

In this issue of the APD *Small States Monitor*...

- **IMF Deputy Managing Director Furusawa visited Fiji for the ADB Annual Meetings**, speaking at a panel on debt sustainability. He noted that global debt is at an unprecedentedly high level and discussed with panelists ways to manage debt that would foster growth and stability.
- **Correspondent banking and remittances have remained a key priority for IMF staff.** In May, the IMF hosted a Roundtable focusing on specific actions to strengthen compliance with international AML standards while lowering costs. Actions include capacity building and strengthening cooperation among banks, money transfer operators, authorities, and IFIs. The Singapore Training Institute hosted its first pilot workshop on correspondent banking issues for Pacific Island officials.
- **In a new IMF paper, we propose a strategy for the adoption of fintech** that could help Pacific Island Countries harness the benefits of such technologies while managing the risks.
- **PFTAC and the Asian Development Bank held a workshop on managing fishing revenues** in the Solomon Islands in August. Fishing revenues are the most important export and source of revenue for some countries in the Pacific and changes in climatic conditions may affect fishing patterns in future.



DMD Furusawa at the ADB Annual Meeting in Fiji, joined by panelists Dr. Kshama Fernandes, Takehiko Nakao, Sonja Gibbs, Dr. Ishrat Husain, and Stefania Palma (left to right) at a seminar on debt sustainability.

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By APD Small States Division

Alison Stuart (Project Leader)

Robin Koepke & Justin Flinner (Project Coordinators)
with inputs from David Kloeden, Emmanuel Mathias, Iris Claus, Jonathan Pampolina, Leni Hunter, Masahiro Nozaki, Richard Neves, Scott Roger, Sonja Davidovic, Vybhavi Balasundharam, and APD small states mission teams

The analysis and policy considerations discussed in this publication are those of the IMF staff and do not represent official IMF policy or the views of IMF Executive Directors or their national authorities.

Please send questions and comments to APDSS@imf.org and AStuart@imf.org

Recent Developments

Growth in the Pacific Island Countries (PICs) is expected to rebound to 4.7 percent in 2019 from 1.4 percent in 2018, primarily driven by the recovery from the earthquake in PNG. Activity in Samoa benefitted from infrastructure related spending and tourism activity for Pacific Games in July 2019, while in Timor-Leste activity was boosted by planned increase in petroleum production and recovery in public spending. In some other countries, growth was hampered by falling private investment and a slowing of tourism-related activities, notably in Palau. The Solomon Islands and Vanuatu were also affected by Cyclone Oma.

Current account balances improved in most countries compared to the 2000-16 average and reserves coverage has been above minimum thresholds. Countries such as Tuvalu and Kiribati benefitted from an increase in fishing license fees, while for PNG, petroleum export receipts improved as oil prices rose. Micronesia's current account surplus reflects the authorities' prudent policy to save windfall tax revenues from investment companies domiciled in the FSM. However, current account balances are expected to deteriorate in several countries due to increased infrastructure spending (notably for Solomon Islands and Marshall Islands), decreased revenues from economic citizenship programs in the case of Vanuatu, declining fishing license fees in Kiribati and scaling down of the Australian Regional Processing Center in Nauru.

There are, however, significant short-term downside risks. PICs have been hit by several major national disasters that inflict large losses on their economies. Due to their size and location, they are particularly vulnerable to climate risk. They should prepare for the prospect of increasing severity and frequency of such disasters. Global trade tensions weighing on the world growth outlook and subdued growth in Asia could dampen the growth for tourism-intensive countries like Fiji, Samoa, Vanuatu, Tonga and Palau and commodity exports-driven countries like Solomon Islands, PNG and Timor-Leste.

Lower energy prices could reduce import costs of energy importers but will lower export earnings for PNG and Timor-Leste. Lower international oil prices between 2014 and 2017 were beneficial to the oil importing countries of the region but they negatively affected PNG and Timor-Leste.

Near-Term Outlook

Fishing revenues are expected to remain stable across the region in the near term. Risks to the outlook are skewed to the downside for some countries with adverse implications for fiscal balances and current accounts, notably in Kiribati, Tuvalu and Nauru. Over the longer run, modelling by FAO suggests significant displacement of skipjack (eastward), yellowfin (eastward) and bigeye (eastward) tuna and South Pacific albacore (poleward) by 2050 in response to climate change. Preliminary analyses indicate that government revenue derived from tuna fishing license fees will markedly decrease for PNG, FSM, Nauru, Kiribati, Tuvalu and Palau while increasing in Fiji and Vanuatu.

Some economies will face challenges keeping debt on a sustainable track while investing in infrastructure. There is substantial variation in debt levels across the Pacific. Public domestic and external debt ranged from just 3 percent of GDP to 56 percent of GDP in 2018, with a median public debt level of 35 percent of GDP. The overall public debt level has been rising for Samoa, Tonga, Vanuatu and PNG. The long pipeline of development projects in many of the PICs is likely to put upward pressure on debt ratios, notably in Tonga, Samoa, and Vanuatu. The increased involvement in the region of a range of development partners, and greater availability of concessional loans, may encourage countries to take on more debt. To ensure debt sustainability, governments should prioritize infrastructure projects carefully while engaging in further fiscal reform and strengthening public financial management. Focusing on resilient infrastructure projects can help countries to cope with natural disaster shocks in the long run.

APD Small States: Real GDP Growth (Year-on-year change; in percent)

	2018	2019 (proj)	2020 (proj)	2021 (proj)
Bhutan	4.6	5.5	7.2	5.9
Fiji	3.5	2.7	3.0	3.2
Kiribati	2.3	2.3	2.3	2.0
Maldives	7.0	6.3	5.5	5.5
Marshall Islands	2.6	2.4	2.3	2.0
Micronesia	1.2	1.4	0.8	0.7
Nauru	-1.5	1.5	0.7	1.3
Palau	1.7	0.3	1.8	2.2
Papua New Guinea	-1.4	5.1	3.3	3.5
Samoa	0.9	3.4	4.4	2.2
Solomon Islands	3.9	2.7	2.9	2.7
Timor-Leste ¹	-0.2	4.5	5.0	4.8
Tonga	1.5	3.5	3.7	2.9
Tuvalu	4.3	4.1	4.4	4.2
Vanuatu	3.2	3.8	3.1	2.8
APD small states and Pacific islands ²	1.4	4.7	4.1	4.0
Small Pacific island countries ^{2,3}	3.1	2.8	3.0	2.9

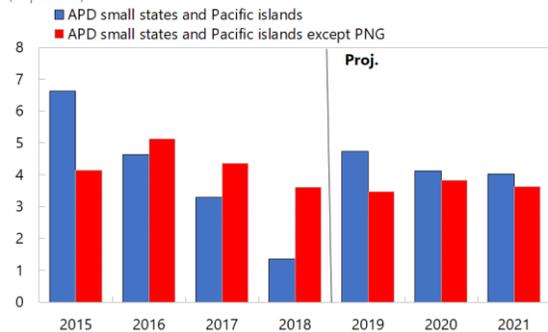
1/ Non-oil GDP; 2/ Weighted average by PPPGDP;

2/ Weighted average by nominal GDP.

3/ Includes Fiji, Kiribati, Marshall Islands, Micronesia, Nauru, Palau, Samoa, Solomon Islands, Tonga, Tuvalu, and Vanuatu.

Growth in the PICs ex. PNG is projected to remain around 3% in coming years

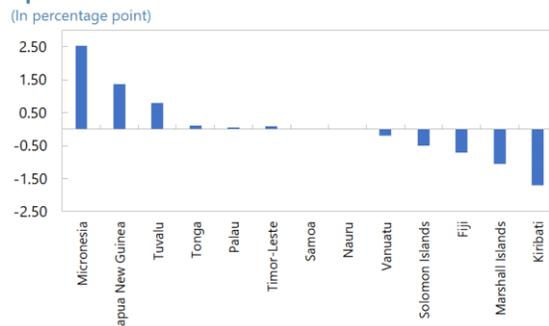
Real GDP Growth in APD Pacific Island Countries
(In percent)



Sources: IMF, World Economic Outlook, and staff calculations.

The outlook has improved in Micronesia and PNG, while other PICs have seen growth forecasts revised down

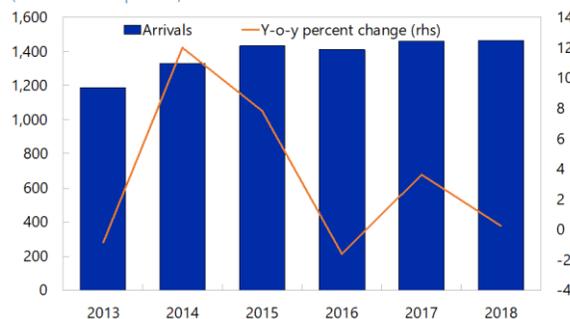
Real GDP Growth Revisions to 2019 Growth Forecasts since April WEO
(In percentage point)



Sources: WEO

The tourism sector has slowed recently

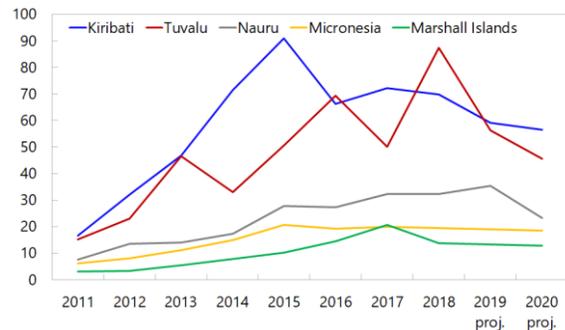
Visitor Arrivals in Selected Pacific Island Countries
(In thousands of persons)



Note: Includes Fiji, Samoa, Palau, PNG, Solomon Islands, Tonga and Vanuatu.
Sources: South Pacific Tourism Organisation (SPTO).

Fishing revenue has been buoyant but is expected to ease back

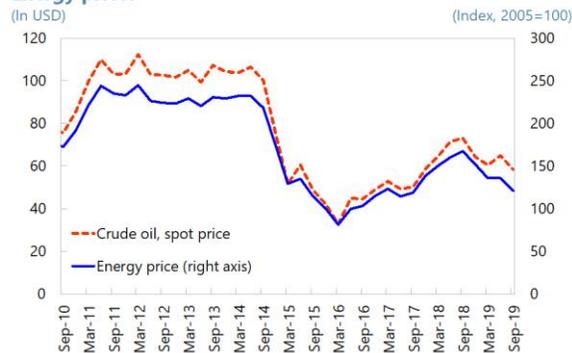
Outlook for Fishing Revenue in the Pacific
(Fishing revenue in percent of GDP)



Sources: Country authorities, and IMF staff projections.

Energy prices have eased in recent months, benefitting oil importers

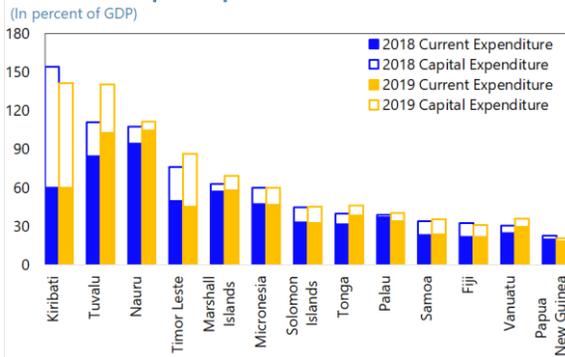
Energy prices



Sources: World Economic Outlook Database.

Small countries face large and growing public spending, in part due to sizeable investment needs

Current and Capital Expenditure

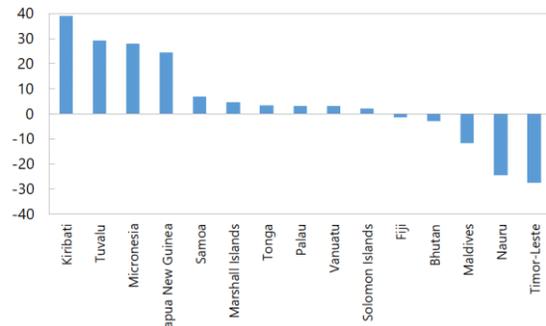


Sources: Countries authorities; and IMF staff estimates and projections.

Many PICs have seen large swings in current account balances, in part due to commodity price fluctuations

Change in Current Account Balances

(2017-18 average vs 2000-16 average; in percent of GDP)

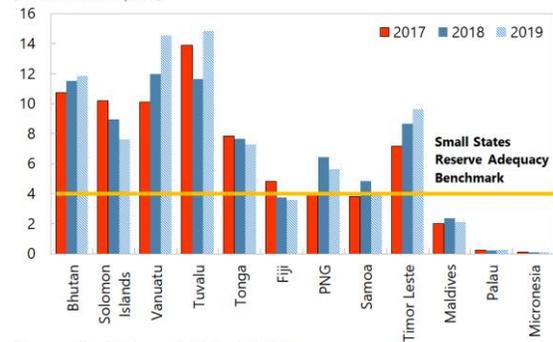


Sources: World Economic Outlook Database.

Most small states have comfortable reserve buffers, though a few fall short of reserve adequacy metrics

Official Reserves

(In months of imports)

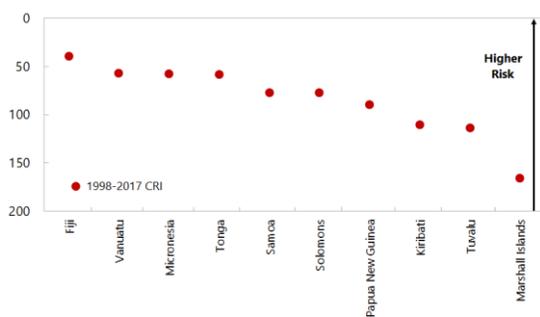


Sources: World Economic Outlook Database.

Many PICs are highly exposed to climate change risks

Long-Term Climate Risk Index for Pacific Island Countries

(Countries with lower CRI scores are more impacted and should consider the CRI as a warning sign)

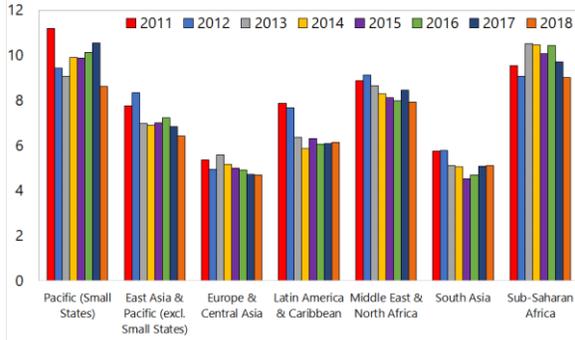


Source: Global Climate Risk Index 2019.

The cost of sending remittances to the region remains high by international comparison

Cost of Remittance by Destination Region

(In percent of amount sent)

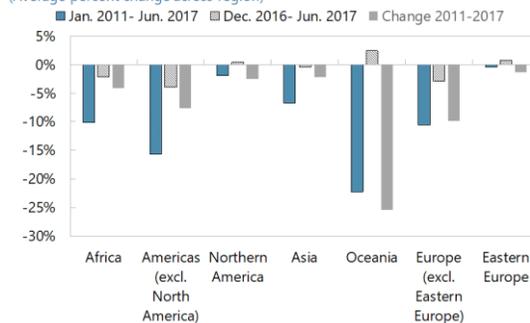


Sources: World Bank, Remittance Prices Worldwide; and IMF staff calculations.

The number of active counterparty countries has fallen sharply for Pacific Island Countries

Number of Active Counterparty Countries by region

(Average percent change across region)

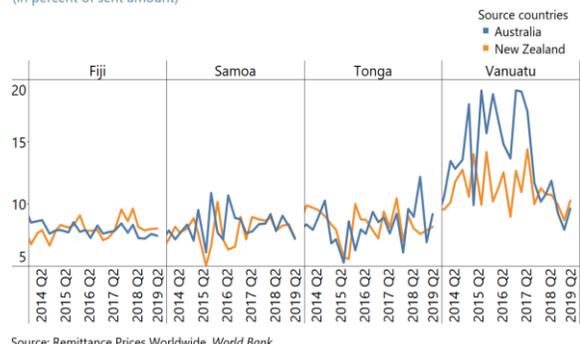


Sources: Financial Stability Board; SWIFT Watch; and National Bank of Belgium.

Countries continue to face significant costs for sending remittances, though Vanuatu's costs have eased after being removed from the FATF AML deficient list

Quarterly average costs of sending AU\$200 or NZ\$200 via MTOs

(in percent of sent amount)



Source: Remittance Prices Worldwide, World Bank.

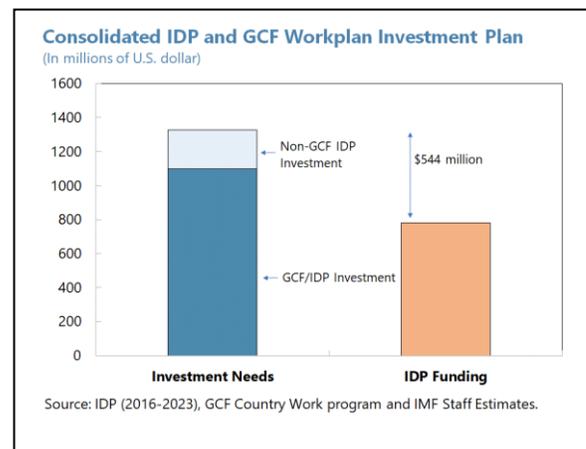
Federated States of Micronesia: Lessons from a Climate Change Policy Assessment

By Masahiro Nozaki

A first Climate Change Policy Assessment (CCPA)¹ was conducted in the Pacific region—for the Federated States of Micronesia (FSM) in June 2019. The assessment was an integral part of the 2019 Article IV Consultation. The CCPA is a joint initiative by the IMF and World Bank to assist small states to understand and manage the expected economic impact of climate change, while safeguarding long-run fiscal and external sustainability. The assessment is a comprehensive stocktaking of climate response plans and their macroeconomic and fiscal implications. It identifies policy gaps and resource needs, and suggests relevant reforms that could strengthen a national strategy for climate change mitigation and adaptation. Since 2017, CCPA pilots have been completed for Seychelles, St Lucia, Belize, and Grenada. A CCPA is planned for Tonga in 2020.

The main findings for FSM:

- FSM has made significant strides to address the effects of climate change, but more action is required. Preparing a National Adaptation Plan and a comprehensive Disaster Resilience Strategy (DRS) could bolster the country's climate change preparedness.
- Accelerating adaptation investments is paramount, which requires addressing critical capacity constraints and increasing grant financing. Progress has been hindered by capacity constraints, particularly in investment project execution at the state level. FSM has a financing gap of around \$500 million over the next 15 years between its ambitious climate change investment plans and currently available grant funding. Improvements in public financial management will support an acceleration of adaptation investment in a fiscally-sustainable manner.
- FSM needs to increase its capacity to address natural disaster risk. Currently, the government relies on the provision of disaster funding from the United States through the Compact Agreement; it is unknown whether this support will continue after the expiry of the Agreement in 2023. FSM could be better prepared for post-2023 by putting in place a National Disaster Risk Financing Strategy as a central element of a broader DRS. This would guide future policy making on risk transfer and retention and provide a framework for seeking increased international support.



The FSM pilot suggests that CCPAs can be a highly useful exercise for other Pacific island countries, as they allow in-depth analysis on macroeconomic implications of climate change and natural disasters, drawing on a wide range of expertise from the IMF and World Bank.

¹ Link to the CCPA: <https://www.imf.org/en/Publications/CR/Issues/2019/09/06/Federated-States-of-Micronesia-Climate-Change-Policy-Assessment-48665>.

By Richard Neves

Fishing revenues are the most important export and source of revenue for some countries in the Pacific and changes in climatic conditions may affect fishing patterns in future. PFTAC and the Asian Development Bank (ADB) co-funded a workshop on managing fishing revenues held at the Pacific Island Forum Fisheries Agency (FFA) in the Solomon Islands in August 2019.

The workshop was a regional effort with a number of regional organizations contributing their expertise across a range of topic areas in the sector including the: ADB; PFTAC; FFA, Parties to the Nauru Agreement (PNA) Secretariat; and the Secretariat for the Pacific Community (SPC). Participants included senior officials from Ministries of Finance and Marine Authorities from those countries where the national budget is significantly dependent on fishing revenue.

Participants provided an initial update on developments within the fishing sector in their own country. The regional organizations provided participants with the latest assessment on the state of the fisheries and expected future trends. The workshop examined the change in country spending patterns since national budgets began to benefit from increased fishing revenues.

Practical tools, developed by PFTAC, to assist countries with improving revenue forecasts in their budgets were shared and examined along with presentations on: (i) approaches to fiscal policy that would accommodate the volatility that can arise from fishing revenue; and (ii) improving transparency around public finances and activities in the fishing sector. The IMF resident representative provided an update on the IMF's role of monitoring national economies and the importance of better understanding the impact of the fishing sector in the economic outcomes of various nations.

The Western and Central Pacific (WCP) catch of 2.7 million metric tonnes in 2018 was the second highest on record, with purse seining accounting for 70 per cent of the catch. Participants learned that the WCP tuna fishery is in a healthier state than other fisheries with no species being overfished. Revenues to Pacific countries from increased license fees have increased from USD 60 million in 2010 to around USD 500 million p.a., these are expected to remain at a similar level over the medium term.

However, climatic conditions (as measured by the southern oscillation index) have a significant impact on which country's Exclusive Economic Zone (EEZ) the tuna will actually be caught. Climate change patterns will have a further impact with tropical tuna biomasses expected to remain stable until 2050, with yellowfin and skipjack stocks expected to shift eastwards, and uncertainties remaining for other species. Some countries will need to examine ways in which they can mitigate the impact on their budgets from stocks shifting from their EEZs as a result of climate change impacts.



[Presentations are available on the PFTAC website.](#)

By Sonja Davidovic

Peoples' connection to new technology is built on the backbone of electrical and fiber-optic cables running beneath our feet—and under oceans. In a new IMF paper, we propose a strategy for the adoption of fintech that could help Pacific Island Countries harness the benefits while managing the risks.

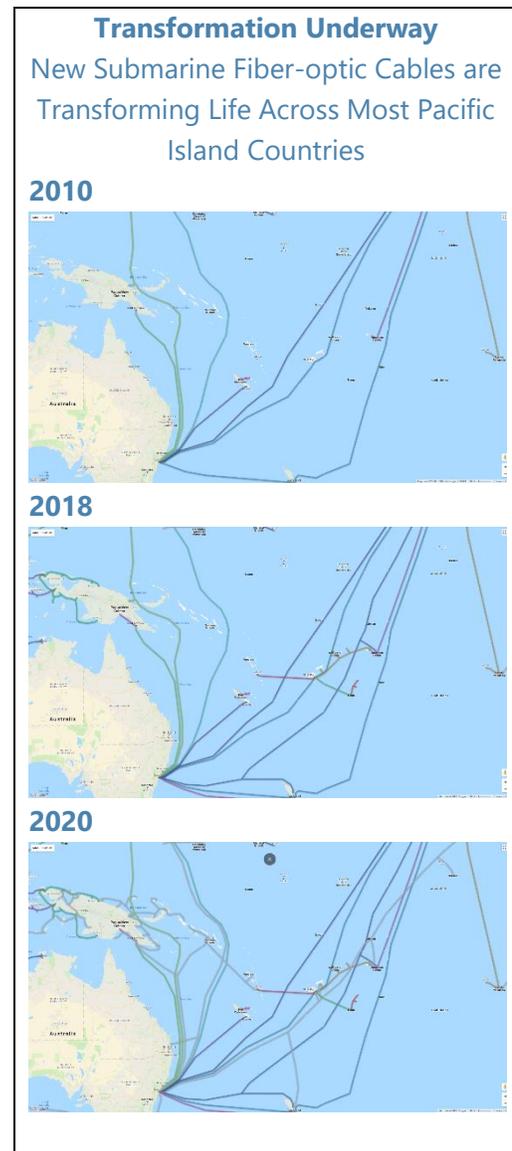
In 2010, most economies that were not connected to the modern, cabled internet could be found in the Pacific. However, this is no longer the case, and by 2020 the region will be almost completely connected. The technological transformation taking place in the Pacific island countries, where the completion of submarine fiber-optic cables will facilitate technology-enabled financial inclusion.

The spread of innovative financial technologies, known as fintech, has expanded financial opportunities to more and more people.

Faster connectivity provided by higher network bandwidth will accelerate the adoption of more sophisticated fintech applications. More advanced, smartphone-enabled fintech applications use a large volume of data and require fast connectivity through higher-bandwidth 3G, 4G, or 5G networks. In many Pacific island countries, however, older and lower-capacity 2G connectivity predominates.

Higher-network bandwidth will allow Pacific island countries to exploit the benefits of technologies beginning with faster and more efficient payment systems. But governments could also harness technology to improve tax collection, government transfers, trade financing, and land registries. Households and businesses will obtain enhanced and more secure access to finance using modern authentication techniques like biometric identity, combined with other authentication factors, to conduct financial transactions through blockchain-enabled mobile wallets on their smartphones. The financial sector will also leverage biometric technology to comply with know-your-customer requirements and use big data to build out their clients' credit information and assess their creditworthiness.

A [new IMF paper](#), *Strategy for Fintech Applications in the Pacific Island Countries*, discusses how fintech solutions in the Pacific islands can complement existing efforts to promote financial inclusion, enhance financial sector development, and increase inclusive growth potential, thereby reducing poverty. Areas for development are: payment systems, identification requirements, credit information sharing, and risk management. Regional approaches could help overcome capacity and scalability constraints.



By Scott Roger

Auckland Roundtable on Correspondent Banking and Remittances, Auckland, May 2019

In May, APD and the IMF Legal Department hosted another Roundtable on correspondent banking and remittance issues in the Pacific. Earlier Roundtables had looked at factors contributing to closure of money transfer operator (MTO) accounts with large banks in the region, which makes it more difficult and costlier for Pacific islanders living and working in Australia, New Zealand and the US to send savings back to the islands. At the Auckland Roundtable, the focus shifted towards agreeing on specific actions to strengthen compliance with international AML standards while also lowering costs. Most agreed actions involve strengthening cooperation and coordination among banks, MTOs, authorities, and IFIs. Other measures focus on capacity building, and developing a regional know-your-customer utility. Progress in implementing the action plan will be reported back to stakeholders periodically by the IMF.

By Jonathan Pampolina & Emmanuel Mathias

Singapore Training Institute

Workshop on Correspondent Banking Relationships (June 2019)

The IMF held a pilot workshop on correspondent banking relationships (CBR) in Singapore.

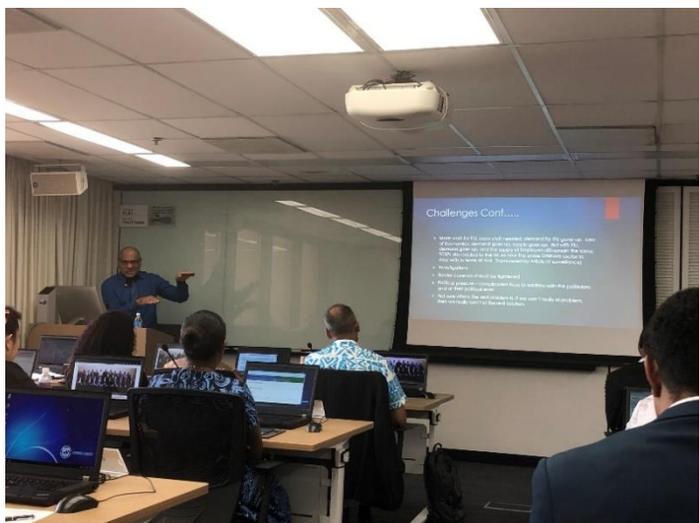
Twenty-five key officials from 12 Pacific Island Countries (PICs) and other stakeholders were invited as participants. Representatives from global correspondent banks, respondent banks, and other international financial institutions contributed to the discussions as speakers. The event was an opportunity for constructive dialogue to gain a better understanding of the drivers of CBR pressures in the Pacific region. The participants explored various possible solutions to address risk and profitability concerns in CBRs of banks and money transfer operators. The discussions also focused on the potential for further outreach, capacity building activities and leveraging financial technology. Given the successful engagement of this pilot workshop, IMF staff is considering replicating and customizing the course in other regions experiencing acute CBR pressures and will hold a follow up course next year.



COURSE ON ADDRESSING PRESSURES ON CORRESPONDENT BANKING RELATIONSHIPS: A GUIDE FOR PACIFIC ISLANDS STATES
JUNE 10 – 14, 2019
SINGAPORE



From Row (L-R) : Nathan Yingsi, Mike Mallinan, Peter Wong, Francisco Figueroa, Emmanuel Mathias, Natan Epstein (Deputy Director), Ananthakrishnan Prasad, Clive Scott, Jochen Schmittmann, Richard Williams, Sreelakshmi Decherong
Middle Row (L-R) : Batebeba Asele, Daphney Maripi Nibarau, Fakole Mika, Godfrey Loloma, Jimmy Sendersley, Nelson Jay Werner, Hussein Derba, Madeline Ann Tambisari, Kuenti Fritia, Aline Tan (Senior Programs Executive)
Back Row (L-R) : Neumi N.W. Utumaki, Piliha William Palik, Samuel Boeman, Rosim Buksh, Lepeni Ulainevili, Sica Atins'e Siba, Damon Iyoneb Adeng, Willem Touffor Akaurio, Galenai Pata, Jesse Glimmer, Jimmy Vajih



Incoming Staff



Todd Schneider, incoming Division Chief for the Small States Division joining November 2019, is a U.S. national and currently the Deputy Chief for the Japan Division in the IMF's Asia & Pacific Department. Before coming to his current position, he was IMF mission chief for Sri Lanka, Nepal, Tajikistan, and Yemen. Prior positions include Deputy Financial Attaché' in the U.S. Embassy in Tokyo (1999-2001); Advisor to the U.S. Executive Director of the IMF (1997-99); and International Economist for the U.S. Treasury Department, where he served on the U.S. negotiating team during the WTO Uruguay Round financial services negotiations, and as the principal coordinator of the U.S.-China and U.S.-Korea subcabinet economic dialogues.



Vybhavi Balasundharam is an Economist (EP) in the Small States Division of APD. She joined the IMF in September 2019. Previously, she was a PhD intern at the IMF in the Strategy, Policy and Review department. Her research interests include growth, development and international trade, with a focus on productivity and firms. She is an Indian national and holds a Ph.D. in Economics from University of Michigan.



Robin Koepke joined APD and the Small States Division in October, serving as desk economist on Fiji and Indonesia. He previously worked in the IMF's Monetary & Capital Markets Department, where he focused on market surveillance and contributed to the Global Financial Stability Report. Before joining the IMF in 2016, he spent six years at the Institute of International Finance (IIF), the global association of financial institutions, where he focused on international capital flows and the U.S. economy. He is a German national and holds a Ph.D. from the University of Wuerzburg.



Seohyun Lee, a South Korean national, is an Economist in the Small States Division. She joined the IMF in June 2019 as a secondee of the Bank of Korea. At the Bank of Korea, she mainly worked in the Economic Research Institute, the Research Department and the Monetary Policy Department, where she was responsible for forecasting and monetary policy analysis supporting the Monetary Policy Committee as well as publications of academic papers on various topics of macroeconomics. She holds a PhD in Economics from University College London (UCL), and a master's degree in Economics from London School of Economics (LSE) with financial support from Chevening Scholarship. Prior to join the IMF, she also worked at the European Bank for Reconstruction and Development (EBRD) on the 2013 Transition Report.



Yun He, a Chinese National, joined the Small States division as a research assistant in June 2019. She previously worked on Singapore, Malaysia and Brunei as a research assistant for the ASEAN 3 Division in APD. Prior to joining the IMF, Yun He worked as a short term Consultant II in the Macroeconomics and Fiscal Department at the World Bank Group, a trading desk analyst at the Industrial and Commercial Bank of China and a data analyst at the Hutchison Telecommunications, Hutchison Whampoa Limited. Yun He holds a Master of Science in Finance degree from American University and Honors Bachelor of Science in Economics and Statistics degree from University of Toronto.

Incoming Staff



University, School of Advanced International Studies.

Haopeng Xu joined the Small States Division as a research analyst in July 2019. He covers Micronesia, Solomon Islands, Tuvalu, and Kiribati. Prior to joining the IMF, he worked at Institute of International Finance as an intern research analyst in China Division, assisting the analysis of China's macroeconomic framework. He holds a bachelor's degree in Economics and Mathematics from Boston University and a master's degree in International Economics and Finance from John Hopkins

New Mission Chiefs



Independent Evaluation Office (2010–2012) participating in the evaluation of the IMF's performance in the run-up to the global financial crisis. She holds a Masters and PhD in Economics from Columbia University.

Angana Banerji, mission chief for Tonga, is a Senior Economist in the IMF's Asia Pacific Department Regional Surveillance Division. Prior to this she was in the IMF's European Department, leading the policy and analytical work stream on structural reforms in the Euro Area (2013–17). She was the IMF's mission chief for Cyprus, Netherlands Antilles and San Marino, and has worked on a broad range of advanced and emerging market economies such as Greece, Indonesia, Malaysia, Russia, and Vietnam. She was previously a Lead Evaluator at the IMF's



University of Auvergne in France.

Tidiane Kinda, mission chief for Palau, is a Senior Economist in the IMF's Asia and Pacific Department, where he was previously Special Assistant to the Director. Since joining the Fund in 2009, he also worked in the African Department and the Fiscal Affairs Department and covered a wide range of countries in the context of surveillance and IMF programs, including the Euro Area, Canada, Indonesia, Croatia, Moldova, and Chad. His work experience prior to the IMF includes the World Bank's Research Department. He holds a Ph.D. in Economics from CERDI-



Department and assisted the Director and the Economic Counsellor of the IMF for various projects, including work on surveillance of G7 economies as well as APEC and ASEAN regions, and regular presentations at the Board to keep its members abreast of the world economic and financial market developments. Ken is a Japanese national and holds a PhD in Economics from the University of Michigan.

Ken Kashiwase, mission chief for Samoa, is a Senior Economist in the Asia and Pacific Department (APD). He joined the IMF in 2010 and has since worked in the Expenditure Policy Division of the Fiscal Affairs Department (FAD) and APD. He took up an assignment to work as a representative of the IMF Regional Office for Asia and the Pacific (OAP) in Tokyo as Deputy Head of Office during 2015-2018. Prior to joining FAD, he worked as an economist at the U.S. Congressional Budget Office. During 1999-2005, he worked in the front office of the IMF Research

By Leni Hunter, Resident Representative of Pacific Island Countries Pacific

Bula Vinaka, Kia Orana, and Pacific Greetings.



In May Leni and Josia Nakete (from PFTAC) assisted with DMD Furusawa's visit to Denarau for the ADB

Annual Meetings – the largest international conference held in Fiji to date. The DMD spoke on a panel on debt sustainability, which was co-hosted by the IMF and ADB. The DMD noted that debt is at an unprecedentedly high level, and debt in Emerging and Developing Asia has been on a rising trend since the global financial crisis. Panelists discussed how to manage debt so it does not jeopardize future growth and stability, agreeing that improved information on public and private debt is needed for better debt management.

Pule and Leni joined the roundtable on Correspondent Banking Relationships that was held in May, in Auckland. The roundtable was well supported by regional central banks and regulators, as well as representatives from commercial banks and international development partners. The Fund will continue to engage with stakeholders to move forward with the work agenda identified at the roundtable.

Jacinta's term will finish at the end of 2019, but we are looking forward to her replacement from the Reserve Bank of Fiji. In addition, the third local economist position was advertised in August in Fiji and Pacific country central banks and Ministries of Economy were invited to send applications. The successful candidate will start in coming weeks.

The Resident Representative Office and PFTAC teams moved back to their renovated offices in the Reserve Bank after Easter, and have largely settled back in (photos of the new office are on page 21). Many thanks to our colleagues and friends in the Reserve Bank of Fiji for kind assistance during the renovation. We are also grateful to the Fijian authorities for taking steps to recognize the IMF as a Specialized Agency under the United Nations Convention on Diplomatic Immunities and Privileges, paving the way for the next step of an MOU with PFTAC.



Kshama Fernandes, Takehiko Nakao, Sonja Gibbs, DMD Furusawa, Ishrat Hussein, Stefania Palma



FSM AIV and CCPA Teams, with ED Nigel Ray and Eugene Amor

By David Kloeden, PFTAC Coordinator



The financial outlook to maintain full PFTAC operations through Phase V has improved following the March 2019 call to Steering Committee (SC) members in Port Moresby for action. With the 66-month long fifth phase of PFTAC operations at the half-way point, stakeholders were advised of a funding gap of approximately US\$ 5.2 million that would present the 2020 SC meeting with difficult choices to scale back programs and CD delivery over the final two years of Phase V if the gap is not closed. The US\$ 5.2 million gap is significantly lower than the nominal gap as a result of savings achieved through the end of FY2019 that are projected to be maintained with careful management through the end of FY2022.



New Zealand very generously responded to the funding call by committing NZ\$ 6 million that was fully received in late June 2019. This generosity elevated New Zealand Phase V contributions to NZ\$ 18 million, approximately US\$ 12.1 million, making New Zealand the largest Phase V donor covering a third of costs and 35 percent of all donor and member contributions since the 1993 launch of PFTAC with total contributions of US\$ 36.9 million. The PFTAC community is very grateful for the support of the New Zealand government and citizens. Prospects to close the balance of the funding gap are positive, with discussions well advanced for a new and sixth donor who is expected to make an announcement soon. Overleaf, Alex Shahryer-Davies explains how New Zealand views PFTAC's work.

Phase V funding pledges and expectations must lead to actual contributions. All but three PFTAC member countries have made financial commitments to share Phase V costs, and cuts will be unavoidable if all countries do not contribute as envisaged under the formula endorsed by the membership. A few of the 13-member countries that made commitments including initial Phase V payments have overdue contributions. Finally, new unfunded demands such as the strong call by members to extend the GFS program beyond April 2020 will be challenging if current funding expectations are not realized let alone the identification of some modest additional financing.



Steering Committee hosts—from the largest to the smallest PFTAC economy. Following the highly successful 2019 Steering Committee meeting hosted by Papua New Guinea, the Pacific's largest economy and PFTAC member country, Niue – the 'Rock of the Pacific' has generously offered to host the 2020 Steering Committee meeting between March 31 and April 2, 2020. The meetings will be held at the Matavai Resort with the promise of warm Niuean hospitality from our hosts. PFTAC stakeholders are asked to note the dates and be ready to confirm arrangements well in advance given limited flight availability.

Two PFTAC evaluations have recently been launched. As a mandate of donor and member country financing, all IMF regional CD centers are subject to an independent external evaluation at the mid-point of each operational phase. An Evaluation Sub-Committee (ESC) of the PFTAC SC was recently constituted to initially review Terms of Reference for solicitation of evaluation tenders. The evaluators are expected to be appointed and have prepared a draft Inception Note before the end of 2019 for ESC review. The evaluators are expected to undertake field visits prior to and in conjunction with the 2020 SC meetings to engage stakeholders. By mid-2020 a draft evaluation report should be submitted, and following an iterative review process, be finalized before end-2020.



Conversation with the Alex Shahryar-Davies, Manager of the Governance & Economic Unit,

New Zealand Ministry of Foreign Affairs and Trade

How does New Zealand's contribution to PFTAC relate to New Zealand's wider objectives in the Pacific region?

For over 25 years, PFTAC has been successfully supporting Pacific governments to develop their economic governance capabilities. We believe that effective economic governance is not only a critical objective in itself but is also necessary for a much wider set of development objectives to be met, so PFTAC's work in this area is fundamentally important to building prosperity and resilience in the Pacific. Our support to PFTAC therefore relates strongly to some of our core objectives in supporting the Pacific region.

What does PFTAC and the IMF offer as a Capacity Development provider that others cannot match?

Two elements in particular stand out for us. First, the deep Pacific-relevant expertise and responsiveness to local contexts that PFTAC offers by being so strongly embedded within the region. Second, the world-class credibility of advice that is ensured by backstopping from IMF headquarters when required. Whilst we value these two elements ourselves, what is far more important is that Pacific governments clearly also value these aspects.

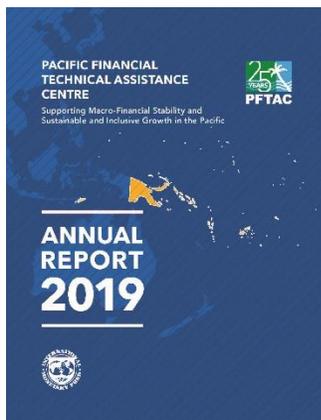
Are there areas of synergies where PFTAC efforts help leverage other NZ engagement on economic governance?

We are engaged in economic policy reform programs in many Pacific countries, working closely with Pacific governments and with other development partners as well. In these programs, we often find that PFTAC has been providing – or can quickly provide – useful technical advice to Pacific colleagues that complements the broader economic policy reforms that governments are pursuing.

Does New Zealand have lessons to share with PFTAC and the development community regarding sustainable Capacity Building outcomes?

We know that there are unique capacity challenges for small states. While we don't claim to have 'cracked' the difficult game of long-term capacity building in our partner countries, we have found that two lessons stand out in particular. First, that this is an on-going challenge that takes time to overcome – there may be some quick wins along the way but building effective economic governance in small developing states is not an overnight task. Second, understanding the local context and making advice and 'solutions' locally-relevant will always be more effective than transplanting unworkable 'best practice' models from outside. We believe PFTAC has been effective in practicing these principles in its work in the Pacific.

A review of the PFTAC Public Financial Management (PFM) program since 2009 has recently been launched. The PFM program was scaled up with a second resident advisor appointed following a 2009 mandate of the Forum Economic Ministers Meeting (FEMM) for PFTAC to take the lead with Public Expenditure Framework Accountability (PEFA) assessments and preparation of resulting PFM Reform Roadmaps. Many PFM developments have occurred over the past decade. Given the usefulness of the 2017 review and report of PFTAC's role in supporting revenue reforms in the Pacific over the previous decade, a similar undertaking has recently been launched and led by the IMF's Fiscal Affairs Department (FAD) to review PFM reform efforts and PFTAC's contribution. The FAD team has begun a literature review to be followed by stakeholder surveys and engagement during field visits planned for October/November 2019 to five case study countries – Fiji, Kiribati, Marshall Islands, Samoa, and the Solomon Islands. Initial findings from the review will be shared at the 2020 SC meeting in Niue prior to publication of a Working Paper later in 2020.



The final version of the 2019 PFTAC Annual Report was just published in a new streamlined format. The draft report issued ahead of the March 2019 SC meeting has now been updated to reflect actual outturn for FY2019 from the projections in the draft report and can be downloaded at the footnote link.¹ A limited supply of hardcopies are available on request from PFTAC.

Two important developments will widen the availability of final PFTAC Technical Assistance (TA) Reports. In accordance with IMF dissemination policies, the final version of any unclassified TA Report is available to PFTAC donors and member country agencies that have signed

Confidentiality Agreements provided that the beneficiary of the TA report and the IMF authoring department have no objection to the report being shared. Copies of qualifying reports previously had to be requested by eligible entities from PFTAC. A new secure section of www.pftac.org now allows for authorized eligible recipients to download qualifying reports. Eligible agency officials are currently being registered and issued log-on credentials for this facility.

Beyond sharing TA Reports within this closed group, country authorities are always encouraged to consider publication of their reports. This requires the explicit agreement of the recipient and no objection of the authoring IMF department. Once submitted to the IMF Executive Board, such reports are then available on www.imf.org and can additionally be downloaded from the PFTAC and beneficiary's websites. A recent TA Report for the Cook Islands will be the first to be published with several more moving through the publication pipeline.

¹ https://www.pftac.org/content/dam/PFTAC/Documents/Reports/Annual%20Reports/FY2019_PFTACFinal_AnnualReport.pdf

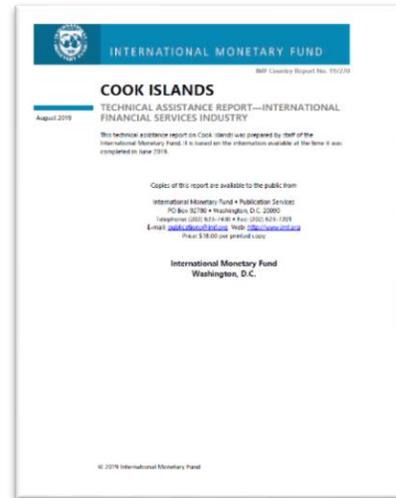
By Iris Claus

News from the Pacific

Congratulations, Cook Islands, for having the first PFTAC technical assistance report published on the IMF website!

Cook Islands International Financial Services Industry

quantifies the economic and fiscal contribution of the international financial services industry in the Cook Islands.² In 2015 the Council of the European Union developed a list of non-cooperative jurisdictions for taxation. One matter raised by the EU is that international companies are exempt from all taxes in the Cook Islands. Taxing international companies in the Cook Islands could lead to the loss of the industry which contributes to the Cook Islands economy directly and indirectly through the goods and services that it purchases from other suppliers and the business it creates for other sectors of the economy. The report estimates that the loss of the international financial services industry would lead to a one-off decline in gross domestic product (GDP) between 2.1 and 2.6 percent while revenue would drop by an estimated NZ\$ 3.5 to 4.1 million a year, which is about 3.1 to 3.2 percent of total value added, income and withholding taxes.



In December 2018 the Cook Islands Government agreed to amend legislation, tax the profits of international companies, and join the Inclusive Framework of the Organization for Economic Cooperation and Development’s Base Erosion and Profit Shifting (BEPS) project.

Fiscal Frameworks Workshop. The Pacific Financial Technical Assistance Center (PFTAC) with the support of the Singapore Regional Training Institute (STI) organized a sub-regional workshop on “Fiscal Frameworks for Pacific Countries” in Port Moresby, Papua New Guinea. A noticeable benefit of the event was its complementarity with skills acquired in previous joint training. PFTAC members consider tailored training most effective for building capacity because it develops knowledge and practical tools that can be adapted further through bilateral technical assistance. It also helps strengthen regional and interagency collaboration and peer learning. The innovation of this workshop was the multi-topic focus on sound fiscal management and public financial management. The Bank of Papua New Guinea, the Department of Treasury, the Australian Department of Foreign Affairs and Trade, and the Economic Governance and Inclusive Growth Partnership were host partners for this event.



² <https://www.imf.org/en/Publications/CR/Issues/2019/08/14/Cook-Islands-Technical-Assistance-Report-International-Financial-Services-Industry-48585>

Fiscal Buffers for Natural Disasters in Pacific Island Countries

Prepared by Hidetaka Nishizawa, Scott Roger, and Huan Zhang

[Read this Working Paper here](#)

Pacific island countries (PICs) are vulnerable to severe natural disasters, especially cyclones, inflicting large losses on their economies. In the aftermath of disasters, PIC governments face revenue losses and spending pressures to support post-disaster relief and recovery efforts. This paper estimates the effects of severe natural disasters on fiscal revenues and expenditure in PICs. These are combined with information on the frequency of large disasters to calculate the rate of budgetary savings needed to build appropriate fiscal buffers. Fiscal buffers provide self-insurance against natural disaster shocks and facilitate quick disbursement for recovery and relief efforts, and protection of spending on essential services and infrastructure. The estimates can provide a benchmark for policymakers, and should be adjusted to take into account other sources of financing, as well as budget risks from less severe and more frequent disasters.

A Possible Approach to Fiscal Rules in Small Islands—Incorporating Natural Disasters and Climate Change

Prepared by Ryota Nakatani

[Read this Working Paper here](#)

A big challenge for the economic development of small island countries is dealing with external shocks. The Pacific Islands are vulnerable to natural disasters, climate change, commodity price changes, and uncertain donor grants. How should small developing countries prone to such shocks formulate fiscal policy to achieve economic stability and fiscal sustainability when? We study how natural disasters affect long-term debt dynamics and propose fiscal policy rules that could help insulate the economy from such shocks, using the example of Papua New Guinea. Our study highlights the advantages of expenditure rules, especially a recurrent expenditure rule based on non-resource and non-grant revenue, interdependently determined by government debt and budget balance targets. This paper contributes to the literature and policy dialogue by theoretically analyzing the impact of natural disasters on debt sustainability and proposing practical fiscal rules against natural disasters and climate change.

Export Diversification in Low-Income Countries and Small States: Do Country Size and Income Level Matter?

Prepared by Dongyeol Lee and Huan Zhang

[Read this Working Paper here](#)

Export structure is less diversified in low-income countries (LICs) and especially small states that face resource constraints and small economic size. This paper explores the potential linkages between export structure and economic growth in LICs and small states, using a range of indices of export concentration differing in the coverage of industries. The empirical analysis suggests that export diversification may promote economic growth and reduce economic volatility in these countries. Furthermore, the analysis demonstrates that the economic benefits of export diversification are greater for relatively larger and poorer countries within the group of LICs and small states.

IMF staff visited Tarawa in June to discuss the economic outlook and policy priorities.

Kiribati enjoyed strong growth in recent years, mainly thanks to higher public spending financed by record-high fishing revenue and donor-financed infrastructure projects. The economy grew at an average annual pace of 5¼ percent in 2015–17, compared to 1½ percent in 2000–14. Inflation remained subdued and external balances were stable. Real GDP is projected to grow at an annual rate of 2¼ percent in 2018–20, marking a moderation primarily driven by a normalization of fishing revenue. Inflation is expected to gradually increase to 2½ percent, consistent with inflation rates of major trading partners. The current account surplus is projected to narrow, as fishing license fees decline and imports related to development spending remain high. Strong fishing revenue improved the fiscal position, including the balance of the sovereign wealth fund and cash reserves, but generated pressure to increase public spending. After registering sizable surpluses in 2015–17, the overall fiscal balance has turned to a deficit in 2018–19.

Risks to the outlook include a reversal of favorable weather conditions, tighter global financial conditions, and commodity price shocks. Long-run prospects are clouded by climate change. Public spending needs are large, driven by an infrastructure gap and climate adaptation costs, and the country remains at high risk of debt distress. Policy priorities are: reinforcing commitment to fiscal discipline, boosting the private sector, and improving governance.



IMF staff visited the Federated States of Micronesia (FSM) in June to hold discussions for the 2019 Article IV Consultation and to conduct a Climate Change Policy Assessment.

A joint IMF and World Bank team conducted a Climate Change Policy Assessment and contributed to the Consultation.

Staff found that the FSM economy has performed well in recent years. GDP growth has remained higher than its historical average, and inflation has remained low. Nonetheless, risks to the outlook are tilted to the downside. Unless economic support under the U.S. Compact Agreement is renewed, the FSM is expected to lose access to U.S. Compact grants in 2023, banking sector oversight by the U.S. Federal Deposit Insurance Corporation (FDIC), and post-disaster rehabilitation assistance by U.S. federal agencies, resulting in substantial macroeconomic uncertainty.

To cope with the scheduled expiration of U.S. Compact grants, a gradual fiscal adjustment of 4-5 percent of GDP through 2023 is warranted to minimize fiscal financing needs. In staff's view, the adjustment should be carried out by growth-friendly tax measures and rationalization of nonessential expenditures, while protecting spending on education, healthcare, and infrastructure. Future revenue windfalls should be saved to strengthen fiscal resilience.

In this regard, staff commended the authorities' decisions to save the revenue windfalls during 2017-18 into the FSM Trust Fund. Staff also recommended stepping up efforts to vitalize the private sector and improve banking regulations to shore up potential growth.

The FSM is highly vulnerable to climate change. The Climate Change Policy Assessment recommended building climate change resilience through swift implementation of the Infrastructure Development Plan. Making greater use of disaster risk transfer mechanisms can help strengthen the government's ability to respond to natural disasters.



Nauru

IMF staff concluded the 2019 Article IV mission to Nauru in September 2019.

Growth picked up to 5.7 percent in FY2018 boosted by activity at the Refugee Processing Centre (RPC) for asylum seekers, fisheries and preparations for the Pacific Island Forum. However, growth slowed in FY2019 as RPC activity was scaled down and phosphate mining declined. The medium-term outlook is shaped by the level of RPC activity, fishing revenues, and completion of infrastructure projects. The outlook is subject to downside risks, including volatility in commodity prices and climate change. The reduction in RPC activity will reduce revenue available to the government to finance its programs and may require adjusting spending to maintain sufficient cash buffers and to continue contributing to the Trust Fund. The authorities recognize the need for finding more reliable revenue sources to partially cover the loss in the RPC revenue. With support from PFTAC, they are considering introducing a consumption tax and improving tax compliance and revenue administration. There was also broad agreement on the need to improve the business environment to mobilize private investment and diversify the economy as well as on improving transparency and accountability of SOEs.



Samoa

IMF staff visited Samoa in September to discuss recent economic developments and identify work priorities for the 2020 Article IV consultation, planned for February 2020.

Samoa introduced rebased GDP in April 2019, based on the most recent and expanded coverage of business and consumer surveys, which shows contraction in economic activities in FY2018 resulting from the impacts of the Yazaki manufacturing plant closure in August 2017 and Cyclone Gita in February 2018. A strong recovery has since taken place with grant-financed infrastructure projects and the Pacific Games. Activities in commerce provide strong support to the economy, underpinned by robust growth in export earnings, tourism receipts and remittances. Growth is expected to reach 3¼

percent in FY2019 and should continue to accelerate. The authorities have been making good progress on a number of fronts, including through strengthening tax administration and public financial management (PFM), and implementing an IT solution to address AML/CFT issues and the 2015 FSAP recommendations, and structural reforms to boost potential growth and make it more inclusive.

Solomon Islands

Country Note

Mission Chief Alison Stuart visited Honiara in June to meet the new government, central bank and other officials to discuss recent developments and policies.

The new government was at an early stage of developing its policy priorities. While growth had been buoyant, there were signs of a slowdown, with logging activity weakening. With the sector in long-term decline, identifying new sources of growth was an important priority for the authorities. The fiscal outlook remained fragile; fiscal adjustment was needed to place policy on a sounder footing, provide a buffer to respond to shocks, including natural disasters, and to create space to pursue economic development goals. Ms Stuart discussed with the authorities how creating an environment for sustainable growth would require reforms to strengthen the regulatory and policy environment for business, increased transparency, and fiscal discipline. They agreed that a continued focus on tax reform offered an opportunity to make the tax system more efficient, fair and equitable. Containing the fiscal risks associated with hosting the Pacific Games in 2023 was seen as an important challenge.

Vanuatu

Country Note

Executive Board concluded the Article IV Consultation for Vanuatu in June.

Real GDP growth softened to 3.2 percent in 2018 but should remain relatively stable going forward. Modest fiscal and current account deficits are expected in 2019 (3.2 and 1.2 percent of GDP, respectively), but the deficits will widen thereafter, reflecting spending on new infrastructure projects and decreased revenues from economic citizenship programs. The largest uncertainty for the economy remains the ever-present danger of natural disasters.

Staff recommended further fiscal reform, including the introduction of a broader tax regime and more prioritization of expenditures, to reduce reliance on revenues from economic citizenship programs, and to remain well below the government's debt target, which should be set at 50 percent of GDP.

This would maintain an extra buffer to manage risks from natural disasters. There is also the need for further analysis of non-performing loans in the banking sector. Vanuatu successfully exited the FATF grey list for AML/CFT issues in 2018. Staff recommended continued efforts to apply the new regime, and to look ahead to mitigating ML/TF risks arising from new fintech usage in the offshore and onshore financial sectors. The Reserve Bank of Vanuatu (RBV) was encouraged to further improve governance and financial supervision. [Vanuatu 2019 [Staff Report](#)]



Recent and Upcoming Events on Asia and Pacific Small States

Recent Events

ADB Annual Meetings

May 2-5, 2019, Nadi, Fiji

FEMM

May 7-9, 2019

Pacific Workshop on CBR Issues

May 16-17, Auckland, New Zealand

Upcoming Events

Annual Meetings

October 18-20, 2019, Washington D.C.

2019 South Pacific Central Banking Research Conference

November 13-15, 2019, Port Vila, Vanuatu

South Pacific Central Bank Governors' Meeting

November 18-19, 2019, Sydney, Australia

Joint PFTAC/CARTAC Workshop: Strengthening Climate Resilience, the Role of Public Finances

December 4-6, 2019, Washington D.C.

Small States Pictures

Impressions from the new office of the Pacific Financial Technical Assistance Center.



Small States Pictures

Participants of the PFTAC Fishing Revenue Workshop in Honiara, Solomon Islands



During staff visit, with the Samoan authorities - after dinner:



Apia waterfront infrastructure projects (view from the Central Bank of Samoa):

