



# Pacific Island Economies

Christopher Browne

INTERNATIONAL MONETARY FUND

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# Contents

Foreword . . . . .	v
Acknowledgments . . . . .	vii
Abbreviations . . . . .	ix
<b>Part I. Regional Issues</b>	
1. Overview of Regional Economic Performance and Prospects . . . . .	3
2. Public Sector Activities . . . . .	12
3. Private Sector Development . . . . .	21
4. The Pacific Plan for Strengthening Regional Cooperation and Integration . . . . .	30
5. Remittances and Migration . . . . .	37
6. The Pacific Islands and the Eastern Caribbean Currency Union: A Comparative Review . . . . .	42
7. Options for Alternative Exchange Rate Arrangements . . . .	56
<b>Part II. Country Notes</b>	
8. Fiji . . . . .	69
9. Kiribati . . . . .	78
10. Marshall Islands . . . . .	89
11. Micronesia . . . . .	99
12. Palau . . . . .	111
13. Papua New Guinea . . . . .	121
14. Samoa . . . . .	133
15. Solomon Islands . . . . .	143
16. Tonga . . . . .	154
17. Vanuatu . . . . .	163

The following conventions are used in this publication:

In tables, a blank cell indicates “not applicable,” ellipsis points (. . .) indicate “not available,” and 0 or 0.0 indicates “zero” or “negligible.” Minor discrepancies between sums of constituent figures and totals are due to rounding.

An en dash (–) between years or months (for example, 2005–06 or January–June) indicates the years or months covered, including the beginning and ending years or months; a slash or virgule (/) between years or months (for example, 2005/06) indicates a fiscal or financial year, as does the abbreviation FY (for example, FY2006).

“Billion” means a thousand million; “trillion” means a thousand billion.

As used in this publication, the term “country” does not in all cases refer to a territorial entity that is a state as understood by international law and practice. As used here, the term also covers some territorial entities that are not states but for which statistical data are maintained on a separate and independent basis.

# Foreword

The Pacific island region has considerable potential for development, especially in the areas of tourism, fisheries, forestry, mining, and agriculture. With these resources and the continued substantial economic assistance from donors that is expected, it is certainly feasible to lift these countries' medium-term economic growth record, improve human development indicators, and reduce poverty. Experience since independence demonstrates that the traditional way of life can be preserved, even while the processes of development create modern institutions and help to meet changing aspirations.

The Pacific island countries face many challenges in developing their economies and raising living standards, including their small size, distance from major markets, and vulnerability to natural disasters. Successfully overcoming these challenges will require the continuation of macro-economic stability and increased emphasis on the structural reforms to which island governments are committed, including improved public sector efficiency and greater private sector activity. While recognizing that important economic, political, and cultural differences exist between the islands, there are a range of policy recommendations that are widely applicable throughout the region.

The International Monetary Fund has for many years enjoyed regular, open, and fruitful discussions on economic policy with all the member countries in the region. This dialogue is now being intensified through more frequent staff visits. The islands have made only limited use of IMF resources in the past, but financial support can always be considered when needed.

The IMF will also continue to play a key role in providing technical assistance to the region, particularly through the Pacific Financial Technical Assistance Center (PFTAC). This institution is located in Suva, Fiji, and serves 15 Pacific island countries: Cook Islands, Federated States of Micronesia, Fiji, Kiribati, Marshall Islands, Nauru, Niue, Palau, Papua New Guinea, Samoa, Solomon Islands, Tokelau, Tonga, Tuvalu, and Vanuatu. It is funded by the Asian Development Bank, Australia, the IMF, Japan, the Republic of Korea, and New Zealand.

This book provides an assessment of regional issues that are currently being addressed by economic policymakers. The country-specific chapters, which comprise the second half of the book, provide in each case a broad overview of the main factors affecting the countries' individual economic performance since independence and the main challenges that lie ahead.

David Burton  
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# Acknowledgments

This volume is a collective effort, authored by economists of the IMF's Asia and Pacific Department (APD) who have worked on Pacific Island countries. The project was conducted under the general guidance of Christopher Browne, Assistant Director, APD, who authored several chapters and reviewed the remaining chapters. Steven Dunaway, Deputy Director of APD, provided helpful comments. Fritz R. Pierre-Louis from APD finalized the charts and tables. We are particularly grateful to Linda Griffin Kean of the IMF's External Relations Department, who edited the manuscript and coordinated production of the book.

The views expressed are those of the authors and do not necessarily reflect those of the IMF, its Executive Board, or its management.



# Abbreviations

ADB	Asian Development Bank
AML	anti–money laundering
AML/CFT	anti–money laundering and combating the financing of terrorism
BCBS	Basel Committee on Banking Supervision
CARICOM	Caribbean Community and Common Market
CCQG	Council on the Cost and Quality of Government
CET	common external tariff
CFT	combating the financing of terrorism
Compact I	original Compact of Free Association with the United States, 1987–2003 (Marshall Islands, Micronesia, and Palau)
Compact II	renewed Compact of Free Association with the United States, 2004–23 (Marshall Islands, Micronesia, and Palau)
ECCU	Eastern Caribbean Currency Union
ECTEL	Eastern Caribbean Telecommunications Authority
EEZ	exclusive economic zone
EMU	European Monetary Union
EPA	Economic Partnership Agreement (with the European Union)
EU	European Union
FATF	Financial Action Task Force on Money Laundering
FDI	foreign direct investment
FDIC	Federal Deposit Insurance Corporation (United States)
FORSEC	Pacific Islands Forum Secretariat
FSM	Federated States of Micronesia
GDP	gross domestic product
IDA	International Development Association (World Bank)
IMF	International Monetary Fund
MDGs	Millennium Development Goals
PACER	Pacific Agreement on Closer Economic Relations

PIC	Pacific island country
PICTA	Pacific Island Countries Trade Agreement
The Plan	Pacific Plan for Strengthening Regional Cooperation and Integration
PNG	Papua New Guinea
PPAC	Pacific Plan Action Committee
RAMSI	Regional Assistance Mission to the Solomon Islands
RERF	Revenue Equalization Reserve Fund (Kiribati)
RMI	Republic of the Marshall Islands
RTFP	Regional Trade Facilitation Program
SI	Solomon Islands
UN	United Nations
VAGST	value-added tax on goods and services
VAT	value-added tax
WTO	World Trade Organization

# I

## REGIONAL ISSUES

# Overview of Regional Economic Performance and Prospects

CHRISTOPHER BROWNE

The island countries of the Pacific region face many challenges in developing their economies and raising living standards over the medium term.<sup>1</sup> Most of these countries enjoyed generally favorable domestic and external conditions at the time of their independence in the 1970s and 1980s, but more recently have faced an increasing number of macroeconomic hurdles. For all countries in the region, these include slower economic growth, increased poverty, heightened governance concerns, lack of private sector activity, limited regional integration (including of labor markets), and questions about aid effectiveness. In several parts of the region, there are additional concerns about a lack of fiscal discipline and potential political uncertainties.

There have been some notable achievements since 2003. Solomon Islands continues to achieve good progress in building on the positive impact of the intervention in 2003 by the Regional Assistance Mission to the Solomon Islands (RAMSI). Papua New Guinea has raised official external reserves to historically high levels through macro stability and higher oil and mineral export prices, and the government appears likely to complete its full term in 2007. Fiji is enjoying strong tourism growth, which helps to offset the loss of textile markets and the potential loss of sugar markets in 2007. Samoa, Tonga, and Vanuatu are receiving more reliable airline service through a partnership with an Australian airline. Marshall Islands and Micronesia are successfully implementing the renewed Compact of Free Association with the United States (Compact II), which runs through 2023.

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<sup>1</sup>The 10 Pacific island IMF member countries are Fiji, Kiribati, Republic of the Marshall Islands (RMI), Federated States of Micronesia (FSM), Palau, Papua New Guinea (PNG), Samoa, Solomon Islands (SI), Tonga, and Vanuatu.

Perhaps the most positive sign was the final approval by Pacific Forum leaders at their meeting in Papua New Guinea in October 2005 of the Pacific Plan, an ambitious strategy to strengthen regional cooperation and integration over the next 10 years (the Plan is outlined in Chapter 4). It was prepared by the Pacific Islands Forum Secretariat, with the strong endorsement of Australia and New Zealand, and addresses most priority needs, including the need to promote the private sector, strengthen public enterprise reforms, address corruption and law-and-order problems, and encourage integration and trade liberalization. The overall emphasis is on the importance of structural reforms, which is welcome. Of course, the key to the Plan's success will be the pace of its implementation, which depends on the support of Pacific island countries, civil society and private sector organizations, development partners, and other stakeholders for regional approaches to addressing the region's existing capacity constraints and lack of economic opportunities. Regionalism under the Plan does not imply any limitations on national sovereignty. The main objective is to support and complement national programs, not to replace them.

There will be close monitoring and evaluation by the Pacific Islands Forum Secretariat of implementation of the Plan's initiatives. Detailed indicators have been incorporated into the Plan to measure progress during the first three years. The initiatives proposed for this initial period relate to encouraging development of National Sustainable Development Strategies; promoting good governance through transparent, accountable, and equitable management of all resources, assisted by the establishment of anticorruption institutions; strengthening infrastructure, especially in telecommunications and transport; enhancing regional integration in trade and labor markets; and increasing security through safer social and political conditions.

While these initiatives are encouraging, the challenges remain formidable, especially to achieving the goal of faster, sustainable economic development. The region has clearly experienced relatively low growth performance, although it is also evident that inflation has been less serious than in other developing country regions (Table 1.1). Some worrying fiscal deficits have been brought under control, most notably in Papua New Guinea and Solomon Islands, but insufficient public expenditure control, transparency, and accountability remain of concern in many countries. On the external front, the countries of the region have largely avoided balance of payments and debt problems, in part with the help of generous aid receipts. Exchange rate policies have been generally appropriate, with basket pegs or dollarization, except for the floating regime in Papua New Guinea.

Nevertheless, current conditions fall far short of what is needed to secure the medium-term growth objective. In particular, the authorities of

Table 1.1. Selected Indicators for Pacific Island Countries<sup>1</sup>

	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
	Real GDP (percent change)												
Fiji	2.6	5.1	2.5	4.7	-2.3	1.2	9.2	-2.8	2.7	4.3	3.0	4.1	2.1
Kiribati	1.5	8.4	5.2	3.8	1.9	12.6	9.5	1.6	1.9	-4.2	2.2	-1.4	0.3
Marshall Islands	2.5	3.9	3.8	-13.9	-11.5	-1.8	0.6	0.9	5.5	4.0	1.8	0.4	3.5
Micronesia	6.7	2.0	1.6	-5.1	-6.1	-0.7	-3.1	9.1	—	1.7	4.2	-3.5	1.3
Palau	-9.1	2.6	10.0	10.5	4.3	2.2	-3.4	0.2	1.3	-3.5	-1.3	4.9	5.5
Papua New Guinea	18.2	5.9	-3.3	7.7	-3.9	-3.8	7.6	-1.2	-0.1	-0.2	2.9	2.9	3.0
Samoa	5.3	6.4	6.6	7.3	0.8	1.1	2.1	6.1	7.1	4.4	1.8	3.5	4.0
Solomon Islands	4.0	9.2	8.2	1.6	-1.4	1.8	-0.5	-14.3	-9.0	-2.4	5.6	5.5	4.4
Tonga	3.7	4.3	4.6	0.3	-3.0	3.6	2.3	5.6	1.8	2.1	2.9	1.5	2.5
Vanuatu	4.5	1.3	7.4	2.5	8.6	4.3	-3.2	2.7	-2.7	-4.6	2.4	4.0	3.0
	Consumer prices (percent change)												
Fiji	5.2	0.6	2.2	4.9	3.4	5.9	2.0	1.1	4.3	0.8	4.2	2.8	3.7
Kiribati (end of period)	6.1	4.0	4.1	-1.5	2.2	4.7	0.4	1.0	7.3	1.1	1.6	-0.6	0.5
Marshall Islands	7.6	4.9	6.8	10.5	5.8	2.9	1.9	0.9	1.8	-0.4	-0.9	2.0	3.5
Micronesia	3.0	2.6	2.8	2.8	2.7	1.6	1.9	2.0	1.3	-0.1	-0.2	2.0	3.5
Palau	3.0	2.6	2.8	2.9	2.3	1.6	2.2	3.0	0.8	-1.2	-0.6	5.8	2.7
Papua New Guinea	5.0	2.9	17.3	11.6	3.9	13.6	14.9	15.6	9.3	11.8	14.7	2.1	2.8
Samoa (end of period)	1.7	12.1	-2.9	5.4	6.9	4.1	-0.6	2.7	1.1	9.8	1.6	17.2	-2.9
Solomon Islands	9.2	13.1	9.8	11.8	8.0	12.3	8.0	6.9	7.6	9.4	10.1	6.9	6.6
Tonga	1.8	3.9	-0.5	2.7	2.0	3.0	3.9	5.3	6.9	10.4	11.1	11.8	9.9
Vanuatu	3.6	2.3	2.2	0.9	2.8	3.3	2.2	2.5	3.7	2.0	3.0	1.4	1.0
	Central government balances (in percent of GDP) <sup>2</sup>												
Fiji	-4.7	-2.6	-1.7	-2.8	-4.0	-4.0	-1.2	-3.2	-6.5	-7.0	-6.0	-3.3	-3.8
Kiribati	0.4	-1.5	-10.2	-35.9	6.4	18.7	-5.8	-2.0	-17.0	-0.6	-31.9	-42.8	-22.6
Marshall Islands	...	...	-21.3	18.5	9.1	15.5	10.6	9.2	8.2	-4.0	11.0	-0.4	-2.1
Micronesia	-4.6	-0.3	-1.5	0.2	0.4	-7.1	-8.2	-6.7	-8.9	6.8	7.9	-4.8	-3.2
Palau	-0.3	-0.5	105.4	-10.3	-16.8	-0.1	-18.0	-15.6	-20.3	-28.3	-2.4	-6.9	-3.9
Papua New Guinea	-6.0	0.1	-1.3	-3.4	-3.6	-0.4	-4.5	-1.3	-3.9	-5.3	-1.6	1.1	1.9
Samoa	-12.8	-7.8	-2.9	0.9	1.0	2.0	0.3	-0.7	-2.3	-2.1	-0.6	-0.9	-0.6

Table 1.1 (continued)

	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Solomon Islands	...	...	-4.8	-3.9	-4.3	1.0	-3.3	-7.8	-12.7	-11.0	-1.9	8.3	-0.5
Tonga	...	...	-3.6	0.9	-4.8	-2.3	-0.2	-0.3	-1.5	-1.5	-3.1	1.3	0.1
Vanuatu	-3.8	-1.6	-2.8	-1.9	-0.5	-6.7	-0.6	-7.0	-3.7	-4.1	-1.7	0.9	1.0
	Central government revenue and grants (in percent of GDP) <sup>2</sup>												
Fiji	24.5	24.9	24.4	23.9	24.6	24.5	25.1	24.2	22.1	24.6	25.1	25.8	25.8
Kiribati	99.1	90.8	93.6	75.7	125.6	135.5	105.8	98.9	118.4	138.7	139.2	106.2	123.2
Marshall Islands	...	...	73.9	80.5	74.6	74.7	67.6	75.2	70.1	64.2	65.0	56.2	58.1
Micronesia	82.5	81.5	81.9	80.2	70.9	76.6	76.6	68.5	64.2	71.8	71.8	53.7	51.0
Palau	63.7	60.8	178.8	59.4	49.6	59.1	41.8	52.6	43.1	42.4	54.0	54.3	53.6
Papua New Guinea	27.4	27.6	28.1	28.4	31.6	29.2	28.8	31.2	29.7	27.8	28.2	31.1	28.1
Samoa	44.4	42.2	47.6	46.8	39.5	36.1	40.0	34.4	31.9	33.8	32.8	32.5	40.0
Solomon Islands	...	...	35.6	34.7	28.9	29.0	27.0	22.1	23.5	18.8	37.6	48.9	48.5
Tonga	...	...	43.8	31.7	31.5	28.4	24.6	26.4	27.5	29.9	27.3	27.5	26.0
Vanuatu	23.1	24.9	27.8	24.8	23.1	21.8	25.8	22.1	20.9	21.0	20.1	21.9	22.2
	Central government expenditure and net lending (in percent of GDP) <sup>2</sup>												
Fiji	29.2	27.5	26.1	26.7	28.6	28.5	26.3	27.4	28.6	31.6	31.1	29.1	29.6
Kiribati	98.8	92.3	103.8	111.7	119.2	116.7	111.6	100.9	135.4	139.3	171.0	149.0	145.8
Marshall Islands	...	...	95.2	62.0	65.5	59.2	57.1	66.0	61.9	68.2	54.0	56.6	60.2
Micronesia	87.0	81.8	83.3	80.0	70.5	83.8	84.8	75.2	73.1	65.0	63.8	58.6	54.2
Palau	60.1	61.7	70.7	72.1	68.8	55.9	63.0	72.8	64.6	66.3	62.6	61.7	54.2
Papua New Guinea	36.3	30.6	27.7	26.7	32.2	30.9	33.4	32.3	33.2	31.8	29.4	29.6	26.2
Samoa	57.1	50.0	52.5	45.9	38.3	34.1	39.6	35.1	34.3	35.9	33.4	33.4	40.6
Solomon Islands	...	...	40.4	38.6	33.2	28.0	30.3	29.9	36.2	29.8	39.5	40.6	49.0
Tonga	...	...	47.4	30.7	36.3	30.7	24.8	26.8	29.0	31.3	30.4	26.2	25.8
Vanuatu	26.8	26.5	30.6	26.7	23.7	28.4	26.4	29.0	24.6	25.0	21.8	21.0	21.2



**Table 1.1 (concluded)**

	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
	Exchange rates (national currency per US\$, period average) <sup>3</sup>												
Fiji (F\$)	1.54	1.46	1.41	1.40	1.44	1.99	1.97	2.12	2.28	2.18	1.89	1.73	1.68
Kiribati (\$A)	1.47	1.37	1.35	1.28	1.34	1.59	1.55	1.72	1.93	1.84	1.53	1.36	1.30
Marshall Islands (US\$)	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Micronesia (US\$)	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Palau (US\$)	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Papua New Guinea (K)	0.98	1.01	1.28	1.32	1.44	2.06	2.54	2.76	3.37	3.88	3.54	3.22	3.10
Samoa (SAT)	2.57	2.53	2.47	2.46	2.56	2.77	3.02	3.11	3.44	3.47	3.19	2.86	2.70
Solomon Islands (SI\$)	3.19	3.29	3.41	3.57	4.75	4.82	4.84	5.10	5.56	7.46	7.49	7.51	7.52
Tonga (T\$)	1.37	1.37	1.28	1.26	1.23	1.35	1.58	1.64	1.97	2.18	2.19	2.04	1.94
Vanuatu (VT)	121.58	116.41	112.11	111.72	115.87	127.52	129.08	137.64	145.31	139.10	122.20	111.90	109.05

Sources: National authorities; IMF, International Financial Statistics; and IMF staff estimates and projections.

<sup>1</sup>Marshall Islands, Federated States of Micronesia, and Palau—fiscal year ending September 30; Samoa and Tonga—fiscal year ending June 30; fiscal year data are shown in the ending calendar year.

<sup>2</sup>Micronesia: consolidated government. Palau: balance figures do not include errors and omissions.

<sup>3</sup>Figures in 2005 are as of end-October.

all countries must make a much greater commitment to accelerate structural reforms in order to improve public sector efficiency, create private sector employment opportunities, and alleviate poverty. Samoa is the most advanced in the reform process, which has been under way there for the past decade, and the benefits are now increasingly evident in higher investment, including foreign direct investment. Fiji is also attracting considerable foreign investment in the tourism sector. However, in most other parts of the region, there has been minimal interest in investment from abroad because of highly cumbersome and restrictive administrative regulations.

The regional approach of the Pacific Plan is appropriate for assisting the Pacific island countries in overcoming many of these challenges, because these countries continue to share many economic characteristics. They are all small in terms of GDP and population (see Table 1.2). They have narrow productive sectors based on primary commodities, with little diversification into manufacturing. Fiscal pressures limit the effectiveness of monetary policy. They have few export products, high import penetration shares, and are vulnerable to terms of trade fluctuations. They are also subject to frequent natural disasters, especially typhoons. Most of the countries have now prepared their own medium-term development strategies, which incorporate measures to promote fiscal consolidation and lower public debt burdens, to introduce more modern monetary policy frameworks, to ensure sound financial systems, and to create more favorable business climates. However, there is an urgent need to incorporate into these national plans more specific and integrated policy advice, including to ensure their consistency with medium-term fiscal strategies. The regional approach can help some of these countries overcome any lack of technical skills and institutional capacity to formulate and implement appropriate economic and financial policies.

The remaining chapters in this book examine in more detail some of the regional and country-specific challenges to achieving faster and sustainable economic growth. The book comprises two parts. Part I covers a number of pressing regional issues. Chapter 2 reviews the past dominance of the public sector in the countries of the region and the revenue and public expenditure management reforms that will be required to address the resultant fiscal pressures. Chapter 3 assesses the limited role of the private sector in the region and outlines a number of measures to reduce impediments to developing modern market economies and thereby achieving faster rates of growth. As noted, Chapter 4 examines the Pacific Plan, particularly the initiatives to promote growth, sustainable development, good governance, and security, as well as the mechanisms for monitoring

**Table 1.2. Pacific Island Countries: Basic Economic and Social Characteristics**

	Population (Thousands)	Area (In thousands of square kilometers)	Year of Independence	Year of Fund Membership	Institutional Inheritance	Main Regional Link
Fiji	840	18.3	1970	1971	United Kingdom	Australia
Kiribati	90	0.7	1971	1986	United Kingdom	Australia
Marshall Islands	58	0.2	1986	1992	United States	United States
Micronesia	108	0.7	1986	1993	United States	United States
Palau	20	0.5	1994	1997	United States	United States
Papua New Guinea	5,600	461.7	1975	1975	Australia	Australia
Samoa	181	2.8	1962	1971	New Zealand	New Zealand
Solomon Islands	471	28.0	1978	1978	United Kingdom	Australia
Tonga	101	0.7	1970	1985	United Kingdom	New Zealand
Vanuatu	215	12.2	1980	1981	United Kingdom; France	Australia

  

	GDP (US\$ millions)	GDP per Capita (US\$)	IMF Quota (SDR millions)	Consultation Cycle (Months)	Main Current Receipts (Remittances from private sector)	Exchange Rate Regime
Fiji	2,624	2,195	70.3	24	Sugar textiles, tourism	Basket peg
Kiribati	66	751	5.6	24	Fish licenses, seamen remittances	Australian dollar
Marshall Islands	144	2,559	3.5	24	Remittances from United States	U.S. dollar
Micronesia	239	2,211	5.1	24	Remittances from United States	U.S. dollar
Palau	134	6,482	3.1	24	Tourism	U.S. dollar
Papua New Guinea	4,000	714	131.6	12	Oil, copper, gold, coffee, cocoa	Float
Samoa	316	1,672	11.6	24	Remittances from New Zealand	Basket peg
Solomon Islands	258	550	10.4	12	Timber, palm oil, fish	Basket peg
Tonga	165	1,629	6.9	12	Remittances from New Zealand	Basket peg
Vanuatu	317	1,493	17.0	24	Tourism	Basket peg

  

	Aid per Capita (U.S. dollars)	Life Expectancy (Years)	Infant Mortality (Per 1,000 live births)	Population Growth (Percent per annum)	Health Spending (Percent of GDP)	Education Spending (Percent of GDP)
Fiji	61	70	16	0.9	4.2	5.6
Kiribati	191	63	49	2.1	8.0	4.9
Marshall Islands	991	65	53	3.5	10.6	16.4
Micronesia	923	69	19	0.6	6.5	7.0
Palau	1,295	70	23	0.7	9.1	11.0
Papua New Guinea	40	57	69	2.1	4.3	2.3
Samoa	186	70	19	0.8	6.2	4.8
Solomon Islands	132	70	19	2.6	4.8	3.5
Tonga	270	71	15	0.4	6.9	5.0
Vanuatu	154	69	31	2.0	3.8	11.0

Sources: World Bank, 2005 World Development Indicators; United Nations Development Programme; and World Health Organization.

and evaluating implementation of the Plan. Chapter 5 outlines the economic issues related to migration and remittances from migrant workers, which in some countries represent a stable source of foreign exchange and play an important role in reducing the economic vulnerability of individuals. Chapter 6 compares the Pacific island economies with those of the developing island countries in the Eastern Caribbean Currency Union (ECCU), drawing lessons from the more successful development policies and experiences of the latter. Chapter 7 examines possible alternatives for exchange rate arrangements in the Pacific island countries, taking into account that their small size and open economies leave them vulnerable to external shocks. Chapters 8–17, which comprise Part II of the book, examine the specific economic and policy challenges facing the 10 IMF member countries in the region.