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*Original Article*

# Sources of Growth Spurts in Pacific Island Economies

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**Abstract**

*There has been a considerable amount of research into the growth of the Pacific island countries; however, there has been no attempt to identify episodes of growth (and non-growth) and to identify and understand the factors behind these episodes. This narrative article examines the growth experiences of the eight small and micro states of the North and South Pacific that are members of the World Bank. The experience of Samoa and Vanuatu supports the idea that economic reform can lead to growth spurts. Overall, the narratives suggest that unless aid leads to changes in institutions and policies, it does not have long-lasting positive growth impacts. As experience in the Federated States of Micronesia and the Republic of the Marshall Islands appears to show, substantial aid may raise Gross Domestic Product (GDP) growth for short periods, but may well have very adverse impacts over the long run.*

**Key words:** sources of growth, Pacific islands, growth episodes

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## 1. Introduction

Following a critical review of the '. . . reams and reams of growth regressions in which literally hundreds of variables have been placed on the right-hand side with growth rates on the left', Pritchett (1998) suggested three 'promising' (related) approaches that could yield insights into growth in developing countries. First, identification of episodes of growth acceleration and deceleration and analysis of the reasons for the upturns and downturns. Second, analysis of the evolution of possible growth determinants. Third, analysis of changes in growth rates over time. Pritchett also pointed to the need to take into account the political economy of the factors behind these growth-impacting factors.

There has been a considerable amount of research into the growth of the Pacific island countries (PICs); however, there has been no attempt to identify episodes of growth (and non-growth) and to identify and understand the factors behind these episodes, as suggested by Pritchett. The approach suggested by Pritchett provides the framework for this study of the growth experiences of the eight small and micro states of the North and South Pacific (PIC-8) that are members of the World Bank.[1]

Section 2 provides a brief economic history of the PICs. Section 3 identifies episodes of good growth and periods of poor or negative growth in the PIC-8 and through individual country narratives suggests reasons for the initiation and maintenance of growth spurts, as well as the reasons for the ending of such spurts

1. The eight countries are: the Federated States of Micronesia (FSM), Kiribati, Palau, Republic of the Marshall Islands (RMI), Samoa, Tonga, Tuvalu and Vanuatu.

and for the periods of poor growth. Section 4 discusses experiences across the PIC-8. As far as data and other information allow, an attempt is made throughout to highlight factors that led to economic success across the PIC-8. Reasons for persistently poor performance are also identified.

## 2. The Economic Performance of the PIC-8

### 2.1. *Pacific economic history*

The economic histories of the PIC-8 are very similar. Early encounters with traders were in the form of the sale of coconut products in exchange for consumption goods and household durable products. When settlers moved in during the 1800s, plantation agriculture became more important. Later, during the colonial period, smallholder production and plantation agriculture was still the primary focus but with attempts to diversify into agricultural products such as cocoa and bananas and small-scale manufacturing of items for domestic consumption as well as coconut processing.

Hence, at their independence, beginning with Samoa in 1962, these economies were still primarily producing coconut products for household consumption and export and perhaps one or two other agricultural products. Fishing was generally undertaken only for subsistence purposes. Manufacturing was a minor activity.

Following independence, some of the PIC-8 (e.g. FSM, Kiribati, Samoa, Tonga and Vanuatu) tried the 'industry policy' approach to development that proved so disastrous for so many developing countries. This approach comprised attempts at import substitution and the processing of agricultural products, mainly coconuts and fish, for export. As well, many state-owned enterprises (SOEs) were established. The most extreme case was Kiribati: until the recent privatisation of a few SOEs, there was very little in the way of a private sector in Kiribati (Duncan 2014). Similar to other developing countries, these government interventions have proven very costly in terms of the subsidies provided and have, in the main, failed.

However, such actions generated extensive vested interests that have subsequently resisted reforms to stimulate the private sector. These vested interests have taken the form of branches of international firms set up in the PICs behind import-protection arrangements that resist any kind of external competition. Further, SOEs have become a means for governments to award supporters through appointment to the management of such enterprises. Unions affiliated with SOEs, particularly utilities, provide some of the strongest resistance to reforms. A consistent issue in the country narratives is the large public–private wage gap that has inhibited private sector development throughout the Pacific. The high public sector wages attract the better-educated to the public sector and likely make them resistant to measures to promote the private sector.

The United Nations Convention on the Law of the Sea, signed in 1982, provided a major advance with respect to the PICs' rights to natural resources. The licencing of Distant Water Fishing Nations' access to the Pacific's migratory tuna has provided substantial revenues for some of the PIC-8, particularly Kiribati, which has an extensive Exclusive Economic Zone (EEZ) in which the tuna spends a long period of time and which therefore allows extended fishing.

Aid for development has been a common theme for the PIC-8. Pacific countries generally receive higher per capita aid than most other developing countries. However, aid does not appear to have promoted development to any great extent. Two lessons about aid come through the following narratives. First, as with FSM, RMI, Kiribati and Tuvalu, the extensive aid appears to have instilled a welfare-dependent attitude in the population that is inimical to individual enterprise and thus to the development of a robust private sector. Second, aid has played a major part in the 'stop-start' economic behaviour of some of the PIC-8. Countries experience a natural disaster, such as a cyclone that damages infrastructure and production facilities or an external economic shock that depresses commodity prices or reduces tourism, which in turn leads to a recession. Aid is provided to repair the physical damage or to prop up the economy in the face of the economic shock.

Knapman and Saldanha (1999) write that for the Pacific, the 1970s was the 'decade of independence', while the 1980s were 'substantially the decade of big government'. In line with these descriptions, the 1990s might be described as the 'decade of reform'. However, independence for the PIC-8 actually extended over the period from 1962 (Samoa) to 1994 (Palau). Tonga became independent in 1970, Tuvalu in 1978, Kiribati in 1979, Vanuatu in 1980 and FSM and RMI in 1990.

The few partly successful reforms (at least in Samoa and Vanuatu) were initiated in the mid-1990s in response to the fiscal difficulties resulting from expansionary government policies of earlier years. Other much less successful attempts at reform were also made in the 1990s in FSM and RMI, which had generated fiscal problems despite the large amounts of aid received. It is perhaps noteworthy, however, that since the mid-1990s, there have been no major fiscal crises. This has been despite major external shocks, for example, the food/fuel price shocks of 2007–08 and the global financial crisis of 2009–10. It may be that Pacific governments have learned from the earlier crises. However, there is still extensive reform of SOEs needed. Moreover, overall it has proven difficult to establish a business-friendly environment.

## 3. Growth Episodes

Table 1 shows real GDP growth rates for the PIC-8 for as far back as available. For each country, episodes of good growth have been identified (see highlighted percentages). These are generally periods of 4 years or more at rates of around 3 per cent and more—not a high benchmark by global standards, but relatively good in terms of the Pacific's performance. In some cases, an intervening year may show a growth rate of much less than 3 per cent but is included in the episode on the grounds that some natural event such as a cyclone could have disrupted a period of good growth. Substantial periods of negative or poor growth are also identified (see underlined percentages).

Following Pritchett (1998), these episodes are examined on an individual country basis to see if the reason(s) for the initiation of the growth spurt or the periods of negative or poor growth can be identified, and if reasons for the ending of the positive or negative episodes can be suggested. The discussion is in the form of a narrative about the macroeconomic or microeconomic reasons for the episodes.

### *3.1. Federated States of Micronesia*

In the case of FSM, one period of good growth is identified, 1988–93, as well as two periods of poor growth, 1994–97 and 2001–09. The first US Compact with FSM ran for 15 years over the period 1987 to 2002, with 'step downs' in the amount of aid at five yearly periods, viz. in 1992 and 1997. Allowance was also made for a possible extension of 2 years. It can be seen that the growth spurt from 1988 to 1993 largely coincided with the implementation of this funding. According to Browne (2006), there was a focus in the use of the aid funds on modernising infrastructure; as well, the public sector was expanded through increased civil service employment and higher wages, and the launch of several loss-making SOEs (involved in coconut processing, fisheries and the pepper industry)—all of which made it difficult for the establishment and expansion of the private sector. Also, two of the four FSM states, Chuuk and Pohnpei, did not adjust to the first 'step down' in aid in 1992 and increased their expenditure. To do so, the governments borrowed heavily from overseas through medium-term notes secured by future Compact flows (Browne 2006). This increased expenditure may explain the continued good growth beyond the first step down. The belated adjustment to the step down may also explain the poor growth from 1994 to 1997.

Compact II came into effect in 2004 (2004–2023). However, there appears to be no stimulatory impact on real GDP, given the second poor growth period identified covers 2001 to 2009 and despite the fact that the United States provided so-called bump up funds during the Compact renegotiation period of 2002–03, with grants set at their average level since 1987. Various International Monetary Fund (IMF) Consultation IV reports identify the withholding of Compacts disbursements under the amended conditions applying in Compact II as the primary reason for the country's very poor economic performance during the latter part of this negative growth period. As well, the inability of the states to agree on and implement reforms that would reduce the dominance of the public sector through promoting the private sector is seen by the IMF as a major hindrance to growth (e.g. reforms such as improving secure access for individuals to land and reducing the large public–private sector wage gap—public sector wages are on average at least twice that in the private sector). The high food and fuel prices during the 2007–08 period were also a contributor to the negative GDP growth during that period.

### *3.2. Republic of the Marshall Islands*

In the case of RMI, three periods of good growth are identified. Two short periods of good growth, 1982 to 1984 and 1986 to 1988, were interrupted by a sharp recession in 1985. The other good growth period is 1992

**Table 1 Real GDP growth rates of the PIC-8, 1980–2013 (%)**

| *Year* | *FSM* | *RMI* | *Palau* | *Samoa* | *Tonga* | *Kiribati* | *Tuvalu* | *Vanuatu* |
|---|---|---|---|---|---|---|---|---|
| 1980 | | | | | | −44.4 | | −11.4 |
| 1981 | | | | | | −3.5 | | **4.2** |
| 1982 | | **4.8** | | | 4.7 | 6.8 | | **10.7** |
| 1983 | | **15.5** | | | 2.0 | 9.0 | | **13.8** |
| 1984 | | **3.9** | | | 1.7 | <u>−1.2</u> | | **9.6** |
| 1985 | | −6.3 | | 3.9 | 6.6 | <u>−4.6</u> | | <u>1.0</u> |
| 1986 | | **24.5** | | 5.5 | 2.1 | <u>1.6</u> | | <u>−0.1</u> |
| 1987 | 1.2 | **9.4** | | 0.5 | 3.0 | <u>−3.1</u> | | <u>−2.9</u> |
| 1988 | **2.5** | **7.8** | | −1.4 | −1.9 | 18.2 | | <u>−1.7</u> |
| 1989 | **3.5** | −1.7 | | 3.7 | 0.4 | −8.6 | | <u>1.5</u> |
| 1990 | **3.7** | 2.7 | | <u>−4.4</u> | −2.0 | 2.1 | | 11.7 |
| 1991 | **7.4** | 0.1 | | <u>−2.3</u> | 6.4 | −4.3 | **3.6** | 3.1 |
| 1992 | **4.0** | **7.1** | −6.4 | <u>−0.2</u> | 0.3 | 3.2 | **2.8** | 2.6 |
| 1993 | **8.1** | **6.0** | −12.3 | <u>4.1</u> | 3.7 | 3.5 | **4.1** | 0.8 |
| 1994 | <u>−0.5</u> | **5.9** | **7.3** | <u>−2.5</u> | 5.0 | 4.9 | **10.3** | 9.1 |
| 1995 | <u>7.1</u> | **8.2** | **10.9** | 6.7 | 3.7 | −1.0 | −5.0 | 1.0 |
| 1996 | <u>−3.1</u> | <u>−10.3</u> | **10.4** | 7.2 | 0.0 | **6.1** | −6.0 | 2.3 |
| 1997 | <u>−6.1</u> | <u>−6.4</u> | 2.3 | 0.6 | −0.1 | **5.6** | 10.0 | 4.9 |
| 1998 | 3.0 | <u>−2.8</u> | 2.0 | 2.2 | **2.7** | **11.0** | 15.5 | 4.3 |
| 1999 | 1.4 | <u>−2.4</u> | −5.4 | 2.2 | **3.9** | **0.1** | <u>−1.6</u> | 0.3 |
| 2000 | 4.6 | <u>5.9</u> | 1.8 | **6.9** | **3.4** | **9.5** | <u>−1.0</u> | 5.9 |
| 2001 | <u>1.7</u> | 5.4 | 2.1 | **6.9** | **3.6** | 0.7 | <u>1.6</u> | −3.5 |
| 2002 | <u>0.6</u> | 2.6 | 4.8 | **4.3** | **3.4** | 0.6 | <u>7.9</u> | −5.1 |
| 2003 | <u>1.8</u> | 0.2 | 0.1 | **4.5** | **2.2** | 4.0 | <u>−3.3</u> | **4.3** |
| 2004 | <u>−3.2</u> | −0.1 | 8.1 | **4.6** | 1.0 | 3.2 | <u>−1.4</u> | **4.0** |
| 2005 | <u>2.2</u> | 2.8 | <u>0.8</u> | **4.2** | 2.4 | −0.2 | <u>−3.8</u> | **5.3** |
| 2006 | <u>−0.2</u> | 1.9 | <u>−1.5</u> | **2.0** | −1.6 | −4.5 | 2.1 | **8.5** |
| 2007 | <u>−2.1</u> | 3.8 | <u>1.8</u> | **6.3** | −4.1 | 7.5 | 6.4 | **5.2** |
| 2008 | <u>−2.6</u> | −2.0 | <u>−5.5</u> | 1.0 | 0.9 | 2.8 | 8.0 | **6.5** |
| 2009 | <u>1.0</u> | −1.7 | <u>−10.8</u> | −4.8 | 3.2 | −0.7 | −4.4 | **3.3** |
| 2010 | 2.5 | 6.1 | 3.3 | 0.5 | 3.3 | −0.5 | −2.7 | 1.6 |
| 2011 | 2.1 | 0.0 | 5.3 | 5.2 | 2.9 | 2.7 | 8.5 | 1.2 |
| 2012 | 0.4 | 4.7 | 5.7 | 1.5 | 0.8 | 2.8 | 0.2 | 1.8 |
| 2013 | −4.0 | 3.0 | −0.3 | −1.1 | 0.5 | 3.0 | 1.3 | 2.0 |

*Note:* PIC, Pacific island countries; FSM, Federated States of Micronesia; RMI, Republic of the Marshall Islands.
*Source:* World Bank, Development Indicators database.
The bolded numbers are years of high growth; the underlined numbers are years of slow growth.

to 1995. A negative growth period, 1996 to 1999, is also identified.

The first Compact between RMI and the United States ran from 1987 to 2001, with the United States guaranteeing aid funds of US $620 million over this period as well as a US $150 million Nuclear Trust Fund to compensate the inhabitants of the four atolls affected by the nuclear testing in the 1940s and 1950s. Similar to the arrangement with FSM, the Compact funds were also subject to step downs in 1992 and 1997. The two short, high-growth periods were likely the result of the high levels of US aid. In 1985, prior to the implementation of Compact I, aid flows were very high. According to the OECD, the level of per capita aid to RMI in 1985 was US$1,900, almost double that of French aid to French Polynesia and New Caledonia, and many times more than that received by other PICs (Thomas 1987). The high growth period 1992 to 1995, following the implementation of Compact I, was also likely the result of the payment of Compact funds, which were used mainly to modernise infrastructure (ADB 2001).

According to Knapman and Saldanha (1999), the very negative growth period 1996–99 reflected not only the cuts in government expenditure and employment made under the ADB's Policy Reform Program, but was also because of the poor performance of the agriculture and fishing sectors. Drought and typhoon Paka (December 1997) had adverse impacts on both of these activities. In the fishing sector, the unprofitable government-owned long-line and purse-seiner vessels had ceased operations in FY 1996. The ADB's reform program had been implemented in the light of the second step down in Compact funding, and in order to reduce the accumulated deficits and debt, as well as improve the business environment. The economic recovery following the negative episode could be the result of the aid-funded roadwork undertaken and growth in fishing activity.

### 3.3. *Palau*

Two growth episodes are selected for Palau: a 3-year rapid growth period, 1994–96; and a 5-year negative growth period, 2005–09. The growth period 1994–96 coincided with the introduction of payments under Compact I when the annual grants were about the same size as the country's GDP. According to Browne (2006), public sector spending was the main driver of growth during this period.

Browne (2006) argues that the poor growth experienced in most years throughout the period 1997 to 2003 was due to a series of events, many of which were related to the fact that Palau tourism has been heavily dependent upon the fast-growing countries of East Asia, viz. the Asian financial crisis of 1997–98, the 9/11 terrorist attack in New York in 2000 and the SARS scare in 2003. The much improved performance in 2004 he attributes to a resurgence in tourism, aided by the establishment of new airline routes in the region, hotel construction and new public infrastructure. External factors also appear to have contributed to the poor performance over the 2005–09 period: the high food and fuel prices of 2007–08 and the global financial crisis of 2009–10, which adversely affected tourism.

In contrast to FSM and RMI, the public sector in Palau has continued to decline since the implementation of Compact I and Palau's per capita income has been growing faster and is much higher than in the other Compact states despite facing similar external shocks. This better economic performance appears to be related to the more enterprising approach taken in Palau, perhaps because of the more facilitating business environment.

### 3.4. *Kiribati*

Two growth episodes have been selected for study in Kiribati: a 4-year negative growth period, 1984–87; and a 5-year positive growth period, 1996–2000. Browne and Scott (1989) reports that Kiribati's economy was buoyant during the 1970s because of the relatively high prices received for phosphate exports. During this time and in light of the upcoming exhaustion of the phosphate deposits, government planning and expenditure was focused on policies to develop alternative sources of income. But efforts to promote agriculture, manufacturing and tourism were unsuccessful. Hence, at independence, coinciding with the loss of phosphate exports, economic prospects were bleak. As seen in Table 1, there was a 44.4 per cent fall in real GDP in 1980 as the result of the exhaustion of the phosphate reserves.

In 1956, the British administration had established the Revenue Equalisation Reserve Fund (RERF) into which were paid royalties from the sale of phosphate. The RERF was set up in anticipation of the exhaustion of the phosphate deposits and recognition of the limited revenue that would be available to provide government services. Following independence, the government decided to continue adding to the fund, which was invested in overseas securities. The earnings on these external assets have provided a financial buffer for the country.

Real GDP growth rates fluctuated sharply throughout the 1980s. These fluctuations, which persist, derive mainly from the fluctuations in the value of copra output and in the revenue received from tuna fishing licences because of changing weather conditions and prices. For example, in 1983, the value of copra output more than doubled because of an upsurge in world demand. Two years later, the value of copra output had halved. The revenue received from fishing licences issued to Distant Water Fishing Nations is even more volatile. Over the 10-year period, 1991–2001 fishing access fees averaged A$23 million. However, annual receipts ranged from a low of A$6.2 million in 1995 to a high of A$46.6 million in 2000. As a result, fishing revenue accounted for only 9.9 per cent of total government revenue in 1996 and for 54 per cent of total government revenue in 2001. These fluctuations are reflected in the negative GDP growth in 1995 and the 9.5 per cent positive growth in 2000.

Hence, the negative growth period 1984–87 appears to be largely because of copra's poor performance. The 1988 upsurge was due to a temporary boost in copra prices and output, which quickly fell in the following year.

Overall, since 1990, GDP has been boosted by increased government expenditure, funded by increased fishing revenue and aid, and since 1994 by larger drawdowns from the RERF. In 1995, in a major break from the previous governments' conservative management approach, the government shifted to a more activist, but unsustainable, fiscal policy: large wage increases, increased public services, increased infrastructure spending and increased subsidies for the many SOEs. The large increase in fishing revenues in 1997–98, which rose to 60 per cent of GDP, also helps to explain the positive growth period of 1996–2000.

### *3.5. Tuvalu*

Two growth episodes were selected for Tuvalu: a 4-year positive growth period, 1991–94; and a 7-year negative growth period, 1999–2005. However, because of the general lack of data prior to 1990 and the uncertainty about the validity of the available data since then—evidenced by the large differences between data points obtained from various sources—it is very difficult to say with any certainty what was behind these growth episodes. We do know that the major sources of government revenue and GDP performance—earnings from the Tuvalu Trust Fund and from the .tv domain name and income from the sale of fishing licences—are highly variable.[2] Therefore, it is to be expected, as can be seen from Table 1, that GDP growth rates are highly variable.

ADB (2003) reports that real GDP grew at an estimated annual rate of 5 per cent from 1988 to 2001, led by the tertiary sector—the government in particular. The secondary sector, largely construction, expanded strongly—again mostly the result of aid-based government spending. However, the primary sector, mainly household output of copra, grew sluggishly.

2. In December 2001, the original DotTV Corporation was bought by VeriSign Inc. The Tuvalu government received US$10 million as its share of the sale price, while its contract with VeriSign, to run until 2016, provides Tuvalu with US$2.2 million per year plus 5 per cent of all revenue exceeding US$20 million from the use of the domain name.

Of the high GDP growth of 15.5 per cent in 1998, one-half was attributed to the government sector, while construction (funded by aid), finance and real estate contributed most of the remainder.

In both 1997 and 1998, prior to the negative growth period (1999–2005), GDP recorded high rates of growth. Almost all of this growth was due to expansion in the public sector arising from the increased civil service wage bill, major public construction activities and growth in SOEs—all of which was funded by 'windfalls' in the revenues accruing to the government. This situation was reversed in the negative growth period with most sources of government revenue drying up. Moreover, agriculture and fishing contracted over the six years to 2002 (ADB 2007b).

Tuvalu has been a member of the IMF only since 2010; and therefore, one cannot resort to the information collected by the IMF Consultation IV process for reasonably good information about performance, except for recent years. Data shown in the IMF Consultation IV report of 2010 illustrate the variability of GDP and of the sources of growth, for example, in 2000, total offshore income was A$42 million, of which Tuvalu Trust Fund distributions were around A$8 million; in 2003, income from this source was zero. Further, income from the lease of the .tv domain name was around A$2 million in 2001 and around A $12 million in 2002.

Hence, the most that can be concluded is that the sources of growth in Tuvalu have been mostly in the form of external funds of one kind or other—including aid—accruing to the government, and that these revenue flows are highly variable. Private sector activity remains very small and cannot drive growth in its present state.

### 3.6. *Tonga*

At independence in 1970, Tonga's economic structure 'was barely developed' with the monetised sector consisting of coconut and banana production and small government businesses, mainly coconut processing (Browne & Scott 1989). During the 1970s, attempts to rehabilitate the coconut sector were unsuccessful because of uncertainty about the profitability of replanting the senile trees. The banana sector also declined in the face of disease, shipping problems and poor fruit quality.

GDP growth was positive throughout the period 1982–87, albeit at fairly low levels in half of those years. A cyclone in 1982 damaged coconut and banana trees. However, construction activity stimulated by damage repair and funded by aid and insurance payments lifted economic growth. The Industrial Development Incentives Act 1978 led in the early 1980s to growth in manufacturing of products such as food and beverages, furniture and joinery and construction materials. The Act provided for subsidies such as tax holidays, tax exemptions, exemptions from export and import duties, subsidized loans, establishment of a Small Industries Centre providing leased space and long-term 'entrepreneurial' visas for expatriate entrepreneurs for as long as the enterprise was in operation ('Ata'ata 1987). But only 'lip service was paid to the need to develop the agriculture sector' (Flemming & Hardaker, 1988). As domestic demand for the subsidised manufactures was satisfied, production levelled off. Exports also fell as the tax holidays expired, and tariff preferences continued to erode. In FY 2001, the government followed the International Finance Corporation (IFC's) Foreign Investment Advisory Service recommendation that the Industrial Development Incentives Act 1978 be repealed.

A cyclone and drought in 1987–88 brought this period of growth to an end. Copra output declined by 60 per cent in the first half of the financial year (July–December 1987) and fell to zero in the latter half of the financial year. In fact, coconuts had to be imported to supply the coconut processing mills.

The 6-year positive growth period, 1998–2003, has been selected for analysis in Tonga. These are not years of robust growth, with two of the years yielding less than 3 per cent growth and no year as high as 4 per cent. In fact, Tonga has not had any outstandingly positive or negative growth periods.

In FY 1996, prior to the identified growth episode, Tongan squash production, its main export, was badly affected by drought. Squash production recovered slightly in FY 1997, but declined again in FY 1998 and FY 1999. However, in FY 2000, squash and other root crop production recovered strongly. In FY 2000, the road transport sector also increased sharply as remittance flows and personal loans financed increased imports of automobiles, mostly second-hand. In FY 2001, the fisheries sector grew most strongly. The Government Administration and Community Services sector rose to become the largest sector of the economy in FY 2001. An important contributor to this growth in FY 2001 was the large civil service wage increase, which pushed up the external and domestic debt of the government (ADB 2002).

The ending of the growth episode in 2004 mainly reflected the bad squash and fishing seasons. However, throughout the whole period, the IMF Consultation IV reports warned about the inability of the government to arrest the long-standing structural weaknesses, increased policy slippages, limited progress in broadening the narrow production and export base and the heavy dependence on remittances.

### 3.7. Samoa

According to Browne (2006), Samoa's inconsistent policies from the mid-1970s to the early 1990s made it one of the weakest performers in the Pacific. During the 1970s, balance of payments difficulties emerged as expansionary expenditure policies were pursued in an attempt to accelerate growth. However, these efforts were unsuccessful. Moreover, major exports were stagnant, reflecting dependence on plantation agriculture of coconuts and cocoa (which both suffered from inadequate investment). The global oil price spike of 1973–74 and the subsequent global recession also hurt, with export prices and remittances falling and import prices rising.

Browne and Scott (1989) claim that economic performance also suffered in the early 1980s from the second sharp global oil price increase and the world recession. However, the long period of poor economic performance was finally reversed during the 1983–85 period through implementation of a comprehensive structural adjustment program. Pursuit of restrictive demand management policies during 1986–87 consolidated these gains. However, few policies were put in place to improve the domestic supply response to the macroeconomic reforms over the long term, particularly in agriculture.

The early 1990s was a particularly difficult period for Samoa as it suffered heavy flooding in 1989 and three cyclones in quick succession in 1990–93, which damaged infrastructure and housing and devastated agricultural capacity.[3] Agricultural exports were reduced by nearly two-thirds in 1992 to the lowest level in several decades. Worse was to come; in September 1993, taro leaf blight destroyed this crop, which was important for both domestic use and exports. In 1992, taro had accounted for 33 per cent of total merchandise exports. The only bright note during this period was the start-up in 1991 of the Japanese automotive harness manufacturer, Yazaki, attracted to the Pacific by the South Pacific Regional Trade and Economic Agreement—a non-reciprocal trade agreement between the PICs and Australia and New Zealand, signed in 1981.

Two growth episodes are selected for analysis for Samoa: a 4-year negative growth period 1990–94; and an 8-year positive growth period 2000 to 2007—a sustained growth episode that has only been matched in the PICs by Vanuatu. From the discussion earlier, it appears that the negative growth in the early 1990s was the direct result of the bad weather experienced. As well, there was a financial crisis in the government-owned airlines, Polynesian Airlines, requiring large subsidies from the government. In addition, recessions in 1991–92 in Australia and New Zealand, Samoa's major trading partners, reduced exports, tourism and remittances. The growth of 4.1 per cent in 1993 appears to be due to some recovery in agriculture following the natural disasters.

3. Cyclone Ofa in 1990, cyclone Val in 1991 and cyclone Lyn in 1993.

Increased aid to assist in the recovery from the natural disasters would have also helped.

The rapid growth in 1995 and 1996 that followed this period of negative growth was said to be due to a doubling of exports and substantial increases in food production, manufacturing output and tourism (ADB 2000). The automotive harnessing manufacturer, Yazaki, is reported to have ramped up its exports by 1995. However, the value of production and exports of Yazaki is not really known, as such, statistics have never been published. In the statistical bulletins, they are placed in the same category as unrevealed diplomatic items.

There had been a major review of Samoa's economic policies and adoption of another comprehensive economic reform program in 1996, involving a wide range of structural reforms—including privatisation of SOEs—supported by sound macroeconomic policies (Browne 2006). The severely deteriorating economic situation that led to the mid-1990s economic reform program derived from the difficulties that the government had got itself into through excessive expenditure, particularly through its subsidising of loss-making SOEs. As a result, it had to resort to heavy foreign borrowings. Consequently, there was substantial external pressure for reform; although there was not the threat of a fiscal crisis in the form of devaluation, as international reserves averaged a healthy 7–8 months of imports over the period 1990–94.

The Government's 1996–97 *Statement of Economic Strategy* outlined the major economic reforms to be undertaken, including, trade and investment liberalisation, financial sector liberalisation (removal of controls on credit and interest rates and strengthening of the central bank), public service reform and corporatisation and privatisation of SOEs. Between 1987 and 1996, 21 SOEs had been either divested or liquidated. In 1994, in the lead up to a tariff reform program, a value added general services tax of 10 per cent was adopted (the value added general services tax was subsequently increased to 12.5 per cent and on 1 October 2006, it was increased again to 15 per cent). As part of the new economic reform program, there was a large reduction in tariffs in 1998; except for vehicles, alcohol and tobacco, the highest tariff rate applied was 20 per cent as compared with 60 per cent previously. Earlier economic reforms also included the divestment of agricultural marketing boards and the removal of price subsidies for major crops.

Financial sector liberalisation began in 1998. Controls on credit and interest rates and on the capital account were removed, while there was a strengthening of prudential supervision. Further reforms in 2003 included the opening up of the telecommunications and postal sectors and in 2004, the liberalisation of international airline services. Between 2002 and the end of 2007, mobile phone access increased from 1.5 per cent of the population to 46 per cent, and internet use increased from 2.2 per cent of the population to 4.5 per cent (Beschorner 2008). There is now almost 100 per cent physical mobile phone coverage in the country. The opening up of the international airlines market involved the sale of the international routes of the state-owned airline, Polynesian Airlines, to Pacific Blue and allowing competition from other international airlines such as Fiji's Air Pacific (now Fiji Airways). In the wake of this introduction of competition, international airfares fell by up to 50 per cent.

Despite the improved investment legislation as part of the reform program, foreign investment remained close to zero. This lack of response was a puzzling and frustrating issue for government. But with the improved overseas airline services in 2004, there were now many more direct flights from Australia and New Zealand. The tourist hotel occupancy rate soared, inducing interest from international hotel chains. Samoa had constraints on foreign investment in the form of obligations to include local investors in any foreign-invested venture. However, the government relaxed this restriction to allow 100 per cent foreign ownership in the case of resort hotels. It also allowed extended leasing of custom land for the erection of tourist resorts.

In the 2000–04 period, both industry and services did well, growing at 9.7 per cent and

4.9 per cent, respectively (ADB 2007a). Then, in the period 2004–08, growth slowed in both areas, largely as a result of the decline in GDP in 2008 because of the global economic crisis. However, the economic growth that has taken place since 2000 has been rather narrowly based. The three sectors of the economy that have grown fastest and are now the largest are trade, transport and communications and construction. According to Sialaoa (2005), economic growth in the first half of the 2000s was driven by construction and tourism. The tourism was mostly in the form of overseas Samoans visiting relatives and friends. Growth in the construction sector was due mainly to construction of church residential buildings, most likely funded by remittances and government spending on facilities for the holding of the 2007 Pacific Games and the construction of the new Development Bank building. As well, through guarantees provided by the Development Bank and the National Provident Fund, the government supported the development of a four-star resort hotel. Thus, it would appear that Samoa's good growth in the first half of the 2000s was largely dependent upon its overseas workers and government expenditure, rather than the economic reforms. As Sialaoa (2005) noted, 'the growth of private sector investment has been very slow'.

Therefore, it is reasonable to argue that up to 2005, the binding constraints to economic growth through private sector development had not been overcome. Many reforms were implemented, but these do not appear to have contributed significantly to growth up to that point, although the macroeconomic reforms served to stabilise the economy. The introduction of competition in international airline services in late 2004 seems to have been the trigger to unlocking the potential of the tourism industry. It appears likely, therefore, that while macroeconomic instability was a problem prior to the mid-1990s reforms, it was probably not the binding constraint to private sector growth. The lack of competition in international airline services appears to have been the binding constraint on private investment in tourism and related activities. Infrastructure development on the main island and the opening of the telecommunications sector likely complemented the opening of international air services to competition in fostering investor interest in the tourist sector, which, in turn, was facilitated by the secure access to custom land.

It is difficult to find support for the idea that it was mainly macroeconomic problems that were constraining growth in the early 1990s. The poor GDP performance in the early 1990s was directly due to the cyclones and the macroeconomic crisis that the government found itself in was due to its poor management of the after-effects of the cyclones. However, it does appear reasonable to argue that the reforms that were undertaken later were triggered by the economic management problems faced by the government. They directed the government's attention to the important economic performance issues that it should be dealing with in order to improve the country's economic development, rather than being so involved in the economy through government businesses. No doubt it was important to adopt fiscal and monetary policies that would provide the private sector with a stable environment for investment, and this macroeconomic stability was achieved in the early period of the reforms.

However, underlying the difficulties that the government experienced in the 1990–94 negative growth period was that the economy was not growing sufficiently strongly to provide the revenues needed to cope with such disasters. Hence, the binding constraints on growth that the government needed to tackle were the ones that were responsible for the poor performance of the economy even prior to the natural disasters of the early 1990s.

Samoa's good growth in the first half of the 2000s was largely dependent upon its overseas workers' remittances and government expenditure, rather than the economic reforms. Therefore, it appears that up to 2004, the binding constraints to economic growth through private sector development had not been overcome. Many economic reforms were implemented, but these do not appear to have contributed significantly to growth up to that point, although the macroeconomic reforms served to stabilise the economy. However, the introduction of competition in international airline services in late 2004 seems to have been the trigger to unlocking the potential of the tourism sector and promoting the period of sustained growth in the latter half of the decade.

### *3.8. Vanuatu*

Browne and Scott (1989) report that Vanuatu experienced steady economic growth in the 1970s. Copra and beef output were increasing in response to stronger world demand. At the time, copra accounted for three-quarters of Vanuatu's total trade, with most of its exports going to Western Europe. However, due to insufficient investment in and maintenance of plantations, coffee and cocoa output declined. Tourism was growing, benefiting from improved airline connections and hotel facilities and from increases in cruise ship visits. The financial sector was also growing as a result of the establishment of an offshore financial centre. The problem areas identified were the heavy duplication of services because of the complex Condominium arrangements in place (particularly, the high-cost of duplication of English and French education systems), shortages of skilled manpower and the poor internal transport system.

Similar to Papua New Guinea, Vanuatu adopted a 'strong vatu' policy following independence in order to protect itself against imported inflation and to foster its growing offshore banking industry.[4] Besides damaging its tourism sector; however, the strong vatu also disadvantaged the export prospects of its quality beef industry.

Three growth episodes have been selected for study in Vanuatu: a 4-year positive growth period, 1981–84; a 5–year negative growth period, 1985–89; and a 7–year positive growth period, 2003–09.

Browne (2006) reports that following independence in 1980, there were initial setbacks due to the loss of skilled expatriates from the plantation sector, rebellion on the outer islands and a decline in tourism resulting from concerns about the civil unrest being experienced because of independence. Table 1 shows the result of these problems with the sharp decline of 11.4 per cent in GDP in 1980. However, despite the downturn in the Australian economy in the early 1980s and its impact on Vanuatu tourism—particularly through the depreciation of the Australian dollar—the Vanuatu economy quickly recovered over the next 4 years until several cyclones hit the islands during the period 1985–1988, resulting in loss of life and extensive crop damage.

Copra, Vanuatu's main export in value terms, fell sharply over the next 2 years from a peak in mid-1984 (copra exports in 1984 were US$27.6 million and in 1985 were US $12.4 million). The spike in export demand was due to drought in Malaysia adversely affecting palm oil output. But then, sharp increases in oil palm output from the second half of 1984 led to a sharp decline in vegetable oil prices early in 1986. Bad weather in Sri Lanka and in the soya bean areas of the United States and a typhoon in the Philippines damaging coconut plantations raised copra prices in the latter part of 1986 (Bell *et al.* 1986). Economic growth during this time was also hurt by the reduction in air services from Australia as well as Vanuatu's persistently high exchange rate, which raised accommodation rates for Australian tourists.

Another factor contributing to the negative growth period of 1985–89 was cyclone Uma in the first half of 1987, which hit the southern islands of Vanuatu, damaging agriculture and infrastructure. Further, a fish-canning operation was halted in 1986 because of inadequate supplies.

During 1996–98, Vanuatu's economic performance was poor; severe fiscal and monetary difficulties had developed in the midst of political instability. For example, there were two changes of government within a short period after the 1995 elections. Therefore, a

4. The vatu had been linked to the French franc until 1981. From then until February 1987, the vatu was linked to the SDR—although there were discrete devaluations. Since that time, it has been on an adjustable peg linked to a basket of currencies of its major trading partners.

Comprehensive Reform Program (CRP) was introduced in June 1998. The priorities of the CRP were public sector reform, improved governance, strengthening of public financial institutions and institutional strengthening (Knapman & Saldanha 1999).

However, there was not a quick improvement in economic performance in response to the reforms. It was not until 2003 that economic growth turned positive. Fiscal accounts continued to be weak; development expenditure remained high, while foreign borrowing and weak oversight in the selection of projects led to a continuing build-up of debt. Despite the work that had gone into planning for the CRP and generating support for the reforms, there was little progress on the CRP owing to a lack of consensus about the policy direction.

The economy picked up from 2003 with an increase in export prices, increased tourist numbers following expansion in airline capacity and liberalisation of trading in cocoa and copra. This was against the background of the adoption of sound fiscal policies (supported by a strong, determined Finance Department) and sound monetary policy (again backed by a strong Central Bank team). These improved institutional arrangements resulted in improved revenue collection and expenditure and debt controls despite political instability and the severe cyclone Ivy in 2004. However, any economic improvement would have been much less substantial without the improved external situation resulting in growth in agricultural exports and increased tourism.

The key factor in the increased tourism appears to have been the liberalisation of overseas air services, with initially Pacific Blue beginning operations in the latter half of 2004 and ultimately resulting in five international airlines flying into Vanuatu. These more reliable and cheaper air services improved connections to Vanuatu's main tourist markets, Australia and New Zealand, as well as opening up the Vanuatu market to tourists connecting internationally through Fiji. The availability of custom land for leasing for up to 75 years, which was established at independence, also allowed the development of tourist facilities.

According to IMF Consultation IV reports, the good fiscal and monetary policies were maintained through 2005 to 2009, supported by aid commitments, including substantial commitments by the United States through the Millennium Challenge Account for the development of transport infrastructure. The tourism industry was assisted by the Fiji coup in December 2006, which led to the redirection of tourists from Fiji. FDI from Australia for investment in tourism facilities and in real estate also supported GDP growth through this period. However, little progress was made on reforms to improve the private sector environment.

All three engines of growth stalled in 2009 and 2010, which brought an end to the sustained growth episode: copra output fell in response to a sharp decline in global prices; infrastructure projects were delayed; and tourism declined after a surge that had been prompted by the global financial crisis of 2009–10, as tourists elected to go to closer/cheaper resorts in Vanuatu rather than further afield.

Up to 2013, economic growth remained sluggish despite the maintenance of sound macroeconomic policies. Therefore, it appears that the sources of Vanuatu's sustained growth episode was initially improved agricultural export markets, followed by aid-funded infrastructure investment, liberalisation of airline services and foreign investment in tourism facilities and real estate. As the IMF has said consistently, the development of an encouraging environment for the private sector still has a long way to go.

## 4. Discussion

Following Pritchett's (1998) article urging the study of growth episodes, Hausmann, Pritchett and Rodrik (2004) analysed the relationship between periods of rapid GDP growth in developed countries and economic reforms that may have contributed to the growth spurts. They found a low correlation between the two and concluded that '. . . the vast majority of growth take-offs are not produced by significant economic reforms, and the vast majority of significant economic reforms do not produce growth take-offs'.

In a follow-up to this research, Rodrik (2004) concluded that the drivers of economic growth were largely country-specific, and that efforts to develop comprehensive policy frameworks for the pursuit of growth were misplaced. However, he did put forward four 'Higher-order General Principles' that seem to be necessary (but not sufficient) in order for rapid economic growth to take place. These are: (i) macroeconomic stability, to prevent high inflation and the build-up of unsustainable debt loads; (ii) global integration; (iii) secure property rights and contract enforcement; and (iv) social cohesion and political stability. But again, how these objectives are achieved could be country-specific. He urged country-specific Binding Constraints analysis to determine the reforms that should have priority in the development of growth-promoting policies.

Samoa and Vanuatu have been able to generate one sustained period of good growth, mostly through internal efforts and mostly from tourism. Remittances have also helped through increased tourism and funding of construction activity. Tonga has not experienced spurts of good or poor growth. This likely reflects the absence of positive policies and institutions on the one hand and the strong support from remittances on the other. Vanuatu has received very little assistance in the form of remittances as few Ni-Vanuatu have been able to migrate for work. Therefore, its ability to generate a sustained growth spurt, mainly through policy reforms supporting tourism, has been commendable.

While remittances have played a role in supporting tourism in Samoa and Tonga, they do not appear to have played a role in supporting economic growth. Especially given the large share of remittances in GDP in Tonga, if remittances were to play a significant role in economic growth, it should be in Tonga. But, this lack of support for growth is not surprising. A review of the many studies of the impact of remittances on growth by Barajas *et al* (2009) confirms that, while remittances have reduced poverty and supported education and housing in developing countries, '. . . at best, workers' remittances have no impact on economic growth' (p.1). Therefore, while emphasis has been given in recent years to increasing labour mobility of Pacific islanders to Australia and New Zealand—especially through seasonal workers' schemes—we should not expect too much in the way of economic growth stimulus.

Palau, FSM, RMI, Kiribati and Tuvalu receive relatively large amounts of aid. For the latter four countries, aid plays the main role in the limited GDP growth spurts these economies have experienced. FSM and Kiribati receive relatively large revenues from fishing licence fees, while Tuvalu has fluctuating support from its trust fund, .tv domain name and fishing fees. However, these have not provided a basis for economic development. Among the US Compact countries, Palau stands out in being able to foster growth through support of tourism. Further, it does not appear to have become as aid-dependent as the other two.

In FSM, RMI and Kiribati, aid dependency has developed from the receipt of large volumes of aid over many years, which appears to have sapped incentives for entrepreneurship and development of the private sector. This outcome is borne out by interviews with former Presidents of FSM and RMI, which led to the following assessment: 'The former presidents stressed that reform proponents need to be cognizant of the pervasive and long-standing "welfare state" attitudes developed over many years of the United States' (US) Compact aid and the way in which these attitudes shape perceptions about the role of government and the direction of national development' (Johnson and Graham 2011). Duncan (2014) also points to the high reliance on aid and the public sector in Kiribati and the antipathy towards people attempting to improve their living standards through private sector activity.

Given the severe natural disasters experienced by most of the PIC-8, especially those in the Southern Pacific, and the economic shocks affecting commodity exports, tourism and remittances, natural disasters and external economic shocks cause substantial fluctuations in economic performance. The limited diversity of economic activities amplifies the impacts of such shocks.

The PIC-8 economies that have performed less well—FSM, Kiribati, RMI and Tuvalu—have the least diversified economies and are the most dependent upon aid. Hence, fluctuations in aid, as well as fluctuations in external receipts from fishing or from external trust funds, appear to be the main driving forces in the fluctuations in their economic growth.

As far as Rodrik's (2004) Higher-order Principles are concerned, Palau, Samoa, Tonga and Vanuatu have enjoyed reasonably stable macroeconomic environments; although such stability was achieved in Samoa and Vanuatu following comprehensive economic reform programs (in Vanuatu's case, after some delay). Samoa and Tonga have had long periods of political stability—albeit achieved in different ways. While Vanuatu continues to have a turbulent political environment, the strong fiscal and monetary institutions established have not allowed the political instability to destabilise the economic environment to the extent that occurred in earlier times.

The GDP per capita growth differences between Palau, Samoa, Tonga and Vanuatu on the one hand and FSM, RMI, Kiribati and Tuvalu on the other have been largely a function of the provision of a friendly business environment—in particular, with respect to the development of tourism. The former have secure property right to land for tourism, as well as open markets for international airline services and mobile phone and internet services. Thus, they have globally integrated their tourism sector, which makes good economic sense given that PICs have comparative advantage in tourism. However, given the abundant arable land in Samoa and Tonga, the lack of secure individual access to land for activities other than tourism appears to be the binding constraint to economic growth that would benefit the majority of the population.

Overall, these narratives suggest that unless it leads to changes in institutions and policies, aid does not have long-lasting positive growth impacts. Somewhat contrary to Hausmann, Pritchett and Rodrik's (2004) conclusions, the limited experience of Samoa and Vanuatu does support the idea that reform can lead to growth spurts. On the other hand, as experience in FSM and RMI appears to show, substantial aid may raise GDP growth for short periods, but may well have very adverse impacts over the long run.

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