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

...we highlight the key messages from the High-Level Dialogue and Workshop (June 22–25, 2015) in Fiji, co-hosted by the Government of Fiji and the IMF with funding support from the Government of Australia. In an [op-ed](#) featured in this issue, IMF Asia and Pacific Department Director Changyong Rhee reaffirms the IMF commitment to continued engagement with Pacific small states to enhance resilience to natural disasters. We also showcase a multi-pillar strategy on enhancing macroeconomic resilience to natural disasters ([Special Topic 1](#)), and look at the challenges in Vanuatu after Cyclone Pam ([Special Topic 2](#)).

We also share stylized facts on China's growing presence in the Pacific and provide a snapshot of infrastructure and public investment in Pacific small states ([Special Topics 3](#) and [4](#)). In addition, we include country notes from the most recent Article IV staff reports on [Kiribati](#), [Samoa](#), and [Vanuatu](#); information on the [Japan-IMF Scholarship Program](#); and coverage of an [IMF learning event for mission chiefs](#) working on small states held in April 2015.

Patrizia Tumbarello,

Chief of the Small States Unit, Asia and Pacific Department, IMF

"Natural disasters are risks that Governments need to incorporate into their budget and fiscal frameworks."

Attorney-General and Minister of Finance Aiyaz Sayed-Khaiyum, Fiji, [speech at the IMF/Government of Fiji High-Level Dialogue on Enhancing Macroeconomic Resilience to Natural Disasters](#), June 25, Nadi



Attorney-General and Minister of Finance of Fiji Aiyaz Sayed-Khaiyum speaking at the IMF/Government of Fiji High-Level Dialogue in Fiji

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Selected trends and developments in APD small states

Prepared by APD Small States Unit—Justin Flinner (Project Coordinator), Kazuaki Washimi, and Fazurin Jamaludin (Project Leaders).

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.

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Economic Developments

Economic performance in APD small states was mixed in the first few months of 2015 ([Figure 1](#)).

- Visitor arrivals in *Palau* soared by around 35 percent in the first five months of 2015, driven by a continuing surge in tourist flows from China ([Special Topic 3](#)), thanks to new flights from Hong Kong Special Administrative Region (SAR). In *Fiji*, tourism remains the primary driver of growth, with visitor arrivals increasing by about 7 percent over the first five months of 2015. Tourism activity in *Maldives*, *Samoa*, and *Cook Islands* was relatively subdued, and *Vanuatu* experienced a decline, mostly because of Cyclone Pam ([Special Topic 2](#)).
- Among commodity exporters (Bhutan, Solomon Islands, and Timor-Leste) and other APD small states, growth remains uneven: robust activity in *Bhutan* was driven mainly by hydropower-related construction activities; in *Solomon Islands*, the protracted closure of the country's only gold mine continues to weigh on the economy, although strong logging activity in the first half of the year has provided support; and *Timor-Leste's* ongoing depletion of oil reserves has led to a tighter budget constraint and lower government spending in the non-oil sector. In the other small states, growth is being supported by externally financed infrastructure projects (e.g. Kiribati and Samoa), although the *Federated States of Micronesia's* growth has been lackluster reflecting the effects of Typhoon Maysak.
- In the first few months of 2015, inflation remained subdued in most of the Pacific Island countries—with deflation recorded in Kiribati, Solomon Islands, and Tonga—owing to continuously low commodity prices.

APD Small States: Real GDP

(Year-on-year change; in percent)

	2010-13	2014	2015	2016
		Est.	Proj.	Proj.
Bhutan	7.7	6.4	7.7	8.4
Cook Islands	0.2	-1.2	2.1	-0.3
Fiji	3.0	4.5	4.3	3.2
Kiribati	1.1	3.7	3.1	1.8
Maldives	5.0	6.1	2.9	3.1
Marshall Islands	3.5	0.5	1.7	2.2
Micronesia	0.3	-1.6	-0.2	1.7
Palau	2.8	8.0	4.0	2.7
Samoa	1.0	1.9	2.6	1.6
Solomon Islands	6.9	1.5	3.3	3.0
Timor-Leste ¹	9.3	6.6	6.8	6.9
Tonga	0.6	2.2	2.5	2.9
Tuvalu	1.8	2.2	2.5	2.5
Vanuatu	1.6	2.3	-2.0	5.0
APD small states ²	2.3	2.2	2.8	2.8
Small Pacific island countries ^{2,3}	1.7	2.2	2.6	2.6
Small states (excl. APD) ²	1.6	2.6	2.7	2.7

1/ Non-oil GDP.

2/ Median.

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

Sources: ADB, Asian Development Outlook database; IMF, World Economic Outlook database; IMF staff reports, whichever is the most recent; and IMF, staff estimates and projections. Data for Bhutan, Cook Islands, the Marshall Islands, Micronesia, Palau, and Samoa are reported on a fiscal year basis.

Outlook

- Average growth is projected steady at around 3 percent in 2015, although economic performance will vary across countries. Recent natural disasters in the Federated States of Micronesia, Tuvalu, and Vanuatu are expected to dampen economic activity in the short term.
- External risks to growth are skewed to the downside, including negative spillovers from slower growth in Asian emerging markets and increased volatility in energy prices. A significantly slower-than-expected growth in China would impact the rest of the region and the world given this economy's large size and deep trade and financial linkages. Combined with continuously low commodity prices, depreciation of the currencies of major regional economies is also likely to help keep inflationary pressures at bay given the high imports from these countries, although visitor arrivals to certain tourism-intensive countries could be negatively affected.

Enhancing Macroeconomic Resilience to Natural Disasters in Pacific Island Countries

by Changyong Rhee, IMF Asia and Pacific Department Director



Natural disasters and climate change are affecting Pacific small states to varying degrees. The widespread damage caused earlier this year by Cyclone Pam in Vanuatu is the latest reminder of this challenge. Beyond their devastating human impact, natural disasters damage economic activity and weaken countries' fiscal positions. These events not only take a toll on island economies in the short term, but they also lower growth prospects into the future and burden countries with higher levels of debt. [Recent analysis by the IMF staff](#) suggests that natural disasters can cause economic growth to slow by 0.7 percentage point for every one percentage point of GDP in damages and losses.

If they are to address this challenge successfully, Pacific island nations—many of which are small states with limited size, resources, and population—need the support of the international community. That is the reason why the Government of Fiji and the IMF hosted the [High-Level Dialogue on Enhancing Macroeconomic Resilience to Natural Disasters in the Pacific Islands](#), with the financial support of the Government of Australia. The Dialogue, which opened on June 25 in Nadi, Fiji, provided an opportunity to listen to different perspectives on challenges; share ideas on how best to address them; and to learn from one another. At the IMF, our focus on natural disasters in the Pacific is not new. Also, we are not alone in scaling up our efforts in Pacific island countries. We have worked together in recent years with other development partners and international financial institutions in identifying key areas of needed reforms and capacity building for policymakers.

During the UN Small Island Developing States conference in Samoa last September, we teamed up with the World Bank Group and other development partners to host an event focused on building economic resilience to natural disasters. The high-level dialogue in Fiji built on that discussion as we continue to find ways to develop and implement a more systematic approach to help countries deal with the increasing frequency and magnitude of these events.

Resilience needs to be enhanced before natural disasters strike. Economic policies can play a vital role and this is where the IMF can help.

Our recent analysis shows that average per capita income growth is positively associated with periods of positive growth. Hence, countries should focus on enhancing resilience to shocks and minimize periods of negative growth. The Pacific island countries have spent a smaller proportion of their time experiencing positive growth (58 percent of the period 1980–2014) and average per capita growth in the Pacific islands during this period was 0.6 percent lower than their peers. This underscores the need to build resilience to shocks, including natural disasters.

While good policies are key, a multi-pillar framework is needed at the national, regional, and multilateral level to enhance resilience. It is also important to enhance countries' risk-management capacities. In addressing the problem of vulnerability to all sorts of external shocks, policy makers in the Pacific islands need to think about how to build and maintain appropriate levels of budget balances, public debt, and foreign reserves. IMF experts work closely with governments to help achieve these goals.

Of course, the IMF is prepared to provide financial assistance when needed as in the recent case of [Vanuatu](#) when the IMF disbursed US\$24 million to help the country cope with its immediate balance of payments needs and to catalyze critical donor support for the recovery after Cyclone Pam.

The IMF is also assisting the Pacific Islands by providing technical assistance and training to strengthen the disaster risk management capacity and public financial management systems, key aspects in building capacity to deal with natural disasters. The [Pacific Financial Technical Assistance Centre \(PFTAC\)](#) has been instrumental to this effect.

The high-level dialogue was preceded by a three-day workshop on strengthening fiscal frameworks, which was attended by mid-career officials from Pacific island countries. In a nutshell, through good policies, technical assistance and lending, the IMF stands ready to work with Pacific island countries with a complete toolkit and in strong collaboration with other development partners to help the Pacific Islands overcome their development challenges and build a prosperous future.



Strengthening Fiscal Frameworks in the Pacific Islands (June 22–24, 2015), in Fiji

The workshop, which was made possible by the funding support from the Australian Government, was organized by an interdepartmental working group comprising IMF staff from the Asia and Pacific Department, the Fiscal Affairs Department, and the IMF Institute for Capacity Development, with inputs from the Pacific Financial Technical Assistance Centre (PFTAC).

The workshop focused on enhancing fiscal frameworks and policy dialogue among the national authorities, the IMF—including mission chiefs—and development partners. It fostered a peer learning network and strengthened the linkages between policy formulation, planning and execution, and capacity development. The workshop was attended by 40 participants, primarily mid-career government officials from the Pacific islands, Timor-Leste, and the Seychelles.

The main messages from the sessions were:

Fiscal policy and macroeconomic performance

- Managing volatility is the key challenge for PICs' policymakers;
- Minimizing fiscal rigidity by lowering recurrent spending to create fiscal space for capital spending;
- Using fiscal spending wisely given the uncertainty regarding shocks;
- Applying medium-term budgeting to address pro-cyclicality; and
- Implementing public financial management reforms to enhance the quality of public spending.

Macro-fiscal linkages and principal fiscal indicators

- Recognizing the main macro-fiscal risks: risks to the implementation of fiscal policy and risks stemming from fiscal policy;
- Improving the composition of revenue to reduce fiscal risk and create buffers; and
- Strengthening revenue mobilization to support rebuilding of policy buffers.

Methods of revenue forecasting

- Revenue projections should not be either too optimistic or pessimistic;
- Incorporating timely information to revise revenue forecasting; and
- Being mindful of the uncertainty of macro variables that affect revenues, and the relevant channels of transmission.

Methods of expenditure forecasting

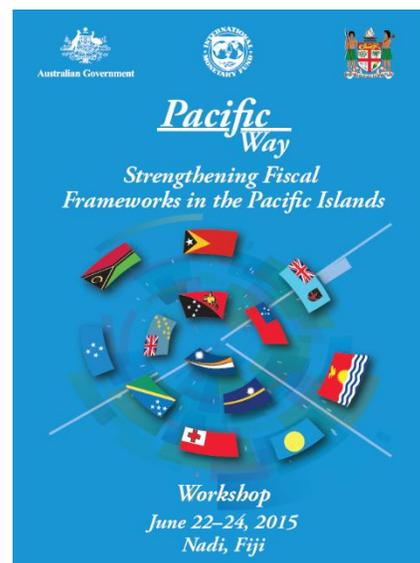
- Taking into account all the important cost drivers to enhance credibility;
- Coordinating and cooperating with key stakeholders to obtain the necessary information; and
- Using medium-term budgeting to reinforce fiscal discipline, facilitating a more strategic allocation of expenditure, and encouraging more efficient inter-temporal planning.

Methods of debt dynamics assessment

- Identifying how much debt is "too much";
- Recognizing the risks related to the debt trajectory and risks related to the composition of debt; and
- Taking into account ex ante the costs of natural disasters in determining safe debt levels and the appropriate size of fiscal buffers.

The role of fiscal rules, fiscal anchors, and fiscal targets

- Using fiscal anchors to help smooth spending and isolate the budget from revenue volatility;
- Designing uncomplicated fiscal frameworks by using anchors that help manage revenue volatility and ensure debt sustainability; and
- Accompanying fiscal anchors with a more broadly based fiscal reform strategy.



Photos from the Recent High-Level Dialogue and Workshop in Fiji (June 22-25)



Reserve Bank of Fiji Governor Barry Whiteside



Fiji Finance Minister Aiyaz Syed-Khaiyum (center), Permanent Secretary Filimone Waqabaca, IMF APD Director Changyong Rhee, R. Guimaraes, and T. Feridhanusetyawan



IMF Executive Director Barry Sterland and Tuvalu Finance Minister Maatia Toafa



Group photo of the High-Level Dialogue participants



HK Yu, Chief Adviser (International), Treasury, Australia



IMF APD Small States Unit Chief Patrizia Tumbarello



New Zealand Aid Programme Principal Development Economist Vinayak Nagaraj and Head of Cooperation at the EU Delegation Renato Mele



IMF APD Director Changyong Rhee's closing remarks at the workshop, Scott Roger, Lorenzo Forni, Patrizia Tumbarello, Eliko Pedastsaar, and Evan Tanner



Richard Bontjer, Public Financial Management Director, Department of Foreign Affairs and Trade; and Kristina Nemet, Analyst, Treasury, Australia



Group photo of workshop participants



Workshop participants during a breakout session

Country Missions

IMF resident representative in the Pacific Islands, Tubagus Feridhanusetyawan, participated in the Vanuatu Article IV consultation in April 2015. In May, the resident representative and Arti Devi (Economist, Resident Representative Office) participated in the Nauru membership mission conducted jointly with the World Bank Group. Shelvin Karan (Economist, Resident Representative Office) joined the Papua New Guinea (PNG) staff visit in late May and he has also participated in the PNG Article IV consultation mission in August 2015. The 2015 Article IV consultation mission visited Kiribati in May, and a Fiji staff visit took place in June. Resident representative Office staff helped organize the IMF Workshop and High-Level Dialogue in Nadi, Fiji, in June.

Outreach and Presentations

The resident representative and Ms. Caroline Badra-Sadacca (World Bank Group) appeared on Nauru's national television and explained the process and benefits of joining the IMF and World Bank Group. The resident representative also made a presentation on the regional outlook during the UN Economic and Social Commission for Asia and the Pacific's (UNESCAP) conference in Fiji in May 2015. He emphasized that Asia's growth remains robust in line with the latest APD Regional Economic Outlook and stressed that the high risk of natural disasters in the Pacific demands larger fiscal buffers. IMF APD Director Changyong Rhee and the Fijian authorities sat for a press conference and television interview during the High-Level Dialogue in Nadi on enhancing macroeconomic resilience to natural disasters.

Nauru Membership Mission

After intensive technical assistance over the past year, the membership mission took place May 7-18 to provide an overview of the Fund, explain the membership process, collect data, and discuss economic developments. The team consisted of staff from the IMF Secretary's Department, Finance Department, Legal Department, and the World Bank Group, led by the IMF resident representative. The mission met with the President, the entire Cabinet, members of parliament, senior government officials, development partners, and representatives from public enterprises and the private sector. The Membership Committee of the IMF Board was established in June, and the Membership Committee meeting to discuss Nauru is expected to be held in late August.



Mr. Feridhanusetyawan and Ms. Badra-Sadacca on Nauru television



Mrs. Bainimarama (center), wife of Fiji Prime Minister, attended a gathering at the IMF Resident Representative Residence with Mr. and Mrs. Feridhanusetyawan



Nauru IMF/World Bank Group team with the Minister of Finance of Nauru David Adeang



IMF Presentation to the President of Nauru and the entire Cabinet

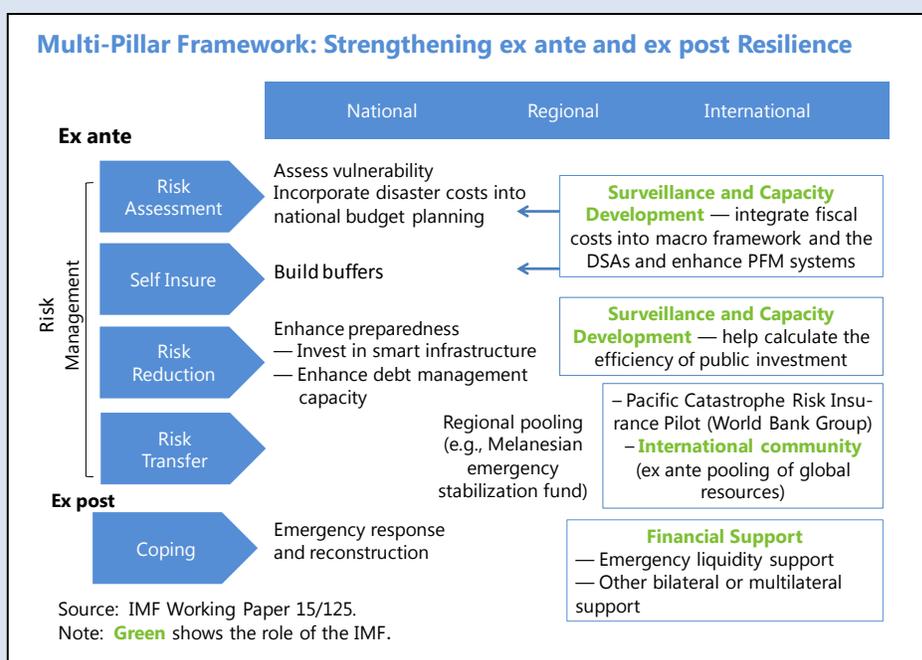
The Pacific island countries are among those most vulnerable to natural disasters and climate change. The combination of location and small size heightens their susceptibility to earthquakes and weather-related extreme events. The Pacific islands are highly exposed to natural disasters—annual damage and losses have averaged 20 percent of GDP in the Pacific islands since 2012, much higher than in other peer groups and non-small states. In addition, climate change poses risks to the continued survival of some Pacific islands.

A strategic approach is needed to help countries deal with the increasing frequency and magnitude of these events. Explicit recognition of the costs of natural disasters and climate change in baseline macro-frameworks and debt sustainability analyses is important, particularly given the risks that these events become increasingly severe over time. While building policy buffers is especially relevant in the small states of the Pacific to enhance resilience, these countries will need continued support with access to external assistance and insurance schemes.²

Enhancing macroeconomic resilience to natural disasters and climate change demands a multi-pillar strategy at the national, regional, and multilateral levels. It also requires enhancing countries' risk-management capacity. The key pillars of disaster risk management, before the event occurs, include:

Ex ante

- *Identifying and undertaking risk assessment:* at the national level, ex-ante resilience entails identifying risks and explicitly integrating such risks into the fiscal frameworks and budget planning.
- *Self-insuring,* by building financial buffers and policy space to be able to respond to shocks.
- *Reducing risks* by enhancing preparedness, including by investing in "smart" infrastructure that can better cope with climate change and natural hazards and by augmenting debt management capacity.
- *Transferring risk* through private or sovereign insurance and through multilateral risk-sharing. Regional solutions/insurance should be further explored and implemented.



Ex post

- *Coping,* together with ensuring a resilient recovery (invest in infrastructure which is climate change proof).

Coping in the wake of a natural disaster, together with ensuring a resilient recovery, is the main pillar of the ex-post disaster risk management. At the national level, the main actions include the emergency response and reconstruction efforts. A sound reconstruction program should consist of measures to reduce risks such as resettlement away from the coastline where feasible and infrastructure investment. Reconstruction can provide an opportunity to accelerate broader growth-enhancing structural reforms.

¹ Prepared by Yiqun Wu (Small States Unit, IMF Asia and Pacific Department).

² Based on Cabezon, Hunter, Tumbarello, Washimi, and Wu, "Enhancing Macroeconomic Resilience to Natural Disasters and Climate Change in the Small States of the Pacific," IMF Working Paper 15/125.

Vanuatu’s low public debt and ample foreign exchange reserves, combined with international assistance, are helping the island nation deal with the fallout from the destructive tropical cyclone that swept through the country in mid-March. The government is working with development partners to secure external support for the reconstruction effort, primarily through grants. But some borrowing will be inevitable. Reconstruction costs are estimated to total around 40 percent of GDP, of which around half will be paid by the public sector. But the country’s prudence in the past means public debt is fairly low, and the government has room to borrow. The main challenges facing the country are restoring its productive capacity, and rebuilding the social and physical infrastructure, while protecting vulnerable groups. Once reconstruction is over, the government should start rebuilding fiscal buffers by mobilizing additional revenues, and strengthening spending discipline.

The cyclone affected two-thirds of the population. Category five tropical Cyclone Pam ripped through Vanuatu with winds of up to 250 kilometers per hour, killing eleven people and inflicting severe damage. The impact was particularly heavy on the central and southern provinces, including the capital city of Port Vila. The cyclone damaged or destroyed much of the housing stock, disrupted the food and water supply, cut off electricity and communication, and forced many schools and medical facilities to close. A forceful response—helped by swift and generous assistance from development partners—averted a humanitarian crisis, but the country faces considerable challenges.

The economy is expected to contract by 2 percent. The value of damaged property, and lost output is estimated at 61 percent of Vanuatu’s GDP. Even though reconstruction activity will partially offset the impact of Cyclone Pam on output, the economy is expected to contract by 2 percent this year. The two sectors most severely affected by the cyclone—tourism and agriculture—are the main generators of export earnings. With several major hotels closed, and many crops damaged, Vanuatu’s exports of goods and services can be expected to decline substantially this year, even as domestic shortages and reconstruction spending boost imports. As a result, the trade balance is likely to deteriorate substantially, even if temporarily, putting pressure on Vanuatu’s international reserves even though they were maintained at a prudent level before the cyclone.

“Quick, unbureaucratic” IMF support. The IMF’s Managing Director Christine Lagarde has promised “quick, unbureaucratic steps” to help Vanuatu deal with the aftermath of the catastrophe, and rebuild the economy. An IMF mission was in the field a month after the cyclone, helping the authorities assess the economic impact and formulate policies for the recovery period. It also evaluated the potential effect of the cyclone on Vanuatu’s international reserves. The country’s request for US\$23.8 million from the IMF in the form of zero-interest and low-interest loans was approved on June 5 (under the IMF’s Rapid Credit Facility and Rapid Financing Instrument), and the Reserve Bank of Vanuatu has already received the money to bolster its international reserves. The IMF is also boosting its technical assistance to Vanuatu in several priority areas.

Enhancing resilience. Vanuatu’s capacity to deal promptly and flexibly with future natural disasters would be enhanced by greater reliance on insurance, and by setting up a contingency fund, while strengthening resilience by building more robust infrastructure. As part of the reconstruction effort, the authorities may also wish to review their infrastructure investment program to make sure that the plans are aligned with national development priorities, implementation capacity, and fiscal space. The island state should also be prepared to deal with pressures on its banking system. A reduction in the reserve requirement and other measures helped avoid a liquidity crunch. The main concern now is the expected increase in non-performing loans. The authorities should be vigilant and ensure that banks maintain adequate capital buffers. It will be important to assess the condition of bank balance sheets once the situation stabilizes. Cyclone Pam is a vivid reminder of the growing impact of climate change and natural disasters on small states. It demonstrates the need for enhanced resilience, stronger insurance mechanisms, and swift international response. These issues were discussed by senior officials of Pacific islands and development partners during the recent IMF High-Level Dialogue in Fiji.

Estimated Damages and Losses by Cyclone Pam

(In percent of GDP)

Sector	Damages	Losses	Total
Productive	10.7	13.0	23.7
Agriculture	1.8	5.8	7.6
Commerce and industry	1.5	2.7	4.2
Tourism	7.4	4.5	11.9
Social	18.0	0.8	18.8
Housing (Private)	11.8	0.6	12.4
Health	1.1	0.1	1.2
Education	4.9	0.1	5.0
Culture	0.1	0.0	0.1
Infrastructure	8.0	3.7	11.7
Transportation	3.8	2.7	6.5
Public buildings	0.7	0.0	0.7
Water	0.5	0.4	0.9
Communication	2.8	0.5	3.3
Environment	0.0	6.7	6.7
Total	36.7	24.2	60.8

Source: Vanuatu Post-Disaster Needs Assessment, Government of Vanuatu, (May 11, 2015).

¹ Prepared by Dongyeol Lee (Small States Unit, IMF Asia and Pacific Department) based on “With External Support, Vanuatu’s Recovery Builds on Prudent Past,” by Vladimir Klyuev (*IMF Survey*, July 6, 2015).

China’s economic engagement with the Pacific Islands countries (PICs) has strengthened in the last 15 years and has lately further accelerated. China has provided a wide range of financial and non-financial support to PICs regardless of the status of diplomatic ties.² China has officially disclosed that by 2013 the amount was equivalent to US\$9.4 billion³ (including project financing, loans, and aid), and it has pledged further increases.

Trade. The PICs’ good trade with China has grown more than 25 times since 1995, with Papua New Guinea and Solomon Islands accounting for a large share of exports to China. Australia remains the main trading partner for most PICs, but its share of trade has declined steadily over the years and China has made up for the gap with its share rising threefold since 2000.

Aid flows. China’s aid contribution to the PICs since 2006 reportedly totals US\$1.5 billion⁴. Australia and, to a lesser extent, New Zealand remain the largest providers of aid to PICs, with the exception of the “Compact” countries (Marshall Islands, Micronesia, and Palau) that rely more on US aid. However, it has been reported that Chinese aid to Fiji, for example, already had exceeded Australian aid in 2013.

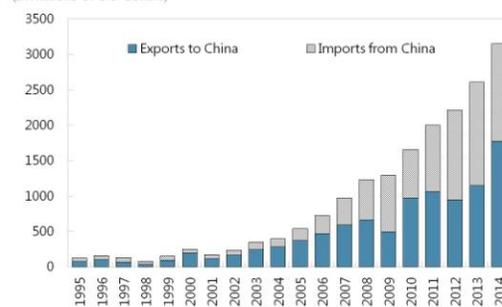
External Debt. Owing to large official development assistance flows, debt levels have remained in check for most countries until recent years. In several countries, debt has increased since the 2008–09 crisis, in part because of the need for countercyclical fiscal support, partly because of new borrowing from Asian emerging markets (including China), and also because of the impact of natural disasters (for example Samoa).

Tourism. Among the PICs, Palau has seen the largest gain in tourist inflows from China in recent years, thanks to more direct chartered flights from China. Chinese tourists accounted for more than 55 percent of Palau’s total as of April 2015. On the other hand, for such other tourism-intensive countries as Fiji and Vanuatu, the share of Chinese tourists remains small, with the dominant tourist group continuing to be Australians and New Zealanders.

Increasing linkages with China will affect the PIC economies more directly than before, while the channels of spillovers vary across countries. The IMF’s *WEO Update, July 2015* revised China’s GDP growth downward to 6.8 percent. China’s economic slowdown could weigh on PICs’ growth more directly (especially in commodity-exporting countries). Thus, PICs are increasingly exposed to the direct transmission channel from China as well as the indirect transmission channel from China to Australia.

PICs: Trade With China, 1995-2014

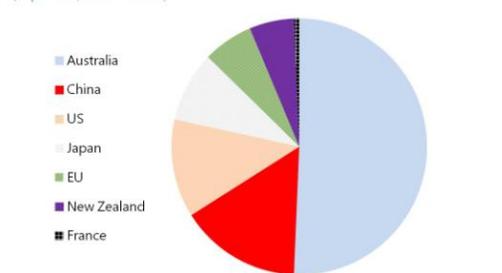
(In millions of U.S. dollars)



Source: IMF staff calculations.

PICs: Total Cumulative Bilateral Aid, 2006-14

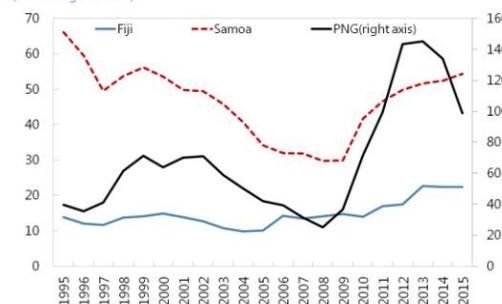
(In percent, share of total)



Sources: Lowy Institute for International Policy; and IMF staff calculations.

PICs: Gross External Debt, 1995-2015

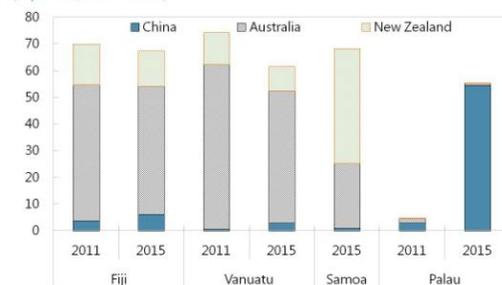
(Percentage of GDP)



Sources: Country authorities; and IMF staff calculations.

PICs: Tourist Arrivals, 2011 and 2015

(In percent, share of total)



Sources: Country authorities; and IMF staff calculations. Note: 2015 data are up to April.

¹ Prepared by Eri Ikeda (Summer Intern, Small States Unit, IMF Asia and Pacific Department). The quantification of the spillover effects from China to PICs will be presented in the upcoming IMF working paper: “Too Small To Fail: How Would a Slowdown in China Affect the Pacific Islands?”.

² The Pacific island countries that have diplomatic relations with China are Fiji, Micronesia, Papua New Guinea, Samoa, Timor-Leste, Tonga, and Vanuatu. Those that have diplomatic relations with Taiwan Province of China are Kiribati, Marshall Islands, Palau, Solomon Islands, and Tuvalu.

³ China’s Ministry of Commerce. <http://english.mofcom.gov.cn/article/newsrelease/significantnews/201311/20131100386982.shtml>.

Most Pacific island small states and Papua New Guinea suffer from a shortage of infrastructure, albeit to varying degrees. For example, while the level of electrification is high in Samoa and Tonga (more than 95 percent of the population), overall, Pacific island small states have lower access to electricity relative to other small states, as well as to advanced countries. In Papua New Guinea, Solomon Islands, and Vanuatu, less than 30 percent of the population has access. Other infrastructure development indicators (e.g., improved water sources, mobile telephone subscriptions, and internet usage) also show some degree of infrastructure gap. In countries with inadequate infrastructure, priority should be given to improving infrastructure by promoting public investment.

Infrastructure Indicators

	Access to electricity (Percent of pop., 2012)	Improved water source (Percent of pop. with access, 2012)	Mobile telephone subscriptions (Per 100 people, 2013)	Internet users (Per 100 people, 2013)
Small states	65.7	89.8	105.4	23.9
Pacific island small states	51.9	90.4	74.0	22.9
Caribbean small states	93.4	95.3	109.4	46.2
Other small states	57.5	88.0	107.2	16.2
OECD countries	99.9	99.1	109.0	75.4
World	84.7	89.3	93.1	38.1
Fiji	59.3	96.3	105.6	37.1
Kiribati	59.3	66.8	16.6	11.5
Marshall Islands	59.3	94.5	n.a.	11.7
Micronesia	52.5	89.0	30.3	27.8
Palau	59.3	95.3 ¹	85.8	n.a.
Papua New Guinea	18.1	39.7	41.0	6.5
Samoa	100.0	98.5	n.a.	15.3
Solomon Islands	22.8	80.5	57.6	8.0
Timor-Leste	41.6	70.5	57.4	1.1
Tonga	95.9	99.3	54.6	35.0
Tuvalu	44.6	97.7	34.4	37.0
Vanuatu	27.1	90.7	50.3	11.3

1/ As of 2011.

Source: World Bank World Development Indicators (2014). Red indicates the three countries with the lowest infrastructure access.

Nonetheless, the authorities must give careful consideration to several factors when undertaking public investment. In Fiji, Samoa, Tonga, and Tuvalu, public debt stood above 40 percent of GDP in 2014. While the increase in public investment is expected to contribute to economic growth, it could also undermine debt sustainability. The economic and social impact of public investment critically depends on its efficiency. Improvements in public financial management could substantially increase the efficiency and productivity of public investment through better budget planning, internal auditing on the use of public funds; at the same time, better monitoring, reporting, and evaluation systems will improve accountability.

Risks stemming from natural disasters are also an important consideration when determining public investment policy. Most Pacific island countries are highly vulnerable to natural disasters. The damage to Vanuatu’s infrastructure caused by Cyclone Pam (March 2015), for example, is estimated to be equivalent to 8 percent of GDP, with total damage and losses equal to 61 percent of GDP. A comprehensive analysis of the effects of public investment on growth and public debt that incorporates the risk of natural disasters would help better inform policy discussions on public investment in Pacific island countries.

Public Debt, 2014
(In percent of GDP)

Fiji	49.5
Kiribati	8.0
Marshall Islands	30.5
Micronesia	26.5
Palau	29.7
Papua New Guinea	35.6
Samoa	55.0
Solomon Islands	13.4
Timor-Leste	4.2
Tonga	47.2
Tuvalu	56.9
Vanuatu	18.5
Median	30.1
Minimum	4.2
Maximum	56.9

Sources: IMF WEO (April 2015); and IMF staff estimates.

¹ Prepared by Dongyeol Lee (Small States Unit, IMF Asia and Pacific Department), based on “Mind the Gap: Public Investment and Debt Sustainability in the Pacific Small States” by M. Ghilardi, D. Lee, P. Tumbarello, and T. Zeinullayev (forthcoming IMF Working Paper). References: “Is It Time for an Infrastructure Push? The Macroeconomic Effects of Public Investment”, IMF *World Economic Outlook*, October 2014; *Making Public Investment More Efficient*, IMF Staff Report, June 2015; *Public Investment, Growth, and Debt Sustainability*, IMF Working Paper 12/144, June 2012; *Debt Sustainability, Public Investment, and Natural Resources in Developing Countries: the DIGNAR Model*, IMF Working Paper 14/50, March 2014.

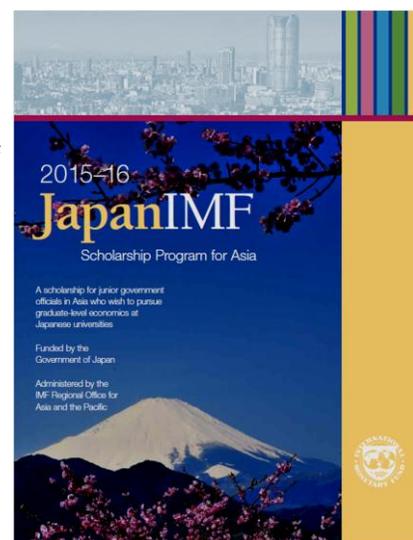
Japan-IMF Scholarship Program for Asia and the Pacific

The Japan-IMF Scholarship Program for Asia (JISPA) is funded by the Government of Japan, administered by the International Monetary Fund (IMF) Regional Office for Asia and the Pacific in Tokyo, and conducted at various graduate schools in Japan. The Japan-IMF Scholarship Program for Asia (JISPA) aims to contribute to institutional capacity building of key macroeconomic management agencies in Asia. With this aim, it provides scholarships for highly motivated government officials who may serve as future macroeconomic policy makers with the capacity and vision to contribute to the economic development of their countries.

The application for 2016–17 will open in September 2015, with the application deadline of December 1, 2015. Currently, the JISPA is open to qualified candidates from the following countries:

Bangladesh, Bhutan, Cambodia, China, India, Indonesia, Kazakhstan, Kyrgyz Republic, Lao P.D.R., Malaysia, Maldives, Mongolia, Myanmar, Nepal, Pacific Island Countries, Papua New Guinea, Philippines, Sri Lanka, Tajikistan, Thailand, Timor-Leste, Turkmenistan, Uzbekistan, and Vietnam

The scholarship covers tuition-related costs and most living expenses for the scholar herself/himself. Officials who receive the JISPA scholarship cannot accept other scholarships. Scholars are expected to devote full time to their studies while in Japan.



For further information refer to <https://www.imf.org/external/oap/schol.htm>

Upcoming and Recent Events on Small States

Upcoming Events

[IMF 2015 High Level Caribbean Forum: Financing Growth](#)

September 3–4, 2015, St. Kitts and Nevis

[Inaugural Conference of Queen Mary University's Centre for Small States: "Small States in a Legal World"](#)

September 7, 2015, London, United Kingdom

[The 46th Pacific Islands Forum Leaders' Meeting](#)

September 7–11, 2015, Port Moresby, Papua New Guinea

[Pacific Islands Forum Economic Ministers' Meeting \(FEMM\)](#)

October 27–31, 2015, Rarotonga, Cook Islands

[South Pacific Central Bank Governors' Meeting](#)

December 2–3, 2015, Wellington, New Zealand

Recent Events

[Workshop on "Strengthening Fiscal Frameworks in the Pacific Islands"](#)

Co-hosted by the Government of Fiji and the IMF, with funding support from the Government of Australia
June 22–24, 2015, Nadi, Fiji

[High-Level Dialogue on "Enhancing Macroeconomic Resilience to Natural Disasters in the Pacific Islands"](#)

Co-hosted by the Government of Fiji and the IMF, with funding support from the Government of Australia
June 25, 2015, Nadi, Fiji

In April 2015, the IMF organized a learning event specifically targeted at mission chiefs assigned to small states. Much of the training content drew on the experiences and insights from the Offices of Executive Directors representing small states, the IMF's area and functional departments, and the World Bank Group, and sought to better equip mission chiefs to work with country authorities and development partners to offer tailored policy solutions to small states.

Small states face numerous challenges: small populations, diseconomies of scale and natural disasters. In addition, capacity constraints limit potential growth and economic resilience. A distinct set of skills is required to address these challenges. With this in mind, the IMF designed and organized a focused training session for mission chiefs working on small states. The two-day session, designed by the IMF's Asia and Pacific Department (APD) in partnership with the Human Resources Department (HRD), took place on April 7–8 in Washington, and was attended by 21 mission chiefs and senior economists from across the IMF.

In his opening remarks at the event, IMF Deputy Managing Director Min Zhu said, "the IMF Executive Board, management, and staff are all strongly committed to supporting small states. Mission chiefs, in particular, play a critical role in understanding the unique challenges small states face and customizing policy advice. This training is a very important step in helping them prepare for their task and further increase the effectiveness of IMF engagement with these countries."

"We designed the course for APD small states mission chiefs who are primarily senior economists leading their first missions," said Hoe Ee Khor, Deputy Director in APD, who supervises the work on small states. "However, the course is equally useful to experienced mission chiefs, and with several spots still available, we reached out to other departments and received an enthusiastic response," said Khor.

The training offered a hands-on approach to learning how to best leverage the IMF's collective knowledge on small states, keeping in mind that the categories of small states, fragile states, and low-income countries often overlap. Participants discussed real-life challenges and the best ways to address them. They benefited from the perspectives of senior staff who had served as mission chiefs to small states, as well as from the views of panelists from several Offices of Executive Directors (OED) representing small states.

"Heading the work on the Caribbean, as Assistant Director in the IMF's Western Hemisphere Department, was one of the best assignments ever in my 25 years at the Fund. Innovative solutions are absolutely necessary in small countries and the Fund can really make a difference. This is why small states work is so rewarding," said Ratna Sahay, Deputy Director of the IMF's Monetary and Capital Markets Department, who participated in one of the panel discussions.

In their capacity as representatives of small country authorities, panelists from the Offices of the Executive Directors provided insights on ways to best address the needs of the authorities and how best to engage with them.

"Offering policy advice and assistance that the authorities can grasp and can take forward given their capacity constraints has an impact," said Vicki Plater, an Alternate Executive Director, whose constituency covers nine small states, including eight Pacific island countries and the Seychelles.



IMF Deputy Managing Director Min Zhu (right) and APD Deputy Director Hoe Ee Khor



IMF DMD Min Zhu, Montenegro Mission Chief Alasdair Scott, and Brunei Mission Chief Kevin Cheng



World Bank East Asia and Pacific Regional Vice President Axel van Trotsenburg



Palau Mission Chief Jaime Guajardo, Senior Economist Sarah Zhou, and Tonga Mission Chief Yasuhisa Ojima

Ketleen Florestal, Advisor to Otaviano Canuto, the Executive Director representing Cabo Verde, Suriname, Timor-Leste, Trinidad and Tobago, and Guyana, noted that although it may not always be easy for new mission chiefs to immediately grasp the context within which small states authorities operate, understanding the political economy context is key to being effective with the authorities.

“This training is a great initiative to help mission chiefs deepen their understanding of the practical realities and challenges faced by small states, and how they can communicate and engage more effectively with authorities, and tailor solutions for countries’ needs,” said Caroline Waqabaca, Advisor to Marzunisham Omar, Executive Director of the constituency that includes Fiji and Tonga.

The training also featured discussions on ways to enhance engagement with development partners and improve communication strategy in the context of mission work. To further highlight some of the more challenging aspects of working on small states training participants were briefed on security and safety measures to safeguard against emergencies, including natural disasters which are very common in many small island countries.

“There are many resources available within the IMF to small states mission chiefs,” said APD Small States Unit Chief, Patrizia Tumbarello. “Within APD, for example, we have launched a toolkit that serves as a go-to reference for new mission chiefs. We also encourage new mission chiefs to be active participants in the Small Islands Club, an interdepartmental working group created several years ago to foster collaboration and dialogue on small states within the IMF,” she added.



Cabo Verde Mission Chief Ulrich Jacoby and Samoa Mission Chief Geoffrey Bannister

Kiribati

Country Note

Context: Kiribati is one of the most remote and geographically dispersed small states in the world. High transportation and communication costs, together with weak infrastructure and a poor investment climate, are key obstacles to development. Extreme poverty is low, at around 5 percent, but 22 percent of the population lives below the basic needs poverty line. Climate change presents significant challenges given the low elevation of the land and rising sea levels.

Outlook and Risks: Recent economic performance has been strong. Donor-financed large infrastructure projects and a pickup in credit to households have boosted real GDP growth to close to 4 percent in 2014 and to about 3 percent in 2015. The medium-term growth outlook is also relatively favorable, although growth is expected to weaken in the next few years with the completion of donor-financed projects. Inflation remains low, underpinned by lower food and commodity prices. The current account turned into a strong surplus in 2013–14 on account of the high fishing license fees, but is expected to revert to a deficit in 2015 due to high imports related to donors’ projects. The fiscal outlook has improved markedly in recent years, similarly reflecting high revenue from fishing license fees. The recurrent balance was in large surplus in 2014 and is expected to remain positive in 2015, notwithstanding a large increase in development expenditures. On structural reforms, significant progress has been achieved with the introduction of a VAT in 2014 and implementation of the State-Owned Enterprise (SOE) Reform Act, including privatization of key assets.

Policy Issues: The key policy challenge is to manage the intergenerational benefits of Kiribati’s large sovereign wealth fund against a background of uncertainty about future fishing license fees and spending pressures to address important infrastructure and social needs and prepare for the adverse consequences of climate change. Under the historic pace of spending, the sovereign wealth fund (Revenue Equalization Reserve Fund, RERF) would be depleted in about 20 years. Ensuring sustainability requires containing nominal growth in on-budget (largely recurrent) expenditure to around 1½ percent per annum over the next five years (after accommodating climate-change-related costs), with transparent and symmetric transfers and withdrawals from the RERF around this path. Public investments should remain largely grant-financed. More progress is needed in creating conditions for private sector growth. Further lowering telecommunication and transportation costs, streamlining business registration processes, and facilitating the private usage of land will be critical to improve the investment climate and lift growth prospects. In SOEs reforms, key outstanding issues include further reforming the energy and copra sectors and improving the investment climate.

Source: [Kiribati-IMF Staff Report for the 2015 Article IV Consultation](#).

Image borrowed from CIA World Factbook and the Government of Kiribati website.



Context: Samoa has a strong record of macroeconomic management, and before the global financial crisis was one of the fastest growing Pacific island countries. A tsunami in September 2009 and cyclone Evan in December 2012 caused major destruction, and prompted the government to request disbursements under IMF-supported programs in 2010 and 2013. Reconstruction is estimated to have cost 40 percent of GDP and added about 15 percent of GDP to Samoa's external debt. Macroeconomic stability has been maintained in the face of external shocks.

Outlook and Risks: Growth is recovering gradually from natural disasters and inflation remains subdued. The current account deficit is expected to narrow on lower international oil prices and a planned fiscal consolidation. The main external risk is the occurrence of another natural disaster in the presence of already high public debt and vulnerabilities in financial institutions. The main domestic risks center around a delay in rebuilding macroeconomic buffers, in particular through fiscal consolidation, reforms of public financial institutions and financial oversight. Debt (mostly external) rose rapidly from 30 percent of GDP in 2008 to 55 percent in 2014. In addition, a subsidized lending program through the public financial institutions (PFIs) and government-guaranteed debt in the state-owned enterprises (SOEs) represent contingent liabilities for the public debt.

Policy Issues: A recent IMF financial sector assessment program mission identified risks in some commercial banks and PFIs. The role of PFIs needs to be refocused to reduce contingent liabilities for public finances and to support the development of private financial markets. Regulation and supervision of financial institutions needs to be improved to reduce the risk of an adverse feedback loop from banks and PFIs to the public finances in case of another external shock. A gradual fiscal consolidation is planned to reduce public debt to the target of 50 percent of GDP by 2020, mainly through improvements in revenue and a reduction in current expenditure. A stronger external position with higher reserves would also provide greater resilience. The authorities' structural reform initiatives emphasize a revitalization of agriculture and food processing, tourism, and an enabling environment for business. Reforms to SOE governance are beginning to bear fruit, but the government should stay the course in planned privatizations and amendments to legislation to reduce the burden of SOEs on public finances. Improvements in financial infrastructure will improve the flow and allocation of credit.

Source: [Samoa-IMF Staff Report for the 2015 Article IV Consultation](#).

Image borrowed from CIA World Factbook and the Government of Samoa website.



Context: Devastating Cyclone Pam hit Vanuatu on March 13, destroying a large share of housing, infrastructure, tourist facilities, crops, and livestock. Estimated damage and losses to the economy exceeded 60 percent of GDP. In view of the urgent balance-of-payments need, the authorities have requested emergency assistance from the IMF under the Rapid Credit Facility and the Rapid Financing Instrument facilities in the amount equivalent to SDR 17 million (100 percent of the quota, or around US\$24 million). Due to prudent macroeconomic policies in the years before the cyclone, Vanuatu had moderate public debt, adequate reserves, and low inflation. At the same time, growth has been disappointingly low over the last 5 years.

Outlook and Risks: GDP is projected to decline by 2 percent in 2015, and risks are to the downside. A wide trade deficit in goods and services—driven by cyclone damage to export facilities and a boost to imports from domestic shortages and reconstruction needs—will put pressure on international reserves. Reconstruction spending is also expected to give rise to large fiscal deficits. For 2015, staff projects a current account deficit of 27 percent of GDP and a budget deficit of 12 percent of GDP. IMF assistance would help ease the pressure on the balance of payments and catalyze financing from development partners to support the recovery and reconstruction efforts.

Policy Issues: Vanuatu should seek grants to finance reconstruction to the maximum extent; for the balance, concessional borrowing could be used. Going forward, the authorities will need to rebuild fiscal buffers and create room for important social and development expenditures by reprioritizing spending. Efforts should continue to strengthen public financial management, and increase tax and non-tax revenues. In the medium term, a contingency fund for natural disasters should be established. The authorities can support the economy and the banking system by providing liquidity to banks with appropriate safeguards, and be ready to withdraw the liquidity once the situation is stabilized. The exchange rate basket peg can be maintained at the current level for now but the authorities should be ready to review and adjust the level to support the external sector and rebuild buffers if balance of payments pressures were to persist after the reconstruction phase.

Source: [Vanuatu-IMF Staff Report for the 2015 Article IV Consultation](#).

Image borrowed from CIA World Factbook and the Government of Vanuatu website.

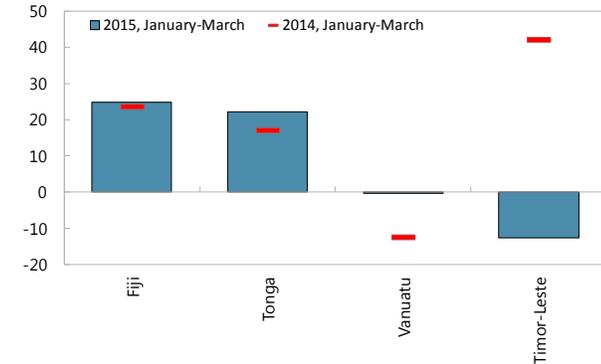


Figure 1. APD Small States: Economic Landscape¹

High-frequency data point to uneven economic activity among APD small states...

Selected APD Small States: Vehicle Registrations, January-March, 2015

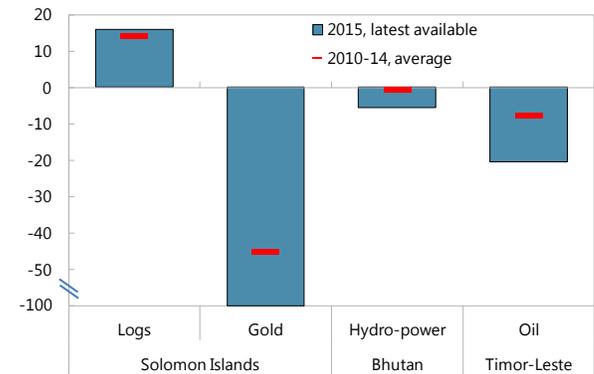
(Year-on-year percent change)



...although commodity output has generally weakened amid low prices and production disruption.

Selected APD Small States: Commodity Production

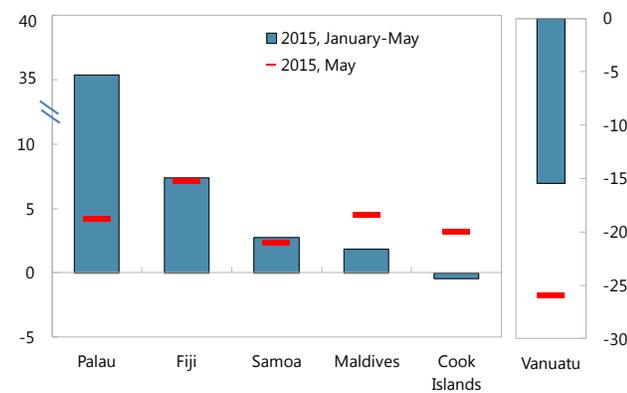
(Year-on-year percent change)



Tourist flows from China benefited Palau, thanks to better flight connectivity, but tourism's growth was generally uneven in the region, weighed down by natural disasters in Vanuatu...

Tourism-intensive APD Small States: Tourist Arrivals

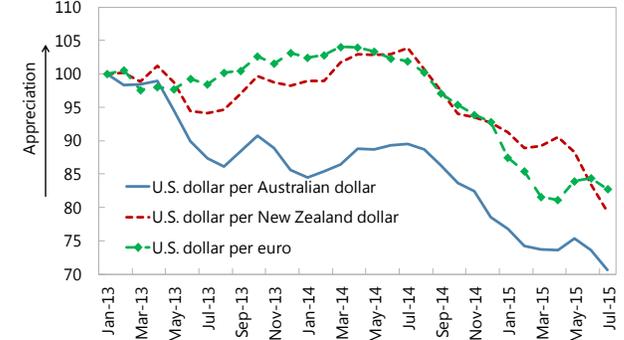
(Year-on-year percent change)



...but also the sharp depreciation of the currencies of major target markets.

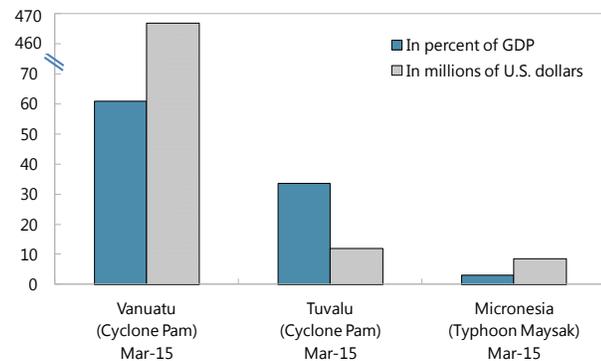
Australia, Eurozone, and New Zealand: Nominal Exchange Rates

(Index, January 2013=100)



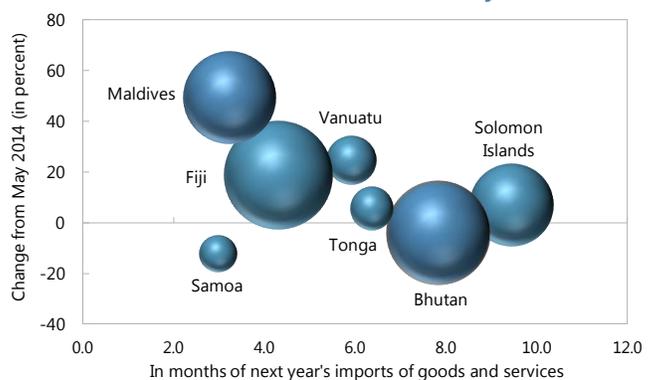
Natural disasters have taken a toll on a few economies...

APD Small States: Economic Damage and Losses From Recent Natural Disasters



...although many APD small states have enhanced resilience to natural disasters by building ample buffers.

APD Small States: International Reserves, May 2015



Note: June for Fiji and Maldives, April for Vanuatu. The size of the bubble represents reserves in billions of U.S. dollars.

Sources: Country authorities; and IMF staff estimates.

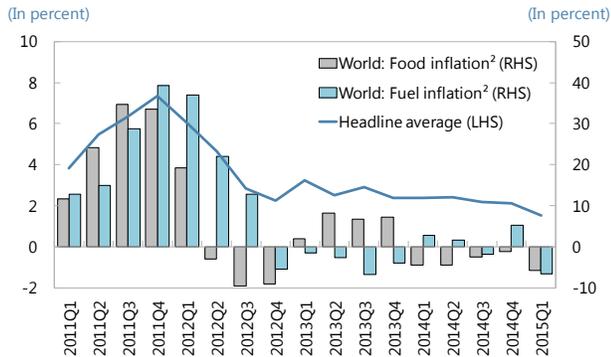
Note: Asia and Pacific developing small states include: Bhutan, Fiji, Kiribati, Maldives, Marshall Islands, Micronesia, Palau, Samoa, Solomon Islands, Timor-Leste, Tonga, Tuvalu, and Vanuatu.

¹ Prepared by Tlek Zeinullayev (Small States Unit, IMF Asia and Pacific Department).

Figure 1. APD Small States: Economic Landscape (concluded)

Continuously low food and fuel prices have kept inflationary pressures down...

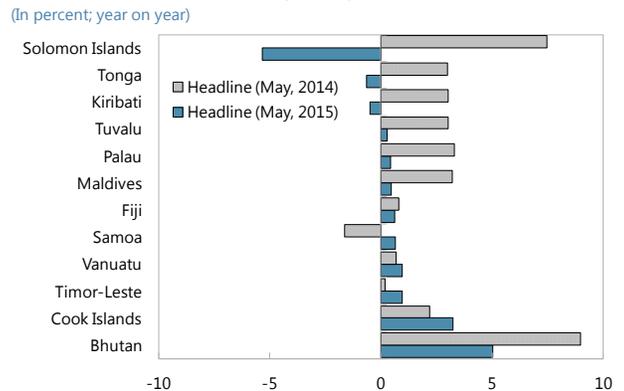
APD Small States: Headline Inflation¹



1/ Simple average.
2/ Two-quarter lag.

...with Kiribati, Solomon Islands, and Tonga experiencing deflation on account of second-round effects of lower fuel and commodity prices...

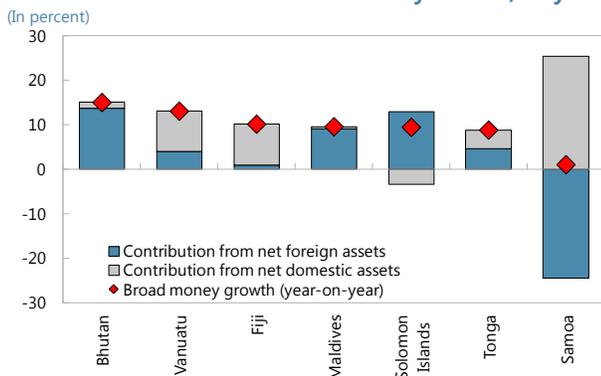
APD Small States: Inflation, 2015, Latest Available



Note: March for Kiribati and Vanuatu; December 2014 for Tuvalu.

...allowing central banks to maintain accommodative monetary conditions.

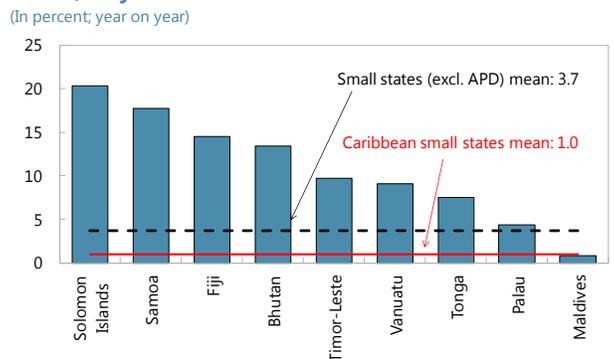
Selected APD Small States: Broad Money Growth, May 2015



Note: March for Vanuatu; and April for Bhutan.

Credit to the private sector has grown at double-digit rates in several APD small states ...

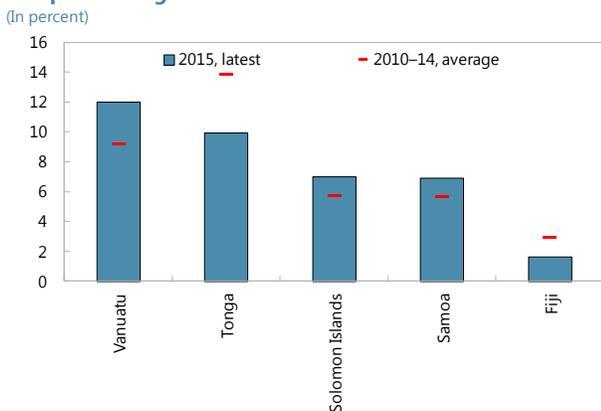
APD Small States: Growth of Domestic Credit to Private Sector, May 2015



Note: April for Vanuatu, March for Bhutan, December 2014 for Palau.

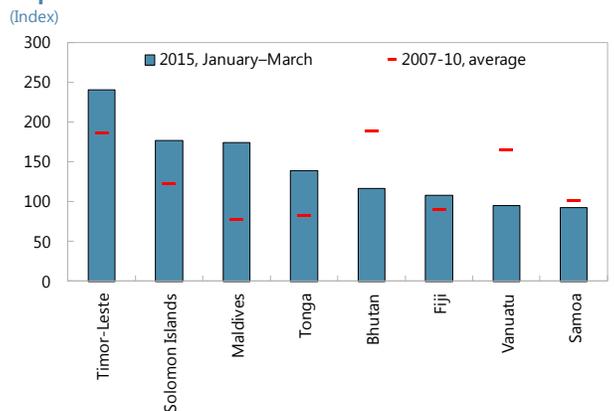
... highlighting the need for continued vigilance, especially in cases where asset quality has deteriorated ...

Nonperforming Loans to Total Gross Loans



...although limited reliance on wholesale funding lowers the risk for banks.

Deposit-to-Loan Ratio



Sources: Country authorities; and IMF staff estimates.