"The Global Economic Crisis and the Pacific Island Countries: The Human and Social Dimensions"

by
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Thank you, Martine.
Hon. Feleti Sevele, Prime Minister of Tonga,
Hon. Murray McCully, Minister of Foreign Affairs of New Zealand,
Distinguished panel, Hon. Ralph Regenvanu and Dr. Jimmie Rodgers,

Respected Ladies and Gentlemen,

It is my great pleasure to be part of this panel and address you today on behalf of the United Nations and, in particular, the United Nations Development Programme (UNDP). We at UNDP are proud to have Helen Clark, one of the most well-known leaders from this region at the helm of our global organization as we pursue our development mandate in 166 countries, including 15 in the Pacific.

This high-level seminar on the impacts of the global economic crisis could not be more timely, and it is indeed an honour to be able to contribute to this discussion. At the UNDP Regional Bureau for Asia and the Pacific, we have been actively involved in monitoring and assessing the crisis as it unfolds in our region, gauging its likely impact and developing effective strategies in response. Today, I would like to share some of my thoughts on the economic, human and social development impacts of the crisis on the region as a whole and the Pacific in particular.

The Crisis Hit Asia Hard but Asia is Responding Well

What is different about this crisis, and why does it matter for Asia? For one, it is a global crisis, with deep social and economic impacts throughout the world. It comes on the heels of the food and fuel crises, which have now tempered but could return. And unlike the financial crisis in late 1990s, this time Asia cannot rely on an export-led recovery.

Some long-term trends provide the backdrop for assessing the significance of the current crisis in Asia. The region's share of world income doubled from 15% of the global economy in 1950 to 33% in 2005, and is projected to grow further to over 50% by 2050. Indeed, although Asian economies will experience serious slowdowns on account of the crisis, Asia is likely to be one of the few regions in the world still growing. With stimulus packages starting to kick in, particularly in China, average growth in China is projected to be 8% this year; India, between 6-7%; Indonesia between 4-5%; and Asia as a whole at about 5%. Might I also add that our host country Australia is also doing well partly because Asia is doing well.

Moreover, banks and other financial institutions in Asia seem to have escaped from the global financial turbulence. This is because, thanks to the Asian financial crisis in the late 1990s, Asian banks have now better supervisory and regulatory mechanisms. Asian banks also have limited exposure to the US sub-prime related products and Asian corporations are not as heavily leveraged.

Despite this growth, it is clear that Asia has felt the impact of the global crisis, because of its trade and financial integration with western economies and the importance of remittances, tourism and ODA in many countries of the region.

Overall, it is estimated that the economic crisis will push some 60 million more people into poverty in Asia this year. Although Asia accounts for 57% of global employment creation in 2008, a significant proportion of these new jobs is not remunerative; consequently, 47% of the employed (over 250 million) in South Asia are classified as working poor compared to the global average of 20%. This is compounded by the collapse of labour-intensive exports, which will result in millions of people losing their jobs; the number of unemployed people in Asia is projected to jump from 80 million in 2007 to 93 million in 2009. The WTO predicts that the volume of global trade will see the biggest drop in 40 years, from a growth rate of 6% in 2007 to a fall of 9% in 2009. In Asia, these effects will be felt especially strongly in labour-intensive exports such as garments and textiles, footwear, toys, gems and jewelry in countries such as Bangladesh, Cambodia, China, India, Indonesia, Sri Lanka and Vietnam. Exporters of electronic items such as China, Malaysia, Thailand and Singapore have also been severely affected. Moreover, women workers will experience the first blow of job cuts, concentrated as they are in the most affected sectors of textiles, trade and retail.

The collapse of equity markets, with rapid capital outflows, has been another factor, with developing Asia hit hard because Asia's equity markets had expanded much more rapidly than GDP in recent years. Share index values declined sharply (more than 50%) in 2008 in many countries; losses on financial assets (equity and bond markets) were estimated to be around $10 trillion -- about one year's worth of region GDP – by the end of 2008. The slump in stock prices and weakening local currencies in almost all parts of Asia not only affected the balance sheets of banks and other financial institutions adversely but also dampened the region's business and consumer confidence. Since then of course, we have seen very substantial recovery in many equity markets in Asia, on the back of growth numbers that have turned out to be better than expected.

These days, with talk of the recession easing, evident recovery in stock markets and a strengthening of commodity prices, there are big debates and discussions on the likely speed of global recovery. I am not entering into that debate here because we believe that the relevant issue is not how quickly the world recovers but rather what the world will look like after the crisis. The post-crisis world will be a very different one, and one in which Asia needs to a serious rethink of its strategies for the future, particularly its export led growth model. While smaller Asian countries may remain trade-dependent, large Asian economies will need to re-balance consumption and investment towards domestic demand. The structure of intra-Asian trade will also change from largely intermediate goods and intra-firm orders to final products. There should be more growth in intra-regional trade as well, with improvements in the legal framework and infrastructure for a common market.

While Asia's high growth helped reduce poverty, it came with huge increases in inequality. In the future, even somewhat lower growth could lead to poverty reduction if it is less unequal. If growth is to translate proportionately into poverty reduction, there needs to be a stronger focus on inclusive growth, with resources directed to the sectors in which the poor work (agriculture), areas in which they live (relatively backward regions), factors of production which they possess (unskilled labour) and outputs which they consume (such as food).

A key characteristic of the pre-crisis global economy was the imbalance of around 5% of GDP reflecting excess consumption by the US and Europe and excess savings in Asia, both as a precautionary measure among households because of inadequate social protection and insurance as well as high corporate savings and investment and managed exchange rates. Asian countries now need to focus on strengthening implementation and targeting of social assistance programmes. Currently, basic social protection coverage is very low in Asia: only 30% of the elderly receive pensions; only 20% of the unemployed and under-employed have access to labour market programmes such as unemployment benefits, training or public works programmes; and only 20% of the population has access to health care assistance. A key requirement for ensuring development gains are maintained is that social insurance programmes -- pensions, health, unemployment – need to be strengthened.

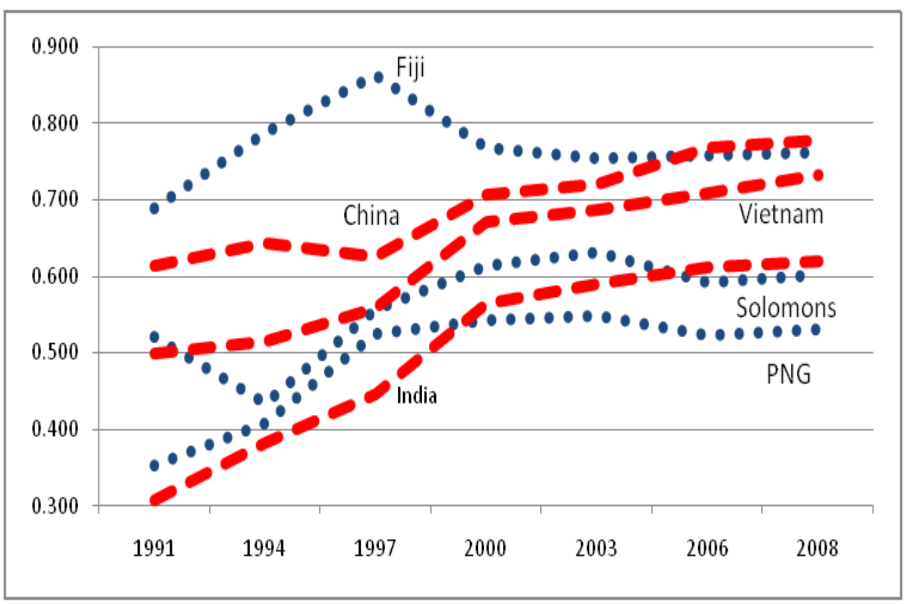
It is also important that the crisis be seen as an opportunity to reset Asia and the world towards cleaner and greener growth, through: a shift from carbon-based growth to renewable energy; more effective conservation of natural and water resources; and introduction of cleaner transport systems and cities.

The Pacific Islands Have Been Affected Badly

The pattern of the transmission of the crisis and the possible beginnings of recovery in Asia also has some parallels in the Pacific. I note, however, that many of the Pacific island economies do not have the same ability to cushion the impacts of the current crisis unlike large parts of Asia where many countries have had at least a decade of strong progress in poverty reduction.

Figure 2

Human Development Indices in 1991-2008: Asia vs. Pacific



Sources: Global Human Development Reports (1991, 1994, 1997, 2000, 2003, 2006, 2007/08), UNDP

A review of UNDP's Human Development Index (which integrates income, access to education, health services and gender equality) shows that steady economic growth in India, China and Viet Nam over the last two decades translated into strong human development gains. In contrast, as seen in Figure 1 above, the relative human development advantage that most Pacific islanders of a generation ago enjoyed relative to many Asians has largely vanished. India, before entering into the reforms, had much lower human development indicators than Solomon Islands and PNG, but has now overtaken both countries. Viet Nam, which was behind Solomon Islands twenty years ago is substantially ahead and now enjoys the same level of human development as Fiji.

Fiji, PNG and the Solomon Islands (accounting for 80% of the population of the Pacific Forum member countries) have also experienced instability, ethnic tensions and political crises, heightening concerns about stability in the region and its mutually reinforcing effect on human development. There is ample research evidence that reminds us of the link between poor growth and declining per capita income in exacerbating the underlying causes of conflict, primarily due to the effect of inequitable access to critical public services, resources and opportunities.

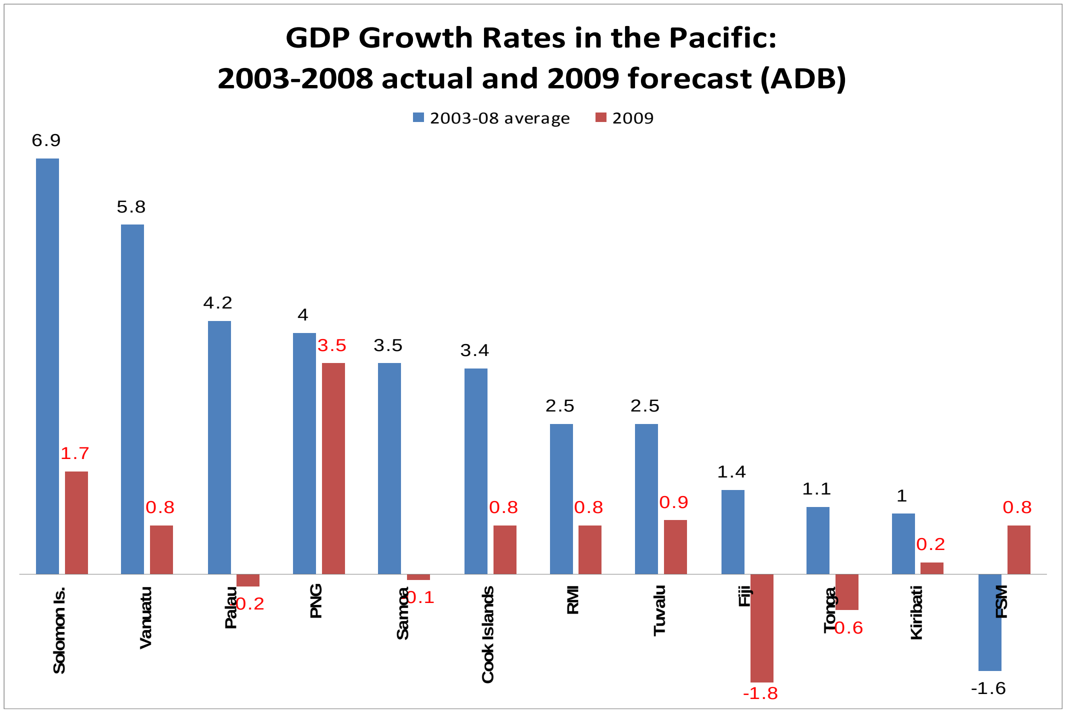
Although changes in key economic indicators over the last few months provide cause for optimism, it is clear that the economic crisis is having a significant impact on the Pacific. The degree and nature of these effects will vary in different countries depending on their individual economic structures and their levels of engagement in the different sectors of the global economy.

- The Pacific economies are very open, with the value of trade in goods and services often exceeding that of GDP. Falls in commodity prices and export earnings from commodities and manufactured items are having significant effects on exporting countries such as PNG, Samoa, Solomon Islands, Fiji and Vanuatu. The recent strengthening in commodity prices has helped in restoring some balance but volatility will continue to pose a problem for economies that are not sufficiently diversified.
- A heavy reliance on imports of food, fuel and manufactured items subject to volatile exchange rates affects all Pacific countries. Rising prices for imported food and fuel in the first half of 2008 had already suppressed consumption spending and pushed up inflation in many of the Pacific countries. All but one country (PNG) import more than 90% of their fossil fuel requirements. Here again, the recent decline in oil prices over the last few months, if sustained, will provide a measure of relief.
- Declines in tourism receipts as unemployment and uncertainty in source countries will discourage people from taking expensive overseas holidays, affecting the Cook Islands, Fiji, Samoa, Palau, Tonga and Vanuatu.
- Reductions in the value of remittances from families living overseas who may themselves be experiencing unemployment, and from temporary migrant and contract workers (including seafarers, caregivers, or security service personnel) will be felt keenly in Samoa, Tonga, Kiribati, Tuvalu and Fiji.
- Reductions in income from internationally-invested trust and sovereign wealth funds will significantly affect the government's budgets in Kiribati, Tuvalu, FSM, RMI and Palau.
- Although Pacific island banks remain relatively profitable, their high level of foreign ownership makes them vulnerable to erosions in the capital of parent banks.
- Finally, most of the Pacific Island Countries are highly reliant on development assistance, but ODA flows are likely to be adversely affected as donor countries themselves experience tighter fiscal positions.

Let me now review the impact of the crisis on a few key economic indicators for the region in greater detail.

Growth: The Pacific saw historic economic growth in 2008. Overall growth of 5.1% was led by the commodity-intensive economies of Papua New Guinea, Solomon Islands, and Timor-Leste. However, as seen in the figure below, a sharp contraction in growth rates is projected for 2009.

Figure 3



Source: Asian Development Outlook (ADB) 2009, Manila (March). Forecasts for the Cook Islands, Marshall Islands, Federated States of Micronesia, Nauru, Palau, Samoa and Tonga are for their fiscal years.

Aggregate growth in the Pacific is set to slow to 3% in 2009, largely because PNG's expansion will abate after two years of strong growth driven by the commodity boom. Fiji's growth is expected to contract, hurt by the negative impact of the global slowdown on tourism and remittances as well as by severe flooding in early 2009 Moreover, the contraction in GDP forecast for 2009 in the Fiji Islands and Samoa is likely to be larger than originally expected.; conditions are deteriorating rapidly in Solomon Islands. Vanuatu, however, is expected to perform better than originally forecast.

Inflation: Inflation shot up in 2008, to an average of 9.6%, propelled by strong growth of domestic demand in PNG and rising global oil prices. Inflation is now easing across the region, mainly because of lower world fuel prices. The devaluation of the Fiji Islands dollar, however, will add to inflationary pressures in the Fiji Islands.

Commodity Exports: Countries exporting natural resources and agricultural products benefited from the commodity price boom in 2007 and 2008. These countries have been confronted with deterioration in their terms of trade with the fall in commodity prices and global demand translating into lower export earnings. The world economy, and hence international commodity prices, is generally expected to improve in 2010, but considerable uncertainty remains.

- Countries exporting oil and minerals have been hardest hit, with oil prices falling more than 60% from a peak in mid-2008. The global demand slump has also adversely affected the prices of key Pacific exports such as coffee, cocoa, palm oil, coconut oil, and copra, although there have been price increases for these commodities during the second quarter of 2009. The ability of these countries to combat the effects of the global economic crisis through countercyclical macroeconomic policies will depend on the extent to which they were able to consolidate gains generated during the commodity price boom.
- PNG and Solomon Islands are particularly vulnerable to deterioration in their terms of trade. Given their heavy dependence on primary product exports, the decline in commodity prices and the deterioration in global demand is projected to have a serious impact on growth rates in 2009 and in the medium term. In PNG, the kina export price index declined by 32% in the last quarter of 2008 compared with the September quarter. The Solomon Islands experienced a decline in one of its key exports (logs) from November 2008 to February 2009, with volumes lower by 22.5% compared with the same period in 2007-2008. However, log export revenue has picked up in the second quarter, which has generated cautious optimism regarding growth prospects.

Imports: The nominal value of imports is declining in most of the larger Pacific economies. While partly due to the effect of lower fuel prices, the decline also points to lower domestic demand. Notably, the value of imports from each country's major trading partner (fuel is normally from a minor trading partner for these countries) is now trending down in the tourism- and remittance-dependent economies.

Other economic indicators: Declines in the value of sovereign wealth funds – some more than 20% in the 12 months leading up to March -- may deprive Kiribati, Tuvalu, Marshall Islands and Palau of both short-term fiscal space as well as long-term savings. Foreign currency reserves are also expected to decline and be of increasing concern for some countries, especially Fiji and Solomon Islands. The demand for temporary farm workers filling gaps at harvest time in New Zealand and Australia may also be adversely affected. In Tuvalu for example, the number of temporary workers going to New Zealand in 2009 was half that of 2008, while there were 10% declines for Tuvalu and Kiribati. In Fiji, the Reserve Bank reported that the value of remittances fell by 25% between 2007 and 2008, and is forecast to decline by a further 15% in 2009.

Equally important from my perspective is the expected impact on human development and MDG achievement. It is clear that the biggest brunt will be felt by the poor in the Pacific Island Countries, as the long-term effects of the global economic and financial crisis translate into further constraints on human development and on the achievement of the MDGs. Even in those countries experiencing positive growth, the distributional impacts are unlikely to favour the poorest and most vulnerable, and current levels of poverty may in fact increase unless governments take active measures to ensure pro-poor economic growth.

As seen in the MDG Status overview below (drawn from UNDP-supported national MDG reports), only a few -- mostly small, Polynesian -- countries are on track to achieve most of the MDGs by 2015 before the crisis.

Figure 4

PACIFIC: MDG STATUS AT A GLANCE

	1	2	3	4	5	6	7	8
PNG	X	X	?	X	X	X	X	?
Fiji		?	√	?	?	X	?	?
Solomon Islands	√	√	X	?	√		?	?
Vanuatu	√	?	?	?	?		√	?
FSM	√	?	?	?	?		√	?
Kiribati	√	√	√	?	?	X	X	?
Marshall Islands	√	√	√	√	√	?	?	?
Nauru		?	?	?	?		X	X
Palau	√	√	√	√	√	√	√	√
Cook Islands	√	√	√	√	√	√	√	?
Niue	√	√	√	√	√	√	√	?
Samoa	√	√	√	√	√	√	√	?
Tokelau		√		√	√			?
Tonga	√	√	√	√	√	?	√	?
Tuvalu	√	√	√	?	√	X	?	?

KEY: √ Mostly on track; ? Slightly off-track / some data gaps; X: Off-track;
Weak / No data SOURCE: National MDG Reports (2004-2008); UNDP estimates

The economic crisis could throw the Pacific region further off-course in achieving the MDGs, as illustrated by the following examples:

- Higher food and fuel prices in 2008 have already pushed inflation into double figures in a number of PICs (Solomons, Samoa, Kiribati and PNG) and between 7.5% and ten percent in most other countries, leading to sharp reductions in real incomes of the poor and increases in the incidence of basic-needs poverty (MDG1). Recent UNDP research indicates that the number of those living below national poverty lines in the region jumped from 4 million to 4.5 million over the two years to mid-2009. The crisis will add pressure on traditional support systems and also contribute to the increase in the number of working poor in the Pacific: already, the proportion of employed people living below $1.25 a day in the sub-region has increased from 35% in 2007 to 38% in 2008.
- In Tuvalu, imports of several basic food items (flour, rice, sugar, powered milk, canned fish, cabin biscuits and chicken parts) as a share of food imports increased from around 40% in 2006 to 60% in 2008, suggesting a narrowing of household diets and a possible reduction in nutritional standards.
- Similarly, even though most Pacific countries had appeared to be on track to achieve universal primary education (MDG2), a concern is that the economic crisis may leave more

Pacific children unable to enroll in school, drop out or experience declines in the quality of education. For instance, In Samoa, it is understood that many children have been "suspended" from school pending the payment of overdue fees for the current year.

- It is feared that lower household incomes or limited access to public services due to constrained government budgets may also lead to increases in infant mortality (MDG4) and maternal mortality (MDG5) rates, and exacerbate the public health challenges of HIV/AIDS, sexually transmitted diseases and malaria (MDG6). As in Asia, women are likely to the most vulnerable to these threats.
- Arguably, one of the strongest development challenges in the Pacific relates to environmental sustainability (MDG7), in particular the effects of climate change. The global economic crisis is likely to exacerbate pressures on the environment in several ways, including increased numbers of urban poor and squatter settlements and slums, which was already a big concern for the Pacific; reverting to unsustainable subsistence farming or livelihoods practices, and an inability to make domestic and ODA resources available for climate change adaptation and mitigation.
- Increases in poverty, horizontal inequalities or extremely skewed progress on the MDGs may also pose a security problem in some countries of the Pacific, as they can create, exacerbate and sustain the conditions, needs and grievances that feed conflict. As a result, there is a risk that the economic crisis may push some countries into a low human development–conflict trap, with conflict destroying accumulated physical, social and human capital.

Moreover, the economic and financial crisis further threatens the social fabric as islanders seek employment or social protection in difficult times. A rise in rural-to-urban-to-overseas migration has led to other problems for those left behind. Rural villages and outer islands are being depleted of their young people, often leaving very young children in the care of aging parents, which can reduce food security in rural areas and further increases the importance of remittances. Traditional social safety nets are weakening as families are split by migration.

It is also instructive to explore the gender impacts of the economic crisis in greater detail. The impact of the crisis will be felt by both men and women but not necessarily in the same manner.

- Women will bear the brunt of the crisis. During difficult times, families often rely on women to care for the sick, elderly and the extended family, even when women are already engaged in paid-work. This means longer-work hours and heavier workloads for women.
- When there are few opportunities for wage work, men may migrate out of rural areas, leaving women as household heads, adding to their burden. In general, households in which only women earn an income and those with many dependents are the poorest.
- Coping strategies of the poor in terms of cutting down on meals, health-care spending, and withdrawing children from schools, invariably affect women and girls the most.
- The deterioration in social protection systems can make future prospects especially bleak for the elderly and single mothers with young children. If the economic situation worsens, more Pacific Island girls and women may end up being lured or forced into transactional sex work, putting them at higher risk of HIV infection and sexual and gender-based violence.

Pacific households are resilient and have learned to cope with natural disasters and difficult times. Urban households are already trying to cope by starting home gardens and launching new small enterprises; rural households are expanding their subsistence production.

In developing macro-level responses to the economic downturn, however, most PIC governments have little scope for initiating conventional counter-crisis economic policies. For around half the PICs that use a third-country currency and have weak or non-existent domestic financial markets, adjustments in monetary policy are not really an option. Even for those countries that have a national currency, there are often only weak links between interest rates and economic activity as capital markets are small and undeveloped. Moreover, PIC foreign exchange reserves are satisfactory at best and extremely vulnerable at worst. The creation of additional domestic liquidity to finance a fiscal stimulus would, therefore, be a risky policy prescription as it could lead to deterioration in the balance of payments, further declines in foreign exchange reserves, a weakening in the exchange rate and increasing inflationary pressures.

Conventional fiscal stimulus packages such as those being implemented in developed countries and larger developing countries of Asia are also not practical or applicable in many of the small PICs. Budgets are already tight and pushing the upper limits of sustainable fiscal deficits. There is little opportunity for small Pacific countries to mobilise additional domestic resources for investment, and virtually none have access to international capital markets. Running larger deficits and/or printing currency to finance such packages are not options.

Those countries with substantial development assistance flows do have some scope for redirecting these flows into new public investment projects. But to get the maximum domestic benefit from such expenditure, the projects need to be labour-intensive and not just focused on imported materials. Office, school, clinic and road maintenance type projects would often yield the greatest employment and multiplier benefits for domestic economies, rather than new large construction projects with high import content.

It is clear that the countries most vulnerable to the economic crisis are those that do not address structural problems and do not prioritise expenditure towards the highest priority objectives, particularly those around basic health, education, law and order and the maintenance of national economic infrastructure. Such investments would help secure MDG gains and human development for the future and reduce the risk of conflict. Policy responses will also need to be grounded in a gender equality perspective to ensure that women as well as men can benefit from employment creation and investments in social infrastructure.

With limited macroeconomic policy options, most Pacific countries will need to seriously consider reforms as their best choice to deal with the impacts of the economic crisis. Most PICs have relatively large and unfocused public sectors, with inefficient and high-cost public utilities and state-owned enterprises. A drive towards reform that targets improvements to economic efficiency and the effectiveness of budget expenditure could yield significant benefits. Although short-term costs may be high, which could be mitigated with donor assistance, such reforms would assist countries to ride the recessionary impacts in the medium term and would yield significant cost, efficiency and development gains in the long term. The creation of a better private sector environment for small and micro-enterprises would help to offset the job losses and declines in remittances that are resulting from the global downturn. Strengthening aid management, and more importantly, aid-effectiveness, should also be high on the list of priority strategies for governments.

Pacific countries have a small window of opportunity to implement these reforms, most of which have been advocated for many years, before the global crisis is really felt in earnest. Failure to rise to this challenge would lead to potentially much more serious problem in the future if budgets are weakened and domestic employment opportunities are not created.

Further, as for Asia, it is even more critical that the crisis be seen as an opportunity to reset the Pacific towards environmentally sustainable, “clean and green” growth. Already countries are beginning to seriously explore a shift towards renewable energy sources, strategies to adapt to climate change that are integrally linked to national development, and place heavy emphasis on the sub-region’s abundant natural resources.

The demonstrated improvements in growth rates, incomes and progress towards MDG targets shown by many PICs before the onset of the current crisis provides confidence that, given appropriate policy responses and the support of the international community, the Pacific region can emerge from its current downturn and get on the path to sustained recovery. Global trends and recent data suggesting that the recession may be easing show Asia emerging progressively as a global center of economic gravity. Due to their proximity to Asia and the potential for greater alignment and strengthening of ties with various Asian countries, the Pacific countries can only benefit from this trend. Australia and New Zealand, with which Pacific economies have close links, also play a key role -- as one of the most significant trading partners for the Pacific as well as an important source provider for Asian countries. The Pacific Island Countries must now look at ways to exploit these opportunities.

I hope that the inputs today will help provide a framework for policy action and the support to be provided by the international community. I look forward to a lively and productive discussion as we focus on the humanitarian and social impact of the crisis.

Thank you.