The global economic crisis shook economies the world over (see Figure 1). The Pacific islands* were no exception (see Figures 2 and 3). Economies weakened significantly as their tourism, agriculture, and manufacturing industries slowed with the fall in global demand. Remittances declined by as much as 20% as source economies slowed. The value of the region’s public offshore investment funds shrank as international equity prices slumped. Underlying structural weaknesses and the residual effects of high inflation in late 2008 added to the severity and pace of the slowdown felt during 2009 and early 2010, as did natural disasters in Fiji, Samoa, and Tonga.

The impacts were felt throughout the Pacific economies. Private sector performance worsened, and jobs were lost. Government revenues contracted, and essential services and critical investments in infrastructure and maintenance were placed at risk. Pressures were particularly intense in the Cook Islands, Fiji, the Republic of the Marshall Islands (RMI), Samoa, Solomon Islands, and Tonga.

A Package of Actions

To assist countries deal with the effects of the crisis, the Asian Development Bank (ADB) implemented a multipronged, policy-based response. The approach used was based on solid diagnostics, and communication and awareness-raising initiatives to ensure a cohesive country-led approach. It built in a long-term engagement for assisting countries manage the aftereffects of the global economic crisis, and the underlying structural weaknesses that aggravated its impact on the Pacific islands.

Analytical and Policy Support. ADB released a policy paper, Navigating the Global Storm, in April 2009 to provide an early view of the impacts of the global economic crisis. The paper highlighted the risks posed by the fall in world demand, as well as the sharp decline in the value of trust funds and superannuation schemes. This paper was followed by Taking the Helm, which provided a common policy framework to guide a response to the crisis and laid the foundation for policy dialogue.

*The use of the term “Pacific islands” in the context of this policy brief refers to all Pacific developing member countries with the exception of Papua New Guinea and Timor-Leste.

Asian Development Bank
ADB launched the *Pacific Economic Monitor* in May 2009 to enhance economic monitoring and surveillance. In some Pacific economies, monitoring has a narrow coverage and is hampered by long lags in data collection—a limitation that hinders early warning of, and response to, approaching impacts. The triannual *Monitor* is widely disseminated and used in the Pacific, and is backed by an extensive online database.

**Technical assistance (TA).** The Pacific Economic Management TA has assisted governments in preparing and implementing their response to the global economic crisis. Other country and regional TA activities also supported a response to the crisis, pursuing the continuation of reform processes (see Box 1).

**Economic Recovery Support Programs (ERSPs).** ADB’s main support to impacted countries—which were identified following country and development partner consultations—was through policy-based programs. These are detailed in Box 3. The program loans and grants provided general budget support totaling close to $80 million (see table on next page). The Cook Islands, RMI, Samoa, Solomon Islands, and Tonga were assisted in this way. Support was provided in coordination with the policy programs of other development partners—Australia, the European Union, New Zealand, and the World Bank—and support from the International Monetary Fund (IMF). The programs supplemented government funds and provided the fiscal space needed to continue infrastructure investment, protect basic social services, strengthen fiscal governance, and pursue priority structural reforms.

**Targeted programs for the vulnerable.** With financial support from the Japan Fund for Poverty Reduction, additional grant-funded projects were put in place to support analysis of the impacts of the crisis on the vulnerable and to pilot implementation of social welfare activities and associated policy responses. Actions to lessen gender inequities were also supported. This support is being progressively rolled out in the Cook Islands, RMI, and Tonga.

## ADB Policy-Based Programs in Practice

### Managing the Macroeconomy

**Supporting Aggregate Demand.** Budget support provided through the policy-based programs helped governments proactively manage the fiscal implications of the shock (see Figure 4). Where fiscally affordable, the programs allowed implementation of value-for-money fiscal stimulus packages to boost internal demand through support for investments in infrastructure (see Figure 5).

In the Cook Islands, a fiscal deficit of 0.8% of gross domestic product (GDP) in fiscal year (FY) 2010 (ending 30 June) helped fund an 86% increase in capital expenditure over the FY2009 level. The economic contraction experienced by the Cook Islands’ economy was held to 0.5% in FY2010, and growth of 1.1% was experienced in FY2011, supported by domestic and external funding for infrastructure investment.

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**Box 1: Supporting Technical Assistance**

The policy-based programs of the Asian Development Bank (ADB) built on areas of prior ADB involvement and, as such, were strongly supported by ADB’s existing technical assistance (TA) program in the Pacific.

- **TA 7280-REG** Pacific Economic Management provides economic monitoring, analysis, and policy advice, with an emphasis on fiscal and structural policy.
- **TA 6353-REG** Pacific Private Sector Development Initiative (Phases 1 and 2) facilitates state-owned enterprise (SOE) reforms, including governance reforms, and actions to improve the legal enabling environment for business, such as secured transaction legislation and updated company law.
- **TA 7287-COO** Infrastructure Services Delivery Improvement strengthened infrastructure planning and asset management in the Cook Islands, as well as supported organizational restructuring in infrastructure-related ministries.
- **TA 7646-COO** Public Finance Management and Public Performance Review in the Cook Islands will help establish, through a government-wide functional analysis, a public service structure that is cost effective and aligned with national priorities.
- In Solomon Islands, national development planning is being supported under **TA 7616-SOL** Support for the Formulation of a National Strategic Plan.
- In the Republic of the Marshall Islands, support for wide-ranging expenditure and tax reforms, including SOE reform and the adjustments required to achieve fiscal sustainability, is being provided under **TA 7336-RMI** Responding to Economic Crisis and **TA 7578-RMI** Supporting the Public Sector Program.
- In Tonga, a wide-ranging program of support for fiscal and economic management is provided under **TA 7475-TON** Support for Economic and Strategic Management, which commenced in July 2010.
In Samoa, a program-supported increase in public works assisted the rebuilding of infrastructure damaged by the tsunami of September 2009 and led to an early pickup in domestic economic activity and employment. These proactive fiscal responses helped stabilize these economies, improve the medium-term outlook, and demonstrate the flexibility of policy-based support.

Protecting the Fiscal Position. The programs helped ensure that the fiscal response to the global economic crisis was prioritized, well targeted, and consistent with overall fiscal prudence. This was especially important in countries where a fiscal stimulus was not affordable, including RMI, Solomon Islands, and Tonga. In these countries, the programs helped protect priority expenditure areas and promoted expenditure restraint. Emphasis was placed on avoiding excessive buildup in public debt and pressure on the balance of payments.

The Cook Islands and Tonga established financial ratios that set targets promoting fiscal stability, e.g., total public debt, government personnel, and operating costs as proportions of GDP. Similarly, the Government of Solomon Islands, in keeping with the Honiara Club Agreement for fiscal prudence, committed to keep its public debt-to-GDP ratio below 30% and to maintain its ratio of payroll charges to GDP in nominal terms.

The program in RMI allowed for Cabinet endorsement of budget targets for FY2011 and FY2012 that will bring budget outcomes in line with IMF’s recommendations. Public Sector Debt Management guidelines for FY2011 and FY2012 were also endorsed, which froze new borrowing to fund general government spending, froze the level of nonconcessional borrowing by 11 state-owned enterprises (SOEs), stopped government lending or loan guarantees to parties outside the public sector, and required Cabinet approval of concessional borrowing by SOEs.

ADB also supported government efforts to strengthen public financial management. These efforts were focused on facilitating the formulation and implementation of public financial management reform plans based on public expenditure and financial accountability assessments. In Samoa, this assistance ensured that the FY2011 budget was prepared against a medium-term expenditure framework that included a fiscal strategy statement, the preparation of forward estimates, and a statement of government operations prepared in accordance with IMF’s Government Finance Statistics standards. In Tonga, efforts are under way to establish a medium-term budgeting framework to guide resource prioritization and allocation in FY2013 and future years.

Linking to IMF Support. In Solomon Islands, the actions of the ERSP were closely coordinated with a standby credit facility provided by IMF, and complemented associated reform actions, in particular the achievement of fiscal targets such as an overall surplus (including grants) of 2.5% of GDP in 2010. The IMF and ADB programs provided initial and follow-on support that allowed Solomon Islands to deepen key fiscal actions under their reform programs.

<table>
<thead>
<tr>
<th>Summary of ADB’s Global Economic Crisis Policy-Based Programs for the Pacific Islands</th>
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<tr>
<td><strong>Country</strong></td>
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<td>Cook Islands</td>
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<td>Republic of the Marshall Islands</td>
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<td>Samoa</td>
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<td>Solomon Islands</td>
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<td>Tonga</td>
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Addressing Key Social Issues

The economic slowdown added to hardship in the Pacific. ADB estimates that an additional 50,000 Pacific islanders, or 2.4% of the Pacific islands’ population—most of whom are engaged in informal sector activities, which were hit hardest by the economic slowdown—were living below the poverty line at the end of 2010 because of the global economic crisis (see Figure 6). Traditional coping mechanisms, such as community groups and churches, were hard pressed to handle the stress of additional shocks.

Analysis of labor markets suggests that the “working poor” were the most exposed to the effects of the global recession. Starting from a position of vulnerability, their incomes are likely to have declined further as construction, manufacturing, retail, and wholesale activity weakened. The decline in remittances also affected the vulnerable members of the community the most. Anecdotal evidence suggests that, where remittances fell or other events left a gap in household budgets, requests were made for support from higher-income family and community members. In this way, the adverse impact of the economic slowdown was being shared across communities.

Policy dialogue and budget support helped avoid potentially damaging across-the-board cuts to expenditures. This lessened the adverse impact of a tightening fiscal position on services to the vulnerable.

The ERSPs were instrumental in placing social welfare and social protection issues on the policy agenda. Cabinets in the Cook Islands and Tonga considered papers that identified the vulnerable groups in society and suggested actions responsive to their needs. The Cook Islands provided for inflation adjustment of allowances for the vulnerable in the FY2011 budget. In Samoa, an Australian Agency for International Development and New Zealand Aid Program-funded free school fees scheme commenced in 2010, which is supporting more children to enroll, and to stay enrolled, in primary school. Policy actions to protect the vulnerable and provide opportunities for economic activity were built into the programs.

The emphasis on protection for the poor and vulnerable was an innovative feature. This emphasis drew attention to an area that had not generally been considered problematic, given the existence of informal social safety nets in the Pacific.

Budget support provided under the Solomon Islands program allowed a higher level of social expenditure than would otherwise have been possible. For example, the government allocated more of its own funds ($19.5 million above the 2009 level) to nonpayroll costs for education, health, and infrastructure services. In Tonga, public expenditure reviews were completed for the ministries of Health and Education to enable improvements in expenditure efficiency and quality of expenditure. There, the budget support quarantined basic health and education expenditures from the impact of significant across-the-board budget cuts.

Good Governance in Practice

To enhance openness and transparency, budget support was provided only after it was approved by the government through the annual budget process. Specific policy actions of the programs were tailored to the priority development needs of each economy. These actions were formulated after wide consultation involving the public sector, development partners, the private sector, civil society, and academia. Consistent with international commitments to make aid more effective in fragile states, emphasis was placed on formulating actions using partner countries’ own institutions and systems, and broadening the participation of a range of national actors. Programs were aligned with national development and sector strategies and budget frameworks. This provided for a country-led approach (see Box 2).

Country ownership was facilitated by programs that were relatively simple in scope (see Box 4). This also kept the programs realistic and firmly within limited capacities, and facilitated communication and awareness of programs and program objectives. A long-term perspective and commitment were critical to underpin reforms, and as such the programs should be seen as the next step in a long-term, sequenced reform process. By linking the program to the ongoing sectors of ADB focus, existing country relationships were strengthened and policy messages made more consistent. The policy matrices for the programs identified medium-term program directions as guideposts for future support.

The ERSPs ensure that program monitoring is led by government agencies, involves development partners, and uses existing coordination mechanisms wherever possible (to strengthen government systems and processes rather than creating duplicate systems). Going into a program with other partners also acts to promote a consistent policy message and facilitates better understanding of institutional modalities for assistance. Joint development partner dialogue around key issues, for example, could ensure that support is provided more efficiently, more systematically, and more effectively.
ADB supported analysis that helped to raise the quality of policy dialogue. This allowed better understanding and collective support for where, when, and by whom interventions could be made. Governments have been open to joint policy discussions on reforms with development partners, given the extent of the crisis' impacts on the economies and the recognition that pushing ahead with reforms is essential to strengthen future resilience and to improve prospects for growth in the medium term. In Tonga, for example, ADB initiated a regular Tonga development partners meeting, which was initially aimed at providing a joint development partner response to the crisis, but has since evolved to the provision of longer term support aimed at creating an economy more resilient to future shocks. The importance of this improved coordination is underscored by Tonga's efforts to reduce its high debt levels through a program of fiscal consolidation; in other words, development partner support will be even more critical in order for Tonga to achieve its development goals in a tight fiscal environment. Importantly, there is agreement among partners that continued coordination of policy dialogue and development support around a core set of government-led policy issues (as with the program policy matrix) should be pursued.

The RMI policy-based program provides a practical example of ADB’s efforts to raise the quality of policy dialogue and coordination. During the processing of the ERSP, the government requested ADB to finance a public symposium in order to adopt a participatory approach to its reform program and to undertake an informed analysis of the options available to carry out the necessary fiscal adjustment. Two consultation sessions were held in the capital, Majuro, in December 2009. The consultations involved a diverse range of stakeholder groups from the government, civil society, nongovernment organizations, the private sector, and youth. The public consultation program was designed and facilitated by ADB consultants, and consultations followed a bilingual format. Open debate on a wide range of issues brought out significant information, opinions, ideas, and recommendations. Findings were posted on the government website, and the local radio station aired live sessions, making the government decision-making process more transparent. A strong consensus emerged on key points related to ongoing economic difficulties, the necessity of adopting serious reform measures to deal with imbalances, and the imperative that the Cabinet and Parliament take the lead in this reform process.

All programs were harmonized with support from other development partners. Development partners have eased the call made on government resources by agreeing to work together, to use common arrangements, and to share analysis. For example, joint missions were undertaken during program preparation when other partners were considering a policy-based program. In Solomon Islands, the policy program was developed by an innovative Core Economic Working Group, established by the Government of Solomon Islands in March 2009 as a forum for dialogue among government agencies, the central bank, and key development partners.

In Samoa and Solomon Islands, the actions of the ERSPs were also linked to support provided by the World Bank and IMF, respectively. The programs have also assisted in leveraging country access to additional funds. In Tonga, the European Union used the second-tranche conditions as the basis for the release of $7.2 million in budget support under their V-Flex facility. Similarly in Samoa and Tonga, ADB’s assessment of performance against release conditions and triggers informed Australia’s release of performance-linked budget support.
engaged in informal sector activities, including these women of Auala, Savai‘i in Samoa

The economic slowdown has added to hardship in the Pacific, with significant impacts on those engaged in informal sector activities, including these women of Auala, Savai‘i in Samoa

The economic slowdown has added to hardship in the Pacific, with significant impacts on those engaged in informal sector activities, including these women of Auala, Savai‘i in Samoa
Development partners’ support toward Tonga’s efforts to reduce its high debt levels is critical for the well-being of future generations

have been allocated in the FY2012 budget for this purpose.

A Personal Property Securities Act is being prepared under the guidance of a task force comprising both public and private sector representatives and with the support of an Asian Development Bank (ADB)-funded consultant. The Act will allow movable assets to be used as credit security through creation of legislative support for the operation of an e-registry. There have been several stages of consultation in undertaking this work. Tabling of the Bill in Parliament is scheduled for December 2011.

SOLOMON ISLANDS

The Solomon Islands’ economy has been among the most affected in the Pacific by the global economic crisis. Gross domestic product (GDP) growth averaged 7.0% per annum in the 5 years to 2008 but contracted by 1.2% in 2009. While in the short term the economic growth rebounded quickly, medium-term growth prospects are uncertain, with the key logging industry expected to be largely exhausted by the middle of the decade. The economy is also one of the most aid dependent in the world. It was critical, therefore, that ADB’s program support the continuation of structural reforms.

The ERSP supported the government’s efforts to improve the efficiency of its SOEs, as well as to promote greater private sector participation. This was done through, among a range of other policy measures, deregulation of the telecommunications industry; improvement of the business regulatory environment to directly reduce the cost of doing business; and development of transport infrastructure to raise investment levels and service standards, and to lower transport operating costs.

Examples of reform achievements in the SOE sector include the public release of an annual SOE monitoring report to create more awareness and understanding of SOE performance; endorsement of a debt restructuring program for Solomon Islands Electricity Authority, and new appointments to senior positions; completion of the tender process for sale of Sasape Marina; initiation of a restructuring of Solomon Airlines; and the implementation of SOE regulations on community service obligations.

Other initiatives include the passing of the Personal Property Securities Act in September 2010. The Act is intended to promote business and consumer’s access to credit by facilitating the use of personal property as collateral or security for loans and other financial obligations. It also establishes an electronic personal property securities registry to receive, store, and disseminate notices of security interests and other rights in personal property.

TONGA

As the global economic crisis hit, Tonga was faced with a pressing need to fund its significant development agenda (particularly in terms of infrastructure needs), as well as continue with its structural reform program, in the face of a substantial decline in revenues (by about 5% of GDP). In response, the Government of Tonga implemented a program of monetary and fiscal easing to stimulate domestic demand. Reserve requirements for commercial banks were reduced, and an expansionary fiscal stance was adopted to raise levels of capital spending.

The government followed up these actions over the course of FY2009 and FY2010 by pushing ahead with its structural reform program. The ERSP supported the government’s efforts on a number of fronts, which include restructuring of 10 SOE Boards to comply with the requirement of the Public Enterprises Act that Government Ministers, members of Parliament (the Legislative Assembly) and civil servants should not serve as directors of public enterprises. In addition, the Public Enterprise Amendment Act (a key policy action) significantly strengthened the manner in which SOEs are governed and managed. It puts in place legal rules that enhance the commercial governance practices of public enterprises, strengthen the monitoring framework for public enterprises, formalize the government’s decision that politicians should not serve as public enterprise directors, clarify the rules and processes associated with the approval of community service obligations, establish clear guidelines for the selection and appointment of directors, and clarify director accountabilities.

The program also supported the end of the legislated monopoly on mobile telecommunications. The voluntary relinquishment of the existing operator’s exclusive license was completed, and new telecommunications legislation was enacted. Follow-up actions have been aimed at supporting the commencement of operations of an independent telecommunications regulator.
The Way Ahead

The policy-based programs have proved a valuable tool in helping Pacific island governments respond to the economic and fiscal shock of the global economic crisis. The Pacific islands remain vulnerable, and need ongoing support to strengthen their resilience to future shocks.

Policy dialogue and TA are important tools to be used in strengthening economic and fiscal management in the Pacific islands. But they cannot meet all needs. Policy-based programs provide an important additional tool that can help Pacific developing member countries tackle the special challenges they face, particularly when fiscal space and added impetus to reforms are needed to make important policy changes.

Future policy-based programs should remain firmly anchored in national policy priorities and be government-led. They should be carefully coordinated with supportive TA, and the support provided by other development partners. Policy-based programs, and the associated budget support, can make an important contribution by focusing on actions that lead to greater resilience to future shocks, while helping sustain the economic growth needed to lift the rate of development. Programs need to pay special attention to vulnerable groups of society. Openness and transparency are essential requirements for success. To ensure that policy-based programs are effective, ADB staff need to ensure that they sustain a deep engagement in policy dialogue.

The situation in Tuvalu provides a useful demonstration of the ongoing need for policy-based programs. A policy-based program was approved for Tuvalu in 2008 that has helped implement long-prioritized reforms. The program has led to significant advancement of SOE reforms (particularly given the political economy and institutional capacity constraints). An SOE Act was passed in late 2010, which, among other initiatives, set out the principles governing the operations of public enterprises (including authorizing the Auditor General to be the auditor for Tuvalu’s public enterprises and subsidiaries). The fiscal risk posed by the SOE sector has been reduced. The government has initiated discussions on a new policy-based program. This is likely to feature ongoing implementation of SOE reform efforts, including the rationalization of some SOEs. The general budget support associated with the program could provide the fiscal space needed to implement such structural reforms.

The structural reform agenda in the Pacific islands remains large, yet it is critical that these efforts continue, given the range of risks to macroeconomic and fiscal stability, including high commodity prices, natural disasters, and the lingering sovereign debt challenges in the European Union and the United States. Despite the significant progress that has been made, there is little room for complacency. An important lesson from the recent experience is that policy-based programs can help sustain the political appetite for reforms, even during difficult times. Notably, in the Cook Islands, Samoa, Solomon Islands, and Tonga, extensive SOE and infrastructure governance improvements were implemented during an economic recession and in election years. Indeed, in countries where there were changes in government, commitment to the programs has been sustained.

The fiscal reform agenda also looms large, particularly for those economies with high levels of public debt.

Policy-based programs can help Pacific developing member countries address the variety of challenges they face.

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Box 4: Program Modalities: Fixed or Responsive Triggers?

Previous policy-based programs released budget support in multiple tranches. Once a program was in place, the release of funds was based on future performance against the predefined policy actions of follow-on tranches. The issue often faced was whether funds could be released on anything other than full compliance of all the actions of a tranche. The release of funds was often held back even when policy actions were delayed by factors beyond the control of governments, or when the overall spirit of the reforms had been followed but some actions were nonetheless incomplete (e.g., when some actions had been surpassed while arguably less critical actions had not been achieved in full).

Most economic recovery support programs employed a cluster approach that established two subprograms. The first funding release was made only after completion of the first subprogram actions. Triggers were also set upfront to define the policy actions that would allow the release of funds under the second subprogram. But flexibility was provided to revise the policy actions of the second subprogram, so long as the overall intent of the program was met. This allowed for the incorporation of new actions, such as those that may not have been envisaged when the triggers were developed. It also provided the flexibility to accommodate a rebalancing of policy priorities by governments.

One of the key issues to be faced in making improvements to economic and fiscal management in the Pacific islands is the need to work within existing capacity, particularly in the line ministries that implement policy actions. Good intent can often overextend capacity, particularly if many actions are tackled simultaneously. The flexibility offered by the cluster approach has proved to be an effective way to accommodate this issue while still ensuring that the intent of reforms was fully met.