

## I. DEFINING FEATURES OF PACIFIC ISLAND COUNTRIES

1. The World Bank's Regional Engagement Framework for the Pacific region for FY2006-09 covers 9 Pacific Island member countries (PICs): Fiji, Federated States of Micronesia (FSM), Kiribati, Marshall Islands, Palau, Samoa, Solomon Islands, Tonga, and Vanuatu. This framework provides the strategic directions for the Bank's engagement that leads into an assistance program, as well as some selected regional initiatives, for each of the member countries. This strategy should thus be considered a regional framework within which country-specific objectives and expected impacts can be more specifically defined, while recognizing that the depth and composition of country-specific assistance will be primarily demand-driven and flexible—particularly in those PICs where Bank re-engagement is at an early stage.

2. While the World Bank's Pacific Island member countries (PICs) differ in some cultural and economic aspects, they also share several defining features that have shaped their development in similar ways. These can be thought of as the exogenous factors or “givens” that constrain any medium-term development strategy. However, these factors have important socio-economic manifestations that could potentially be better managed with appropriate policies and instruments. This section first outlines the exogenous factors, then moves on to a discussion of these socio-economic manifestations. The latter provide the starting point for defining a Bank role in the region, though it is important to bear in mind that the Bank is also on a learning curve in adapting well-known policy prescriptions to the special circumstances that prevail in the Pacific Island countries. Box 1 provides a brief overview of subregional differences.

### A. Exogenous Factors

3. **Remoteness and Isolation.** The constraints of geography have played a major role in shaping economic opportunities in the Pacific. The total land area of the PICs, dispersed among hundreds of small islands and atolls, is only 88,800 square kilometers (km)—about one-third the size of New Zealand. However, the sea area controlled through exclusive economic zones exceeds the land area of the United States. Kiribati, for example, has a population of a little under 100,000 that is spread over 33 islands that cover 4,000 km from east to west, and 2,000 km from north to south, while the 200,000 inhabitants of Vanuatu are spread over 80 islands in a 800-km chain. The total population of the PICs is about 2.1 million, with Fiji accounting for about 40 percent and Palau for 1 percent (Table 1). The PICs' physical distances from world trade centers make them among the most isolated populations in the world. For most islands, the closest major ports are Auckland, Sydney, or Tokyo, which are over 3,000 km away on average. The least remote island, Palau, is 1,677 km from Manila. This can be contrasted with the small island states of the Caribbean, which are less than 1,000 km from the huge U.S. market.

4. **Legacy of Colonial Experience.** The formal political systems that exist in the region reflect the interaction of traditional political systems, colonial histories, and the relatively recent re-independence experiences. Colonial history, stretching back over 200 years, has involved Australia, Britain, France, Germany, Japan, New Zealand, Spain, and the United States. The move to political re-independence in the Pacific began in 1962 when Samoa regained its independence. These are new countries still coming to terms with the overlay of colonial systems over traditional foundations.

### Box 1. Subregional Differences in the Pacific

While there are some important similarities between all the Pacific Island countries, the region is not homogenous. In particular, the recognition of the differences between Melanesia (Fiji, Solomon Islands and Vanuatu); Polynesia (Samoa and Tonga); and Micronesia (Kiribati, Marshall Islands, Federated States of Micronesia, and Palau) is important in informing the World Bank's regional approach.

Geographically, Melanesia is characterized by larger land masses and populations; Polynesia by smaller but relatively compact land masses, and Micronesia by very small and widely dispersed land masses. In terms of natural resources, Melanesia tends to be relatively resource-rich; Polynesia generally possesses adequate resources; while Micronesia tends to be resource-poor, thereby posing some different development opportunities and challenges.

Social cohesion tends to be much stronger in Polynesia than in Melanesia and is intermediate in Micronesia primarily because, though generally sharing a language, the islands of Micronesia are much more widely dispersed. Land disputes also tend to be much more common and significant in Melanesia than in Polynesia, again a reflection of social fragmentation. Traditional social and political systems also differ among the three subregions; for example, clans are primarily a Melanesian social structure and are more extensive than the *ainga* of Samoa or *kainga* of Kiribati.

As such, a key distinction between the Melanesian states and the rest of the region has to do with ethnic tensions, which are sometimes exacerbated by conflict over resource rights. Governance structures and quality vary considerably across the region. Both the Solomon Islands and Fiji have had serious problems in relations between ethnic groups in the last five years, while Vanuatu has also had problems in the past.

There are also differences between the subregions in their susceptibility to natural disasters. The Micronesian islands are generally out of the typhoon/cyclone path, but are more susceptible to the effects of climate change and rising sea levels, due to the low-lying nature of the atolls.

**Table 1. Defining Features of Pacific Island Countries**

	Fiji	Kiribati	Marshall Is	FSM	Palau	Samoa	Solomon Is	Tonga	Vanuatu	EAP region	Low-middle income
Population ('000, 2004)	848	98	53	127	20	179	471	102	215	1,854,500	2,655,200
Km to nearest major port	3,215	4,534	4,501	3,703	1,677	4,340	2,854	3,580	2,471	-	-
Atlas GNI per capita (US\$, 2003)	2,360	880	2,710	2,090	7,500	1,600	600	1,490	1,180	1,080	1,480
Avg. aid per capita (US\$, 1998-2002)	40	198	1,183	911	2,308	194	113	214	187	5	8
Aid as a % of GNI (1998-2002)	2	20	52	45	35	14	16	14	16	1	1
Fertility rate (births per woman, 2002)	2.6	3.6	-	3.5	2.5	4.0	5.3	3.4	4.3	2.1	2.1
Avg. population growth (annual %, 1998-2004)	1.1	2.3	0.9	1.9	1.5	1.0	2.8	0.6	2.6	1.0	0.9

Source: World Development Indicators, 2004.

5. **Communally Focused Cultural Norms.** Unlike the Indian Island and Caribbean countries to which they are sometimes compared, Pacific indigenous cultures have remained strong. They

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continue to play a large part in national life and exert considerable influence over national policies and decision making, thus influencing asset ownership, economic mobility, and overall governance outcomes—all of which vary across the region. The existence of a defining sense of family, clan, and ethnic identity manifests itself in two significant ways. First, social networks defined by clan, and family relations have done much to alleviate the harshest effects of poverty due to access to communally owned land for subsistence agriculture, as well as strong social norms to provide support to the needy in the community. Second, the primacy of the community places social barriers against the development of a culture of aggressive private entrepreneurship, as all successes (and failures) are viewed as belonging to the family or clan. Moreover, these cultural standards mean that there is generally widespread support for the involvement of the public sector in many economic activities that in other countries would be regarded as solely in the sphere of private activity.

6. Land is an asset that identifies family, clan, and lineage. It is valued for what it symbolizes, as well as the subsistence and livelihood it provides. Nonetheless, while the social support networks that are reflected in the importance of communal land ownership have done much to ameliorate real destitution in the Pacific, this aspect of the Pacific identity does present a sizeable barrier to mobilizing investment in the PICs, as communally owned land is generally unavailable to collateralize lending activities. This greatly limits the scale and scope of financial intermediation in the islands. In addition, the high incidence of disputes over land ownership, especially in the Melanesian states, increases the risk premium facing investors considering leasing arrangements; or conversely makes the land open to exploitation in the absence of clear ownership rights (e.g., illegal logging).

7. **Susceptibility to Natural Disasters.** The Pacific Island region is vulnerable to extreme weather events. The potential impact of these events is increasing as the islands' vulnerability rises due to growing urbanization, degradation of coastal ecosystems, and concentration of infrastructure on fragile coastal areas. In addition, climate change and the expected rise in sea levels will further exacerbate current problems. In low-lying islands (such as Kiribati, Marshall Islands, and other atolls), inundation due to storm surges could increase significantly, leading to loss of assets and salinization of groundwater sources. Climate change could also cause more intense cyclones and droughts, prompt the failure of subsistence crops and fisheries, and intensify the spread of infectious diseases.

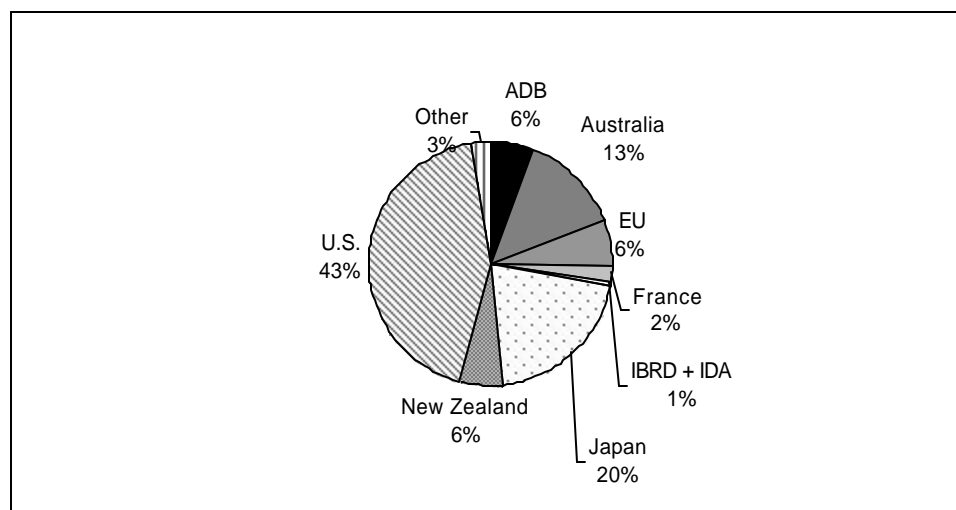
8. **Reliance on Natural Resources.** Pacific countries tend to be highly dependent on natural resources for their livelihood, and resource management is a critical factor in their economic development. The majority of the PIC populations are still dependent on subsistence agriculture and fishing to supplement money incomes. Some islands also have significant mineral resources, and many have commercially exploitable forest and fishery resources. Indeed, in resource-rich but socially fragmented Melanesia, one of the key challenges is the development of cooperation and transparency in the exploitation of resources. The richest tuna fishing grounds in the world are found in the South Pacific. But despite the large exclusive economic zones controlled by many of the PICs, fishing rights are leased out to foreign fishing companies at terms that are not favorable to the Pacific. Access fees represent significant components of government revenue for some of the PICs, especially Kiribati (47 percent) and FSM (25 percent).<sup>4</sup>

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<sup>4</sup> Figures are for 2001 (IMF Article IV staff reports).

9. **Aid Dependence.** With the exception of Fiji, PIC economies are generally dependent on official aid flows (refer back to Table 1). This is in part a legacy of the decolonization process, partly a reflection of international recognition of the problems facing small island states, and partly related to donors' strategic interests in the region. Aid levels, on both a per capita basis and relative to gross national income (GNI), are significantly higher than income-level comparators. Most aid is provided by bilateral donors and, as illustrated in Figure 1, in the last five years the largest donors have been the United States, followed by Japan, Australia, and the European Union (EU). The U.S. aid is focused on the North Pacific, Australian aid on the Melanesia and Polynesia, and New Zealand aid on Polynesia.

**Figure 1. Aid Donors to the PICs (Average 1998-2002)**



Source: *International Development Statistics* online database.

## B. Socio-Economic Manifestations

10. The interactions of the exogenous factors described above have manifested themselves in a number of ways in the Pacific. Focusing on improving their management through the appropriate policies forms the broad basis of the World Bank's engagement in the region. Some of these could be effectively addressed through well-designed regional initiatives.

11. **Dominant Public Sectors.** Large public sectors are characteristic of many PICs, supported by the inability of small population sizes to exploit returns to scale in the provision of public sector services, communal attitudes to proper scope for state involvement, as well as the large aid flows that made feasible its financing. Government spending to gross domestic product (GDP) ranges from a low of around 20 percent in Vanuatu, up to 150 percent in Kiribati (Table 2). Government employment accounts for nearly one-third of total formal employment in Fiji and the Solomon Islands and about two-thirds in Kiribati. This relative size of the public sector, combined with the sizeable involvement of state-owned enterprises in many economic activities, has led to a crowding out of private sector activity. Public sector wage levels tend to drive trends in the private sector, which makes many activities uneconomic, especially when compared to production costs in the low wage economies of South East Asia.

12. As a consequence of the large size of the public sectors in PICs, governance issues affecting the management and control of the public sector budget take on an even greater importance. Table 2 indicates the size of budget deficits over the last five years, which in some cases have been exacerbated by the effects of civil conflict (e.g., Solomon Islands and the attempts of the Fijian government to overcome the downturn associated with the coup of 2000) and the instability of parliamentary majorities (e.g., Vanuatu). In many PICs, weakness in public expenditure management has led to a recurrence of unbudgeted spending and arrears to government employees, to suppliers, or to holders of government debt. More generally, budget management has been weak, with loose procedures for enforcing public accountability and oversight.

**Table 2. Public Sector Indicators**

	Fiji	Kiribati	Marshall Is	FSM	Palau	Samoa	Solomon Is	Tonga	Vanuatu
Government expenditure as a % of GDP, 2004	34.5 <sup>a</sup>	150.0 <sup>a</sup>	78.2	58.8	68.7	32.3	44.1	26.1	20.1
Avg. budget balance as a % of GDP, 1999-2003	-7.7	-3.1	8.6	-2.7	-17.0	-1.1	-6.6	-1.4	-4.0
Public sector debt as a % of GDP, 2003, of which	57.2	26.9	86.5	25.2	19.4	54.0	91.5	47.8	37.2
<i>Domestic</i>	46.2	-	-	-	-	0.1	27.6	3.2	9.0 <sup>b</sup>
<i>External</i>	11.0	26.9	86.5	25.2	19.4	53.9	63.9	44.6	28.2
Proportion of external debt on concessional terms, 2003	13.3	-	-	-	100.0	98.9	96.4	92.4	92.0

Sources: World Development Indicators, 2004, and IMF Article IV Staff Reports

<sup>a</sup> Data for 2003

<sup>b</sup> Data for 2002

13. Despite issues with public expenditure management, total public and publicly guaranteed debt levels have generally been stable or falling over the last five years. Exceptions to this generally positive trend include the Solomon Islands,<sup>5</sup> in which debt levels have increased by around 30 percentage points of GDP; and Fiji, which has seen a smaller, though still significant, increase in debt levels. While most debt in the PICs is on concessional terms, the relative size of the principals outstanding has in some cases raised concerns about the sustainability of additional loans. These concerns, coupled with large bilateral grant assistance, have contributed to shifting the emphasis of the Bank's role toward nonlending services.

14. **Poor Delivery of Public Services.** Pacific Island governments spend comparatively large proportions of their budgets and GDP on the social sectors (Table 3); and donor support for social sectors also dominates. However, these generous resource flows have not, by themselves, shown a significant positive relationship with health or education outcomes, although there is some evidence to suggest that a positive relationship may exist once governance structures are taken into account.<sup>6</sup>

<sup>5</sup> Debt levels and arrears have fallen since the Regional Assistance Mission to the Solomon Islands intervention in 2003.

<sup>6</sup> *Current Trends, Future Opportunities: Human Development Outcomes in the Pacific Islands*, World Bank, 2005.

**Table 3. Public Spending in Social Sectors (2001)**

	Fiji	Marshall Islands	FSM	Palau	Samoa	Tonga	Vanuatu
Public expenditure on health & education as % of total public exp.	27.2	37.5	20.3	24.9	30.3	22.9	43.1

*Source: Human Development Outcomes in the Pacific Islands: Current Trends, Future Opportunities, 2004-05.*

15. The most important challenge for education in the Pacific region is that schooling is not adequately equipping children with the basic skills needed to pursue further studies/training or to succeed in the labor market. Although primary enrolment rates are generally high, many children quit before completing basic education, or complete but without the expected educational achievements. These problems are associated with the variable quality of school facilities, school management, curriculum and learning materials, teachers, and district support staff. Moreover, access to lower secondary schooling is very low in some of the PICs, particularly in Melanesia, largely due to government's insufficient resources to meet the recurrent costs and compounded by the lack of physical facilities. These poor outcomes persist despite the relatively high levels of government expenditures and donor support to education

16. While aggregate health measures, such as life expectancy and infant mortality rates tend to compare well with countries at a similar level of development, the incidence of malaria and HIV/AIDS is quite high and rising in some parts of the Pacific. Non-communicable diseases, such as cancer, diabetes, hypertension, and cardiovascular disease, have also become prevalent and are replacing communicable diseases as the primary cause of death in some of these island economies. The care and treatment of noncommunicable diseases constitute a large burden on households and national health budgets, with treatment often being provided by overseas referral. The fact that a large proportion of recurrent health expenditure is dedicated to expensive overseas tertiary care has meant that there has been limited funding for pro-poor public health programs such as reproductive health and community health care. In addition, there are on-going problems associated with the inability of governments to retain and utilize trained health personnel, as many emigrate in search of better opportunities (notwithstanding the future potential benefits from remittances and knowledge transfers from Diaspora).

17. **Undiversified Exports.** Due to their endowments, size, and remoteness from large foreign markets, the PICs produce a relatively narrow range of goods and services, but they consume and therefore need to import a wide range.<sup>7</sup> For some PICs, merchandise imports are a multiple of exports, implying large merchandise deficits. Table 4 shows the size of the trade and goods and services deficits, and indicates the degree of concentration in goods exports. This reliance on a small number of export goods makes the economies susceptible to terms of trade shocks, and in particular those economies that are almost entirely reliant on commodity exports often face correlated falls in prices. Preferential access into developed markets based on historical factors has

<sup>7</sup> Invisible earnings reduce the gap somewhat in most countries, except the Solomon Islands, Marshall Islands, and FSM. Of these, tourism earnings are important for Fiji, Vanuatu, Tonga, and Samoa; and remittance flows are a major contributor to the Kiribati, Tongan, and Samoan economies. Despite these flows, a large gap remains that is met through aid.

also played a role in distorting trade competitiveness and left these small economies vulnerable to the duration of these special terms.

**Table 4. External Trade Indicators**

	<b>Fiji</b>	<b>Kiribati</b>	<b>Marshall Is</b>	<b>FSM</b>	<b>Palau</b>	<b>Samoa</b>	<b>Solomon Is</b>	<b>Tonga</b>	<b>Vanuatu</b>
Average trade deficit as a % of GDP, 1999-2003	-10.1	-42.6	-43.9	-39.3	-75.9	-15.2	-5.7	-32.4	-24.5
Average deficit in G&S as a % of GDP, 1999-2003	-5.4	-56.7	-48.0	-44.3	-35.5	-25.6	-5.8	-33.8	-5.3
Main exports (% of total exports)	Garments (20), Sugar (18)	Copra (23), Seaweed (16)	Diesel reexport (72), Copra cake (15)	Fish (92), Banana (1)	Garments (100)	Fresh fish (36), Garments (10)	Timber (67), Fish (17)	Squash (37), Fish (32)	Copra (12), Cocoa (3)

*Sources: World Development Indicators, 2003; IMF Article IV Staff Reports; Central Bank Bulletins.*

18. **Subdued Private Sector Activity.** The role of the private sector has generally been marginal in the Pacific, in large part a reflection of the constraints posed by small population sizes and the marked remoteness of these island states. Cultural standards opposing the development of aggressive private entrepreneurship, communal ownership of land that renders it unavailable for collateralization, and large flows of foreign aid that have supported bloated public sectors have also combined to constrain private sector development. Key public utilities, such as those in the power, telecommunications, and water subsectors, are too often inefficient and unreliable, imposing large costs on private sector activity. Furthermore, planning and management in natural resource-based sectors, such as forestry and fisheries, has been weak or subject to corruption undermining the ability of these sectors to contribute to growth.

19. Recent Bank work on benchmarking the Doing Business Indicators in 2005 has illuminated some of the regulatory constraints to private sector growth. While the data do show significant variation in the performance of the individual PICs, common features include a lack of disclosure on ownership and business financials, time consuming and costly contract enforcement, and weak bankruptcy resolution practices.

20. **Significant Costs Imposed by Natural Disaster Cleanup.** Since 1950, the reported cost of extreme events (primarily cyclones and droughts) in the PICs has been significant (Table 5). During disaster years the average economic losses are nearly half of GDP for Samoa and a third of GDP for Vanuatu, and over 40 percent of the population of Tonga and Samoa are affected. While extreme weather events will always be a major factor in the Pacific, there is much that can be done to alleviate this risk, such as introducing appropriate adaptation measures that reduce the vulnerability of physical assets and local populations. These include setting back infrastructure from vulnerable areas, better management of coastal ecosystems, and protection of water sources.

During the 2004 Cyclone Heta, Samoa is estimated to have saved up to US\$165 million in damages due to hazard management procedures adopted in the 1990s.

**Table 5. Losses Due to Natural Disasters**

	<i>Number disasters reported</i>	<i>Average annual total affected (% of total population in disaster years)</i>	<i>Average annual total affected (% of total population, 1950-2004)</i>	<i>Average annual damages (% of GDP in disaster years)</i>	<i>Average annual damages (% of GDP, 1950-2004)</i>
<b>Fiji</b>	38	10.8	5.1	7.7	2.7
<b>Samoa</b>	12	42.2	6.1	45.6	6.6
<b>Tonga</b>	37	42.0	5.3	14.2	1.8
<b>Vanuatu</b>	16	15.5	4.5	30.0	4.4

*Source: EM-DAT: the OFDA/CRED International Disaster Database for 1950-2004 data, adjusted by SOPAC (2005) for 1994-2004 data.*

21. **Rapid Population Growth.** Fertility rates in the PICs are high, and well above both regional and income-level averages, particularly for Melanesian countries, such as the Solomon Islands and Vanuatu (refer to Table 1). In most cases these high fertility rates have generated high population growth rates, although those countries for which emigration is available (Samoa and Tonga to New Zealand, and the Northern Pacific countries to the United States) have managed to ameliorate this issue somewhat. Nevertheless, around 40 percent of PIC population are between 0 and 15 years of age (and another 20 percent is between 15 and 24), and this expanding youth bulge is exerting significant pressure throughout PIC societies.

22. **Stagnant Economic Growth and Poverty.** All the issues highlighted above have contributed to the stagnant growth performance exhibited by the PICs over the last five years, which is consistent with longer-run trends (Table 6). While Samoa and Fiji have been the better performers in the Pacific, even they still lag behind regional and income-level comparators to a significant degree. In the case of the Solomon Islands and Vanuatu, living standards have fallen significantly over the period. In Vanuatu's case, real per capita incomes in 2004 are the same as they were at independence in 1980.

23. While the poverty data are not strictly comparable across countries because they are based on nationally defined poverty lines, Kiribati, Vanuatu, and FSM (and very likely Solomon Islands) have high percentages of their populations living in poverty. Anecdotally, there is an understanding that with the gradual erosion of traditional support systems, rural-urban migration, and a move away from subsistence farming, poverty (or "hardship" as it is referred to in the Pacific) is rising significantly.

24. Unemployment statistics also signal elevated risk levels in some countries. Figure 2 presents unemployment rates according to recent censuses in all nine Pacific countries.<sup>8</sup> The

<sup>8</sup> Due to the limitations of the census instrument, definitions of unemployment within the census data bases differ in some respects from those used to calculate unemployment from labor force surveys. For example, it is not possible to distinguish active from inactive unemployed in all surveys. However, the analysis permits a consistent comparison between and within countries of the order of magnitude of unemployment.

results show several important patterns. First, there is wide variation in unemployment rates among Pacific countries. The Solomon Islands and FSM report much higher levels of unemployment than the other countries, with the former registering over 30 percent unemployment. In Tonga and Marshall Islands, rates are moderate (officials have reported an increase in Tonga and Fiji since 1996). It is important to note that in countries where the measured unemployment rate is very low (e.g., Kiribati), employment is predominately in subsistence work.

**Table 6. Average Growth in Per Capita Income and Population in Poverty**

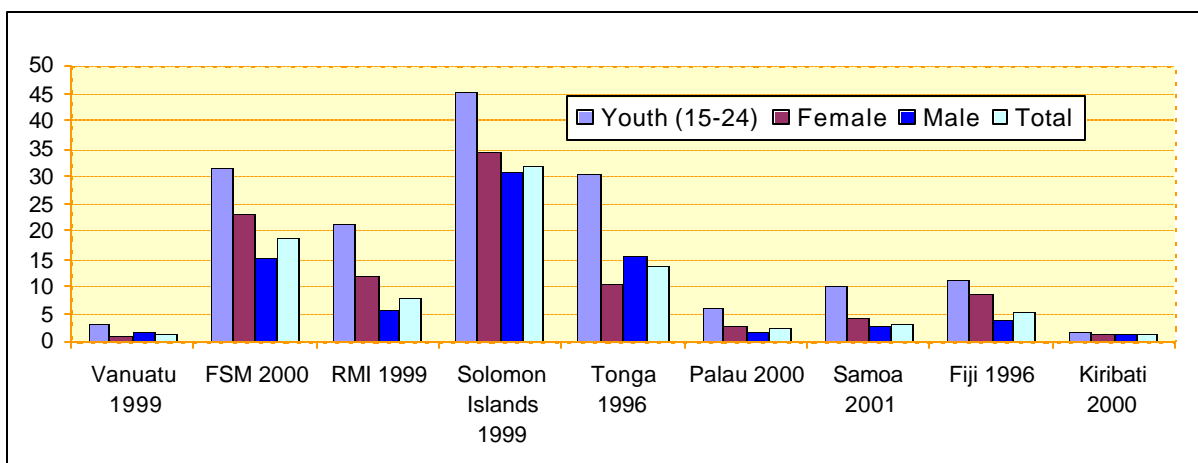
	Fiji	Kiribati	Marshall Is	FSM	Palau	Samoa	Solomon Is	Tonga	Vanuatu	EAP region	Low-middle income
Average growth in real GDP per capita, 1999-2003	2.6	0.9	0.1	-0.1	2.0	3.0	-7.4	2.1	-2.4	5.6	3.7
Percent population below poverty line (latest year available)	26	51	20	40	-	20	-	23	40	-	-

Source: World Development Indicators, 2003, and Asian Development Bank estimates.

Note: Poverty statistics are based on nationally defined poverty lines.

25. A second important pattern is the high level of youth unemployment. While expected to be relatively high in any labor market, youth unemployment is more than double the total male unemployment rate in most of the Pacific countries (Fiji, FSM, Marshall Islands, Palau, Samoa, and Tonga). At the same time, the female unemployment rate is consistently higher than the unemployment rate of males, except for Tonga.

**Figure 2. Youth Unemployment Rates**



Source: Human Development Outcomes in the Pacific Islands: Current Trends, Future Opportunities, 2004-05.

Note: Updates and projections for youth unemployment are estimated in the context of the labor mobility study using latest population projection figures and estimates of sectoral demand for labor in the PICs.