THE PACIFIC ISLANDS

FISCAL POLICY TO BUILD RESILIENCE AND ADDRESS VULNERABILITY

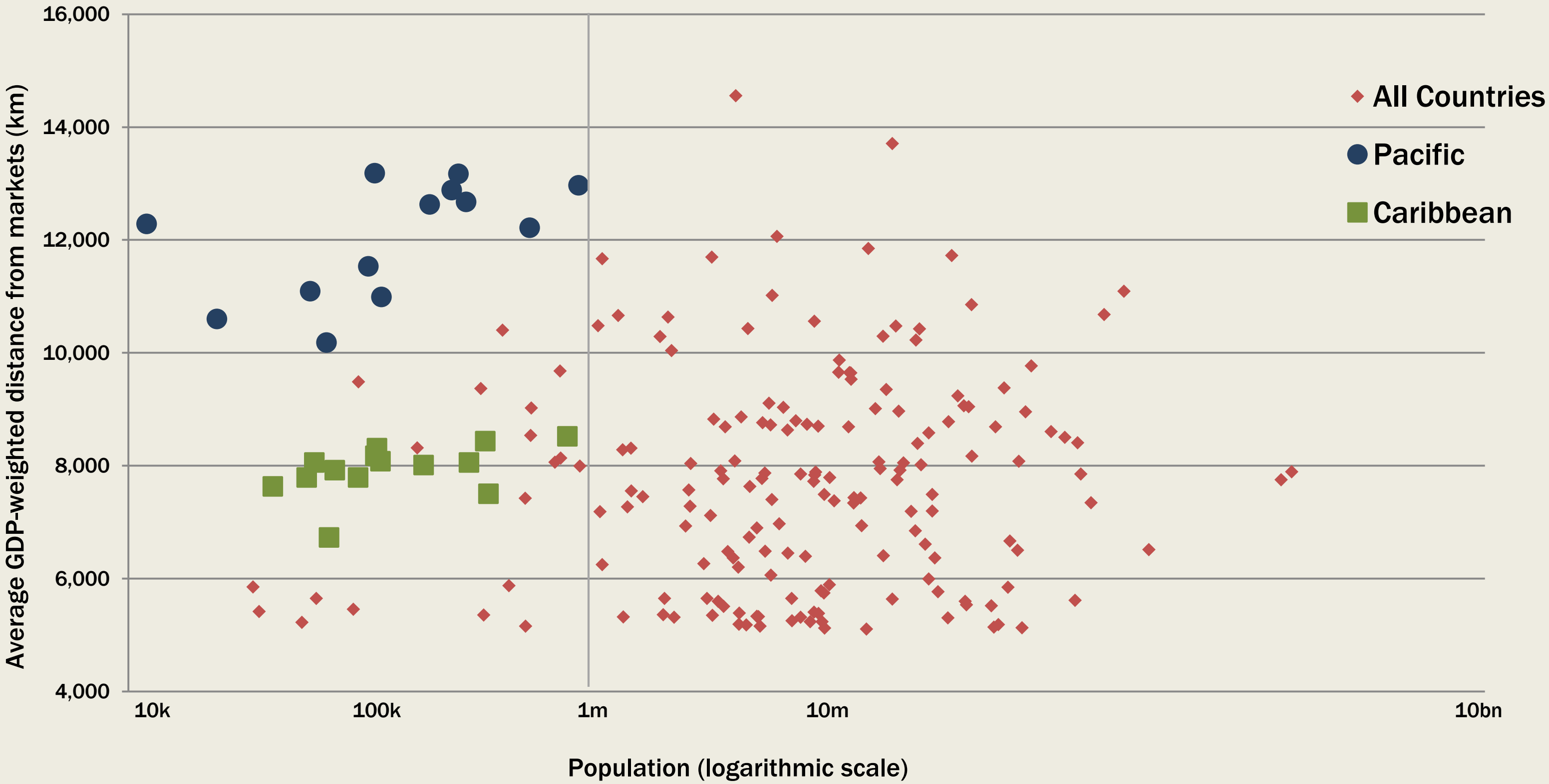
Poverty Reduction and Economic Management
East Asia and Pacific Region

The World Bank
Pacific Department
www.wordbank.org/pi

THE PACIFIC ISLANDS

SMALL AND ISOLATED (BY LAND) | LARGE AND CONNECTED (BY OCEAN)

Pacific Islands: Extreme Remoteness from Major Markets



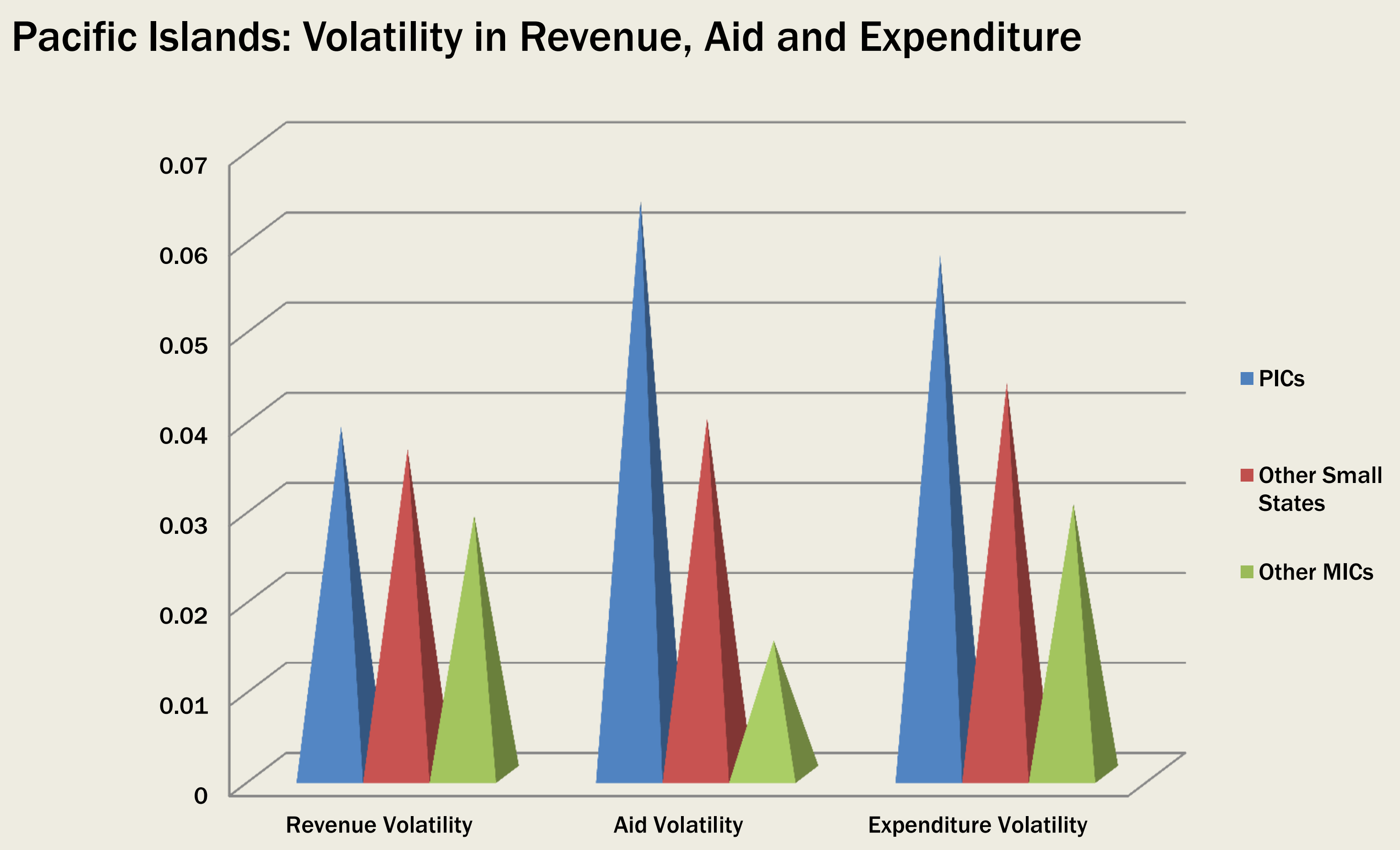
OUTLINE

- Vulnerability to shocks → volatility is the norm
- Fiscal policy responses to shocks
- Building resilience to cope with volatility

FIVE SOURCES OF VOLATILITY

Concentration of Exports	• Shocks to key natural resource or cash crop exports • Economic downturns in tourism source countries
High Import Dependence	• Fuel price shocks • Food price shocks
Significance of Remittances	• Economic downturns in remittance source countries • Tightening of labour market access • Demographic shifts in diasporas
Importance of Aid	• Can mitigate or contribute to overall economic volatility depending on donor aid policies and project cycles
Vulnerability to Natural Disasters	• Cyclones, floods, earthquakes, tsunamis • Effects of climate change

REVENUE, AID AND EXPENDITURE VOLATILITY



FOUR MAIN FISCAL POLICY RESPONSES

⇧/⇩ Assets	• Trust funds / sovereign wealth funds • Reserves • Cash balances
⇧/⇩ Debt	• Concessional loans from IFIs • Loans from bilateral donors • Domestic borrowing, bank overdrafts
Address Quality of Spending	• Protects service delivery in the event of revenue shortfalls, without increasing deficits • Augments value of other fiscal buffers
⇧/⇩ Grants	• Grants from bilateral donors • Grants from IFIs (for countries at high risk of debt distress)

FIVE AVENUES TO BUILD RESILIENCE

Macro/Budget Management	• Prudent macroeconomic management best positions the economy against shocks and facilitates rapid donor response • Sound budget management maximizes value from resources
Debt Headroom	• Maintaining a cushion between current debt levels and 'debt distress' thresholds provides room to use concessional loans to mitigate the impact of shocks on the economy
Asset Buffers	• Sovereign wealth/trust funds can help mitigate the impact of shocks if they are protected from unsustainable drawdowns • Directing windfall gains to these funds or to reserves can help augment the robustness of asset buffers over time
Grants	• Process rigidity and objectives other than shock absorption mean that donor projects can add to volatility • More work is needed to make aid an effective fiscal buffer, to support the public sector's role as a shock absorber
Sources of Volatility	• Facilitate use of alternative energy to reduce oil dependence • Facilitate natural resource/tourism industry development • Expand labour market access to secure remittances

RULES AND RESILIENCE

- Fiscal discipline can be important for building and maintaining the resilience to manage shocks

- Fiscal disciplines have tended to work well where –
  - For deficits, they have been target ceilings (rather than rules) with justification required for breaches of the targets
  - For debt, they have either been target ceilings, with justification required for breaches, or they have been policy moratoriums on contracting new debt, in contexts where new debt is not justifiable
  - For sovereign wealth/trust funds, they have been rules for maintaining the value of the funds, in contexts where donors have provided additional grant support in extraordinary circumstances
- In each case, the appropriateness of the form that fiscal discipline has taken has been context specific and it has been only one part of a broader fiscal management approach, including support from development partners

THANK YOU

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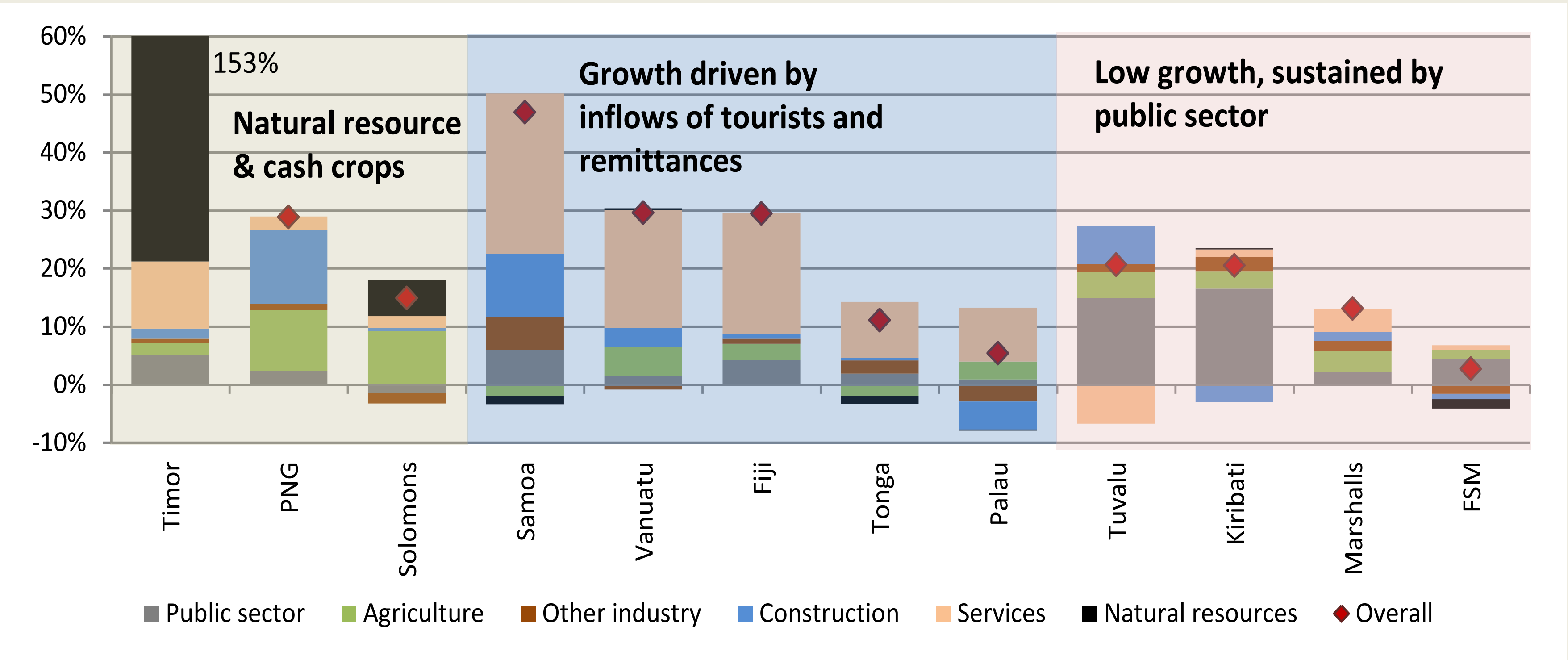
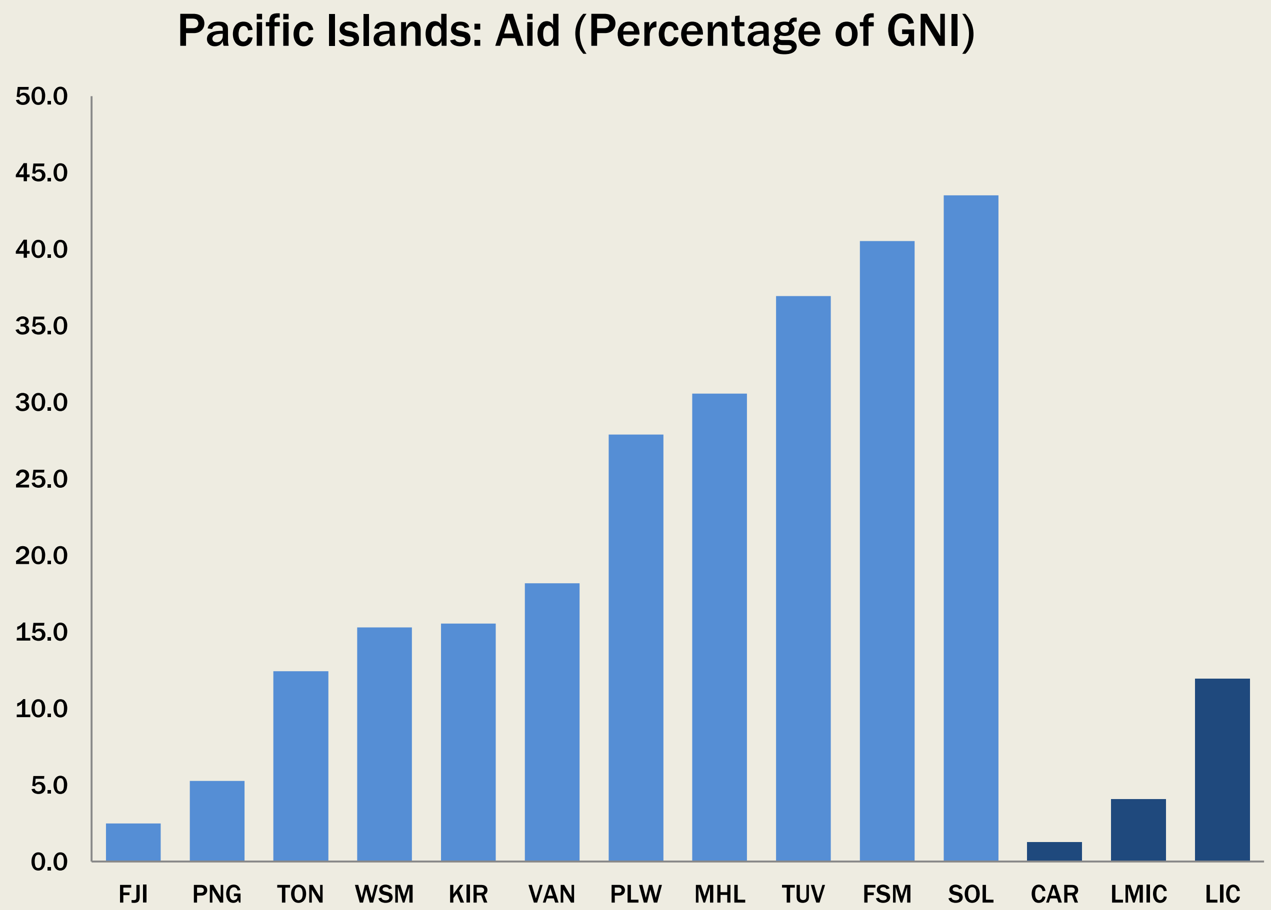
ANNEX 1: DIFFERENT TYPES OF ECONOMY

Growth by Source – 1998-2008

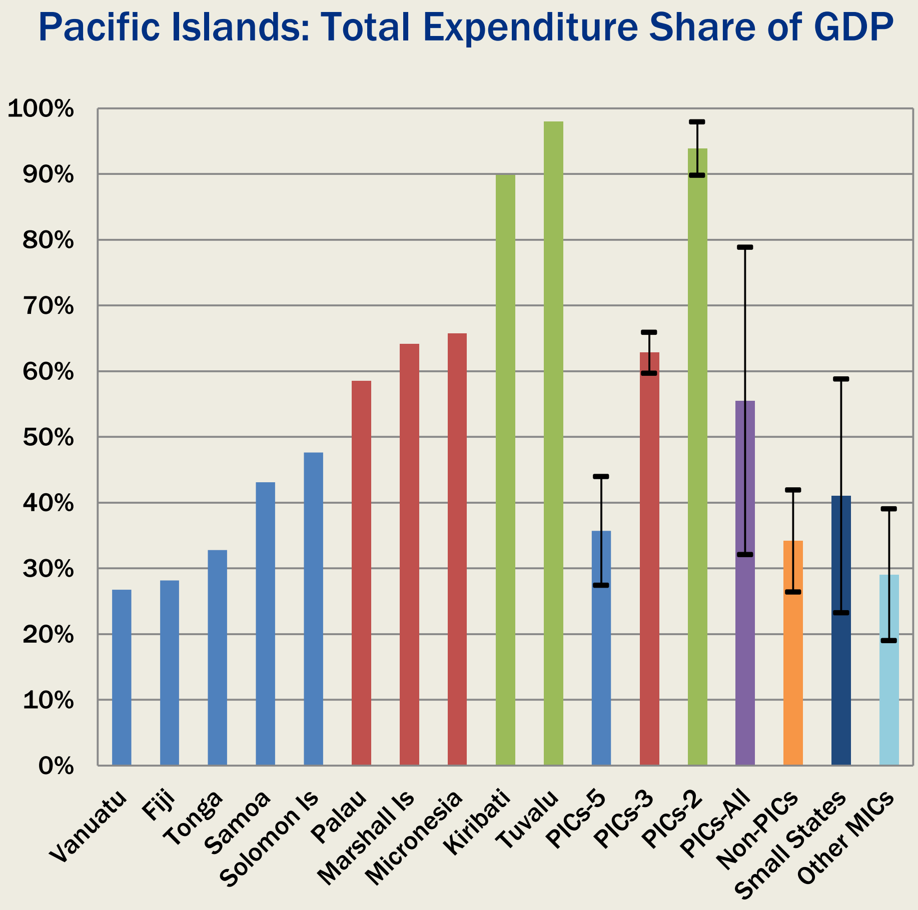


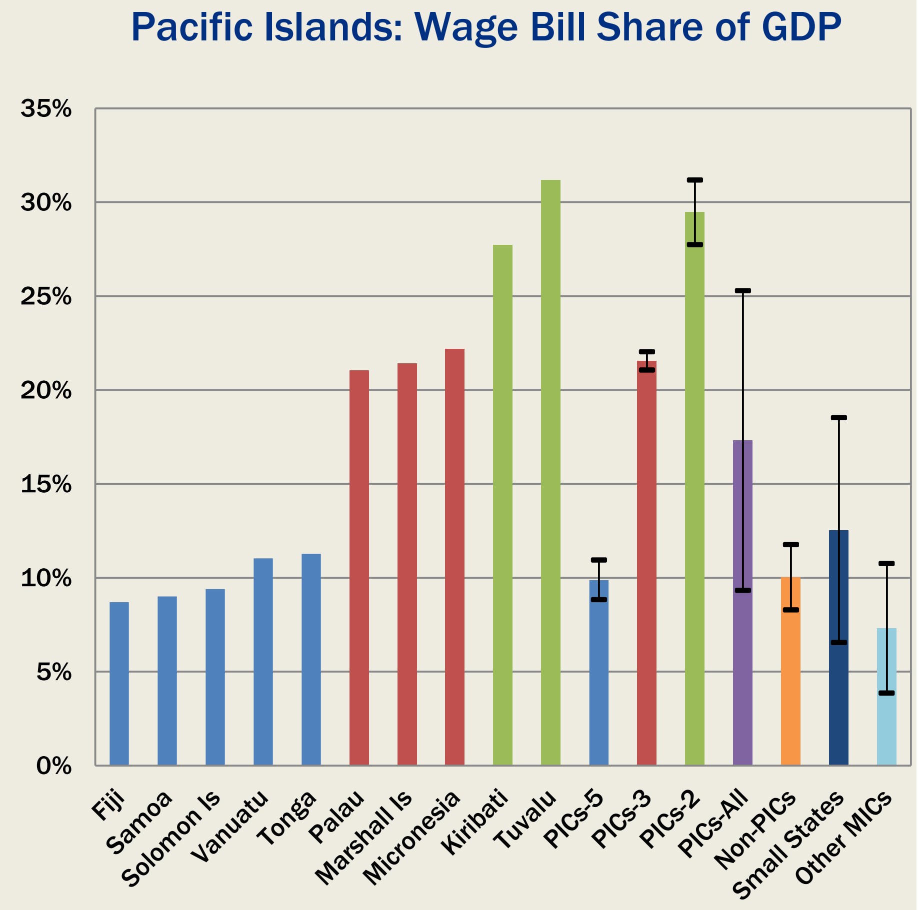
Structure of Pacific economies reflects the special challenges and opportunities facing small, remote economies.

ANNEX 2: IMPORTANCE OF AID



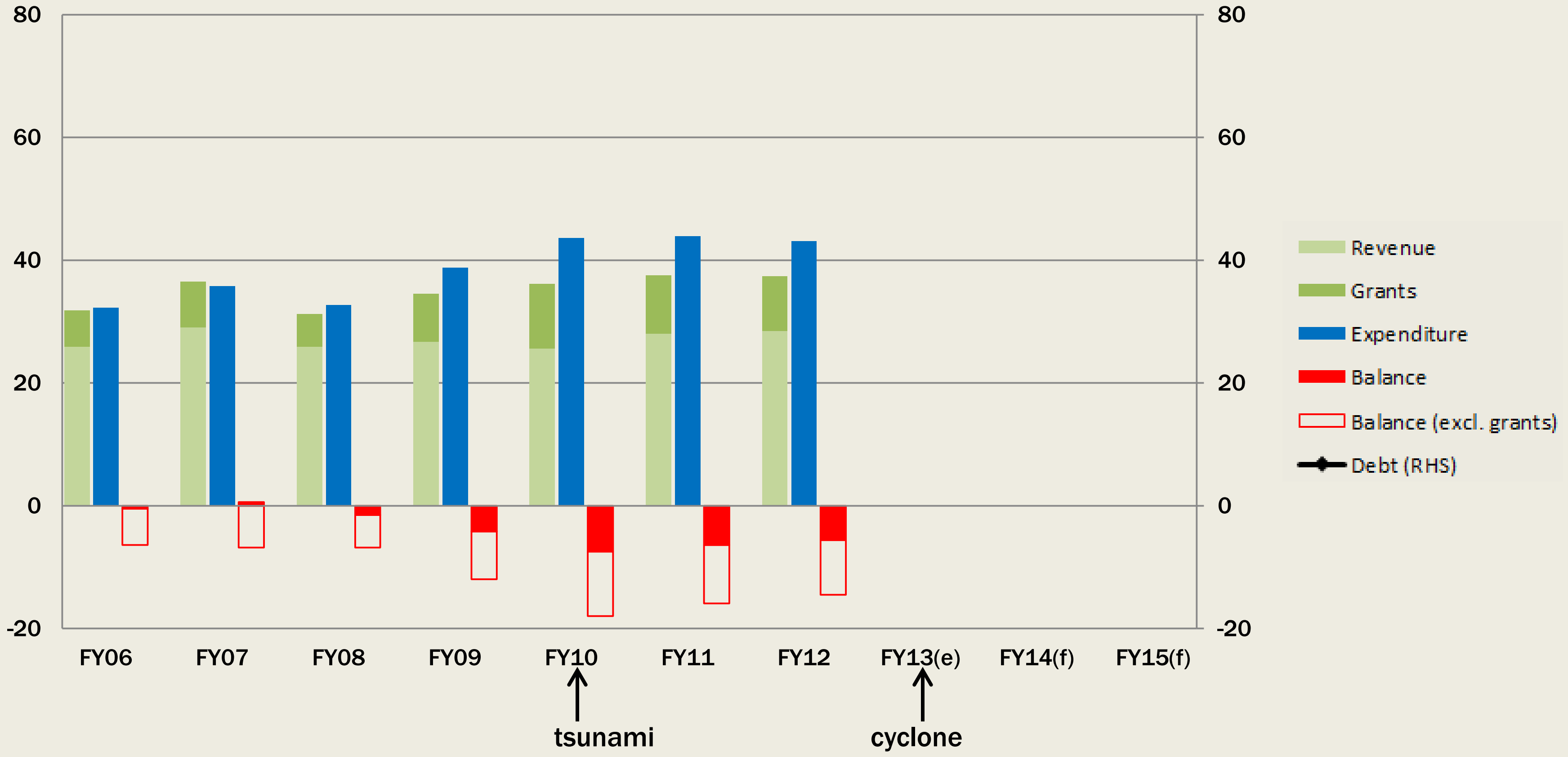
ANNEX 3: SIZE OF GOVERNMENTS





CASE STUDY: NATURAL DISASTERS IN SAMOA

Samoa: Fiscal Responses to Successive Natural Disasters



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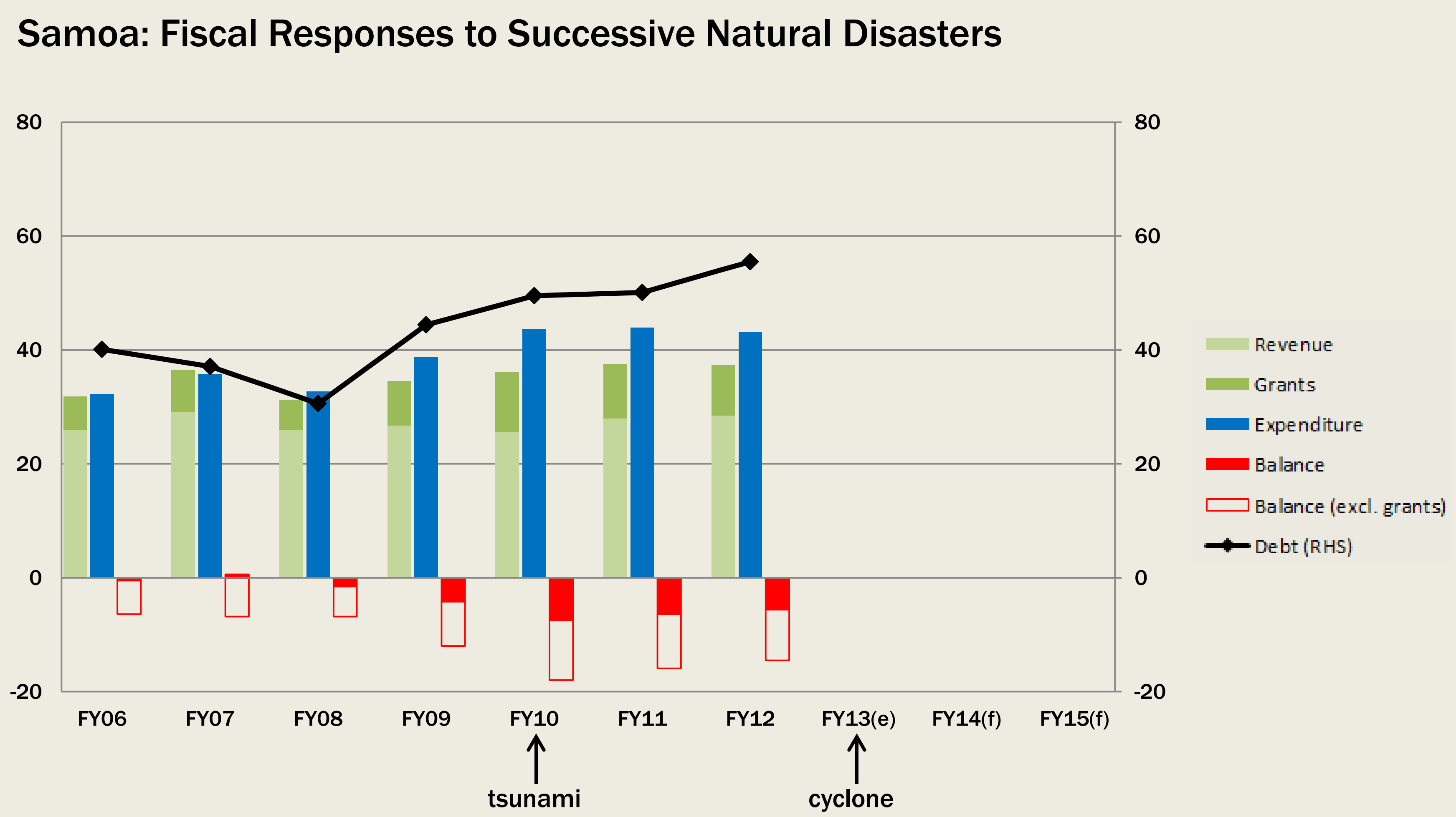

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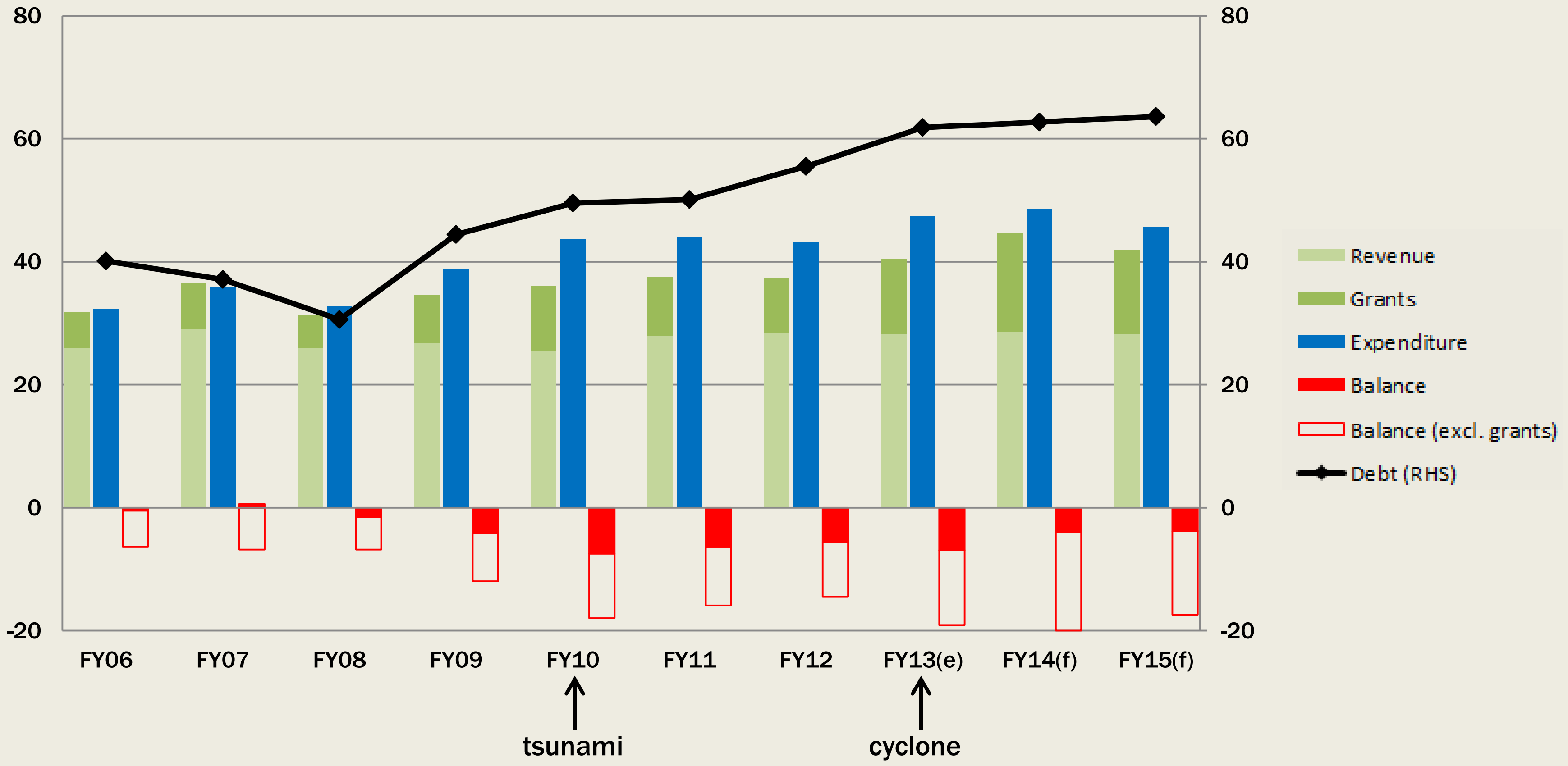
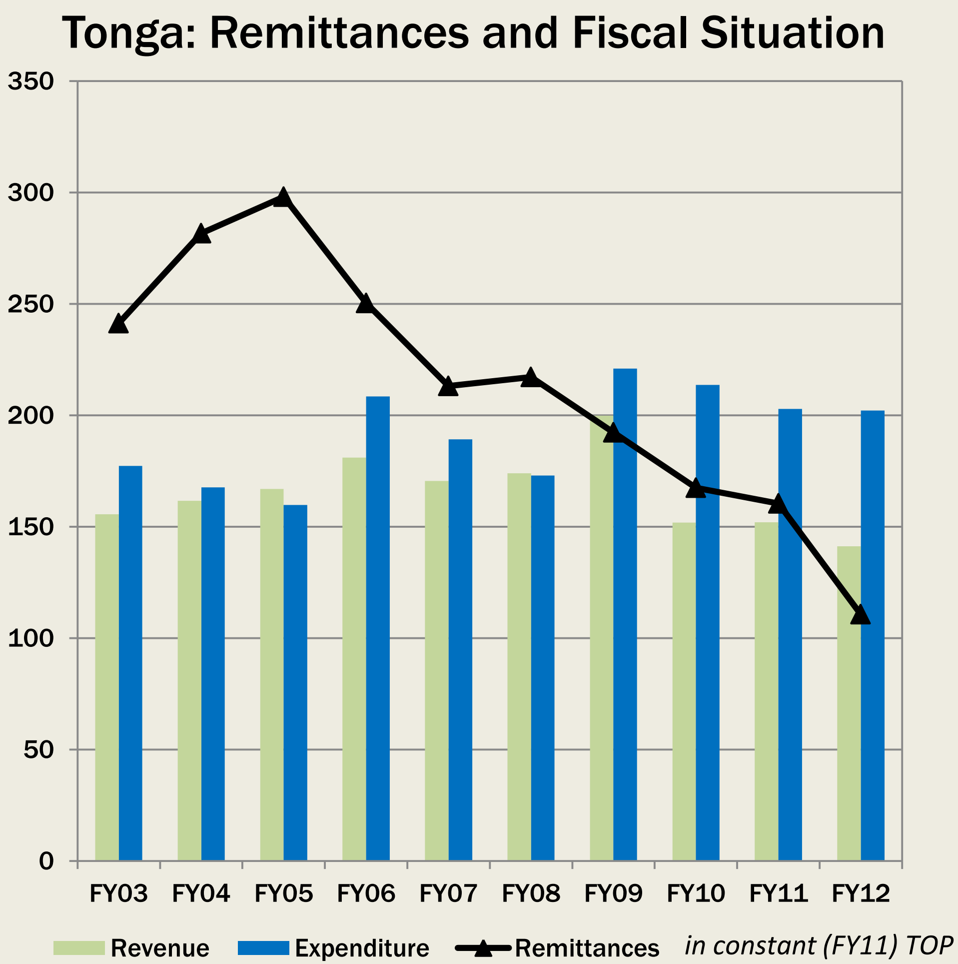


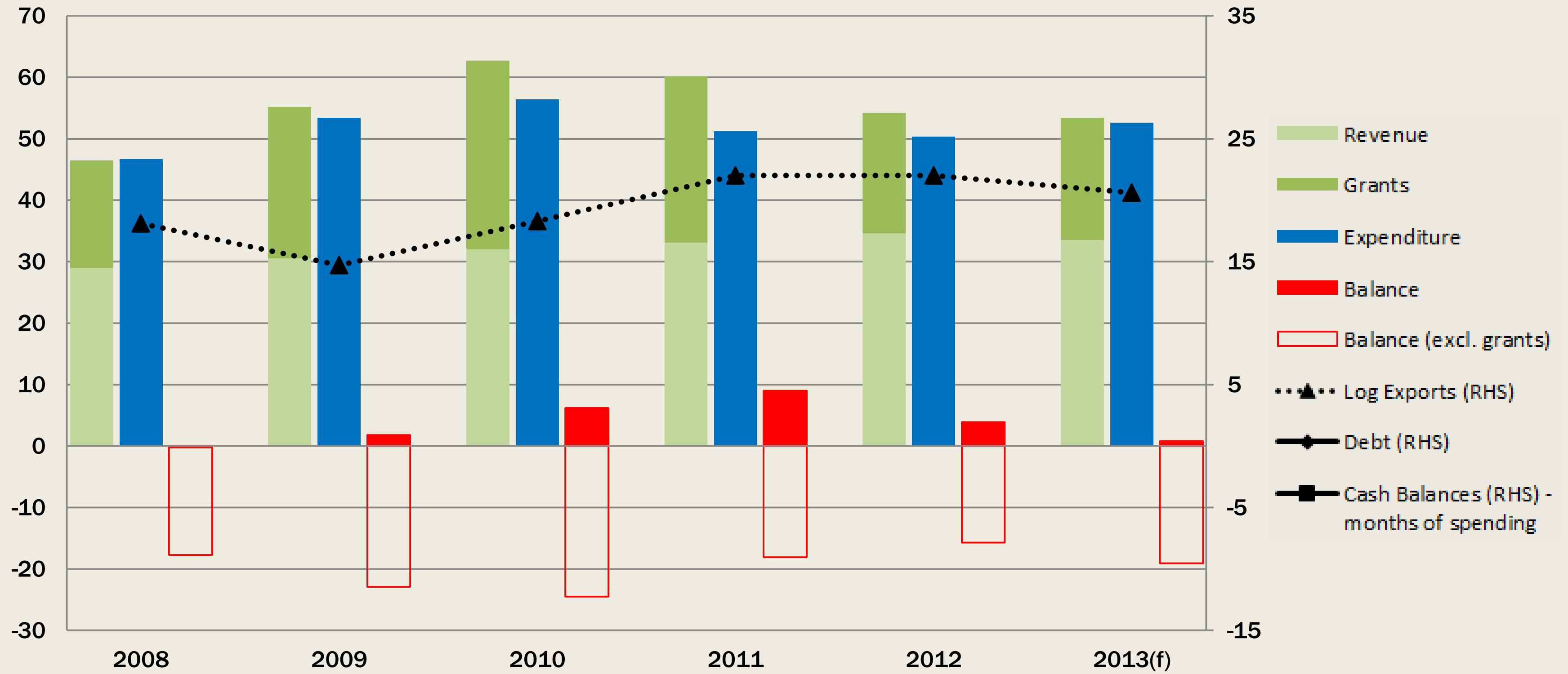
CASE STUDY: REMITTANCE DECLINE IN TONGA



- No new borrowing
- Increased grants
- Improved quality of spending to mitigate the impact of the decline in revenue on service delivery
  - Closer alignment of allocations and priorities in the approved budget
  - Better monitoring and control of budget execution

CASE STUDY: WINDFALL GAINS IN SOLOMON IS

Solomon Islands: Paying Down Debt and Building Up Cash Balances in the Good Years



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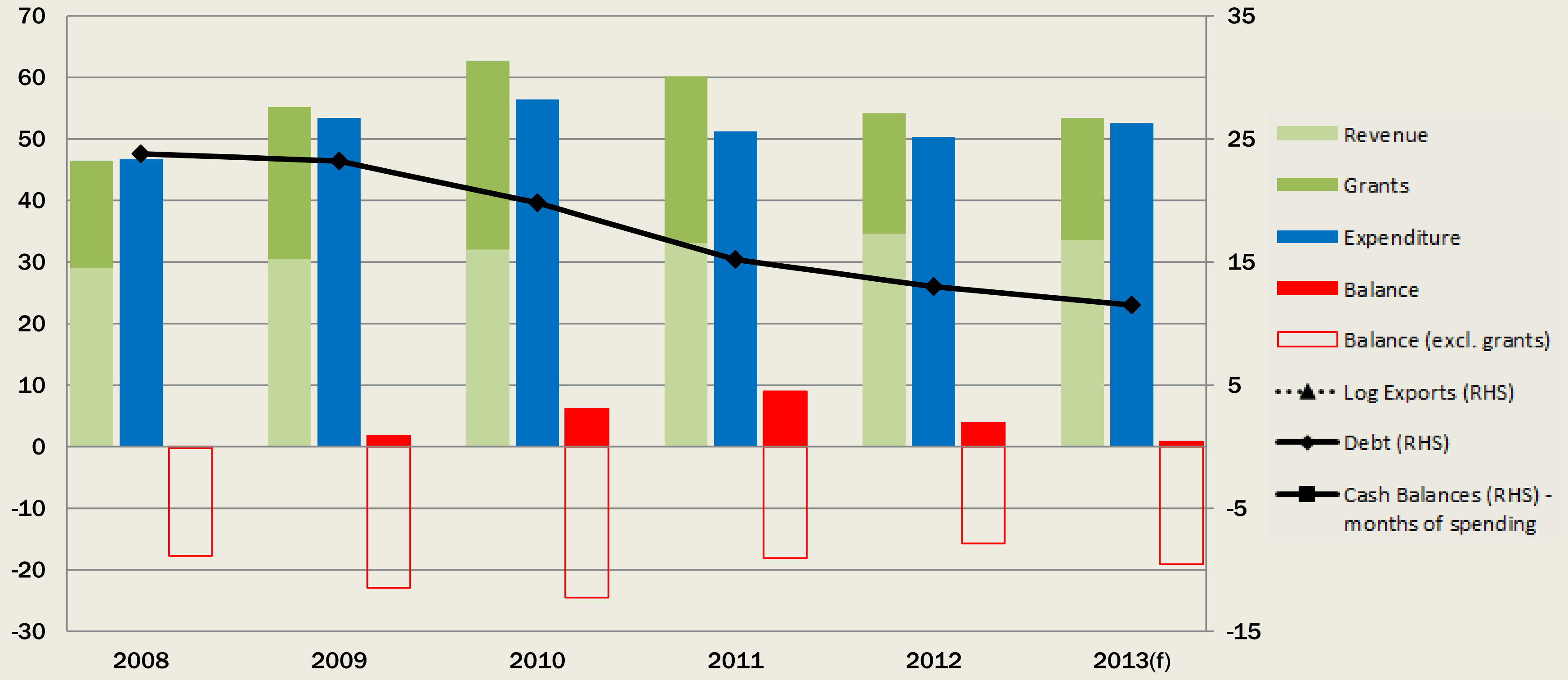

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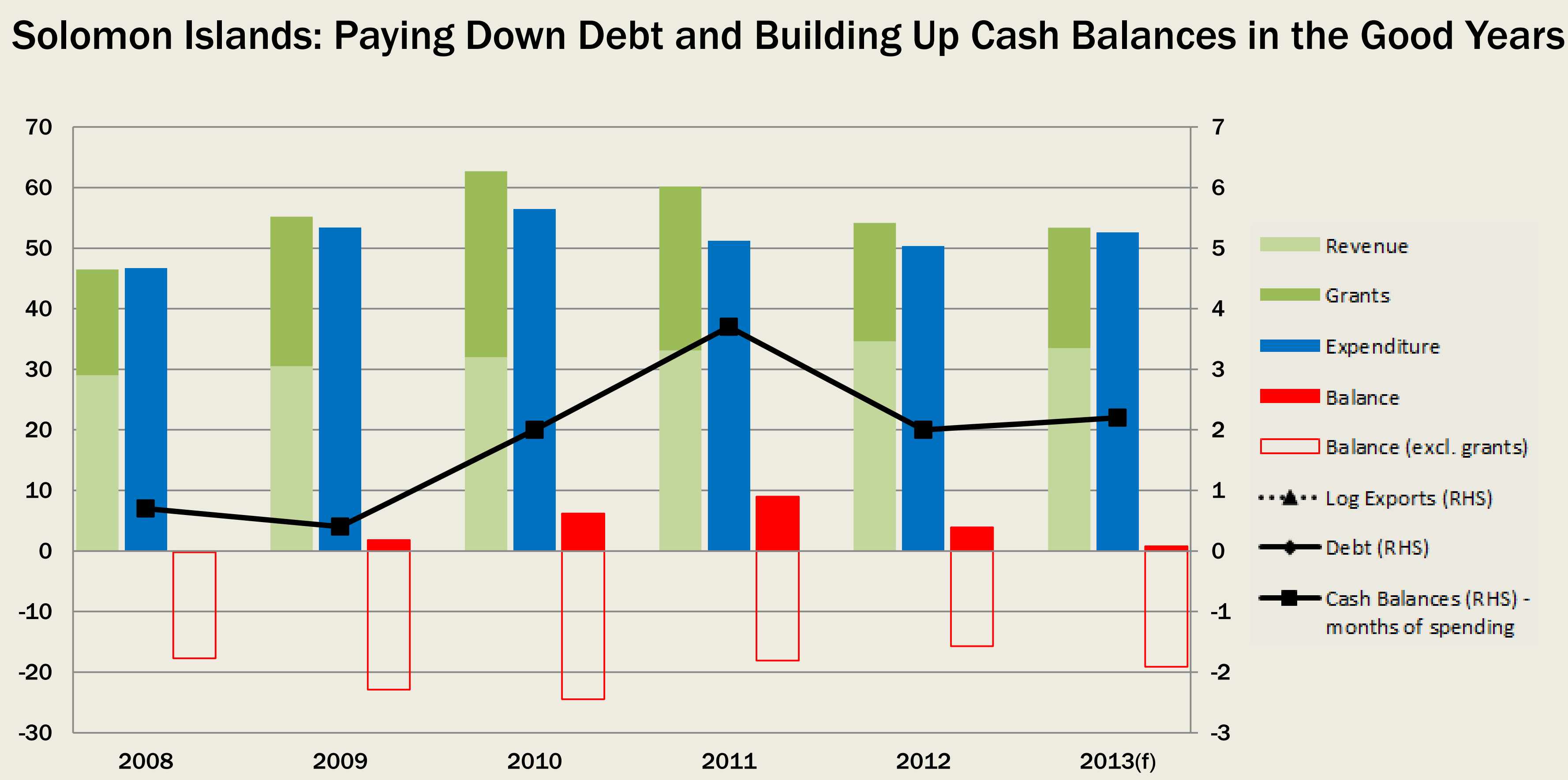


CASE STUDY: GFC ON KIRIBATI AND TUVALU

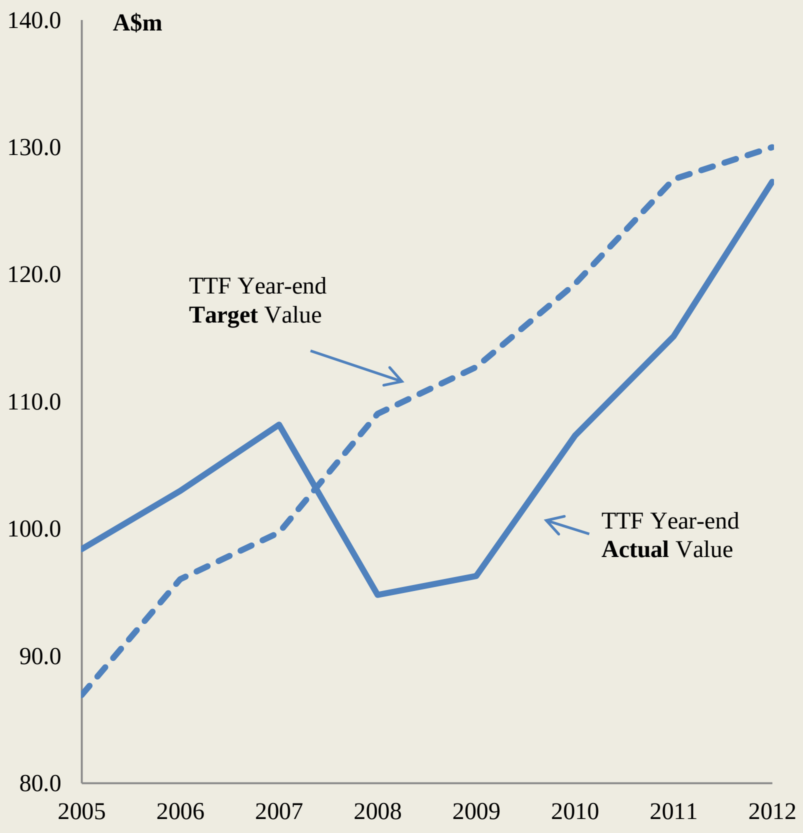
- The sovereign wealth/trust funds of Kiribati and Tuvalu were severely affected by the GFC
  - Asset values fell by over 12 percent, on average
  - Income streams from the sovereign wealth/trust funds have been subdued since the GFC
- Governments were able to increase public spending to mitigate hardship in the wake of the GFC using funds from
  - Grant receipts
  - Drawdowns from sovereign wealth/trust funds
- These sources of funds enabled the governments to protect expenditure and service delivery, while avoiding borrowing to finance deficits, thereby supporting short term fiscal and debt sustainability

CASE STUDY: GFC ON KIRIBATI AND TUVALU

- Kiribati sought to maintain the real per capita value of its sovereign wealth fund at 1996 levels
  - Since the early 2000s, drawdowns to fund deficits have exceeded sustainable levels, and Kiribati might benefit from an updated, formal rule to maintain the real per capita value at its current level
- Tuvalu only receives distributions from its trust fund when the market value of the fund exceeds its targeted value (which is linked to the Australian CPI)
  - Distributions accumulate in a reserve fund, which is available for budgetary spending
  - Tuvalu seeks to have a sufficient balance in this reserve fund to cover a ‘dry spell’ (four years without trust fund distributions)
  - In good years, the reserve fund should be built up so that in bad years it can be run down while financing the budget
  - The reserve fund thus serves as an important fiscal buffer

SAVING IN GOOD TIMES… TO SPEND IN BAD TIMES

Tuvalu Trust Fund Value



Tuvalu Consolidated Investment Fund Value