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Recent Developments

The COVID-19 pandemic led to severe economic contractions in most of the Pacific Island Countries (PICs) in 2020. Even though most PICs have managed to avoid a local outbreak, economic activity has been significantly disrupted by the pandemic with unweighted average real GDP for the group contracting by an estimated 4.5 percent in 2020.¹ The largest impact has been felt by tourism-dependent PICs. For example, the sudden evaporation of tourism is estimated to have led to double-digit contractions in Fiji and Palau. Subdued commodity demand and falls in commodity prices have negatively impacted those dependent on commodity exports such as Papua New Guinea and Solomon Islands. The closure of borders has held back imports of capital goods and the arrival of foreign experts, delaying infrastructure and reconstruction efforts for many PICs (such as Marshall Islands, Micronesia, Solomon Islands, Tonga, and Vanuatu). Nevertheless, for most of the islands, the contraction in 2020 has turned out to be less severe than previously expected, as governments have taken measures to support the populations and sectors most affected by the pandemic. The economic contraction in some of PICs’ main trading partners (such as Australia and New Zealand) also turned out to be less severe than expected; and remittances have held up relatively well.

Fiscal balances worsened in general while current account balances improved for some Pacific Islands in 2020. Lower tax revenues, the need to deploy policy support, and higher healthcare spending have led to a deterioration in the fiscal position for most PICs, notwithstanding an increase in grant support from multilateral and bilateral development partners. As a group, the average fiscal balance is estimated to have deteriorated from a surplus of 3.5 percent of GDP in 2019 to a smaller surplus of 0.3 percent of GDP in 2020² while the average level of public debt is estimated to have increased from about 33 percent of GDP to 38 percent of GDP over the same period. Government development spending is expected to be crowded out during the pandemic, as eight out of the twelve PICs likely had lower government development spending as a share of GDP in 2020 compared to 2019. Largely due to substantial donor support, current account balances for the group as a whole are estimated to have improved, with the average current account deficit moving from a deficit of 1.1 percent of GDP in 2019 to a smaller deficit of 0.1 percent of GDP in 2020. The level of foreign exchange reserves cover remains adequate for most of the PICs.

¹ References to “average” refer to simple, unweighted average throughout. For countries following Fiscal Year (FY) budget, such as Marshall Islands, Micronesia, Palau, and Tonga, all the numbers refer to their FY outturns.

² The average fiscal balance would be -2.5 percent of GDP in 2020 if Nauru is excluded, as it is estimated to register a large fiscal surplus on the back of strong revenue from selling fishing licenses.
Outlook

The prospects for a rebound in 2021 vary among the islands. The PICs as a group are now projected to contract by an average of 0.6 percent in 2021. This compares to a 1.4 percent expansion forecast in the October 2020 World Economic Outlook (WEO). The downward revision reflects, among other factors, slower-than-expected vaccine availability, delays in border reopening, and slow resumption of tourism activity.

Even when recovery takes hold, it will take time for output to recover to pre-pandemic levels. The prolonged reduction in economic activity and border closures will likely have more lasting effects in such sectors such as tourism, and those reliant on trade, supply/demand chains, and expertise from abroad. Tourism-reliant PICs are expected to see a more gradual recovery than other PICs, while PICs as a group are projected to take a longer time to recover than emerging market and developing economies. The uncertainty on when vaccination programs will be widely implemented is a key risk to the economic outlook.

<table>
<thead>
<tr>
<th>APD Pacific Island Countries: Real GDP</th>
<th>(Year-over-year change; percent)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Actuals and Latest Projections</td>
<td>Difference from October 2020 World Economic Outlook</td>
</tr>
<tr>
<td>---</td>
<td>---</td>
</tr>
<tr>
<td>Pacific island countries 1/</td>
<td>2.6</td>
</tr>
<tr>
<td>Fiji</td>
<td>-0.4</td>
</tr>
<tr>
<td>Kiribati</td>
<td>3.9</td>
</tr>
<tr>
<td>Marshall Islands</td>
<td>6.5</td>
</tr>
<tr>
<td>Micronesia</td>
<td>1.2</td>
</tr>
<tr>
<td>Nauru</td>
<td>1.0</td>
</tr>
<tr>
<td>Palau</td>
<td>-1.8</td>
</tr>
<tr>
<td>Papua New Guinea</td>
<td>5.9</td>
</tr>
<tr>
<td>Samoa</td>
<td>3.6</td>
</tr>
<tr>
<td>Solomon Islands</td>
<td>1.2</td>
</tr>
<tr>
<td>Tonga</td>
<td>0.7</td>
</tr>
<tr>
<td>Tuvalu</td>
<td>6.0</td>
</tr>
<tr>
<td>Vanuatu</td>
<td>3.3</td>
</tr>
</tbody>
</table>

Sources: World Economic Outlook; and IMF staff estimates.
1/ Unweighted average.

Fiscal positions are expected to remain weak in 2021. Revenues are expected to decline further in many countries. On the other hand, government spending is expected to remain high as measures to mitigate the impacts of the pandemic are likely to be withdrawn gradually given the continued negative impact of the pandemic on vulnerable populations and sectors. As a group, the average fiscal balance among the PICs is projected to deteriorate from a small surplus of 0.3 percent of GDP in 2020 to a deficit of 4.3 percent in 2021. In addition, except for Nauru, all PICs are currently projected to run fiscal deficits over the medium term, compared to only five running deficits in 2019. These persistent fiscal deficits are projected to lead to an uptick in the average level of public debt—from 33 percent of GDP in 2019 to 42 percent of GDP by 2025.

Current account balances are projected to deteriorate further for many PICs in 2021. As borders may remain closed for a substantial part of 2021, the negative impact from the loss of tourism-related inflows is expected to continue for a number of the islands. Further, the gradual
recovery of commodity prices such as fuels will contribute to higher import bills for many PICs. Papua New Guinea is expected to benefit from higher energy prices while the outlook for fishing revenue remains uncertain for those dependent on this stream of foreign exchange. There is also the risk that COVID-related grant support from development partners could diminish, widening the current account deficit for some PICs. As a group, the average current account balance among the PICs is projected to deteriorate from a deficit of 0.1 percent of GDP in 2020 to a higher deficit of 4.2 percent of GDP in 2021. The current account balance is expected to remain in deficit for most PICs over the medium term, and foreign exchange reserve cover is expected to decline for some.

### Challenges

**Economic recovery will come in time, but the pandemic may leave an enduring impact not captured by headline macroeconomic indicators.** There is the risk that persistent scarring may lead to higher poverty, lower levels of employment in the formal sector, and higher levels of inequality. The reallocation of health resources for the pandemic could mean less resources available for non-communicable diseases, which have high incidence in some PICs. The full extent of the losses on bank loan portfolios is likely to be only exposed after the expiration of the debt service moratoriums introduced by some countries to ease the burden on borrowers during the crisis. Closure of correspondent banking relationships for some banks in the region could also affect foreign exchange inflows (such as remittances) and bank profitability. Severe revenue losses in national airlines, many of which are state-owned, will not only weigh on public sector balance sheets but could also pose risks to economic recovery as airline connectivity is vital for tourism, education, employment opportunities, access to healthcare, and delivery of goods and services.

**The pandemic has highlighted some areas for attention.** Government's ability to reach vulnerable populations and sectors through emergency relief has been affected by comparatively less developed social protection mechanisms in the Pacific Islands and the prevalence of the informal sector—which often does not have registries with government ministries. The impact of the border closure is felt not only by the exporters of goods and services but also by sectors that rely on foreign expertise (such as reconstruction efforts and general technical support), revealing the skill shortage faced by many PICs. Underdeveloped capacity in data collection, sharing, and analysis is further worsened by the pandemic, constraining policy makers’ capacity to make timely and appropriate decisions. Continued external support will be needed to improve capacity in these areas and help prepare PICs for future shocks.
The economic contraction of PICs’ main trading partners turned out to be less severe than expected.

Revisions vary across countries, with more upward revisions in 2020 and more downward revisions in 2021.

The timing for border opening remains crucial for several PIC countries that rely on tourism.

Energy prices have recovered somewhat, benefiting energy exporters but can put pressure on energy importers.

Revenues from fisheries remain uncertain for countries dependent on this sector.

PICs’ medium-term growth remains weaker compared to the emerging market and developing economies.
Trade balance is expected to remain weak.

Foreign exchange reserve coverage is expected to decline for several PICs.

Government revenue, especially tax revenue, is projected to be lower in 2021 than in 2020 for many PICs.

Government expenditure in 2021 is projected to be higher than in 2020 for many PICs.

The growth shock and fiscal response have resulted in an uptick in the level of public debt.

There are ever-present risks from natural disasters and climate change.

Pacific Island Countries: Average Public Debt, 2015-25

Long-Term Climate Risk Index for Pacific Island Countries (Countries with lower CRI scores are more impacted and should consider the CRI as a warning sign)
The pandemic is taking a toll on the global economy. The World Bank has estimated that the pandemic could push more than 100 million people into extreme poverty. Against this backdrop, the IMF and other international financial institutions are providing financial assistance to support their member countries.

To date, the IMF has approved financing request from 86 countries, committing some US$110 billion. Among Pacific Island Countries (PICs), Papua New Guinea, Samoa, Solomon Islands, and Tonga have received in total US$424.1 million (1.6 percent of GDP) through the Rapid Credit Facility (RCF) and the Rapid Financing instrument (RFI). The IMF has also provided debt relief to vulnerable countries under the Catastrophe Containment and Relief Trust (CCRT) for 29 countries totaling US$742 million, covering the period through October 15, 2021. Solomon Islands, the only PIC eligible for the CCRT, has benefited from the program.

The IMF, the World Bank, the G20, and the Paris Club established the Debt Service Suspension Initiative (DSSI) to help 73 eligible countries to concentrate their resources on fighting the pandemic. It is estimated that 43 countries have benefited from US$5.7 billion in debt service suspension from May to December 2020. The six-month DSSI extension through June 2021 could provide an additional US$7.3 billion of debt service suspension for 46 participating countries (as of March 8, 2021). PICs are estimated to benefit from US$335 million in 2020 and an additional US$59 million in 2021.

In November 2020, the G20 have agreed on a Common Framework for Debt Treatments beyond the DSSI to coordinate and cooperate on debt treatments for countries that are eligible for the DSSI and have an IMF-supported program.

An additional scheme to assist member countries through a new Special Drawing Rights (SDRs) allocation equivalent to US$650 million based on the IMF’s assessment of global reserve needs is under discussion. Any new allocation could provide additional liquidity to member countries, including PICs.

### IMF’s Financial Assistance to PICs

<table>
<thead>
<tr>
<th>Country</th>
<th>Type of Emergency Financing</th>
<th>Million of US$</th>
<th>Percent of GDP</th>
<th>Date of Approval</th>
</tr>
</thead>
<tbody>
<tr>
<td>Papua New Guinea</td>
<td>RCF</td>
<td>363.6</td>
<td>1.5</td>
<td>June 9, 2020</td>
</tr>
<tr>
<td>Samoa</td>
<td>RCF</td>
<td>22.0</td>
<td>2.7</td>
<td>April 24, 2020</td>
</tr>
<tr>
<td>Solomon Islands</td>
<td>RCF</td>
<td>9.5</td>
<td>0.6</td>
<td>June 1, 2020</td>
</tr>
<tr>
<td></td>
<td>RFI</td>
<td>19.0</td>
<td>1.2</td>
<td></td>
</tr>
<tr>
<td>Tonga</td>
<td>RCF</td>
<td>10.0</td>
<td>2.0</td>
<td>January 25, 2021</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td><strong>424.1</strong></td>
<td><strong>1.6</strong></td>
<td></td>
</tr>
</tbody>
</table>

### Regional Participation in DSSI

[Chart showing regional participation in DSSI]
**Kiribati**

Kam na mauri! Kiribati’s timely containment measures have successfully limited the risk of a domestic outbreak while fiscal measures have supported the economy, but the outlook remains uncertain. The necessary preemptive containment measures put strains on domestic economic activity by limiting labor mobility and port activity. A drop in fishing revenues by 16 percent in 2020 also pointed to unfavorable external conditions. An economic relief package of AUD$13.5 million in 2020 (5 percent of 2020 GDP) helped to somewhat cushion the impact of the pandemic, limiting the real GDP growth contraction to an estimated 0.5 percent. While a recovery is expected in 2021, real GDP growth is expected to remain subdued at 1.8 percent compared to the pre-COVID average of 4¾ percent in 2015–19. In the near-term, supporting economic recovery remains critical through fiscal measures that are well-targeted and focus on social spending. Once the recovery is firmly underway, unwinding recurrent spending and mobilizing revenue will help finance SDGs and climate related spending priorities. The long-term consequence of the pandemic can be mitigated through structural reforms to support a dynamic private sector, encourage economic diversification, improve governance, and promote sustainable financial deepening. The 2021 Article IV consultations were held through a virtual mission during February 11-28th, and the team had informative discussions with President Taneti Maamau, Vice President and Minister of Finance and Economic Development Teuea Toatu, and other senior government officials as well as representatives of the private sector and civil society. More details about the mission findings can be accessed at: [https://www.imf.org/en/News/Articles/2021/03/02/mcs030221-kiribati-staff-concluding-statement-of-the-2021-article-iv-mission](https://www.imf.org/en/News/Articles/2021/03/02/mcs030221-kiribati-staff-concluding-statement-of-the-2021-article-iv-mission)

**Marshall Islands**

The 2021 Article IV consultation was completed through a virtual mission in March. The team met Finance Minister, the Cabinet, Secretary of Finance, Banking Commissioner, other government officials, private sector, and development partners. The government has taken swift and strong measures to contain the COVID-19 pandemic. As of March 2021, there were zero active COVID-19 cases, and more than 30 percent of the population had received first-round vaccinations supported by the United States. However, the pandemic is expected to have a continued negative effect on the economy, reflecting the slumps in the transportation and tourism sectors. The fishery sector provides some offset, supported by new capacity. Growth is projected to contract by 3.3 percent in FY2020 and by 1.5 percent in FY2021. A recovery should start in FY2022. The authorities announced a COVID-19 response package of US$63 million (27 percent of GDP) to strengthen health preparedness and support vulnerable groups. Development partners have so far provided grant financing US$50 million (21 percent of GDP). The package should remain in place until the recovery is firmly underway, but the authorities should consult with donors to reprioritize and reallocate COVID-19 packages given the uncertainty about the virus development. Post-pandemic, a gradual fiscal consolidation is necessary to prepare for the possible expiration of U.S. grants, to reduce fiscal risks of a fiscal cliff and protect long-term income. Achieving a green, inclusive, and sustainable post-COVID-19 recovery would also require to safeguard financial stability, adopt a National Adaptation Plan to climate change, accelerate SOEs reforms, and support a dynamic private sector. More details about the mission findings can be accessed at: [https://www.imf.org/en/News/Articles/2021/03/22/pr2173-marshall-islands-imf-staff-completes-2021-article-iv-mission](https://www.imf.org/en/News/Articles/2021/03/22/pr2173-marshall-islands-imf-staff-completes-2021-article-iv-mission)
Federated States of Micronesia

IMF staff held virtual meetings with the FSM authorities in February 2021 to discuss recent economic developments and outlook in the context of its regular surveillance activities. To date, the FSM has been successful in preventing the spread of COVID-19. Given the limited capacity of the healthcare system, the government is rightly prioritizing the response to address the health emergency. Measures to support vulnerable households, the unemployed, and businesses affected by the pandemic has helped mitigate the adverse impact on the population and economy. Nevertheless, the economic contraction is likely to deepen in FY2021 and risks are still tilted to the downside. Until the border re-opens and the economic recovery takes hold, it is essential to sustain relief to workers, firms, and vulnerable populations. Looking ahead, tackling fiscal and structural challenges will be more critical than ever to set the stage for a robust recovery and pursue sustainable and inclusive growth. More details about the mission findings can be accessed at: https://www.imf.org/en/News/Articles/2021/03/04/pr2158-micronesia-imf-staff-concludes-virtual-staff-visit-to-federated-states-of-micronesia

Nauru

The IMF Nauru team held a virtual staff visit in October and November 2020. The Nauruan authorities have so far been successful in preventing a local outbreak of COVID-19, and Nauru is one of the only two countries in the region with positive economic growth. This better-than-expected growth performance is a result of strong revenues, especially from fishing licenses, and continued presence of the Regional Processing Center (RPC) throughout 2020, as well as responsible fiscal management. However, the medium-term growth, fiscal and employment outlook remain highly uncertain pending an agreement about the future of Regional Processing Center (RPC) activities. The climate-resilient port project, financed by the Green Climate Fund and ADB, has been delayed due to the pandemic, but progressing. Progress on structural reforms has been mixed. Nauru Airlines and Nauru Utilities have benefited from SOE reforms, however little progress has been made to restructure Ronphos, the largest recipient of SOE subsidies. Ratification of PACER Plus and elimination of import duties will lead to revenue losses over the longer run and necessitate a broadening of the local tax base or other tax reforms. More emphasis is needed on improving statistical data collection, especially balance of payments.
Samoa

The Samoa team completed the first-ever virtual mission for Article IV consultation in January 2021. Close coordination with the authorities, and IMF TA experts made it possible to integrate the consultation with IMF's capacity development efforts, and conclude it successfully. The consultation focused on how to turn adversity into opportunity, and noted that Samoa has shown resilience to past economic shocks, underpinned by the authorities' strong commitment to support the economy and financial assistance provided by the international community. The authorities’ quick response to the measles outbreak and the global pandemic has identified the policy priorities well. Nevertheless, the prolonged effects of the global pandemic have heightened the economic challenges. The compounding effects of the two consecutive health shocks pushed the 2020 September quarter real GDP to its 2014 level. The economy is projected to contract again and more severely in FY2021 (ending June 2021). Resilient remittances and the government's commitment to maintaining expansionary fiscal policies in the near term will likely turn the economy around for a gradual recovery in FY2022.

For more details, please find the staff report.

Solomon Islands

An IMF team conducted a virtual staff visit to Solomon Islands for meetings with the Minister of Finance, the central bank Governor, officials, parliamentarians and development partners to discuss recent economic developments and policy plans in response to the COVID-19 pandemic. As a result of strong and timely containment measures, Solomon Islands has thus far remained one of the few countries with no record of local transmission of COVID-19. However, the economic impact of COVID-19 has been severe, with GDP growth estimated to have declined to -4.3 percent in 2020, due to a slowdown in commodity exports, tourism, and domestic activity. Growth is expected to pick up to 1.5 percent in 2021, with the initial recovery phase hampered by ongoing pandemic-related disruption. The authorities moved swiftly to mitigate the economic impacts of the pandemic, but further policy support will be required until a firm recovery is underway. The IMF stands ready to support the government's reform efforts, including through policy advice and technical assistance, especially with respect to fiscal management and reform, supporting the environment for sustainable and inclusive growth, and maintaining macroeconomic and financial stability. More details about the mission findings can be accessed at: https://www.imf.org/en/News/Articles/2021/03/05/pr2162-solomon-islands-imf-staff-concludes-visit-to-solomon-islands
Tonga

The IMF conducted a Climate Change Policy Assessment, concluded the 2020 Article IV Consultation, and provided emergency financing support under the Rapid Credit Facility. IMF staff conducted Article IV consultation discussions during a February 2020 visit to Tonga, followed by virtual discussions in November. Tonga’s slow recovery from the devastating 2018 Tropical Cyclone (TC) Gita has been derailed by twin shocks from the COVID-19 pandemic and TC Harold. Although Tonga remains COVID-free to date due to proactive measures, its economy is expected to suffer two successive years of contraction in FY2020–21 due to a sudden stop in tourism, delayed reconstruction, and subdued consumption. While border closures are likely to be extended, Tonga is likely to return to positive growth in FY2022 due to strong remittances, policy support, and base effects. Notwithstanding upside risks from early vaccination, downside risks remain large, stemming from a weaker global recovery that weighs on aid and remittances, and the possibility of a local outbreak. The pandemic has also worsened Tonga’s pre-existing vulnerabilities, namely a high risk of public and external debt distress. Moreover, Tonga’s medium-term outlook is modest and fragile due to its vulnerability to natural disasters and reliance on labor exports. The immediate policy challenge is to support the economy through the pandemic while ensuring fiscal sustainability and achieving longer-term climate-resilience and development goals. The 2020 Climate Change Policy Assessment assessed the cost of achieving climate-resilience and development goals to be formidable, requiring additional grant financing support to avoid aggravating debt sustainability concerns. Given limited fiscal buffers and urgent balance of payments needs, the IMF provided emergency financial assistance under the Rapid Credit Facility, which, together with funding from other international partners and debt relief under the Debt Service Suspension Initiative, is expected to help Tonga weather the twin shocks.

For more details, please find the staff report and TA report on Climate Change Policy Assessment.

Vanuatu

Vanuatu has successfully contained COVID-19, but the prolonged closure of the border has severely hit the economy—particularly tourism. In 2020, Vanuatu was also hit by Tropical Cyclone Harold and volcanic eruptions in Tanna Island. Real GDP contracted in 2020 and is expected to turn positive during 2021. The outlook remains subject to such downside risks as extended disruption from COVID-19, volatile revenue from the Economic Citizenship Program (ECP), potential reduction in correspondent banking relationships, and further natural disasters. Mitigating some of these risks will require tackling fiscal and structural challenges for a robust recovery and sustainable and inclusive growth. Staff see the needs for a medium-term revenue strategy, reinforcing compliance of institutions with the AML/CFT regime, ensuring effective implementation of tax information exchange, strengthening governance of the government business enterprises, and continuing to tackle climate change adaptation. More details about the mission findings can be accessed at: https://www.imf.org/en/News/Articles/2021/03/12/pr2166-vanuatu-imf-staff-concludes-virtual-staff-visit
By Leni Hunter, Resident Representative for Pacific Island Countries

*Bula vinaka, Kaselehlia, Mauri, Ekamwir-omo, Alii, Halo, Lakwe, Talofa, Halo olaketa, Malo e lelei, Fakatalofa atu, Hello and Kia orāna,*

After just over a year, Pacific island countries have been among the very few to successfully keep COVID-19 out of communities, and vaccination programs are getting started. A growth recovery is underway in key trading partners for Pacific countries. However, the pandemic has taken a severe economic toll in the Pacific, and the recovery path remains challenging.

During 2020, as the IMF received record numbers of emergency financing requests from across the membership, Article IV missions and staff visits were largely put on hold. Surveillance activities restarted this year—Reshika joined the missions for Samoa and Solomon Islands, Deven joined the PNG SMP review, and Seruwaia joined the Vanuatu staff visit. I joined these missions as well as the Kiribati AIV. The economic impact of COVID-19 varies across countries, with growth in the tourism-based economies hit especially hard. Alongside work with country teams I have also co-authored on a paper on national airlines in the Pacific, which looks at national airlines in the region from a fiscal risk management perspective.

**Reshika Singh is leaving the Res Rep Office, to take a position with the World Bank.** Reshika has made a great contribution to the IMF’s work in the Pacific over the years, and many of you know Reshika well. However, I’m pleased that we will be able to continue working with Reshika in her new role as World Bank country economist, based here in Suva. We have also recently welcomed Mr. Munesh Deo to our team. Munesh has 14 years of experience with the Reserve Bank of Fiji, and will be assigned to the Samoa and Solomon Islands teams.

We hope this finds you, your families, and colleagues safe and well. The virtual missions have worked well in terms of the technology, but it is difficult to substitute for being on the ground. Very best regards from the Suva Res Rep office.
By David Kloeden, PFTAC Coordinator

From March to September 2020, all PFTAC operations were remotely performed from home, either in Fiji for the administrative team and two of the advisors, and for the rest of the advisors from their place of temporary relocation. With a few exceptions for Fiji, all Capacity Development (CD) will have been remotely delivered in FY2021. Despite the challenges, we are on track to deliver a robust CD program of around 135 missions/activities versus a pre-COVID plan of 183, but utilizing about 60 percent of the budget given savings in the absence of travel and in-person training and other cost efficiencies from remote delivery. There has been a phased return to office operations since September with the repatriation of the coordinator in September and arrival by December of three newly appointed advisors (Financial Sector Supervision (FSS) and both PFM advisors) who worked remotely from their former locations before arriving in Fiji. The Macro advisor repatriated in January, and the two Statistics advisors are expected to return by April.

Paul Seeds, a British national, joined PFTAC on October 1, 2020 as resident Public Financial Management (PFM) advisor coming from East AFRITAC, the IMF's technical assistance center for East Africa, where he has worked for the past five years. Starting his overseas career in Kiribati, he has worked extensively with many development partners covering 20 countries, in a career spanning nearly 40 years. Paul replaced Richard Neves who left PFTAC in February for an assignment in Africa after four years at PFTAC and an extensive career in the Pacific beforehand.

In December 2020, the United States Government signed a Letter of Understanding with the International Monetary Fund (IMF) to become the seventh donor to the fifth Phase of PFTAC operations followed by receipt of their full financial contribution of USD 2.0 million on December 30, 2020. The PFTAC community welcomes and appreciates the financial commitment and support of the United States Government in their contribution to the IMF and PFTAC for the macroeconomic stability and sustainable development of Pacific nations. This was recognized at a short event at the PFTAC office on February 23, 2021 when Chargé d’Affaires Antone Greubel from the United States embassy in Suva was guest of honor as pictured below.

The contribution comes in the context of the United States ‘2020 Pacific Pledge’ announced in September 2020 with a range of regional initiatives including the support to PFTAC noted in the following public announcement made at that time:

‘The State Department is partnering with the Treasury Department on a $2 million U.S. grant to the International Monetary Fund (IMF) Pacific Financial Technical Assistance Center (PFTAC). Support for PFTAC’s macroeconomic and financial training and technical assistance programs will strengthen the resilience of Pacific Island economies against volatility associated with natural disasters and economic shocks such as COVID-19, ensuring public finances are sustainable and growth is inclusive.’
The IMF in partnership with PFTAC is launching a three-year capacity development project in debt management for the Pacific region. The project, which is funded by the Japanese government, will primarily assist PFTAC member countries to strengthen public debt management capacity. With both the size and the complexity of the debt stock increasing throughout the region, debt levels and debt management are areas of widespread and significant macro-critical concern for Pacific Island Countries, and the COVID-19 crisis has only increased the importance of delivering technical assistance to help address these issues. The project will adopt a comprehensive and programmatic approach to target country needs, and will focus on building institutional capacity on a sustainable basis through the close support of a long-term resident advisor based in PFTAC due to arrive in Fiji in mid-May.

The project is designed to strengthen the debt management capabilities of PFTAC member countries by: (i) building capacity in debt-related analyses and reporting; (ii) building capacity to implement debt and risk management strategies; (iii) strengthening the institutional arrangements for debt management; and (iv) improving the functioning and depth of domestic debt markets. The placement of a regional advisor is expected to enable the type of responsive, frequent, and customized technical assistance that has been successful in building similar capacities in other regions, such as West Africa and the Caribbean. Enhancing capacity in debt-management activities strongly complements PFTAC’s current work program, which includes a focus on PFM, macroeconomic analysis, and macroeconomic statistics. The project will aim to leverage and closely integrate CD efforts by other development partners.

PFTAC Steering Committee (SC) engagement has increased in the COVID-19 induced virtual world. With the annual in-person SC meeting in Niue in March 2020 canceled, virtual update meetings have been held in April and August 2020, and most recently again at a hybrid event on February 23 where Suva-based stakeholders met at the PFTAC office (pictured right) linking up with more than 50 participants across the Pacific and beyond. An update on delivery and projected outturn for FY2021 was followed by the endorsement of proposals to: (1) briefly extend the assignment of the Government Finance Statistics (GFS) advisor through end-August before the program winds down; (2) continued role of the Macro advisor in regional Correspondent Banking Relationship initiatives; and (3) recruitment of a second resident revenue advisor for the remainder of Phase V to maintain the scaled-up revenue program.

The 2021 annual SC meeting is planned for late June and will be a hybrid virtual event with Suva in-person participation. The agenda will be dominated by eliciting stakeholder views and input on the priorities and resources for Phase VI due to launch in 2022. Several virtual Working Groups (VWG) have been proposed to solicit stakeholder inputs and views ahead of the June meeting.
Over two days in late January, the PFTAC team came together for an off-site staff retreat in Nadi, Fiji. The theme of the retreat was ‘Moving from COVID affected 2020 towards Phase VI’. Given the current COVID induced restrictions most countries are experiencing, this was a rare opportunity only possible by the absence of any community COVID transmission in Fiji for the past 300 days. After returning to office-based operations after six months of work-from-home, it was a welcome chance to rebuild team cohesion, particularly given the arrival of three new resident advisors and a local administrative staff member since the last retreat in January 2020. The retreat entailed a busy agenda, including remote training sessions with Washington on new systems and procedures, and an exercise to reinforce critical cyber security issues and safeguards.
Public debt in the Pacific Island Countries (PICs) has risen on average since the end of the Global Financial Crisis and now poses a significantly heavier burden due to the pandemic. The magnitude of increase and the underlying dynamics behind it are heterogeneous, although subgroups of countries in the region share some similarities. For those with the most rapid rise, low growth amid frequent natural disasters and increased loan-financing to meet capital spending needs played an important role. Debt and debt service profiles in the region have shifted with the growing presence of loans from non-Paris Club creditors, as well as debt on non-concessional terms. Standard debt dynamics decomposition sheds some light on the increase in government debt-to-GDP ratios in PICs over the last ten years. For a subgroup of Fiji, PNG, Samoa, Solomon Islands, Tonga, and Vanuatu, the primary balance and low growth have been key drivers contributing to the change in public debt. But the impact of the real interest rate and the real effective exchange rate on debt dynamics in the selected PICs has been limited.

The COVID-19 pandemic has had a sizeable impact on many of the PICs. Fiscal positions in most PICs have been hard hit, with revenues declining most dramatically in tourism-dependent countries (Fiji, Palau, Vanuatu, and Samoa) and expenditures rising in response to COVID-related spending needs and efforts to protect the most vulnerable. The widening of fiscal deficits and heavy reliance on debt financing is expected to leave a significant debt overhang for some PICs. A combination of factors specific to PICs—(i) low growth; (ii) limited capacity in both revenue generation and debt management; and (iii) high vulnerability to external shocks and need to invest in climate resilience—suggest that the overhang of public debt from the pandemic may take many years to resolve.

With potential long-lasting negative effects of the pandemic on growth, fiscal balances, and public debt in the region, a key question for policymakers is whether higher debt levels threaten macroeconomic and fiscal sustainability. This raises the issue of how to assess a country’s debt carrying capacity considering the specific characteristics of the Pacific Island economies. While the Debt Sustainability Framework (DSF) developed by the IMF and World Bank provides a reasonable and standardized starting point for assessing debt carrying capacity, substantial judgement must be added to take account for its limitations. The factors relevant to PICs include: (i) limited scope for domestic borrowing by the government; (ii) the vulnerability to natural disasters and climate change, adversely affecting growth and fiscal costs; (iii) narrow production and export bases that increase the vulnerability to external shocks; (iv) limited institutional capacity; and (v) heavy reliance on external grants and remittances.

This leaves us important policy implications in the post-pandemic environment for PICs: (i) better debt management capacity, including medium-term debt strategies; (ii) fiscal rules; (iii) debt restructuring; and (iv) governance/transparency and high value-added investment that addresses growth and resilience challenges.
Managing Fiscal Risks from National Airlines in PICs

By Vybhavi Balasundharam and Leni Hunter

The Pacific Islands are among the most geographically isolated countries in the world. They rely on airline connectivity for tourism, education, employment opportunities, access to healthcare, and delivery of goods and services. This dependence has driven many PICs to have state-owned national airlines that cater to both domestic and international markets. Many of these national airlines generally had weak financial conditions prior to the pandemic, largely due to their high fixed costs, particularly the capital requirements that result in excessive debt burden, vulnerability to external shocks, limited commercial viability and weak governance. With virtually no international travel since March 2020, these airlines are being struck hard by COVID-19 and have been receiving substantial financial support from governments to stay afloat. With a backdrop of tight fiscal space and increasing government debt, losses in airlines are adding to fiscal risks in some PICs.

In forthcoming work, we discuss tools to evaluate and manage the fiscal risks from national airlines in the Pacific. We present a snapshot of the current state of Public Financial Management (PFM) practices related to national airlines in PICs and benchmark against the best practices. This exercise illustrates the areas in which PICs have scope to improve their risk management from national airlines. Specifically, we show that inadequate governance frameworks, government capacity constraints to oversee the companies, and lack of transparency from the airlines undermine the ability to monitor and contain the risks from national airlines. We then discuss the use of diagnostic tools and capacity development to enhance monitoring and risk management. We present some guiding principles for countries to consider when offering additional financial support to national airlines and show how even the use of a simple “SOE Health Check” could illustrate the vulnerabilities of airlines. PICs should use the recovery from this crisis as an opportunity to overhaul governance and oversight of national airlines to mitigate future risks.
Diversion of Tourism Flows in the Asia & Pacific Region:
Lessons for the COVID-19 Recovery

By Vybhavi Balasundharam and Robin Koepke

The COVID-19 pandemic has brought international tourism in the Pacific Island Countries (PICs) to a standstill pending the distribution of vaccines, measures to ensure traveler and public safety, and the reopening of borders (Figure 1). The focus among some PIC authorities has recently shifted to recovery, particularly on how to re-open borders and revive the tourism industry. Many countries are eager to establish travel bubbles with key source countries to jumpstart the rebound. Tourism diversion effects could accelerate their recovery if PICs can establish themselves as more attractive travel destinations than competitor countries (such as Indonesia, Thailand, and other Asian tourism hubs).

In an ongoing study, we investigate such diversion effects. We study the response of outbound travel from Australia (the primary source country for PICs in the South Pacific) during previous global shocks like the SARS epidemic and September 11 attacks, in addition to more localized external shocks like the Bali Bombings and Indian Ocean Tsunami. We find that PICs have generally been insulated from external shocks and tend to gain from the diversion of visitors away from more affected countries. For example, departures to PICs remained stable during the SARS epidemic despite a significant fall in total departures from Australia, corresponding to a substantial increase in share of departures to PICs (Figure 2). However, these gains were short-lived, lasting for a quarter before reverting back towards the previous trend.

Based on prior experiences, when borders start reopening, PICs could benefit from pent up tourism demand and diversion of tourism from competitor countries that have not been as successful in containing the virus. Targeted policies could amplify such gains, for example through carefully designed public health policies that protect travelers and the public from COVID-19. Additional policy measures could help turn temporary diversion effects into longer-term gains, including improvements to the tourism infrastructure and labor resources, and policies to harness digitalization and promote environmental sustainability.

3 The latest UNWTO Travel Restrictions Report finds that 69 of the 217 destinations (32 percent) remain completely closed to international tourism, of which 30 destinations are in the Asia and Pacific, some of which are the PICs.
Access to Climate Finance Among Pacific Island Countries

By Natalija Novta, Scott Roger, and Todd Schneider

The Pacific Island Countries (PICs) are among the world’s most vulnerable to climate change, given their high exposure to the physical impacts of climate change and the dominance of weather-dependent sectors—tourism and natural resources—in their economies. Over the past 100 years, the PICs have experienced approximately 17 centimeters of sea-level rise due to the rise of average global temperatures. More frequent and intense storms, consistent with climate change, have caused widespread coastal flooding and shoreline erosion. These changes are contributing to stressed water systems, displaced fish stocks, loss of coral reefs and biodiversity, all of which can devastate economic activity and people’s livelihoods in Pacific countries (UNDP, 2012).

Being among the smallest in terms of population and GDP, and with limited or nonexistent domestic debt markets, the PICs urgently need access to medium- and long-term financing to improve their resilience and adaptation to climate change. The Green Climate Fund (GCF) is intended to provide such financing, but PIC’s access to these funds has been limited thus far, in part due to deficiencies in public financial management (PFM).

This project has three main components. First, it reviews the landscape of international sources of climate finance available to the Pacific Island Countries and the region’s current track record in accessing these funds. Second, it identifies the key challenges PICs face when trying to access major multilateral climate funds, such as the Green Climate Fund. These challenges were identified through webinar discussions with PIC authorities who lead local efforts to access climate finance, as well as through detailed analysis of the requirements—especially PFM-related—to access climate funds. Third, it aims to build consensus on recommendations and best practice that would allow PICs to overcome these challenges.

Recent data indicate that PICs with higher exposure to climate change have been able to secure more funds for climate adaptation (Figure), which is encouraging. However, faster approval and disbursements are needed, especially from the Green Climate Fund, which is the key source of finance for large climate adaptation and resilience projects (Figure).

Preliminary findings from this project will be discussed during the Spring Meetings 2021 and will be published in a joint paper by IMF’s Asia Pacific Department and the Fiscal Affairs Department.
## Recent and Upcoming Events on Pacific Island Countries

### Recent Events

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<td>PFTAC: Virtual Workshop on Annual National Accounts</td>
<td>February 8-19, 2021</td>
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<td>PFTAC: Steering Committee Meeting</td>
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<td>PFTAC: Virtual Workshop on Managing Large Taxpayer Compliance</td>
<td>February 23 - March 4, 2021</td>
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<td>STI/PFTAC: Webinar on Fiscal Analysis, Debt Sustainability and Risks</td>
<td>March 16-18, 2021</td>
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<td>IMF: Policy Advice to Asia in the COVID-19 Era</td>
<td>March 25, 2021</td>
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<td>PFTAC/Association of Financial Supervisors of Pacific Island Countries (AFSPC): Abridged Virtual Annual Meeting</td>
<td>March 30, 2021</td>
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### Upcoming Events

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<td>IMF: APD High-Level Meeting in the Regional Economic Outlook</td>
<td>April 7, 2021</td>
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<td>CDOT/PFTAC: Workshop on Balance of Payments: Methodology and Compilation Challenges</td>
<td>April 19-23, 2021</td>
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<td>PFTAC: Virtual Workshop on Managing Tax Debt and Tax Return Compliance</td>
<td>April 19-23, 2021</td>
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<td>PFTAC/FAD: Virtual Workshop on Public Investment Management Assessment (PIBA)</td>
<td>April 27 - May 6, 2021</td>
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<td>ADB: 54th ADB Annual Meeting</td>
<td>May 3-5, 2021</td>
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<td>PFTAC: 2021 Annual Steering Committee Meeting</td>
<td>June 29 - July 2, 2021</td>
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<td>South Pacific Central Banks 2021 Virtual Governors’ Forum</td>
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<td>Japan - IMF Scholarship Program for Asia (JISPA) Application Period for Partnership Track (Masters level)</td>
<td>September 1 – December 1, 2021 (subject to change)</td>
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<td>Japan - IMF Scholarship Program for Asia (JISPA) Application Period for Open Track (PhD level)</td>
<td>April 1 – June 1, 2022 (subject to change)</td>
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