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Sharnit S. Gosai

Small Island Developing Counties (SIDC) has continued to face economic crisis throughout the history. The global financial crisis and Great Depression had a substantial impact to Small Islands Developing Countries (SIDCs) in the Pacific. The 2007 financial crisis that disastrously damaged SIDCs fiscal and monetary policy formulation that led debt and borrowing to remain high and record-breaking. The United Nations report highlighted channel of impact on high borrowing due to financial crisis faced:

"Even the staggering estimated costs understate the true price of the crisis, as they do not take into account output losses; moreover, they disregard the negative effects of the crisis on human and social development, and it will now take many more years to recover from the setback towards the achievement of the MDGs. While some developed countries and a number of large emerging market countries are now showing some signs of recovery, the effect of the crisis on developing countries has not yet fully unfolded. It is possible that the negative economic and social consequences of the crisis, for example on employment, will be felt for some time to come - especially given that a double-dip recession in the developed economies cannot be ruled out" [1].

The crisis impacted many nations via different channels and platforms that caused vast effects on SIDCs. Trade and other sectors were heavily damaged due to financial lacking. This impacts best describe:

"The crisis affected developing countries mainly via the trade channel, declines in commodities prices, and financial linkages. Some emerging market economies which entered the crisis with strong fiscal positions or with large war chests of foreign exchange reserves were able to implement counter-cyclical macroeconomic policies. However, most low-income countries were in a much weaker position and were not able to respond to the crisis with adequate policy actions. As a consequence, the severity of the external shocks directly passed through to their economies" [1].

Borrowing is a phenomenon that will never stop. To finance debt, the state will borrow internally and externally. External borrowing supports small and developing countries to reduce gaps such as savings and ease foreign exchange shortages. This is an ideal way to

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promote economic growth of the borrowing nation and achieve improve standard of living [6]. In SDCs, borrowing has continuously increased periodically. Many countries are getting connected to financial institution to finance debt and it continues to accumulate overtime.

Debt Crisis and Background in SDCs

In 1980s, external debt for developing nations was huge. SDCs attracted large credit to finance the falling economy, as a result, debts accumulated, and they became large debtors. The OECD in 1982 highlighted that debt continued to escalate and burden developing nations.

According to OECD data, the external debts of developing countries totalled $625 billion at the end of 1982. As this does not include certain forms of credit, their indebtedness can be estimated at more than $700 billion, of which $500 billion consists just of bank loans. The resultant burden of interest and redemption payments has become so great that many more developing countries will be forced to seek rescheduling in the future. The debt burdens of developing countries and the vulnerability of the world financial system must be reduced for development policy reasons and also to ensure that the economies of the industrialised countries are not harmed [2].

Poor savings and economic downfall led many smaller nations to seek assistance from international financing institution. Through the past years many small developing nations debts has been wiped out or paid off by the international funding organization to avoid national crisis for the borrowing nation. The debt burden for the Least Developed Countries reached to a record taking mark of $744 billion in 2019 [3].

Formation and support by HIPC Initiative

In 1996, the World Bank and the International Monetary Fund introduced Heavily Indebted Poor Countries (HIPC) Initiative to support poor nations that face problems seeking for financial assistance. The initiative launched in the year 1996 in G7 summit and was further revised to strengthen its policies and procedures in 1999. In 1999, European Commissions pledged its support with donations and financial assistance to Pacific Countries, Caribbean and African Nations [11] [14].

The purpose of this initiative was to support poor countries with debt reduction. Many poor and heavily indebted nations faced slow growth and difficulties to generate revenue.

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Therefore, they refinanced the loan borrowed to further support the nations operation. Any country that required assistance through the scheme needed to be part of 2-stage process. The first stage is normally for qualifying basis and second for completion. First stage will go through check and balances and all arrears the nation is holding. Under the HIPC scheme, once the country has been approved of the initiative, assistance and full recovery will be made by IMF and the World Bank [11] [13]. However, the process has no scheduled timeframe as when the checks will be finalised, and financial support is made available for the desperate countries. Despite the support, the international funding organisation will continue to monitor financial stability, track countries performance, and provide policy reforms. The poor performing countries must adopt and implement poverty alleviation and employment creation opportunities [11] [13].

The financial funding under the HIPC initiative in 2021 approved debt reduction for 39 countries for the support from which 36 nations are receiving full time debt relief from IMF. From the total recipients, 31 of them are from African countries and total debt relief support amounting up to USD $100 billion [12] [13]. The debt relief has been much needed supported to poor nations in order to boost social spending. More support to fund health and education sector. More investment is required to enable these two sectors to operate efficiently. Poor performing countries lack medical supplies and professionals. Due to high poverty and underdevelopment, education facilities are very few. Majority of the students are left out from schools due to scarcity in food and less income. The international debt relief funds target these two sectors very closely. However, the challenge remains persistent. Political instability and bad governance have tremendously damaged nations image and societies to an extend that recovery takes more time than a normal economic crisis [13].

Pacific Debt

The South Pacific nations are considered to be the most vulnerable in the world towards debt sustainability. The Pacific nations are also potentially vulnerable towards debt trap from their bilateral lender [15]. For example, Pacific Island nations alongside Fiji, small Pacific economic – Tonga, Samoa, and Vanuatu appear to be heavily indebted to China [15]. Debt risk in Pacific has been rising higher compared to the past decade. Table 1 highlights general government gross debt (% of GDP). Pacific islands have been continually rising with their general government gross debt. Countries such as Asia and the Pacific has 80 percent of Gross

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Debt in 2017. The higher the percent goes, the less likely the country has chances of paying back the debt. This will lead into more debt refinancing and eventually extensive debt burden.

Table 1: General Government Gross Debt (% of GDP)

	2008	2016	2017
Asia and the Pacific	78.9	80.6	80.0
Australia and New Zealand	12.6	39.7	39.6
Pacific islands	28.3	38.0	38.3
South Asia	70.2	66.6	67.8
Southeast Asia	43.2	47.3	47.4

(Source: International Monetary Fund, 2018) [7]

Inflation and price have perfect relationship. Rise and decline in prices have direct impact on GDP. A rise in price means there will be increase in inflation, purchasing power of money will decline. Through this consumption falls and hence GDP declines. A vice versa effect on decrease in price. The GDP has a very strong relationship with inflation and fiscal balance of the economy. A positive fiscal balance indicates the government has surplus and GDP will be positive. The economy is efficiently operating without in need of external borrowing. If the economy has negative fiscal balance, it means expenditure is higher than the revenue, the economy has deficit account. Continuation to have negative fiscal balance will force the economy seek financial assistance and through borrowing finance its deficit. This is the exact story Table 2 explains for the Pacific Island Countries.

Table 2: Pacific Islands GDP, Inflation and Fiscal Balance for 4 Years

Countries	GDP Growth (% per annum)				Inflation (% annual average)				Fiscal Balance (% of GDP)			
	2019e	2020e	2021p	2022p	2019e	2020e	2021p	2022p	2019e	2020e	2021p	2022p
Cook Islands	5.3	-5.9	-26.0	7.6	0.0	0.7	1.0	0.7	5.0	-2.9	-28.5	-14.4
FSM	1.2	-5.4	-1.8	2.0	-1.0	1.6	1.9	2.0	17.6	0.0	0.2	0.0
Fiji	-0.4	-15.7	-5.0	8.8	1.8	-2.6	3.5	3.0	-3.6	-5.9	-11.5	-16.2
Kiribati	2.4	0.6	-0.2	2.3	-1.8	1.0	1.1	1.5	36.6	-0.7	1.1	-12.7

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Marshall Islands	3.8	-5.5	-1.4	2.5	0.1	0.3	1.0	1.5	-2.2	-4.9	-15.4	-3.9
Nauru	1.0	0.8	1.5	1.0	4.3	1.0	1.1	2.0	32.7	32.5	28.9	12.4
Niue	-	-	-	-	-	-	-	-	-	-4.9	-12.2	-
Palau	-1.8	-10.3	-7.8	10.4	0.6	0.0	0.0	1.0	0.3	-11.2	-15.7	-14.4
PNG	5.0	-3.3	2.5	3.0	3.6	4.9	4.3	4.4	-4.9	-8.9	-7.3	-5.3
Samoa	3.6	-3.2	-9.2	3.1	2.2	1.5	-3.0	2.7	2.7	6.2	-3.1	-8.9
Solomon Islands	1.2	-4.5	1.0	4.5	1.6	3.0	2.5	3.5	-1.7	-2.0	-2.5	-2.4
Tonga	0.7	-0.8	-5.3	1.8	4.0	0.2	1.3	2.5	3.1	5.1	-1.1	-1.2
Tuvalu	4.1	1.0	2.5	3.0	3.3	1.6	3.3	3.5	-9.8	8.4	0.0	15.6
Vanuatu	2.9	-8.5	-3.0	5.0	2.8	3.0	3.5	3.7	4.9	0.4	0.4	1.5

(Source: ADB Economic Review, World Bank and IMF, 2021)

Figure 1 illustrates the Public debt help by Pacific Island Countries in 2019. Each country has been heavily borrowing to finance their economic operations. A sharp growth in borrowing will lead into economic crisis and economic into slumber.

This can occur through a variety of channels including higher long-term interest rates, possibly higher future distortionary taxation, higher inflation, greater uncertainty and vulnerability to crises. If economic growth is negatively affected, fiscal sustainability issues are likely to be exacerbated, which further increases the premia on early and decisive fiscal adjustment efforts to reduce the debts to more sustainable levels. Despite the importance of the issue, there is little systematic evidence on the extent to which large debts are likely to reduce potential growth [17].

There have been many arguments regarding the impact of public debt on developing countries. It is eident that high debt will have negative impact on GDP. High-rate public debt also causes increase in poverty rate of the countries [20]. Every debt we borrow comes with certain obligation that needs to be fulfilled. Among the Pacific nations, Nauru leads the highest public debt borrowing to cover its short- and long-term financial requirement. The second is Vanuatu as Fiji is slightly above Samoa taking up the third place in the all-time public debt borrowing for the South Pacific. Regardless of this been a global problem, governments see it as investment for survival.

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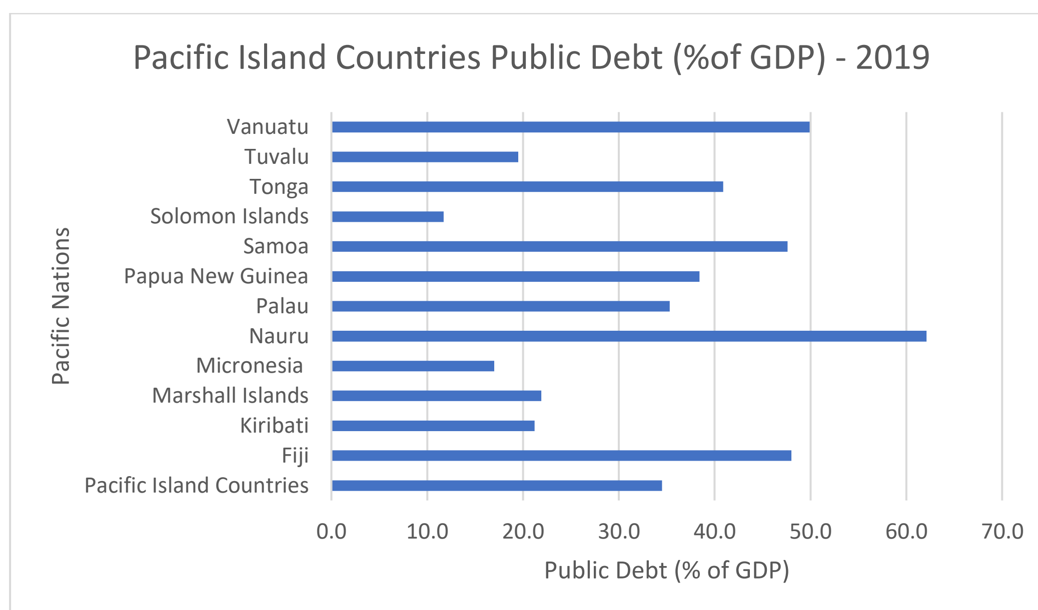
Figure 1: Pacific Island Countries Public Debt (% of GDP) - 2019



(Source: ADB & IMF, 2019)

The Pacific has been heavily involved in external borrowing regardless of receiving averagely large amount of foreign aid.

The Pacific is, by some margin, the most aid-dependent region in the world. Difficult economic geography drives an enormous need for development financing, creating a predictable pressure towards potentially unsustainable fiscal policies and debt accumulation [5].

The long-term fiscal imbalances will start worrying the nations resources and reserves. Economies with poor economic investment and climate change uncertainty leads the government to borrow and finance its budget deficits. The Figure 2 illustrates small islands and HIPC countries net ODA a percent of Gross National Income. In small states countries such as Fiji, Samoa, Tonga, Vanuatu, and Solomon Islands etc are included. In HIPC, majority are the African and Caribbean countries, those who are largely poor with less GDP and high debt.in Pacific nations, bilateral partners external aid has been supporting these countries for many years to finance capital expenditures and finance government budget. In the Pacific, economic growth in 2019 remained low while the external and fiscal balances improved [22].

Figure 2: HIPC and Small States as per Net ODA (% of GNI)

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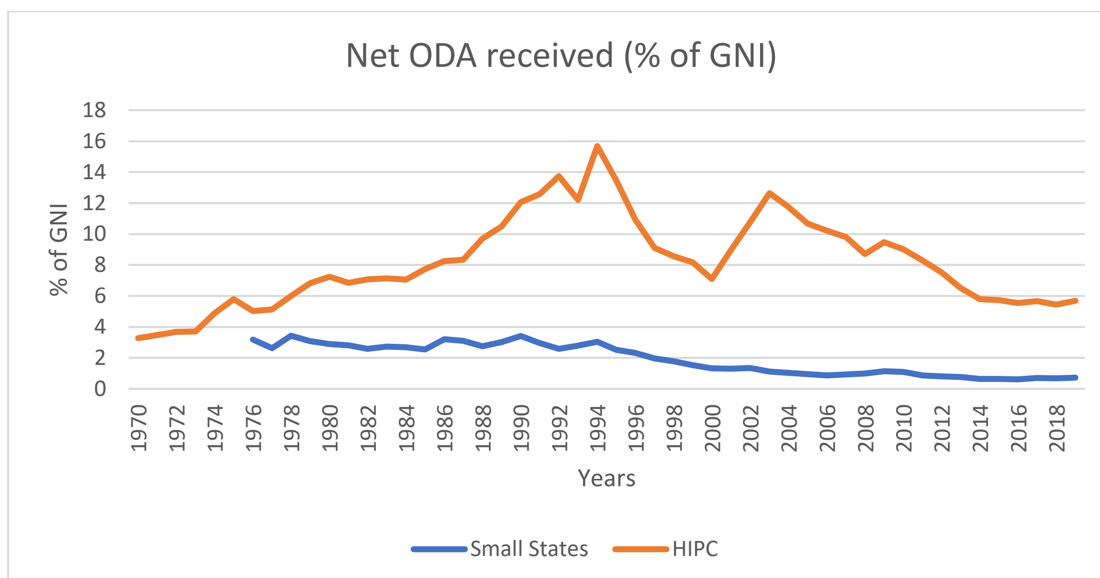

(Source: Authors graphical presentation based on The World Bank Data, 2019)

(Note** ODA = Official Development Assistance, GNI = Gross National Income, HIPC = Highly Indebted Poor Countries)

In the South Pacific, China has been the largest bilateral lender [4]. The Pacific has been most vulnerable in terms of finance needs. Fiji among those Pacific and Small Developing Nations has been in need to continue borrowing to finance its accumulating debts. By far most there are 6 nations in the Pacific are currently debtors of China.

Six Pacific governments are currently debtors to China — Cook Islands, Fiji, Papua New Guinea, Samoa, Tonga, and Vanuatu — although only Papua New Guinea and Vanuatu have taken on new Chinese loans since 2016. Three small countries—Tonga, Samoa, and Vanuatu— are particularly heavily indebted [5].

Small and Developing Nations in Pacific: Fiji has been the most prominent in terms of development and growth. However, Fiji is expecting a high increase in national debt:

The fiscal deficit is expected to increase to the equivalent of 20.2% of GDP in FY2021 from 8.2% in FY2020. Government debt is projected to increase from the equivalent of 49.3% of GDP at the end of FY2019 to 65.6% at the end of FY2020 and 83.4% the end of FY2021. Given the fall in revenues and the need for continued stimulus, the Government of Fiji increased its external borrowings. In the FY2021 budget, 51% of gross financing is expected to be financed by external loans, much larger than in previous years. [8].

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IMF has been considerably supportive to the Pacific as they do not consider the Pacific to be in debt distress. A possible solution is to introduce formal lending platforms for the borrowing countries to manage and finance their debts. Many larger nations target poor performing and highly debt nations, especially nations with political turmoil.

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