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# Well-being from Work

in the Pacific Island Countries





World Bank East Asia and Pacific Regional Report

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# Well-being from Work in the Pacific Island Countries

## Introduction and summary

*In the Pacific island countries, which are small and far from world markets, labor mobility represents the most significant and substantial opportunity for overcoming geographic constraints on employment.*

This report presents a brief overview of employment challenges in small Pacific island countries and recommendations for addressing them. The report contributes to an ongoing World Bank analytical program examining the linkages between employment and well-being around the world, begun with the World Development Report 2013: Jobs (henceforth WDR2013: World Bank 2012b).

Discussion in this report relates to Pacific Island states, with populations of significantly less than one million, including Solomon Islands, Vanuatu, Samoa, Tonga, Tuvalu, Kiribati, Republic of Marshall Islands, Federated States of Micronesia, and Palau. Economic growth and diversification has been very limited in these countries because of the barriers imposed by smallness and distance, and these barriers will not be quickly overcome. Policy tweaks to the business environment aimed at fostering the

emergence of an export-oriented private sector are unlikely to be effective in generating substantial employment growth. The challenge for policy-makers is therefore to think about how to meet employment challenges within the formidable constraints imposed by geography.

Slow economic growth, population growth, and accelerating urbanization mean that employment creation is a pressing priority for small Pacific island countries. The appropriate employment strategy will vary between these countries, given their diversity in size, location, natural resource endowments, and demographics. Nevertheless, this report proposes five priorities that are likely to be broadly applicable to this unique group of countries.

First, stakeholders' expectations about the trajectory of development will need to be realistic. Due to inherent geographic obstacles, PICs are unlikely to experience export-driven development and associated employment creation on the scale seen in the broader East Asia Pacific region. While business environment reforms can open up new opportunities for private sector development and employment creation, such measures are unlikely to spur sufficient work to meet emerging demands even in the best

possible business environment. Employment strategies must therefore include less conventional policy options and focus on areas where PICs have established strengths and advantages.

Second, the volume of international labor mobility should be increased through the erosion of regulatory barriers and investment in transferable human capital. PICs will never be able to achieve the scale and integration seen in larger regional economies. The greatest potential for work is therefore through the movement of Pacific Islanders to areas where employment opportunities are concentrated. The priority for policy is to provide people from PICs with access to work wherever it exists. Echoing the conclusions of earlier World Bank reports (Luthria 2006), this will require both changes in the immigration policies of the nearest large economies and careful investment in internationally transferable human capital by small PIC governments.

Third, governments can work to harness the positive potential of urbanization through investment in improved rural services, connective infrastructure, and improved urban administration. Urbanization is a reality in most PICs and one that should be enthusiastically embraced. Urbanization accompanies development, allowing the realization of scale economies, greater thickness in markets, and increased specialization. Urbanization driven by these positive economic benefits should be facilitated. But urbanization occurring as a result of poor services in rural areas, conflict, food insecurity, or land shortages simply leads to congestion and urban unemployment, delivering few economic benefits and placing pressure on social cohesion. Policies should not be biased toward employment in either urban or rural areas, but rather should seek to ensure acceptable standards of living across all communities and allow individuals to respond as they choose to the inevitable concentration of economic opportunities in

urban areas. This will require (1) movement away from policies aimed at preventing urbanization, such as inadequate legal protection for recent arrivals in urban areas, underprovision of peri-urban services and infrastructure, and production subsidies for rural areas; (2) sufficient public investment in infrastructure links between agricultural areas and urban areas; (3) improved land administration and increased investment in services in urban areas; and (4) interventions to assist agricultural productivity and support rural services and standards of living.

Fourth, productive public spending can be used as a mechanism for creating new employment opportunities. Large public sectors in PICs are often a source of concern, with public sector employment thought to exist at the expense of increased private sector employment. In reality, the scope for private sector-led employment creation is often constrained by geography. Public sectors, while large relative to the size of the economy, remain small in absolute terms and with regard to diseconomies of scale in administration and service delivery. Public sector employment is therefore likely to continue to provide a substantial share of work in PICs. Policy attention can usefully focus on ensuring that such employment is productive and sustainable rather than on reducing the number of public sector jobs. Private participation can provide incentives for efficient delivery of public services, but needs to be approached carefully and selectively. Broader public sector reforms to ensure efficiency and effectiveness need to continue. Donor agencies and governments can work to ensure that development expenditure supports the creation of local employment opportunities.

Finally, policies can ensure that natural resource industries provide a sustainable source of employment creation. Natural resource industries can flourish in PICs despite higher cost structures. But work in natural resource industries is often unsustainable and contributes little to living



standards. Judgments about policy interventions to create employment within these industries should consider the quality and sustainability of the work they are likely to create. PICs might often benefit most from converting rents from natural resource industries into improved infrastructure, services, and human capital, rather than seeking to create direct large-scale employment in those industries through implicit or explicit subsidization.

## 1 Employment challenges of the small Pacific island countries

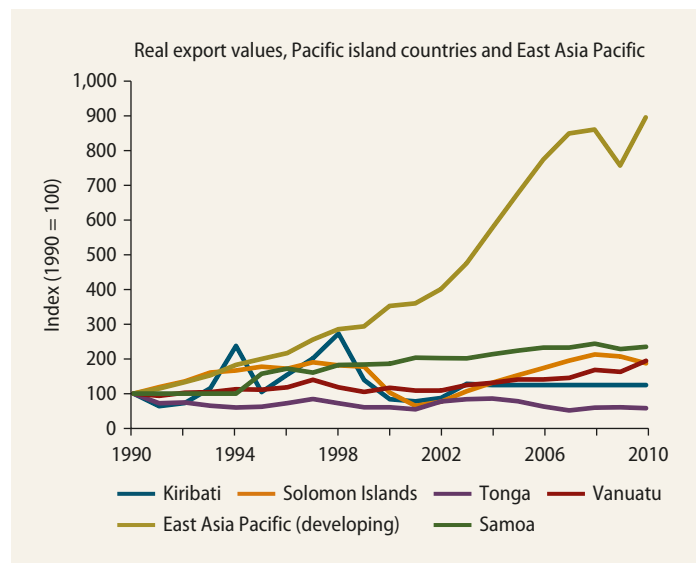
The Pacific island countries are following an employment trajectory different from the rest of the region. Much of East Asia Pacific has enjoyed rapid economic growth and economy-wide increases in productivity in recent years, driven by the large emerging economies of East Asia. This has occurred with an explosion of work opportunities in higher-productivity manufacturing and service sectors, often globally integrated and focused on exporting and almost entirely in urban areas. This transformation has fed on itself, with productivity gains from agglomeration and increasing wage incomes fueling domestic demand. In short, export-driven structural transitions of East Asian economies have contributed to creating employment and boosting the well-being that people get from work. The experience of East Asia, however, has not been the experience of most Pacific island countries. There is little sign in PICs of the broader economic changes that are transforming much of the region. Access to regular paid work is limited, and labor productivity remains almost static. Real gross domestic product (GDP) per capita has increased 650 percent for the East Asia Pacific region since 1982, but for the larger of the economies discussed in this report, output per person has increased only 38 percent. Real exports from East Asia Pacific as a whole have increased by

a factor of nine since 1990, while exports from these Pacific island countries are only about twice their 1990 value (figure 1.1). The percentage of the population living in cities in the average small PIC is about the same as the percentage of the population living in cities in East Asia in 1960, and the scale of urbanization since 1990 has been significantly less (figure 1.2).

Official statistics are scarce, providing an incomplete picture of employment and work in small Pacific island countries. Little data on employment are available beyond that which are collected from household income and expenditure surveys and censuses. There are important inconsistencies in the definitions used in available surveys across countries, leading to large variation in reported labor force participation and unemployment rates that do not reflect underlying economic or social realities.

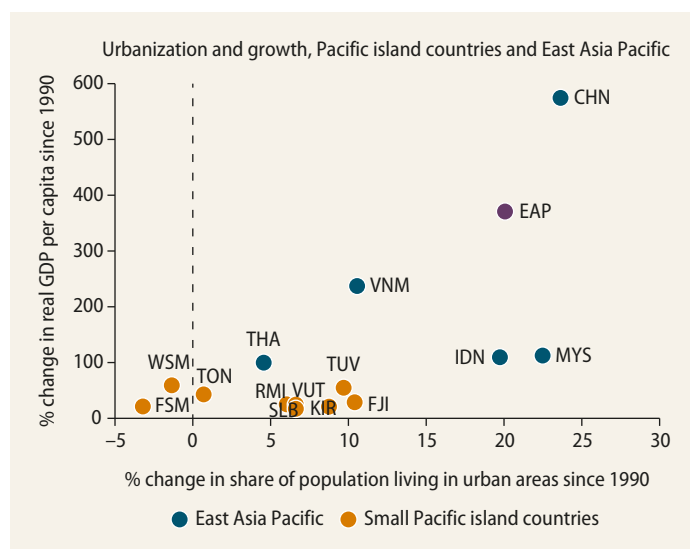
Some employment patterns are common across most PICs. A small number of Pacific Islanders have formal employment, most of which is in cities and much of which is in the public sector (box 1). Most Pacific Islanders

**FIGURE 1.1** Pacific island countries have not transitioned to export-led manufacturing and services



Source: World Development Indicators.

**FIGURE 1.2 Pacific island countries have lower rates of growth and are less urbanized than the rest of East Asia Pacific**



Source: World Development Indicators.

engage in some combination of agriculture, subsistence activities and cash or barter exchange, and informal small-business activity, either as part-time employees or as business owners. In cities, many individuals are employed on a part-time or casual basis by small businesses operating informally, while many others generate income through a range of informal and part-time own-business trading opportunities, such as operating a temporary retail stall or selling products in the town market. Many Pacific Islanders move between agricultural production for exchange, subsistence agriculture, and informal small-business activities and cannot easily be assigned to a single employment category. Those with formal employment may also engage in agricultural or subsistence activities at various times to generate additional cash income or meet various social obligations.<sup>2</sup>

Work patterns vary strongly by gender (figure 1.3). Across Pacific island countries, men dominate paid employment outside of agriculture, with approximately half as many women accessing these opportunities. In Melanesia, women occupy only a third of positions within the formal economy.

Women's economic activity tends to be concentrated in the informal sector, especially in agriculture (UNESCAP 2007). While data constraints preclude extensive analysis, it is clear that women have access to a narrower range of employment opportunities than men and often lack access to higher-paid work. This imposes costs on the economy, with analysis from the broader East Asia Pacific region suggesting that eliminating barriers to women's participation in certain sectors and occupations could improve labor productivity by up to 25 percent for some countries (UNESCAP 2007).

Growing youth populations put pressure on the economy to generate enough work. High fertility rates are driving rapid population growth in several PICs, with the Pacific population expected to double over the next 28 years. PICs also face a youth bulge: 54 percent of the population is below the age of 24—a higher proportion than in East Asia, all developing countries, and the world. The number of people between the ages of 0 and 14 substantially exceeds the proportion of the population between the ages of 14 and 25, and the number of working-age youth is expected to grow quickly over the next decade (figures 1.4 and 1.5). Previous research by the World Bank has shown that it will be a challenge for the private sector to generate enough new jobs to meet expected increases in labor supply. Formal employment opportunities are already limited relative to the labor force in many PICs. Recent estimates from the International Labour Organization (ILO) suggest that the percentage of men between 20 and 24 years of age who are not engaged in *productive activities* (defined as “paid or unpaid activity that contributes to their personal livelihood or that of their family and community as a whole”) is as high as 58 percent in Kiribati, 44 percent in the Marshall Islands, and 46 percent in Samoa (ILO 2013).

Other factors will also affect the demand for work. Social services have achieved remarkable success in improving health and education outcomes across small Pacific countries in recent decades. At the same

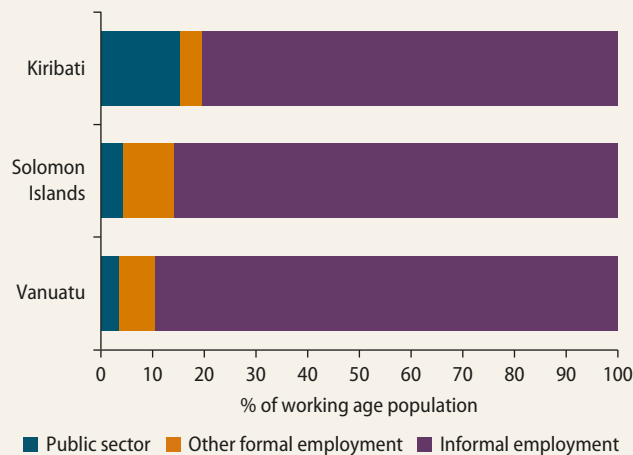
**BOX 1 Where is the work?**

Based on data from the National Provident Funds of Kiribati, the Solomon Islands, and Vanuatu, figure B1.1 shows employment shares in the formal private sector, the public sector, and various forms of informal employment.

A large share of formal employment is in the public sector, ranging from 30 percent in

the Solomon Islands to nearly 80 percent in Kiribati. Given that the vast majority of Pacific Islanders are engaged in some form of work, the dominance of informal employment, including agriculture for exchange, is also clear from the size of the working-age population without formal work.

**FIGURE B1.1** The majority of Pacific islanders are engaged in some form of work, many in informal employment



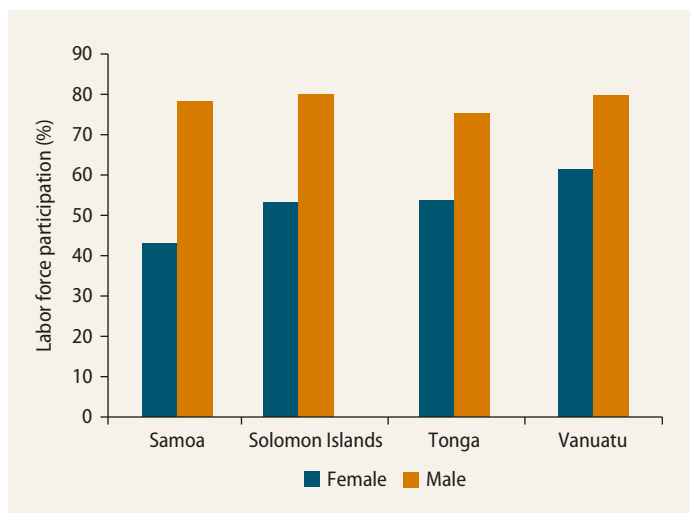
Sources: National Provident Fund and census data.

time, the spread of telecommunications and mass media has fueled aspirations for higher living standards and increased awareness of the wider world. Relatively better-educated and healthier people are more likely to have aspirations beyond village-based and family-oriented agricultural and fishing activities. The pressure associated with these growing aspirations is already spilling over into higher rates of urban migration as young people seek cash incomes and broader opportunities. It is likely to be felt most acutely in countries with currently low levels of emigration and limited formal sector employment

opportunities. While global trends suggest that agriculture-based livelihoods are becoming less desirable, they may also be becoming more difficult. In some countries, including Kiribati and the Solomon Islands, rural population growth is placing pressure on subsistence systems, leading to falling productivity and crop yields (Reddy 2007). Pressure on subsistence systems may become an additional driver of urban migration and demand for alternative employment opportunities.

Small Pacific island countries face a cluster of overlapping employment challenges (box 2).

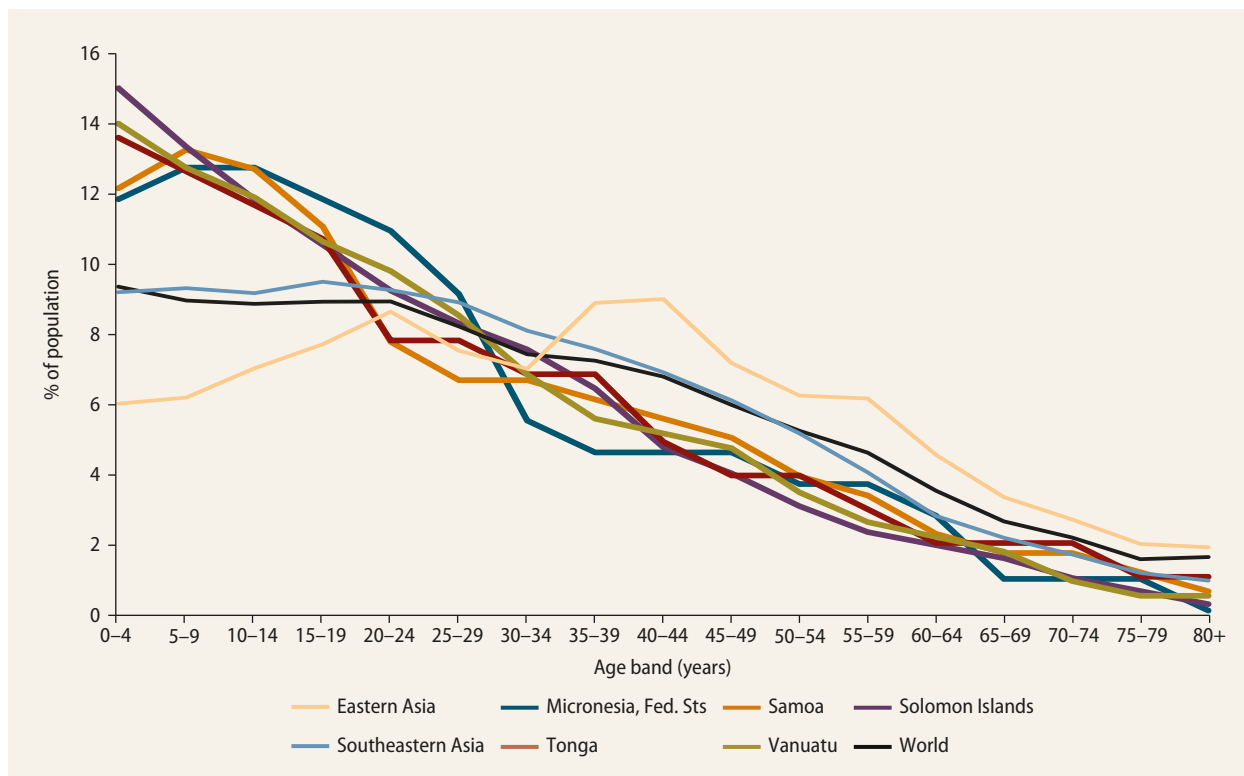
**FIGURE 1.3 Women are less likely than men to participate in the labor force**



Source: World Development Indicators.

Without the opportunities generated by rapid economic transformation, PICs face several challenges to creating employment. Many have rapidly growing populations of young people who are unlikely to be satisfied with the limited opportunities for self-advancement offered by agricultural subsistence. Some small PICs are already facing the related challenge of rapid urbanization and are struggling to generate work for growing urban populations. Some have emerged from conflict and face ongoing conflict pressures, with the accompanying need to maintain access to opportunities and ensure their careful distribution between groups and regions. Several countries are struggling to ensure sustainable benefits from extractive resource industries, including encouraging the development of ancillary industries, diversification, and sustainable employment generation.

**FIGURE 1.4 Pacific island countries have very young populations**



Source: United Nations Department of Economic and Social Affairs.

Governments and donors are concerned about the quality and quantity of employment available to Pacific Islanders. Governments and donors in PICs and elsewhere have previously implemented policies to support employment creation in specific geographic locations or sectors, based on prior assumptions about what “good” employment is. Often, policies have sought to support employment in rural areas over employment in urban areas; work within the local economy over work in larger markets; private sector employment over public sector employment; and employment within specific natural resource industries, through concessions or subsidies. Results of this approach have mostly been unsatisfactory, with underlying economic realities derailing well-intentioned plans. As discussed in the *World Development Report 2013; Jobs* (hereafter referred to as WDR 2013), the employment strategies that are most likely to succeed focus on ensuring that work raises living standards, drives greater productivity, and contributes to greater social cohesion, regardless of the geographic location or sector where that work takes place.

## 2 Five employment priorities for Pacific island countries

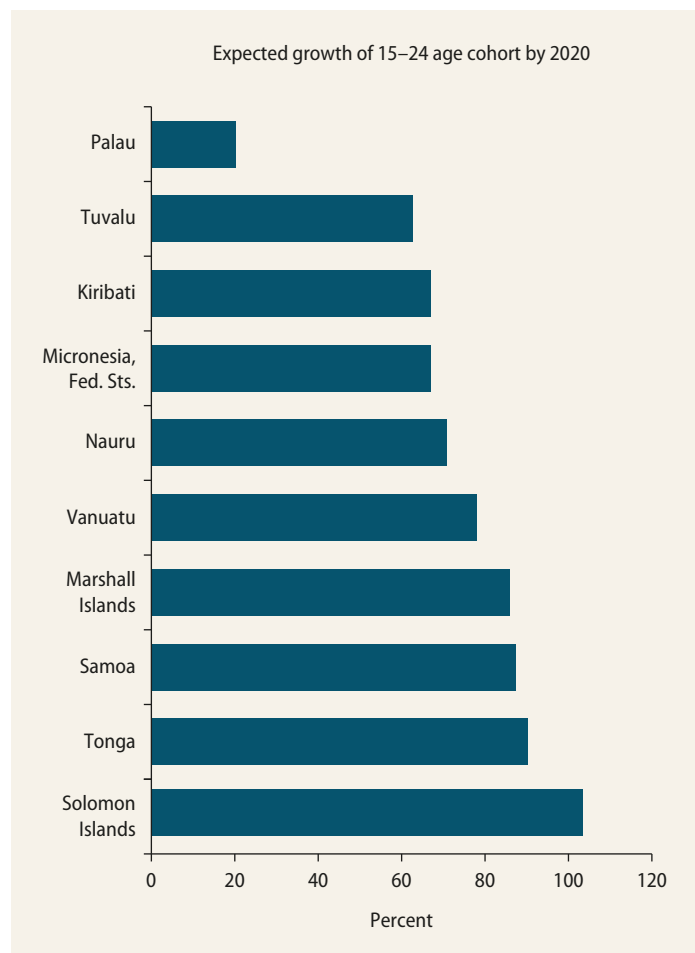
In this section we present five employment priorities for PICs. The applicability of these priorities varies across countries according to size, location, demographic profile, natural resource endowments, and nature of existing economic activities. No single strategy will be appropriate for all countries. Nonetheless, shared geographic characteristics suggest some shared challenges and some potential common solutions.

### 2.1 Trajectory of development

#### *Priority 1 Set realistic expectations about the trajectory of development*

- *Summary.* Due to inherent geographic obstacles, Pacific island countries are unlikely to experience export-driven development and

**FIGURE 1.5** Rapid growth in the number of youth is expected over the coming years



Source: Adapted from Bedford 2012.

associated employment creation of the scale and nature seen in much of the East Asia Pacific region, even with the best possible business environment. Employment strategies need to include less conventional policy options and focus on areas where Pacific countries have established strengths and advantages.

- *Countries of relevance.* All Pacific island countries, especially those where populations are very small and dispersed.
- *Living standards.* Forces of economic geography mean that Pacific island countries are unlikely to see rapid improvements

## BOX 2 Pacific island countries face overlapping employment challenges

The *World Development Report 2013: Jobs* (hereafter WDR 2013; World Bank 2012c) explicitly recognizes that different employment challenges will require different policy responses. Small Pacific island countries face a complex and overlapping range of challenges, including at least five of the challenges specifically identified in the WDR 2013. Figure B2.1 shows the challenges relevant to PICs and the associated priorities for policy makers identified in the WDR 2013. These priorities are elaborated in the recommendations of this report.

All small island countries face inherent barriers of scale and distance, which can preclude the development of manufacturing and service industries associated with high-productivity, better-paid work. Many countries in the region are endowed with natural resources, in the form of mineral deposits, forests, and fisheries. The development of these industries can

lead to uneven and unsustainable development and squeeze out growth in other parts of the economy. The Solomon Islands remains a postconflict country and faces continued conflict pressures arising partly from uneven distribution of economic opportunities, including the concentration of formal sector employment in the capital city, Honiara. Urbanization continues to generate pressures for small Pacific island countries like Kiribati, the Marshall Islands, the Solomon Islands, and Vanuatu, with the pace of growth in urban populations outstripping the pace of employment creation and feeding concerns regarding youth unemployment and associated social problems. These problems are exacerbated by very large and growing youth populations in many PICs, especially in Melanesia.

Source: World Bank 2012c.

**FIGURE B2.1** Small Pacific island countries face a complex and overlapping range of challenges requiring a range of priorities



in living standards from private sector employment creation. Alternative means of supporting higher living standards through work are required.

- *Productivity.* Scale and concentration are vital for productivity. Small, dispersed, and distant populations face inherent limits to productivity that need to be reflected in employment strategies.

- *Social cohesion.* Social cohesion can be undermined by unrealistic expectations regarding the prospects for economic and employment growth.

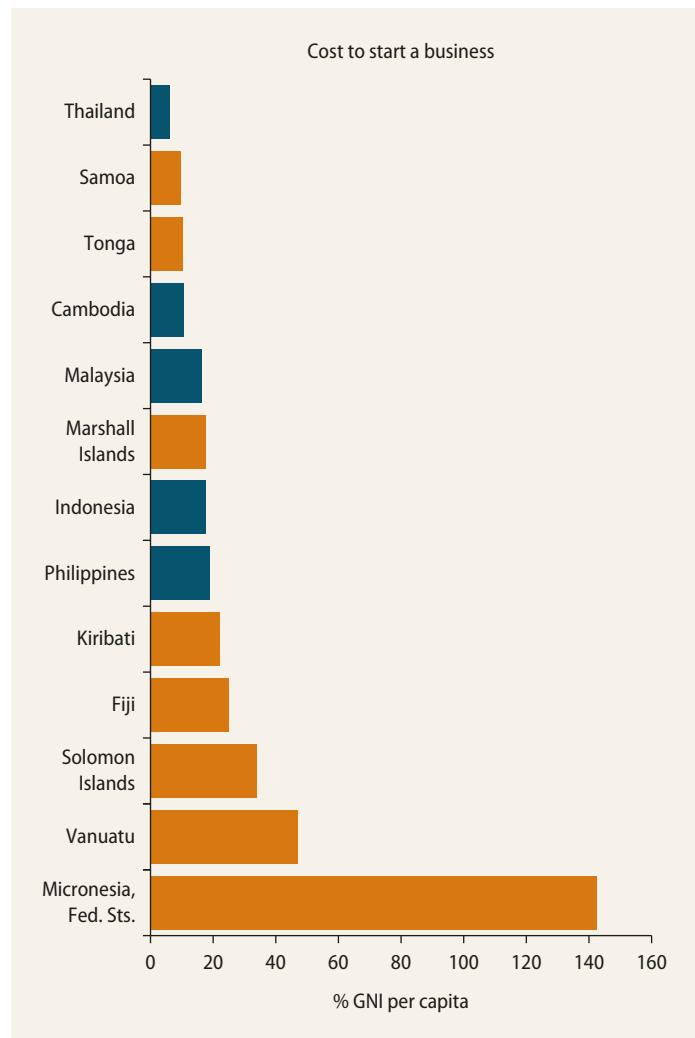
Export-driven, private sector development is unlikely to be the answer to employment challenges facing small Pacific island countries. A common message in reports

regarding economic growth or employment creation in PICs is the importance of reforms aimed at improving the environment for the private sector. Improving the business environment can deliver important benefits to small Pacific island countries. A legal and regulatory framework that supports investment and the sound functioning of factor markets can facilitate the creation of employment within businesses supplying local markets or in niche export industries. Continued investment in reforms to reduce the costs of doing business therefore remains an important priority, especially for countries where compliance costs facing businesses are out of line with regional or global norms Figures 2.1 and 2.2 and box 3. It is important, however, not to overstate the likely impact of such reforms on employment creation. Due to inherent geographic obstacles, PICs are unlikely to experience the scale of export-driven development and associated employment growth seen in much of the East Asia Pacific region under any regulatory or policy setting.

The formidable geographic challenges of smallness and distance impose costs. The small PICs discussed in this report are among the world's 50 smallest countries. Smallness makes it hard for businesses to achieve economies of scale. With relatively few domestic businesses, firms find it difficult to outsource upward and downward through the supply chain. Firms also experience less exposure to positive knowledge externalities, as they are unable to observe the practices of other firms in the same industry and lack access to a pool of workers with experience in different firms. In other small countries, firms overcome some of the costs of smallness by trading internationally. But PICs are also some of the most isolated countries in the world, when measured using a variety of economic measures.<sup>3</sup> Great distances increase the costs of exporting and the price of imported inputs.

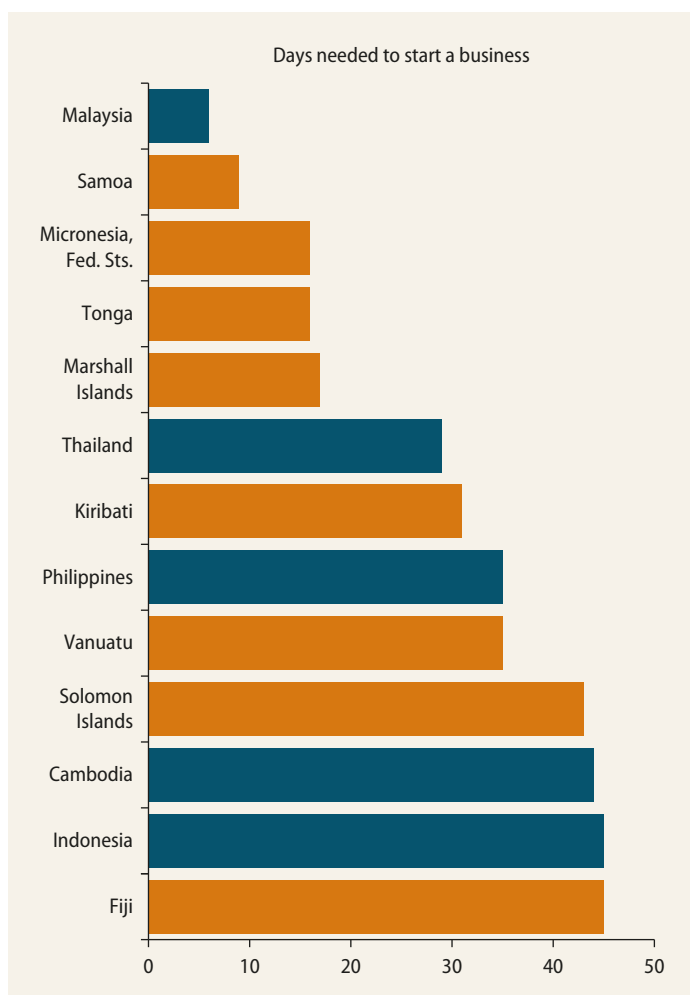
The combined impacts of smallness and distance on cost are sufficient to undermine competitiveness of the industries that have supported growth in larger economies

**FIGURE 2.1** Costs to start a business are higher in many Pacific island countries



Source: Doing Business Indicators 2013.

(Figures 2.3 and 2.4). Recent quantitative research has investigated just how significant the costs arising from small scale and remoteness might be for countries like those in the Pacific (Yang et al. 2012; Tumbarello, Cabezon, and Wu 2013). Winters and Martins (2004) find that capital would earn negative returns if it were invested in export manufacturing in nearly all of the Pacific island economies. Even if wages were zero in most Pacific countries, total costs would still

**FIGURE 2.2** The time required to start a business is burdensome in Pacific island countries

Source: Doing Business Indicators 2013.

exceed world prices both in manufacturing and also in a service industry such as tourism.

Constraints of geography have been consistently reflected in the structure and performance of small PIC economies. The economies of small PICs have remained dependent on aid, remittances, and natural resource industries (Bertram and Watters 1985). Large structural current account deficits have continued for all but a few natural resource-rich Pacific countries. Growth in consumption, fueled by aid and remittances, has been met almost entirely by increased imports rather than increased domestic

production, reflecting higher local cost structures. Economic activity and employment have occurred in areas where inevitably higher costs do not undermine viability and local activity does not face direct international competition (World Bank 2011). These areas include (1) public services and infrastructure, which account for a large share of formal employment; (2) nontradable private sector goods and services, often focused on meeting demand from the public sector or public sector employees; and (3) natural resource industries, including tourism, where rents can be generated despite higher cost structures. Although the economic drivers in small PICs are different from those in larger economies, they have served PICs very well in lifting incomes and living standards well above those in many larger and less isolated developing economies.

The geographic forces that determine what work is available in PICs will remain significant over time. Contrary to the East Asian experience of diversification, PICs might expect further concentration in traditional areas as preferential access arrangements for key export industries are removed, trade and investment are liberalized, and transport and communication links are improved. Loss of preferential access will mean that PICs face the full impacts of higher costs in manufacturing and services for export, while economic integration will reduce barriers to competition from imports. As global economic activity becomes more and more concentrated and the benefits of agglomeration in large urban centers increase, the scale disadvantages faced by PICs will become relatively more significant.

Employment strategies will need to be feasible within the constraints imposed by geography. The extent of employment creation from improvements in the business environment should not be overstated. Even under the best possible business environment, it is not clear that the private sector would be able to generate significant employment through export-driven growth, due to the cost disadvantages of geography (box 4). This is not, however, reason for pessimism. Policy

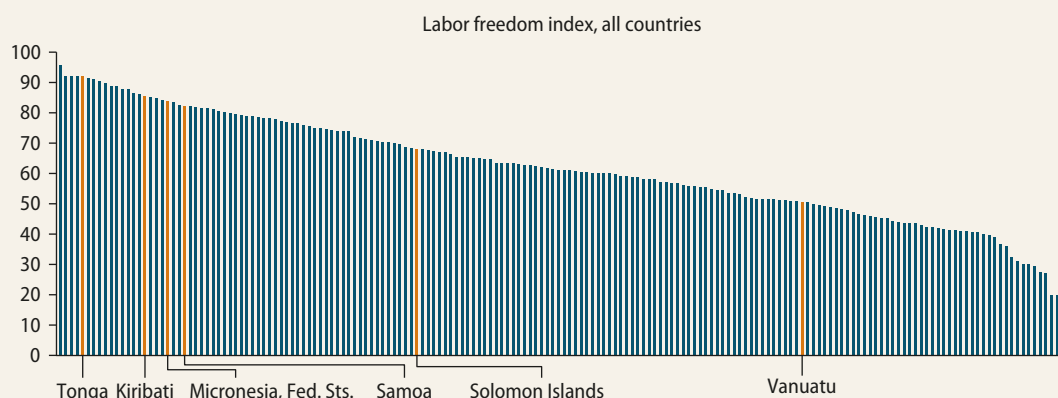


### BOX 3 Is labor regulation “off the plateau” in Pacific island countries?

Very limited data are available on labor market policies and their impacts on PICs. The Labor Freedom Index—a component of the Heritage Foundation’s Index of Economic Freedom—ranks the restrictiveness of labor regulations from an employer perspective, using data collected through the World Bank’s Doing Business survey. Reaching any firm conclusions regarding labor regulation in PICs would require better information, as labor regulations imposed on firms are just one element

of labor market policies. These data suggest, however, that labor regulation in PICs is not unusually restrictive (figure B3.1). Four of seven PICs included in the index are among the 25 countries with the least restrictive policies. Only Vanuatu is among the “more restrictive” half of countries covered by the index. On the basis of this evidence, it seems unlikely that overly prescriptive labor regulation is a primary constraint on private sector growth and productivity in most PICs.

FIGURE B3.1 Labor market regulation is not especially restrictive in Pacific island countries



Source: Heritage Foundation Labor Freedom Index.

options are available that build on Pacific island countries’ existing strengths, despite inherent geographic constraints.

## 2.2 Labor mobility

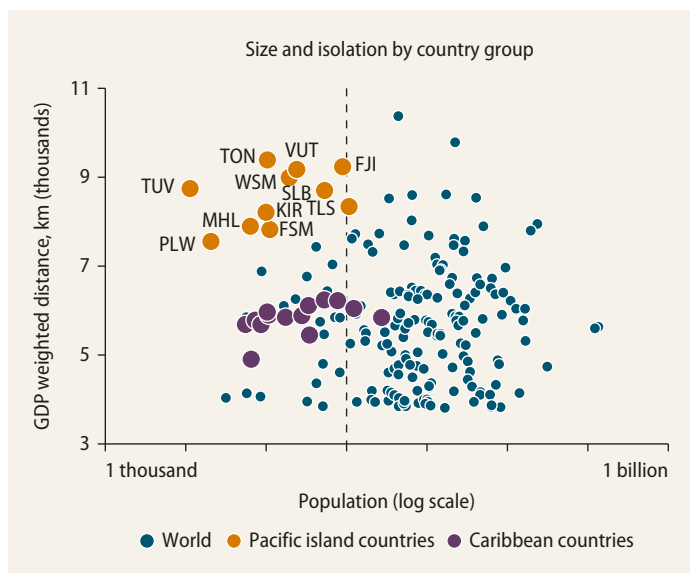
*Priority 2 Improve international labor mobility through the erosion of regulatory barriers and investment in transferable human capital*

- *Summary.* Geographic realities will constrain work opportunities in Pacific island countries. Governments and donors can facilitate access of Pacific Islanders to

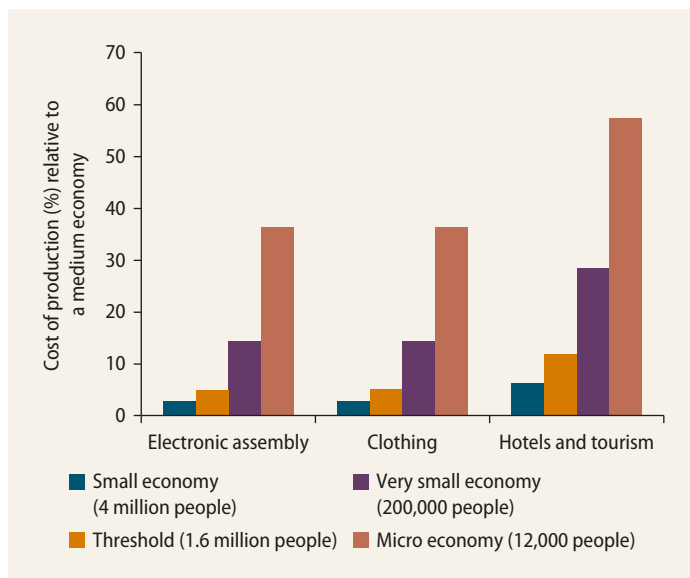
employment opportunities even across national boundaries. This will require both changes in the immigration policies of the large regional economies and careful investment in internationally transferable human capital.

- *Countries of relevance.* All Pacific island countries, especially those where population growth is rapid and current access to international labor markets is limited.
- *Living standards.* Overseas employment opportunities have been shown to support higher living standards for migrant workers and their families.

**FIGURE 2.3 Pacific island countries are unique in their combination of smallness and isolation**



**FIGURE 2.4 The costs of smallness and isolation undermine competitiveness in transformational industries**



Source: Adapted from Winters and Martins 2004.

- **Productivity.** Mobility allows labor to flow to areas where it can be employed most productively. Labor mobility can encourage investment in human capital, benefiting both sending and receiving countries.

- **Social cohesion.** Labor mobility can reduce pressures arising from youth unemployment and defuse contests over access to economic opportunities.

Labor mobility represents the most significant and substantial opportunity for overcoming geographic constraints to employment in the PICs. A key lesson from the *World Development Report 2009: Reshaping Economic Geography* (World Bank 2008) is that productivity is associated with scale, density, and concentration. The geographic location of a worker is an important determinant of that worker’s productivity and, therefore, income. Even within the same densely populated industrial country, a worker in a large city typically earns more than a worker with identical experience and skills in a smaller city because of the productivity benefits associated with scale, specialization, and knowledge spillovers (Venables 2006). Work in small PIC economies, with small, dispersed populations and located thousands of kilometers from global centers of production, is likely to remain, on average, substantially less economically productive, and therefore less well paid, than work in larger, better integrated economies. GDP per capita of Australia is now around 20 times that of Vanuatu and 40 times that of the Solomon Islands. Living and working in nearby Australia and New Zealand provides a range and depth of economic opportunity far beyond what is likely to be available in small Pacific economies for the foreseeable future, given low rates of growth and limited opportunities for economic diversification (box 5; World Bank 2011). A key opportunity for improving the living standards and productivity of PIC workers is to provide improved access to employment opportunities in places that do not face the same constraints of smallness and isolation. A growing body of evidence demonstrates that improved labor mobility for Pacific Islanders would provide benefits to migrants, their families, sending countries, and receiving countries.

Migrants and their families benefit from labor mobility. The attractiveness of

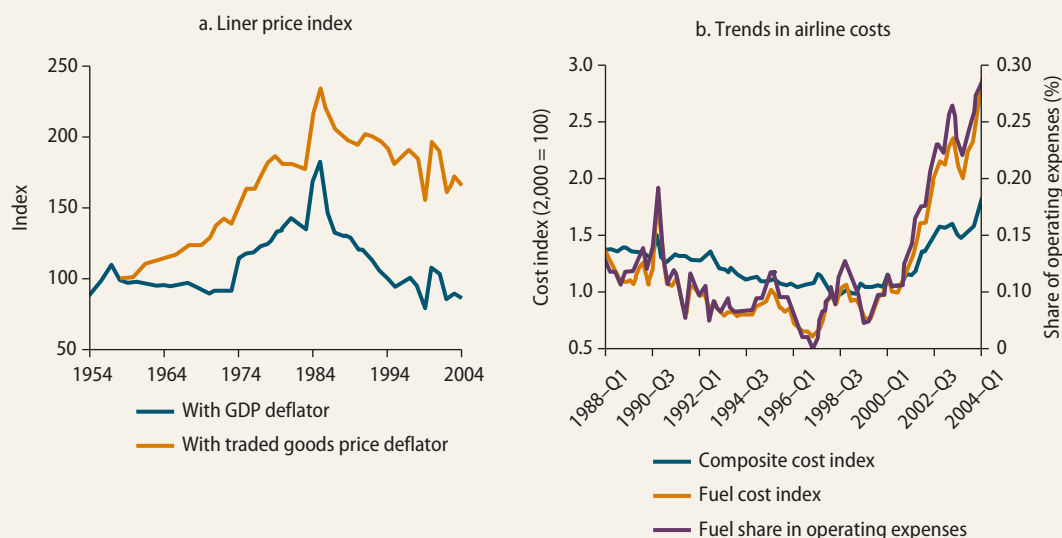
#### BOX 4 Are the costs of distance declining?

Advances in technology might be expected to have reduced the costs of transport over time, mitigating the disadvantages faced by PICs in accessing international export markets and reducing the cost of imported inputs. A trend of falling transport costs might suggest new export and economic development opportunities for PICs and a decline in the significance of geography in constraining employment creation in the private sector. Unfortunately, available evidence suggests that geographic proximity remains a primary determinant of trade links and shows no significant reduction in costs of distance over time.

Analysis from economic “gravity models” shows that even in the current age of globalization, 90 percent of the trade that occurs over a distance of 1,000

kilometers would cease at a distance of 9,000 kilometers. Because costs of distance are so important, around 23 percent of global trade occurs across a shared land border between countries. This proportion has been constant for several decades. Hummels (2007) provides a detailed analysis of air and ship freight costs over time. He finds that, despite innovations including containerization and introduction of the jet engine, there has been no significant reduction in shipping costs (as a proportion of the value of products shipped) since the 1950s, while air transport costs have actually increased substantially over the past decade (figure B4.1). Cost trends have been driven by higher fuel costs, with oil price increases more than offsetting the cost reductions associated with new technologies.

**FIGURE B4.1** Shipping costs remained relatively stable, while air transport costs have risen substantially over the past decade



Sources: Venables 2006; Hummels 2007; Yang et al. 2012.

migration is reflected in large proportions of the working-age population of some PICs now living abroad. While social and economic indicators for recent migrants to these countries can lag those of the broader

population in migrant-receiving countries, migrants generally foresee broader educational and economic opportunities for their children, even for those whose immediate opportunities are limited. Recent analyses

### BOX 5 Labor mobility arrangements in Australia and New Zealand affect development outcomes in Pacific island countries

New Zealand, Australian, and U.S. migration policies continue to have an important impact on labor mobility and broader development outcomes in PICs. Increases in Pacific populations living in New Zealand and Australia have fueled remittance flows, offset population growth, and expanded economic opportunities. Since 1971, the Pacific-born population of New Zealand and Australia has increased from 46,000 to more than 250,000, with around 140,000 in New Zealand and 110,000 in Australia (Bedford 2012). The growth in Pacific-born populations has occurred through very different channels, reflecting divergent policy approaches to Pacific migration.

Alongside its country-neutral points-based immigration schemes, New Zealand has maintained a range of special access arrangements for PICs. These are targeted toward those countries that have the strongest constitutional or historical links to New Zealand. Such arrangements include the following measures:

- *Special citizenship relationships.* The populations of the Cook Islands, Niue, and Tokelau have full New Zealand citizenship and associated rights to work in New Zealand.
- *The Samoan quota.* New Zealand allocates residence visas, by ballot, to 1,100 Samoans between the ages of 18 and 45 each year. Successful primary applicants must obtain an offer of work in New Zealand before immigration is approved. The scheme is typically oversubscribed, partly due to the number of places taken up by secondary applicants, who are included within the quota cap. Over the past three years, 1,201 out of 19,326 registrations were drawn from the ballot, representing odds of around 6 percent (Gibson, McKenzie, and Stillman 2011, 11).
- *The Pacific access category.* Under the Pacific access category, 250 citizens of Tonga, 75 citizens of Tuvalu, and 75 citizens of Kiribati can be

granted residence-class visas in New Zealand each year. The cap includes principal applicants, partners, and dependent children. Applicants must meet English language proficiency standards and have a “suitable offer of employment” that provides a salary equal to a specified minimum income requirement (currently NZ\$31,500). This scheme is also oversubscribed, despite offer-of-employment requirements.

- *Recognized seasonal employer (RSE) scheme.* Under this scheme, up to 8,000 PIC workers can be hired on a part-time basis by New Zealand farmers in the horticulture and viticulture industry.

In contrast to New Zealand, Australia has very limited special labor access for Pacific island countries. Consequently, three times more Pacific islanders migrated to New Zealand than to Australia between 2003 and 2007, despite Australia’s much larger population and economy (Bedford 2012). Nearly all Pacific-born workers in Australia either qualified for entry through country-neutral schemes (including large numbers of relatively highly educated Fijians, following recent coups) or traveled to Australia after acquiring New Zealand citizenship through the Trans-Tasman Travel Arrangement, which allows free movement of Australian and New Zealand citizens across both countries. A very small number of Pacific-born workers have accessed employment opportunities in Australia through the recent pilot of the Pacific seasonal worker scheme, which operates on a basis similar to New Zealand’s RSE scheme. Places within the scheme were limited to 2,500 over the four years from 2008 to 2012, and only around 1,600 places were offered due to low uptake by employers (Reed et al. 2011). Participation has increased slowly, with around 710 visas being issued under the scheme during the first half of FY2013/14, and the cap is still unlikely to be reached.

of the recognized seasonal employer (RSE) scheme, which provides short-term access to New Zealand labor opportunities, primarily in horticulture, and broader survey data of families with members working

overseas, demonstrate the benefits to families in sending countries of both short-term and permanent migration (McKenzie and Gibson 2010; Gibson, McKenzie, and Stillman 2011; Luthria et al. 2006; Gibson

and McKenzie 2011). Households in PICs with family members working overseas experience the following improvements:

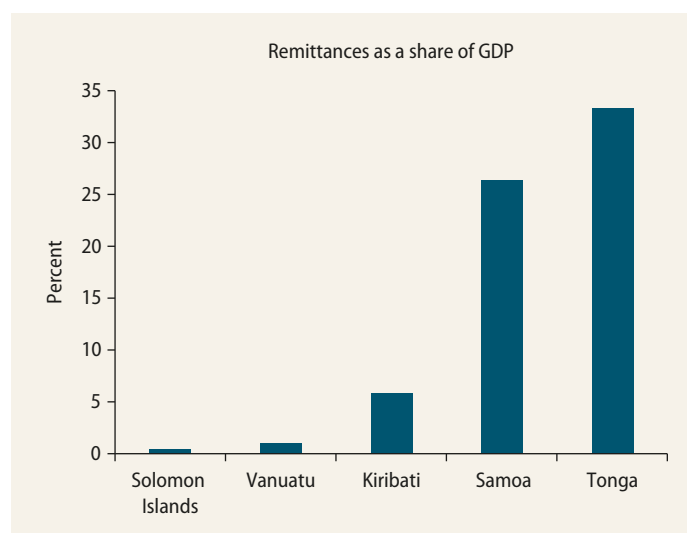
- Higher per capita incomes over comparator groups, driven by remittances
- Increased subjective economic welfare, with households reporting that they benefited from labor mobility opportunities
- Improved ownership of assets, including radios, ovens, and DVD players
- Higher rates of financial inclusion and savings, including a greater likelihood of holding a bank account
- Improved educational attainment, with school attendance rates shown to have increased, and broader evidence of a positive impact of remittances on primary and tertiary educational attainment, likely due to improved affordability with higher incomes.

Labor mobility provides economy-wide benefits to migrant-sending countries. Remittance-receiving households benefit the broader economy through increased investment in business activities (McKenzie and Gibson 2010). Opportunities for migration can also generate incentives for increased human capital development, which can potentially offset any loss of human capital experienced by sending countries. Recent evidence from Fiji demonstrates that the expectation of migration opportunities generated an increase in the level of tertiary education of Fijians, with the stock of Fijians with tertiary education remaining within Fiji also increasing (Chand and Clemens 2008). Available evidence from small countries suggests that the benefits to sending countries from the emigration of high-performing students and academics—including remittances and knowledge transfer—generally outweigh the costs, especially when high rates of return migration are taken into account (Gibson and McKenzie 2010, 2013). Knowledge transfer is particularly significant, with 13 percent of expatriate Tongans from a sample of academic high achievers providing advice to the Tongan government while overseas, more than 50 percent providing advice to Tongan

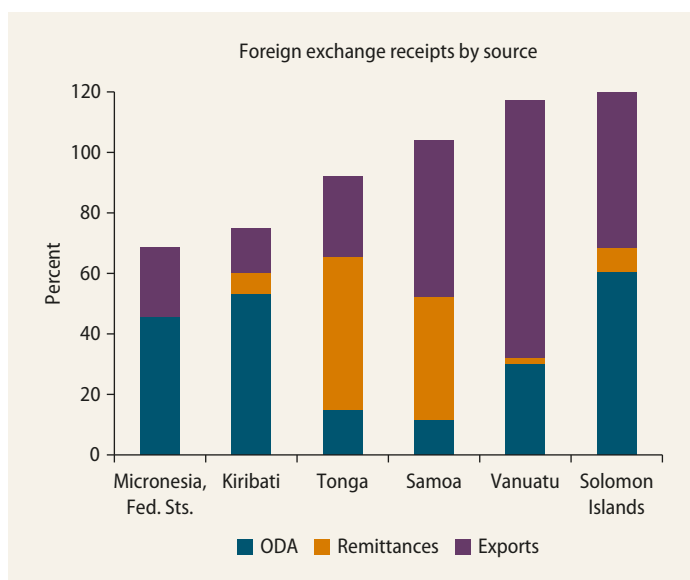
residents on study and work opportunities, and 20 percent providing sponsorships for Tongan residents seeking work overseas (Gibson and McKenzie 2010). Diaspora tourism resulting from large emigrant populations is also an important benefit to sending countries, accounting for a large share of tourism industries in Pacific countries, with 40 percent of arrivals in Samoa from New Zealand visiting friends and relatives (Scheyvens and Russell 2009). Remittance flows clearly can reduce income inequality and create new opportunities for the disadvantaged. Remittances from long-term migrants have been shown to reduce disparities in income between households in Fiji and Tonga, while participants in New Zealand's seasonal employer scheme are typically from poorer rural households in Tonga (Luthria et al. 2006; Gibson and McKenzie 2009).<sup>4</sup>

Remittances provide an important and relatively stable source of foreign exchange. Remittances provide a substantial proportion of foreign exchange receipts in several PICs, increasing imports and consumption (see figures 2.5 and 2.6). While some PICs have been heavily affected by the decline in

**FIGURE 2.5** Remittances are very significant for some Pacific island economies



Source: Estimates based on data from country authorities.

**FIGURE 2.6** Remittances support imports, consumption, and living standards

Source: Estimates based on data from country authorities.  
 Note: ODA = official development assistance.

remittances during the recent global economic crisis, over the longer term, remittances tend to provide a more dependable source of foreign exchange than the natural resource industries or donor aid flows on which small PICs typically rely.<sup>5</sup>

Demographic shifts are creating opportunities for greater mutual benefit from mobility (figures 2.7 and 2.8). Patterns of demographic change vary between countries in the Pacific region. While some PICs have large and growing youth populations, the populations of the larger regional economies are aging and likely to decline over coming decades. The larger regional economies face impending labor shortages that could partially be met by Pacific labor. Permanent migration to New Zealand during fiscal 2010–11 was below planned levels by 9,000 places, even as the Samoan quota and Pacific access entries remained oversubscribed (Department of Labour 2013). In fiscal 2011–12, net permanent and long-term migration to New Zealand was negative for the first time in more than a decade (Department of Labour 2013). Shortages

of unskilled labor during the construction boom following the Christchurch earthquake have led the local business community to call for increased migration opportunities.<sup>6</sup> Recent labor shortages in Australia, where Pacific-born workers currently constitute a negligible proportion of migrants and the total workforce, have also led to appeals from the business community for increased temporary work arrangements from developing countries (Earl 2012).

Differences in the supply of and demand for labor across countries present opportunities for mutual benefits from mobility (Bedford 2012). The net economic gains from labor mobility have been long established in the economic literature (World Bank 2006; Walmsley, Ahmed, and Parsons 2005). Recent evaluations have demonstrated how businesses have benefited from reliable and relatively low-cost labor provided through New Zealand's RSE scheme at the micro level (Department of Labour 2010). The benefits of labor mobility will increase further as demographic trends lead to a scarcity of young workers in the larger regional economies.

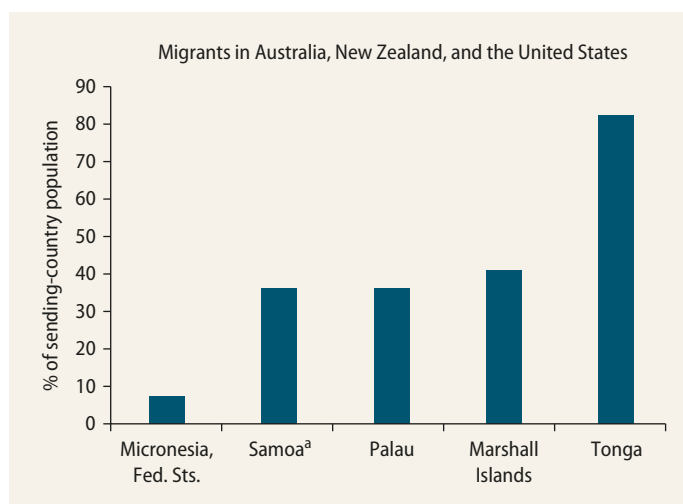
Distribution of opportunities could be better matched with development needs. Many PICs already enjoy relatively easy access to larger labor markets, including the North Pacific countries with access to the U.S. labor market. Samoa and Tonga have strong historical ties with New Zealand, and preferential access to the New Zealand labor market has translated, through step migration, into large populations in Australia. Partly because of migration opportunities and their large Australian and New Zealand populations, Samoa and Tonga have some of the best development outcomes in the Pacific. Strong education outcomes and transport links support participation in seasonal worker schemes, with Samoa and Tonga accounting for 50 percent of participants in the first seasons of the New Zealand scheme and more than 80 percent of participants in the Australian scheme. Other Pacific countries, where domestic economic opportunities are most constrained by smallness and isolation (Tuvalu) or where

incomes are lowest (Kiribati and the Solomon Islands), tend to have less access to short-term and permanent migration opportunities and are constrained in their participation in seasonal schemes by costs of transport and institutional weaknesses.

Greater policy effort on the part of receiving countries is required to expand access. Opportunities for labor mobility are heavily constrained by the immigration policies of large neighboring countries, such as Australia and New Zealand. These same neighboring countries allocate a large proportion of their overseas development budgets to the Pacific region with the stated aim of improving economic opportunities and living standards in the region. Increased policy coherence between aid and immigration policies would see a large expansion in temporary and permanent labor mobility opportunities available to Pacific people. This would not only represent a very cost-effective development intervention, but also bring economic benefits to those receiving countries, especially as their populations age. Achieving the greatest mutual benefits from emerging demographic transitions will require more action from large economies in the region on several fronts:

- *Expansion and improvement of temporary worker schemes.* Efforts to expand participation in the seasonal worker schemes could bring substantial benefits to PICs. Seasonal schemes currently make only a small contribution to overall remittance flows to Pacific countries. Samoa and Tonga alone receive around US\$270 million a year in remittances from permanent migrants, compared to around US\$30 million a year in remittances from seasonal workers in Australia and New Zealand. If Australia were to offer as many seasonal worker places as New Zealand relative to its population, however, total remittances from seasonal workers in the scheme could reach 10 percent of the GDP of participating countries or 60 percent of their current aid flows (see box 6). Scope to expand seasonal worker schemes in both

**FIGURE 2.7** Migrants to high-income countries make up a substantial portion of Pacific working people



Source: Adapted from Bedford 2012.

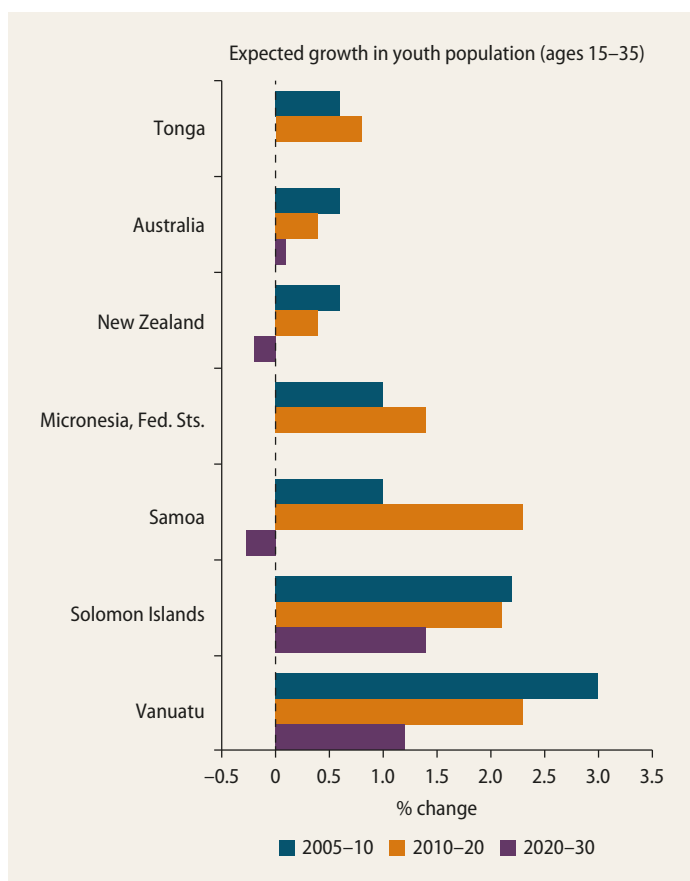
Note: Opportunities for permanent labor mobility are greatest for Polynesian countries.

a. Samoa excludes the U.S. diaspora due to inability to isolate American Samoa in census data.

Australia and New Zealand can be demonstrated by the relatively small number of seasonal workers arriving from Pacific countries, compared to the number of job opportunities available to citizens of much wealthier countries through “working holiday” visa schemes (figures 2.9 and 2.10). Expansion of the successful New Zealand scheme and improvements to the Australian scheme could generate development impacts that are significant at the macroeconomic scale.

- *Increased permanent migration.* While seasonal schemes could provide important opportunities for generating remittances, evidence demonstrates the broader range of benefits accruing to Pacific island countries from access to permanent labor. Such benefits include skills and knowledge transfer, increased tourism receipts, and huge improvements in living standards for permanent migrants. Under any scenario, seasonal schemes will not close the very large gap in incomes between large regional economies and small Pacific islands. The best opportunities for

**FIGURE 2.8** Demographic differences suggest mutual gains from mobility for receiving and sending countries



Source: Adapted from Bedford 2012.

Note: Population pressures are building in Melanesia, while the working-age population is declining in nearby large economies.

improved productivity and incomes for many Pacific Islanders will be to move to where greater opportunities exist. Seasonal schemes must be viewed as a complement to, rather than a substitute for, increased permanent labor mobility. Seasonal schemes are appropriate only to certain industries, and not those, such as elderly care and construction, where demand is likely to be greatest over coming decades. Seasonal work schemes require intensive involvement of sending and receiving governments and therefore impose administrative costs with sustainable gains less easily assured. Finally, male

workers tend to dominate in the sectors best suited to seasonal work schemes—such as agriculture and horticulture—posing challenges for greater participation by women. Permanent migration must therefore remain a key focus of policy attention. Allocations for New Zealand's existing Pacific Access category could be expanded and a broader range of countries could be offered a dedicated quota (as provided to Samoa). Australia could consider the introduction of similar quota or lottery-based permanent access schemes. A modest start-point would be the introduction of an Australian Pacific Access category visa, with 2,000 permanent visas offered per year to immigrants from small PICs, based on the New Zealand Pacific Access category allocations adjusted for Australia's larger population size.<sup>7</sup> Another important priority is to develop processes through which seasonal workers can transition to more permanent visas.

- *Reorientation of mobility links.* With the exception of high Vanuatu participation in the New Zealand seasonal worker scheme, existing labor mobility arrangements deliver greatest benefit to the Pacific countries where incomes are highest and development outcomes are strongest. To boost well-being from work, further expansion of both seasonal and permanent labor mobility arrangements should be targeted toward countries such as Kiribati and the Solomon Islands, where domestic economic prospects and mobility opportunities are heavily constrained and challenges from growing youth populations and accelerating urbanization are most severe. Increased participation of these countries in seasonal schemes would likely require further country-specific donor subsidization of training and transport costs.

Improving and expanding seasonal labor mobility opportunities for Pacific Islanders offers immediate benefits without any significant costs. Large policy shifts toward



## BOX 6 An expanded seasonal worker scheme has potential benefits

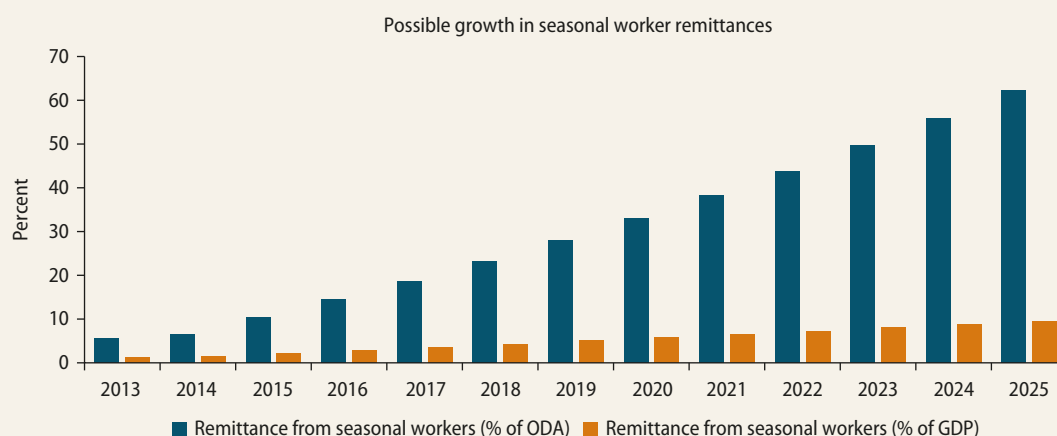
Existing data from seasonal worker schemes in New Zealand and Australia can be used to model the potential impacts of an expanded scheme. As a starting point, we assume that the number of seasonal workers to New Zealand remains constant at around 8,000 a year, while Australia expands its scheme to provide an equivalent number of places relative to population (roughly 40,000 places, by 2025). We make the following assumptions:

- Workers work an average of 20 weeks a year
- Workers remit the same proportion of income as in the New Zealand scheme and under the Australian pilot, allowing for deductions and worker spending
- Places offered in Australia increase to 8,000 in 2014 and then grow 30 percent annually until the target of 40,000 places is reached (equal to 30 percent of the number of current working holiday visas issued annually)

- All places are offered to citizens of small Pacific island countries currently participating in the scheme (Kiribati, Samoa, the Solomon Islands, Tonga, Tuvalu, and Vanuatu).
- Wages increase at a rate of 3 percent a year, allowing economy-wide total factor productivity growth and labor productivity improvements associated with repeated participation in the scheme.

Given these assumptions, total remittances from the Australian and New Zealand schemes could reach US\$390 million by 2025 (in 2013 U.S. dollars), equivalent to 10 percent of GDP of currently participating small Pacific island countries or 60 percent of their total aid flows (figure B6.1). These estimates rely heavily on an expansion of participation of Kiribati and the Solomon Islands within the scheme, which will be required to avoid a damagingly large, accelerated drain of human capital from Samoa, Tonga, and Vanuatu.

**FIGURE B6.1** Remittances could grow significantly with expanded seasonal work opportunities



Note: ODA = official development assistance.

increased permanent labor mobility also offer clear mutual benefits, but will require some balancing of several important objectives: protecting labor rights while ensuring access to employment for relatively low-skilled

immigrant workers; expanding low-skilled immigration while avoiding the displacement of opportunities for low-skilled New Zealand and Australian workers; and expanding migration opportunities to lower-skilled

**FIGURE 2.9 Immigration policies in Australia favor guest workers from high-income countries**



Source: Department of Immigration and Citizenship 2012.  
 Note: The number of working holiday visas approved in Australia and New Zealand demonstrates potential to expand seasonal worker opportunities.

**FIGURE 2.10 Pacific seasonal workers account for a small proportion of temporary work visas in New Zealand**



Source: Department of Labour 2013.  
 Note: The number of working holiday visas approved in Australia and New Zealand demonstrates potential to expand seasonal worker opportunities.

and less-educated Pacific Islanders while ensuring that these workers have adequate skills for employment within Australian and New Zealand businesses. New Zealand and Australia both have demonstrated strong commitment to improving development outcomes in neighboring Pacific countries over recent decades. Improved labor access for Pacific workers offers one of the most effective means of achieving this objective and can help to address growing labor shortages as the Australian and New Zealand populations age (box 7).

Policy action is also needed from governments in sending countries. Within Pacific island countries, continued investment is needed to build human capital through both health and education, so that working-age Pacific Islanders have the capacity to take advantage of the overseas opportunities that are available. This is an immediate priority in the “compact countries” of the North Pacific, where—despite populations having access to the U.S. labor market—remittance flows and development impacts have so far been limited because migrants can only access very low-paying work (Connell and Brown 2005). Basic numeracy, literacy, and behavioral skills are transferable across work types and countries and should continue to receive strong emphasis within human development strategies. More specifically, PIC governments could ensure that some qualifications are recognized internationally, through the adoption of Australian, New Zealand, or U.S. education standards. The Kiribati Institute of Technology, for example, now offers a curriculum and qualifications fully aligned with those of Technical and Further Education Australia, while international accreditation has been achieved by the Marine Training Centre, allowing graduates to access a wide range of international opportunities.

Policies should be designed to improve opportunities for women. Women have limited access to labor mobility options. The majority of participants in the Australian and New Zealand seasonal worker schemes are men, exacerbating gender differences in

### **BOX 7 Seasonal worker schemes in New Zealand and Australia are an important opportunity to expand work opportunities for Pacific people**

New Zealand's seasonal labor scheme was launched in 2007, allowing 5,000 workers to fill positions for 7 months over an 11-month period in the horticulture and viticulture industries. Kiribati, Samoa, Tonga, Tuvalu, and Vanuatu were selected for special assistance in mobilizing workers, but the scheme is open to all Pacific Island Forum member countries other than Fiji. A "New Zealander first" principle is applied, under which vacancies have to be lodged with government agencies responsible for social welfare benefits so that available opportunities are offered to local employment seekers before they are offered to migrant workers. Pacific workers can be hired directly by employers, through agents, or through a prescreened "work-ready pool" administered by government agencies. Demand has been strong, with the number of workers in the "work-ready pool" far outstripping the number of available places. Since its introduction, 24,600 workers have participated in the scheme (with annual quotas of 5,000–8,000 workers). More than half of workers return at least once, and 23 percent of workers have participated in all four seasons, suggesting that the scheme can provide a sustainable source of income. Knowledge of and access to the scheme are uneven, with the majority of workers from Tonga and Vanuatu.

The scheme has been subject to several evaluations (Department of Labour 2010; McKenzie and Gibson 2010; Merwood 2012; Research New Zealand 2012). The following are the key findings:

- *The scheme benefits employers.* Employers rate Pacific RSE workers higher than all other groups of employees for their dependability, enthusiasm while working, and productivity. Specifically, Pacific RSE workers are viewed as significantly more dependable, productive, and enthusiastic than all other categories of seasonal worker. Many employers (86 percent) believe that returning workers are "much more productive" than those in the initial season. Almost all employers (93 percent) believe that the benefits of participating in the scheme outweigh the costs. At least 95 percent of employers agree that participation

in the program has resulted in better-quality and more productive workers and a more stable workforce than in previous years.

- *The scheme benefits worker-sending families.* Research carried out in Tonga and Vanuatu found that participating in the RSE scheme has a large and statistically significant positive impact on household income per capita. Household expenditure per capita also increases with participation in the RSE scheme in Tonga. Substantial, statistically significant increases in subjective well-being were identified, along with positive impacts on housing quality and higher ownership rates of durable assets.
- *The scheme increases incomes of workers.* The median after-tax income earned in New Zealand, as reported by seasonal migrants, is approximately \$NZ12,000, several times the income per capita of those not participating in the scheme (approximately \$NZ1,400 in Tonga and \$NZ2,500 in Vanuatu).

With the New Zealand scheme considered "one of the most effective development policies evaluated to date," there is a clear case to expand the number of available places, including through expansion into additional sectors where domestic labor shortages are present or emerging (Mackenzie and Gibson 2010).

The Australian seasonal worker scheme was introduced following completion of a pilot scheme in 2012. An evaluation of the scheme's development impacts found significant benefits for the small number of participating households in Tonga, with incomes per household increasing almost 40 percent. Evaluations have also shown productivity benefits for participating farmers (Leith and Davidson 2013). But the scheme operates at a much smaller scale than the New Zealand scheme and has been subject to various implementation problems. During the pilot, 2,300 places were offered, but only 1,600 of these were actually filled. The number of workers recruited was around 100 a month in 2012, about half of the cap and a third of the number hired under the New Zealand program.

The largest constraint to uptake is the absence of labor shortages in targeted sectors of agriculture and horticulture. Such labor shortages have

*continued*

**BOX 7** *(continued)*

historically been very significant. But, in 2006, reforms were implemented under which primarily European “backpackers” on working holiday visas are offered one-year visa extensions subject to working for three months or more in the agriculture or horticulture sectors. These reforms—and the associated increase in supply of farm labor from backpackers—are reported to have almost entirely eliminated previously pressing labor shortages. The continued prevalence of illegal labor in the horticulture industry also undermines demand for seasonal workers. Additional factors constraining growth of the scheme include (a) lack of knowledge of the scheme among potential employers (a recent review found that around half of farmers have simply not heard of the scheme) and (b) perceptions that the scheme involves high transaction costs and red tape (Howes and Hay 2012).

Australia has recently decided to expand the scheme, opening opportunities in additional sectors, including tourism, and placing a higher cap on the total number of participants. However, uptake in new sectors has also been very low, and significant reforms of the scheme and broader policy settings are needed if it is to achieve the same success as the New Zealand program. The first priority is to address the existing policy distortion that encourages backpackers to work for short periods in the agriculture and horticulture sectors in order to access a visa extension. Options include simply removing this offer of extension to backpackers, offering it to those who work in a different or broader range of sectors, or making Pacific Islanders eligible for the same visa class (that is, the working holiday maker visa). Additional priorities include (a) addressing the

widespread use of illegal labor in the agriculture and horticultural sectors; (b) investing in promotion of the scheme to potential employers; (c) reducing the minimum number of employment hours in order to ensure a good balance between flexibility to employers and certainty to workers; (d) requiring employers to meet a lower proportion of travel costs (given the differential in minimum wages between Australia and New Zealand, most workers under the scheme would have the capacity to meet a larger proportion of transport costs); and (e) reviewing reporting and paperwork requirements to reduce transaction costs that are frequently cited as a major constraint to participation.

For both the New Zealand and Australian schemes, future work could also focus on opportunities to expand the participation of small PICs where domestic employment opportunities are most constrained and participation in seasonal schemes has so far been limited (such as Kiribati, the Solomon Islands, and Tuvalu). In these cases, further investment could be made in two important areas. First, donor agencies could do more to support training and vetting of potential participants to ensure that participating workers are able to meet the productivity expectations of farmers and other employers. This would maximize the likelihood of repeated participation and ensure that seasonal workers from that country build a good reputation among potential employers. Second, donor agencies could consider subsidizing the transport costs for those participating from more remote PICs. This would address an important existing cost wedge that disadvantages some of the small PICs with greatest need.

access to paid work. Such disparities arise primarily because of disproportionate male representation in the pool of workers nominated for potential selection by recruitment agencies and authorities within Pacific island countries. Such gender disparities may be of particular concern given evidence that women migrants remit a greater proportion of their income more regularly and are more likely to send remittances to other women

members of the household (Connell and Brown 2005). Broadening seasonal work opportunities in sectors such as hospitality would be likely to create new opportunities for women. Expansion of permanent migration schemes may also have positive gender impacts. Evidence from Fiji and Tonga suggests that equivalent numbers of men and women are able to access long-term and permanent migration opportunities (Luthria

et al. 2006). Family access provisions under preferential New Zealand schemes allow spouses to access the New Zealand labor market, regardless of the gender of the primary applicant, ensuring rough gender balance. Ensuring equitable access to educational opportunities for women (including support for dependent family members for scholarship recipients), increasing women's participation in seasonal schemes (including through addressing constraints to uptake in new sectors), expanding permanent migration opportunities for families, and closely monitoring the impacts on women of the long-term absence of males from households participating in seasonal schemes are important priorities.

International assistance is needed to support the policy and institutional improvements required for increased international mobility of Pacific Islanders. Institutions with responsibility for negotiating international labor arrangements need to be strengthened. Financial and technical support continues to be needed for agencies facilitating the participation of workers in regional or global schemes, such as divisions within PIC foreign ministries responsible for selecting workers for participation in Australia's and New Zealand's seasonal worker schemes. Finally, ongoing aid assistance for all levels of education—including provision of tertiary scholarships—can provide a major boost to prospects for increased labor mobility through seasonal and permanent schemes.

### 2.3 Urbanization

*Priority 3 Make the most of urbanization through investment in rural services, connective infrastructure, and improved urban administration*

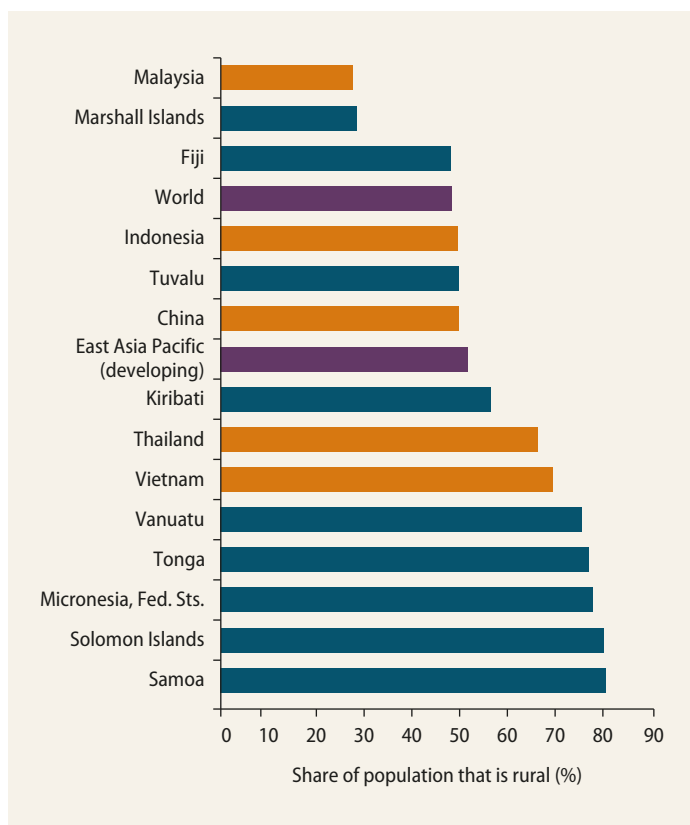
- *Summary.* Urbanization brings employment benefits if it allows the realization of scale economies, greater thickness in markets, and increased specialization. But urbanization occurring as a result of poor services in rural areas, conflict, food insecurity, or land shortages simply leads to congestion

and urban unemployment, delivering few economic benefits and placing pressure on social cohesion. Policies should not be biased toward jobs in either urban or rural areas, but rather seek to ensure acceptable standards of living across all communities and allow individuals to respond as they choose to the concentration of economic opportunities in urban areas.

- *Countries of relevance.* Rapidly urbanizing Pacific island countries, including Kiribati, the Marshall Islands, the Solomon Islands, and Vanuatu.
- *Living standards.* Access to paid employment is, and will likely remain, concentrated in urban areas. People should be free to seek the broader opportunities available in cities. But adequate living standards, involving access to adequate services, must be maintained in rural areas.
- *Productivity.* Population concentration allows specialization and some economies of scale. Urbanization therefore presents an important opportunity for productivity growth. Subsidizing work in particular places is an inefficient use of resources and undermines the potential benefits of concentration for private sector development.
- *Social cohesion.* Poorly managed urbanization can weaken social cohesion. Public investment should be prioritized toward improving urban administration and services rather than preventing urbanization from occurring.

Urbanization is an important phenomenon for employment in the Pacific. Pacific cities are growing very rapidly. Measured as the percentage growth of urban populations, Kiribati, the Solomon Islands, and Vanuatu are urbanizing at similar rates as the rapidly growing East Asian economies (figures 2.11 and 2.12).<sup>8</sup> Even in countries where recorded rates of urban growth are slower, urbanization is frequently cited as a major policy issue. A challenge for policy makers is to ensure that the potential benefits of urbanization can be realized while minimizing the costs.

Urbanization can be an engine of growth and employment opportunities. It is typically

**FIGURE 2.11 Pacific populations remain largely rural**

Source: United Nations Department of Economic and Social Affairs.

associated with higher incomes, improved service quality and coverage, lower fertility rates leading to slower population growth, more integration with global markets, and diversification leading to broader economic opportunities (World Bank 2008; United Nations Center for Human Settlements 1994; see figure 2.13). Urbanization in PICs can provide an engine for employment creation. Increased urban populations offer businesses the opportunity to integrate into supply chains, thicker labor and input markets, and larger markets for goods and services. While prospects for export-driven diversification into manufacturing and service exports are likely to remain limited even in the largest Pacific island cities, the best prospects for expanding private sector opportunities in the

provision of services for local markets, including the public sector, lie in a more urbanized future. Urbanization also offers governments the chance to provide services and infrastructure at efficient scale—reducing the costs associated with serving dispersed and inaccessible rural populations—and facilitating important improvements in quality and coverage. Many Pacific Islanders demonstrate a strong revealed preference for urban life, which provides improved access to earning opportunities, relief from the insecurity and physical labor associated with rural subsistence, access to consumer goods and services, and the prospect of upward social mobility.

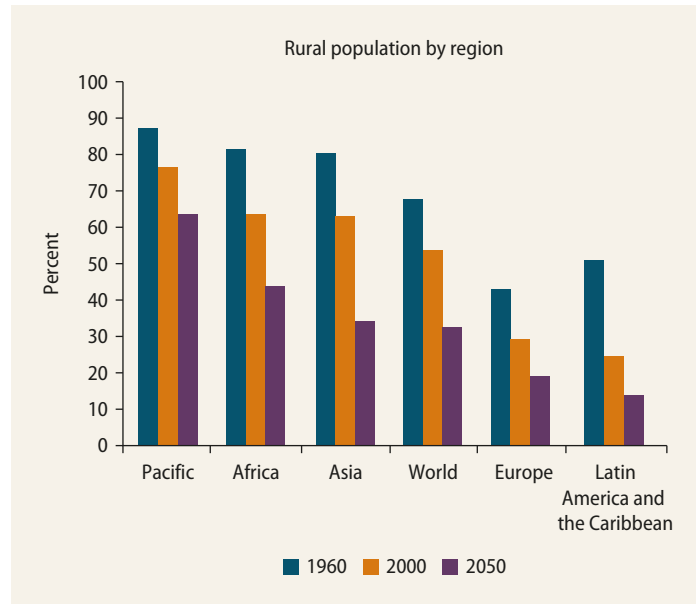
Urbanization in PICs is not always happening for the right reasons. People who are moving to cities are not always doing so because they expect more productive and better-paid work. Rather, urbanization is also being fueled by a lack of adequate services and declining living standards in rural areas (figures 2.14 and 2.15). For these reasons, some PICs face an unusual combination of slow economic growth and rapid urbanization (figure 2.16). Even when relatively broad coverage is achieved in rural areas, the quality of services typically lags far behind what is available in urban areas. Inadequate services are compounded by poor agricultural productivity. Agricultural production in PICs remains concentrated around smallholder subsistence production, with marketing options often constrained by insufficient scale, poor transport links between islands or regions, limited access to finance, and lack of knowledge and training on agricultural production techniques. Subsistence farming in rural areas is often only weakly linked to food markets in urban areas, with PICs heavily reliant on food imports despite large agriculture sectors. There is little evidence of any significant increase in agricultural productivity in PICs over recent decades, while population growth has placed pressure on agricultural subsistence systems in some areas.

Potential benefits are in danger of being outweighed by a range of social and economic costs. Rather than moving into

productive work that spurs economic growth and finances increased service delivery, many urban arrivals face limited prospects and simply add to the burden on overstretched urban services and infrastructure. Urbanization in PICs is therefore often associated with a higher risk of poverty, high youth unemployment, and frustrated aspirations for social mobility, feeding into increased rates of substance abuse, crime, and loss of social cohesion (Allen and others 2013). The breakdown in family structures and informal social safety net systems as young people move to cities has led to unprecedented levels of inequality and crime. These dangers are frequently cited in analyses of Pacific urbanization and are reflected in available statistics on crime and violence (Connell 2011; ADB 2012a; United Nations Office on Drugs and Crime data from Storey 2003).

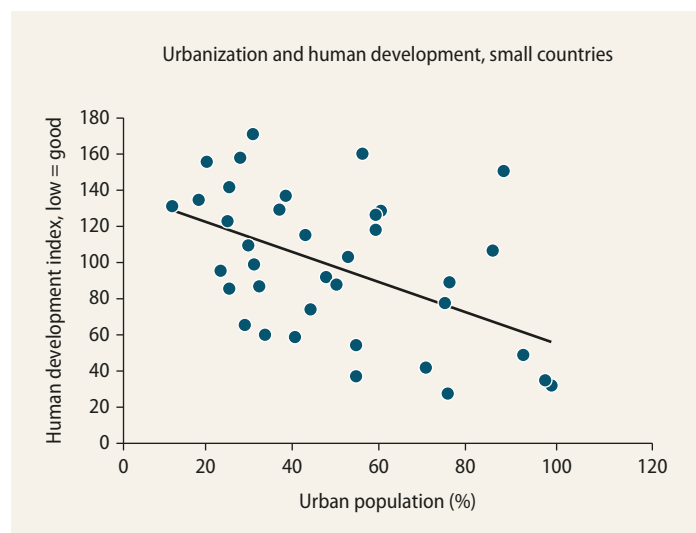
The right reforms can facilitate both urban and rural development (box 8). Policy discussions of urbanization in PICs often pose an artificial choice between rural and urban employment. Obvious problems of urbanization, accompanied by stagnation in rural livelihoods, have fostered opposition to urbanization and fed perceptions that economic development in urban centers is occurring at the cost of development in rural areas. Common complaints include the inequitable concentration of public and private sector employment in urban areas, the loss of human capital in rural areas as working-age people move to cities, and growing disparities in access to services and infrastructure between urban and rural areas. But economic development is not a zero-sum game, and urban development does not have to impose costs on rural areas. Urbanization can provide a pathway to employment for many if it occurs for the right reasons. With appropriate linkages between urban and rural areas, economic opportunities in urban areas can support improvements in rural standards of living. At the same time, reasonable services and living standards in rural areas can ensure that urbanization is driven by opportunity rather than desperation and leads to good outcomes. Focusing on the following policy

**FIGURE 2.12** And this will continue despite urbanization

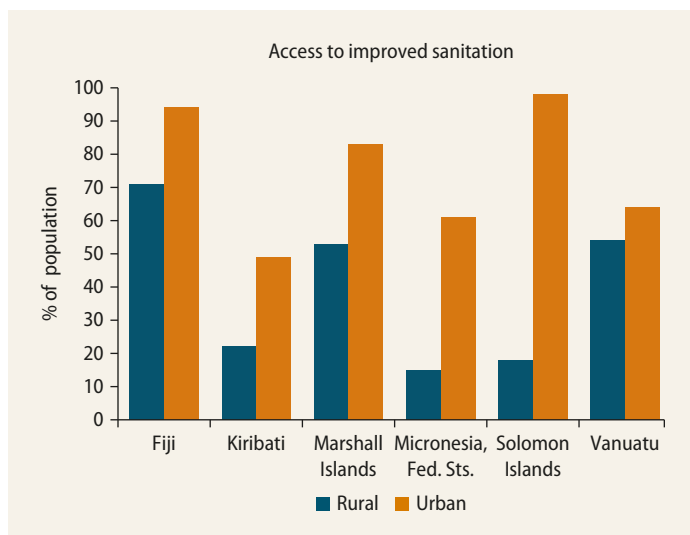


Source: United Nations Department of Economic and Social Affairs.

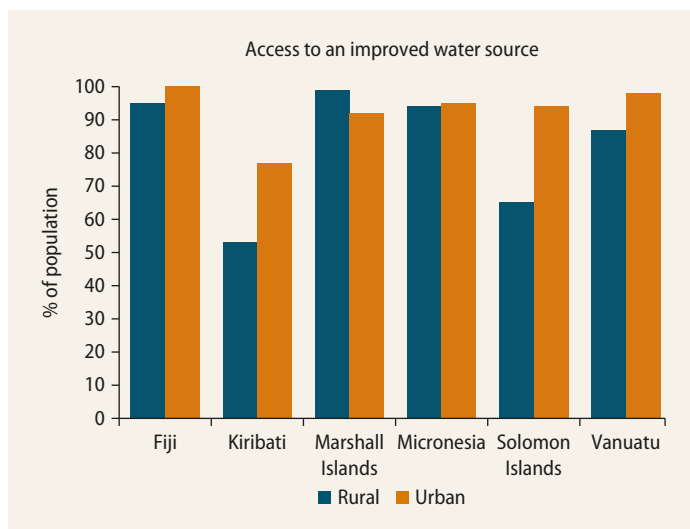
**FIGURE 2.13** Urbanization is associated with improved human development



Source: World Development Indicators.

**FIGURE 2.14** Access to sanitation in rural areas is not as good as in urban areas

Source: World Development Indicators.

**FIGURE 2.15** Access to water in rural areas is not as good as in urban areas

Source: World Development Indicators.

areas may increase the likelihood of complementary urban and rural development:

- *Avoid policies to prevent urbanization.* In several PICs, policies have been discussed or implemented that are explicitly

intended to slow or prevent urbanization and redistribute economic production to rural areas. Examples include (a) the explicit or implicit subsidization of economic activities in rural areas (including production subsidies and government investment in production facilities); (b) deliberate underinvestment in provision of urban services and infrastructure to growing urban populations (especially in squatter settlements where recent arrivals are concentrated); (c) absence of measures by which squatters can acquire formal land rights; and (d) destruction of residential and commercial properties in settlement areas by state or municipal authorities. Such measures have destroyed jobs and seldom fostered sustainable economic growth in rural areas or arrested the pace of urbanization.

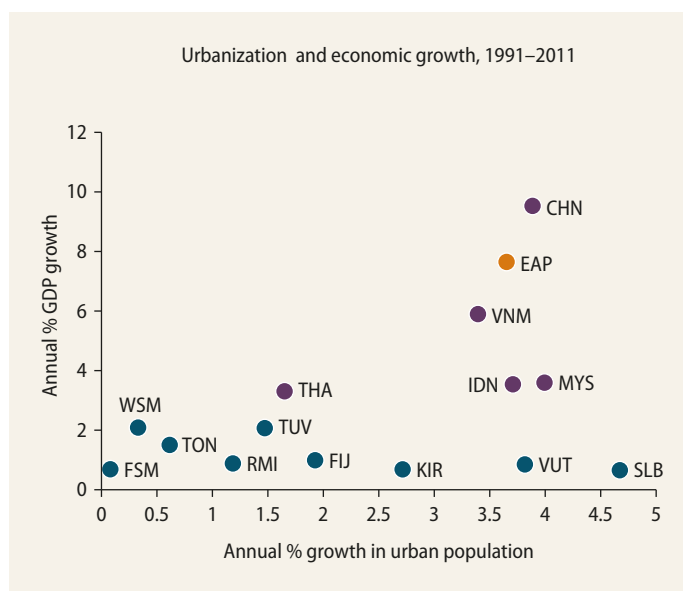
- *Provide adequate basic services across all communities.* Urbanization fueled by uneven access to services leads to the congestion of urban facilities and excess supply of low-skilled labor in urban areas. Relatively large aid flows to PICs provide an opportunity to finance a basic standard of services in all communities, allowing migration decisions to be based on economic opportunities and preferences rather than basic service needs.
- *Invest in connective infrastructure.* Rural areas can share the benefits of increased employment opportunities and improved service delivery in urban areas if people, goods, and information can move freely and at reasonable cost. Infrastructure links between capitals and other areas of concentrated population are vital to facilitate the supply of urban markets by rural producers. Subsidization of transport links can facilitate access of rural people to urban services, reducing urbanization motivated by the desire to access services. Good-quality, low-cost, and reliable transport can also allow people to take advantage of work opportunities on a short-term basis, as they arise, allowing reversibility and reducing the risks facing persons seeking urban jobs.



- *Facilitate efficient use of urban land.* Lack of access to land and dysfunction in land markets often undermine living standards and private sector development in urban areas. It is important to ensure that housing is available to new arrivals in urban areas and that land is allocated to its most efficient use. Measures that provide formal recognition of landownership and transactions in squatter areas can provide vital security to new migrants and facilitate improved access to finance when property rights over land can be used as collateral. Reforms to land administration in urban areas, where land has typically been alienated from traditional ownership, can often be implemented without undermining collective land ownership systems in rural areas (AusAID 2008).

Urbanization gains can be increased through urban investments that take account of the needs of women. Research from the region demonstrates that women stand to benefit from improved services and access to income generation opportunities resulting from urbanization, supporting broader economic and development gains. Gains, however, are often constrained by

**FIGURE 2.16** Slow growth is not preventing urbanization in some Pacific island countries



Sources: United Nations Development Programme and World Development Indicators.

household work requirements limiting the time available for broader economic participation. Infrastructure that meets the transport needs of women can free up women's time for new economic activities, as can

### **BOX 8** A copra subsidy scheme intended to support rural development in Kiribati is costly and inefficient

Kiribati has one of the most widely dispersed populations in the world. While nearly half of the population of 100,000 lives in and around the urban center of South Tarawa, the other half is distributed across 20 islands spread across 3.5 million square kilometers of ocean. Since independence, the government has operated a copra subsidy scheme, through which inhabitants of outer islands can sell copra to a state-owned enterprise at a regulated price. Copra production has become the primary source of cash income for many communities in the outer islands, and the scheme is explicitly intended to protect livelihoods and reduce urbanization pressures in the outer islands.

But with volatile world copra prices, inefficiencies in processing, and high transport costs, the scheme is imposing increasingly unaffordable costs on government. There is an economic loss of more than US\$1 for every kilogram of copra produced in the outer islands, with total costs of the scheme reaching nearly 5 percent of GDP. The scheme is also regressive, as food and basic needs poverty is concentrated in urban areas. Government is working with the World Bank to reform the scheme. Difficult trade-offs will need to be made between subsidizing rural livelihoods to avoid urbanization pressures and redirecting available resources into more efficient investments in urban services and infrastructure links that may encourage urbanization.

good coverage of sanitation and water services. Adequate public investment in laws and institutions to prevent crime and sexual exploitation can also facilitate women's participation in a broader range of economic activities (box 9).

## 2.4 Public spending

### *Priority 4 Ensure that public spending delivers efficient services and creates employment*

- *Summary.* Public sectors in Pacific island countries are often viewed as a source of concern, with public sector employment thought to exist at the expense of private sector employment. In reality, scope for private sector-led employment creation is often constrained by geography, and public sectors, while large relative to the size of the economy, remain small in absolute terms. This is especially true when diseconomies of scale in administration and service delivery are taken into account. Policy attention can usefully focus on improving the quality of public sector jobs, regarding what they provide for civil servants and society, rather than on reducing public sector employment.
- *Countries of relevance.* All Pacific island countries, especially those where populations are very small and employment is concentrated in the public sector.
- *Living standards.* Public servants tend to enjoy higher living standards, with salaries often supporting larger family and community networks.
- *Productivity.* Incentives for effort and skills acquisition are sometimes blunted in the public sector. Selective use of private participation and continued public sector reform have the potential to achieve productivity gains.
- *Social cohesion.* Social cohesion would be strengthened if appointments in the public sector were based on merit and employment opportunities were distributed equitably among social groups and geographic areas.

The public sector provides a large share of cash employment in many Pacific island countries (figures 2.17 and 2.18). PICs face challenges in meeting the high fixed costs associated with a fully functioning sovereign government. Because there are large economies of scale in operating the various institutions required for governance and service delivery, the costs of government are high relative to the size of the economy. At the same time, barriers of geography prevent rapid employment growth in export-oriented manufacturing and services. Consequently, public sector employment is likely to continue to represent a large share of total formal and cash-earning employment, especially for the smallest PICs. Given the continued importance of the public sector, an important challenge for PICs is to ensure that public sector jobs are good jobs, both for public servants and for society.

The benefits of public sector employment are broad and widely shared. Public sector salaries are often well above average levels of income. Recent analysis suggests that the average public servant earns around 5 times GDP per capita in Kiribati and around 2.8 times GDP per capita in Tonga, compared to global norms of about 1.2 times. In both countries, public service salaries are also higher than average private sector salaries. Benefits of public sector employment also include training opportunities, international travel, and opportunities to form global networks that would be very unusual in most private sector employment. Given strong social pressures for sharing wealth, the benefits from higher pay and broader opportunities are often widely shared, with every public sector job often supporting the living standards of a wider family group or community. Training and networking opportunities available to public sector employees are often a key gateway to international labor market opportunities and much higher standards of living, sometimes via scholarships and further higher education.

Public sectors in PICs experience the same incentive problems as public sectors in the rest of the developing world. Given the extent to which their economy-wide resources are

### BOX 9 Unmanaged urbanization increases poverty and weakens social cohesion in the Solomon Islands

The squatter settlements of Honiara illustrate many of the issues associated with rapid urbanization in PICs. Evidence from the national census and the “people’s survey” commissioned by the regional peacekeeping and reconstruction force reflect the risks associated with rapid urbanization driven partly by uneven access to services (figure B9.1).

These surveys show that persons living in urban areas not only have far greater access to paid employment than persons living in rural areas, but also far greater access to services and infrastructure. As Solomon Islanders move to access both economic opportunities and better services, the population of Honiara has grown at around 5 percent a year. Weak land administration has led to inflexible land use, contributing to housing shortages and forcing many immigrants to live in squatter settlements located outside the formal town boundaries and with limited access to services and infrastructure.

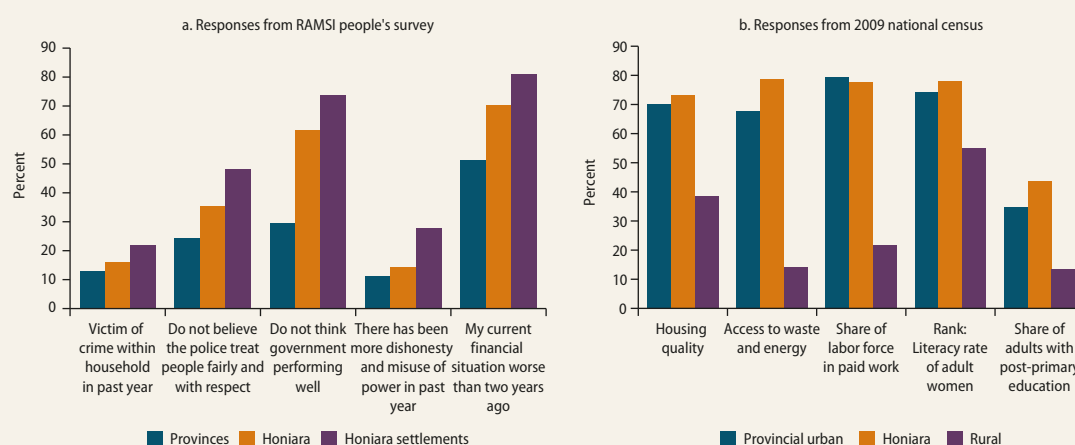
With urbanization being driven by both economic opportunities and the desire to access services, labor supply has outgrown demand. Underemployment

is widespread, especially among youth; in a recent survey, 67 percent of youth residing in the squatter settlement of White River reported that they had no regular source of cash employment and were looking for work. These dynamics have led to declines in social cohesion, including higher levels of crime and violence and dissatisfaction with the performance of police and government.

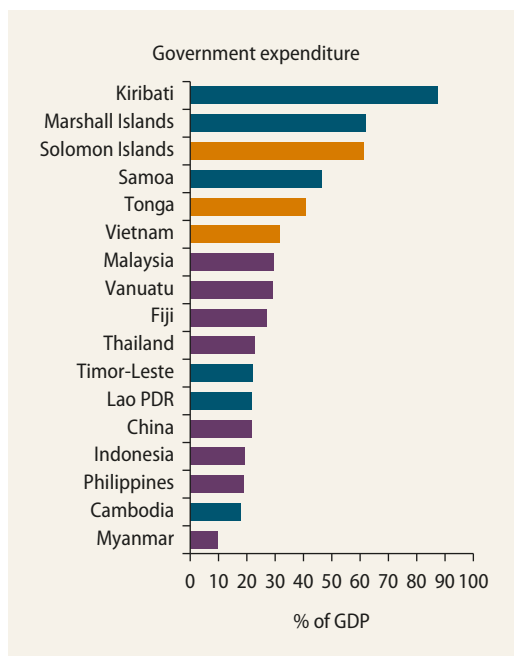
There is little evidence of significant return migration to rural areas, and challenges in urban areas need to be addressed. Improved administration, improved services, and better infrastructure in urban areas might allow Solomon Islanders to continue to seek the economic opportunities associated with urbanization without facing such severe declines in living standards and social cohesion. Increased investment in rural services might reduce the incentives for migration for those with little prospect of finding employment.

Sources: World Bank 2010a; Regional Assistance Mission to Solomon Islands people’s survey 2011; Solomon Islands National Statistics Office.

FIGURE B9.1 Rapid urbanization in the Solomon Islands is accompanied by risks



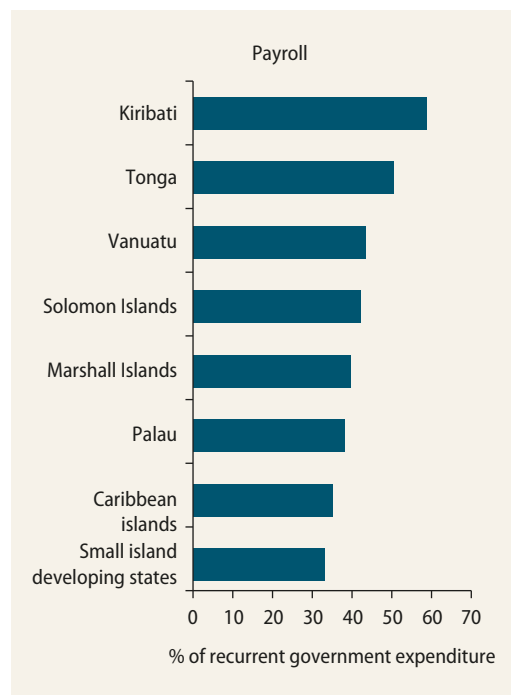
Sources: Data from the Regional Assistance Mission to Solomon Islands (RAMSI) people’s survey, 2011; national census, 2009.

**FIGURE 2.17** Government in Pacific island countries is large

Source: Estimates based on data from country authorities.

invested in the public sector, efficiency in public administration and in the delivery of public services is especially important. Good public sector jobs would provide strong incentives for human capital development and productivity, while also supporting adequate living standards for public sector workers and their families. Public services in Pacific island countries, however, face common challenges, including limited accountability, weak performance management systems, and severe capacity constraints that impede the delivery of core government outputs and functions (ADB 2010b). The severity of these challenges varies across countries, but public sector employment, while providing benefits for public sector employees and their families, often does not have as positive an impact on society as it could (ADB 2010b). These issues often lead to calls to reduce government spending and the role of government in the economy.<sup>9</sup>

There is little evidence that simply reducing public spending would lead to improved

**FIGURE 2.18** Public service employment is substantial

Source: Estimates based on data from country authorities.

employment opportunities in PICs. Well-paid jobs in large public sectors can come at a cost to the private sector, with businesses facing higher taxes to support bloated governments and increased public sector competition for labor and associated wage inflation. However, it is not clear that the public sector is crowding out the private sector in PICs.

First, a large proportion of government revenues typically comes from natural resource royalties and aid. Government spending often supplements domestic demand, with public servants supporting the emergence of private sector service economies, especially in capital cities. For some countries, economic growth has closely tracked growth in public spending, with changes in public sector demand exerting a determining influence on private sector performance (see box 10).

Second, given sluggish growth, reliance on natural resource industries, and the predominance of agricultural work, it is not

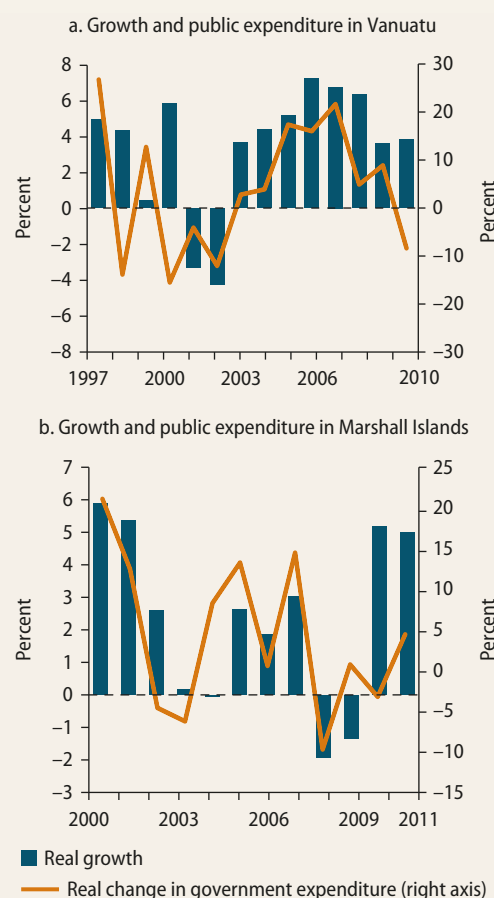
### BOX 10 Public sector expenditure supports economic growth in Vanuatu and the Marshall Islands

The recent experiences of Vanuatu and the Marshall Islands illustrate the potential for public expenditure and public employment to “crowd in” private sector activity, supporting broader economic growth.

In Vanuatu, tourism-based private sector growth during the previous decade drove a rapid increase in government revenues. This revenue growth supported rapid increases in government expenditure and employment (an increase in real wage expenditure of more than 50 percent), with changes in aggregate economic growth, tourism arrivals, and government spending closely aligned. With many tourism operations weakly integrated into local supply chains, growth of public expenditure through increased tax revenues supported a broader expansion of paid employment opportunities both within the public sector and in private sector businesses supplying goods and services to public servants and government entities.

In the Marshall Islands, under renewed arrangements for fiscal transfers from the United States, public expenditures grew at an annual average rate of 12 percent between fiscal 2003 and fiscal 2007. Employment in the public sector added 507 jobs, growing at an annual average rate of 6 percent over the period. Expansion in public spending fueled growth of 1.9 percent in this period, peaking at 3 percent in 2007. With the flattening off of public expenditure, growth fell during 2008 and 2009, but recovered during 2010 and 2011 partly due to the impact of new publicly funded infrastructure projects. Public expenditure was the dominant driver of both employment creation, inside and outside the public sector, and economic growth in an economy with limited alternative prospects (figure B8.10.1).

**FIGURE B10.1** In small Pacific island countries, public expenditure and economic growth move in tandem



Source: Estimates based on data from country authorities.

clear that public sector workers could find employment acceptable to them in the private sector if the size of government were substantially reduced. For many jobs, competition for labor between the public and private sectors is not always apparent. In some cases, higher public sector salaries for more senior

or specialized staff often reflect a legitimate attempt to retain the vital skills required to undertake key government functions in the context of a very narrow pool of appropriately educated professionals and competition from overseas employers, nongovernmental organizations, and donor agencies. Recent

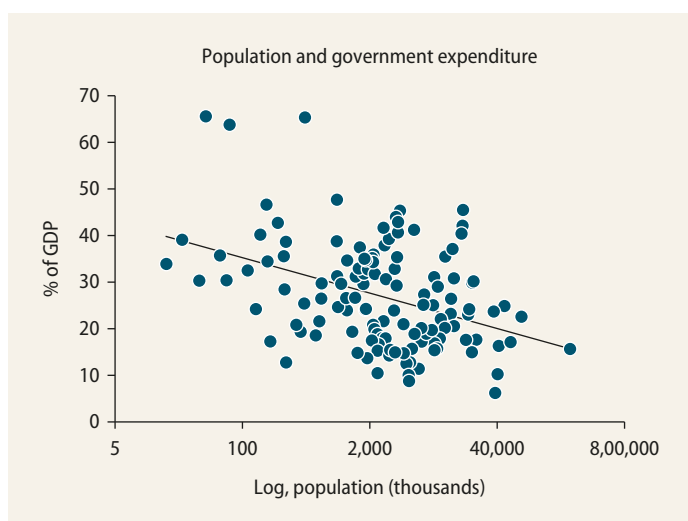
reviews of the experience of public sector reforms in the Pacific cast serious doubt on the assumption that the private sector will necessarily absorb retrenched public employees in the context of widespread redundancies (ADB 2009a; Collins and Warrington 1997). The large-scale retrenchment of public sector workers in the Cook Islands and the Marshall Islands led to the emigration of qualified workers rather than their absorption into the private sector.

Finally, public sector spending and public service numbers may need to be large, relative to very small economies and populations, to ensure the delivery of vital services (Brown 2010). Cross-country evidence shows that small countries tend to have larger public sectors and more public sector employment, reflecting diseconomies of scale in service delivery and administration (figure 2.19). Reducing the capacity of governments to hire and retain enough people to carry out all the necessary functions of government and provide the public goods required for successful private sector activity is likely to have an adverse impact on living standards, employment creation, and productivity (World Bank 2011).

Outsourcing and privatization should be approached cautiously, but they can sometimes bring benefits. Outsourcing the delivery of services and privatizing government agencies that can operate on a commercial basis are often seen as an effective means of overcoming the agency problems associated with public sector delivery of services. The profit motive and competition can sharpen the incentives for productivity, feeding through into better services at lower cost. Privatizing state-owned enterprises that were competing directly with the private sector in Kiribati, Samoa, and other PICs has led to the expansion of employment opportunities and improvements in services, as inefficiencies associated with poor public sector management have been eliminated (ADB 2011). Restructuring the road transport sector in Samoa to allow the outsourcing of road maintenance has facilitated the emergence of several efficient and well-run private sector firms that provide both employment and vastly improved services to government. But privatization and outsourcing in the absence of a competitive market environment can also undermine service delivery and employment creation. Inadequately regulated private monopolies are no better than public monopolies at expanding access to services and are more likely to involve loss of local employment and expatriation of monopoly rents. Efficient delivery of outsourced government services relies on competition for contracts and effective monitoring of delivery by government agencies. While outsourcing and privatization continue to provide important opportunities for increasing work in the delivery of public services, these opportunities need to be pursued carefully, taking account of the following:

- The economic significance of efficiency benefits that could be achieved through the introduction of private participation
- The impacts on living standards and social cohesion arising from associated public sector employment losses, especially in the context of limited private sector employment opportunities

**FIGURE 2.19** Government is bigger in smaller countries



Source: World Development Indicators.

- The capacity of government to monitor and enforce contractual or regulatory arrangements effectively to realize any potential benefits of private participation.

Basic public sector management systems are important. Given constraints on the range of government functions that can be delivered effectively by the private sector, dramatic reductions in the size of the public sector and public service are unlikely in PICs over the medium term. Because of this, basic systems for public sector management, performance, and accountability need to be improved further. Performance-based budgeting and performance-based pay are likely to be too capacity intensive for effective implementation in PICs over the medium term and to require institutional underpinnings that are seldom present. Public financial management systems that improve transparency and encourage public dialogue regarding the use of resources may represent a useful initial

priority to align public sector incentives better with efficient service delivery, along with public sector pay scales and merit-based promotions that generate substantial incentives for skills development and productivity on behalf of individual public servants. Ensuring merit-based appointment and promotion in the public sector is also vital, given the likely continued importance of the public sector as a source of employment. Recent experiences during the Arab Spring indicate the extent to which frustrations regarding nepotism and inequality in the distribution of public sector opportunities can undermine social cohesion and fuel conflict (World Bank 2010b, 2012a).

Donors can support increased local employment in the delivery of projects (box 11). With a substantial proportion of public expenditure in small PICs being financed by overseas development assistance, donors can also contribute to local employment creation by increasing the participation of local vendors and labor in project delivery.

### BOX 11 Outsourcing aid?

Experience with involving local private sector firms in the delivery of aid projects in PICs suggests that such arrangements are not always easy, but can provide long-term benefits both through better projects and the creation of employment opportunities. Donors could consider the following lessons:

- *Actively build, rather than expect the spontaneous emergence of, a private sector able to meet donor needs.* This means providing a sustained source of demand to keep growing firms in business as their capacity improves.
- *Do more to advertise procurement opportunities and streamline procurement processes.* Pacific firms are not likely to come across donor procurement opportunities as they are currently advertised. Ensuring local awareness of opportunities is an important priority. Donors could also ensure that bidding processes are not too complicated for capacity-constrained Pacific firms or could provide direct assistance in preparing tender documents.
- *Ensure that contracts are offered at a size and scope that facilitate local participation.* While not always feasible, dividing work into smaller contracts may provide more opportunities for local firms.
- *Move beyond a single-project perspective when considering the participation of local firms.* Putting the time and effort into engaging local firms may not look appealing for the purposes of any one project. But if gains can be expanded and capitalized on by subsequent projects—through lower costs and better-quality delivery—the cost-benefit equation is likely to look more favorable. It is therefore vital that decisions made at the project level take into account the potential for broader benefits.
- *Make trade-offs between project-level efficiency and broader social and economic benefits.* Involvement of local contractors may sometimes delay projects and force compromises on quality relative to reliance on international contractors. These costs need to be traded off systematically against broader development benefits when decisions are made.

Donors could introduce preferences in their procurement processes for businesses using local labor or produce. Donors could also make greater use of general and sector budget support, with expenditure of this kind typically having a larger impact on local employment than project financing.

## 2.5 Natural resource industries

### *Priority 5 Generate sustainable employment from natural resource industries*

- *Summary.* Natural resource extraction is often seen as an easy source of new employment. In reality, employment in natural resource industries in the Pacific is often unsustainable, of poor quality, and reliant on implicit or explicit subsidies. Countries with natural resource endowments should support employment creation in natural resource industries based on careful consideration of the likely quality of associated work, taking careful account of the opportunity costs of the implicit and explicit subsidies often required.
- *Countries of relevance.* Pacific island countries with natural resource endowments, including fisheries, minerals, and forestry.
- *Living standards.* Natural resource industries have a poor record of delivering sustainable improvements in living standards in the region. The most sustainable improvements may come from investing rents from these activities in areas that open new employment opportunities in other sectors, locally or internationally.
- *Productivity.* Investing rents from natural resource industries into improved service delivery and human capital can avoid the problems of low-productivity employment in natural resource industries.
- *Social cohesion.* Social cohesion can be undermined by geographically concentrated, short-term natural resource-related employment. Public investment of natural resource rents can provide broader and more equitably distributed opportunities.

Natural resource opportunities, including tourism, attract investment to areas where resources and attractions are located rather than to where business costs are low. High business costs in PICs do not, therefore, preclude investment, as economic rent can be earned from the exploitation of natural resources even given the high costs associated with distance. This is reflected in Pacific island countries' historically high reliance on fisheries, minerals, forestry, and tourism for foreign exchange and income. With rapid growth in international tourism arrivals projected over coming decades, a large share of global stocks of certain fish species located in Pacific waters, and ongoing discoveries of new mineral wealth in the region, PICs will continue to attract the attention of natural resource investors (figure 2.20).

Policy makers and the public often want to see substantial direct employment created from natural resource endowments, given growing populations. Sometimes, governments have considered or pursued mandates for local employment creation as a negotiated condition of resource access or have provided tax exemptions or subsidies to encourage tourism investments expected to bring employment. The labor intensity of extractive natural resource industries is typically very low. Work with higher pay and productivity within natural resource industries is often highly specialized and tends to be performed by expatriates rather than local labor. Because PICs lack economies of scale, there are limited opportunities for development of ancillary industries around natural resources, and natural resource industries are not typically integrated into local chains of production. It is generally cheaper for natural resource investors to process products overseas than to develop local production chains, given high operating costs and skill shortages. The forestry industry in the Solomon Islands, for example, which has contributed double-figure shares of GDP and government revenues for several decades, employs only around 5,000 unskilled workers, mostly at wage rates below the national minimum established for all other industries (World Bank 2010a).



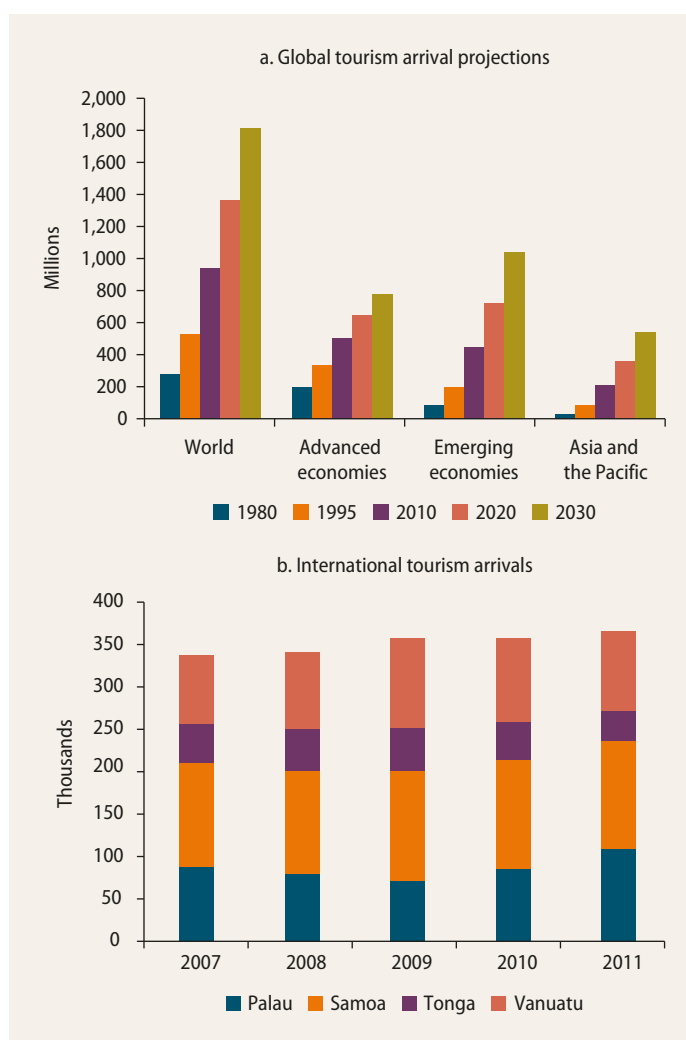
Nearly all processing is undertaken offshore, and forestry methods are purely extractive, with very little local investment. Pacific tuna fishery resources are among the largest in the world and generate more than 10 percent of government revenue for four PICs. But onshore processing and value added have been difficult to establish, with employment in the industry contracting in the years since independence (Gillett 2009).

The need to subsidize tourism investment reflects pressures of regional and global tax competition. In contrast to extractive industries, tourism is relatively labor intensive, hires a large percentage of local workers, and can be better integrated into local supply chains with broader economic impacts (Scheyvens and Russell 2009). For this reason, tourism investment is often attractive, with several PIC governments offering tax concessions for tourism investors. This has fueled “tax competition” in the region, with governments competing to offer the most favorable tax or investment incentive package to international investors, despite high fiscal costs and limited evidence that such concessions exert a determining influence on investment decisions (James 2009).

While tourism has been proven to generate employment that is reasonably sustainable and can open the doors to broader opportunities in Pacific countries, work based on extractive natural resource industries is often short term and limited to the lifespan of extractive activities. Creating unsustainable employment creates risks of lower living standards and pressures on social cohesion when natural resources are exhausted and employment opportunities cease. Work based on extractive natural resource industries also tends to be geographically concentrated around the location of resources. Such concentration can lead to rapid growth in inequality, rapid internal migration, and a corresponding emergence of conflict pressures—a possibility illustrated by natural resource development in Papua New Guinea (Collier and Hoeffler 2004).

Employment in natural resource industries can have negative impacts on women.

**FIGURE 2.20** Tourism to the Pacific island countries is expected to keep growing



Source: World Tourism Organization.

Gender discrimination limits the role of women in fisheries in many Pacific island countries, due to prevailing cultural divisions of labor (Novakzec, Mitchell, and Veitayaki 2005). As a result, access to economic opportunities around the tuna industry is strongly gendered in favor of men (Barclay and Cartwright 2007). Fishing, logging, and mining activities have been associated with increased sexual abuse and exploitation in Pacific island countries (Herbert 2007).

More generally, cross-country evidence suggests that reliance on natural resource industries reduces and discourages female labor force participation, which reduces women's political influence (Ross 2008; World Bank 2012b). The historical reliance of PICs on natural resource industries may help to explain, at least in part, slow progress toward gender equality, particularly with respect to voice and influence in society (World Bank 2012a).

Decisions to subsidize employment creation in natural resource industries and tourism should be informed by careful analysis of the opportunity costs of alternative public investments (box 12). Ultimately, the public bears the costs of tax concessions and employment creation mandates. Concessions lead directly to forgone tax revenue. Mandating job creation for natural resource industries is only required if such jobs are not efficiently undertaken locally, and government will likely have to meet

the costs of associated economic inefficiencies in the form of lower royalties, access payments, or profit taxes. As an alternative to mandating or subsidizing direct employment creation in natural resource industries, PICs could support overall employment in other ways: directly (through sustainable increases in public employment) or indirectly (through investment in the human capital, infrastructure, and social services that can support new economic opportunities in a broad range of sectors, locally and overseas). Therefore, policy makers have to consider carefully the full explicit and implicit costs and benefits of subsidizing employment in natural resource industries and take account of alternative employment-creating investments that potentially could be financed with these resources (box 13). This requires the following:

- Careful long-term costing of employment creation concession agreements for

### BOX 12 Employment in fisheries or employment supported by fisheries revenues?

The fisheries industry in the Pacific is a good example of the pressures faced by government to create work in natural resource industries.

For several decades, Pacific island countries have been working to conserve fish stocks and increase license revenues through coordinated control of access to fisheries resources. Substantial progress has been made in recent years through the establishment of a vessel day scheme by eight Pacific countries with the most significant tuna resources (Kiribati, the Marshall Islands, the Federated States of Micronesia, Nauru, Palau, Papua New Guinea, the Solomon Islands, and Tuvalu). Under this scheme, participating countries are allocated a fixed number of "vessel days," through which rights to undertake any fishing activity are allocated to purse seiner vessels for a 24-hour period. Vessel days can be traded between countries, with the total number of vessel days issued under the scheme nominally equivalent to total effort in 2008. By imposing

coordinated controls on access, implementation of the vessel day scheme has allowed parties to the Nauru Agreement to generate significantly higher license fees and improve data collection, strengthening the prospects for sustainable management of the resource. Estimates based on limited public data suggest that the value of a fishing day may have increased from around US\$1,350 in 2004 to more than US\$5,000 due to the impacts of the scheme (Havice 2013).

Progress toward maximizing license revenues, however, is being slowed by a countervailing trend toward granting special access rights or discounted licenses to foreign fishing firms that commit to supporting domestic economic development and employment (typically through offloading, provisioning, infrastructure investments, and employment of crew). Such discounted access arrangements are sometimes accompanied by tax concessions and various forms of subsidization to fishery operators.

*continued*

**BOX 12** (continued)

The number of vessels operating under such arrangements increased from 16 in 2001 to 53 by mid-2012, contributing an 18 percent increase in total purse seiner business between 2004 and 2010. PIC governments are often of the view that the employment and direct economic impacts of such arrangements are worth more than the corresponding loss of license fees and revenues. However, policy decisions to grant special access or discounted licenses have seldom been informed by detailed analysis of the costs and benefits. Revenue costs have not been fully calculated. Expected employment creation has sometimes not been realized. Dividends from government shares in joint venture companies have not been forthcoming due to poor accounting practices.

As a result, the primary beneficiaries have been foreign fishing companies.

Pacific island countries with the greatest fisheries resources now face a difficult decision between granting further discounted licenses guaranteeing onshore economic and employment impacts and ensuring the best possible price for each license sold. The former option may lead to greater short-term employment in fisheries (dependent on varying degrees of subsidization). The latter may provide a more sustainable and substantial stream of revenues with which to finance public investments for broader employment growth. Whatever option is pursued, PICs will need to assess accurately the full costs and benefits of different options before making potentially costly decisions.

**BOX 13** Regulatory requirements for extractive industries to support overall employment creation

Sound regulatory and public finance frameworks are indispensable if extractive natural resource industries are to support employment creation in small PICs. International and regional experience illustrates both the importance and the difficulty of establishing basic systems to ensure sound investment of natural resource revenues. Building such frameworks represents a key priority for small PICs that face particular capacity and political economy challenges. Priorities include the following:

- *Policies and legislation governing royalties and taxation.* Good regulations and policies can ensure that a fair share of benefits from natural resource industries flows to government and resource owners. Licensing and tax provisions need to be specified in the law, and appropriate regulations and legislation need to be drafted and passed.
- *Strong capacity in natural resource agencies and tax departments.* Ministries responsible for regulating natural resource industries need capacity to ensure that policies and regulations are well designed and implemented. There is no point in having good policies or fair benefit-sharing arrangements if

compliance cannot be monitored and enforced. Specialist capacity may also be required in tax departments to ensure that investors are complying with local tax rules. Some of this capacity is likely to need to be sourced from donors or regional facilities, given the shortage of local specialists.

- *Appropriate measures for managing revenue flows to government.* Increases in government revenue from natural resource activities will only deliver benefits if they are managed and used wisely. Policies are needed to ensure that revenue inflows do not fuel unsustainable and short-term growth in expenditure, but rather allow for sustainable improvements in infrastructure and services, such as health and education. Strong basic public finance management systems are required to ensure that revenues are allocated to areas where investment can facilitate the creation of sustainable employment. Such areas might include connective infrastructure between urban and rural areas, improved administration and services in urban centers, improved extension services for agriculture, and investments in education and health to open local and international employment opportunities for Pacific island workers.

- tourism or access arrangements for extractive industries prior to making decisions
- A good understanding of the likely impacts of employment created by these measures on productivity, living standards, and social cohesion
  - Comparison of these benefits against employment creation or other public policy goals that could be achieved through alternative public investments financed from forgone tax or royalty revenues
  - Careful design of concession or employment mandate schemes to ensure that they incentivize new investment and employment creation rather than reward investors for activities that would have occurred in the absence of subsidies
  - Close monitoring of the effectiveness of subsidies and concessions and compliance of investors with employment creation requirements to ensure that expected benefits are being realized.

### 3 Conclusions

Pacific island countries will follow a different path to improving employment outcomes. Population growth and rapid urbanization are causing understandable concern in the context of weak historical growth and a shortage of cash-earning employment opportunities. Common policy prescriptions and responses tend to involve a combination of efforts (a) to stem urbanization by subsidizing private sector activities in rural areas, (b) to improve the broad business environment, often including retrenchment of the public sector, in the hope of attracting investment and facilitating private sector employment creation, and (c) to spur employment in natural resource industries, including tourism, often through implicit or explicit subsidization. But these strategies should be considered carefully and implemented selectively.

First, international experience shows very limited success with policy interventions aimed at stemming urbanization. If well managed, the benefits of urbanization—economies of scale in service delivery and

potential for new market opportunities in population concentrations—can often outweigh the costs. Second, although improving conditions for the private sector is important, realism is needed regarding the likely extent of private sector growth and employment creation, especially following any large-scale public sector retrenchment. PICs face inherent difficulties of geography, which private sector firms often cite as the primary constraint on growth by private sector firms. Limited financial and human capacity is available to provide all of the institutional, infrastructure, and regulatory needs of globally competitive export sectors. Finally, the employment that is associated with natural resource endowments is seldom sustainable, and the subsidies provided for employment creation in these sectors could often have been put to better use creating employment in other areas.

The most appropriate employment strategy will vary even between Pacific island countries, as will the importance of various options and opportunities. However, strategies should take account of the following realities.

Pacific Islanders have proven adept at taking advantage of economic opportunities, wherever they exist, and converting these opportunities into widely shared improvements in living standards. Facilitating internal and international mobility is likely to be more successful in improving employment than encouraging people to remain in areas where, by accidents of history and geography, opportunities are inevitably limited. To ensure that the benefits of urbanization are shared widely, it is important to invest in infrastructure to connect urban and rural areas and to provide agricultural producers with the tools to take advantage of increased market opportunities accompanying the growth of concentrated urban populations.

Public sectors in Pacific island countries have achieved impressive improvements in social indicators over recent decades, and employment created in delivering these improvements can be socially and economically valuable. But it is important

to strengthen the incentives to use public resources efficiently. This can sometimes be achieved through carefully considered and selective involvement of the private sector, but continued progress with public sector reforms is also vital.

Natural resource industries, which can flourish despite higher cost structures in PICs, offer employment opportunities. But improvement in employment supported by natural resource industries does not have to involve the creation of jobs within those industries. Natural resource industries have a poor track record of delivering substantial increases in sustainable jobs. But well-regulated natural resource industries can generate sustainable flows of revenue to support employment in the delivery of public services and opportunities for better local and international employment through improvements in human capital.

Economic growth is not sufficient to create employment or to sustain well-being from work. A key question posed in the WDR 2013 is whether a “job strategy” is any different from a “growth strategy.” In PICs, growth—in itself—is not a sufficient goal, considering the role of work in supporting productivity gains, higher living standards, and improved social cohesion. Labor mobility offers the best employment prospects for many Pacific Islanders. But the output produced by Pacific Islanders working overseas is not recorded in GDP statistics at home. The remittances that they send home to their families fuel the consumption of imports and improve living standards but have a negligible impact on GDP growth. Efficiency improvements in public sector work are notoriously difficult to capture in GDP accounts, and the associated improvements in social indicators are not reflected. Natural resource extraction tends to have a similar impact on growth regardless of whether it is sustainably managed or employs the local population. Overall, in PICs, the factors that influence GDP are very different from those that influence living standards and well-being from work. A key priority is to develop better information on employment, economic opportunities,

and living standards for people from these countries, wherever they might be living and working, and to use that information to establish targets and monitor progress.

## Notes

1. Because of the specific set of challenges facing the smaller independent Pacific countries, we restrict our analysis to countries with populations of significantly less than 1 million, therefore excluding Fiji, Papua New Guinea, and Timor-Leste.
2. Strong institutions of informal reciprocity within kinship groups mean that a broad range of social considerations influence participation in economic activities and the distribution of benefits. Labor (or goods and other services) may be provided in return for access to various common-pool resources without immediate or direct cash compensation. Wages from a single individual with a regular formal sector job are often shared widely and support living standards across family groups. See Attahir (2002) and Curry (1999).
3. The average Pacific island country is 11,456 kilometers from any other randomly selected country weighted by rest-of-the world GDP, compared to 8,103 kilometers for small countries in the Caribbean. The countries that Pacific island countries trade with are typically smaller and more distant than the trade partners of other small states, especially Caribbean countries, which have easy access to the large U.S. market.
4. Ni-Vanuatu participating in the New Zealand seasonal worker scheme, in contrast, tend to be from wealthier households but are still unlikely to have access to overseas labor markets through any other available channels (McKenzie, Garcia-Martinez, and Winters 2008).
5. Although remittance flows typically fluctuate as the composition of and economic conditions facing remitting migrant populations change, evidence shows no secular decline in the amount remitted by Pacific migrants over time, although smaller amounts are remitted less regularly by second- and third-generation migrants (Brown 1998; Connell and Brown 2005).
6. “Desperate Need for Unskilled Workers in New Zealand,” PacNews Biz, January 8, 2013.

7. Australia has traditionally opposed such country-based allocations in favor of points-based, country-neutral allocation systems. New Zealand, however, has managed to offer preferential access to Pacific Islanders for many decades without significantly undermining the integrity of its broader points-based system.
8. Recorded growth in urban populations may understate the pace of urbanization in many PICs. Calculations of urban populations are based on populations within formal municipal boundaries. These boundaries often exclude peri-urban settlements where population growth has been most rapid.
9. For examples, see Asian Development Bank economic reports on Pacific island countries (ADB 2007, 2009b, 2010a, 2012b).

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