Asia-Pacific Small States: Developments and Outlook

Growth and Inflation Average growth in the small states in the Asia and Pacific region remained weak (1 percent) in 2013 and underperformed that in other small states—2 percent. However, activity within the Asia-Pacific small states was uneven, with commodity exporters growing at the rate of 3 percent which, while robust, was lower than past rates (Figure 1). Economic performance in the microstates (i.e., countries with a population below 200,000—Kiribati, the Marshall Islands, Micronesia, Palau, Samoa, Tonga, and Tuvalu) lagged behind with growth estimated at less than 1 percent. Inflation has remained broadly in check. These countries remain highly vulnerable to natural disasters as shown by the recent cyclones in Tonga and Vanuatu, and severe floods in Solomon Islands.

Fiscal Performance Tax reforms led to strong tax revenue performance in some tourism-intensive economies (Maldives and Samoa), while nontax receipts—mainly fishing license fees—surged in Kiribati and Tuvalu (see special topic). The underlying fiscal position in commodity exporters and in countries dependent on fishing license fees (proxied by the change in the overall fiscal balance excluding natural resources) has deteriorated, however, despite minor changes in the overall fiscal balance because of spending pressures (Figure 2).

Policy Buffers External reserves are at comfortable levels in several small states (Bhutan, Solomon Islands, Tonga, and Vanuatu), and fiscal space has been rebuilt in Kiribati, the Marshall Islands, Solomon Islands, and Tuvalu (Figure 3). But more effort is required to rebuild policy buffers in some others to strengthen their resilience to shocks.

Outlook Externally financed infrastructure projects and steady growth in Emerging Asia and Australia will underpin APD small states' short- and medium-term performance under the baseline scenario. Lower commodity prices are expected to contain inflationary pressures. The recent natural disasters are expected to take a toll on economic activity in the short term. Elections in late 2014 in Fiji and Solomon Islands introduce some uncertainty to their outlook. Other risks are mainly external. Negative spillovers from Asian emerging markets in the event of increased financial volatility would pose challenges for APD small states. The key challenge remains how to lift potential growth in the medium term.

Special Topic—Leveraging Marine Fishery Resources: Implications for Fiscal Policy[1]

Fishing license fees are a major source of revenue in several Pacific island countries (Kiribati, the Marshall Islands, Micronesia, and Tuvalu). In 2013 the fee earnings ranged from 15 percent of total revenues in the Marshall Islands to 65 percent in Kiribati. Despite the large fishery-derived wealth, PICs still have enormous untapped marine resources and further efforts are under way to properly leverage and manage them. First, the ratio of the income PICs receive by selling fishing rights to foreign companies to the value of the fish catch is very low. Second, an improperly designed access right scheme could lead to the overexploitation of marine resources. This would mean a decline in the fish supply (mainly tuna) and, eventually, a depletion of fish stocks, which would undermine fiscal sustainability. Finally, the intrinsic volatility of revenue from fishing license fees poses a challenge for fiscal policy.[2]

Regional cooperation to strengthen control over marine resources and extract more revenue has been facilitated by the 1982 Nauru Agreement among eight Pacific island countries.[3] This agreement sought to strengthen the bargaining power of license-issuing countries and regional control to stop illegal fishing. The regional license scheme regulated only the maximum number of vessels eligible for access rights in the region. Under that scheme, PICs were not able to realize the full benefit of their fishing wealth; specifically, there was a large disproportion between the value of catches by foreign companies and revenues received by PICs. In 2007, Nauru Agreement members introduced a new mechanism, the vessel day scheme, to extract more rent and strengthen PICs' bargaining power. The scheme did this by moving away from setting a limit on the number of vessels in the region (205) to limiting the total number of fishing days. Under the vessel day scheme, Nauru Agreement members jointly agreed to allocate a fixed number of transferable fishing days to each member according to the size of its Exclusive Economic Zones and historical catch. The fishing companies pay a flat fee per vessel per day. Nauru Agreement members further strengthened the vessel day scheme in 2011 by introducing a minimum fee for fishing per vessel day, operating de facto as an oligopolistic cartel. The minimum fee was set at US$5,000 effective in 2012 and raised to US$6,000 effective in January 2014.