

## **Pacific Island Countries in a Globalized World: A Study of Macroeconomic Interdependence and Regional Integration**

**T K Jayaraman and Chee-Keong Choong**

*In the context of globalization and development, and in particular the complex interactions between them, the Pacific Island Countries (PICs), once considered remote and untouched by sophisticated financial sector instruments, are now deeply affected by the second and third waves of the world-wide recession following the financial and banking crises in the industrialized countries. Consequent decline in economic activities in the advanced countries caused a general slow-down in all PICs. With the exception of Papua New Guinea, the PICs have narrow resource bases and limited export earning capabilities. Further, they are heavily dependent on imports ranging from food and fuel to machinery and manufactured goods. Global economic downturn has resulted in decrease in tourism earnings and inward remittances, which are the main sources of foreign exchange earnings. Thus, the economic crisis has brought into sharp focus the topic of macroeconomic interdependence of PICs for further examination, as part of regional economic integration. This paper deals with six major countries in the South Pacific region, viz., Fiji, Papua New Guinea, Samoa, Solomon Islands, Tonga and Vanuatu. Adopting a vector autoregressive (VAR) methodology, the study shows that there is strong evidence of country-specific shock affecting the variability of outputs in all PICs in the short-run. In the long run, it is found that the global output shock represented by the USA output shock is the most important shock followed by regional shocks. However, the quick and early recovery of Australia has re-established the case of regional economic integration with Australia and New Zealand. This has been the goal of Pacific Plan endorsed by the inter-governmental organization consisting of PICs, and Australia and New Zealand.*

### **I Introduction**

The ongoing global economic recession since the third quarter of 2008 has once again brought into sharp focus the topic of regional integration of 14 independent Pacific Island Countries (PICs),<sup>1</sup> which is the goal of Pacific Plan approved in

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T K Jayaraman, Associate Professor, School of Economics, Faculty of Business and Economics, University of the South Pacific, Fiji Islands, email: jayaraman\_tk@usp.ac.fj.

Chee-Keong Choong, Associate Professor and Deputy Dean, Faculty of Business and Finance, Universiti Tunku Abdul Rahman (Perak Campus), Malaysia, email: choongck@utar.edu.my.

<sup>1</sup> The 14 independent Pacific island countries, which are the members of the formal inter-governmental organization, known as Pacific Islands Forum are: Cook Islands, Fiji, Kiribati, Federated States of Micronesia (FSM), Marshall Islands, Nauru, Niue, Palau, Papua New Guinea, Samoa, Solomon Islands, Tonga, Tuvalu and Vanuatu.