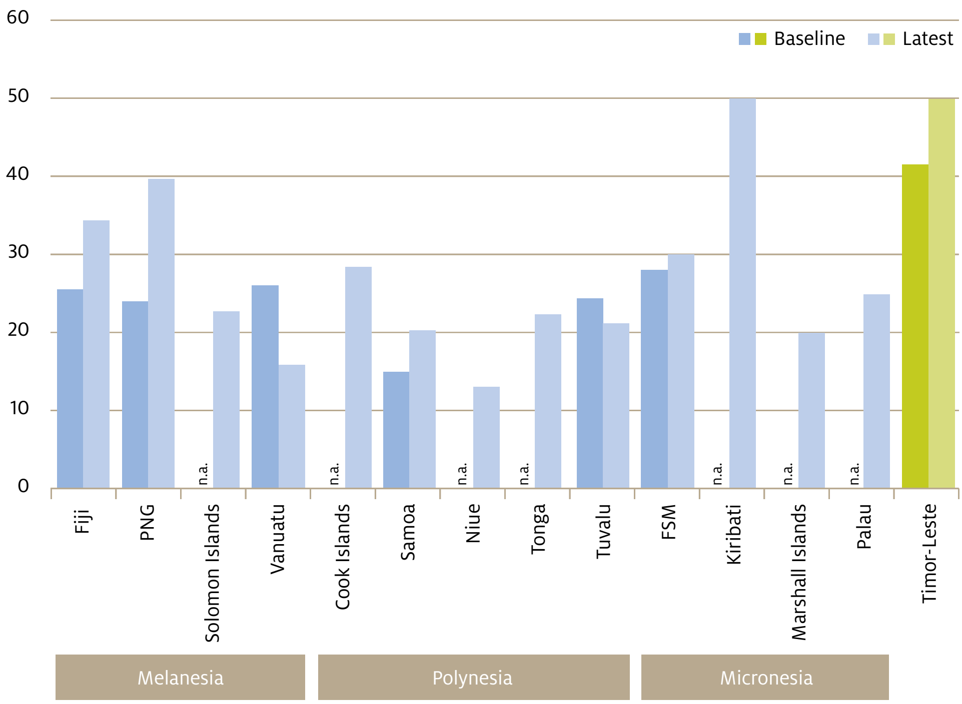
3.2 Poverty

Rising poverty is evident, with one-third of people living below national poverty lines

Of all MDGs, progress towards MDG 1—reducing poverty and hunger—has been the slowest and is of most concern in the region. While monitoring and understanding poverty in the Pacific is hampered by poor quality and out-of-date data, indications are that the number of people living in poverty continues to rise and was doing so even before the food and fuel crisis and the onset of the global recession. The number of people living below national basic needs poverty lines has increased in Fiji, PNG, FSM, Samoa and Timor-Leste. Only Vanuatu appears to have made progress in reducing poverty and is on track to reducing poverty by half by 2015 (Figure 3.1).

Figure 3.1: Poverty has risen in Fiji, Papua New Guinea, Samoa, Federated States of Micronesia and Timor-Leste

Incidence of basic needs poverty, various years (% of total population)



Source: SPC (2009); United Nations Development Programme (UNDP) and Government of Timor-Leste (2009)

High population growth on the one hand and low levels of investment and job creation on the other hand, has resulted in large-scale unemployment and under-employment across the region, which have contributed to the rising incidence of poverty. In most Pacific island countries and

Timor-Leste, the growing young population finds it difficult to access quality education and training and even more difficult to find paid employment—the number of new entrants into the labour market each year far outweighs the number of job openings (Box 3.1).

An important avenue for generating income for the majority of Pacific island countries and Timor-Leste will remain in the informal sector and there is a strong need to actively support the development of this sector in both rural and urban areas. However under existing circumstances, many Pacific island economies cannot be realistically expected to generate sufficient employment in either the formal or informal sector for the many unemployed and underemployed young people. The best chances for employment for young people are overseas. The opportunities presented within the region and internationally are examined in Chapter 5.

Box 3.1: Jobs are needed to ensure school leavers have livelihoods

Fiji has a comparatively large formal sector accounting for about one-third of the labour force. Although jobs in the formal sector have been growing steadily this trend is insufficient to absorb new labour market entrants—estimated to be around 17 000 each year.

PNG formal sector employment has been growing rapidly (from a low base). During 2008, employment increased by 8.2 per cent. Job growth was strongest in the building and construction sector (20 per cent), followed by manufacturing (10 per cent). (Bank of PNG)

In 2005, about 27 per cent of **Kiribati's** labour force was employed in the formal sector with most jobs either with the Government or government enterprises. Around 2000 people enter the labour force each year, with most having to undertake village work if they want to earn a cash income. Migration remains low but has been increasing and is identified as a key strategy of the Government. The main overseas employment opportunities are for seafarers on merchant vessels and fishermen on Asian fishing boats.

Formal sector employment opportunities are growing in **Vanuatu** with around 700 new jobs created each year, mainly in the service sector. Like elsewhere in the region, this growth is insufficient to absorb the 3500 entrants to the labour market each year.

Source: International Labour Organization (ILO) (2008)

Economic growth in Pacific island countries and Timor-Leste has not necessarily led to reductions in poverty

Economic growth is essential for achieving progress towards reducing poverty and achieving the MDGs. In the Pacific, economic growth has historically been less pro-poor than in other regions.[21] Figure 3.2 demonstrates this relationship in more detail and shows that while all six countries, for

21 See, for example, ADB (2009d).

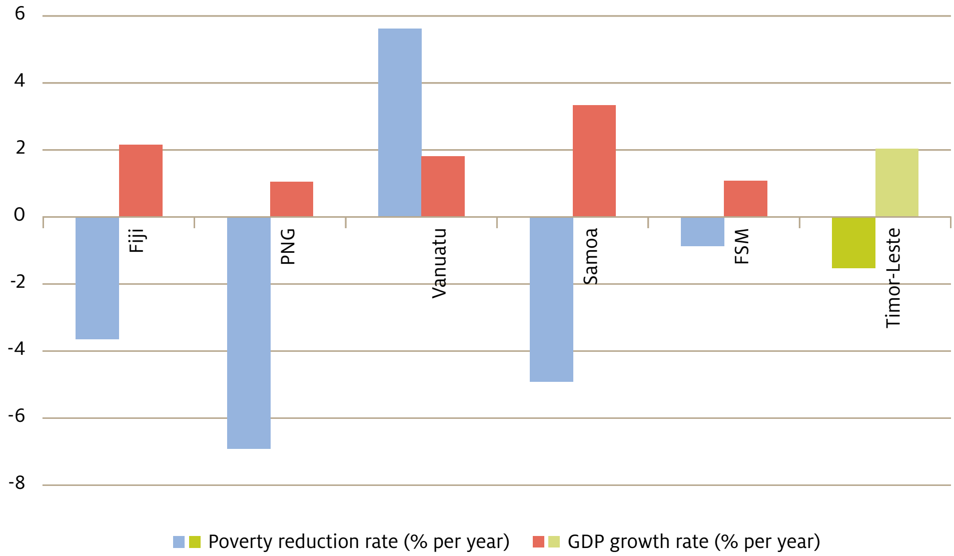
which there is data, recorded positive levels of GDP growth, the proportion of people living in basic needs poverty has increased in all countries except Vanuatu.

The statistics in Figure 3.2 suggest that even as the global recession eases and economic growth rates increase, fewer people will be pulled out of poverty in the Pacific, compared to other regions *if* existing economic growth patterns continue. Maximising the rate of economic growth, together with making it more pro-poor and inclusive, is an important challenge for greater progress towards the MDGs.

To help meet this challenge, policies are needed to support the development of sectors which have high market potential and high human development potential. Such sectors share some or all of the following characteristics: they are labour intensive; have strong inter-sectoral links with other domestic sectors; and also provide revenue to governments.

Figure 3.2: Vanuatu has recorded positive economic growth and reductions in poverty

Poverty reduction and GDP growth rates, selected countries and years



Source: SPC (2009); ADB (2009b)

Note: The countries included in the chart are those for which two data observations on the incidence of basic needs poverty data is available. Poverty reduction and GDP growth rates correspond to the same years. For instance, between 1998 and 2006, the proportion of people living in basic needs poverty in Vanuatu decreased from 26 per cent to 16 per cent, which equates to an average rate of poverty reduction of six per cent per year. During this time, GDP grew at an average rate of two per cent per year.

3.3 Education and health

More children are entering the school system, but many children still do not finish primary school

Countries are edging closer towards universal primary education; however still more than 20 per cent of primary school-aged children in Melanesia and eight per cent in Polynesia and Micronesia are not enrolled in school.[22] Major breakthroughs have been achieved in Solomon Islands where enrolment levels have more than doubled over the past 20 years.[23] Girls' access to primary education has particularly improved in PNG, Solomon Islands and Vanuatu and six out of 15 countries in the region have achieved gender equality in primary education.

Across the region, children particularly at risk of not completing primary school are those living in remote communities, those with a disability and those from poorer families who undertake paid or domestic labour. Inequalities are particularly wide for children with a disability: UNESCAP estimates that less than 10 per cent of children and youth with a disability in the Asia-Pacific region have access to primary education, compared to 70 per cent of those who do not have a disability.[24] In Samoa, for instance, it is estimated that 85 per cent of children with a disability live in rural areas and most of these have never attended school or have only done so for limited periods.[25]

Access to education, however, is only part of the solution. Basic education should provide graduates with sound literacy and numeracy skills upon which they can build in secondary school or take with them into the workforce. Yet the quality of education and learning achievement is low in the region with many children leaving primary school unable to read, write or solve basic mathematical problems. A 2007 survey of literacy levels in Vanuatu, for example, found that 27 per cent of children who had completed six years or more of school could not write three dictated sentences. The quality of education, combined with the relevance of the curriculum, the fees and other costs, and lack of job prospects, form barriers and disincentives for students to attend and complete primary school. Low primary completion rates are a particular concern in PNG where only 45 per cent of children who start primary school will complete primary education.

The large number of out-of-school children in the region is especially worrisome because of the impact on the other MDGs. Evidence shows, for instance, that an increase in the share of mothers with a primary or secondary education is associated with a reduction in the child mortality rate, and that educated parents have better nourished children.

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22 SPC (2009)

23 Net primary enrolment rate increased from 39 per cent in 1986 to 94 per cent in 2005.

24 UNESCAP (2006)

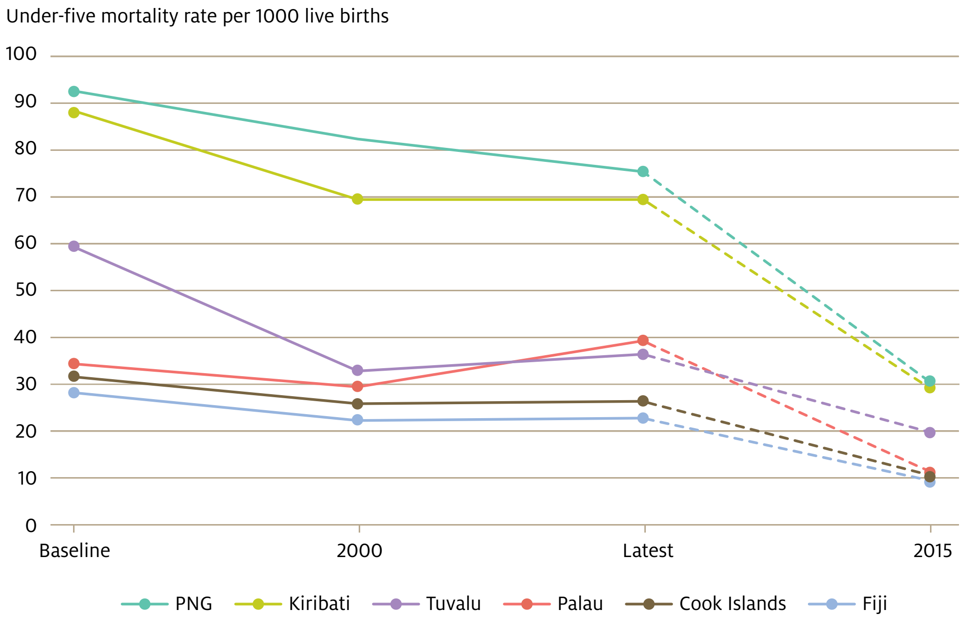
25 Lene (2009)

Urgent action is required to improve child and maternal health

Under-five mortality rates in all Pacific island countries and Timor-Leste are currently better than the average for developing countries which is 80 deaths per 1000 live births. The health status of children in the Pacific has improved from the 1960s as a consequence of general improvements in primary health care coverage and quality, improvements in water and sanitation and programs focusing on child and maternal health. However, only three out of the 15 countries are on track to meet the MDG target of reducing by two-thirds the child mortality rate. Six Pacific island countries are off track to meeting this goal (Figure 3.3).

Countries that started from very poor levels of child health (Solomon Islands, Vanuatu and Timor-Leste), have made good progress in reducing the under-five mortality rate, and if these trends continue they are likely to achieve this MDG target. Relatively good progress was made during the 1990s in improving child health in Cook Islands, Fiji, Kiribati, the Marshall Islands, Palau, Samoa, Tonga and Tuvalu. But since 2000, the child mortality rates in these countries have not changed or, in some cases, have deteriorated (Fiji, Palau, Tonga and Tuvalu). This indicates that further reductions become progressively more difficult to achieve as the under-five mortality rate declines.

Figure 3.3: Six Pacific island countries are off track to reduce child mortality rates by two-thirds



Source: SPC (2009); UNDP and Government of Timor-Leste (2009)

Access to clean water and effective sanitation is essential for a healthy population and environmental sustainability. Globally, the World Health Organization (WHO) estimates that 88 per cent of diarrhoeal disease—a major killer of children in Melanesia—is attributed to unsafe water supply, inadequate sanitation and hygiene. Countries on track to halve the proportion of households without access to safe water supply and improved sanitation include Cook Islands, Fiji, Niue, Palau, Samoa and Tonga. PNG, Kiribati and Timor-Leste are off track to meet this target by 2015. Large disparities between urban and rural populations exist in most countries. For example, in Kiribati, 70 per cent of urban households in 2005 had access to a safe water supply compared to only 37 per cent of rural households.

Only three countries are on track to reduce maternal mortality by three-quarters by 2015

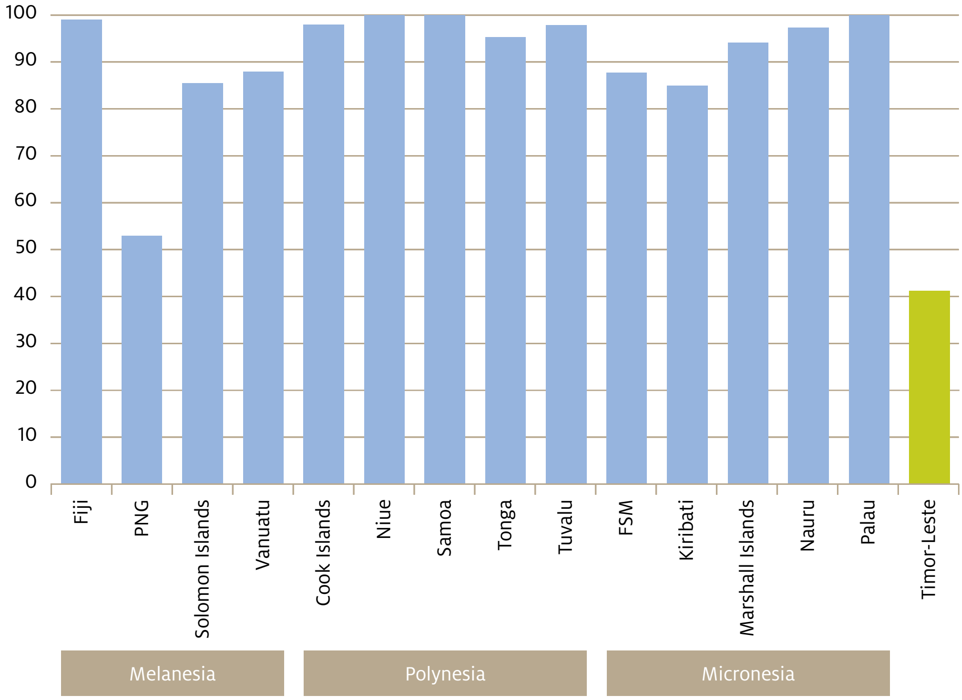
Reducing maternal and infant mortality requires that emergency care be accessible and used by pregnant women experiencing life-threatening complications. Life-threatening complications can occur in all pregnancies and in the Pacific there is a high correlation between mortality rates and delays in receiving required care.[26] This underscores the importance of having births delivered by skilled health personnel and the need for birth attendants to be competent in emergency interventions and equipped with the necessary supplies and equipment (for instance, blood transfusions).

Currently only Samoa, Solomon Islands and Tuvalu are on track to achieve this MDG. Maternal mortality ratios are very high in PNG and Timor-Leste—at 733 and 660 maternal deaths per 100 000 live births respectively. Measuring maternal mortality trends is difficult in the Pacific region: only a few countries have the registration systems needed to monitor maternal deaths and where maternal mortality ratios are estimated through household surveys, large sample sizes are needed because maternal deaths are a relatively uncommon event. For these reasons, the proportion of births attended by skilled health personnel is used as an additional measure of progress towards reducing maternal mortality (Figure 3.4).

26 SPC and UNDP (2004)

Figure 3.4: The majority of births in Polynesia and Micronesia are delivered by trained health personnel

Proportion of births attended by skilled health personnel, various years (% of total births)



Source: SPC (2009); UNDP and Government of Timor-Leste (2009)

As Figure 3.4 shows, in PNG and Timor-Leste, where maternal mortality is highest, access to skilled care at delivery is very low at 53 and 41 per cent respectively. In Solomon Islands, the likelihood of a medically assisted delivery increases substantially with the mother's education level, from 69 per cent among mothers with no education to 92 per cent among mothers with some secondary education. This difference is larger than the rural-urban divide. It also highlights more generally how improving girls' education (MDGs 2 and 3) is important for progressing the other MDGs (including improved maternal health).

In Polynesian and Micronesian countries, the majority of maternal deaths take place in hospitals or health clinics, which indicates that patient monitoring and emergency services need strengthening. In some of these countries, the incidence of maternal mortality rates has increased (for instance in Kiribati and Tonga), raising concerns over the quality of service delivery.

Other health threats are growing

Non-communicable diseases (NCDs) are responsible for an estimated three in four deaths in the Pacific region. Exposure of Pacific populations to preventable risk factors is among the highest in the world. For example, 30 per cent of Samoans are considered overweight, half of Nauru's adult population smokes and less than 10 per cent of the population in the Marshall Islands eats five serves of fruit or vegetables per day. Treating NCDs such as diabetes, heart disease and cancer is expensive and resource intensive, and therefore prevention needs to be a high priority for regional governments and organisations throughout the Pacific.

When coupled with existing high levels of infectious diseases, the rise in NCDs imposes a 'double burden' on the health of individuals and places additional pressure on fragile health systems and human resources. The risks posed by infectious diseases such as diarrhoeal diseases, HIV, malaria, TB, cholera, pandemic H1N1 2009 and dengue fever—in addition to NCDs—can only be responded to effectively through incremental improvements in strengthening national health systems.

The prevalence of infectious diseases varies across the region. HIV/AIDS imposes significant health burdens on PNG, while malaria is common in PNG, Solomon Islands, Vanuatu and Timor-Leste. In other parts of the Pacific, vigorous immunisation programs and improved living conditions have reduced the previously large number of deaths due to infectious diseases. However, deaths and morbidity due to NCDs are increasing and are now considered the leading cause of death in at least eight Pacific island countries.

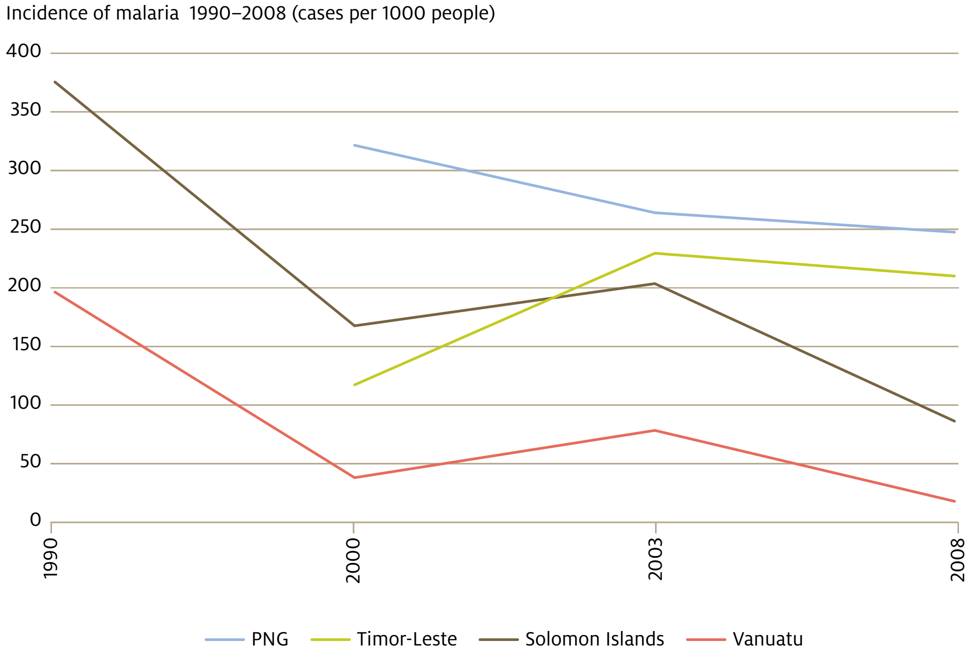
According to the PNG Department of Health, an estimated 76 600 people were living with HIV at the end of 2008. This represents more than 98 per cent of the total estimate of people infected with HIV throughout the Pacific. With a prevalence rate estimated at two per cent of the population, PNG's epidemic has increased exponentially since 2000 when the lowest estimate of infection was 5500. Despite the currently low levels of HIV infection in many Pacific island countries, they are at significant risk of a worsening epidemic. These countries have multiple risk factors in common with PNG. Countries such as Fiji, Samoa and Tuvalu continue to show alarming rates of other sexually transmitted infections (STIs). This signals high-risk behaviour that can eventually lead to the transmission of HIV.[27]

Malaria remains a significant problem in PNG, Timor-Leste, Solomon Islands and Vanuatu. PNG is included in the WHO's 30 high-burden malaria countries. But strong and renewed political commitment in Solomon Islands and Vanuatu, backed by support from international organisations, has seen remarkable progress in rebuilding the reach and effectiveness of their malaria control efforts over the last five years. In Solomon Islands, malaria incidence decreased from 199 cases per thousand people in 2003 to 82 cases per thousand in 2008. In Vanuatu, malaria incidence decreased from 74 cases per thousand people in 2003 to 14 cases per thousand in 2008

27 SPC (2009c)

(Figure 3.5). These two countries are scaling up their malaria programs with the aim of controlling and progressively eliminating malaria, island by island.

Figure 3.5: Solomon Islands and Vanuatu are successfully reducing the spread of malaria



Source: WHO (2008); UNDP and Government of Timor-Leste (2009); Vector Borne Disease Control Program in Vanuatu and Solomon Islands.

TB is a health problem in some countries. Rates range from around 20 cases per 100 000 people in Cook Islands, Samoa, Tonga and Fiji to in excess of 400 in Timor-Leste, PNG, Kiribati and Tuvalu. On top of these high rates, multi-drug resistant TB (MDR TB), TB and diabetes, and TB-HIV co-infections are becoming more common with potentially huge public health implications. The burden of MDR TB is extremely high in FSM, accounting for more than 10 per cent of all newly diagnosed cases in 2008. Treating MDR TB is a long and expensive process and therefore its prevention is a priority for national TB programs throughout the Pacific.

Two separate outbreaks of cholera were reported in Morobe Province, PNG in mid 2009. This is the first confirmed outbreak of cholera in PNG since the 1960s. The first outbreak was in an isolated community in the Siassi district. The second outbreak in Lae presents the most significant risk. Lae is the second largest city in PNG, a hub of economic activity, a major port and the start of the major economic artery of the country, the Highlands Highway.

The threat of emerging infectious diseases, including avian and pandemic influenza, is of growing concern for the Pacific. As of 25 August 2009, the region had 1266 confirmed cases and two deaths of pandemic H1N1 2009 (or swine flu).[28] The ability to respond depends on the strength of animal and human health systems within Pacific island countries, including: national pandemic preparedness planning; trained human and animal health personnel; supply, storage and distribution of medicines; supply of appropriate personal protective equipment; and laboratory testing facilities or testing referral systems.

Dengue fever remains a concern in the Pacific, with several thousand cases and six related deaths reported across 13 countries in the region since September 2008. These figures represent a large proportion of Pacific populations and are likely to increase with climate change bringing more rain and increasing the number of mosquitoes. The potential economic as well as human impact of dengue to the region is therefore considerable.

3.4 Environmental sustainability

Environmental threats are intensifying

One of the most pressing environmental issues facing Pacific island countries and Timor-Leste is climate change. While these countries are negligible contributors to climate change, they are vulnerable to its impacts. Rising temperatures, changes in rainfall, rises in sea level and more frequent, intense tropical cyclones and storm surges are expected to lead to increased flooding of coastal areas, reduced fishery and reef resources, and local water scarcities. Many island nations face high costs but have limited options or resources to adapt to the impact of climate change. In the Pacific, applying better knowledge of trends and local vulnerabilities to building adaptive responses and resilience (for example, by predicting and preparing for sea-level rises and cyclones) are key climate change challenges.

28 The region refers to the 19 Pacific island countries and territories. It does not include Timor-Leste.

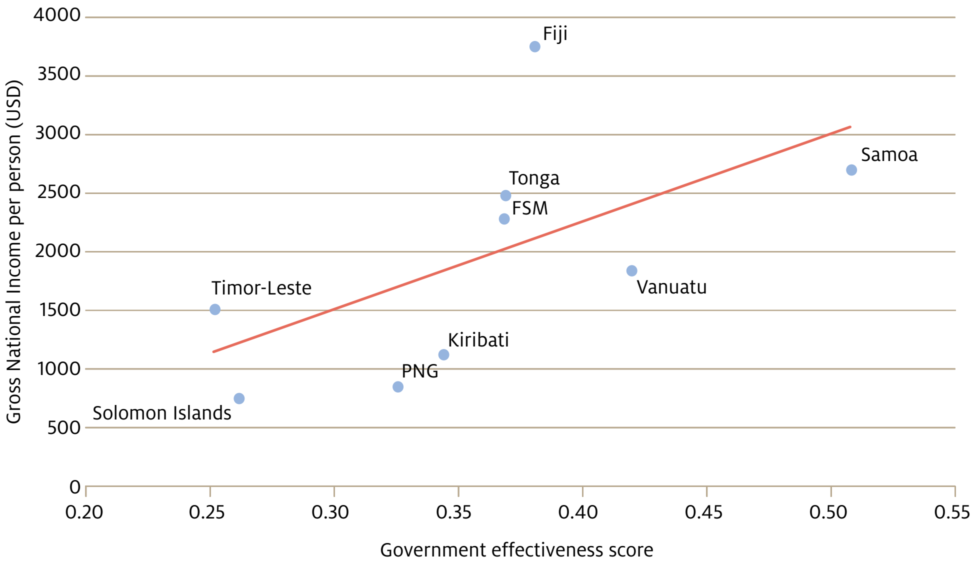
3.5 Governance and the Millennium Development Goals

Governance matters for progress towards the Millennium Development Goals in the Pacific

International consensus is that good governance is a key driver of growth and that, in turn, growth is a key driver of progress towards the MDGs. The cross-country evidence of the link between governance and growth in the Pacific and Timor-Leste is presented in Figure 3.6.

Figure 3.6 uses scaled World Bank scores for government effectiveness for 2007.[29] A simple analysis of this data suggests that a 10 per cent overall improvement in government effectiveness is associated, on average, with a 14 per cent increase in GNI per person. The analysis indicates that if Tonga, for example, had been able to achieve a 20 per cent overall improvement in the quality of service delivery, the capacity of the public service and the quality of its policy formulation, its GNI per capita in 2007 would have been US$2759 instead of its actual level of US$2480.

Figure 3.6: Income increases with government effectiveness



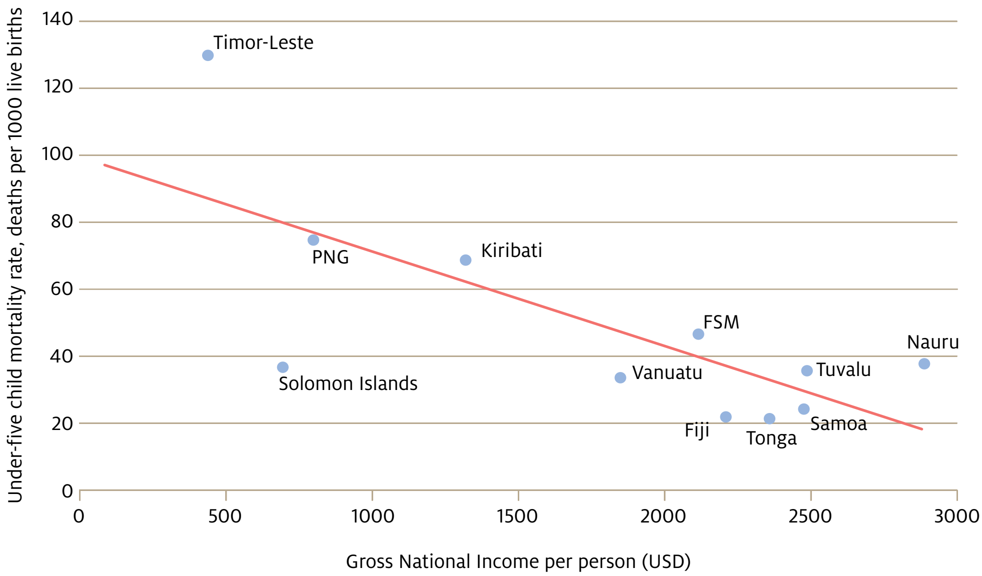
Source: AusAID calculations using data for 2007 from World Bank (2009f, g)

Note: Countries included in the chart are those for which both governance and Gross National Income (GNI) data is available. The Marshall Islands and Palau are excluded as outliers.

29 The World Bank's original scores are scaled so the global average is zero. To simplify the analysis, scores have been rescaled so that the highest score out of 212 countries (Singapore) is one and the lowest score (Somalia) is zero.

Combining this analysis with the equivalent analysis of the cross-country links between child mortality and economic growth provides further evidence of the importance of governance in the Pacific (Figure 3.7). Again consider the case of Tonga. A 10 per cent improvement in Tonga's government effectiveness, by increasing per capita income, would have decreased the child mortality rate to 14 deaths per 1000 live births (from 22 in 2006). In other words, the improvement in government effectiveness would have been associated with eight fewer children per 1000 dying before their fifth birthdays. Across the Pacific region as a whole a 10 per cent increase in government effectiveness would in 2008 alone have resulted in around 1870 fewer children dying before their fifth birthdays in the 14 Pacific island countries.[30] Achieving an improvement in government effectiveness of 10 per cent is not an unreasonable expectation.

Figure 3.7: Income matters for reducing child mortality



Sources: Child mortality data is sourced from the SPC (2009) and GNI per capita data from World Bank (2009g).
Note: under-five mortality rate data is for latest year available and GNI per capita data corresponds to this latest year.

Achieving MDG4 requires a two-thirds reduction in the child (under five) mortality rate between 1990 and 2015. The 1990 child mortality rate for the Pacific region was around 111 deaths per 1000 live births.[31] A two-thirds reduction would see this rate fall to 37 deaths per 1000 live births.

30 The reduction in child deaths is estimated using the projected Pacific region population aged zero in 2008 from SPC Population 2008–15 by one- and five-year age groups, which is just over 250 000 children.

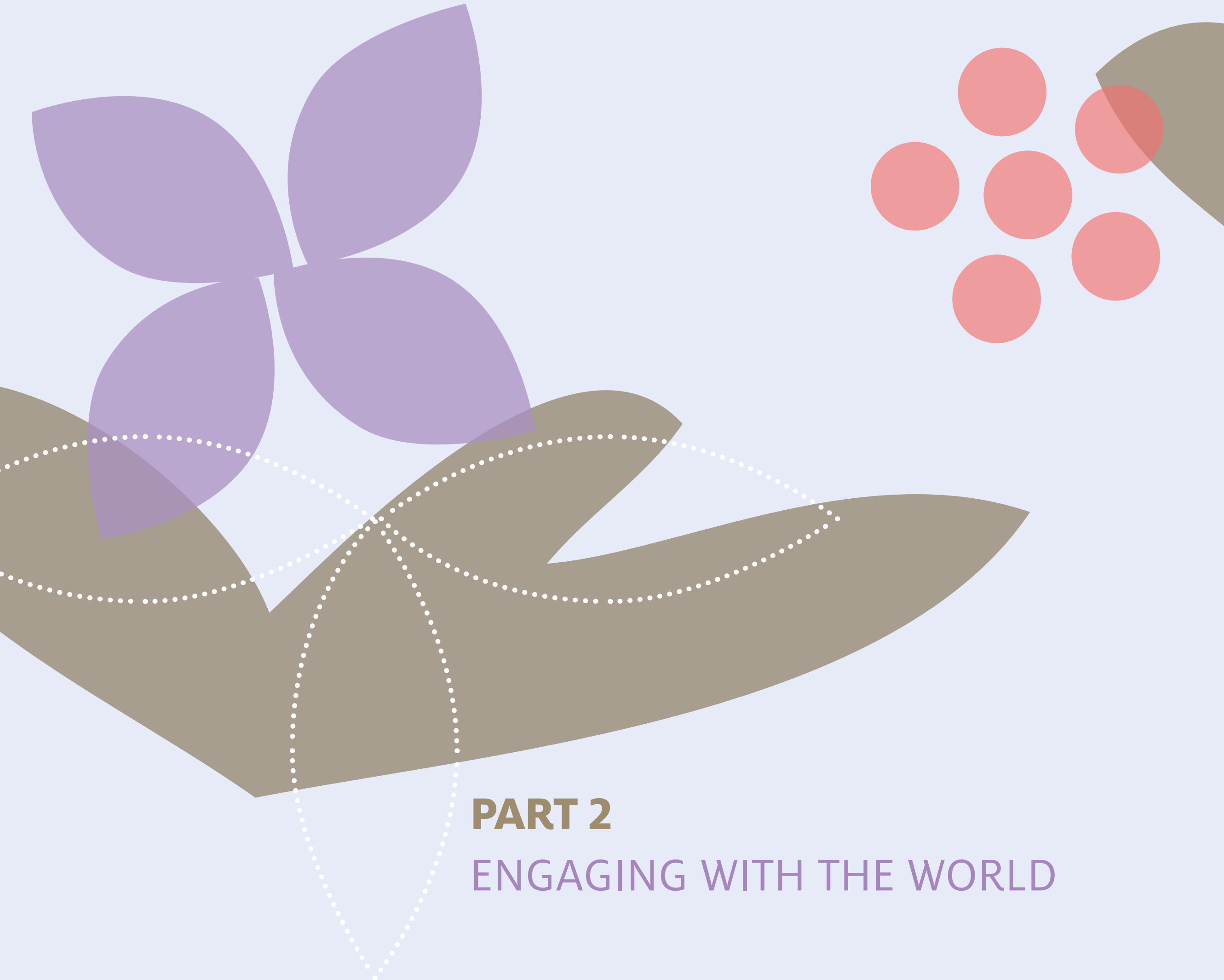
31 Estimated using under-five mortality rates for 1990 or nearest available year, weighted by country shares of regional population. Nauru, Niue and Solomon Islands are not included in this average as their earliest data are for 1999 or later.

This equates to a total of approximately 9800 deaths of children born in 2015. The actual number in 2008 is estimated to be 16 400 deaths.[32] The magnitude of the challenge in achieving such a reduction points to the importance of improving governance and the importance of priorities such as further stimulating economic growth, enhancing the pro-poor nature of economic growth, increasing support for basic service delivery, improving infrastructure and improving development coordination.

The evidence on the importance of governance for development outcomes in the Pacific is only indicative and based on a relatively simple analysis of often patchy data. It is, however, fully consistent with the findings of more sophisticated international research, which has firmly established that better governance means higher growth and that higher growth, in turn, means better human development outcomes.[33]

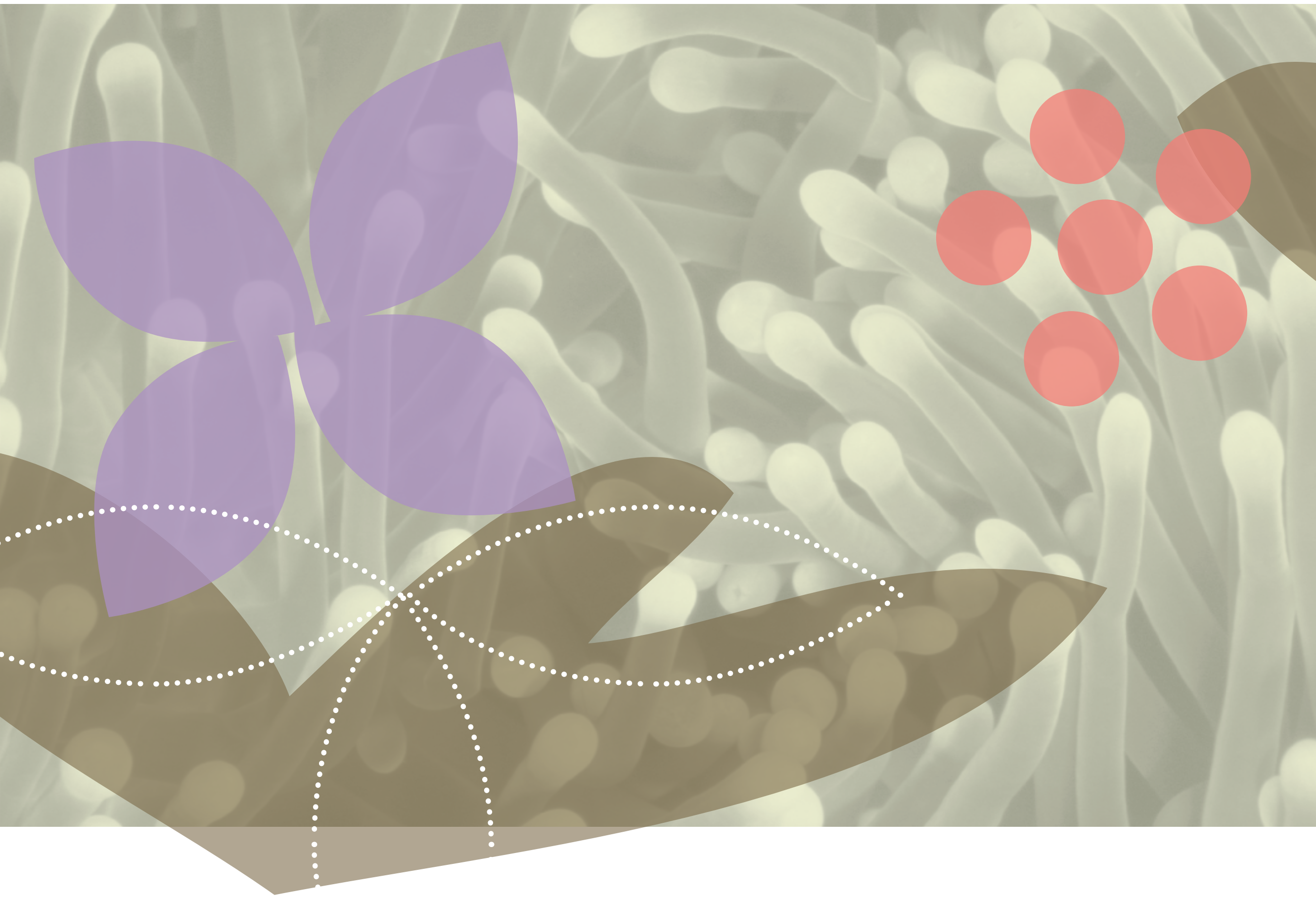
32 This is the estimated number of children born in 2008 expected to die before their fifth birthday.

33 See, for example, Knack S and Keefer P (1995); Newman B and Randall R (1989)



PART 2

ENGAGING WITH THE WORLD



Engaging with the world

The volatile and high food and fuel prices experienced in 2008 combined with the impacts of the global recession provide a powerful case for why Pacific island countries and Timor-Leste need to build resilience to external economic shocks. Without greater resilience to global economic events, their growth may stagnate or fall and the many benefits from growth, including greater progress towards the MDGs, may not be realised.

Part 2 of this survey looks at three areas in which Pacific island countries and Timor-Leste can build their resilience and sustain growth by better engaging with the world:

› promoting trade opportunities

› increasing opportunities for labour mobility

› mitigating food and fuel price shocks

It is useful to look more broadly at reducing vulnerability and, in so doing, building resilience before examining these three areas in detail.

Pacific island countries and Timor-Leste are particularly vulnerable to external shocks, be they environmental or economic. They are challenged by geographic factors. Located on the tectonic 'Ring of Fire', many Pacific islands are volcanically or seismically active, as is Timor-Leste. Their tropical location leaves them vulnerable to storms, with around 10 tropical cyclones forming per year in the south-west Pacific, and a further 20 cyclones forming in the north-west. Islands in the Pacific Ocean are typically small and low-lying, meaning that tsunami waves (generated by submarine earthquakes) and storm surges (generated by tropical storms) can completely destroy communities and farmland.

Their small populations and physical size means Pacific island countries and Timor-Leste are also prone to external economic shocks. Many depend on a very small set of exports and any change in global prices can profoundly impact on employment and economic stability. Remoteness means shipping is the artery of goods trade, and a small change in energy prices can mean the difference between competitive and uncompetitive exports. As Pacific island countries and Timor-Leste are net food importers, energy prices also affect the food security of many communities.

The magnitude and frequency of the shocks they face make Pacific island economies and Timor-Leste particularly vulnerable. They typically struggle to rebound from economic and environmental setbacks and their ability to respond to emergencies without international assistance is limited.

Countries need policy settings that treat shocks as the rule, rather than the exception

While these countries cannot change their geography, they can manage for risk. Countries can strengthen institutions and implement policies that improve their economic resilience and prepare for both economic and environmental shocks. Given their vulnerability to commodity price shocks—in particular energy price shocks—governments have been exploring ways to make their economies more resilient to changes in global prices. Some countries are leading the way in better management of energy imports, but there is still more the region can do to improve policy development around energy and food security.

More effective currency management can help offset external shocks to some degree. But many countries have been slow to respond to global changes and implement good currency-management practices. As a consequence, currencies are often overvalued to lower the price of imports. This has made wages uncompetitive with competing countries and, partly in consequence, Pacific island countries and Timor-Leste still contain sizeable unwaged populations. It has also placed increasing pressure on government management of reserves, many of which are pushed to breaking point when key exports fall and energy prices rise.

Despite a high degree of openness, Pacific island countries and Timor-Leste have fewer opportunities in goods exports

Like many small island states, most Pacific island countries are net goods importers. There is little manufacturing activity in the region, and that which exists is poorly diversified. Countries like Samoa, for example, depend on one company for much of its formal private sector employment, and as such are highly vulnerable to changes in trading partners' economies. The global recession has increased the pressure on production by decreasing prices for commodities, particularly minerals, and lowering partner-country demand for goods and labour.

Growing economies are drawing income from the services sector, particularly tourism and trade in labour

The two main service sector exports of Pacific island countries are tourism and labour, and countries like Vanuatu continue to grow despite the global recession because they are benefitting from both.

Pacific island countries continued to benefit from tourism despite the global recession: bookings are relatively stable and in some countries they are increasing as Australian and New Zealand tourists switch from more expensive destinations to less expensive holidays closer to home. Cook Islands and Palau are the most tourism-intensive economies in the region and are also, by far, the most prosperous.

However for trade in labour the impacts of the global recession on Pacific remittance flows appear troubling. While remittances are often counter-cyclical, unemployment has risen unilaterally in developed economies, including key destination countries for Pacific islanders. Vanuatu is less affected, with New Zealand's Recognised Seasonal Employer Scheme increasing its intake of Ni-Vanuatu workers, but Samoa and Tonga have been hurt by the economic downturn in the United States.

By focusing strategically on assistance that promotes future exports, countries can diversify and strengthen their export base

Many factors contribute to a country's ability to trade. Opportunities for trade can be increased by improvements in the business environment for exporters and by the development of trade-related infrastructure and institutions such as customs, ports and roads. The ultimate goal should be to increase the volume and value of exports, diversify export markets and products in which comparative advantages exist, and attract foreign investment to create jobs and build skills.

Growing populations and urbanisation are increasing pressure on traditional farming methods to adequately supply food for domestic consumption

Urbanisation and the high population growth rates occurring in Pacific island countries and Timor-Leste pose severe challenges to existing farming systems and their ability to produce enough food to meet domestic needs. Consequently, countries are importing many household staples. All Pacific island countries import the bulk of their cereals, for example, and net food imports have increased during the last decade. Only Fiji is a net food exporter, primarily due to preferential access for sugar to the European Union (EU), however, the EU has recently announced it will suspend its support to Fiji's sugar industry. Canned fish is increasingly the protein of choice in the region, replacing canned beef, but challenges remain in ensuring communities receive the nutrition they need to live healthy lives.

The oil-intensive nature of the region means that prices affect everyone—government, business and community

Oil prices peaked globally during mid-2008. Since then, the decline in the price of oil has provided some relief to countries, but there remain serious concerns about the region's ability to cope with future oil price shocks. Growth in Pacific economies means energy demand is increasing, driven by expansion of the services sector (especially tourism) and household demand. The need to provide energy to remote communities in dispersed geographic locations keeps the cost of energy in the region high. The rapid oil price rise in late 2007 through to mid- 2008 highlighted the risks oil dependency poses to Pacific island countries. Only PNG and Timor-Leste are energy exporters. The Marshall Islands declared a State of Economic Emergency in July 2008 to deal with economic pressures exacerbated by the price rise. The October 2008 Forum Economic Ministers Meeting noted the long-term problem of oil dependence in the region and discussed management options, including improved energy efficiency and more production from renewable energy resources.

Many Pacific island countries rely heavily on diesel as an energy source. This is in part a response to remoteness. Only Nauru, Niue, Palau and Samoa have populations that are relatively geographically concentrated. All others have dispersed communities that are difficult to service. For remote and small communities, diesel is relatively easy to access, generators are cheap to purchase and maintain, and smaller volumes of energy can be generated.

Some renewable energy sources may be suited to the provision of off-grid energy in remote areas, but technologies used to generate electricity often require specialised parts and maintenance. In the longer term—as technologies become more reliable, cheaper and commercially proven—the contribution from renewables may become more viable. Currently, however, even larger urban markets are relatively small, dispersed and difficult to serve. The scale of infrastructure needed to provide energy services requires large investments often resulting in long-term overcapacity that reduces cost-efficiency and discourages further investment. But the alternatives available to Pacific island countries are limited. There is no obvious, widely available renewable resource that would provide affordable, reliable and environmentally sound energy, despite much analytic work underway in the region.

Better policies can help manage the risk from global energy prices

Improving energy efficiency can help manage the demand for oil. The region has been slow to adopt energy-efficiency practices and has thus far had difficulty incorporating efficiency into energy planning, building codes, appliance standards, power system operations and industrial development policies. This partly stems from the lack of enabling policies and programs, the lack of information and education and the reticence of customers and energy suppliers to make investments up-front to achieve savings. Donors have tended to focus more on energy-supply approaches and devote only a small proportion of their funds to energy-efficiency programs. But there are also other barriers to optimising energy efficiency, such as the lack of access to energy-efficient technologies and financial resources, as well as market-related and institutional issues.

Samoa's success in managing high oil prices through bulk oil purchasing has encouraged Pacific island governments to investigate cooperative procurement and improve storage facilities. A regional bulk fuel purchasing initiative aims to capture benefits from regional cooperation in purchasing, shipping, port handling, storing, managing risk and distributing petroleum products. But long-term solutions will require vastly improved coordination between government agencies and donors, and in particular a focus on creating cohesive and strategic national plans for the supply and management of energy. Energy departments need to be integrated into the national planning process as the region's economic welfare becomes increasingly tied to energy prices.

4 Expanding opportunities to trade

This chapter examines ways the region is trading with the world, in goods and services, to improve economic growth and development.

Pacific island countries and Timor-Leste are engaging with the world to expand trade and stimulate economic growth

Pacific island countries and Timor-Leste recognise the importance of trade to their economies and are seeking ways to maximise the benefits to their communities through regional and multilateral trade agreements. In the *Pacific Plan*, leaders acknowledge the importance of trade in stimulating economic growth, with a key regional priority being the expansion of markets for goods and integrating trade in services. In Timor-Leste, the Government has commenced work with the World Bank to undertake a Diagnostic Trade Integration Study, a first step toward better integrating trade into national economic development plans.

4.1 Exporting goods and services

Trade is important for economic stability and resilience

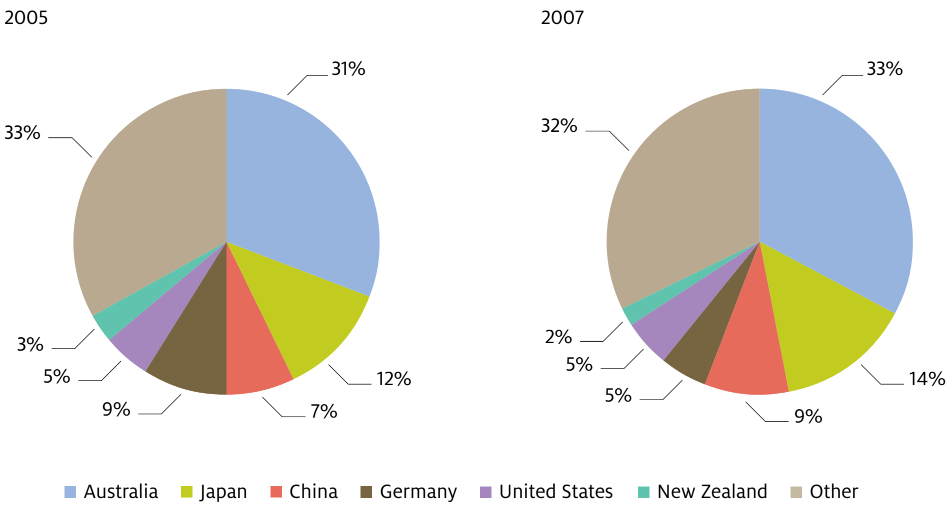
Many Pacific islands countries and Timor-Leste are small in size and remote from global markets. They suffer both environmental and economic shocks that affect exports, particularly when exports are concentrated in a small range of goods and services. A diverse trading base—both trading partners and product lines—can help minimise the impact of individual shocks to trading partners and commodity prices. Trade is also constrained by a range of policy and regulatory factors. Improving productivity and competitiveness in the business sector, improving the policy and regulatory environment for economic growth, and improving infrastructure and education can build a more resilient private sector that can take advantage of opportunities to trade with the world.

Trade agreements are creating opportunities for growth

To expand trade opportunities, Pacific island countries are deepening their engagement with the global trading system. Samoa and Vanuatu will soon join Fiji, PNG, Solomon Islands and Tonga as WTO member countries. Pacific island countries are also engaged in three regional trade agreements: the intra-regional Pacific Island Countries Trade Agreement (PICTA); the European Union Economic Partnership Agreement; and the new trade agreement with Australia and New Zealand (PACER Plus). Timor-Leste has yet to enter into any trade agreements, but as a Special Observer to the Pacific Islands Forum, and as a likely future member of the Association of South-East Asian Nations (ASEAN), Timor-Leste is exploring opportunities to better integrate its economy, regionally and globally.

All Pacific island countries and Timor-Leste have quota-free and duty-free access to the Australian market. For Pacific island countries this is through the South Pacific Regional Trade and Economic Cooperation Agreement, which also grants access to the New Zealand market, and for Timor-Leste it is through Australia's provision of quota-free and duty-free access to least developed economies.

Figure 4.1: Export markets for Pacific island countries and Timor-Leste, 2005 and 2007 (% of total goods exports)

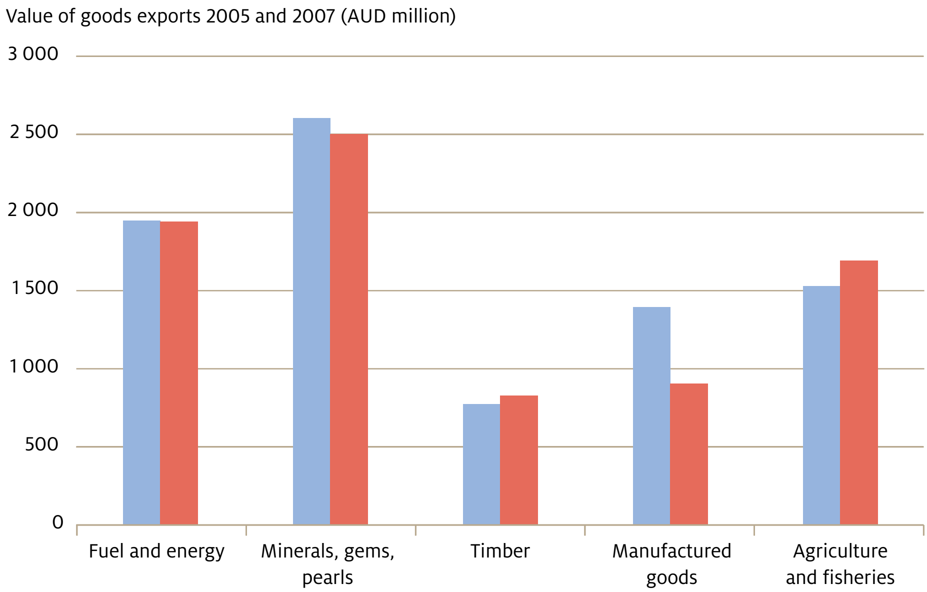


Source: International Trade Centre Trade Map (COMTRADE) 'mirror' data

But despite access to markets, goods trade remains poorly diversified by both partner and product

Diversifying trade can help reduce the impact of shocks. During the global recession, countries with diversified trading partners—both developed and developing countries—have performed better than those without. By identifying export opportunities where countries have a comparative advantage, they can gain more benefits from diversification. But diversification will only add value if countries are truly competitive in these exports. Trading behind subsidies and other distortions is likely to lead to slower rather than stronger growth and distract the private sector from investing in more efficient and competitive industries.

Figure 4.2: Goods exports are concentrated in natural resources



Source: ITC Trade Map (COMTRADE) 'mirror' data

The region's goods exports are primarily minerals and energy

In 2007, minerals and oil exports comprised more than 54 per cent of all trade with the world by Pacific island countries and Timor-Leste (Figure 4.2).

While neighbouring countries like Australia and New Zealand offer easy access, Pacific island countries and Timor-Leste may not be fully exploiting opportunities for trade in other goods, particularly agricultural commodities. Agricultural trade with New Zealand comprised 23 per cent of goods exports (driven by demand for edible tubers and vegetables among Pacific-community residents in New Zealand), but goods trade with Australia is weak outside of mineral and oil commodities with agricultural products less than 1.8 per cent of exports to Australia in 2007.

Minerals form the backbone of PNG's exports, and both PNG and Timor-Leste have liquid natural gas reserves likely to come on-stream in the near future. Solomon Islands and Fiji have inactive gold mines being reinvigorated and Nauru has recommenced phosphate mining. A major source of revenue for Pacific island countries is fisheries, both licensing and domestic processing.

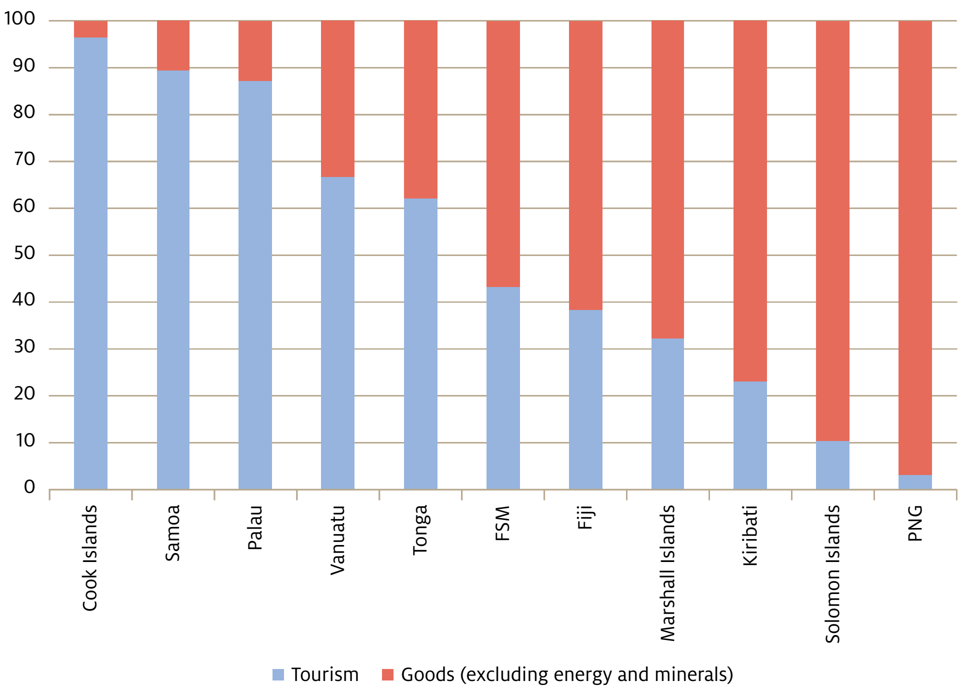
Agricultural products are generally exported in smaller volumes, the exceptions being coffee from PNG and Timor-Leste, vanilla and palm oil primarily from PNG, sugar from Fiji, cocoa and sawn logs from PNG and Solomon Islands and coconut products (copra and copra oil) from PNG and Kiribati. Storage constraints, quality and quarantine challenges, and the cost of transportation from remote locations to market hubs, make it difficult for the region to expand agricultural trade.

Trade in services—particularly tourism and labour—is helping many economies grow

One of the greatest resources of Pacific island countries and Timor-Leste are its people, demonstrated by the rapid growth of the services sector over the last few decades. Many countries now earn more money from tourism than from goods exports. Movement of people is increasing, within the region and around the world, and is discussed further in the next Chapter. Tourism, the other service sector of importance to much of the region, is an area where countries can draw on their diverse cultures to build strong niche markets.

Figure 4.3: Tourism is now a major export earner for some Pacific island countries

Ratio of tourism exports to goods exports, various years (%)



Source: Levantis (2008).

Note: Goods include agriculture, but excludes mineral and energy exports. Data for Timor-Leste is not available.

Tourism is a leading export earner in a number of Pacific island countries. In Cook Islands, Palau and Samoa, the value of goods exports is just a fraction of the value of tourism exports (Figure 4.3). The value of tourism exports also exceeds total goods exports in Vanuatu and Tonga.

In total, tourism export receipts for Pacific island countries reached US$1 billion in 2006, and visitor numbers 1.07 million in 2006. Fiji received around half of all tourists to Pacific island countries with 545 000 visitors in 2006. Average expenditure per tourist in Pacific island countries for that year was US$934. Cook Islands and Palau have built their economies around tourism. Both countries are smaller island states and attract more than four times as many tourists each year as they have residents. Countries that have reformed their aviation sector, such as Samoa, Tonga and Vanuatu, have seen total visitor numbers grow.

The value of spending by tourists can be as important as total tourist arrivals. Tourism numbers to Vanuatu are low relative to its population, but tourists spend more and as a result tourism receipts exceed 20 per cent of GDP.

Table 4.1: Higher-spending tourists are better for business

	Visitors, 2006	Tourism receipts, 2006	Receipts per visitor, 2006
	('000 people)	(USD million)	(USD)
Fiji	545.2	433.3	795
Samoa	115.9	89.7	774
Cook Islands	92.4	96.2	1041
Palau	86.4	93.2	1079
PNG	77.5	139.2	1796
Vanuatu	67.8	92.4	1363
Tonga	40.0	15.7	392
FSM	19.1	16.3	853
Solomon Islands	11.5	14.1	1225
Marshall Islands	8.0	5.7	713
Kiribati	4.4	1.9	428
Total	**1068.2**	**997.7**	**934**

Source: Levantis (2008)

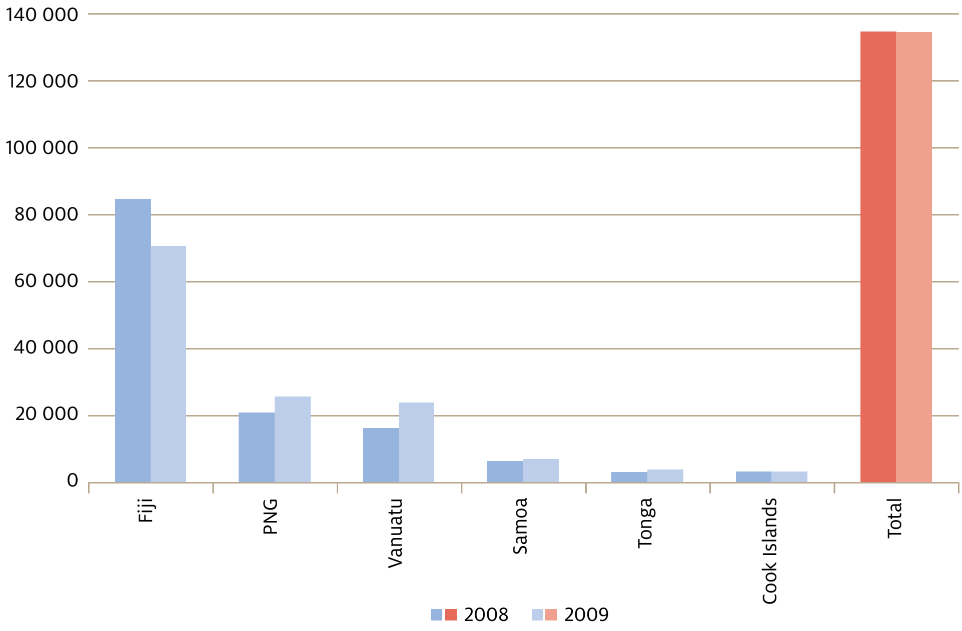
In PNG, the Government has identified tourism as a key economic sector with potential for further development. Total arrivals to PNG grew more than 15 per cent in 2008. Much of PNG's strength as a tourism destination comes from the unique and diverse culture and wide biodiversity within the country.

Tourism appears to be steady despite the global downturn

While arrivals from northern hemisphere countries appear to be falling, Australian and New Zealand travellers are choosing to holiday closer to home and the Pacific islands are benefiting. In Australia, departures in the first five months of 2009 were approximately the same as in 2008, albeit with a 17 per cent fall in visitor numbers to Fiji (Figure 4.4). Falling energy prices and increased competition on many air routes have also ensured that the Pacific remains an attractive holiday destination, and cruise boat lines such as P&O are expanding their activities in the region. In Vanuatu, total tourism arrivals in April 2009 were 24 per cent higher than for the same period in 2008. Fiji is suffering and the tangible decline in visitor numbers to the country can in part be attributed to the political environment.

Figure 4.4: Australians are still visiting the Pacific

Number of visitor departures from Australia to selected Pacific island countries, 2008–09



Source: Australian Bureau of Statistics (2009)

Tourism is good for the region as it has demonstrable pro-poor outcomes

A study of tourism in the Pacific found that around two-thirds of tourism expenditure stays in-country, with the other third spent on imported goods and services or directed to foreign owned tourism businesses. Twenty-four per cent of all tourism export revenues were directed to local labour with a further 25 per cent spent on local goods and services, and 18 per cent to other domestic beneficiaries, including taxes and lease payments. It is estimated that between one-fifth and one-third of tourism export receipts benefit the poor due to the sector's labour intensity, use of low-skilled workers and the opportunities taken up by small and informal business.[34] Tourism particularly offers opportunities to employ women: in Samoa 60 per cent of those employed in the tourism industry are female.

4.2 Developing and diversifying trade in goods and services

Trade liberalisation needs to be accompanied by trade development and facilitation if countries are going to make the most of new opportunities

No country in the world has generated sustained economic growth and poverty reduction by closing itself off to international trade. Trade provides access to a wider range of goods and services, technologies and knowledge. It creates entrepreneurial activity and jobs, and provides opportunities for skills transfer and knowledge development. It attracts private capital and increases foreign exchange earnings. Most importantly, it can lead to equitable, sustainable economic development and poverty reduction.

But trade liberalisation is not an end in itself and, as many countries have discovered, liberalisation does not guarantee that the benefits of trade will flow immediately. For the benefits of trade liberalisation to be fully realised it must be accompanied by an improvement in domestic resources and domestic competitiveness. This includes improving skills, knowledge, technology, and the business enabling environment including improving access to finance.

Countries that improve competitiveness and build a robust private sector find it easier to benefit from international trade. Good domestic policy settings form the foundation of a growing export base.

Niche markets provide valuable opportunities

Product differentiation is increasingly important for commodity exporters. An identifiable, high-quality commodity will attract a higher price at market. Product differentiation, through branding, certification programs and value-adding, offers potential for improving returns to farming communities. Exporters are also finding success by using agricultural products in new and innovative ways. Beauty products are a growing industry, and exporting companies include Pure Fiji and Vanuatu's Volcanic Earth (Box 4.1).

34 Overseas Development Institute (ODI) (2007)

Box 4.1: Exporting beauty from Fiji

Pure Fiji, established in 1996, uses the country's natural resources to produce beauty products that are sold around the world, used in day spas at Four Seasons Hotels and coveted by Hollywood. Pure Fiji has attracted numerous accolades for its founder, Gaetane Austin, including the 2003 Fiji Businesswoman of the Year Award, Exporter of the Year Award, and Excellence in Tourism Award. By using local products and branding that capture the spirit of Fiji's organic products, Pure Fiji has become an international export success.

Pure Fiji takes a strong community development approach to its business. About 75 per cent of its 55 employees are women and at the core of its operations is a commitment to support the communities the company works in and protect the environment. Raw materials used in its products, such as cold-pressed coconut oil, natural papers, masi (bark cloth) and woven baskets are all sourced from community projects in Fijian villages. The income from the sale of these items has enabled communities to purchase water tanks, pay for school fees and improve nutrition and health.

Certification offers farmers the opportunity to earn more for their products

Certification programs like Organic and Fairtrade have the potential to generate higher returns to farmers. Organic certification, where produce is certified as having been grown without the use of chemicals, is made simpler in those farming communities where there has been limited use of pesticide and chemicals in agriculture. Certification programs also have the potential to achieve social outcomes. Certification programs like Fairtrade include a component that delivers benefits to communities and ensures ethical labour practices are used on farms. But certification programs can be costly and have not been widely adopted as the process of obtaining certification can be difficult for small producers.

Certification programs like Fairtrade can be effective in helping women and marginalised producers integrate with international markets. Gender equality is a key principle of Fairtrade, which ensures women's work is paid and valued equally and that women gain leadership, decision-making and managerial positions within their cooperatives.

Box 4.2: Vanuatu organic beef

Vanuatu beef is known throughout the Pacific region for its high quality and exceptional flavour. The beef industry in Vanuatu is thriving, with exports in 2007 accounting for around six per cent of goods export. Around two-thirds are sold on the local market and the rest exported to other Pacific island countries, Japan and Australia. Vanuatu beef can be found in the best restaurants throughout the region.

The industry comprises large- and small-scale producers, with the cattle population roughly 160 000. Cattle are farmed on Efate in coconut plantations, or the outer islands (primarily Santo or Malapula) where the cattle is fattened on local flora. With year-round rain and a volcanic landscape, Vanuatu's soil is arable and nitrogen-rich, a combination that produces long grasses all year. Feeding hormones to cattle is illegal in Vanuatu, grain feed is not used, and the cattle receive Organic certification which enables the beef to be sold at a premium price to markets overseas.

Improving the skills base can promote trade

Formal skills training underpins a workforce that allows the private sector to grow and innovate. The lack of skilled tradespeople has constrained many businesses, and service industries such as tourism need efficient managers and operators if they are to reach their full potential. International experience also creates innovation. Entrepreneurs often bring ideas home from overseas, and all exporters need a sound knowledge of the needs and wants of their export market. Increasing the movement of people both within and outside the region helps build a knowledge base for export of both goods and services.

Box 4.3: The Body Shop buys Samoan

Women in Business Development Inc. (WIBDI) is an innovative NGO which has become an engine for the development of women's enterprise. WIBDI commenced in 1991 with the goal of providing training, access to finance and small-enterprise development to women in Samoa. What began as a women's group has since grown to include men, youth, the elderly, people with disability and people with HIV-AIDS.

WIBDI were early adopters of the concept and practice of organic farming. Sheree Stehlin, a founding member, said she sought to teach traditional farming methods '... the way our ancestors used to farm, without damaging chemicals.' WIBDI helps organic farmers achieve organic certification. To date more than 200 farms are certified and more are on the waiting list. WIBDI is now the lead organisation for the promotion of Organic and Fairtrade certification programs in Samoa.

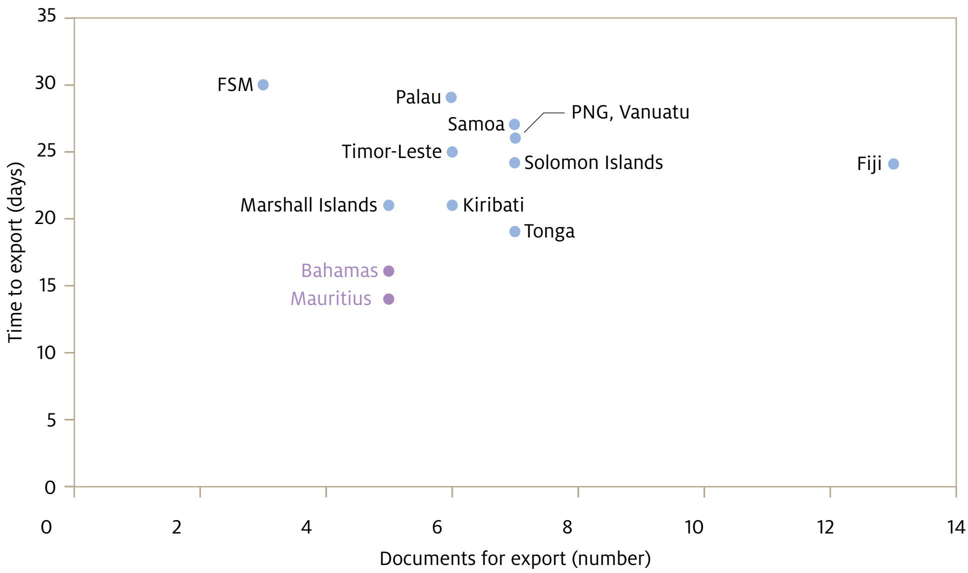
Organic certification led to internationally recognised success when natural beauty product retailer The Body Shop contracted WIBDI to provide virgin organic coconut oil for use in its products. The partnership between WIBDI and The Body Shop is managed according to fair trade practices, with WIBDI acting as marketing agent but with all money going to farmers. Coconut oil, derived from Samoa's most abundant crop, is extracted by the certified organic farmers, using the standards and methods approved by the international certifying teams. Farmers must also meet The Body Shop's Community Trade standards, which include rules around children's participation in farming activity.

The Body Shop's coconut range was re-launched in July 2009 and Samoan coconut oil can now be found in beauty products sold around the world.

Better trade facilitation can build trade for a small investment

Countries with efficient customs and quarantine systems, good transport networks and fewer document requirements (making compliance with export and import procedures faster and cheaper) are more competitive globally. Studies suggest that eliminating red tape at country borders will generate approximately twice as much benefit to GDP than tariff liberalisation, and will especially benefit developing countries in which bureaucratic inefficiencies are sometimes more costly to business than are tariff barriers. Indeed, studies suggest that each extra signature an exporter has to collect reduces trade by 4.2 per cent. Yet Fiji has 13 documents to complete before goods can leave the country—more than any other small island state in the world—and FSM is among the slowest of the small island states to export goods (Figure 4.5).

Figure 4.5: Trading across borders is a lengthy and often complex procedure in the region



Source: World Bank (2009b)

According to the 2009 World Bank's Doing Business indicators for the hardest places in the world to trade across borders, the Pacific ranked poorly with Palau at 130 and Vanuatu at 136 out of 181 economies. Palau is improving, however. The country now accepts electronic customs declarations, cutting the time to import by two days. Countries working from a low base have the opportunity to gain easy wins by simplifying and modernising procedures. Some Pacific island countries such as Fiji, Tonga and PNG—through the regional body Oceania Customs Organisation—are also starting to focus on modernising their customs systems. This will enable these countries to begin to identify national priorities for assistance and more accurately record and manage their cross-border trade as required to align with regional trade agreements.

Improving the business environment can have a big impact and lead to more broadly-based growth

In Pacific island countries and Timor-Leste, work by the World Bank and IFC has shown that onerous and inefficient licensing of business is a major constraint to private sector development.[35]

35 IFC and World Bank (2009)

Permits for business activities such as fishing and selling liquor can take a long time to issue, meaning entrepreneurs must either break the law or not engage in that activity. For women, travelling to urban centres to obtain permits and licenses can be difficult as it takes time away from family and community responsibilities. Licensing for business activities conducted in cash may also be open to corruption. Simplifying licensing and introducing online services where possible, can make a major difference to making entrepreneurs efficient and can increase government revenues through improved compliance and reduced corruption.

A number of studies have shown that when it is easier for entrepreneurs to do business, more women are likely to participate in economic activity. Gender inequality is linked to countries' economic performance, with less equal countries having greater poverty than more equal countries. It is estimated that restrictions on women's participation in Asia and Pacific economies costs the region between US$42 billion and US$47 billion a year in 2007.[36]

Therefore, improving the business environment, particularly ensuring that women and men have equal access to finance, property and commercial rights, creates stronger and more resilient economies with benefits flowing to communities and families. Research shows that as women gain control of money and household budgets, more is spent on education, health and nutrition. A more inclusive private sector is good for business, and for achieving the MDGs.

Good policy settings that encourage tourism investment have yielded results in the services sector

Countries that have reformed their aviation markets through liberalisation and privatisation have seen strong growth in tourism on the back of lower-priced airfares, particularly in countries like Vanuatu and Samoa.[37] The introduction of competition in telecommunications and better, cheaper mobile phone services has helped individuals and businesses throughout the region connect to global markets more effectively. Countries that identify high-cost inputs to business activity in restricted sectors can help grow businesses simply by deregulating.

Trade in many goods and services is constrained by weak business infrastructure and difficulties accessing land

A recent study of business in PNG found that transport, access to markets, access to finance and the availability and cost of electricity were the most significant barriers to business activity, and this finding applies throughout the region. Ports, the arteries of global trade, are among the most expensive and least efficient in the world, and most can only meet basic commodity shipping needs. Most are cramped, poorly maintained, lack adequate cargo sheds and have few cargo-handling facilities.

36 UNESCAP (2007)
37 AusAID (2008)

Tourism also requires good infrastructure, in the form of roads, airports, tourist ports, electricity, waste and water services. In Kiribati and FSM, lack of sanitation facilities and the pollution of lagoon waters make for far less desirable tourist destinations. Despite the importance of cruise tourism in the region, few countries have dedicated resources to improved passenger terminals, and this is threatening the attractiveness of the region to cruise ship operators.

Box 4.4: Tourism reaches remote communities in Vanuatu

Tourism has helped Vanuatu to become the strongest performing economy in the region. Estimates suggest that, on average, a one per cent increase in tourist arrivals results in a 0.5 per cent increase in real GDP, and the sector employs around 10 000 people—more than a third of all formal sector employment. Many more benefit from informal enterprise, selling souvenirs and handicrafts and providing services to visitors.

Vanuatu's tourism sector has grown strongly in response to successful reforms instigated by its Government. Aviation liberalisation undertaken in 2004 resulted in the arrival of Pacific Blue, and the following 12 months saw tourist arrivals from Australia increase by 19 per cent. The global recession poses a potential threat and, despite tourism arrivals growing in the first quarter of 2009, there are risks that travellers will delay holiday plans or decide to visit countries where heavy discounting of airfares and hotel accommodation is occurring. The Government of Vanuatu is initiating a marketing program by the Vanuatu Tourism Office to strengthen the country's brand as a tourist destination.

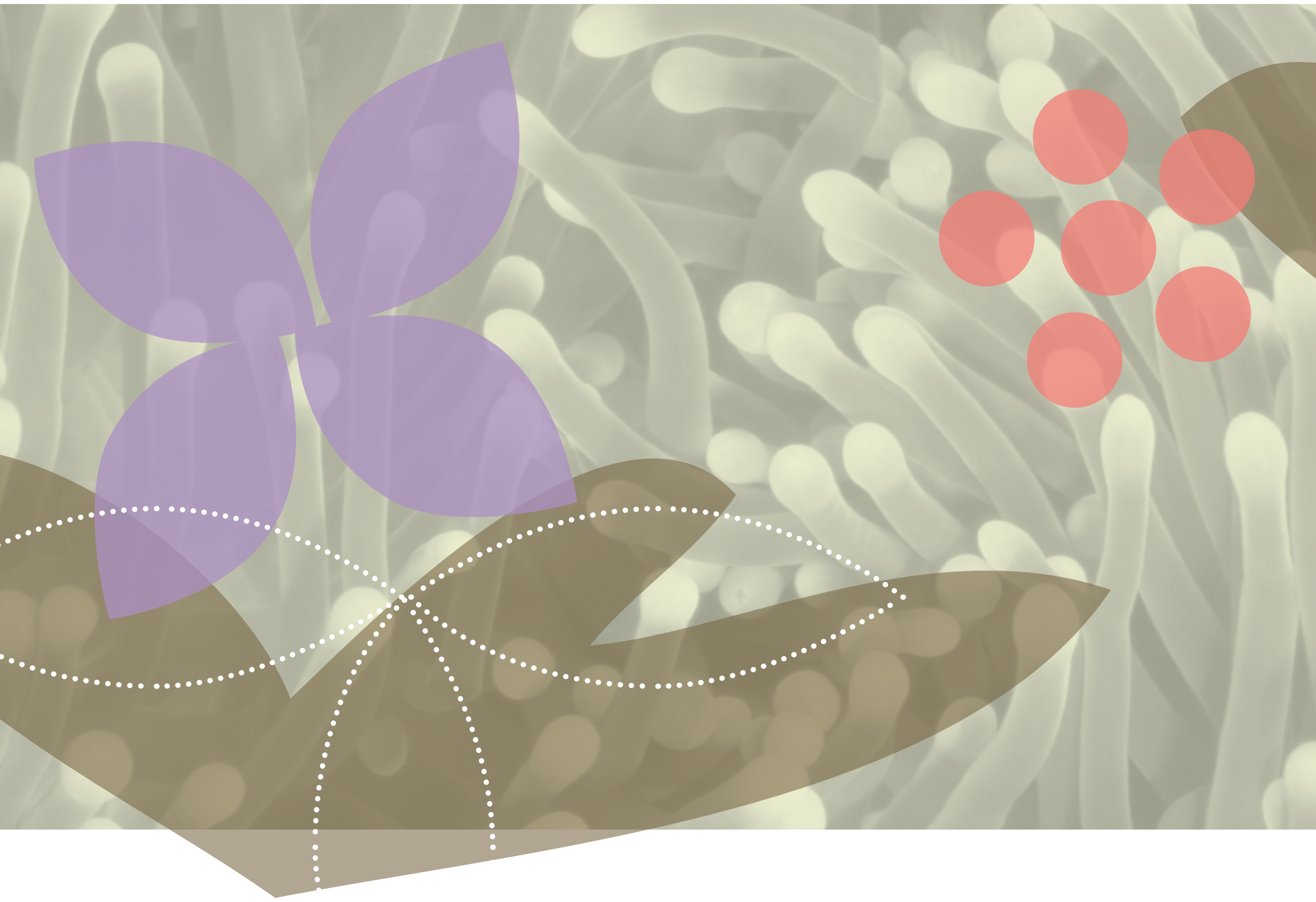
Cruise ship tourism is a growing business for Pacific islands countries and has the added advantage of allowing tourists to reach remote islands where air services are infrequent or non-existent. One company, Carnival Australia, brings more than 150 000 passengers to Pacific island countries each year. The company's ships visit Port Vila, the capital of Vanuatu, and also more remote parts of the country. But poor docking and other facilities in many remote locations, together with the increasing size of the cruise ships, makes it difficult to visit these areas. As a result, Carnival Australia is helping to upgrade post facilities to help bring more tourists to regions away from Port Vila, including Mystery Island, Wala Island and Champagne Beach. Carnival Australia will upgrade jetties, build sanitary facilities and provide fresh water supplies. Construction will use sustainable techniques, with rainwater used for toilet facilities and a solar-powered treatment system allowing waste to be used for irrigation.

Carnival Australia also recognises that many tourists want to trade with local producers by purchasing handicrafts and 'experiences' like bicycle tours, kayaking, bush walking and cultural activities. The company, as a result, is helping to train local traders in hospitality, financial management and development of small enterprises so locals can create interesting holiday experiences for tourists visiting their communities and generate greater income for their families. This initiative, if it proves successful, could point the way for other regions wishing to attract tourists to remote island locations.

Enterprise is growing most strongly where land is easy to access. Vanuatu has a well developed land market with secure long-term leases. In Fiji, the Native Lands Trust Board—the agency responsible for mobilising and leasing customary land—plays an important role in directing tourism development. The high fragmentation of land ownership in Cook Islands makes the leasing of large parcels of land difficult, which may explain the predominance of small tourism operations and the low levels of large-scale farming activity. For most other countries, leasing land is an option, but one that often requires a lengthy process.

Governments can promote trade by linking trade and development policy

Pacific island countries and Timor-Leste prioritise trade as a way to reduce poverty and increase economic growth. But if countries simply liberalise markets without ensuring producers can use new market access opportunities, their trade policies will fail to impact on development.
Trade policy and development need to be planned, implemented and managed in an integrated way. Strong, positive development outcomes are likely when low-income communities are targeted by good policy reforms designed to improve the ability to trade.



5 Connecting to labour markets

The movement of Pacific island and Timor-Leste labour regionally and globally is an increasingly important source of income for countries

The previous chapter highlights the importance of trade to Pacific island countries and Timor-Leste, and shows that services are a growing source of income for the region. Labour migration offers opportunities for a more prosperous region. But the movement of people also has a range of social impacts that need to be taken into account by policy-makers. This chapter will examine some of the benefits, challenges and good practices for labour mobility in Pacific island countries and Timor-Leste.

5.1 Labour mobility in the region

Labour mobility creates income, develops new skills and improves standards of living

With demographic change in developed countries, the demand for skilled and unskilled migrant workers will continue to rise, particularly in horticulture, construction, health, domestic services and hospitality sectors.[38] Matching these needs with the supply of skilled and low-skilled labour will bring mutual benefits for sending and host countries.

Sending countries can benefit from labour migration in several ways. Individuals acquire new skills, gain employment experience, and grow through cultural and social exchange. Individuals also earn an income of which a share is often sent back (or remitted) to family members and community organisations back home. Temporary migrants are also likely to save some of their income to reinvest for when they move back to their home communities. The World Bank estimates that free movement of labour globally would increase gross wages by US$356 billion, or 0.6 per cent of world income which is the equivalent of three times that of all aid flows during 2003.[39] The important role of remittances in supporting domestic economic activity and reducing poverty in many Pacific island countries is examined in Section 5.2.

38 Pritchett (2006)

39 World Bank (2006) For detailed modelling, refer to Walmsley and Winters (2005)

Host countries benefit by gaining access to a supply of workers otherwise unavailable. Many developed countries have experienced very low levels of unemployment over the last decade meaning there are fewer workers for temporary skilled and low-skilled jobs, particularly in rural or remote areas. Ageing populations means there is growing demand for health and domestic service workers.

Labour mobility also promotes regional integration. The economic and social connections developed through the movement of people can be a powerful catalyst for integration, promoting cross-border industry, knowledge sharing and cultural understanding. Cooperation to manage the movement of workers and protect workers' rights from exploitation creates closer ties in policy and practice between sending and host countries.[40]

Labour mobility, however, is also accompanied by a range of challenges and costs for sending countries. The most significant adverse impact faced by sending countries is the loss of skilled people or 'brain drain'. The temporary or permanent loss of skilled labour may arguably result in short-run capacity constraints, restricting economic growth and hampering the delivery of social services. Temporary migration, as opposed to permanent migration, can help minimise some of these adverse impacts (Box 5.1).

Box 5.1: Managing the challenges and benefits of migration

Temporary and permanent labour migration has accelerated in the last decade, with people from Pacific island countries and Timor-Leste taking up job opportunities in the region and further afield. One main concern for sending countries is brain drain. However, these impacts can be minimised and the gains from labour mobility maximised when people move temporarily for employment opportunities, rather than exiting permanently.

Temporary migrants often retain closer family and community ties, minimising social costs. They are also more likely to send greater remittance volumes to their home country than are permanent migrants. Expectations of returning home can also result in increased savings and plans to invest money in education, enterprise and community development. Most importantly, temporary migrants may gain new skills which they can then bring back and contribute to their home country's development. Temporary migration therefore helps to minimise some of the social and economic costs borne by sending countries arising from the permanent exit of their human capital.[41]

There are two types of temporary migration: circular and short-term. While short-term migration can be seen as a one-off opportunity, circular migration programs allow people to move to work, return home, and then move to work again. Circular migration programs have two main advantages over short-term migration programs: there is more incentive for business to invest in skilling-up circular migrant workers, and there is more incentive for workers to leave the host country knowing they can return.

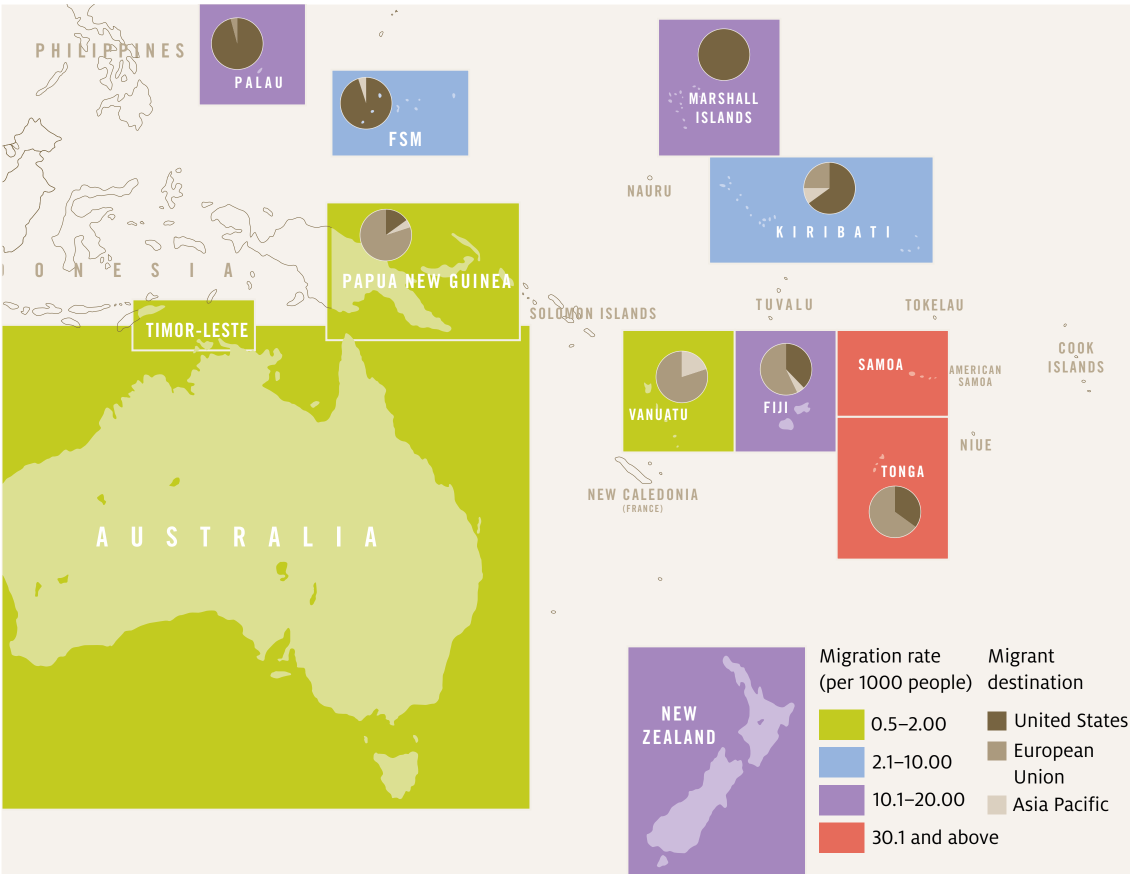
40 See Chia Siow Yue (2006)
41 World Bank (2006c)

Pacific islanders move mainly between Pacific island countries, Oceania, Europe and America

The movement of people to places where they can find employment is well understood in the Pacific. Historically, workers have moved both within and between countries to provide labour when employment opportunities arise.

Figure 5.1: Pacific migrants are spread across the globe

Gross migration rate



Source: Gibson and Nero (2007)

Note: This map does not show intra-regional migration

As shown in Figure 5.1, people have traditionally tended to move to countries with close ties to their own through shared history or family links through past migration (the diaspora). Micronesians have strong links with the United States and Polynesians and Melanesians to Australia and New Zealand. People from Timor-Leste have moved to Australia, Indonesia and

Portugal. But wider labour migration opportunities for Pacific islanders are available globally, including in Asia and the Middle East.

Some Pacific island countries are facing skilled labour shortages of their own in the construction, mining and tourism sectors. Facilitating greater intra-regional labour migration represents an important opportunity for many workers and can help build Pacific regional integration.

Box 5.2: New Zealand and Australian labour mobility schemes

Pacific islanders now have access to labour markets in New Zealand and Australia through their respective circular labour mobility programs. New Zealand's 'Recognised Seasonal Employer' (RSE) scheme and Australia's 'Pacific Seasonal Worker Pilot Scheme' (PSWPS) aim to address domestic labour market shortages in horticulture. The RSE and PSWPS are substantial steps towards greater integration of labour markets within the region.

For participants in both schemes, work can last for up to seven months. Employers must pay at least the minimum wage, guarantee 30 hours per week and are responsible for providing acceptable working conditions and accommodation. These arrangements are closely monitored through government agencies, local advisory bodies and community organisations.

Assessments of the RSE show good pro-poor development outcomes.[42] Development impacts from the PSWPS are soon to be assessed by the World Bank; however anecdotally the scheme is producing positive outcomes. Tongan seasonal workers working in Victoria and Queensland, for example, have sent money home to build a solar energy source on an island which previously did not have electricity.[43]

Formal employment may be supplemented through additional training in the PSWPS and the RSE. Pacific seasonal workers may access skills training for financial literacy, basic literacy and numeracy. Within the PSWPS additional training opportunities will become available in Pacific seasonal workers' home countries.

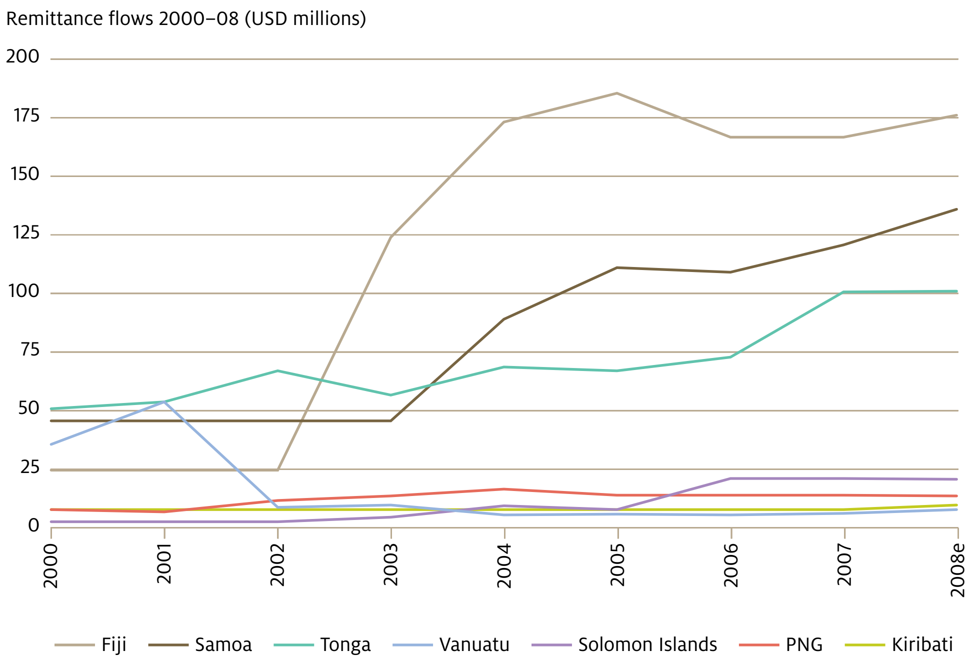
42 Gibson, McKenzie and Rohorua (2008)
43 *Courier-Mail* (2009)

5.2 Remittances

Some Pacific island countries are benefiting from remittances, an important and growing source of income for development

The benefits of remittances are many and they are well-documented.[44] Firstly they can be an important source of foreign exchange earnings. Secondly, they may serve as a defacto social safety net—when times are hard at home workers try to send more money to help their families. Thirdly, spending remittances on goods and services contributes to a country's tax base and increases government revenues. Remittances also tend to increase during times of crisis or low economic growth in the recipient country.[45] After the Indian Ocean tsunami in 2004, for example, affected countries in Asia saw remittance inflows increase by 33 per cent.

Figure 5.2: Remittances are an important source of income in some countries



Source: World Bank (2009h)

Note: e refers to estimate

44 World Bank (2003)

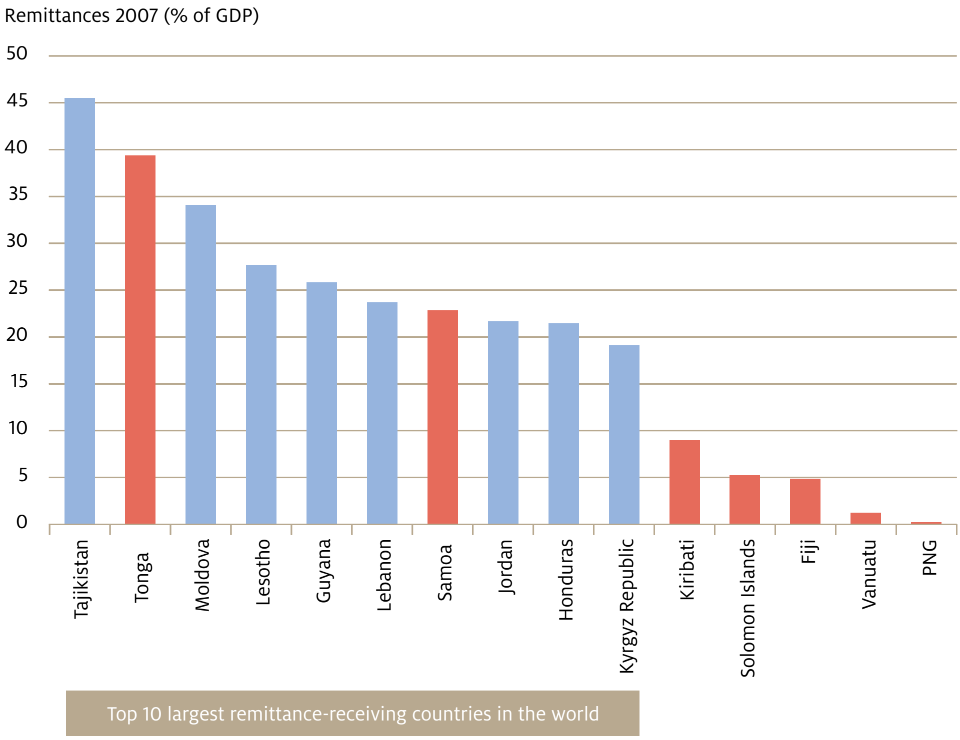
45 ibid

However, remittances may be negatively affected when remittance-sending countries experience economic instability and low growth. The World Bank forecasts, for example, that due to the current global recession the value of remittances worldwide will decline by 7.3 per cent in 2009.[46]

Remittances globally are an increasingly important source of income and this is also true for many Pacific island countries. In the Pacific, remittances paid to Pacific islanders by family members and others working overseas have grown strongly in the last decade, and totalled an estimated US$446 million in 2008 (Figure 5.2).

Some Pacific countries are also the world's highest recipients of remittance flows relative to the size of their economies. Tonga and Samoa are among the top 10 remittance receivers in the world (Figure 5.3).

Figure 5.3: Some Pacific countries receive the highest levels of remittances in the world



Source: World Bank (2009c)

46 World Bank (2009c)

In Tonga, remittances are equivalent to 39 per cent of GDP and 90 per cent of households report receiving remittance income through cash transfers or in kind.[47] In Samoa, migrants to New Zealand, the United States and Australia sent the equivalent of 23 per cent of GDP home during 2007. Kiribati—primarily through seafarers—remits approximately nine per cent of GDP and this is likely to grow as I-Kiribati workers are integrated into Australia and New Zealand's seasonal-worker programs.

In Melanesia, the relative volume of remittances is lower, although this may change as greater opportunities for labour migration emerge and are taken advantage of. Remittances to Vanuatu are expected to rise following participation in the New Zealand RSE scheme. Fiji has seen migration and remittances increase dramatically since the 1980s and now more than 43 per cent of households receive income from this source.[48] Some studies suggest that Fiji now has more than 15 per cent of its population living overseas, a trend which accelerated in the wake of the 1987, 2000 and 2006 coups.[49]

Remittances can contribute to economic growth and progress towards the Millennium Development Goals

Remittance flows globally are second only to foreign direct investment in developing country income and, in some countries, remittances exceed aid.[50] Remittances are an important source of foreign exchange for governments and when the money is spent in the community it may contribute to government revenues through taxes.

Remittances contribute to development in a number of ways. Increasing incomes for families and communities at home helps reduce income poverty. Remittance income allows families to spend more on healthcare, improved nutrition and education. In Pacific island countries, studies have shown that remittances to Tonga and Fiji provide strong benefits to poorer households.[51] Global evidence shows that remittances often finance education.[52] In El Salvador and Sri Lanka, for example, children from remittance-receiving households have lower school drop out rates than those in households that do not receive remittances. In Fiji, remittance-receiving households invest more in tertiary education.

Remittances and labour migration offer both social and economic benefits to women

Labour migration and remittances sent home to family members can contribute to improving gender equity and improvements in other development outcomes. Women working overseas learn new skills and new ways of operating. On return, they may be motivated to question existing policies and practices, become more politically active and take on leadership roles.[53] Its is also

47 Non-cash transfers include assets such as cars and farm machinery, or consumables such as clothing and food items.
48 World Bank (2006)
49 ibid.
50 Department for International Development, United Kingdom (2007)
51 Brown R and Jimenez E (2008)
52 World Bank (2003); Chand and Clemens (2008)
53 United Nations International Research and Training Institute for the Advancement of Women (2006)

observed that developing countries with migration links to low fertility countries have lower fertility rates than similar countries with links to high fertility countries.[54]

Remittances can have a positive impact on women's access to education. In the Dominican Republic, remittance income has been shown to improve girls' access to higher education. In Pacific island countries, investment in children's education occurs particularly if remittances are made by women and to women.[55] Remittances can also be a source of financing for small-scale enterprises, many of which are run by women. In the Dominican Republic, for instance, five per cent of households receiving remittances use the money to begin new businesses, the majority of which are owned by women. Across Latin America and the Caribbean, the rate of remittance-funded entrepreneurship ranges between one per cent and 17 per cent.[56]

Governments, donors and the private sector are helping countries to maximise the benefits of remittances

Recognising the development potential of remittances, development partners are working with sending countries to lower the transaction costs of sending remittances, improve data collection, extend the availability of financial services to poor people and rural areas, and fund research on the patterns and uses of remittances.

Regulatory changes can also lower the cost of sending remittances. In response to global money-laundering concerns, many countries require money senders and receivers to demonstrate their identity. This creates difficulties for low-income recipients who may not have standard identification documents like passports and birth certificates. New Zealand has reduced regulatory requirements on identification for small transactions totalling no more than NZ$10 000 in one year. This means workers can use low-identification accounts to send remittances, significantly lowering transaction costs for remittance service providers and making it easier for families to access funds.

Creative policies in South Asia and Central America demonstrate policy innovation to maximise development impacts from remittances.[57] Mobile phone banking has made sending remittances to South Asia more accessible. Some communities in Central America and Tonga are pooling their remittances to invest in community infrastructure such as schools, parks and clinics. In certain cases, local contributions are matched with funding from local governments.

54 Department for International Development (DfiD) (2007)
55 World Bank (2006)
56 United Nations International Research and Training Institute for the Advancement of Women (2006)
57 Lirne Asia (2009); World Bank (2006b)

Box 5.3: Reducing the cost of remittances to the Pacific

An increase in remittances can lead to sizeable poverty improvements, making many governments concerned about the high cost of sending money. Given the significant numbers of people with family members in the Pacific islands who live and work in Australia and New Zealand, both countries are important sources of remittances (in 2006 around 105 000 Australian residents and 135 000 New Zealand residents were born in the Pacific Islands). But the cost of sending remittances from Australia and New Zealand to Pacific island countries is high by global standards. The average cost is between 15 and 20 per cent of the amount remitted, compared to the global average of five per cent.[58] Workers find choosing a cost-efficient remittance service provider difficult, as fees and charges are often confused with foreign-exchange costs.

Improving information about the true cost of remittances and improving competition in the money transfer and banking sector, can significantly reduce the cost of sending remittances home. In 2007, DFID (United Kingdom) pioneered the 'Send Money Home' website that provides information about products and prices for remittance corridors between the United Kingdom, Africa and South Asia. Within 12 months, the cost of remitting money to these regions had fallen by eight per cent.

In 2009, Australia and New Zealand launched a remittance website for Pacific island communities: www.spendingmoneypacific.org. The website allows users to compare the price and speed of remittance-sending channels. 'Mystery shopping' ensures the information submitted by providers to the website manager is accurate. Within six months, the average cost of sending remittances to the Pacific fell by at least three per cent, and up to 20 per cent in some cases.

As part of induction training for seasonal workers, Australia and New Zealand are including training on how to use the website so they can make good choices when sending money home to their families.

5.3 Skills development for labour mobility

Skills development can increase employment opportunities both at home and abroad

To benefit most from migration opportunities, countries need to improve the availability and quality of education and training for those who remain to work in their country of origin, as well as those who take up temporary employment elsewhere.

Skills development is central to improving productivity, living standards and economic growth. With a high demand for technical and vocational skills both at home and abroad, investments in technical education have the potential to pay dividends to Pacific communities. Improving the

58 World Bank (2009d)

skills base of Pacific island countries and Timor-Leste to meet dynamic labour demand across the region requires long-term investment in basic education as well as tertiary education and training.

To increase labour market opportunities within the region and globally, education and training must meet international standards. Regional initiatives are addressing this need. The South Pacific Board for Educational Assessment assists national education bodies to deliver assessment towards national and regional accreditation, while the Australia Pacific Technical College provides vocational education and training qualifications to Australian and New Zealand standards.

Working overseas helps develop new skills and knowledge

In addition to earning an income, migrant workers develop new skills and experience through on-the-job training. As well, workers develop social links to their new country which can result in stronger business ties between countries, including export opportunities.

Host countries are recognising that labour mobility provides an opportunity to increase the skill base of developing country partners. In Europe, a number of proposals are being discussed to help migrant workers achieve higher levels of education through workplace language training and access to after-work classes.[59] Similar programs are being considered through pilot labour mobility schemes in the Pacific.

5.4 Improving policies for labour mobility

Successful labour mobility requires policy coordination and extensive stakeholder management in both sending and receiving countries

A successful labour mobility program starts in the host country. Programs need to be demand driven so that local residents do not perceive migrants to be driving down wages or taking job opportunities from the local workforce. An effective program involves consultation with stakeholders, provides flexible working arrangements, close supervision of recruitment procedures, clear admission criteria, and protection of all labour and associated social rights. Host countries need to consider how social security and similar provisions can be transferred back to home countries simply and cost-effectively. They could also consider ways for workers to improve their skill base through additional training and education.[60]

Circular migration programs can increase development impacts by allowing workers to leave and return again at a later date. This helps to minimise the chances of overstaying: when workers know they can return to a host country, they have less reason to stay in that country illegally. This

59 Organisation for Economic Co-operation and Development (OECD) (2007)
60 OECD (2007)

approach also encourages employers to invest in up-skilling these workers as they know many will return to work for them.

The most successful labour sending countries are very engaged in ensuring workers move in and out of work easily

Sending countries take a range of approaches to managing labour mobility, but the most effective programs are clearly linked to long-term development plans. Sending countries work closely with host countries to ensure workers are treated well, are integrated into local communities and are able to make the most of their time overseas. On the demand side, countries can regulate the recruitment of workers, identify preferred recruitment practices, supervise and screen job offers, and set minimum standards for employment contracts. On the supply side, countries can screen workers for a 'work-ready' pool, allowing recruiters to select pre-approved workers who require few final checks before an offer of employment can be made and a visa issued.

Box 5.4: Creating cross-border linkages in Tonga

Tonga was one of the first Pacific island countries to take up New Zealand's offer of a seasonal worker program. The RSE scheme is the first formal labour market scheme the Tongan Government has managed, and it is treated as a business venture. The New Zealand Immigration Minister describes it as part of an industry restructuring process involving employers and unions and Tongan officials describe it as an opportunity to develop and strengthen the country's reputation for the reliable provision of labour. The scheme has been branded 'Tonga Works' and its benefits are being marketed to New Zealand employer organisations.

Domestically, the Ministry of Labour Commerce and Industry staff involve town officers, church leaders, and community leaders in the selection phase. Orientation is jointly conducted by Ministry officials and employer organisations. Upon arrival in New Zealand, liaison officers assist Tongan workers with transport and accommodation.

Since the RSE scheme commenced in 2007, farm visits by Ministry officials and reciprocal visits by New Zealand employers to Tongan villages have built cross-border linkages and fostered a better understanding of respective cultures and contexts.

As countries integrate labour migration into their national development plans, it is also important for them to incorporate it into their relationships with development partners, particularly when donors are also host countries. Joint consideration and understanding of migration and development issues helps improve policies on both sides and can maximise development outcomes. For example, Australia's PSWPS features an add-on skills program to help workers move to more skilled employment. Workers receive training in foundation skills—workplace literacy and numeracy—when they arrive in Australia for the first time. When they return they are eligible for funding to attend training colleges in home countries to obtain technical and vocational skills.

These additional skills help secure employment at home and overseas and are an important part of the Australian program.[61]

Governments can engage with migrant diaspora to promote development outcomes

Those who have migrated overseas permanently, or who are second generation migrants, are known as a sending country's 'diaspora'. Diaspora often form close-knit ethnic communities and help to maintain strong links with home countries. Development partners, such as DfID, are pioneering policies enabling diaspora to become involved in the development of their home countries.

Sending countries can also use diaspora to create innovative development policies. In India, for example, the Ministry of Overseas Indian Affairs has a strong outreach program encouraging multi-generational ties to home. Conferences, social and employment services, and a forthcoming remittance facility help maintain links with their increasingly widespread diaspora.

Labour mobility is an opportunity to build closer regional ties, increase skills and develop economic opportunity

Labour mobility can bring host and sending country governments together to develop the benefits of labour mobility and manage some of its challenges. This requires careful policy development that is well integrated with country development plans. Sending country governments need to efficiently manage the movement of workers, find ways to harness the benefits of remittances and ensure diaspora remains well connected with communities at home. Host country governments can assist by introducing temporary and circular migration schemes, thereby helping workers stay connected to family and encouraging workers and employers to build the skill base for work in future years. Both host and sending country governments can cooperate to ensure remittances are sent cheaply and effectively, and that there is a ready supply of well trained, work-ready labour with the skills to benefit from employment opportunities at home and abroad.

61 More information on the PSWPS: http://www.workplace.gov.au/workplace/Individual/Migrant/PacificSeasonalWorkerPilotScheme.htm

6 Dealing with global shocks

While countries search for growth through exports, they must also manage the impact of price rises in two critical imports—food and fuel

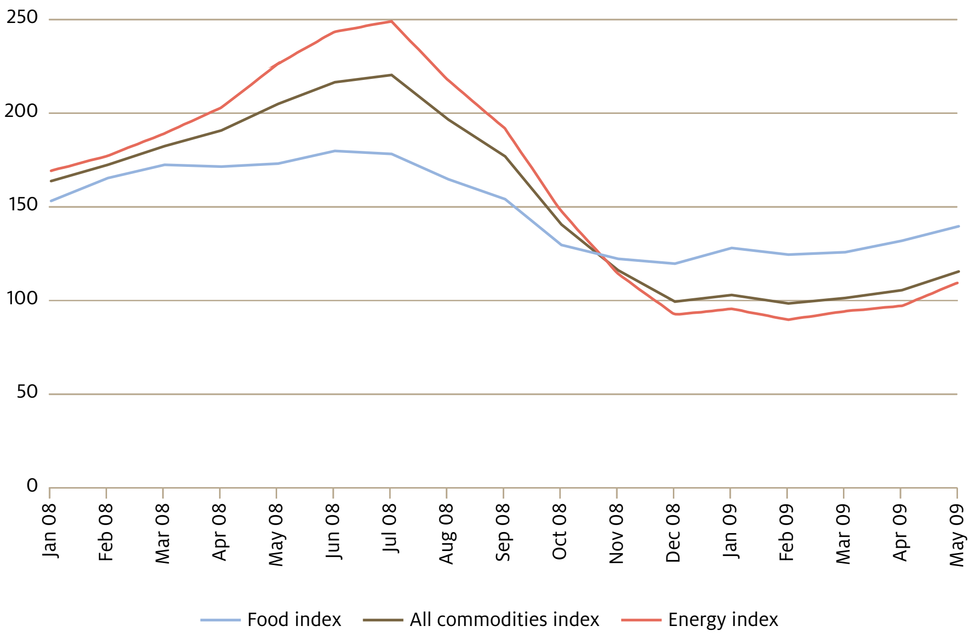
The previous chapters have focused on ways Pacific island countries and Timor-Leste can improve their income from exports in both goods and services. This Chapter looks at ways imports affect the economies in the region. Most countries are net energy importers so their ability to manage government budgets comes under pressure when oil prices rise. Their distance from major markets means that fuel prices affect the cost of other imported goods, particularly food. When high oil prices couple with high prices for basic food staples, as they did during 2008, countries suffer stress. This chapter looks at these two critical external pressures on Pacific island countries and Timor-Leste, and identifies practical ways to address them and build stronger, more resilient economies.

6.1 Vulnerability to food and energy shocks

2007–09 was a turbulent time for world food and fuel prices

Soaring food and energy prices during 2007 and 2008 highlighted the vulnerability of Pacific island countries and Timor-Leste to external economic shocks. Food and fuel prices peaked between May and July 2008, but fell to around half these levels by December 2008. The impact of the subsequent global recession has lowered prices in 2009, but despite FAO forecasts of strong production in 2009, prices are starting to rise again (Figure 6.1).

Figure 6.1: Energy and food prices were volatile during 2008 and 2009



Source: IMF (2009c)

Note: 2005 equals base year

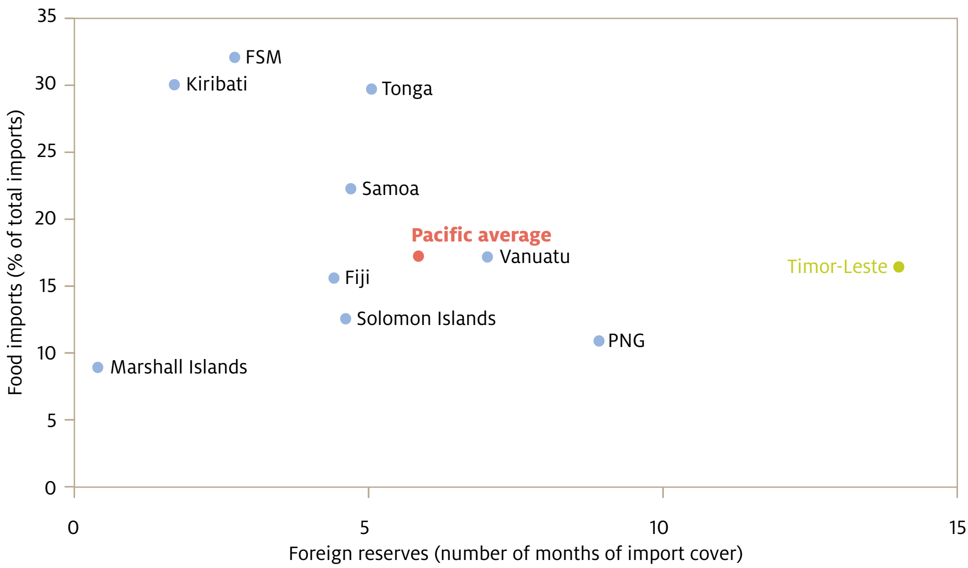
Individual commodity prices are influenced by cyclical and environmental factors, but the underlying influence for food commodities has been demographic trends. Population growth and increasing urbanisation across developing countries, and rising incomes in emerging economies like China and India, have seen consumption patterns change. Greater demand for meats by a growing urban middle-class means more grain is being consumed by livestock. There has been increasing demand for grain to supply the growing biofuel renewable energy market, which has also put upward pressure on grain prices.

The FAO has estimated that the amount of food produced by developing countries will need to double by 2050 to keep pace with growing populations and increased urbanisation—equivalent to a 70 per cent rise in world food production. This has far-reaching implications for both food production and food importation in Pacific island countries and Timor-Leste.

High energy prices drew attention to the difficulties faced by Pacific island countries and Timor-Leste in managing supply and cost

Meeting the energy needs of Pacific island countries and Timor-Leste will continue to be a challenge for governments. Modern energy services require efficiencies of scale, and when these efficiencies are not present the cost of providing services is high. Communities living in rural and remote areas will always have difficulty in attracting the range of services provided in urban areas, and they face higher costs unless they have access to government or donor subsidises.

Figure 6.2: Some Pacific countries are highly vulnerable to rising prices



Source: ADB (2008c); various Central Bank and Reserve Bank reports

Despite their agrarian and subsistence heritage, all countries in the region import food staples—only Fiji continues to export more food than it imports. This reliance on imported food, and the region's distance from major markets, means countries are affected not only by rising food prices but also rising energy prices. Transportation costs to the region are high and in 2008 high food prices and high energy prices combined to significantly strain poor communities. Polynesian and Micronesian countries were especially affected, as they have a higher proportion of food in their import baskets than do other countries (Figure 6.2).

6.2 Managing food

Subsistence farming and fishing underpin food security in Pacific island countries and Timor-Leste

Farming and fishing continue to provide food security in Melanesia and the larger Polynesian countries. There are issues related to access and nutritional quality of food, particularly for the urban populations which generally rely more heavily on imported food, but by global standards food availability in these countries is regarded as satisfactory. In contrast, in the small islands of Micronesia and Polynesia, staple food production is severely limited by insufficient arable land and poor crop growing conditions. These countries depend on food imports, making them extremely vulnerable to global price shocks, and they rely on the cash economy to ensure their food requirements are met.

Box 6.1: The four dimensions of food security

1 *Availability:* sufficient quantities of appropriate quality food, through domestic production or imports.

2 *Access:* sufficient access to adequate resources for acquiring appropriate foods for a nutritious diet.

3 *Use*: through adequate diet, clean water, sanitation and health care to reach a state of nutritional wellbeing.

4 *Stability:* the ability to maintain the above three factors during sudden shocks or cyclical events.

Timor-Leste has acute food security issues and up to 70 per cent of households go without adequate food for some part of each year.[62] Approximately 50 per cent of the population lives below the poverty line and consumes less than the daily 2100 kcal required for a normal, healthy life. This has a substantial affect on health and nutrition, and in 2007 and 49 per cent of children under five were underweight and 54 per cent were stunted.[63] Food insecurity has many causes, but can be attributed to low agricultural output, high post-harvest cereal losses, distortionary food subsidies, limited market access and limited options for earning income in rural areas to be able to purchase food.

The small microstates of Micronesia and Polynesia have the least capacity in domestic food production and in generating export earnings from agriculture. Nevertheless their outer island communities generally retain the capability for subsistence food production, albeit at a basic level. In contrast, urban centres increasingly depend on imported food. For these countries

62 Oxfam (2008)
63 UNICEF (2009)

sustainable management of the marine sector is vitally important for domestic food security and for generating national income and foreign reserves.

Food security for Pacific island countries and Timor-Leste depends on the ability to produce food and the ability to export goods and services in order to import food

A country can be a substantial importer of food and enjoy a high level of food security provided it has more than sufficient foreign exchange earnings to cover the cost of imports. Food security for the region, therefore, depends on the capacity to produce food and the capacity to export goods and services to pay for food imports. Both improved agricultural productivity and freer trade in agriculture are necessary to ensure regional food security.

As shown in Table 6.1, only Fiji continues to export more food than it imports, but this is unlikely to last as trade preferences for exports to Europe erode due to WTO commitments.

Table 6.1: Only Fiji exports more food than it imports

Food trade balance for selected countries (USD millions)

	2002	2003	2004	2005	2006	2007
Cook Islands	-11.6	-9.6	-11.9	-19	-21	-19.3
Fiji	9.6	44.4	-54	24.7	11	24.3
PNG	11.9	85.5	23.3	-271.4	88.4	-79.6
Samoa	-19	-26.4	-29.3	-32.4	-39.6	-49.5
Solomon Islands	-21	-12.4	-17	-28.6	-31.3	-21.5
Tonga	-19.3	-15.7	-18.5	-27	-19.7	-31.9
Tuvalu	-2.8	-2	-3.5	-4.2	-3.4	-4.6
Vanuatu	-11.4	-25.4	-13.7	-16.3	-15.4	-28

Source: SPC Regional Trade Statistics Database (2009), Government of Timor-Leste (2009)

Pacific island countries and Timor-Leste must increase production if they are to improve both food security and food exports

Throughout the region, agriculture and fisheries comprise a substantial share of goods exports, and food production activities (agriculture and fisheries) continue to employ the greatest percentage of the labour force, either in commercial activity or through self-sufficiency endeavours.

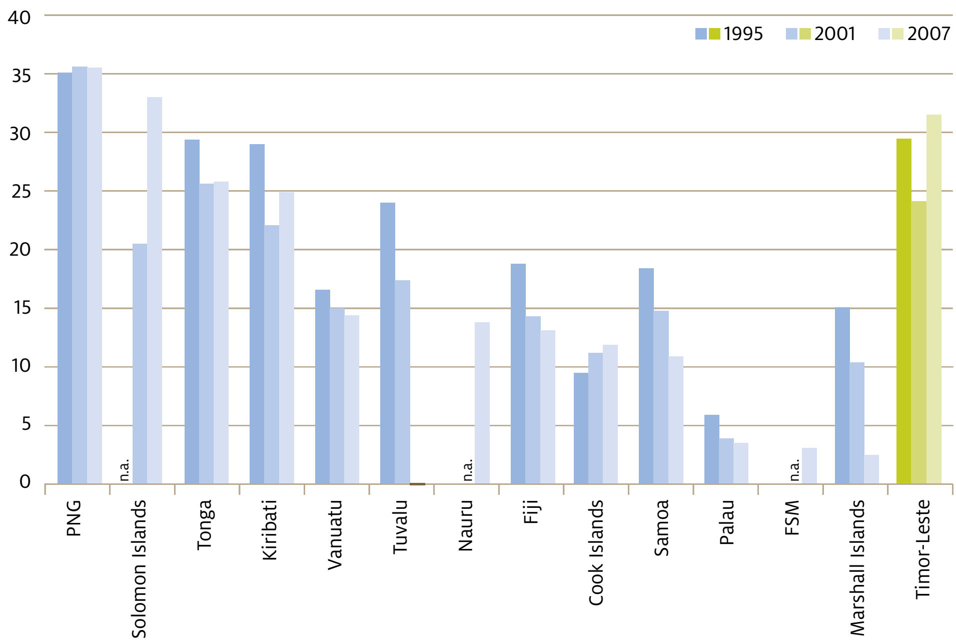
Agricultural productivity in Pacific island countries and Timor-Leste has stagnated for the last 45 years. In comparison, the long-term rate of agricultural productivity growth in Australia and the United States, which have capital-intensive agriculture, has been around two per cent.[64] In consequence, population growth and urbanisation pose a significant threat to food security

64 Reddy M and Duncan R (2006)

in Pacific island countries and Timor-Leste as production has been unable to keep up with demographic changes. Greater productivity of existing staple food crops and better management of land resources is required if food production is to keep pace with rapidly increasing populations.

Figure 6.3: Agriculture is becoming less important to overall growth

Size of agriculture, forestry and fishery sectors (% share of GDP)



Source: ADB (2009b) National Statistics Offices

Note: Data for Palau is for 1995, 2002 and 2006.

Another consequence of low agricultural productivity growth is that agriculture is becoming less important for regional economies. PNG, Solomon Islands, Tonga and Timor-Leste still derive more than 25 per cent of their GDP from agricultural activity, but the relative value is falling in other countries. In Vanuatu, Fiji, Samoa and Cook Islands, agriculture and fisheries still contribute in excess of 10 per cent of GDP, but both the relative and absolute value of agriculture output has declined fairly steadily over the last decade. In the Marshall Islands, agriculture and fisheries now contributes only about three per cent of GDP (Figure 6.3).

Box 6.2: Improving atoll agriculture in Kiribati

Producing food crops on an atoll island requires perseverance. Little actual land area, coupled with infertile coralline soils and long spells of dry weather, make agriculture extremely difficult. As a result, atoll communities face problems in maintaining food security and eating a balanced diet.

In partnership with the SPC and the International Fund for Agricultural Development, the Government of Kiribati has established a new research and development centre for atoll agriculture in south Tarawa. The Centre of Excellence for Atoll Agriculture Research and Development in the Pacific aims to become a focal point for developing technologies to help atoll farmers increase their productivity, improving local food supplies and nutrition.

Research activities at the Centre are being developed and will be undertaken in partnership with farmers. Technologies developed or refined will be tested by farmers in Tarawa and on the outer islands of Kiribati and other Pacific atolls, using established outreach approaches such as farmer field schools. Information on successful technologies will also be made available through specially developed extension materials.

The Centre will also also work with farmers and other community groups to promote local produce and revive production of traditional food. It will also promote gender equity and seek the involvement of women and youth in agricultural and fisheries production. Research areas will include soil improvement, water harvesting and irrigation, crops adapted to atoll conditions, pest and disease control, improved local livestock breeds, waste management and improved agro-forestry systems.

Urbanisation is increasing rapidly throughout the region, exacerbating food supply and access issues

Rural to urban migration and population pressures affect all Pacific island countries and Timor-Leste. In small atoll countries, such as the Marshall Islands and Kiribati, population movement from rural areas to main urban centres has resulted in high population densities and overcrowding. The Marshall Islands is one of the most urbanised countries in the Pacific with almost 70 per cent of the population living either on Majuro or Ebeye, and it has some of the highest population densities in the world. This minimises opportunities for local food production and places increasing pressure on food supply systems.

Urbanisation has been particularly high in Melanesia and Timor-Leste (Table 6.2). In 2007, the urban population in Fiji stood at 51 per cent and is projected to reach 61 per cent by 2030. Population pressure is making food production more difficult in some countries, particularly in parts of the PNG Highlands, many of the small islands in Melanesian countries and in north Malaita Island in Solomon Islands.

Labour migration has moderated population growth rates in Cook Islands, Samoa and Tonga and has resulted in a negative population growth rate in Niue.

Table 6.2: Urbanisation is becoming more prevalent

	Mid-year population estimate (2008)	Crude net migration rate (%)	Population growth rate (%)	Land area km^2	Population density	Urban population (%)	Annual growth rate urban (%)	Annual growth rate rural (%)
Melanesia								
Fiji	839,324	-10.1	0.6	18,271	46	51	1.5	-.01
PNG	6,473,910	0.0	2.2	462,824	14	13	2.8	2.7
Solomon Islands	521,120	0.0	2.8	28,370	18	16	4.2	2.5
Vanuatu	233,026	0.0	2.6	12,190	19	21	4.0	2.2
Polynesia								
Cook Islands	15,537	-7.7	0.4	237	66	72	3.0	-1.5
Niue	1,549	-30.6	-2.4	259	6	36	-1.1	-2.4
Samoa	182,724	-17.3	0.4	2,935	62	21	-0.6	0.7
Tonga	102,724	-17.2	0.4	650	158	23	0.5	0.4
Tuvalu	9,729	-9.4	0.3	26	374	47	1.4	-0.2
Micronesia								
FSM	110,443	-16.0	0.4	701	158	22	-2.2	1.0
Kiribati	97,232	-1.0	1.8	811	120	44	1.9	1.8
Marshall Islands	53,236	-16.0	1.0	181	294	68	1.6	1.3
Nauru	9,570	0.0	2.1	21	456	100	2.1	
Palau	20,279	0.0	0.6	444	46	46	-1.0	4.4
Timor-Leste	1,048,000 (2007)[1]		3.2[1]	15,000[1]	70[1]	26.1[1] (2005)	4.1[2]	

Source: SPC (2009b); for Timor-Leste: ADB (2009b)

Poor nutrition is a side-effect of urbanising economies

As dependency on imported food commodities, such as rice, wheat flour and processed fish, increases in the region, vulnerability to high world food prices also increases. This has resulted in an increase in diet-related illness in several countries, particularly Samoa and Tonga. There has been a substantial increase in the incidence of non-communicable diseases, many of which have dietary causes including, vitamin A deficiency and anaemia among children, and diabetes, heart disease and certain cancers among adults.

Traditional Pacific island subsistence crops are of high nutritional value. These crops include coconut, banana, breadfruit and root and tuber crops (sweet potato, taro, cassava and yam) plus leaf vegetables and fruits. Governments in the region are exploring ways to discourage the consumption of unhealthy, imported foods in preference for domestic produce.

Box 6.3: Samoa addresses debt and diet

Weddings and funerals are important festivals in Pacific island countries. The main way individuals and families pay respect, strengthen cultural bonds and reinforce community values is by sharing and giving food. This practice supports a strong social safety net with regards to food security and welfare for individuals and families, but it can also be a considerable financial burden and may generate family debt that spans generations.

Two village councils in Samoa have banned the use of imported canned fish, various red meats and also chicken parts in village funerals. Sala'ilua and Sili on Savaii Island were the first villages in Samoa to announce the ban after a government initiative to ease massive financial burdens facing some families after a funeral. The Government's move came after several families were prosecuted for not being able to pay a bill at a local store for imported meats and canned fish bought for the funeral. Some of the family's overseas relatives were also unable to return home because their passports were taken by the store, to be returned only when the debt was paid in full.[65]

Directly managing food prices can be difficult and, in the long run, distorting

Economic policy responses to high food prices (tariff reductions, subsidies and transfers of cash or food) have implications for macroeconomic stability and are particularly difficult for small, narrowly based economies. Government responses to mitigate the impact of the food price crisis generally require increased public outlays, which has adverse implications for financing basic services. For example, the total expenditure on food subsidies has been projected to exceed one per cent of GDP in Timor-Leste in 2008.[66]

Fiji has introduced price controls on basic food items in response to the substantial rises in food prices—more than 32 items are currently under control by Fiji's Prices and Incomes Board. Controlling food prices and delaying or preventing upwards adjustment in the face of rising global food prices has the understandable aim of minimising the negative impact on poorer households. But controlling food prices also places a significant burden on both state and service providers, who can be caught in a cost-price squeeze. While intuitively appealing during times of crisis, price controls create longer-term management problems. They also fail to target those most in crisis, with rich and poor alike benefiting from price control measures.

Price subsidies on basic food items have similar drawbacks to price controls in that subsidies can distort price signals and encourage over-consumption while discouraging local food production. Subsidies can be targeted to foods which are more popular with low-budget households but more often food subsidies benefit both rich and poor. This policy action also imposes substantial fiscal costs and may be politically difficult to reverse.

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65 Radio New Zealand, 16 January 2009

66 FAO (2008)

Box 6.4: Hungry season in Timor-Leste

In October 2008, a range of charities and multilateral organisations warned that Timor-Leste's annual 'hungry season' would be more severe than usual. Running from November to March, hungry season—the gap between the end of the consumption of the previous harvest and the start of the next—has increased from three to five months of the year. Agencies now estimate that almost 70 per cent of households are affected by food shortages during this time, and that the number of children under five suffering from chronic malnutrition may be as high as 59 per cent in some areas.

Rice production has been low for a number of years and the World Bank estimates that rice crops in Timor-Leste have among the lowest yields in the East Asian region. Rice production in 2007 was estimated at 41 400 tonnes, while the Government of Timor-Leste estimates that 83 000 tonnes per year are needed to feed its population.[67] Almost half of rice therefore consumed in Timor-Leste must be imported and the 2008 rise in food and fuel prices had a significant impact on the welfare of many communities.

The Government made several attempts to remedy the situation. It introduced a rice subsidy in an attempt to keep food prices affordable, and at one stage imported rice which it sold for US$12 per 35kg bag, regardless of the market price. The Government also attempted to stockpile rice against shortages. Media reports suggest that many poor communities did not benefit from these subsidies, due to their geographic isolation and the reality that the subsidised price was still higher than they could afford.

Ultimately more work is needed to find sustainable solutions and to sustainably increase food production and supply. Some good progress has been made, however, such as through Seeds of Life, a project funded by the Government of Timor-Leste and AusAID, which has released seven new varieties of four staple food crops since September 2005. More than 2000 households have grown at least one of these new varieties, with yield increases from 17 to 138 per cent.

Tariff reductions can help lower the price of food staples

Tariff reductions on basic food staples can be effective in lowering the price of imported foods during times of price pressure, and are consistent with longer-term policies of trade liberalisation. In 2008, Fiji reduced its import tariffs from 27 to 15 per cent on white rice, leguminous vegetables, fish and meat, and has since eliminated tariffs for edible oils, white rice and canned fish. The Marshall Islands has granted exemptions on import duties for basic food staples and Timor-Leste has also reduced sales taxes and import duties.

67 FAO Background Paper (2009)

Improving food security in Pacific island countries and Timor-Leste requires policies that promote both a more diverse domestic supply of products and increased opportunities for exports

In an increasingly liberalised and deregulated global market, agriculture, livestock and fisheries industries need to be internationally competitive. Helping farmers increase agricultural production (and productivity) is a long-standing policy objective which is made more pressing in the event of price shocks. Investments in infrastructure, agricultural research and institutions that provide farmers with access to finance, agriculture needs such as seeds and fertiliser, and information on new crops and methods, can help improve production and productivity.[68]

Poor infrastructure continues to work against farmers in the region. Efficient ports, fast border processing and good refrigeration facilities allow farmers to export a wider range of products, but, as discussed in Chapter 2, Pacific ports remain inefficient, expensive and slow. This makes it hard to export perishable goods and it degrades the quality of goods reaching markets.

Export strategies need to focus on agricultural products for which the region has a comparative advantage

Niche differentiated products such as organic virgin coconut oil, Organic and Fairtrade cocoa and coffee, dried tropical fruits, tropical nuts, premium grade beef and sashimi-grade fish are examples of products which have good international market demand and which are based on the region's comparative advantages in agriculture.

6.3 Managing energy

Access to affordable and reliable energy is necessary for economic development and poverty reduction

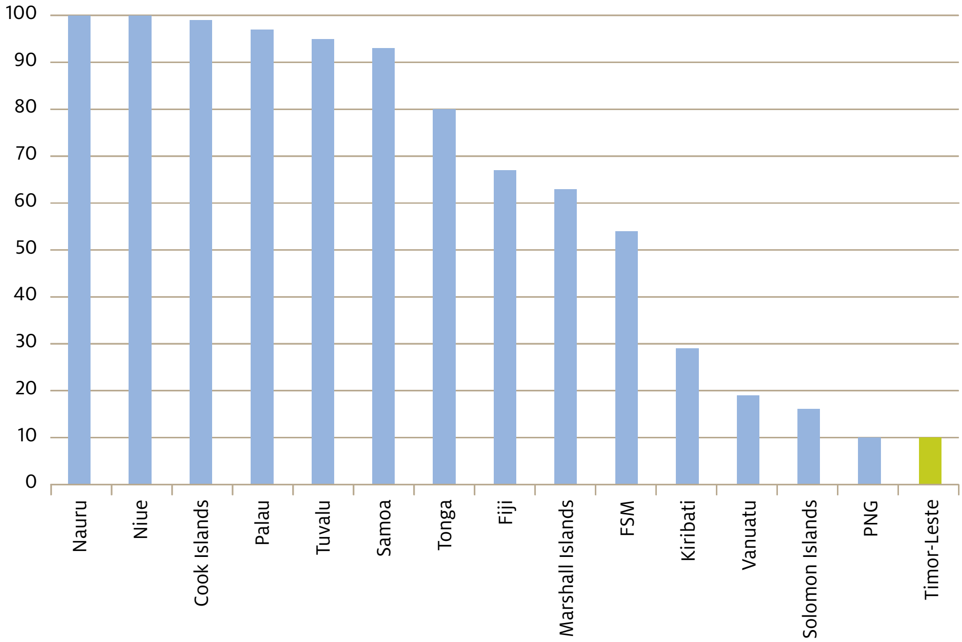
For the poor, basic energy services such as lighting, heating and power for transport, water pumping and processing basic agricultural commodities can fundamentally affect quality of life and livelihoods. Use of traditional fuels such as wood, dung and crop residue—known as biomass—carries a significantly higher disease burden than other forms of fuel due to indoor air pollution.[69] Electricity is critical for providing basic social services, including education and health. A lack of electricity can undermine sterilisation, water supply and purification, sanitation, and refrigeration of essential medicines. Electricity can also power machines that support income-generating opportunities such as pumping water for agriculture, food processing, apparel production and light manufacturing. In rural areas, lack of modern energy services can decrease the willingness of more-educated workers (such as teachers, doctors, nurses and extension agents) to reside in those areas, further limiting services and opportunities for local communities. International evidence

68 McGregor (2006)
69 UNDP (2005)

suggests that major improvements in the quality and quantity of energy services in developing countries are required if the MDGs are to be met.

Figure 6.4: In larger countries, much of the population lacks access to electricity

Access to electricity, various years (% of total population)



Source: PRISM Utility Statistics cited in Hook (2009).

The poor, particularly those in rural and remote areas, have difficulty accessing electricity and they pay a large proportion of their income for the energy supplies they can access.[70] In Pacific island countries, studies suggest there is a strong correlation between household expenditure and the consumption of modern energy forms such as kerosene, Liquefied Petroleum Gas and electricity.[71] Households using mostly biomass are typically those with less income. PNG, Solomon Islands and Vanuatu have the Pacific island's lowest Pacific Human Development Index rankings and also have the highest percentage of households cooking primarily with biomass. In Solomon Islands, more than 95 per cent of rural households use wood for cooking as opposed to 63 per cent of urban households.[72] Moving to cleaner cooking fuels has a demonstrable impact on child and maternal health, and electricity helps boost incomes by enabling economic activity to be conducted beyond

70 UNDP (2005)

71 Fiji Department of Energy (2006)

72 UNDP Pacific Centre and Solomon Islands National Statistic Office (2008)

daylight hours. The use of more efficient energy sources can also lower the share of household income spent on energy.

Table 6.3: Households' main source of cooking fuel (% of total households)

	Year	Electricity	LPG	Kerosene	Firewood/ charcoal	Not stated
Cook Islands	2006	6	87	1	5	1
Fiji	2002–03	9	44	59	20	
Kiribati	2001	12	12	14	63	
Nauru	2002	96	1	2		1
Samoa	2001	11	12	14	63	
Solomon Islands	2006–07	1	6	3	91	
Tuvalu	2004–05	1	7	49	42	

Source: various HIES and Censuses cited in Hook (2009)

Note: Fiji data does not add up to 100 per cent because households were able to identify more than one cooking fuel.

Energy prices affect the wider economy through transport and electricity services, and put pressure on government macroeconomic policy

For most Pacific island countries, energy is a substantial import expense and in many the total cost of energy imports exceeds the total value of exports (Table 6.4). UNDP analysis suggests that of all the countries highly vulnerable to oil price rises, four are in the Pacific (Fiji, Samoa, Solomon Islands and Vanuatu).[73] This was evident during 2007-08 when the rise in oil prices had a negative effect on economic growth and placed pressure on external accounts of many governments. High oil prices weakened macroeconomic policy management by increasing inflation, reducing growth and weakening the balance of payments. Tonga, Fiji and Solomon Islands experienced a large reduction in foreign reserves, and the Marshall Islands became so concerned about rising oil prices that President Tomeing declared a State of Economic Emergency on 3 July 2008.

73 UNDP (2008)

Table 6.4: The value of imported oil in the Pacific and share of imports and exports in 2007

Country	Fuel import value (USD millions)	Fuel imports as a share of total imports (%)	Fuel imports as a share of total exports (%)
Cook Islands	6.2	8.4	86.1
FSM	17.3	13.0	88.3
Fiji	340.2	23.5	50.0
Kiribati	5.7	10.0	172.7
Marshall Islands	20.4	37.3	224.2
Palau	12.4	13.0	104.5
PNG	358.7	25.1	16.2
Samoa	22.6	15.1	160.3
Solomon Islands	11.7	27.4	15.8
Tonga	17.6	25.5	293.3
Vanuatu	12.8	14.3	64.3

Source: Woodruff (2007)

Better energy policies and strategies can improve energy management

While 10 of the 14 Forum island countries include energy in their national sustainable development strategies, the sector could be better integrated into national priority areas and budgets.[74]
In most countries, national governments play a key role in developing the energy sector, but to best manage energy, considerable resources are needed to oversee energy supply development. National energy offices need to be well integrated with other government departments to influence national development priorities, decisions or budget allocations.

Better management of oil supplies can help countries manage volatile global prices

Inefficient fuel procurement arrangements, weak and inefficient regulatory frameworks and the poor state of fuel-related infrastructure (including ports and storage) combine to push the cost of fuel in the region above global prices. While privatisation of energy utilities has proven controversial in many countries, Samoa has successfully introduced the best elements of competition while retaining strong oversight of the sector. Samoa's approach is being considered by Forum Economic Ministers for application in the wider region.

74 South Pacific Applied Geoscience Commission (2008)

Box 6.5: Samoa's bulk purchasing program

Samoa has been a regional innovator in the purchase and storage of oil. The country has a competitive model for fuel management, which is based on international tenders issued for the operation of government-owned oil terminals and the supply and distribution of petroleum products.

The international tenders are issued every five years for the supply of petroleum products and the operation of terminals. The successful company or companies pay a fee to the Government which funds the maintenance and capital works of the terminals. This arrangement ensures that the terminals are in good condition at the end of the contract and avoids the incumbent supplier running down the asset. The Government sets prices based on international fuel prices and a negotiated profit margin, with a strict monthly review of the prices agreed to. The periodic tenders are competitive. The oil companies recognise that if they do not win the tender they will be locked out of the market for the duration of the contract.

The effectiveness of this approach was demonstrated in 2003 when pre-tax petroleum product prices were less than half the prices in comparably-sized Pacific countries, and 60 to 70 per cent of prices in much larger markets such as PNG and New Caledonia.

The bulk purchasing program has become a regional model of good practice, and a Pacific Island Forum-wide bulk procurement initiative is making progress. The project aims to capture benefits from regional cooperation in purchasing, shipping, port handling, storage, risk management and distributing petroleum products, and will ultimately negotiate common terms and conditions for the supply of petroleum to individual governments or contracting authorities.

Improved energy efficiency can have a big impact

Simple efficiency measures can lead to substantial improvements in energy supply without requiring a major investment in infrastructure. Much of the region has been slow to adopt modern energy-efficiency practices and designs, meaning there is substantial room for efficiency gains.

For example, the use of energy-efficient light bulbs can greatly reduce the demand for electricity thus making better use of the small amounts of electricity being produced, but the high cost of these products in Pacific countries means it is unlikely they will be widely adopted by consumers. A World Bank program in Timor-Leste showed that when free, compact fluorescent light bulbs were provided to low-income customers, it resulted in households saving US$4 per month—around 25 per cent of their total energy bill. The World Bank conservatively estimates that, for a full-scale program, the Government could receive an economic rate of return of 125 per cent and a payback period of less than one year. They estimate that the peak load would be reduced by 1 MW, effectively delaying the need to upgrade existing power facilities while still enabling growth in the economy.

Renewables have been used primarily for small scale, off-grid access

In practice, it will be many years before it is possible to electrify small and remote parts of the Pacific. These areas currently rely on biomass and imported energy and seem to be ideal locations for renewable energies. However, despite the generally low cost of the energy source itself (solar, wind, hydro), forms of renewable energy production generally require high fixed, or up-front, capital costs. By comparison, diesel generation and use of bio-fuel are the opposite, with low up-front costs but high recurrent costs in fuel and maintenance. This means that government policy needs to play a significant role in encouraging more diverse sources of energy supply and creating appropriate incentives to ensure communities receive the best long-term solutions for their needs. But when implemented successfully, off-grid solutions can have a positive economic impact on local communities.

Box 6.6: Driti Village solar refrigeration project

In 2002, the village of Driti in Vanua Levu, Fiji, had two unused fish ponds. Now the Seatura Women's Club aquaculture project is creating wealth for the women of the village and providing much needed protein for the community. Having re-established the ponds and added three more with assistance from donors and the Government of Fiji, the women raised money from the sale of the fish to install nine solar panels and a refrigerator house. This enables them to store their harvested fish for sale at a later date, allowing more fish to be produced and to be sold to neighbouring villages. Nutrition in the village has improved, as have incomes as much of the community participates in the venture.

The energy generated is also being used for other income-earning opportunities and enables the community to use lights at night, so children can study for school.

The project is managed by a committee that pays a monthly repair and replacement fee of FJ$30 into an account with ANZ Rural Banking. The Ministry of Women has provided training in bookkeeping, administration and financial management to help the community manage the project. These skills have been applied to other income-earning ventures.

But while renewables offer potential, to go to scale they require a strong policy framework

For renewable energy technologies to be more widely used in Pacific island countries and Timor-Leste, it will require a strong government policy setting and the implementation of innovative, low-oversight solutions. Over the past 15 years, most approaches to renewable energy in Pacific island countries have largely failed to develop into viable alternatives to conventional approaches, and while a number of small-scale rural renewable energy-based electrification projects have been carried out in the region over the last two decades, their impacts have been minimal.[75] This is not to say that renewables are not an appropriate solution for Pacific island countries—many technologies offer significant promise and some, like solar energy and biofuels, are being used in limited quantities throughout the region. But greater use of renewables requires a holistic approach to energy and economic development policy. Many projects undertaken in the region have had little sense of priorities or costs, poor links to national planning efforts, often limited apparent national ownership, and have been generally unconnected to the national budgeting process.[76]

The long-term management of imports continues to be a challenge for Pacific island countries and Timor-Leste

Countries need to find better ways to manage energy supplies over the long term, given the important role of these supplies in development. This could include programs such as bulk procurement and storage. The use of renewables needs to be better integrated into long-term plans for on- and off-grid energy. But there are few ways to address the challenge of high transport costs for food staples. Diversifying economies, and taking advantage of high international prices when appropriate to sell to international markets, can help. Better management of food is needed in the region for health and nutrition, food security and long-term prosperity.

75 Pacific Regional Energy Project, South Pacific Regional Environmental Program, (2005)
76 Coordination and Implementation Mechanisms for Regional Energy and Pacific ACP EDF-10 Energy Initiatives, P Johnston (2008)

Box 6.7: Tonga's vision for renewable energy

Responding to the demands for energy within the context of sustainable development involves balancing the many complex and independent factors addressed in national, regional and international statements, policies and strategies. Tonga has become one of the first countries in the Pacific to develop legislation for renewable energy. Working with support from donors and regional agencies, Tonga's legislation has the following objectives:

- To promote the development of the renewable energy sector in Tonga.
- To establish an authority to deal with matters relating to renewable energy.
- To empower such an authority to regulate all matters relating to renewable energy.
- To promote the implementation of commercially sustainable renewable energy by encouraging economically efficient investment in electrification services and infrastructure to provide these services.
- To promote access for people residing in remote areas to renewable energy services to the extent that it is reasonably and commercially practicable to provide such services.

To implement the Act the Government is funding the establishment of a new renewable energy authority. Standards are being developed for the specification of renewable energy equipment and the production, storage and distribution of renewable energy. The authority has also made public concession agreements with providers, transferred physical assets and ownership to the provider and made renewable energy technology exempt from import duty and taxes. Finally, the new renewable energy authority has regulated the feed-in tariffs for renewable energy-generated electricity of operators and installers.[77]

The Tonga Government has also announced a commitment in its national energy strategy to make a percentage of its energy renewable.

77 Drawn from a presentation made to World Bank in August 2008 by G. Zieroth.

Annex 1

Contributors to the *Pacific Economic Survey 2009*

This annex acknowledges the people who were involved in the *Pacific Economic Survey 2009: engaging with the world*. The views and policies expressed in this survey do not necessarily represent the views of any sponsoring individual and/or organisation involved in the project.

The Pacific Economic Survey Regional Steering Committee

The *Pacific Economic Survey 2009* was directed by a Regional Steering Committee comprising leading figures from around the region. The Steering Committee reviewed the concept note for the survey and provided comments and recommendations on the drafts, donating their valuable time and expertise.

Mark McGillivray (Chair)	Chief Economist, AusAID, Canberra
Margaret Callan	Assistant Director General, AusAID, Canberra
Peter Forau	Deputy Secretary General, Pacific Islands Forum Secretariat, Fiji
Rui Gomes	MDG-1 Policy Specialist, Head, Pro-Poor Policy Unit, United Nations Development Programme, Timor-Leste
Jane Lake	Assistant Director General, AusAID, Canberra
Joyce Mafi	Governor, Reserve Bank of Tonga, Tonga
Priscilla Maruariki	Manager Treasury Operations, Ministry of Finance and Economic Management, Cook Islands
Rhoda Moses	Executive Officer, Leadership PNG Inc, Papua New Guinea
Biman C. Prasad	Professor of Economics and Dean, University of the South Pacific, Fiji
Odo Tevi	Governor, Reserve Bank of Vanuatu, Vanuatu
Afamasaga Toleafoa	Consultant Economic Specialist, Samoa
Jane Waitara	Ministry of Development Planning and Aid Coordination, Solomon Islands
Thomas Webster	Director, National Research Institute, Papua New Guinea

Background papers

Background papers prepared for the *Pacific Economic Survey 2009*:

Clarke, M 2009, 'Economic Growth and Outlook', Deakin University

Duncan, R 2009, 'The Impact of Petroleum Product Price Volatility in Pacific Island Economies', Australian National University

Hook, SM 2009, 'Pacific Energy Paper II', Economics, Policy and Ideas Pty Ltd

Prasad, BC 2009, 'Food Security in the Pacific Region', University of the South Pacific

United Nations Food and Agriculture Organization 2009, 'Background Paper: Food'

Institute for International Trade 2009, 'Labour Mobility', University of Adelaide

Institute for International Trade 2009, 'Trade in the Pacific', University of Adelaide

Authors

The principal AusAID contributors to the survey were Mark McGillivray, Chakriya Bowman, Sophie Mackinnon and Cindy Wiryakusuma, assisted by Julia Wheeler. AusAID staff in Canberra and Pacific and Timor-Leste Posts provided input into the report.

Peer review

In addition to review by the Steering Group, the draft *Pacific Economic Survey 2009* was reviewed by the following Australian Government departments: Department of Foreign Affairs and Trade, Department of Agriculture, Fisheries and Forestry, Department of Education, Employment and Workplace Relations and The Treasury. Any remaining errors or omissions are, however, the responsibility of AusAID.

Pacific Economic Survey 2009 Working Group

Pacific Economic Survey 2009 was supported by a working group consisting of the following AusAID staff: Mark McGillivray, Jane Lake, Julie Delforce, Chakriya Bowman, Sophie Mackinnon, James Donald, Ben O'Sullivan, Cindy Wiryakusuma, Joanne Ridolfi and Julia Wheeler.

Annex 2

Country progress towards the Millennium Development Goals

	Goal 1	Goal 2		Goal 3	Goal 4	Goal 5	Goal 6		Goal 7	
	Eradicate extreme poverty	Achieve universal primary education		Promote gender equality and empower women	Reduce child mortality	Improve maternal health	Combat HIV/AIDS, malaria and other diseases		Ensure environmental sustainability	
Indicator	% below basic needs poverty line (1)	Net primary enrolment rate (1)	Primary completion rate (1)	Secondary school enrolment ratio (1)	Under-five mortality rate (per 1000 live births) (1)	Deaths (per 100 000 live births) (1)	Prevalence of tuberculosis (per 100 000 population) (2)	Incidence of malaria (cases per 1000 people) (3)	% population with access to improved water source (1)	% population with access to improved sanitation (1)
Melanesia										
Fiji	34.3 p	94.2	99.0	1.06	22.4	57.6	31	-	92.7	98.8
PNG	39.6	53.0 b	45.0 b	0.67	75.0 e	733.0 e	513	243	40.0 h	45.0 h
Solomon Islands	22.7 p	94.0 c	79.0 c	0.77	37.0 p, f	135.0	194	82 i	29.8	22.4
Vanuatu	15.9 p	85.4 d	59.0 d	1.05	34.0 g	68.0 h	65	14 i	75.3	95.2
Polynesia										
Cook Islands	28.4 p	100.0	85.0	1.01	26.0	-	24	-	95.1	99.3
Niue	13.0	100.0	100.0	0.87	19.0	-	85	-	99.0	100.0
Samoa	20.3	90.0	94.0	1.06	24.7	15.0 h	25	-	97.3	100.0
Tonga	22.3	95.0	89.0	0.98	21.9	78.2	34	-	98.0	99.0
Tuvalu	21.2 p	-	100.0	1.21	36.0 p	1 death	504	-	92.5	86.5
Micronesia										
FSM	29.9	100.0	67.0	0.99	47.0	83.0	109	-	94.0 h	44.0
Kiribati	50.0	97.0	82.0	1.01	69.0	158.0	402	-	53.1	36.5
Marshall Islands	20.0	90.0	89.0	0.98	46.0 p	73.8	241	-	98.4 p	70.7 p
Nauru	-	60.3	92.0	1.06	38.0 p	-	134	-	81.7	96.9
Palau	24.9 p	93.0	80.0	1.05	38.9	-	51	-	100.0	100.0
Timor-Leste	49.9 a	63.0 a	73.0 a	-	130 a	660.0 a	789	206	61.0 a	46.8 a

Source: (1) SPC unless otherwise noted; (2) UNESCAP (2008), unless otherwise noted; (3) WHO (2008), unless otherwise noted. a = UNDP and Government of Timor-Leste (2009); b = Ministry of Education, PNG; c = Ministry of Education, Solomon Islands; d = Ministry of Education, Vanuatu; e = PNG Demographic and Health Survey 2006, preliminary report; f = Solomon Islands Demographic and Health Survey 2007, preliminary report; g = UNICEF (2009b); h = UN Statistics Division, MDG database; i = Vector Borne Disease Control Program; p = provisional.

Note: Countries on track to meet the target are shaded in green. Countries progressing slowly but with extra resources could meet the target are shaded in yellow. These are also countries which have limited data. Countries highly unlikely to meet the target are shaded in red. Data is drawn from different years.

Annex 3
Pacific statistics

Table A3.1 Socio-economic characteristics

	Population (2008)	Population forecast (2015)	Youth population (2008)	Youth population (2015)	Gross National Income per person
	(1)	(1)	% aged 0-14 (1)	% aged 0-14 (1)	Atlas method, USD (2007)
Melanesia					
Fiji	840 032	868 198	29	29	3 750
PNG	6 468 405	7 490 303	39	37	850
Solomon Islands	520 617	624 667	41	39	750
Vanuatu	232 908	277 572	38	37	1 840
Polynesia					
Cook Islands	15 564	16 060	29	26	9990
Niue	1 550	1 328	26	23	-
Samoa	181 964	185 440	39	36	2 700
Tonga	102 652	104 851	38	37	2 480
Tuvalu	11 035	11 445	33	30	2720
Micronesia					
FSM	110 445	113 864	37	34	2 280
Kiribati	97 201	110 280	36	33	1 120
Marshall Islands	53 889	57 127	42	41	3 240
Nauru	9 570	11 006	36	35	2310
Palau	20 278	21 168	22	19	8 270
Timor-Leste	994 500^	1 350 000	45.6^	40.8	1 510

Source: (1) SPC (2009b) and World Bank (2009g) (2) ADB (2009b)

Notes: GNI data for Niue not available. Cook Islands GNI data is for 2005, Nauru and Tuvalu GNI data is for 2006; ^ Data is for 2005.

Table A3.2 Real Gross Domestic Product growth per annum (%)

	2003	2004	2005	2006	2007	2008	2009 (f)	2010 (f)
Melanesia								
Fiji	1.1	5.2	0.6	3.4	-6.6	0.2	-1	0.2
PNG	4.4	0.6	3.9	2.3	4.1	7.2	4.5	3.5
Solomon Islands	6.5	8	5	6.1	10.7	6.7	0	1.7
Vanuatu	3.2	5.5	6.5	7.4	6.8	6.3	4	0.8
Polynesia								
Cook Islands	8.2	4.3	0	0.7	1.3	-0.1	-0.1	0.8
Niue								
Samoa	4.8	4.8	5.4	1	6.4	-3.4	-0.8	-0.1
Tonga	3.4	2.6	-3	3	0.2	0.7	0.4	-0.6
Tuvalu		4	2	1	2	1.5	1	0.9
Micronesia								
FSM	2.9	-3.3	-0.6	-2.3	-3.2	-1	0.5	0.8
Kiribati	3.3	-0.7	0	3.2	-0.5	3.4	1	0.9
Marshall Islands	3.2	5.9	1.7	0.8	2.3	1.2	0.5	0.8
Nauru			-14.5	6.3	-27.3	0	1	1.5
Palau		6	5.9	4.8	2.1	-1	-3	-0.2
Timor-Leste	0.1	4.2	6.2	-5.8	7.8	10	8	8

Source: ADB (2009b,c)

Table A3.3 Fiscal balance of central government, (% of Gross Domestic Product)

	2000	2002	2004	2006	2007	2008	2009f
Melanesia							
Fiji	-3.1	-5.8	-3.1	-3.4	-2.2	-1.5	-3.0
PNG	-2.0	-0.9	1.7	3.2	2.6	-2.2	-3.3
Solomon Islands	-0.6	-5.8	4.9	-3.9	0.5	0.0	-3.7
Vanuatu	-7.0	-2.2	0.9	0.4	0.3	6.3	1.0
Polynesia							
Cook Islands	-1.8	-4.2	-1.0	2.1	0.0	-1.0	-4.6
Samoa	-0.7	-2.0	-0.8	0.3	1.1	-3.3	-5.5
Tonga	-0.4	-1.4	0.9	1.5	1.4	2.0	1.0
Tuvalu	-2.2	33.7	-14.7	18.7	-14.3	-5.4	na
Micronesia							
FSM	-3.7	7.8	-16.0	-6.4	-3.3	-3.0	3.0
Kiribati			-16.9	-5.7	-3.4	-13.3	-12.0
Marshall Islands	8.4	-9.0	-1.3	1.0	-0.7	-0.3	na
Nauru							na
Palau	-15.1	-29.2	-9.5	-1.2	-7.5	-4.8	na
Timor-Leste	na	0.5	13.2	129.7	221.0	251.8	90.1

Source: ADB (2009b,c)

Table A3.4 Remittances flows (net), current USD millions

	2003	2004	2005	2006	2007	2008e
Melanesia						
Fiji	123.0	171.9	184.2	165.5	165.5	175.0
PNG	13.0	15.7	13.3	13.3	13.3	13.0
Solomon Islands	4.0	8.7	7.2	20.4	20.4	20.0
Vanuatu	9.0	4.9	5.1	5.0	5.5	7.0
Polynesia						
Cook Islands						
Niue						
Samoa	45.0	87.9	109.9	108.0	119.8	135.0
Tonga	55.8	67.6	66.0	72.0	99.5	100.0
Tuvalu						
Micronesia						
FSM						
Kiribati	7.0	7.0	7.0	7.0	7.0	9.0
Marshall Islands						
Nauru						
Palau						
Timor-Leste						

Source: World Bank (2009c)
Note: data for 2008 is an estimate.

Table A3.5 Governance indicators, percentile ranks 2008

	Voice and accountability	Political stability	Government effectiveness	Regulatory quality	Rule of law	Control of corruption
Micronesia						
Fiji	29	41	16	25	36	46
PNG	51	27	20	30	18	10
Solomon Islands	54	50	21	8	24	43
Vanuatu	67	95	44	22	64	66
Polynesia						
Cook Islands			38			
Niue			38			
Samoa	67	87	53	37	72	64
Tonga	46	52	42	23	57	27
Tuvalu	71	98	29	13	83	52
Micronesia						
FSM	83	89	32	29	62	42
Kiribati	69	98	34	11	61	59
Marshall Islands	89	90	10	25	58	35
Nauru	84	90	10	25	88	35
Palau	90	90	35	23	70	47
Timor-Leste	53	14	12	6	11	19

Source: World Bank (2009f)

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