South Pacific economies

The South Pacific economies of the Cook Islands, Samoa, and Tonga all grew in 2018. The Cook Islands expanded strongly on record visitor arrivals. Samoa also saw strong growth in visitor arrivals but slower GDP growth because of substantial declines in manufacturing and fishing. Tonga was severely affected by Cyclone Gita in February. South Pacific economies must keep tourism sustainable to ensure that this remains an important source of growth into the future.

Economic performance

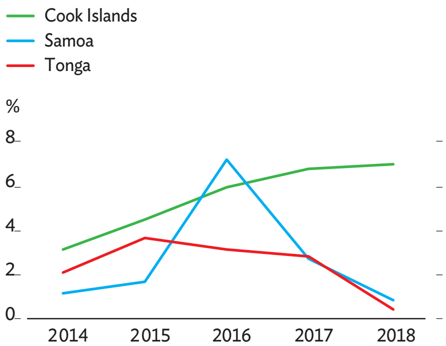
The Cook Islands economy grew by 7.0% in fiscal year 2018 (FY2018, ended 30 June 2018), supported by continued strong growth in tourism (Figure 3.38.1). Visitor arrivals increased by 6.2% with a notable 23.4% increase from Canada and 23.7% from French Polynesia. Benefiting from expansion in tourism were related sectors: retail trade, hotels and restaurants, and transport and communications. Aside from these sectors, the implementation of projects for renewable energy on outer islands and water supply and sanitation pushed growth in construction to 25.0%. Small declines were recorded in fishing, finance, and health care.

Growth in Samoa at 0.9% in FY2018 was considerably slower as a large manufacturing enterprise closed and fishing declined. A steep fall in nonfood manufacturing was, however, offset by growth in hotels and restaurants, construction, and communications and business services. Visitor arrivals grew by 11.5%, a sixfold improvement on average annual tourism growth in FY2010–FY2017 at 1.9%. Agriculture, transport, and finance all declined.

The vulnerability of Tonga to disasters was evident from damage inflicted on the economy by Cyclone Gita in February 2018. The destruction of crops, public infrastructure, and buildings limited growth to 0.4% in FY2018, well below the 3.2% average posted from FY2015 to FY2017. Only rapid recovery efforts soon after the cyclone saved the Tongan economy from contraction.

In the Cook Islands, prices rose in FY2018 by 0.4% as increases for food and transportation more than offset falling prices for housing and household operation (Figure 3.38.2).

3.38.1 GDP growth in the South Pacific economies



Note: Years are fiscal years ending on 30 June of that year.
Sources: Cook Islands Ministry of Finance & Economic Management; Samoa Bureau of Statistics; Tonga Department of Statistics; ADB estimates.

This chapter was written by Shiu Raj Singh of the Pacific Subregional Office, ADB, Suva; and Noel Del Castillo, consultant, Pacific Department, ADB, Manila.

In Samoa, higher domestic and import prices in FY2018 pushed inflation to 3.7%, with substantially higher prices for food and nonalcoholic beverages and for education and lesser rises for alcoholic beverages and for transport and communications. Somewhat offsetting these higher prices were price declines for housing and household operation. Tonga's inflation averaged higher by 5.3% in FY2018, with food prices increasing substantially as a result of the damage and losses caused by Cyclone Gita. Contributing to inflation were higher prices for transportation and beverages, including kava, a local relaxant.

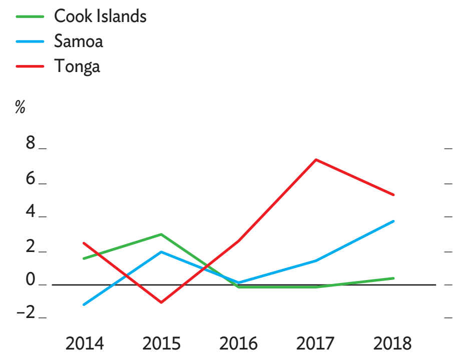
The Cook Islands' fiscal surplus shrank by more than half from the equivalent of 9.2% of GDP in FY2017 to 4.1% a year later. Although revenue increased in FY2018, even higher operating and capital expenditure narrowed the surplus. Net public debt, all of it external, fell from the equivalent of 17.3% of GDP in FY2017 to 16.8% only because of strong GDP growth, as debt was higher in nominal terms. In any case, debt remains comfortably below the government ceiling of 35% of GDP. The government maintained a debt-service reserve equal to 3.6% of GDP in FY2018 and held additional cash reserves equal to 20.6% of GDP.

Samoa had a small fiscal surplus in FY2018, reversing a deficit equal to 1.1% of GDP in FY2017. This first surplus in 9 years was achieved through rigorous expenditure control and higher external grants received after the International Monetary Fund assessed Samoa to be at high risk of debt distress because of its exposure to disasters. At the end of FY2018, external debt equaled 49.4% of GDP, slightly higher than a year earlier because exchange rate movements were unfavorable and contracted loans continued to be disbursed for ongoing projects.

Tonga's fiscal balance ended FY2018 in a surplus equal to 1.6% of GDP as budget support from development partners, and the postponement of investment projects following Cyclone Gita, more than offset higher spending on emergency response and rehabilitation. External debt increased from the equivalent of 39.5% of GDP at the end of FY2017 to 41.8% a year later.

The Cook Islands updated and substantially revised in FY2018 data on the balance of payments. The result was sharply lower estimates for past current account surpluses, which followed from revised estimates for tourism inflows. The surplus in FY2017 was revised down from the equivalent of 25.5% of GDP to 1.6%, rising in FY2018 to 2.2% on a higher surplus in trade in services. In Samoa, a current account surplus equal to 4.7% of GDP in FY2018 reversed a 1.8% deficit in the previous year thanks to strong growth in visitor arrivals and a 24.3% increase in remittances. In Tonga, higher imports offset huge grant flows from development partners for cyclone relief to narrow the current account surplus to the equivalent

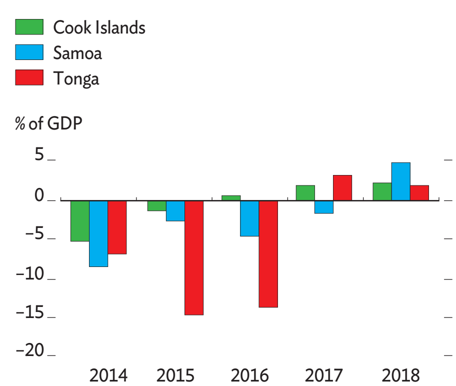
3.38.2 Inflation



Note: Years are fiscal years ending on 30 June of that year.

Sources: Cook Islands Ministry of Finance & Economic Management; Samoa Bureau of Statistics; Tonga Department of Statistics; ADB estimates.

3.38.3 Current account balance



Note: Years are fiscal years ending on 30 June of that year.

Sources: Cook Islands Ministry of Finance & Economic Management; Samoa Bureau of Statistics; Tonga Department of Statistics; ADB estimates.

of 1.8% of GDP in FY2018 (Figure 3.38.3). Meanwhile, remittances remained robust as Tongans living overseas provided support to their families back home, particularly after the disaster, with inward private transfers rising by 8.9%.

Economic prospects

Growth is seen to moderate in the Cook Islands and pick up in Samoa and Tonga during the forecast period.

The Cook Islands economy is projected to grow by 6.0% in FY2019. Tourism and large infrastructure projects for water supply and sanitation, renewable energy, and improved internet connectivity will continue to contribute significantly to economic expansion. Growth is projected to slow further in FY2020 as tourism is constrained by low availability of accommodation.

In Samoa, growth is expected to accelerate in FY2019, driven up as higher visitor arrivals boost growth in commerce, hotels, transport, and other activities ancillary to tourism. Growth is forecast to increase further to 3.0% in FY2020 on continued growth in tourism but also strengthening growth in communications. The 2019 Pacific Games, which Samoa will host in July 2019, are expected to provide further impetus.

Following slow growth in FY2018 as a result of losses from Cyclone Gita, Tonga is expected to enjoy higher economic growth in FY2019 and FY2020 thanks to reconstruction and infrastructure projects in the pipeline.

Inflation expectations are mixed across the three economies in the forecast period. Prices are seen to grow by 1.0% in the Cook Islands and 2.0% in Samoa in FY2019, and inflation in both will converge at 1.5% in FY2020 as higher global food prices affect these import-dependent island economies. In Tonga, inflation is expected to continue to hover at 5.3% in both FY2019 and FY2020 as the government ramps up construction projects.

The Government of the Cook Islands projects a fiscal deficit equal to 1.9% of GDP in FY2019 to pay for an ambitious investment plan for water supply, renewable energy, and communications (Figure 3.38.4). In FY2020, these projects will have progressed substantially, so a surplus equal to 1.0% of GDP is projected. With improved tax collection and a growing economy, the government does not intend to finance projects with loans except when it needs technical assistance for implementation. Continued economic growth and available cash balances should keep net public debt below target. Cash reserves are expected to continue rising over the forecast years.

Samoa's fiscal deficit is budgeted to equal 3.5% of GDP in both FY2019 and FY2020, in line with the government's fiscal strategy to stimulate the economy with expansionary fiscal and

3.38.1 Selected economic indicators (%)

Cook Islands	2019	2020
GDP growth	6.0	4.5
Inflation	1.0	1.5
Current account balance (share of GDP)	2.8	3.4
Samoa		
GDP growth	2.0	3.0
Inflation	2.0	1.5
Current account balance (share of GDP)	–3.5	–3.0
Tonga		
GDP growth	2.1	1.9
Inflation	5.3	5.3
Current account balance (share of GDP)	–12.2	–11.2

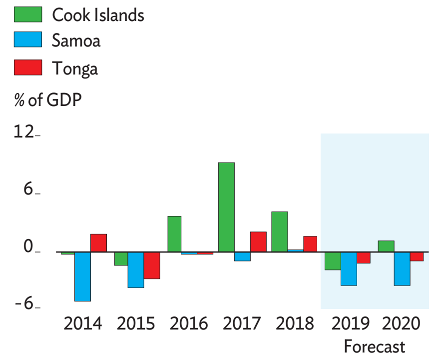
Note: Years are fiscal years ending in 30 June of that year.
Source: ADB estimates.

monetary policies. Meanwhile, it intends to keep its focus on revenue collection through measures to improve compliance.

Tonga is forecast to post a deficit in both FY2019 and FY2020 on increased spending on infrastructure and reconstruction, which are expected to remain substantial components of expenditure. Higher projected tax revenue in FY2020 is expected to narrow the fiscal deficit slightly.

Cook Islands current account surpluses are expected to expand to the equivalent of 2.8% of GDP in FY2019 and 3.4% in FY2020. Growing tourism earnings are likely to offset higher imports of goods and services for public investment projects implemented during the period. Samoa's current account is expected to fall into deficit equal to 3.5% of GDP in FY2019, in part because of imports for the 2019 Pacific Games, the deficit easing to 3.0% in FY2020. Increased imports of goods for reconstruction are projected to push Tonga's current account into deficit in FY2019. The deficit is expected to persist in FY2020 with the forecast resurgence in global food prices.

3.38.4 Fiscal balance



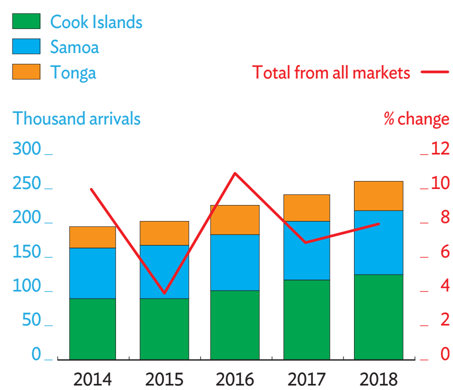
Note: Years are fiscal years ending on 30 June of that year.
Sources: Cook Islands Ministry of Finance & Economic Management; Samoa Ministry of Finance; Tonga Ministry of Finance and National Planning.

Policy challenge—ensuring sustainable growth in tourism

The South Pacific economies depend on tourism to drive economic growth (Figure 3.38.5). Cook Islands exports of services, largely tourism receipts, provided 49.6% of GDP on average from FY2012 to FY2018. Growth in the Cook Islands economy mirrors visitor arrivals. In Samoa as well, tourism is growing in importance despite challenges encountered in the aftermath of a tsunami in September 2009. Tourism earnings in Samoa averaged 18.1% of GDP from FY2012 to FY2018, the latter of which was a record year for tourism in Samoa with earnings rising to 20.6% of GDP. The contribution of tourism in Tonga has grown steadily, albeit from a small base of only 7.0% in FY2010, reaching 11.5% in FY2017. All three economies face similar issues in their tourism industries: First is a need to improve infrastructure to ensure that the benefits of tourism spread across the country. Second is to ensure that infrastructure for tourism is sufficiently resilient, able to withstand the cyclones to which these economies are prone. Third is to keep tourism environmentally friendly and sustainable.

Tourism is constrained in the South Pacific economies by underdeveloped infrastructure, which confines and concentrates these industries in accessible areas. Consideration should be given to policies that use infrastructure development to encourage industry diversification. Appropriate infrastructure development will catalyze private sector investment as it is attracted to new locations around the country. The Cook Islands in particular

3.38.5 Visitor arrivals from Australia and New Zealand to the South Pacific



Note: Years are fiscal years ending on 30 June of that year.
Sources: Australian Bureau of Statistics; Statistics New Zealand.

is in a favorable fiscal position to support infrastructure development to spread tourism to outer islands. Samoa and Tonga should incorporate facilitative infrastructure investments in their longer-term tourism development plans.

Although diversification supports resilience in industry, long-term sustainability across the South Pacific economies demands additional considerations, notably factoring disaster resilience into investments in buildings and other infrastructure. The Cook Islands has not had a major disaster recently, but Samoa struggled to expand its tourism industry after the 2009 tsunami, which pushed earnings to as low as the equivalent of 16.6% of GDP in the years that followed. This highlights the country's vulnerability to natural disasters and the need for tourism to remain sustainable over the long run. Tourism was the industry second most affected in Tonga after the onslaught of Cyclone Gita. The government intends to adopt the policy in its reconstruction and recovery plan to "build back better" with the emphasis on resilient physical infrastructure.

The growing importance of tourism and its expanding scale mean that its environmental and social impacts should not be overlooked. Here, too, there is a need to embrace opportunities for sustainability. Governments can consider enhancing legislation to better address issues that threaten the sustainability of the tourism industry and policies promoting sustainable tourism practices. The Vava'u island group in Tonga, for example, is one of the country's popular destinations, well known for watching whales and swimming with them. While the government has passed laws regulating these activities, rising demand has greatly increased the number of whale-watching operators. Industry leaders have expressed concern over the increase in activity as noise and other environmental pollutants adversely affect whale populations.