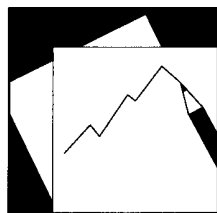


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IMF Working Paper

Are the Asia and Pacific Small States Different from Other Small States?

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IMF Working Paper

Asia and Pacific Department

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May 2013

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Abstract

The small states of the Asia and Pacific region face unique challenges in raising their growth potential and living standards relative to other small states due to their small populations, geographical isolation and dispersion, narrow export and production bases, exposure to shocks, and heavy reliance on aid. Higher fixed government costs, low access to credit by the private sector, and capacity constraints are also key challenges. The econometric analysis confirms that the Pacific Island Countries (PICs) have underperformed relative to their peers over the last 20 years. Although these countries often face more limited policy tools, policies do matter and can further help build resilience and raise potential growth, as evidenced in the recent business cycle. The Asia and Pacific small states should continue rebuilding buffers and improve the composition of public spending in order to foster inclusive growth. Regional solutions should also continue to be pursued.

JEL Classification Numbers: F15, F41, F42, F43, F47

Keywords: Asia and Pacific; small states; micro states, Pacific islands, growth, volatility

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¹ The authors would like to thank Peter Allum, Luis Breuer, Ian Davidoff, Sergei Dodzin, Romain Duval, Tubagus Feridhanusetyawan, Craig Fookes, Leni Hunter, Sonali Jain-Chandra, Fazurin Jamaludin, Nghi Luu, Koshy Mathai, Vance Martin, Brad McDonald, Shanaka Peiris, Alexander Pitt, Jack Ree, Neil Saker, Werner Schule, Niamh Sheridan, Shiu Singh, Olaf Unterroberdoerster, Yongzheng Yang, Akihiko Yoshida, the participants of the Small Islands Club at the IMF for their comments, and Hoe Ee Khor for his guidance throughout the project. Shari Boyce provided excellent editorial assistance.

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I. INTRODUCTION

The small states of the Asia and Pacific region face unique challenges in raising their growth potential and living standards. These countries are particularly vulnerable because of their small populations, geographical isolation and dispersion, narrow export and production bases, lack of economies of scale, limited access to international capital markets, exposure to shocks (including climate change), and heavy reliance on aid. In providing public services, they face higher fixed government costs relative to other states because public services must be provided regardless of their small population size. Low access to credit by the private sector is an impediment to inclusive growth. Capacity constraints are another key challenge. These challenges seem to be particularly acute in micro states (states with a population of less than 200,000 people). The small states of the Asia and Pacific region face higher volatility than other small states in several respects, specifically, per capita GDP growth, changes in the terms of trade, aid, current account balance, and revenue.

The econometric analysis confirms that the Pacific Island Countries (PICs) have underperformed relative to their peers over the last 20 years. After controlling for some standard variables that explain per capita GDP growth, PICs suffer a disadvantage in per capita GDP growth of about 2 percentage points, compared with an average small state.

The small states also face more limited policy tools. Five out of 13 countries do not have a central bank and the scope for diversifying their economies is narrow. Given their large development needs, fiscal policies have been, at times, pro-cyclical. Within the Asia-Pacific small states group, the micro states are subject to more vulnerability and macroeconomic volatility than the rest of the Asia-Pacific small states.

But policies do matter and they can further help build resilience and raise potential growth. Despite all these challenges, these countries have done slightly better than some comparators during the recent business cycle, thanks to sound policies and strong linkages with resilient economies in the region, and some small states in the region have made progress in building policy buffers. But growth rates have remained quite low. Going forward, given their high vulnerability to external shocks, these countries should continue rebuilding buffers and improve the composition of public spending with regard to education, health, and infrastructure in order to foster inclusive growth. The Asia and Pacific small states have enormous untapped marine resources and further effort is needed to properly exploit and manage them. Regional solutions should also continue to be pursued, mainly in fisheries, information technology, and aviation safety. Further integration with the Asia and Pacific region should help raise growth potential.

