

# NORTH PACIFIC ISLANDS

## Key conditions and challenges

**Table 1** 2020

Population, million	
Federated States of Micronesia	0.12
Republic of the Marshall Island	0.06
Palau	0.02
North Pacific	0.19
GDP, US\$, billion	
Federated States of Micronesia	0.41
Republic of the Marshall Island	0.24
Palau	0.25
North Pacific	0.90
GDP per capita, current US\$	
Federated States of Micronesia	3566
Republic of the Marshall Island	4047
Palau	13945
North Pacific	4691

Sources: WDI, World Bank staff estimates.

COVID-19 has led to recessions in the Federated States of Micronesia (FSM), Republic of the Marshall Islands (RMI) and Palau in FY21. A rebound is projected in FY22 assuming there is an easing of restrictive international arrivals policies. In the short term, fiscal surpluses are projected for FSM and RMI, while Palau's deficit will remain large. Fiscal risks are substantial over the medium term, including due to the scheduled expiry of Compact-related fiscal transfers from the US in 2023-2024.

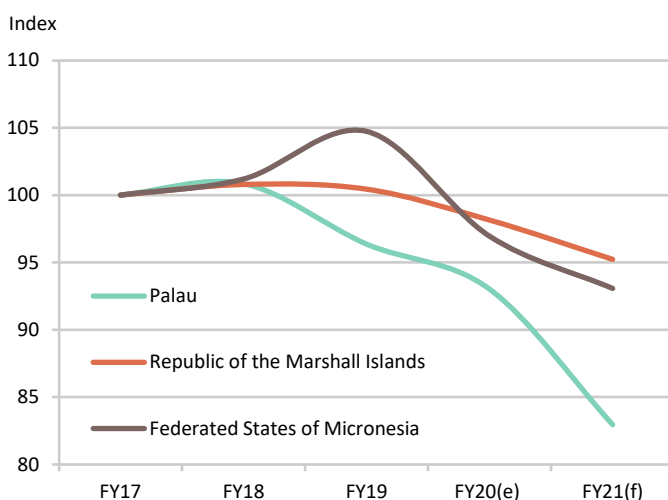
Remoteness has helped the North Pacific avoid a COVID-19 outbreak, but the prevention strategies have had severe economic consequences. Strict international border restrictions have been in place since early 2020. A fledgling quarantine-free travel bubble between Palau and Taiwan opened in April 2021, only to be closed within weeks due to surging Delta-variant cases in Taiwan. Formal sector employment is estimated to have contracted by 5 to 14 percent relative to pre-crisis levels, although temporary social protection measures mitigated the impacts on household incomes. Supported by the US, all three nations began their national vaccination programs in December 2020/January 2021. By early September, over 90 percent, 67 percent and 60 percent of adults in Palau, RMI and FSM were fully vaccinated. In the short term, the key challenges facing the North Pacific are: (i) the ongoing roll out of the COVID-19 vaccines, thus allowing for strict border restrictions to be relaxed; and (ii) to support a sustainable and inclusive economic recovery while managing acute fiscal pressures (particularly for Palau). Over the medium term, the key challenge is the scheduled expiry of Compact-related grants and programs in 2023-2024. This poses a key structural risk to the long-term fiscal sustainability, considering the limited space for additional debt. This is

exacerbated by the fact that the projected annual distributions from the nations' Compact-related trust funds are not sufficient to fully offset the expiring fiscal transfers. In 2020, all three countries began negotiations with the US on amending their Compact agreements, but the details of the scope, size and duration of any amendment remain uncertain. Natural disasters pose another constant threat to livelihoods, economic growth, and fiscal sustainability. Sea level rise threatens the physical viability of numerous islands, particularly in RMI. Enhancing resilience to climate change and natural disasters is crucial to achieving sustainable improvements in living standards and poverty reduction. Finally, the lack of recent household data in FSM and Palau makes it challenging to monitor development progress and impacts of shocks on the poor and limits the potential for evidence-based policy. In RMI, the pre-crisis poverty rate is estimated to be 7.2 percent, based on recently released 2019-20 HIES data and a national cost of basic needs poverty line.

## Recent developments

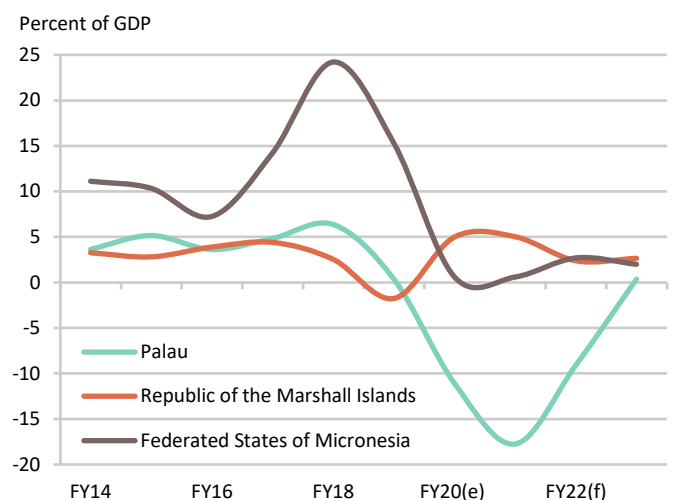
Prior to the pandemic, FSM and RMI had each registered five consecutive years of positive growth, and the longest period of sustained economic expansion since 2003. However, the economic impact of the pandemic drove both economies into recession in FY20. Output is expected to contract by a further 3.2 percent in FSM and

**FIGURE 1 North Pacific Islands / Formal sector employment (Index, 2017=100)**



Sources: National sources via EconMap and World Bank projections.

**FIGURE 2 North Pacific Islands / Overall fiscal balance (share of GDP)**



Sources: National sources via EconMap and World Bank projections.

2.5 percent in RMI in FY21, as ongoing strict border closures and related trade disruptions have curtailed construction activity, transport and domestic consumption. Large parts of FSM and RMI government revenues have been relatively protected from the downturn in domestic activity—particularly donor grants and fishing revenues, which remained relatively strong in FY20 and FY21. Grants from the ADB and the U.S. (along with other partners, including the World Bank)—combined with substantial fiscal buffers in FSM—provided the fiscal space for economic and social stimulus packages of 12 and 19 percent of GDP, which have been rolled out during FY20 and FY21. Despite the large stimulus, FSM and RMI registered fiscal surpluses of 0.6 percent and 5 percent of GDP in FY20, respectively, and are expected to register surpluses of similar magnitudes in FY21.

In Palau, the pandemic represents an economic shock of unprecedented scale. The tourism industry (40 percent of GDP) is at standstill, trade flows are severely disrupted, and business activities have been curtailed. The collapse in tourist arrivals is estimated to have resulted in an 8 percent GDP contraction in FY20, and a further 16 percent contraction in FY21. A substantial fall in tax receipts, combined with required spending for the health sector and to support businesses and households, led

to a deficit of over 11 percent of GDP in FY20. A deficit of almost 18 percent of GDP is expected in FY21. The deficits have been financed by external borrowing, which is estimated to have raised public external debt to GDP to around 80 percent.

## Outlook

The timing and shape of the economic recovery in the North Pacific depends on when border restrictions can be safely eased, and whether the countries remain free of the virus. Both factors depend on the rollout of the COVID-19 vaccines. Conditional on a recovery in the global economy and the easing of restrictive arrivals and customs policies in early 2022, an economic rebound is projected in FY22. The economies of the FSM and RMI are projected to rebound by 1.0 percent and 3.5 percent, owing to a pick-up in construction activity and visitor arrivals, as easing border restrictions facilitate the entry of foreign workers, merchandise imports and business travel. The Palauan economy is expected to grow by 12 percent, as tourist arrivals recover to around two-thirds of pre-crisis levels. Fiscal surpluses of 2 – 3 percent of GDP are projected in FSM and RMI, as tax revenues recover in line with economic activity and

stimulus spending is unwound, partially offset by a normalization in foreign grants from their high levels in FY20 and FY21. However, another large deficit is projected in Palau, as revenues remain around 17 percent below pre-crisis levels. This is expected to be financed from cash reserves that were built up through external borrowing in FY21.

Poverty in the North Pacific is expected to rise relative to pre-crisis levels. The sharp economic contraction in FY20 and FY21 led to formal-sector job losses and lower demand for goods in the informal economy. While the projected gradual economic rebound is likely to reverse some of the adverse impacts on livelihoods, GDP is not expected to recover to pre-crisis levels until FY23 in FSM and RMI, and FY24 in Palau. The severe impacts on economic activity and jobs have led to increased vulnerability for many Palauan households—particularly for the substantial non-resident population that predominantly work in the tourism sector. The RMI and FSM receive annual remittance inflows of around 13 percent and 6 percent of GDP, respectively. These flows are projected to have declined in FY21 and to remain depressed due to the impacts of the pandemic on US labor market conditions—particularly for low-skilled labor, which represents the majority of FSM and RMI migrants.

**TABLE 2 North Pacific Islands / Macro poverty outlook indicators**

(annual percent change unless indicated otherwise)

	2018	2019	2020 e	2021 f	2022 f	2023 f
<b>Real GDP growth, at constant market prices</b>						
Republic of the Marshall Islands	3.3	6.6	-2.2	-2.5	3.5	2.5
Federated States of Micronesia	0.2	1.2	-1.8	-3.2	1.0	3.0
Palau	5.8	-1.8	-8.0	-16.0	12.0	14.0

Sources: EconMAP, IMF, and World Bank.

e = estimate; f = forecast.

Note: Values for each country correspond to their fiscal years ending September 30.