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.

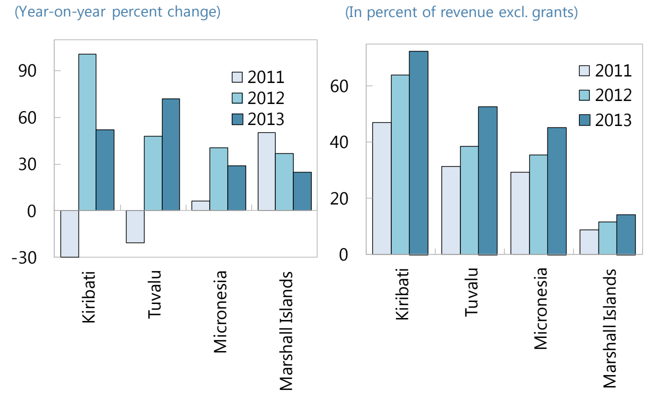
Outlook Externally financed infrastructure projects and steady growth in Emerging Asia and Australia will underpin APD small states' short- and medium-term performance under the baseline scenario. Lower commodity prices are expected to contain inflationary pressures. The recent natural disasters are 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]

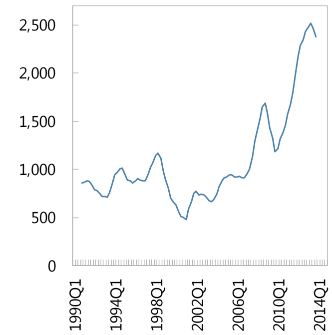
Regional cooperation to strengthen control over marine resources and extract more revenue has been facilitated by the 1982 Nauru Agreement among eight Pacific island countries.[3] This agreement sought to strengthen the bargaining power of license-issuing countries and regional control to stop illegal 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.

Selected Members of the Nauru Agreement: Fishing License Fees Revenues



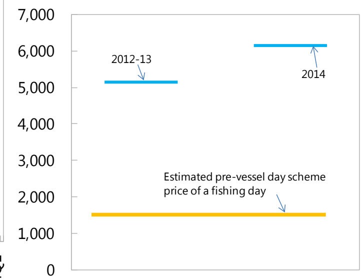
Note: Includes countries heavily dependent on fishing license fees.
Sources: IMF, WEO; and IMF staff estimates.

Price of Tuna[1]
(U.S. dollars per ton)



1/ Four-quarter moving average.
Sources: Globe Fish, Ministry of Trade of Thailand; and IMF staff estimates.

Members of the Nauru Agreement: Minimum Benchmark Price for Fishing Day
(In U.S. dollars)



Source: Pacific Islands Forum Fisheries Agency.

Preliminary data suggest that overall fishing license fee revenue almost quadrupled, from about US$60 million in 2010 to US$230 million in 2012,[4] with the largest increases occurring in Kiribati and Tuvalu. Under the vessel day scheme, access to fishing grounds is tightened, and fishing fleets compete among themselves for available fishing vessel days. In addition, by limiting the number of fishing vessel days, the vessel day scheme also limits fishing volume available to the companies. This has helped curb overfishing and helped raise fish prices. Despite the higher revenue, there is scope for improving the scheme as it now covers only members of the Nauru Agreement. The ratio of revenue to the value of the catch is still low because the price of tuna has risen. The World Bank sees scope for enhancing the competitiveness of fishing arrangements and consistency among the regional agreements beyond the Nauru Agreement and provides assistance in this regard.

From a fiscal policy perspective, there is uncertainty about whether the recent surge in earnings will be enduring and consistent with long-term resource sustainability or whether it should be seen only as a windfall—which countries should either use to build buffers and enhance resilience to shocks or spend wisely on health, education, or infrastructure to lift potential growth. Finally, even with considerable scope for improving the scheme, other factors, such as the El Niño cycle (which affects fish movement) and the exchange rate of national currencies against the U.S. dollar (which is the invoice currency of most license fees) will continue to contribute to the volatility in these nontax revenues. This suggests the need for countries highly dependent on fishing license fees to enhance their fiscal frameworks. They can do this by strengthening the medium-term orientation of fiscal policy (as opposed to a year-by-year formulation based on volatile and uncertain revenue) and using as a fiscal anchor a measure of structural balance—defined as the overall balance minus a normal level of fishing license fees (using backward-and forward-looking averages)—to reduce the budget's exposure to volatile fishing license fees. This suggests the need for countries highly dependent on fishing license fees to enhance their fiscal frameworks.[5] Moreover, strengthening the framework for managing fishing rights at the regional level is key given the risk of depletion of marine resources.

[1]Prepared by Ezequiel Cabezon, Sergei Dodzin, and Yiqun Wu (Pacific Islands Unit, Asia and Pacific Department).

[2] IMF, 2013, "Asia and Pacific Small States: Raising Potential Growth and Enhancing Resilience to Shocks," https://www.imf.org/external/np/pp/eng/2013/022013a.pdf; and IMF, 2013, "Macroeconomic Issues in Small States and Implications for Fund Engagement," www.imf.org/external/np/pp/eng/2013/022013.pdf.

[3] The members of the Nauru Agreement are: Kiribati, the Marshall Islands, Micronesia, Nauru, Palau, Papua New Guinea, Solomon Islands, and Tuvalu.

[4] World Bank, 2013, "The Living Ocean Resources of the Pacific: Developing a Sustainable Blue Economy," Manuscript.

[5] "Pacific Island Countries: Strengthening Fiscal Frameworks to Support Growth and Macro Stability," Emanuele Baldacci, Ezequiel Cabezon, and Patrizia Tumbarello, forthcoming IMF Working Paper.