PACIFIC STUDIES SERIES

# A DIFFERENT KIND OF VOYAGE:
## Development and Dependence in the Pacific Islands

**Office of Pacific Operations**

Asian Development Bank

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# PACIFIC STUDIES SERIES

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A Report of RETA 5657:

# Economic and Policy Analysis in Pacific Developing Member Countries

by

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Except where otherwise stated, the opinions and interpretations in this paper are those of the author, who gratefully acknowledges the help he had from comments by colleagues at ESCAP/POC and staff of ADB during the preparation of the paper.

# FOREWORD

This book originates in a request by the Asian Development Bank in mid-1996 for the author to contribute material on the Pacific islands to the Bank's May 1997 publication "Emerging Asia - Changes and Challenges". In preparation it became apparent that the circumstances of the Pacific islands were such that a separate study was more meaningful. The Bank decided to commission a separate study on development issues in the Pacific islands. The resulting report is not intended to represent the views of the Bank, but the Bank is pleased to publish it as a contribution to economic management in the Pacific islands and further afield.

Basudev Dahal
Director
Office of Pacific Operations

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# ABBREVIATIONS AND ACRONYMS

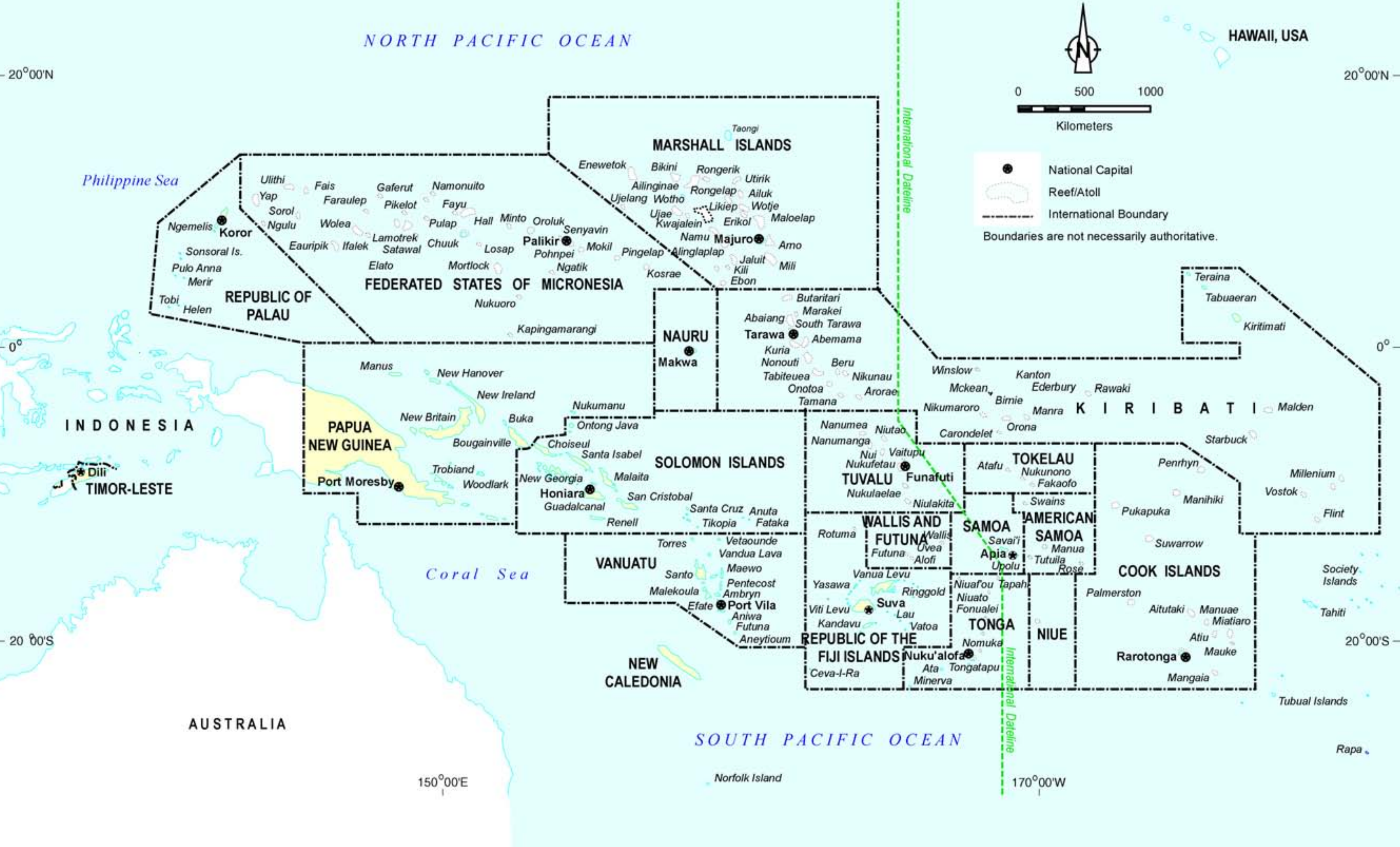
| | | |
|---|---|---|
| ACP | - | African, Caribbean and Pacific developing countries associated with the EU by the Lome Convention |
| ADB | - | Asian Development Bank |
| ADF | - | Asian Development Fund (the concessionary loan window of ADB) |
| AIDS | - | Acquired Immune Deficiency Syndrome |
| ANU | - | Australian National University |
| AOSIS | - | Association of Small Island States a lobbying group at the UN |
| APEC | - | Asia Pacific Economic Council |
| EEZ | - | Exclusive Economic Zone extending 200 nautical miles beyond a nation's territorial sea |
| ESCAP | - | Economic and Social Commission for Asia and the Pacific |
| EU | - | European Union (formerly European Community) |
| FFA | - | Forum Fisheries Agency |
| FIAS | - | Foreign Investment Advisory Service part of the World Bank group |
| ForSec | - | Forum Secretariat, formerly known as SPEC |
| FSM | - | Federated States of Micronesia The states are Yap, Chuuk, Pohnpei and Kosrae |
| GDP | - | Gross Domestic Product (output of resident economic agents) |
| GNP | - | Gross National Product (output of nationally owned economic agents) |
| GSP | - | General System of Preferences under the General Agreement on Trade and Tariffs |
| GST | - | Goods and Services Tax |
| HIV | - | Human Immuno-deficiency Virus |
| IDA | - | International Development Association (the concessionary loan institution in the World Bank group) |
| IF AD | - | International Fund for Agricultural Development |
| IMF | - | International Monetary Fund |
| MSG | - | Melanesian Spearhead Group |
| NBF | - | National Bank of Fiji |
| NBSI | - | National Bank of Solomon Islands |
| NEMS | - | National Environmental Management Strategy |
| NPF | - | National Provident Fund |

| | | |
|---|---|---|
| NPO | - | National Planning Office |
| ODA | - | Official Development Assistance |
| OECD | - | Organisation for Economic Cooperation and Development |
| PATCRA | - | PNG-Australia Trade and Commerce Reciprocal Agreement |
| PFL | - | Pacific Forum Line |
| PIDP | - | Pacific Islands Development Programme |
| PNG | - | Papua New Guinea |
| SIDT | - | Solomon Islands Development Trust |
| SOP AC | - | South Pacific Applied Geoscience Commission |
| SPARTECA | - | South Pacific and Australia Regional Trade and Economic Cooperation Agreement |
| SPC | - | South Pacific Commission |
| SPEC | - | South Pacific Bureau for Economic Cooperation (now ForSec) |
| SPESD | - | South Pacific Economic and Social Data Base, at ANU |
| SPOCC | - | South Pacific Organisations Coordinating Committee |
| SPPF | - | South Pacific Project Facility (cofinanced by World Bank, AusAID and others) |
| SPREP | - | South Pacific Regional Environmental Programme |
| TA | - | Technical assistance |
| TCSP | - | Tourism Council of the South Pacific |
| TNC | - | Transnational corporation (sometimes MNC, multi-national...) |
| UK | - | United Kingdom (sometimes Britain, British) |
| UN | - | United Nations |
| UNDP | - | United Nations Development Programme |
| USA | - | United States of America |
| USP | - | University of the South Pacific |
| USSR | - | Union of Soviet Socialist Republics |
| VAT | - | Value-added Tax |
| WHO | - | World Health Organisation |
| WTO | - | World Trade Organisation |

# CONVERSIONS

Monetary values in the text are in United States dollars ($) unless otherwise stated.

# THE PACIFIC ISLANDS



# INTRODUCTION

The passage below is translation of part of the creation legend of the people of Kiribati[1]. It appeared as the introduction to the 1973-76 Development Plan of the then Gilbert and Ellice Islands. A generation later, it seems to have wider relevance, and may serve to introduce this paper:

...then came the voice a third time saying, “Nareau, how can you remain floating in emptiness, alone and without thought? Are you tired of just floating? Do you want to do somthing for yourself? A third time Nareau marveled to hear the voice cry out to him, and he searched the emptiness to discover who had called him. He opened his eyes and shook himself to make sure he was not dreaming. He stretched himself and stood on his feet to cast off his drowsiness, until he was wide awake.

When he was wide awake, Nareau thought to himself, “How childish I have been. I have only just realised, this very moment, that I have been calling out my own name. Here I have been searching for the voice that called me but in fact it was really myself!” Nareau therefore kept his eyes wide open, and gathering his wits about him he decided to think.

1 Recorded and translated by R. Turpin (unpublished).

# 1 Outlook for the Voyage: Oceanic Perspective

The Pacific Ocean has shaped the social and economic history of its island peoples. The ocean and its surface winds carried the migrating islanders to their new homes, and later brought European and Asians in search of wealth and empire. Even the highlanders of New Guinea came originally by sea from Southeast Asia, and for the peoples of the rest of Papua New Guinea and all the islands east and south, the ocean has been a powerful and continuing influence on the way they have developed. Oral traditions and a host of social references are evidence of the power of the sea in people's minds, long after the era of great canoe voyages. The ocean provides a rich harvest of food and is potentially a vast source of energy; but it kills foolhardy sailors, and is a perennial cause of destruction when stirred by violent storms, while the expected rise in its level threatens to extinguish many atoll and coastal settlements. In living memory the ocean was the scene of huge naval battles; now it attracts the world's tuna fleets, and in the next few decades it will see capital and technology deployed to mine the sea bed. Attitudes to the ocean are changing. In the past it was not something to be owned or controlled, negotiated over and rented out to foreigners on the basis of lines on a chart: it was an awesome source of good and bad occurrences, that were better or worse according to how well you were prepared, how carefully you had observed the rules of your community, and how respectfully you had behaved towards whatever power it was that moved the ocean's temper.

It is not only attitudes to the ocean that are changing. Against the oceanic backdrop, this essay is a commentary on economic and social development in the Pacific islands, and particularly those that are members of the Asian Development Bank (ADB), at a time of great change in the world around them and in the islands themselves. It aims to shed light on the problems facing governments and peoples in the Pacific islands, and to suggest development strategies that combine both political and technical feasibility. It sets national problems in a regional context, and current issues in a historical perspective. It stresses the fundamental parameters of size, location and resource endowment in the economic calculus, but argues that good management can lift incomes and welfare substantially above current levels, and (barring natural catastrophes) sustain them there: within any given boundary of economic potential, and any given incidence of shocks, actual performance will depend upon how successfully all the factors determining income and welfare are combined in the face of external conditions - in other words, on how well the economy is managed.

The arrangement of the paper is as follows: Part 1 sketches the dimensions of distance, scale, variety and change. Part 2 describes the process of achieving political independence, and some of the external constraints and opportunities that have emerged for the independent island states in their pursuit of economic growth. Part 3 looks at issues in the management of Pacific island economies, both at the level of the whole economy and in specific sectors, including foreign aid and financial systems. Part 4 discusses some of the social dimensions of the development process, and describes how problems of governance and public sector reform are evolving. Part 5 suggests broad guidelines for economic managers based on experiences of the last two or three decades in the Pacific islands and elsewhere. There are few, if any, new ideas in the paper, which draws consciously or unconsciously on the work of many persons and institutions. Its intended contribution to the understanding of development is to look at problems in the round, to identify many of the factors that determine the speed and quality of development and suggest how they interact; and so to reinforce the efforts of Pacific island countries to manage their affairs in the best long-term interests of their own people.

General statements are unavoidable in most argument, but they can cause problems, both when reasoning from experience in other countries, and when discussing the Pacific islands as a group. Sometimes the island states provide more exceptions than conformities. It is useful to distinguish between, firstly, broad observations of human, economic or environmental behavior that seem to have enduring and general validity, e.g. budget deficits weaken the balance of payments, custom embodied in statute is no longer custom, deforestation reduces rainfall; secondly, descriptions of particular phenomena based on study over a sufficient period, e.g. remittances in Polynesia finance both consumption and investment, indigenous capitalists are creating a new middle class across the Pacific, women in Melanesia have less access to education than men; and lastly, specific policy prescriptions, that may or may not fit the circumstances of a particular country, e.g. privatise inter-island shipping, support credit unions, promote eco-tourism. All three kinds of assertion have roles in the process by which policies are made, and all three are found in this paper, but the more precise the assertion, the greater the caution needed in transporting it.

An important assumption underlies the approach taken in the paper, namely that what governments do really matters; so it is worthwhile paying attention to the policies and capacities of governments, and the pressures, open or covert, that move them. Governments at least appear to believe in their own importance, and on this basis they dispose of large parts of the cash national income of the Pacific Islands. The paper assumes that governments can under certain conditions represent the aspirations of their people, and can, to a significant degree, influence the economic course of the nation state. Whether they actually do so, and with what result, is for examination.

The Pacific islands region lies east of south-east Asia, stretching 10,000 kilometers from east to west and 3,000 kilometers from north to south, an area that would comfortably cover Japan to Indonesia, and Bangladesh to the Philippines. Papua New Guinea (PNG) aside, the Pacific islands are among the world's smallest and most remote states. They exist as separate constitutional entities because of their geography. If they were contiguous to each other or to a larger state, they would have long ago merged into a bigger entity. For the smallest of the small, geographic reality limits their economic potential in ways that can only be overcome by exploiting occasional geopolitical opportunities, or asserting rights to as yet untapped natural resources.

Among the island nations, there are such disparities of land area, population, access to natural resources, state of civil society and human skills, and such ethnic, cultural and linguistic diversity that it is misleading to think of them as a collective social or economic identity. Table 1 provides some indicators of these differences. PNG stands out because of its size and location. It is seven times as big, and has twice as many people, as all the other Pacific island states put together. Between ten thousand and five thousand years ago in the highlands of New Guinea, food crops were being domesticated and settled agriculture established, as they were (with different crops) in China, Western Asia and Mesoamerica. PNG forms a natural bridge between the Pacific and South East Asia, sharing its main island with Indonesia's West Irian province along a 700 kilometer border.

The twelve Pacific island members of ADB have a total land area of just over half a million square kilometers (about the same as Thailand), but 88 percent of that is in PNG, and a further 11 percent in Fiji, Solomon Islands and Vanuatu, while the other eight average less than 700 square kilometers each. The size and ecological diversity of the Pacific islands falls from south west to north east, tapering from the high, forested islands of Melanesia to scores of tiny, sparsely vegetated atolls scattered across the central Pacific. They are both linked and separated by vast expanses of deep ocean (map at front cover). The combined Exclusive Economic Zones (EEZs) of ADB's Pacific island members, at almost 19 million square kilometers, are thirty-six times bigger than their land area, and in the northern belt, astride the equator, contain much of the world's richest tuna fishery.

The total population of these twelve island states is about six million people, around one-thousandth of the world's population. Of these over four million are in PNG; at the other end of the scale are Nauru and Tuvalu, with 11,000 and 10,000 people respectively. The islands were settled between fifty thousand and a thousand years ago, by people from east and south-east Asia, who were pushed or drawn into the islands by invasion, deliberate exploration or accident, in many separate migrations, some of which retraced routes their ancestors had followed. Three broad cultural areas were shaped by this process - Melanesia, Micronesia and Polynesia - with evidence of ancient and modern interactions, but with distinctive, physical and social characteristics and speaking 1,200 different languages, 700 of them in PNG. The three cultural areas also have quite different access to economic opportunity. Among the island states who are members of ADB, the Melanesian states have almost all the land and land-based mineral resources, Micronesia occupies the greatest sea areas with the largest tuna resources, and Polynesia combines useful agricultural and marine resources, including possibly vast but as yet inaccessible deposits of sea bed minerals. Faced with limited opportunities at home, Polynesia and Micronesia have developed the most efficient emigration arrangements.

The geographic and cultural facts are the only parameters of development that are not rapidly changing or in doubt. These remote and diverse states are entering a new phase of their political and economic history under conditions of considerable uncertainty. Even outside the global mainstream, the island states are being strongly affected by changes in the determinants of trade, investment and official aid flows that drive their economic activity: generally the world is becoming more competitive, interactive, technology-intensive, environmentally aware but less aid-generous, while the island economies' terms of commodity trade are in long-term decline. Rapid and pervasive social change is afoot throughout the islands, driven by population growth and mobility, the spread of education and the use of money, and advances in transportation and communications technology; by its nature this process is sporadic and uneven, creating divisive inequity and straining the cohesion of communities.

The structures of domestic and external allegiances and distribution systems that have served them since the Second World War, straddling the achievement of political independence, are quietly disintegrating. Fragments are coalescing into new alignments and systems, domestically and externally, but in an increasingly cynical environment. Sources of foreign aid that have supported island economies for two or three decades are being cut back. New Asian sources are opening up with different political and strategic strings attached. Doubt about the direction and outcomes of policy is widespread, and ordinary Pacific Islanders' views about the future are both more articulate and less confident than a decade ago. Populations continue to increase, resulting in emigration or increased pressure on resources. Stark differences of resource endowment between islands, the widening income gap between their richer and poorer inhabitants, and increasing reliance on market forces to deliver development, suggest that further polarisation lies ahead. Closer integration with faraway markets raises fears of domination by outside forces, but long-distance two-way trading is unavoidable for the island economies. Only the terms, the timing and the degree of integration may be open to influence for better or worse.

Many people and some governments are uneasy about these trends but feel impotent in the face of them. It is not clear what the future holds for the island states, nor how far Pacific Islanders can shape their destiny. For the smallest Pacific islands, orthodox development models based on production for competitive global markets do not make sense; their future lies in pragmatic management of deal-making opportunities as and when these arise, extracting maximum rental and donation benefits and distributing them in a politically sustainable manner. People at large would like to have systems and relationships that work efficiently in the interactive economic world they must live in, and at the same time strengthen the self-respect of communities and individuals. But this will not be achieved without effort. The colonial experience both suppressed the evolutionary growth of local initiative, and facilitated the post-independence rise of an exploitative local elite, supported by foreign aid and private capital, which has got in the way of a more dynamic transformation. In the search for economic and social viability, Pacific Islanders will have to draw more deeply on their own mental and physical resources than has been their practice in the last few decades: in other words, think more critically, re-assessing imported models and neocolonial mindsets, and work harder, rejecting both noble savage and lazy native stereotypes.

Fortunately some people are doing this: an emerging indigenous entrepreneurial class is learning to compete successfully with entrenched foreign interests in primary production and services, by combining customary and modern skills. To commend this is not to promote autarky. Self-sufficiency of economies is impracticable, even undesirable. The island states that want to trade and grow have to ride the tiger of closer integration with overseas markets. Free movement of capital and know-how can be positive for their growth. But self-respect of people is essential to their well-being, and that involves a substantial degree of self-accountability and self-reliance, even if elements of dependence continue indefinitely. The paper looks at how these qualities can be promoted in the seemingly directionless transition now taking place; and how a positive steer can be given to the development process, so that growth cannot only be achieved, but also sustained.

This modern task of economic management, involving the setting of goals, devising ways of achieving them, and then guiding the political economy through months and years of concerted effort, is somewhat analogous to the deliberate undertaking of a long-distance sea voyage, such as both Pacific islanders and foreign intruders undertook in years gone by. Not surprisingly, cross-cultural maritime metaphors, some rather well-worn, abound in policy statements. The waters are uncharted and dotted with reefs, the winds and currents variously favorable or adverse, the hull is leaky and the sails torn, the pilot at odds with the captain, the crew from time to time sick or mutinous, and other vessels encountered may be friendly traders or bloodthirsty pirates. Nevertheless, the venture is launched and the fleet is at sea, destination unknown, hazards a-plenty, resources limited. This essay is dedicated to the sailing masters, passengers and crew alike.

**TABLE 1**

PACIFIC ISLAND MEMBERS OF ADB[a]: Key Indicators, Part I

| | ***Geographic*** | | | | ***Demographic, 1995*** | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | ***Area: '000s sq. km.*** | | ***Land Use % 1993*** | | ***Est. total pop'n*** | ***Pop'n growth rate 1990-95*** | ***Pop'n aged 0-14 yrs*** | ***Urban[i] pop'n*** | ***Overall density*** | ***Life expectancy at birth[h]*** | |
| *Country* | *land* | *sea (EEZ)* | *agric.* | *forest* | *'000s* | *% p.a.* | *as % of total* | *per as % of total* | *sq. km. of land* | *years F* | *M* |
| Cook Islands[c] | 0.24 | 1830 | 21.70 | - | 20.2 | 1.9 | 34.1 | 60.4 | 84 | - | - |
| Fiji[b] | 18.24 | 1290 | 23.8 | 64.9 | 793.3 | 1.6 | 34.7 | 40.7 | 43 | 74 | 70 |
| Kiribati | 0.69[f] | 3550 | 50.7 | 2.7 | 80.8 | 2.3 | 40.3 | 35.7 | 117 | 58 | 56 |
| Marshall Islands | 0.18 | 2131 | 60.0 | - | 55.6 | 3.8 | 50.6 | 69.1 | 308 | 64 | 61 |
| Fed. States of Micronesia[d] | 0.70 | 2798 | - | - | 106.0 | 1.1 | 42.7 | 28.0 | 151 | 64 | 62 |
| Nauru | 0.02 | 320 | - | - | **11.0** | 1.9 | 46.5[g] | 100.0 | 550 | - | - |
| PNG[b] | 462.24 | 3120 | 1.1 | 92.7 | 4100.0 | 2.0 | 39.5 | 16.0 | 9 | 57 | 56 |
| Samoa | 2.94 | 120 | 43.5 | 47.3 | 167.6 | 0.4 | 46.3 | 21.0 | 57 | 71 | 67 |
| Solomon Islands[b] | 27.56 | 1340 | 3.4 | 87.5 | 381.7 | 3.7 | 44.2 | 17.1 | 14 | 63 | 61 |
| Tonga[c] | 0.75 | 700 | 72.3 | 11.1 | 97.7 | 0.3 | 40.6 | 41.1 | 130 | 71 | 67 |
| Tuvalu | 0.02 | 900 | - | - | 9.7 | 1.4 | - | 46.2 | 485 | - | - |
| Vanuatu[b] | 12.19 | 680 | 13.9 | 75.0 | 168.4 | 2.7 | 43.4 | 19.3 | 14 | 61 | 59 |
| **Total** | **525.77** | **18779** | | | **5992.0** | | | | 11 | | |

[a] The Pacific Island states and territories that are <u>not</u> members of ADB are Palau (which has applied for membership), American Samoa, Northern Marianas, Niue, Tokelau, New Caledonia and French Polynesia.

[b] Members of the Melanesian Spearhead Group (MSG), accounting for 95 percent of the land area of the Pacific Islands (99 percent for the ADB members) and four out of every five Pacific Islanders (nine out often for the ADB members).

[c] Self governing “in free association with New Zealand”.

[d] Formed, along with Palau and the Northern Marianas, out of the post-war US Trust Territory of the Pacific Islands, and linked to the USA by 15-year “Compacts of Free Association”.

[e] Tonga, which gave itself a constitution in 1875, was never a colony but its foreign policy was under the jurisdiction of the UK by treaty until 1970.

[f] Two-thirds of Kiribati’s land area is in Kiritimati (Christmas Island) atoll, 2000 km south of Hawaii and 3000 km east of the capital, Tarawa.

[g] 1985 estimates.

[h] Most recent period available.

[i] Definitions of urban and rural have to be interpreted with care.

\- Not Available

***TABLE 1***

**PACIFIC ISLAND MEMBERS OF ADB: KEY INDICATORS, PART 2**

| | *Economic* | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | *Output/Incomes 1994* | | | *Trade later of 1994 or 1995* | | | *Aid 1994* | |
| | *GNP* | *GNP per head* | *5-year % change in real GDP, 1990-95* | *Total trade* | *With Asia % of total* | | *ODA from all sources* | |
| | *US$m* | *US$* | | *as % GNP* | *exports* | *imports* | *US$m.* | *%GNP* |
| Cook Islands | 80 | 4150 | 9 | 107 | – | – | 14.3 | 17.9 |
| Fiji | 1780 | 2320 | 13 | 75 | 16.3 | 22.1 | 40.4 | 2.3 |
| Kiribati | 60 | 730 | 10 [1] | 123 | 60.5 | 9.7 | 15.4 | 25.7 |
| Marshall Islands | 90 | 1680 | 12 | 93 | – | 49.3 | 54.8 | |
| Fed. States of Micronesia | 200 | 1890 | 12 | 59 | 77.0 [4] | 31.2 [4] | 104.2 | 52.1 |
| Nauru | 48 | 4382 | -14 | 164 | – | – | 2.4 | – |
| PNG | 4860 | 1160 | 10 [2] | 76 | 42.3 | 35.7 | 325.7 | 6.7 |
| Samoa | 160 | 970 | -26 | 68 | 3.6 | 13.7 | 48.7 | 30.0 |
| Solomon Island | 290 | 800 | 23 [3] | 110 | 81.5 | 40.9 | 47.0 | 16.2 |
| Tonga | 160 | 1640 | 2.1 | 54 | 58.5 | 16.1 | 35.2 | 22.0 |
| Tuvalu | 12 | 1282 | 33 | 55 | 0.0 | 1.9 | 7.4 | – |
| Vanuatu | 190 | 1150 | 28 | 60 | 27.7 | 51.6 | 41.8 | 22.0 |
| **Total** | **7930** | **22154** | | | | | **731.8** (US$122 per head) | |

Source: Key indicators of Developing Asian and Pacific Countries, ADB, 1996, plus country reports and national publications.

a 1987-92 only.
c 1987-92
b 1989-94
d Japan and “other, 1993 data.
– Not Available

# 2 Taking Command: Dimensions of Political Independence

Political independence implies autonomy in domestic and external affairs. Eleven of the twelve Pacific island members of the ADB are politically independent states, while Cook Islands is self-governing 'in free association with New Zealand'[1]. Turning aspects of their independence into money, the three former US Trust Territories have accepted temporary derogations from their autonomy in areas of concern to the USA, in return for payments under their Compacts of Free Association. In all the island states the exercise of autonomy in domestic and external affairs is constrained by geography, history and relationships entered into voluntarily or under pressure. This part of the paper looks at several sets of influences that help to shape the behavior of the island states, conditioning the attitudes of political leaders and people alike: the experiences of achieving independence and making constitutions; the fragmented nature of several of the island states; the institutions of international and regional cooperation; and developing links with Asia.

## 2.1 SOVEREIGNTY AND ISLANDISM

Attaining national independence, the making of constitutions, the assertion of international rights and putting on the trappings of statehood occupied centre stage among Pacific island members of the ADB in the 1960s and 1970s. Politicians and officials had plenty of interesting and worthwhile things to do, and there was no doubt about the purpose of all the activity. For some the process was portrayed as regaining a sovereign identity that had been lost during colonial rule. For some, though, the territorial boundaries and concepts of nationality that came with independence had little pre-colonial significance, and were to present problems of nation-building to their

[1] For all practical purposes, as they have not so far wished to declare war on anyone, successive Cook Islands governments have managed to make self-government equivalent to political independence.

independent governments; while for Fiji, the dominant legacy of colonial rule was a population ethnically divided in two.

Beginning with Samoa (then known as Western Samoa) in 1962, one or two island states became independent every three or four years until 1986. Fiji achieved independence in 1970, Papua New Guinea in 1975, and the territories of Britain's Western Pacific High Commission between 1978 and 1980. Vanuatu (formerly the Anglo-French Condominium of the New Hebrides) had to put down an armed rebellion in some French-speaking areas, which it did with the help of PNG soldiers; while the Gilbert and Ellice Islands split peacefully, though not without some acrimony, into two parts, Micronesian Kiribati and Polynesian Tuvalu. Solomon Islands became briefly embroiled in PNG's problems with secessionist movements in Bougainville during both countries' run up to independence in the mid-1970s, providing a foretaste of the more serious troubles on their joint border twenty years later. By 1980 only the French and US territories were still dependencies, and the split of the US Trust Territory of the Pacific Islands into four separate constitutional entities was at an advanced stage of financial deal-making.

The steady drumbeat of political independence thus provided a shared sense of advancement in the Pacific area for much of the last thirty years. It was generally accepted as a natural and proper course of events, whose benefits were widely anticipated, but whose costs were given less consideration. Those who were further advanced along the road looked back pityingly on the slower ones, and expressed particular concern for lack of progress in the French territories (resulting in the formation of the Melanesian Spearhead Group to exert pressure on behalf of the Kanak independence movement in New Caledonia). In the making of constitutions, described[2] by an adviser who was involved in several of them, as "for many... the first real exercise in national politics", domestic tensions were aired and compromises hammered out, special interests protected, common interests elevated to guiding principles, and noble visions eloquently expressed in carefully drafted preambles. People who took part in that process look back on it as a high point in their political or bureaucratic careers, and in many cases wonder what has gone wrong since then.[3]

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2 Ghai(1983)atp.26.

3 George Orwell's account of the hijacking of the Russian revolution in his book "Animal Farm" illuminates how the benefits of supposedly thoroughgoing change such as throwing off the capitalist (read colonial) yoke may elude all except the new bosses.

Pacific island states were the late-coming beneficiaries of a structure of support and enablement created during the 1960s and 1970s by the US-led anti-Communist alliance, to promote the emergence of democratic, freedom-loving capitalist states, and so to contain Soviet or Chinese-led communist hegemony. As the new states were very small, the idea of going it alone in the big world was anyway a daunting one; and as their recent colonial experiences had mostly been relatively benign, their leaders had few problems with the idea of remaining on friendly terms with their ex-rulcrs. The new political entities were examples of what have been termed quasi-states[4], brought into existence by external forces, and shored up by international and bilateral support. In that view they were "creatures of change in the rules of membership and modes of operation of international society which were deliberately made to replace the institutions of European overseas colonialism". Colonies had become costly and potentially embarrassing for the UK and the USA, who by the mid-1970s were actively urging independence upon their charges. France, with a totally different view of its overseas territories, was by contrast in no hurry to change their status.

The achievement of independence was accompanied by multi-year agreements on bilateral aid, membership of the IMF/World Bank/ADB and a full programme of feel-good activities that enabled island leaders and people to overlook how poorly most of them were equipped to implement their new-found sovereignty. It had become possible, for reasons partly to do with the Cold War, but more generally because of a widespread revulsion in the industrialised world against the idea of colonial rule, for the small, poor and weak Pacific island communities to become juridical nation states, to assert their right to a vote in the United Nations alongside the USA and the Soviet Union, and to sit with India and China in meetings of the G77.

Pacific island governments were now confronted with the painful reality of being constitutionally sovereign but politically unable to act like a sovereign power. This has been partly explained in terms of negative and positive sovereignty[5] analogous to negative and positive individual liberty. Negative sovereignty is "the distinctive liberty acquired by former colonies as a consequence of the international enfranchisement movement" i.e. freedom from past colonial rule, and from new impositions of foreign rule. This freedom is not absolute, as the international community can still, on occasion, act against states that flagrantly suppress their own citizens' rights

4 Jackson (1990) pp. 21-31
5 Ibid.

to self-determination e.g. white-ruled South Africa[6]. Positive sovereignty is more a matter of fact than of law: the ability of states actively to exert their sovereignty in the interests of their citizens, both internally in the provision of political goods and externally by acting with or against other states. Clearly, while all politically independent states have negative sovereignty, subject to a general condition of non-oppression of subjects, some of them have much more positive sovereignty than others. In this respect, there is a wide range among nations, apparently related mainly to resource endowment and the effectiveness of their machinery' of government. In the Pacific islands, governments sometimes find that their sovereign writ does not run even to their own outer islands, if local feelings are strongly disaffected.

In this context, the making of constitutions was for most states a unifying activity. In all cases, overseas lawyers assisted with the preparation of issues papers and drafts of constitutions, but there were lengthy consultative processes in PNG, Solomon Islands, the US Trust Territory of the Pacific islands, Kiribati and Tuvalu (as Gilbert and EUice Islands), Vanuatu (as New Hebrides), with greater or lesser local ownership of the process depending on the state of community politicization at the time[7]. In Fiji, consultations on the 1970 constitution were limited to the existing political parties, representing ethnic Fijian and Indian interests: the parties were well established and this seemed an adequate way of sounding public opinion. The subsequent overthrow of Fiji's 1970 constitution by a military coup in 1987, revealed how far the unifying aims of its makers had gone unfulfilled. Fiji's 1990 constitution, drafted by the army-backed administration at the behest of Fijian extremists, was a fonnal entrenchment of indigenous Fijian power and exclusion of Indo-Fijians from high office. As a result of persistent and mounting criticism inside and outside Fiji, it has been replaced in mid-1997 by a constitution that offers a more unifying expression of Fiji's nationhood.

Vanuatu's constitution was strongly influenced by its relatively difficult passage from a joint Anglo-French colony to independence: this required a clear assertion of the character of the new state that included a new name,

[6] The record suggests that South Africa was a special case because of black solidarity in the USA and the Commonwealth. Action against other repressive regimes, e.g. Nigeria, has been far less coherent, with attempts to impose sanctions commonly falling foul of commercial interests in trade and investment. Fiji left the Commonwealth in the wake of the 1987 coups, and a widely-held wish to rejoin has certainly been a contributory factor in the current return to a more equitable constitution, but trade sanctions were never imposed on Fiji, despite efforts to do so by Australian trade unions.

[7] Ghai(1983).

stressing the affinity of the people to the land. In Kiribati an extensive consultation process that resulted in several unique features, including the means of electing the President, seems to have contributed to the stability of politics and the prudence of policies in subsequent years. Solomon Islands in 1970-72 briefly experimented with a self-government constitution designed to operate parliamentarily in the absence of well-defined political parties, but reverted to a Westminster model before independence (as political parties are still poorly defined in Solomon Islands, the move back to Westminster may have been misguided). In Samoa and Cook Islands, the social structure meant that in the 1960s consultations were effectively limited to traditional title-holders, roughly equivalent to heads of extended families. Since then, education and pressure for democracy has resulted in constitutional and electoral reforms including universal franchise (though not, in Samoa, universal eligibility for election). In Tonga, steadily mounting pressure from educated Tongans in the country and overseas seems sure to lead to a shift of power from the monarchy and nobility to a broader-based parliament, though when and how this will occur is not yet clear. The US Trust Territory was an administrative legacy of military and strategic concerns. Transition to political independence, in response to widespread disenchantment with trusteeship, saw the separation of its geographic extremities of Palau, Northern Marianas and Marshall Islands, leaving Yap, Chuuk, Pohnpei and Kosrae in an uneasy federation heavily dependent on US aid.

Constitution-making in Melanesia and Micronesia brought to the surface two issues that had much exercised colonial administrations and had been generally handled by administrative rather than legal process, but now had to be confronted and formalised. These were decentralisation and the role of customary systems and leaders. The two issues were connected, in part because colonial administrations had had more effective relationships with customary systems at the district or island level than at the seat of government or national level, where there was no customary counterpart; and in part because outside of the Polynesian states, traditional leaders were being gradually elbowed out from political power by a younger, more educated elite. Colonial governments achieved some kind of distribution of services by regular touring of remote areas and kept a lid on inter-island hostilities (at the intellectual level, by being a common enemy). They made use of islandism to contain independence-minded political movements, such as Ma'asina Rum in Solomon Islands, using police from one island against dissidents from another. But these administrations lost much of their morale and went into decline during the self-government stage. Weakened government led to complaints of neglect or discrimination against outlying communities or ethnic minorities, and occasional outbreaks of violence between groups, e.g., at sporting events or over insulting remarks in a market place.

The geographic and social make-up of the new states seemed to argue for decentralisation of functions and power-sharing: especially in Melanesia and Micronesia they were collections of island communities that clearly had some capability and resources for self-government, and who could not be effectively coerced by a central government into activities they did not like. Island loyalties were strong, even where a common language was spoken throughout the country; where linguistic and ethnic differences compounded distance factors, islandism was an older and stronger sense than nationalism. Many incoming politicians and officials had strong personal connections with rural and remote communities. And public finances were in reasonably healthy shape, backed by ready access to foreign aid for anything remotely 'developmental'. In these circumstances, decentralisation was a popular component of the decolonisation process.

It was not so clear what to do about customary' systems. Custom was recognised as a source of law in most of the new constitutions, but the practical effect of this was not clear, in absence of a body of case-law. Land tenure that had evolved to support traditional agriculture obtruded forcibly into the cash-based development prospects of the new states; and the network of family and wider obligations, rights, sanctions and powers that stemmed from the land both supported and enmeshed people at all stages of the independence process. It was already clear that what actually happened in land tenure was often different from what was described by the guardians of customary knowledge. Some particularly skillful people managed to be traditional and modern at the same time, and prospered accordingly. Some fell down the cracks between the systems. Some of the new political leaders also wielded customary' power, and favored entrenching their own version of this in constitutional form. Some, especially in Melanesia, were less well connected, and were ambivalent about constitutionalising traditional institutions, though few could risk openly opposing the idea. The result has been a mixed bag, with a variety of attempts to preserve by law institutions whose original basis for existence is being undermined by inexorable forces of change.

In Fiji, where the efforts to stem the tide on behalf of the chiefly system go back to early colonial days, a complex interlocking of customary and statutory arrangements purports to guarantee the role of chiefs. But increasingly they are accused of misusing their powers and neglecting their responsibilities, or being duped by unscrupulous operators, and are being bypassed or bought off by the movers and shakers of Fiji's evolution. Similar trends are apparent throughout the island states as education and mobility at the same time both level the playing field and accentuate the differences of talent and morality among the players.

Efforts continue to incorporate traditional leadership into constitutional government at national and local level. These all suffer from the defect that the traditional role of customary leaders, which is integral with the way they are chosen or emerge, is different from the role they are assigned by modern legislation. As soon as custom is combined with statute its customary legitimacy is tarnished , essential adaptability is diminished, and traditional accountability lost. Some chiefs become figures of fun, others exploit the position to personal advantage, in either case bringing into disrepute both their customary and their modern role. This is an unhappy situation. Outcomes will no doubt differ in Polynesia, Micronesia and Melanesia, with chiefly authority most closely interwoven with constitutional forms in the first, and practically unconnected in the last (in part because concepts of traditional leadership in Melanesia are more diffuse and flexible, and "chiefs" with authority outside their own close kin were in many areas a construct of colonial administrative convenience). In Fiji, constitutional changes are likely to further confuse, and in the process undermine, both the traditional and modern role of chiefs. Aware of this danger, chiefs in Fiji are reported to be requesting training in leadership techniques suitable for their changing roles.

The decentralisation issue is very much alive, and goes to the heart of the nation-building process. People in the larger and more scattered island states identify much more readily with their island or language group than with the larger concept of the nation state. In extreme cases they will kill and destroy to assert this local identity[8]. More commonly, island governments engage in constant altercation with the national government over finance, staff, authority to license resource exploitation, and access to social and economic services. Various degrees of decentralisation and federalism lie along the power-sharing continuum between the centre and the outliers. Practical difficulties and additional costs, that eat into actual service delivery, arise where existing institutions are incapable (or are deemed unsuitable)

[8] Kabutaulaka (1994) points out the distinction between a nation and a state, and the particular importance of this in Melanesia, where the modem states of PNG and Solomon Islands comprise several 'nations, some of which have aspirations to become states'.

for performance of more complex and costly functions, and resources are directed into build-up of political *md* administrative superstructure. PNG and Solomon Islands are currently making drastic reforms to the (slightly different) systems of provincial government that they adopted at independence, trying to cut back the layers of political and bureaucratic padding that have grown up. In both countries, the provincial structures that were created in the name of decentralisation have been costly and inefficient, though scarcely more so than the national government itself. The real reason for the present changes appears to be the hostility that developed between politicians at national and provincial levels, and structural changes are aimed at reducing that. The degree of mutual respect and trust between the various communities (who will be represented both at the national level and in their own island governments) seems to be critically important to making less-than-federal systems work.

It also helps if the national government has enough money to be reasonably helpful to the local-level authorities. As public finances have tightened in recent years, and untied foreign aid is becoming noticeably scarcer, forms of decentralisation that increase financial costs become harder to handle. But recentralisation may be impractical, for all the reasons that led to decentralisation in the first place, and in island nations may in any case not reduce total costs. The chosen level of decentralisation is bound to reflect political trade-offs designed to hold the nation-state together. The problem is then to operate that problematic system so that it delivers services at affordable cost. Tighter control of overheads along the decentralised chain will be an essential part of any improvements.

Because independence came rather quickly and smoothly in most cases, political development and nation-building have largely come after the event rather than as part of the preparation for it. Vanuatu was the exception, but there the struggle to emerge from Anglo-French rule left many internal scars. There are overt or latent secessionist tendencies in the Melanesian nations involving individual islands bigger and more populous than some of the smaller independent states. In FSM, where little holds together the four states except Compact money, the attractions of separate independence, Tuvalu-style, are likely to grow stronger with the dwindling of Compact funding. There is only one land frontier in the region, and that is the largely inaccessible but potentially troublesome boundary between Papua New Guinea and Indonesia's West Irian Province. The other frontiers are lines on ocean charts, allocating fish and as yet unknown seabed resources: only one of these marine borders has given rise to persistent problems, in the narrow strait between

Solomon Islands and PNG, and there the problem is not fixing it, but enforcing it as a barrier when traditionally people have moved freely to and fro. Many islands are closer to their ethnic kin across the border than they are to the national capital. In these conditions, building a nation that will tolerate costs imposed by a far-off government for so-called national purposes, makes impossible demands on its national leadership. Some form of cost-effective decentralisation of government is clearly required.

Leaders need to enunciate goals that appeal to their followers. Attainment of political independence, and assertion of the rights that went with it vis-a-vis foreign governments and individuals, definitions of citizenship, land tenure and so forth, provided a clear and attractive set of goals in the 1960s and 1970s. There was much in the colonial past that needed to be put right, and the prospect concentrated the efforts of many able people. Support for policies that would strengthen independence was broad-based, and political parties (mostly with names implying origins in popular struggle) produced generally similar manifestos, in which ideology was less important than sovereignty. Only Vanuatu had to struggle for independence; this was reflected in both the sharper and stronger definitions of goals that preceded independence, and the communal divisions that have dogged the new state's progress ever since. There as elsewhere, though, with the attainment of independence, and the checking-off of the number one objective, more mundane and difficult problems of economic and political management came to the fore, with politics absorbing more ministerial energy than economics. Party allegiances have proved weak, particularly in Melanesia, and politicians in many states have changed sides (some more than once), particularly during post-election contests for the top job, according to their sense of which leader is most likely to win and reward them for their support. Leaders then come to power burdened with political as well as financial debts to repay, and appointments to high office (and lucrative opportunities) are the means of payment.

The departing colonial administrations generally left the machinery of government in running order, but like an old-fashioned engine that had been kept going by a wily mechanic, it was unable to adjust to new drivers and new loads, and soon began to break down. The post-independence leadership had to cope not only with the rising aspirations of politically awakening and more numerous electorates, but with the overdue maintenance and repair needs of social and economic infrastructure, lack of private investment, low skill levels and the absence of an indigenous entrepreneurial class. New goals needed to be defined, policies worked out and investment decisions made, at a time when everything domestically and externally seemed to be in a state of flux. There were so many things needing to be done, so many opportunities to do good (or bad), and so little capacity in the public at large to check what its leaders were up to. Not surprisingly, the temptation to take advantage of the general confusion and breakdown of accountability was too great for some people in political office and the public service. Leadership became tainted by accusations of corrupt dealing, cronyism, nepotism, hoarding in Swiss (or Vanuatu) bank accounts and the like. In several cases formal investigations have led to loss of office and other punishments; but the forgiving attitude of the man in the street where crimes against public finance are concerned, and the rising influx of entrepreneurs from countries where official corruption is endemic, has ensured that this sickness continues to spread.

## 2.2 PNG AND FIJI

PNG and Fiji together account for 84 percent of the estimated output and 82 percent of the population of ADB's Pacific island members. The two countries have strikingly different colonial histories, resource endowments and social structures. There is a latent rivalry between them for the informal leadership of the Pacific islands, but they have shown much skill in keeping this in the background of their regional cooperation. For many years before and after independence their representatives treated each other with a certain reserve. Recently they have moved closer, through Fiji's joining the Melanesian Spearhead Group with the aim of opening up trade and investment channels. This proximity may sharpen their rivalry. PNG's mineral wealth, forests and agricultural and fish resources, substantial domestic markets and its location at the south eastern gateway to Asia give it great economic potential; while Fiji's relatively diversified economy and versatile work force should make it the best able of the island states to exploit opportunities in a deregulating environment. Yet both countries have been caught in a web of essentially domestic difficulties caused by ethnic differences and communal tensions, exacerbated in PNG's case by its size and the inaccessibility of many of its communities; and in both countries the size, cost and political impact of a standing army add a complicating dimension to economic management.

Despite a GDP per head higher than several of its neighbors, at around $1,250, PNG's human development indicators are the worst in the Pacific. Low levels of literacy, poor coverage of education and health services and short life expectancy handicap most of PNG's four million people. The minerals sector drives the PNG economy, accounting for two-thirds of total exports and 30 percent of estimated GDP, and it seems certain that more mineral development lies ahead. The peculiar nature of minerals development - financially huge, capital intensive, foreign-financed, environmentally hazardous, location-specific, and of finite (though uncertain) duration - has presented PNG's economic managers with serious stabilisation and distribution problems. In many parts of PNG, social and economic infrastructure is absent or in disrepair, while the enclaves of minerals development enjoy international standards of communications, services and consumption. The failure of other sectors of the economy to absorb the increasing workforce has led to open unemployment and severe law and order problems in the larger towns and some rural areas. Successive governments have failed to reduce the size and cost of the public service and improve its productivity: the problem is compounded by conflicting needs to decentralise the provision of services and centralise the allocation of resources in this scattered and unevenly endowed country. The long-running secessionist struggle in Bougainville has its roots in ethnic and political differences between that island and other parts of PNG. It erupted into violence in 1989 over distribution of benefits from massive mining operations, and has shown in loss of lives and wealth how deep and how bitter these divisions can be. PNG's economy retains great potential, and PNG has many able and dedicated people who have shown skill and courage in political and commercial fields; but the specters of lawlessness, communal strife, disregard for the environment and incompetence or corruption in the public sector, along with high costs of labour and services, are frightening off much-needed private investment, while internal conflict is weakening government and absorbing leadership resources, preventing PNG from assuming a greater economic and political role in the region. Fiji's circumstances are at once very different and in some respects, curiously similar. With over 40 percent of its people in urban areas, annual income per head around $2,500, manufacturing accounting for around 18 percent of GDP, and almost universal education and literacy, Fiji is the most developed of the Pacific islands. Smaller, much more accessible and in contact with the outside world for much longer than PNG, Fiji was for many years acknowledged (rather grudgingly) as the unofficial leader of the Pacific island community. A relatively long colonial history, ethnic links to Melanesia and Polynesia, a social system that made sure all Fijians knew their place, relatively strong and pervasive education and health services, and the codification and embodiment in statute of elements of customary land tenure, combined to give Fiji before and after independence an aura of confidence and stability. Sugar, gold mining and tourism earned Fiji's foreign exchange, while smallholder agriculture, a diversified light industrial sector, excellent public transport, and a competent if not over-energetic public service looked after domestic needs. The problem was that a large part of this economic activity was performed by the ethnically Indian half of Fiji's population. As the 1980s brought sharper perceptions and increased aspirations, among ethnic Fijians for economic power and among ethnic Indians for political power, while the government continually in office since independence became lazy and corrupt, the aura of stability began to weaken. In 1987, a general election brought to office a trade union-backed government with strong Indian participation. This was almost immediately overthrown by a military coup aimed at restoring ethnic Fijian supremacy. The economic aftermath has rumbled on through ten years of constitutional uncertainty, emigration of skilled personnel, and low levels of investor confidence, at the same time as Fiji has been trying hard to improve its competitiveness through trade liberalisation and public sector reforms (albeit not too enthusiastically) and flexible exchange rate policy. Fiji has acquired a garment manufacturing sector, strengthened its tourist industry and seen gold mining and tuna fishing expand; but the sugar industry faces a problematic future as the leasehold basis of its most productive Indian-operated farms remains at political risk, and its high-cost production and processing technology fails to prepare for more competitive trading conditions; while the near-collapse of a government-owned commercial bank has revealed financial malpractice on a scale that has shaken public confidence in the political leadership. Under these circumstances Fiji's ability to withstand shocks has been impressive: a less resilient economy run by less sensible people could have done much worse. As it is, the economy has been marking time, waiting for constitutional and political uncertainties to be settled in a way that restores investor confidence. If that can be done, Fiji's combination of human and natural resources gives it the best prospects for resumption of diversified and sustained growth of all the Pacific islands.

## 2.3 INTERNATIONAL RELATIONS

Small, remote nation states could easily drop out of the world picture altogether if they did not cultivate bilateral relationships with bigger countries, join international clubs of various kinds and link hands with other small states in cooperative efforts. Pacific Island nations are anxious observers of continuing shifts and realignments in the international community, not wanting to be left out, but not wanting to be sucked in and eaten alive. So far they have done pretty well, but the parameters of the game seem to be changing. The playing field looks to be tilting against them, there are some powerful new players on the field, and the cost of participation may be rising - but so too is the cost of staying out.

During the colonial period the island territories were variously linked to the USA, France, Spain, Britain, Australia and New Zealand, Germany and Japan: eight colonial powers engaged in the regional carve-up in 200 years, latterly punctuated and rearranged by the two world wars[9]. The connections crisscrossed the ocean, the result of expansionist commerce and religion or strategic defense, defined by treaties in far-off places, with varying degrees of physical control. Japan's between-wars occupation of Micronesia was the most intensive form of colonisation, and was followed by a thorough, but as can now be seen temporary, sweeping-out of all things Japanese by the USA. French colonisation of New Caledonia started earlier and has endured longer than other European penetration in the Pacific, leading to bitter clashes in the mid-1980s between colonists and Kanaks; even here, though, material prosperity, education and the passage of time seem to be producing a consensus of 'independence, yes, but not yet'. In Fiji and the Polynesian states, accommodations were reached between the colonisers and the local leadership that suited both sides (with occasional violent troubles such as the Mau revolt in Samoa). In Melanesia, German ambitions were frustrated by losing the First World War, and British-Australian colonialism was a half-hearted affair at best, Britain trying several times to persuade Australia to take over its role in the Western Pacific.

These connections generally involved projection of power over long sea distances. The exception was the case of PNG and its subordination to Australia, which administered PNG for sixty years until independence. The extreme proximity of these two countries is almost unique in colonial history,

[9] Palau, for example, was successively a Spanish, German, Japanese and US possession in between losing its old and receiving its new independence.

and has been a defining factor in their relationships during and after the colonial period. Australia's attitudes to independent PNG have been shaped by, among other things, concern to maintain good relations with Indonesia[10], feelings of guilt about the treatment of aborigines in Australia, and gratitude for the loyalty of PNG natives during the war against Japan. But a key element has been the dawning recognition that PNG will not go away, and that their relationship must be able to accommodate frictions and strains as both countries develop internally and in their involvement with Asia. In the 1960s there was serious thought of making PNG a state of Australia. Many members of PNG's elite were educated in Australia, send their children to school "down south", own property and take holidays there. Unlike most ex-colonies, PNG's future is permanently tied up with that of its colonial mentor because of their physical juxtaposition.

At the other end of the scale, and the map, Cook Islands retains very close links with New Zealand, even though they are 2000 miles apart, partly because successive Cook Islands government have skillfully manipulated the 'ex-colonial' relationship to obtain maximum benefits from it, and partly because many more Cook Islanders live in New Zealand than live in the island nation itself. New Zealand's response to Cook Islands' chronic financial mismanagement, culminating in the 1996 debacle, has illuminated the nature of this relationship, with New Zealand refusing simply to bail out the insolvent island government, but equally unable to turn its back, and using its close ethnic and political ties to press the Cook Islands to sort itself out in ways that could attract more broad-based external support.

The other independent island states have been diversifying their international connections and aid dependencies away from their colonial administrators. This is partly at their own wish, to develop more options and sources; but it also reflects the withering away of British interest in the Pacific Islands, and the USA's re-assessment of its strategic needs after the end of the Cold War. The European Union has become a major aid donor in the region, urged on by Britain and France; most of the ADB's island members are members of the Africa-Caribbean-Pacific (ACP) group of developing countries, and preferential access to European markets has been of crucial importance to Fiji's sugar exports, and to canned tuna from Solomon Islands

[10] Indonesia, with a population of 200 million, naturally looms large in Australian policy. It annexed the sparsely populated mineral-rich western half of PNG's main island in 1962, with the Cold-War-driven connivance of the USA, on the grounds that, like Indonesia itself, West New Guinea had been a Dutch colony.

and Fiji. Impending changes in these preferential arrangements, as tariffs generally are set to come down, present these countries with serious adjustment problems. Most island governments have made use of the friction between Beijing and Taipei to obtain financial and other assistance from one or the other of the Chinese republics, but they are increasingly aware that in the medium term the power of the mainland economy will cast a long shadow over the Western Pacific. Japan has emerged to rival Australia as the biggest bilateral aid donor to the Pacific Islands, pursuing broad aims of diplomacy and support for its UN ambitions, special interests in access to marine and land-based resources, and now the use of remote locations for launching and recovery of space vehicles.

France remains strongly connected to the Pacific, the only European power now to be so. The use of Mururoa atoll in French Polynesia for nuclear weapons testing put France off-side with most island states, who engaged in many high-profile but on the whole fruitless attempts (along with Australia, New Zealand and Greenpeace) to have the tests stopped; the French Government appears to have started, suspended, restarted and finally stopped the testing programme according to predominantly military and technical criteria. When Fiji left the Commonwealth after the military coups of 1987, it quickly developed a friendship with France that led to small amounts of military assistance. With the closure of the Mururoa bomb-testing site in 1996, evolutionary changes in the political environment in New Caledonia and French Polynesia, and the decline of US and UK involvement in the region, the way is clear for France to build as many new relationships as its aid budget can accommodate, and there are regular announcements of steps along this road.

Australia and New Zealand are inextricably linked with the Pacific islands by history, migration, business and security concerns. They have a strong interest in the people of the Pacific islands being peaceful, healthy, prosperous and staying at home, except for rugby football tours[11]. Inevitably Australia and to a lesser extent New Zealand have been accused of being paternalistic or exploitative or both. In recent years Australia's public exasperation with Melanesian 'resource politics' has several times given

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11 Sporting and cultural achievements are important for national self respect. Fiji, Samoa and Tonga have all produced outstanding individual nigby football players and national representative sides. Fiji has produced one of the world's top golfers. Tongan boxers and Nauruan weight lifters have swelled national pride. In other island states, lack of competition and facilities at home and less opportunity to train overseas probably hold back natural talent, but Solomon Islands and Vanuatu take pride (or despair, depending on results) in their soccer teams' performance, and PNG is edging closer to Australian standards.

island leaders a chance to be seen defending their sovereignty against the bullies in Canberra. Both countries have been important sources of official development assistance to all the island states, and the main supporters of regional organisations. Australia's special relationship with PNG in some ways corresponds to New Zealand's commitment to the Cook Islands and Samoa. And both donors have protected their aid programmes to the Pacific from the sharpest of the budget cuts of recent years. Their support for regional organisations has been remarkable, providing a financial stability and access to professional standards these far-flung agencies might not otherwise have had.

The Cold War lent the island states and the ocean they inhabit a strategic market value that they were sometimes able to exploit. The USA, having inflicted lasting injury on the people of Marshall Islands by nuclear testing at Bikini[12], was particularly keen to have the right for its ships and aircraft to use Pacific island ports (without disclosing nuclear armaments) and to deny these facilities to the USSR and China. Across the Micronesian chain the USA built testing and staging points to support its military presence in Asia, providing jobs and rents to the inhabitants, but dislocating communities and distorting their economic aspirations. The Compact of Free Association offered to the ex-Trust Territory nations of Palau, FSM and Marshall Islands was a straight cash-for-exclusive-access deal. Earlier, in the Cold War environment, Kiribati had caused a diplomatic flurry when it concluded a one-year fisheries access agreement with the USSR; Vanuatu did likewise by sending an unusual selection of government employees to train in Libya as 'journalists'; and Tonga played the Russian card to some effect by offering a marine base to the USSR. In all these cases and more, Australia and other donors rallied round to counter the threat by increased offers of financial assistance. The passing of these virtually costless opportunities to attract extra aid led to the comment at a Pacific regional meeting in 1990 that the Cold War had ended, and the Pacific islands had lost.

Tonga, which conducts much of its diplomacy through the person of its monarch, has cast its net the furthest, inviting investment from a wide range of countries, becoming involved in a dispute with Indonesia over satellite stationing in inner space, and selling passports to non-Tongans, mainly from Hong Kong,

[12] Between 1946 and 1958 the USA detonated 66 nuclear devices in the Marshall Islands.

for substantial sums[13]. Samoa has expertly parlayed its orthodox relationships with a wide range of bilateral and multilateral agencies into an impressive level of access to external assistance, while maintaining its status as a least-developed country eligible for the most concessionary terms[14].

Small countries can mitigate some of the problems of smallness by working out how to cooperate effectively vis-a-vis the outside world, particularly in one-nation-one-vote legislatures. The Pacific island states, except for Nauru, all joined the UN and its specialized agencies and the regional agency, ESCAP, at independence or soon thereafter (even dependent territories are associate members of ESCAP). In response to the islands' demands for attention, ESCAP maintains a Pacific Operations Centre in Vanuatu, and convenes an intergovernmental Special Body on the Pacific Island countries every two years. The Pacific Islands at UN took a leading role in forming the Association of Small Island States (AOSIS), and made it into an influential lobbying group in world environmental consultations. As members of the IMF and the World Bank group of institutions (all except Cook Islands, Nauru, and Tuvalu) undaunted by their microscopic voting power, they make some attempt to coordinate their arguments at annual meetings, and present their case for flexibility of treatment based on their undoubted characteristics of smallness and remoteness. In the ADB, the twelve Pacific island members occupy a significant amount of administrative attention and speaking time at annual meetings, and are served at a disproportionately (but unavoidably) high cost of Bank resources per head of population, by an Office of Pacific Operations in Manila and a Regional Mission in Vanuatu. In the voting constituencies of these institutions, the island states cluster variously around Australia, New Zealand, Indonesia and Korea[15].

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[13] The Tonga Trust Fund, mainly built up from passport sales, stood at around $25m in mid-1995, bigger than the official reserves held by Tonga's central bank. Similar schemes exist, and generate significant government revenues, in Kiribati and Marshall Islands. The USA has taken steps to limit onward access to the USA for holders of these special Marshall Islands papers. The international acceptability of the Kiribati "green passports" does not seem to have been widely tested as yet. Tuvalu is preparing to sell passports to mainland Chinese, though presumably not with a view to their moving to Tuvalu. In Vanuatu a proposal to sell passports apparently led to the downfall of Prime Minister Walter Lini in 1991, while a similar proposal rocked the Fiji government of Sitiveni Rabuka in 1995, and passport sales have provoked public controversy in Samoa.

[14] Samoa's economic management in recent years has been astute and disciplined, coping with severe cyclone damage, crop disease and the huge debts of Polynesian Airlines with remarkable success. So much so that a recent review of Australian aid recommends the 'graduation' of Samoa out of the aid-worthy category.

[15] Those who choose to be represented by Australia have to live with Canberra's view of development issues in the multilateral as well as the bilateral context, and the way they feel about their representation in Washington and Manila depends on the skill of the Australian Executive Director in persuading them that their interests are not being subordinated to those of Australia.

## 2.4 REGIONAL COOPERATION

Meanwhile in the Pacific region there exists an impressive array of institutions aimed at cooperation among governments and among non-government organisations. A systematic estimate in 1983[16] put the total at over 200, and there have been many additions since then. Specialized regional organisations exist for cooperation of some kind between national governments, churches, trade unions, women's movements, airlines, shipping, ports authorities, power utilities, chambers of commerce, news media, education, linguistics, sports and culture. The definition of region varies between institutions, but most island states are covered by most regional organisations. Regional and subregional sports competitions and cultural festivals are popular, and serve to unify the competing states internally and develop regional identity: they are severely handicapped, though, by the high costs of travel between the islands, and the tightening of government budgets that used to provide much of their funding[17].

Subregional identities are also reflected in some political groupings. The most significant is the Melanesian Spearhead Group (MSG), consisting of PNG, Solomon Islands, Vanuatu, representatives of New Caledonia's Kanak people, and, since June 1996, Fiji. In the 1970s and 1980s Fiji had rather kept its distance from the other Melanesian states, who were linked more closely by their colonial history and the use of pidgin as a lingua franca. In the 1990s the unmistakable economic potential of the group seems to have overcome Fiji's earlier reservations. The MSG emerged in the mid-1980s, in part the product of resentment by Melanesian leaders of what they saw as unjustified Polynesian dominance of the region and its organisations. As noted earlier, the original business of the MSG was to provide moral support to the Kanak people of New Caledonia in their quest for political autonomy. In this it had some success, contributing to the pressures that resulted in the 1988 Matignon Accords on a 10-year period of preparation for decisions on independence. Recently the group has begun to tackle the problems of promoting inter-island trade and investment, and adoption of a coordinated stance towards Asia, where PNG is a member of APEC. Progress

[16] Crocombe (1983).

[17] Commercial sponsorship of sporting events is now common, with tobacco manufacturers and breweries prominent in financing all kinds of sport. Even national teams are moving towards commercial sponsorship. At the same time, increased smoking and drinking, particularly among young people, are a cause of growing concern. A confrontation over the propriety of such sponsorship cannot be far away.

being made at this scale is encouraging the Pacific islands to look wider and more boldly at the scope for freeing up trade among themselves, as a precursor to the eventual free trade with Asia that is implied by general liberalisation policy (see Box A). Inevitably the formation of the MSG was seen as a threat to Polynesian, and to a lesser extent Micronesian, interests, though members of the Group have been careful not to take divisive positions within the wider regional organisations. Moves are made from time to time to establish similar Micronesian and Polynesian groupings, but these have not so far defined a clear enough role for themselves to develop operational form. A Council of Micronesian Chief Executives met twice in 1996 to promote "socio-economic collaboration and cooperation in the Micronesia region". Annual summit meetings for Smaller Island States have brought together Cook Islands, Kiribati, Nauru, Niue and Tuvalu, but so far this is a means to coordinate positions in other organisations rather than to execute joint activities.

A few non-government regional organisations go back well into colonial times, but the oldest inter-government institution is the South Pacific Commission (SPC), founded in 1947. It was a creature of the then colonial powers who read the writing on the post-war wall, and saw regional cooperation as one way of easing the transition to self-government and independence. SPC was created fifty years ago to provide a single technical services agency to take on some of the support functions the island nations would need and, in the political climate of the then-incipient Cold War, a bulwark against the spread of communism[18]. Australia, France, New Zealand, UK, USA and (briefly) Holland became members with their Pacific Island dependencies and Tonga. For over twenty years, the SPC provided a focal point for coordination of economic and social services and a priceless opportunity for emerging political leaders and officials to meet on and off duty and talk about the kind of South Pacific they wanted. But the colonial powers banned politics from the SPC's formal agenda, thus forcing the emerging leaders of the island states to create another regional organisation, the South Pacific Forum, with politics at its centre and excluding the 'non-Pacific' colonial powers. Australia and New Zealand hung in there, by promising each to pay one third of the new organisation's operating costs. In the next few years the Forum became the acknowledged focus of the

[18] Gough Whitfam, in *his* political memoirs quoted by Uentabo Neemia, thought part of the objective may also have been to minimise interference in the area by the United Nations (Neemia, 1986).

BOX A

**Melanesian Spearhead Group: Steps Towards Regional Free Trade**

Despite its name, redolent of traditional solutions to inter-tribal disputes, the Melanesian Spearhead Group (MSG) is evolving from its political beginnings to become the Pacific islands' first serious experiment in freeing-up trade and investment among themselves, through a process of lengthy consultation, negotiation and foot-dragging implementation. The experiment is important. Pressure is mounting internationally, under the banner of the WTO, to dismantle protection and open up domestic markets to the joys of foreign competition. The MSG members are the Pacific islands with the best long-run chances of competing internationally, at least in their areas of comparative advantage; they are finding out, ever so cautiously, what trade liberalisation means in their open, shallow economies; and what happens in the MSG countries makes a big difference to the regional picture.

The four current MSG states (Fiji, PNG, Solomon Islands and Vanuatu) account for 99% of the land area, 90% of the people and 90% of the estimated output (GDP) of the Pacific islands that are members of ADB. Within the MSG itself, PNG and Fiji greatly outweigh Solomon Islands and Vanuatu, while estimated GDP per head in Fiji is twice that of PNG and Vanuatu, and three times that of Solomon Islands. These inequalities may strain the unity of the group, if some are able to make better use of new opportunities than others. The potential for New Caledonia to accede to the group as and when its political evolution permits gives MSG a further dimension of great economic significance, as the estimated income per head of New Caledonia's 200,000 people is seven or eight times higher than that of Fiji, and the territory's crucially important economic connection to France, and so to Europe, is likely to survive in some form for a long time.

Trade among the MSG states is at present insignificant in terms of their balance of payments; but individual producers of goods and services are finding opportunities for trade and investment, encouraged by the favorable light in which the MSG governments profess to view such initiatives. Costly and inconvenient shipping schedules and undeveloped banking

*continued next page*

*Box A continued*

and financial services, are a drag on potential intra-MSG trade, and studies are in hand to see how to improve these and other intra-MSG links. Though there are now 150 tariff items that are duty-free between MSG states, the main items of trade are still the same as five years ago, namely beef from Vanuatu, canned fish from Solomon Islands, and small amounts of tea and coffee from PNG. Fiji's more diversified and sophisticated economy and aggressive exporters will certainly change this pattern once Fiji is allo%ved to accede to the trade protocols of the MSG agreement.

The MSG is very far from being a regional free-trade area, but as a means of understanding what such a concept would involve, and as an introduction to liberalisation generally, the MSG experience is very important. The member states are willy-nilly being drawn into an increasingly free trade relationship with Asia and the world. PNG has embraced this with enthusiasm, seeking new relationships in APEC; the others are liberalising more because it seems to be expected of them: everyone is joining WTO so they had better do so too or appear out-of-date (even though for most island states the costs of global liberalisation are clearer than the benefits). Meanwhile trade, customs and quarantine officials of the MSG states are learning to understand and negotiate with each other, and finding out how their domestic economies are affected by barriers to trade. Removal of protective tariff barriers, even on as limited a scale as the MSG, throws light on intrinsic competitiveness in quality and price and exposes handicaps to competitiveness such as high labour costs, costly and unreliable utilities, and opaque permitting procedures. Successful trade opens up investment opportunities that in turn allow greater economies of scale, profitability and accumulation of financial capital and know-how, in preparation for the challenges of opening up to Asia and the world, as that prospect draws ever nearer. Progress with freer trade among MSG countries will encourage steps towards free trade in goods and services among all the Pacific island countries, providing a new dimension to their development prospects.

independent Pacific island states[19]; while SPC soldiered on with diminished political status, but still the only organisation that encompassed the largest and the smallest island territories.

The pace of regional institutional creation quickened as more island states achieved independence. Both governments and civil society felt the need for specialised exchanges and friendly professional reinforcements in dealing with domestic or international issues. Much of the genesis came from aid donors, who wanted to be able to give aid in larger lumps than could be digested by the very small states, and found it difficult to focus down to such small units. They hoped that regional organisations could effectively retail their assistance. There was no master plan for this growth, and by the mid-1970s questions were being asked about duplication that have been repeated ever since. In 1976 a study of aid effectiveness[20] organised by the Forum Secretariat (then known as SPEC) broached the subject of merging SPC and SPEC, but the recommendations of that and a more detailed study in 1981 were killed at the donor level, because France and the USA and their dependencies would have had to accept a status in the resulting organisation of less than full membership, and Australia did not want a row with either of them. The case of France and its dependencies appears to be still the main reason why the organisations cannot be integrated. If that is so, political developments in the French Territories over the next few years may hold the key to rationalising the regional organisations.

In the aid-abundant decades of the 1970s and 1980s, more organisations were created to meet high-profile needs. The Forum Fisheries Agency (FFA) was established in 1979 in Solomon Islands to coordinate management of and access to tuna stocks in its island members' extensive 200-mile EEZs. FFA has had important successes, notably with the regional register of foreign fishing vessels, the multilateral access treaty with the USA, and the development of a satellite-based computerised system for monitoring the position of licensed vessels. The Agency has built up a formidable reputation with the distant water fishing nations, which is now being deployed in the negotiation with those nations by FFA members aimed at harmonised tuna management in the high seas zones as well as the surrounding EEZs. SPREP, the region's environmental

[19] A subregional group of small island states brings together Cook Islands, Kiribati, Nauru, Niue and Tuvalu for periodic meetings. Proposals have been made for some institutional development specifically to serve this group, e.g. a fund or bank, but so far nothing has been established, for lack of funds, and it seems unlikely that institutions at this scale would be cost-effective.

[20] Forum Secretariat (1976).

agency, was hived off from the SPC in 1993 to a new base in Western Samoa and has campaigned energetically for national environmental management, a coordinated regional position on global issues, and access by Pacific islands to global funding for environmental activities. SOPAC, the regional geoscience agency, provides advice and technical assistance to its members from its Fiji base. The Commission has an impressive record of data analysis, but finds it increasingly difficult to attract funding in the post-Cold-War environment. SOPAC's predecessor, CCOP/SOPAC, was the only regional organisation that engaged active support from the Soviet Union, which had a considerable interest in oceanography because of its submarine fleet operations. The Pacific Islands Development Program (PIDP), based at East-West Center in Hawaii, has also suffered from the changing priorities of the U.S. government with the ending of the Cold War. PIDP serves the Pacific Islands Conference of Leaders, a group which uniquely brings all the US Pacific territories, including Hawaii, into one forum with the independent states. But PIDP's research activities are being cut back, as the East-West Center itself suffers budget cuts. Meanwhile in Fiji, the University of the South Pacific (USP), founded in 1967, has struggled to preserve the fully regional identity of its early years against pressures, at staff and student level, to turn it into a Fiji national university with some places for foreign students. Concepts of intellectual freedom came under attack at and after the time of the military coups in Fiji in 1987, and some of the scars remain. USP also faces problems of maintaining academic standards in the face of increasing competition from universities in Australia and New Zealand, and of sustaining its regional support in competition with moves to set up national universities in island states, linked to metropolitan 'academic mentor' institutions.

The Forum Secretariat itself, like its predecessor SPEC, has gone through expansions and restructurings in its efforts to implement the directives of heads of governments meeting in the SP Forum. The most recent review, carried out in 1995, requires it to concentrate on assisting in policy formulation at national and regional level, and shift its programme - implementing activities to others, or close them down. The most sustained effort, and probably the greatest impact, of SPEC/Forum Secretariat has been in the area of trade development[21]. This has been effective at the policy level (Forum Secretariat has observer status in APEC, and has assisted Fiji

[21] This has historical roots. When Pacific island leaders decided to form a politically competent regional organisation in 1972, they cast around for a foundation and picked on the Pacific Islands Producers Association (PIPA), then concerned with promoting the export of coconuts, bananas and spices. PIPA was converted into the South Pacific Bureau for Economic Cooperation (SPEC), which later evolved into the Forum Secretariat.

and others in negotiations with the European Union) and at the promotion level, where Forum Secretariat has been instrumental in setting up trade promotion offices in Australia, New Zealand and now Japan. Meanwhile the subregional MSG, mentioned earlier and in Box A, has begun the long process of dismantling tariff barriers, harmonising procedures and rethinking quarantine requirements, to promote trade among its own members. This example is stirring interest in a possible free trade area among all Pacific island states.

Proliferation of inter-government organisations, all serving the same stakeholders, approaching the same sources of funds and drawing on the same limited pool of able Pacific island nationals for executive jobs, has led to calls for better coordination, avoidance of overlap and harmonisation of employment conditions. The Forum Secretariat, as ‘first among equals’, has set up a coordinating committee (SPOCC) with this job, but it has difficulty avoiding the trap of becoming a mere talking-shop for organisational grumbles.

Regional cooperation as a principle resonates well in the Pacific, but in practice it only works in rather specific conditions. They include the existence of a need or threat that cannot be effectively dealt with at national or bilateral level, or safely be left to market forces to handle; a clear coincidence, or substantial overlap, of national interests among the would-be cooperators, supported by mutual trust; the availability of economies of scale from pooling of resources, markets, ideas; and the technical feasibility of the proposed operations. But these conditions, though necessary, are not sufficient. There must also be a convinced and persuasive ‘champion’ of the cooperative solution, not only to launch the project, but to sustain it after the honeymoon is over (the problem now facing SOPAC and PIDP, and lying ahead for others in the next few years).

The cases of regional shipping and air services are illuminating. In the early 1970s these seemed obvious areas where cooperation would pay off. The Pacific Forum Line (PFL) was set up with most island states as shareholders, ostensibly to operate on routes inadequately served by commercial lines. Purpose-built vessels were provided to selected island members by aid donors, for on-charter to PFL. Direct subsidies to uneconomic routes (Micronesia, Kiribati, Tuvalu) were provided by Australia and New Zealand. After many loss-making years and wrangling over routes and cross-subsidies, a review of PFL in 1994 led to an attack on costs, and revised strategies and goals. PFL now operates commercially, but on profitable routes only, and the original social purposes have been abandoned. Cooperative air services also went nowhere in the 1970s and 1980s, with

Fiji taking control of Air Pacific and no less than six other island states setting up their own, inevitably loss-making, national airlines. Only now, after years of bloody-minded disputation and nationalistic policy-making, are financial realities forcing them into effective collaboration, in the use of aircraft, route-sharing and servicing. Continental Micronesia serves the Micronesian subregion lying along the equator and links it to Manila and Honolulu, and there are intergovernmental moves afoot to float another subregional operation linking Micronesia to Fiji. But there is still no regional airline, and little prospect of one and airfares per kilometer in the Pacific are likely to remain among the highest in the world.

Cooperation implies incurring a cost, by giving up some freedom of action to pursue individual benefit, in return for the benefits of acting together. Governments usually want the benefits without the costs (the free-rider problem), an attitude which continually threatens the viability of regional organisations and provides their managements with most of their problems. So far the Pacific islands have managed to keep their own financial commitment to regional organisations very low, but this is coming under scrutiny as the foreign aid climate cools. With the exception of USP and PIDP, the regional organisations making up SPOCC had expenditure budgets for 1996 of just over $40 million, and employed 382 persons, of whom 238 were Pacific Islanders (see Table 2). SPC alone accounted for 46 percent of the expenditure and 44 percent of the staff. The island states provided 46 percent of the professional staff and 80 percent of the support staff, but contributed only 5 percent of the total cost of the five organisations (13 percent of the core budgets). Australia and New Zealand met half of the core budget costs (39 percent of total costs). Two-thirds of the programme (non-core) budgets of the five organisations were met by donors other than Australia and New Zealand. This heavy dependence on external funding has not inhibited island states from asserting rights of ownership of the organisations, and a significant amount of time of senior officials is occupied in meetings of governing bodies and specialised committees. Salaries and working conditions in the organisations are better than in most Pacific national governments, and emoluments are tax free for persons outside their own country, so jobs are keenly sought after. Present and would-be incumbents form a strong lobby in favor of current or better conditions of service. Key appointments are made after extensive political consultation, making it unavoidable that criteria other than professional merit are applied in the selection process. On several occasions strong feelings, for whatever reason, have led to open division among member countries and delays in completing

**Table 2: Funding and Staffing of SPOCC Organiations 1996 (Except USP and PIDP)**

| Funding | From PICs | | From Australia and New Zealand | | From Other Source | | Total | |
|---|---|---|---|---|---|---|---|---|
| Core/Regular Budget | 1.7 | **13.3** | 6.4 | 50.0 | 4.7 | 36.7 | 12.8 | 100 |
| Progammer/C apital Budget | 0.3 | 0.1 | 9.3 | 34.1 | 17.7 | 64.8 | 27.3 | 100 |
| Total | 2.0 | 5.0 | 15.7 | 39.2 | 22.4 | 55.8 | 40.1 | 100 |
| **Staffing** | no. | % | **no.** | % | no. | % | **no.** | % |
| Professional posts | 90 | 45.9 | 58 | 29.5 | 48 | 24.5 | 196 | 100 |
| Support statt" | 148 | 79.5 | 24 | 12.9 | 14 | 7.5 | 186 | 100 |
| **Total** | **238** | **62.3** | **82** | 21.5 | **62** | **16.2** | **382** | **100** |

Source: Direct inquiry to organizations (Forum Secretariat, SPC, FFA, SOP AC, SPREP).

appointments while a consensus was negotiated, leaving the eventual appointee to build relationships with those who opposed him.

It seems certain that the output of technical services being delivered by the present set of intergovernmental regional organisations could be delivered at lower cost by fewer organisations. There is much talk of a regional strategy in the SPOCC organisations. Though institutional convergence and eventual integration is not what is currently meant[22], if that becomes the goal it will usefully concentrate minds and in due course release resources from overheads into operations. An appropriate strategy in such circumstances is to plan the desired goal in sufficient detail to see how to get there; and then set the existing organisations on paths that converge into the new arrangement over a reasonably short period of time. At the same time, the island states will have to demonstrate the value they set on regional cooperation by significantly increasing the contribution they make to the operating costs of the regional institutions. Fewer organisations would also make that easier to achieve.

[22] The regional strategy being developed by the Forum Secretariat is a method of organising and ranking bids from regional organisations for assistance from official aid sources, so as to reflect a regional view of development goals and priorities.

The aim of such streamlining is not to weaken regional cooperation, but to strengthen it for new tasks ahead. The network of regional organisations that has grown up since the 1960s has meant a lot to the island states as they became independent and took their first steps as politically sovereign nations. Regional meetings have provided exposure for political leaders in a less formal setting than the UN General Assembly, and officials have had useful practice in managing and documenting meetings, handling disagreements and drafting conclusions. Working together has produced solid results that could not have been achieved by one or two countries on their own: offshore fisheries, relations with the European Union, nuclear-free treaty, and first deliberate moves towards Asia. By collaborating effectively on a few key issues, governments of tiny nations have added some of the attributes of positive sovereignty to the negative sovereignty they acquired at independence. Much the same is true of the churches, trade unions and the many other NGOs that come together at regional level. Cooperation has helped to build self-confidence, and has shown how by acting together the small states can exert influence on important details of wider and unavoidable changes as they affect the Pacific islands. It is the bureaucratic costs of cooperation that need to be attacked, not the cooperative function itself.

As and when the number and structure of regional organisations again comes under scrutiny, the prickly question of membership status for the developed countries with interests in the region will have to be grasped. The dimensions of this problem are different now from when the SP Forum was set up in 1972, let alone when SPC was created fifty years ago. The relationship of China, Japan, Taiwan, Indonesia, the EU, Britain, France and the USA to the islands region will all need to be reviewed and reflected in appropriate forms of interlocution or association with the Pacific islands' organisation(s). Moreover, the role of Australia and New Zealand will also come under scrutiny. These two Pacific nations provide half of the money for the core costs of SPOCC organisations, and Australia in particular exerts considerable influence in and on the regional bureaucracies. Such influence can cause resentment, especially when it is exercised with a robustness normal in Australian politics but considered arrogant in Pacific cultures. Pacific islands leaders nowadays deal with representatives of a variety of cultural, political and economic interests, and some of these show more skill in understanding modern Pacific aspirations than do the ex-Dominions to the west and south. Australia in particular will need to develop a less patronising image in the region if it wants to remain on the inside of politically important regional forums[23].

## 2.5 ASIAN CONNECTIONS

The new factor in Pacific external relations is the growing political and strategic power of the Asian, and particularly East Asian economies. This is manifested mainly in new aid and trade relationships, but it also has diplomatic and strategic aspects, and implications for regional cooperation. The phenomenon is best seen in its historical context. Asian involvement in Pacific island economies goes back hundreds of years, but in the last two decades its scope and nature has changed dramatically. In the late 18th and early 19th centuries a slow and erratic trade in sandalwood, beche-de-mer, marine shells and coconut oil was finding its way to buyers in Asian ports, via American and European-owned sailing vessels and itinerant traders of various origins. As the 19th century advanced, European missionaries, traders, planters and beachcombers struck bargains of various kinds with island communities and came ashore to stay. Colonial administrations followed, often reluctantly, and small colonial townships began to appear.

Chinese artisans, shop-keepers, middleman traders and small-ship operators came too, from Hong Kong or direct from strife-ridden mainland China, quickly becoming an important part of the emerging island economies. By the time of the First World War, small Chinese communities were emerging in most of the little towns that marked foreign involvement in the Pacific islands. In the French territories and the New Hebrides (now Vanuatu) a similar role in entrepreneurship and investment was performed by Vietnamese, coming via the colonial connection with Indochina, either as employees of the French in the first place, subsequently going into business, or as entrepreneurs from the start.

A different kind of Asian participation occurred in Fiji, where indentured workers for sugar plantations were brought from India at the end of the 19th century, under arrangements sponsored by the British government

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[23] The Australian government's move in 1997 to close down Radio Australia (the popular and respected overseas service of the Australian Broadcasting Corporation) because people in Australia were not interested in it, exposed an alarmingly inward-looking mindset. Though the Pacific service of Radio Australia has been partially reprieved in response to strong regional protest, the Asian service has been severely cut, and the implications of this have been widely noted. A further, though passing, setback to Australian influence was the leaking and publication of a confidential and uncomplimentary assessment of Pacific islands leaders and economic policies, intended 'for Australian eyes only', after the 1997 meeting of Forum economic ministers.

(Fiji was by then a Crown Colony by Deed of Cession). Between 1879 and 1916, when the British administration bowed to pressure from human-rights groups to end the indenture system, over sixty thousand people entered Fiji from India, most of them from the northern states. Six out of ten stayed on after their indentures expired, settling in Fiji and becoming the main source of that economy's agricultural workforce and entrepreneurial class. This ethnic outlier later attracted merchants and traders from other parts of India to migrate to Fiji. Most of the strengths and weaknesses of Fiji's present-day political economy have their roots in this massive transplant of Asian people into a Pacific island; working out how to harness the economic dynamism of the Indian half of its population in a politically sustainable framework has long been Fiji's top priority.

Japanese involvement in the Pacific islands was sparse until this century, and the rise of military-imperial ambitions in Tokyo. Japan displaced Germany in western Micronesia during the First World War, and obtained a League of Nations mandate over most of the area. Between the wars Japan fortified its Micronesian possessions as a preparation for pushing southwards. When war came in 1942, the Japanese navy and army quickly occupied key islands in Melanesia and Micronesia, and were only dislodged at great cost in lives and material. Many thousands of Pacific islanders enlisted and fought alongside US, Australian and New Zealand troops. Many more were astonished witnesses of sea-borne assaults and naval battles. Attitudes to colonial rule were permanently changed, especially in Melanesia, where incipient independence movements took heart from contacts with the outside world. But the war itself was understood as a fight against aberrant Japanese expansionism, and had little effect on Pacific islands perceptions of Asia.

By the 1960s, Asia's connections with the Pacific islands were beginning to diversify and deepen. Well-established and prosperous Chinese families dominated the trading and light industrial sectors of most Pacific island economies. Some families intermarried with islanders, more commonly in Polynesia than Melanesia. Many sent their children to school in Australia or New Zealand, and bought property there. Close friendships and business relationships developed between resident Chinese and rising political leaders. What was regarded as the typically Chinese combination of family loyalty, hard work and thrift, allied with a weakness for gambling, was much respected among islanders. Outbursts of xenophobia around the time of independence caused many Chinese to emigrate, and most of those who remained took precautions against future troubles by having some of their family members take up permanent residence around the Pacific Rim.

As the newly independent states were courted diplomatically by Beijing and Taipei, the resident Chinese had to decide whose side they were on: sometimes families split over the issue. As Hong Kong and Singapore grew in output and competitiveness, they became important suppliers of Pacific island imports of food, general manufactures and petroleum products. Japan's rapidly expanding industries became the islands' main source of machinery, vehicles and electronics. Japanese long-range fishing vessels hunted tuna throughout the Pacific islands, and were the first to negotiate access agreements and joint ventures with Pacific island governments when they established 200-mile EEZs under the UN Treaty on the Law of the Sea. Japan's need for minerals and timber brought the Japanese trading and financial conglomerates into the islands as investors, traders and logging operators.

Where Japan showed the way, Korea and Malaysia followed, along with Indonesian and Filipino entrepreneurs in various fields, and South Asian traders from Singapore seeking out any kind of import-export opportunity. By the 1990s, Malaysian firms (most of them Chinese-owned) dominated the logging industry in PNG and Solomon Islands, and were engaged in tourism and banking in Fiji and Tonga and property development in several island states, as well as Australia and New Zealand. Pacific islands obtain up to half of their imports from Asia, and Asia takes up to 80 percent of Pacific islands exports. Asia is the fastest-growing source of tourists to the Pacific islands, with travelers from Korea, Taiwan and now mainland China setting foot on beaches already trodden by Japanese visitors.

As colonial connections wither, the more distant aid donors lose interest, and Australia and New Zealand proclaim that their own economic future lies in closer ties with Asia, the Pacific islands also move inexorably into closer economic and political relations with Asia. Private investments by Asian entrepreneurs dominate the commercial news in PNG, Solomon Islands, Vanuatu, Fiji, Tonga and Western Samoa. Investment comes directly from Malaysia, Indonesia, Korea, Taiwan and China or indirectly via Asian interests in Hawaii, California, New Zealand and Australia. Diplomatic and commercial relations are advancing together. Strategic interests reinforce commerce as Japan and China build satellite tracking stations and space research bases in the central Pacific, providing the smallest and remotest states with rental income and employment opportunities. Japan is emerging as the biggest single aid donor to the Pacific islands, and this will be more marked after the EU's Lome Convention expires in 2000. The ADB, under strong Japanese influence, is already the largest source of development loans and technical assistance to the islands (apart from France's aid to its own dependencies). Japan has excellent diplomatic relations with the Pacific islands. Korea, Malaysia and Indonesia are rapidly following suit. Taipei and Beijing conduct an elaborate dance around the Pacific, respectively trailing offers of soft loans and technical assistance, or threats of unspecified nasty consequences, for the support of Taiwan's continued autonomy.

The next century is variously said to belong to the Pacific or Asia or both. In any case, it is going to see the fate of the Pacific islands increasingly bound up with what happens in, comes out of and goes into, Asia. Asia itself is about to be reshaped by the rise of China to economic dominance, and the tendency to political and military hegemony that will come with that resurgence. Industrialised Europe and the Americas will find it hard enough to adjust to this re-ordering of international affairs. The Pacific islands are much closer to the earthquake's epicenter in every way. The problem the island states face is how to retain any significant control over what is happening to them: if not over the broad direction, which is probably out of their hands, at least over the speed and modalities of the deep economic and social changes already afoot. This conundrum underlies the often muddled and inarticulate economic policies of the Pacific islands. The scope for preserving national identity and self-respect, while seeking the financial means to raise, or even just to maintain, existing levels of material welfare, will be significantly different for the relatively well-endowed and the poorer island states, but neither will find it easy. Asian enterprise is increasingly going to provide the investment capital and the markets for economic activity in the former, and Asian governments are going to provide an increasing share of official aid to the latter.

The island states are uncertain whether to compete or cooperate in their pursuit of national benefits from closer contacts with Asia. In practice they try to do both. They are competing to attract investment and to supply markets, and cooperating in collecting information and making the region known in Asia, through contacts with APEC, opening of a trade centre in Tokyo, and participating in tourism and trade shows in Asia. Meanwhile a substantial part of the export sector, and a growing proportion of domestic manufacturing and service industry, is being set up or acquired by Asian entrepreneurs. This can easily appear as a re-run of the colonial past, but with different and potentially more numerous colonisers, supported by pervasive alliances between them and the indigenous political leadership.

It is striking that the island governments and people generally know very little about Asia, far less than they know about their previous colonisers.

Apart from experience with the Chinese communities found in most Pacific states, and the Vietnamese in Vanuatu, who have generally concentrated on building up family enterprises, Asian entrepreneurship and business methods are less familiar to most people than those of European origin. There is no history of diplomatic or cultural interchange, or education of Pacific students in Asian countries or languages. Any early misconception about a brotherhood of developing nations has been bulldozed (literally) away, but no more relevant and useful paradigm has yet emerged. The Pacific islands are collectively and in some cases anxiously cosying up to people they generally do not understand, with results they did not entirely expect, and in many cases do not like.

# 3 Wind in the Sails: the Management of Island Economics

Along with political independence went the assumption that economic development would necessarily follow, to support and strengthen new-found autonomy in domestic and external affairs. The island states would benefit in wealth and knowledge from exploitation of their natural resources, education and training of their people and expansion of their domestic production of goods and services. The process would be underpinned by external aid, in the first place mainly from the ex-colonial powers, but later involving new economic and political relationships. This process would lead, over a period of years that would vary among the island states, to the emergence of a family of independent and self-respecting nations, linked by effective regional organisations in a mutually supportive alliance. In many respects, this assumption has been borne out by events. But the process has also produced many unexpected and unwelcome results, and has created social and economic trends whose likely outcomes are at best a matter of concern, at worst deeply alarming. This part of the paper discusses aspects of the development process from the standpoint of economic management - the steersman's view point, necessarily alert to the direction and strength of the wind in the sails.

## 3.1 MEASUREMENT AND COMPARISONS

Questions of definition and measurement unavoidably intrude into discussion of Pacific island economies. This is partly because of the role of non-cash production and exchange in providing a substantial part of people's livelihood; partly because national statistics offices generally have difficulty collecting and processing data necessary for orthodox measurement of economic activity; and partly because of the failure of those measurements in any case to reflect the consumption of natural capital to generate current incomes. These problems are particularly acute in the Melanesian states other than Fiji and in Micronesia, but they affect all the island states to some degree.

Non-cash production supplies an unqualified but substantial part of the needs of rural people throughout the Pacific. There are now no purely subsistence economies in the Pacific islands: virtually every household has some contact with the cash economy. But for many remote communities, totaling many hundreds of thousands of people, cash incomes provide only a small and intermittent part of their needs: they cultivate, forage, hunt, fish, build, weave and exchange the larger part. Efforts have been made in the past to quantify the value of production/consumption/investment that does not enter the market. The results are now out of date, but they suggested in the 1970s that as much as one-third of the national product of Solomon Islands and FSM, for example, was not sold for cash. Developed economies also have this problem of valuing non-marketed output (housekeeping, for example) but in the Pacific islands it has real significance for assessing overall growth. A high rate of growth in the cash sector may be offset by a decline in non-cash production/incomes, or difficulties in the modern sector may be cushioned by increases in non-cash output, with the real or financial adjustments in both cases being distributed through family networks.

Statistics offices are generally not top of a government's budget priorities. They are not vote-catchers, indeed the facts they produce can be politically embarrassing. So they often lack the resources to produce comprehensive data on output, incomes, investment and growth. Most island states have reliable (if not always timely) data on trade, travel, the banking system and government finance, and much can be deduced from this data about the level of economic activity, at least in the monetary sector; but gaps in coverage of private sector consumption and investment, and the treatment of such important components as residual values, suggest a possible error range of several percentage points in estimating economic growth rates.

Adding to the problem of unreliable old-style measurement of national income is the sharpened awareness in recent years that the accounting framework itself is defective, and for resource-based economies can be seriously misleading. The orthodox national accounts ignore the depletion of natural resources and the degradation of the environment caused by economic activity. Capital in the form of mineral deposits, soil quality, natural forest, lagoon and reef ecology and clean water catchments is routinely treated as of no cost (no intrinsic value), merely because it was not produced or put there by economic actors. At the same time, expenditures on repairing damage to the environment are counted as adding to national income, when more properly they are an indicator of how much capital has been consumed. Preliminary steps are being made to introduce “green accounting”, a method of quantifying the drawdown of natural capital and getting the result into the national economic accounts, initially as a set of supplementary statements. Among Pacific states, most work has been done in PNG, with assistance from the United Nations Statistical Office and the World Bank. Early results suggest that the impact of adjustments for resource depletion and associated environmental degradation in PNG would reduce GDP in the key mining sector by 27 percent. A similar adjustment will be needed for logging of natural forest, its amount depending in part on how non-logging uses of the forest are valued. Acceptance of green accounts may not come easily, partly for quite substantial technical reasons, including the amount of hard work required to produce estimated values; and partly because the process may be unpopular with powerful interests, local and foreign, who are able to extract large rents from resource-based activities precisely because resource replacement/depreciation costs are not deducted from the distributable surplus.

Given such reservations about national data, it seems obvious that comparisons among the island states need to be treated cautiously. Published data itself frequently offers a choice of figures. As the Forum Secretariat recently noted, “the quality of statistics in the region is quite variable. It is common to find widely different estimates of a given figure if two or more sources are used”. A further complication has been that achievement of ‘Least Developed Country’ status, which gives access to highly concessionary loans and technical assistance from multilateral institutions, has depended on having annual GDP per head below a level set from time to time by the UN[24]. It can be assumed that some governments have responded rationally to this incentive by making sure that their countries do not appear too prosperous. Somewhat higher up the GDP scale, Nauru faced a similar problem in getting itself classified as a developing country member of the ADB, rather than as a potential donor; the problem has not been entirely solved by the recent disclosure of the approximate magnitude of Nauru’s financial problems[25], and Nauru’s current status in the Bank is ‘unclassified’.

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[24] The current threshold is an average of $765 in 1992-94. The criterion is used in conjunction with indicators of quality of life and economic diversification.

[25] GDP in Nauru has declined sharply since 1989 due to falling volume and prices for phosphate. Export earnings crashed from A$100 million to A$33 million in two years, and have not recovered. The problem has been compounded by heavy borrowing against reserve assets, lack of transparency, the depredations of fraudsters and financial mismanagement.

There are in any case vast differences among the ADB's Pacific island members (see Table 1). Of the group's estimated total GNP of just under \$8 billion in 1994, PNG accounted for \$4.9 billion and Fiji \$1.8 billion, reflecting the relative size of the former, and the more developed economy of the latter. Estimated GNP per head in 1994 ranged from \$730 in Kiribati and \$800 in Solomon Islands through \$1890 in FSM and \$2320 in Fiji to over \$4000 in Cook Islands and Nauru. The composition and distribution of national income is different among the island states, as later discussion shows, while growth rates vary widely between countries, and between years. In the six years 1989-1994, Fiji's annual rates ranged from 12.9 to 0.5 percent, Tonga's from -0.2 to 6.4 percent, and that of PNG from -3 to 16.5 percent. Population growth rates range from 3-4 percent in Solomon Islands, Marshall Islands and Tuvalu through 2.5 percent in PNG and 1.3 percent in Fiji, to close to zero in Tonga and Samoa, where emigration effectively relieves population pressure. The very high population growth rates are probably slowing with the spread of education and the cash economy, but there is substantial momentum in the age structure (more women entering the reproductive age group) so reduced fertility will take some years to become apparent. Meanwhile growth of population above 1-1.5 percent makes it all the harder to achieve significant gains in income per head, and so in the scope for improvement in general well-being.

With so many caveats on GDP data, it seems particularly risky to aggregate them to an average growth rate and compare it with other regional averages. Yet such comparisons have some appeal, and the World Bank has paid much attention to them, puzzling over what it labeled the Pacific paradox, of abundant external assistance, plentiful natural resources, high levels of investment as a ratio of GDP, but low rates of economic growth. Pacific island economies were shown to have been growing much slower than those in the Caribbean and Indian Ocean. Many observers felt there was nothing paradoxical about the phenomena the Bank was observing: the political and social history of the Caribbean and Indian Ocean islands linked them closely to the economic dynamos of Europe and North America, while the more abundant natural resources and foreign aid available to the Pacific islands simply encouraged inefficient use of both. But the Bank's puzzlement carried weight, and a comparative study was mounted by the Forum Secretariat in 1995 to examine why the Pacific had done so poorly compared with the Caribbean.

The study ranged over many aspects of economic and social development, and its report[26] contains a wealth of comparative information and enlightenment. It concluded that the Caribbean island states were much better located for investment and trade, had more educated and skilled people, were not handicapped in adapting to new economic challenges by customary land tenure or social structures (i.e., the indigenous people had been wiped out long ago), and were closer together physically, culturally and organisationally than the Pacific islands. It also discovered, though, as did the World Bank, that the relative economic performance of the two areas had reversed in the early 1990s, and the Pacific islands had collectively outperformed the Caribbean.

The Pacific paradox, having provided a lesson in the hazards of comparative economics, seems now to have evaporated, perhaps to be replaced by the Caribbean conundrum, but the problem of the growth of output and incomes in the Pacific islands failing to outstrip population growth has not gone away. Economic development is not only a matter of increasing aggregate output from whatever natural and human resources God has provided. It is also a matter of the form, location, continuity and social or distributive efficiency of the activities producing that output. The development performance of the Pacific island economies, regarded by most participants as unsatisfactory, is being shaped by a combination of structural (long-term, hard to change, comparative advantage) factors, and policy (shorter term, easier to change, competitiveness) factors. How well the economies perform in future will depend on their adaptability: how far, how quickly and how skillfully their structures and policies can adjust to changes in their economic environment. Both traditional practices and the colonial mindset were conservative, protective, slow to change, more concerned with relationships than performance. The transition now taking place is driven by changes in the domestic and external economic environment that are bigger than anything that has happened to the Pacific islands since the European intrusion into the

Pacific in the last century, and are more pervasive and happening much faster. The adjustments imposed by this transition can be traumatic for individuals and for societies; managing the response requires a high level of technical skill and political cohesion.

[26] Fairbairn and Worrell (1996).

## 3.2 MANAGING ABSOLUTE DISADVANTAGE

The theory of comparative cost, commonly but confusingly referred to as comparative advantage, demonstrates how trade between two countries can be mutually beneficial, even if one country is less efficient than the other at all forms of production i.e. has an absolute productivity disadvantage vis-a-vis the other. If each country exports those goods that make comparatively efficient use of its factors of production and imports those which make less efficient use of those factors, both countries will be better off than if they did not trade. This does not say anything about the terms of trade or relative standards of welfare as between the two countries. It is inevitable that the absolutely advantaged country will achieve greater output with less resources i.e. will be better off, than the other; but it will be even more better off through trade, and so will its poorer trading partners. The more efficiently each country can use its own resources in accordance with its comparative cost structure, the more it can export and the more it can afford to import of other countries' comparative advantage products. Expanded to take in the multi-economy web of international trade, this theory explains why even faraway, high-cost, absolutely disadvantaged producers like the Pacific islands do best to examine themselves carefully to see which are their sectors and activities of comparative advantage, before rushing to diversify into activities they can only perform at great opportunity cost[27].

This self-examination should be repeated periodically in a strategic planning process. Relative costs are not static. Advances in technology and changes in the mix of resources going into production of traded goods are continuously altering the parameters of comparative advantage. The productive capability of a country's factors of production can be changed over time by investment in infrastructure and education, while depletion of natural resources can extinguish the basis of a comparative advantage. The terms of trade for primary producers such as the Pacific islands appear to be in long-term decline, as more primary products have to be exported to purchase a given quantity of manufactured imports[28]. Trade theory, revolving around comparative advantage (or comparative cost), strongly suggests that

[27] In certain circumstances, assembly of high-tech products or parts thereof, can be viable in the poorer trading partner', e.g. Samoa's automotive wiring plant, which makes use of the huge difference in wage rates between Samoa and Australia to offset distance and other cost disadvantages.

[28] Interestingly, fierce competition and technological advances are making this statement untrue for electronics and computers, where real costs are falling and Pacific islands can more readily afford them, greatly assisting modernisation.

Pacific islands should stick to what they do most efficiently i.e. combine their natural and human resources with injections of foreign capital, market access and know-how to produce minerals, fish, timber, tree crops, tourist destinations and research locations and a range of niche-marketed marine and horticultural products. At the same time investment to improve the productivity of endowed human and natural resources must continue. Activities not based in comparative advantage are likely to be transient, and dependent on potentially unsustainable levels of subsidy, protection or preferential access.

But international competition is so intense, products and information so mobile, and (with the exception of PNG's minerals and the region's tuna fishery) the Pacific islands are such small producers of anything, that they cannot simply produce comparative-advantage products at a domestically-determined price and expect the world to buy them. Markets demand quality to meet increasingly stringent standards, logistical arrangements to be reliable and the price to be competitive. The Pacific island economies have problems in all three areas. A fourth dimension, of environmental sustainability, is looming larger as the relatively abundant environment of the Pacific islands is invaded and damaged by economic activity. Some overseas markets are beginning to require evidence that this dimension has also been covered, and in some cases to offer premium prices in return, providing a niche opportunity for those who can use it[29].

Tlie appropriate strategy is one that most Pacific islands have tended towards, guided more by a combination of instinct and market forces than deliberate analysis. It combines a sense of 'what to do' intuitively based on comparative advantage/cost theory, with a set of policies on 'how to do it', based on the perceived need for international competitiveness. It embraces also a bias on 'who should do it', bearing in mind that it is political economies that exhibit comparative advantage in this or that sector, but it is enterprises that actually produce and compete in markets. Here there has been a marked shift in the last decade, under the influence of worldwide trends and local experience. Public opinion in most Pacific islands is now persuaded that economic activity should be left to the private sector as much as possible, with the government's role being to provide a secure and equitable environment for commercial enterprise. This is a far cry from the state-

[29] Solomon Islands obtains a price premium for canned pole-and line-caught tuna, and small amounts of sawn timber from certified sustainably-harvested rain forest. In practice the latter means forest that is not being logged by heavy machinery.

interventionist policies which held sway just before and after independence, and created much of today's institutional framework.

Perceptions of government failure and the need for structural change have filled many reports and budget speeches, and are embodied in several comprehensive programmes of reform, but with few exceptions (Niue, Cook Islands) have not so far greatly changed the economic landscape. In many cases departmental structures and staffing levels inflated by expansionist domestic politics and supportive aid programmes are still a drain on appropriations. In most island states, government-owned enterprises that grew fat on monopoly protection and budgetary subventions still provide inefficient and costly services. Lack of funds is now forcing some governments to cut appropriations, but the manner of cutting often misses the real culprits and weakens services that ought to be strengthened: there are worrying indications of service failure in the Melanesian states. Privatisation has been widely embraced as a policy goal, to the applause of aid donors, but real progress is rare, sales of public assets occur in obscure circumstances, and monopoly abuses continue under private ownership.

Economic management in a democracy depends on building and maintaining a broad consensus as to goals and how to achieve them. In most Pacific islands such consensus has evaporated since the rather clear and popular goal of political independence was achieved. The Asian experience underlines not only the role of effective government, but the importance of being collectively able to look beyond a three or four-year electoral horizon, to base economic strategy on a consensus of political, commercial and community interests, and to sustain policies that forgo current consumption long enough for the benefits to be realised in improved living standards. The Pacific islands' experience tends to support this proposition by default. The basic machinery of economic management with which they came to political independence stagnated during the 1970s and 1980s, concentrating on managing aid programmes, compiling detailed (but little used) development plans, and becoming increasingly out of touch with political and commercial reality. Planners lost prestige and influence, and were excluded from policy and decision processes.

As a result, Pacific islands development plans, and such policies as they have articulated, have tended to address the problems of the past rather than the future. Social and economic changes occurring under the noses of the planners and politicians, transforming urban and rural life and reworking the fabric of domestic and external relationships at the level of family, business and state, have been scarcely taken into account in official policy and allocation of resources. Many political leaders have been fully occupied devising ways of profiting from office, while all but the best (or the dullest) officials became cynical or corrupt. The discipline and accountability implicit in medium-term planning and strong budgetary controls were anathema to those in power. The outcome has been disappointing economic performance, bloated public sector enterprises, disaffection and disillusion among large sectors of the island communities, and loss of will and capacity in the public service.

By the early 1990s economic management was in disarray and disrepute in most Pacific island states, contributing to the rise in some countries of a warped version of liberalisation in economic policy, amounting to a distribution of assets and rental opportunities among the political elite and their cronies. But there are now some signs that the decline may have bottomed out. In the last three years, a roughly concerted effort by multilateral and some bilateral donors, allied to small bands of politicians and officials in the island states who still believe in the possibility of sound economic management, and aided by a more alert and critical general public, has begun to make some headway. At regional and national level, ideas and techniques for conceiving strategies, allocating resources and accounting for results are being aired in a distinctly more up-beat atmosphere than has obtained since the 1970s. A series of regional meetings organised by the Forum Secretariat has produced an impressive number of statements of intent to do better, by heads of government, finance and planning ministers. At the very least, this is making blatant mismanagement more difficult to do and get away with. Gradually the pressure, and the will, for improved performance is increasing.

There are many reasons for this. A better educated public is more knowledgeable and vocal in critical commentary. In several of the island states, a home-grown private sector is emerging, based on hard-won experience and business know-how, not dependent on government hand-outs. External aid, if not yet scarcer, is being made more accountable by both giver and receiver. Resources in the hands of governments are coming under closer public scrutiny and allocations are more fiercely debated. In some cases, extreme mismanagement has led to a financial crisis that can no longer be blamed on bad luck or a foreign conspiracy, necessitating drastic changes. Connections between the environment, natural resources, domestic savings, investment and the well-being of future generations are being convincingly exposed. And the ever-growing mobility of people, ideas and capital throughout the region is presenting more alternatives, and more cautionary tales, to review, compare and contrast. The Pacific islands confront the need to compete from a position of absolute disadvantage in a fast-moving, almost barrierless world. To do this they will have to raise the standards of their own economic management, and do so with levels of understanding and techniques that match those of the Pacific Rim economies.

## 3.3 KEY PRICES AND COMPETITIVENESS

The idea that the underlying competitiveness of enterprises making up the economy can be captured in a set of key prices is a useful notion in Pacific island circumstances, both because it is easily understood in public and private sectors i.e. the key prices are things that people are already concerned about; and because the cluster of policies and interest groups that mainly influence each key price can be readily identified and subjected to scrutiny. The message for the Pacific islands is that while high prices for some costs of production (labour, utilities) may be offset by low prices for others (access to resources) a small, remote economy with all-round high costs is never going to be able to compete, except by reducing its own level of consumption, e.g. by devaluing its currency and restraining nominal wages. For those without their own currency, there is no alternative to simply cutting costs. Either way real incomes will have to fall before increased productive investment on a competitive basis can lead to sustained growth.

The key prices are:

- the exchange rate, i.e. the price of foreign currencies (paid and received for traded goods) in domestic currency (i.e. the medium of payment and receipts for non-traded goods). The exchange rate is the price that usually has to adjust, or is sometimes unsustainably defended, to offset the international uncompetitiveness of other key prices. The relative value of exporting and import-competing activities as against import-consuming activities is the most important price of all in terms of economic growth. A rise in domestic prices relative to prices overseas makes exports (including tourism) less profitable and imports more attractive, a similar effect on competitiveness to an appreciation of the nominal exchange rate. Adjusting the nominal rate for changes in inflation at home and abroad, and weighting it to reflect trade patterns, provides the real effective exchange rate (REER). This is generally the best single pointer to trends in trade competitiveness. The REER can be shifted by a change in the nominal exchange rate, or a change in relative prices at home and abroad, or some combination of these; targeting such an adjustment commonly lies at the heart of economic stabilisation and adjustment programmes, as in PNG, Fiji, Samoa and Solomon Islands over the last decade. Earlier tendencies to see the exchange rate as a kind of virility symbol seem to be fading, and Pacific islands authorities are more ready than they were to make frequent minor adjustments to the nominal rate to preserve export competitiveness, making dramatic devaluations less likely. Across Micronesia, and in Tuvalu and Cook Islands the use of US, Australian or New Zealand currency means that there is no policy debate about the exchange rate, and the authorities cannot use it to counteract cost increases[30]; equally, though, the inflationary danger of monetising fiscal deficits by printing money is absent.

- taxation, i.e. the proportion of personal and business income taken by the state as direct and indirect tax, and constituting the biggest part of the price of government. Personal and business income taxes have been coming down in the Pacific islands, from a high point in the 1970s, and now take 20-40 percent of taxable incomes. Tax amounts to 20-30 percent of GNP. As with wages, discussed below, this price needs the amplification of a measure of government efficiency i.e. how much service does the government deliver for the tax it receives? Physical indicators such as road maintenance, places in school, medicines in clinics, extension workers visiting farmers, and trends in crime statistics are useful proxies for government output.
- interest rates, i.e. the price of credit, and the reward for saving. The margin between them measures the costs and risks of intermediation, provided that monopoly rents are not being taken by an uncompetitive financial system. Margins are wide in the island states, and not wholly explainable by high operating costs, raising concern about monopoly or cartel pricing[31]. On the other hand there is a growing acceptance in Pacific island central banks that repression of interest rates turns away potential savings, induces creative accounting to protect banks' profits, and deters lenders from financing all but the safest investments, which are often not the most developmentally efficient. Private savings by-households and small businesses are not very sensitive to deposit interest rates, being driven more by 'rain} day' prudence and seasonal

[30] In FSM, a proposal to simulate a devaluation, as part of the economic reform programme, by taxing imports and subsidising exports, was rejected because of its complexity and uncertain side effects.

[31] Central banks in the island countries have exchanged information in an attempt to detect unreasonable marking-up of rates, but domestic factors vary so much that a benchmark has been difficult to establish.

needs (crop cycles, school fees); but large corporate savers and wealthy individuals do adjust their financial assets according to real interest rates. Deregulation is proceeding cautiously, and (with one eye on the exchange rate in the case of PNG) interest rates are slowly converging with rates in Australia and New Zealand,

- wages, i.e. the price of labour at any skill level required for an economic activity. This can give a misleading picture of competitiveness unless it is supported by a measure of labour's ability to combine effectively with natural resources and technology. Wage rates for unskilled and semi-skilled workers in most Pacific islands are two to three times higher than in Asian economies with similar natural resources. People are often prepared to work, if not very hard, for a wage (the supply price of labour) too low to enable them individually to buy formal-sector standards of food and shelter; they survive by pooling and sharing costs and incomes within a household or other small group. It is unusual now for labour's supply price, or reservation price, to be higher than what is on offer. But responding to trade union and other public pressure (invariably exerted on behalf of the already employed rather than jobseekers), most Pacific islands prescribe a legal minimum wage in urban areas, thereby reducing the number of jobs available at entry and low-skill levels.
- rents and royalties, i.e. the cost of access to land and natural resources and normally the critical factor in holding resource owners in a long-term agreement. Low-cost access to natural resources (including tourist locations) is the main offset the Pacific islands can offer to their otherwise high cost structure. Unrealistic ambitions, greed, jealousy or hostility to change can operate to set rents at deterrent levels, holding back land-based developments. More often, though, inept or corrupt negotiations have produced access deals that undervalue the resource and leave large economic rents in the hands of the (mostly foreign) loggers, fishers or miners. Competent and impartial advice to resource owners, leading to rents linked to output volumes and values and capital replenishment, offer the best way forward, combined with transparent, well-publicized protection against speculation in undeveloped land. Unfortunately resource owners have been notoriously unwilling to use independent professional advice, and have lost out heavily as a result.
- utilities charges, i.e. the cost of electric power, water and telecommunications, often provided in the Pacific islands by monopolies owned by or closely linked to the state, and rarely subject to effective cost-scrutiny.

As privatisation creeps forward, the performance of privatised monopolies poses a new challenge to competitiveness in Pacific islands. Existing unit costs of utilities are significantly higher than in Asian economies. Supervisory arrangements are in their infancy, and represent an as yet unrealised cost of commercialisation.

- transaction costs, i.e. the time and money cost of doing business in a given location, made up of finding and talking to people, dealing with authorities, making applications, paying bribes, waiting for responses, chasing up officials, clearing sites, placing contracts, supervising work and rewarding helpers. There is still little sense in the Pacific islands of the deterrent effect of inefficiency and corruption upon the kind of investors they say they want to attract. Many studies have highlighted this problem. Rent-seeking vested interests obstruct progress in several countries.

A lot of heat is generated in debate about exchange rates, interest rates, rents and wages. It is helpful to remember that they are all prices, and distortions away from supply-demand equilibrium will enrich one party at the expense of another. The case of exchange rates illustrates this. The advocates of a "stronger" currency (i.e., appreciation of the exchange rate) are normally importers and consumers of imports, who mostly live in town and have the ear of politicians. They are the users of foreign exchange earned by the comparative-advantage producers. The beneficiaries of a "weaker" currency, or at least a downward flexibility of the exchange rate, are the (usually rural) producers of comparative-advantage exports and import-replacing foodstuffs and materials, who are much less able to articulate their needs. This asymmetry in lobbying power needs to be corrected by advice from clear-minded technocrats.

For those states that issue their own currency, but must use foreign currency in their external trade, the exchange rate needs to move to reflect the relative scarcity of foreign exchange in terms of domestic money. If the money supply is rising through monetisation of the fiscal deficit or an expansionary credit policy, and export income is not rising (i.e. the balance of payments and external reserves are not improving) then the nominal exchange rate needs to depreciate both to defend the competitiveness of traded goods (comparative advantage) output, and to prevent the reserves being depleted by rising import payments, driven by increased domestic-currency purchasing power. Such a shift in relative prices has to be sustained to be effective, i.e., the real exchange rate must show a sustained depreciation.

Experience in PNG, Fiji, Samoa and Solomon Islands shows clearly the importance of backing up a nominal depreciation by effective containment of wage and other domestic price pressures; otherwise the benefit of the depreciation to traded-goods competitiveness is quickly undone by rising costs of non-traded inputs. If the external account is in chronic surplus, and reserves rise to unnecessarily high levels, (the problem most authorities can only long for) these resources can be drawn into use by a rise in the exchange rate, making foreign goods cheaper for consumption or investment purposes.

With a free-floating exchange rate, market forces will achieve a kind of equilibrium, as excess demand or supply is corrected by price shifts. But Pacific islands have such small volumes and lumpy transactions that for most of them a floating exchange rate would raise fears of market failure, or at least very erratic prices, because of mis-match of supply and demand. So for Pacific islands that issue their own currency, other than PNG, a flexibly managed exchange rate seems appropriate, with the central bank keeping an eye on price index movements at home and overseas, in the context of the whole structure of key prices. This also enables the authorities to target the real exchange rate, and protect the competitiveness of the traded goods (comparative advantage) sector by adjusting the nominal rate to offset domestic cost increases: as the experiences of the four island states that have done it all confirm, however, this will not be effective unless the exchange rate is managed coherently with fiscal and incomes policies. For the island states that do not issue their own currency, it will be important not to give up (for example under real or imaginary pressure to liberalise trade) the power to adjust the relative prices of domestically purchased and imported goods and the profitability of exporting, by use of tariffs and subsidies on trade and investment.

## 3.4 USING NATURAL RESOURCES

The ecological range of the Pacific islands is vast, and the content rich, but far from evenly distributed. The high volcanic islands in the west and south contain extensive mineralisation, are clothed in forest, and collect abundant rain to wash soil and nutrients down to agriculturally fertile lowlands, with rivers and swamps sustaining coastal marine life. The coral atolls to the north and east, rarely rising more than two meters above sea level, support a narrow range of plants on a fragile lens of fresh water an arm’s length below the coral and sand surface. These atolls, and some of the coastal flats of the high islands, are now seriously threatened by inundation by a rising and increasingly stormy ocean. Traditional use of land and marine resources struck a balance between current consumption and future needs, sometimes by extensive hunter-gatherer use of vast areas, sometimes by intensive but communally regulated residential access to limited resources. Modern commercial demand, and the monetisation of costs and benefits, has swept away customary ideas of sustainability, and generally failed so far to substitute an effective administrative or statutory regime. Land, forest and fish resources are all being mined rather than farmed, with the welfare of future generations left for them to worry about. The extraction of hard rock minerals, oil and gas at least makes no pretense of being sustainable; its contribution to future welfare depends upon governments saving large parts of their minerai revenues and investing them in ways that will create incomes to replace those flowing from the mining process[32].

The island states' huge EEZs are not uniformly stocked with marine life. The annual catch of the Western Pacific tuna fishery is worth around $1,700 million. The high-value deep-swimming big tunas are caught widely, but the surface-swimming skipjack and yellow-fin that yield the big tonnages are only plentiful between 10 degrees north and south of the equator. Pressure on the fishery is certain to increase as world population and incomes rise, providing both a threat to sustainability and an economic opportunity for the island states At present island governments obtain revenue by licensing foreign fishing vessels, under arrangements brokered by FFA or negotiated bilaterally, yielding on average 4-5 percent of the value of the fish caught (the US government and industry together pay much more, under a multilateral treaty now variously regarded as a benchmark or as a mistake not to be repeated).

More effective ways of managing the resource and of capturing the economic rent available within the market value, by methods such as the auctioning of access rights, are being investigated by FFA, while negotiations have begun between FFA's members and the distant-water fishing nations on a management regime to extend to the high-seas areas as well as the nationally-managed EEZs. Some Pacific islands firms, notably in Fiji, are successfully moving into supplying the high-value sashimi market, using foreign-owned longline vessels; this trade is growing, but in most countries

[32] Results in the region are mixed. Fiji and PNG spend their minerals revenues as part of their annual budget covering consumption and investment outlays. Nauru saved up substantial reserves from phosphate earnings, but has lost a considerable portion in recent years. Kiribati put Ocean Island phosphate taxes into a reserve fund that is still growing, long after the end of mining (see Box G).

is dominated by Asian-owned firms, often with close connections to senior politicians or officials[33]. Many government-backed efforts to participate directly in the Pacific tuna fishery have failed. The longest-running and best known joint venture is Solomon Taiyo in Solomon Islands. This is technically successful, a net earner of foreign exchange for the economy and directly employing over two thousand Solomon Islanders. But it has accumulated huge balance-sheet losses over its twenty-five years of operation, because of its highly-geared financial structure and costly foreign inputs; and the company faces serious problems of adjustment to lower prices when the preferential access of its canned fish to Europe is curtailed under the impact of global liberalisation.

Tropical hardwood forests abound in the main island of PNG and its island provinces. Botanically similar forests occur in Solomon Islands on a smaller scale. In both countries, governments since independence have failed to put in place effective resource management regimes. Despite strong efforts by domestic NGOs and trenchant criticism from the World Bank and aid-donor governments, no effective counter has been found to the alliance between foreign logging companies (some operating as sub-contractors under licenses issued to local 'front' companies) and influential nationals seeking immediate cash incomes. Logging has proceeded in recent years at rates well above the natural regeneration rate of the forest; indeed current logging methods make it unlikely that much of the logged-over forest will ever regenerate to valuable timber stands, while soil degradation is reducing the productive potential of the land and the nearby reefs. Under such a regime large parts of the commercially attractive forest become in effect a non-renewable resource. Natural capital is being consumed, with most of its value lost to overseas interests, and neither PNG nor Solomon Islands is saving from current income and investing to provide for future income needs. Plantation forestry exists in both countries, and will become increasingly important, but it started too late and on too small a scale to sustain the industry at anywhere near its present scope and scale after the existing forests are exhausted[34]. The bigger Asian logging companies are already moving on

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33 Similar connections seem to lie behind the issue of quotas in Solomon Islands for purse seine operations (wholly financed and managed from abroad but paraded as joint ventures for quota purposes) which add up to several times the estimated sustainable catch for the country's EEZ. Only under-performance by the quota-holders has so far protected the resource.

34 Forest plantations, depending on species, will yield many times the volume of wood available from the natural forests they replace, but market values of fast-growing species are generally lower, and the economic impact of the operation is concentrated around the much smaller area under managed production

from the Western Pacific to much more extensive forests in South America. In Fiji, plantation softwoods are well established, supporting wood-chip and sawn timber exports and supplementing controlled hardwood forests that now also include mature plantations. Vanuatu and Samoa have smaller but potentially important forest resources that require careful management in collaboration between the customary landholders and the government.

Large-scale agriculture has comprised oil palm, coconut, cocoa and coffee plantations, and beef cattle in Vanuatu, with the bigger and more capital-intensive operations wholly or partly foreign owned. Sugar is grown as an expensive plantation crop for domestic consumption in PNG, protected of necessity by a ban on sugar imports: this arrangement is sure to come under review as trade liberalisation takes hoid in PNG. In Fiji, sugar is an old-established small-holder crop, mostly grown by Indian farmers, but processed and marketed by a state-owned corporation. Sugar accounted for 31 percent of exports and 13 percent of Fiji's GDP in 1994, but it is troubled in the short term by the uncertain politics of land tenure, where most of the best cane land is under leases that expire in the next four years with no certainty of renewal; and the need to invest in more efficient production and processing technology, where it lags behind its competitors. In the longer term Fiji, like other ACP sugar producers, faces the probable loss of preferential overseas markets, particuiariy in Europe and USA, and must drastically reduce production costs to survive in an open market.

New developments in the mid-sized island states include exploitation by Tonga and Vanuatu of a seasonal niche market for squash pumpkin in Japan, the growing trade in taro to Polynesians living overseas, success in fresh fruit and puree exports, and the strong interest by pharmaceutical TNCs in kava (made from the root of the shrub, piper methysticum) as a stress reliever. In all these cases, overseas entrepreneurs with market access have teamed up with island-based growers to exploit an export opportunity. On the domestic front, smallholder agriculture does well when nearby markets provide ready sales at prices that farmers feel reward their efforts. Rapidly growing towns are supporting market gardening and small livestock operations.

Growing tree crop commodities for export is less rewarding, and increasingly is the cash source of last resort, when shorter-rotation crops (or fishing or chain-saw timber production) are for some reason not feasible. Large coconut stands exist throughout the islands, and copra is still a significant smallholder and export crop, but replanting is well below sustainability levels, and old trees are being sold for conversion to coconut timber in Fiji and elsewhere.

Overall this is a varied and potentially dynamic agricultural picture, with considerable scope for diversification, product development, improvement of yields, addition of value by post-harvest processing and marketing, provided always that an appropriate policy environment is created. Governments have been slow to realise this, in some cases apparently fascinated by the instant wealth available from licensing foreign exploitation of minerals, fish and timber, pursuing exchange rate and incomes policies that hurt farm profitability by making imported foods cheaper and local production more costly, neglecting domestic transport infrastructure and allowing national agricultural research and extension services to wither away through poor planning and managerial neglect (in PNG and Solomon Islands this was compounded by the executive incapacity of provincial government). The result has been the misdirection and failure of many attempts to diversify and boost agricultural production.

Now, rising populations and growing towns, more educated and motivated farmers, access to processing technology, better communications, the prospect of an expanding tourist sector, and higher disposable incomes and environmental awareness in overseas markets combine to provide a positive setting in several island states for upgrading agriculture, and equipping it both to supply domestic demand and to compete in the less protected (but strictly quarantined) overseas markets that lie ahead. Governments have a key role to play in assisting their farmers to meet quality standards, pass rigorous quarantine tests, and get access to efficient, low-cost transport services. Urban markets in Port Moresby, Lae, Honiara, Vila, Suva and Apia are all growing in size, diversity and sophistication; in Suva a substantial part of the growth is supplied by new-immigrant Chinese producers, providing a handy if irritating demonstration to Fijian farmers of what can be done. The export dynamism of Tonga's agricultural sector shows what happens when good land, entrepreneurial and farming skills, crop financing and access to markets (provided in this case, as often happens, by alert overseas entrepreneurs) come together in a profitable combination. Vanilla and squash pumpkin have made strong contributions to total output, and transformed the household incomes of the successful growers. Niche markets can go as well as come[35], and Tonga's farmers have to be alert and

[35] Niches depend on differentiations of product characteristics, in this case, growing season. Once a niche market is discovered and targeted by many producers with similar products and seasons, including soine who are more efficient than the original supplier, the quasi-monopoly profits of the niche disappear. This may be happening to Tonga's Japanese squash market, which is now being partly supplied by New Caledonia and Vanuatu, with other suppliers in the offing.

ready to diversify when that happens, but they have gained valuable experience against such an eventuality. Organically grown, seasonally targeted, high-quality fruit, nuts and their products offer island farmers a good return for well-organised effort. Those opportunities, though, are open only to the island states with land that can support commercial agriculture, and are a far cry from the prospects of the atoll islands, who have to look with robust optimism for niche opportunities in reef or lagoon products, intensive hydroponic culture of vegetables, and small-scale, environmentally benign activities in tourism or service industry.

## 3.5 TOURISM AND MANUFACTURING

These two sectors offer some illuminating contrasts and similarities. Tourism is an activity based firmly on comparative advantage, making use of resources that are abundant and accessible in the Pacific islands (spectacular scenery, clean environment, hospitable cultures and people) selling its products to an expanding world market with a particularly strong Asian segment, where individual final consumers choose the product (destination, accommodation, activity) that they want on the basis of brochures or recommendations, and actual!)' travel there to consume it. In some locations tourism competes with the other resource-based industries, by requiring that the environment be as far as possible in its natural state. Apart from the well-known need for clean beaches and beautiful views, ecologically aware tourists have expressed dismay at the damage being caused by logging in Solomon Islands.

Manufacturing, by contrast, requires intensive use of technology and capital to produce goods to tight, frequently changing specifications, selling to markets where final consumers do not particularly care where the product originates, only that it delivers value-for-moncy performance.

Success in manufacturing requires island states to invest heavily in shifting the parameters of comparative advantage, by upgrading workforce skills and economic infrastructure, while exploiting (and prolonging) any preferential access to overseas markets that they can find, to offset their intrinsic uncompetitiveness vis-a-vis bigger and lower-cost producers. Both tourism and manufacturing suffer in price competitiveness from the high transport costs associated with remote locations. But remoteness, contributing

[36] Tourism Council of the South Pacific, 1995 statistics release.

to rarity and pristine quality, is also one of tourism's selling points, particularly to the growing eco-tourist market; by contrast the 'natural protection[1] that remoteness affords to Pacific islands manufacturers against competing imported goods is more than outweighed, once they outgrow their small local markets, by the high cost of reaching distant export markets.

All the Pacific island destinations (except Hawaii) together account for only about one half of one percent of the world's tourists and 80 percent of those go to only four destinations (French Polynesia, Fiji, Guam and Saipan). Among the ADB's twelve island members there are great disparities in size and nature of their tourist sectors. According to TCSP[36], of the twelve states' 600,000 visitors in 1995, over half went to Fiji, ten times as many as went to PNG. Many visitors to Tonga and Western Samoa are visiting relatives. Only one in three of Solomon Islands' 10,000 visitors went there for a holiday. The number of 'real' holiday visitors to the twelve island states in 1995 was around 400,000, of whom two out of three went to Fiji. Tourism in Fiji, with good infrastructure and an established reputation in overseas markets, accounts for almost one-fifth of all Fiji's formal jobs and one-third of export earnings. Cook Islands and Vanuatu, though much smaller, also depend heavily on tourism, with 40-50,000 visitors a year in each case contributing valuable foreign income; and Vanuatu makes good use of the cruise ship market, which needs no hotel accommodation, for the further 50-60,000 visitors it brings for one or two days each year.

All the island states want to enlarge their tourist sectors, but their attempts to do so often seem disjointed. At government level they have ambitions for large (several hundred beds) hotels and golf courses, while in the indigenous private sector there is much interest in so-called eco-tourism, meaning small-scale rurally-located resorts and nature-based activities, and a growing number of successful ventures at this level. In the bigger states and islands, there is physically room for both, but the capital costs and determinants of control and competitiveness are vastly different. Eco-tourism looks more manageable, more marketable and altogether more feasible, offering scope for the entry of national entrepreneurs as owners and managers of resorts and supporting services that market the islands' environment. These smaller entities need cooperative marketing and training arrangements, and government support to break into competitive overseas markets.

Manufacturing in the ADB's island members generally contributes less than 10 percent of GDP, because of structural economic biases and strong competition from abroad. Fiji has the most diversified sector, supporting 20 percent of fonnal jobs (excluding sugar) and accounting for around 18 percent of GDP. All but the smallest states have a cluster of manufacturing activities aimed mainly at their domestic markets (confectionery and biscuits, cigarettes and tobacco, brewing, soap, dairy products, furniture, aluminum and glass fabrication, ship repair and boat building in steel, fiberglass and wood, metal and plastic manufactures and paint) and enjoying substantial tariff protection. As tariffs come down, for example among the MSG states, there is likely to be some shaking-out of the less efficient producers and a growth in inter-island trade as their output is displaced by imports. In PNG most enterprises arc foreign-owned, half of the value added in manufacturing is in food processing and beverages, and almost all output is for the domestic market. Garment manufacture aimed at the Australian and USA markets saw a burst of investment activity in the late 1980s, especially in Fiji where generous tax concessions were given, but this has now stabilised. A range of small-scale manufacturing firms were established in Tonga in the 1970s aimed at Australia and New Zealand markets under preferential access, but most have closed down as competition in those markets intensified under deregulation policies (see Box B).

The statistical share of manufacturing in GDP considerably understates the importance of manufacturing in the economy of urban areas, where it provides a larger share of formal jobs, pays for urban infrastructure, creates markets for goods and services from the rural and informal sector, and supplies people to leadership roles in the community and urban government. Despite the obvious problems of scale factors and poor infrastructure, there is scope for expansion based on rising skill levels, imaginative and persevering exploitation of niche products and markets, and intelligent support from governments e.g. competitive real exchange rates, realistic wage policies, low taxes, affordable factory sites, access to credit, and assistance with market development. Luck and timing plays a big part in capturing footloose investment, especially in the smallest economies. The relocation of the Yazaki car-wiring plant from Australia to Apia came about when the Samoan authorities were quicker off the mark and more generous than Tonga or Fiji. Assistance with factor}' construction, land rent, and loan capital from the NPF were powerful incentives on top of low labour costs, a non-unionised workforce and a stable government. Yazaki's investment has been a boost to the economy and a valuable commercial advertisement for Samoa. But this case illustrates also how a host country can become dependent on one or two large investments, finding itself pressed for ever more generous concessions and incentives, potentially involving substantial subsidy, under the threat (spoken or not) that the investment might

BOX B

**Financial Scams in the Pacific**

The Pacific islands have for many years attracted the attention of confidence tricksters and financial fraudsters, resulting in some well publicised (and some successfully hushed-up) damage to public and private finances. While such goings-on are not unique to the Pacific islands, the small size of the island economies means that one successful fraud can seriously weaken the whole financial system. Efforts have been made from time to time at national and regional levels to raise public, political and bureaucratic awareness of the common techniques of fraudsters and the risks of falling in with them. Nevertheless, human nature remains vulnerable to the promise of instant wealth even on wildly improbable premises (such as: " your country has been selected by my anonymous but incredibly rich client to be the sole recipient of this billion-dollar low-interest loan opportunity") and at least once a year news breaks of another scam being perpetrated on a finance ministry or financial institution somewhere in the Pacific. The commonest forms of financial fraud aimed at governments are:

- the obtaining of up-front fees, commissions and expenses payments for arranging supposedly enormous and very cheap loans (or even grants, in some cases) from third parties, and
- persuading governments to issue letters of guarantee or other fiduciary documents to be traded internationally or otherwise dealt in by the fraudster, in such a way that (the government is told) vast profits will rapidly accrue to the government, with no risk of loss.

Both propositions are invariably and completely fraudulent: the promised benefits are a total illusion. Either or both of these forms of scam have been detected in the last ten years in PNG, Solomon Islands, Vanuatu, Fiji, Cook Islands and the Marshall Islands. Substantial amounts of money have been paid to fraudsters in the form of fees and expenses, confidential details of government bank accounts and powers of attorney have been given to complete strangers, and considerable damage has been done to the island states' efforts to build up a sound financial reputation. Several governments have narrowly escaped incurring huge liabilities to third parties claiming under letters of guarantee, through prompt action by other friendly governments to retrieve the documents.

The most common hallmarks of the fraudster are:

- wanting (and usually getting) direct access to Ministers, avoiding officials as much as possible;
- use of impenetrable pseudo-technical jargon in conversation and on paper,

*continued next page*

*Box continued*

- offering a degree of financial gain out of all reasonable proportion to the supposed costs and risks entailed;
- insistence on secrecy and speed in the proposed dealing; and
- wanting upfront payment of fees, expenses etc., and even (the ultimate effrontery) a deposit as evidence of the government's good faith.

Any proposition put forward in that way is certainly fraudulent. The proven defenses against such fraud are:

- requiring that competent officials are present and take part in and keep records of al! discussions;
- refusal to provide official paper, details of bank accounts, or 'approval in principle';
- rejection of upfront payments of any kind;
- careful checking of the professional and financial background of the proposer of the deal;
- requiring full, verifiable disclosure of the identity of all the persons and institutions proposed to be involved in the deal, and the authenticity of any documents or copies put forward in support of the proposal; and
- thorough checking by reputable and independent agents (international search companies, or foreign central banks) as to the identity, reputation and financial capability of the proposed parties to the deal.

The knowledge that any proposal will unavoidably have to undergo such a verification process will act as a powerful deterrent to fraudsters, but will in no way obstruct a genuine proposal from a bona fide institution.

Other serious fraud, most conspicuously in Nauru, has involved the theft of reserve funds by overseas firms entrusted with their care, this is rarer than the scams described above, but much harder to prevent and more direct in its damaging impact. As the Pacific islands are small and remote, continuous pooling of information by means of a fraud hotline and databank, and periodic meetings of finance and central bank officials to compare notes and update defensive techniques, are important ways of strengthening the barriers against major frauds. Besides these frauds on the grand scale, the Pacific islands also have their share of petty fraudsters, sometimes linked to overseas collaborators, defrauding individuals and firms of their savings by, for example, seductive offers of high returns on deposits. The best defense against these is a belter educated and aware public, periodic published warnings by the authorities, and strong internal procedures in private firms. Financial fraud will not be eliminated by preventive measures, but the degree of risk to public and private funds can be greatly reduced go elsewhere. Success compounds the problem. Nearly 4000 jobs, one-fifth of all formal employment, are now at stake in Yazaki's continued presence in Apia, and any efforts to increase Samoa's share of financial benefits are constrained by this reality.

## 3.6 LIBERALISING TRADE AND INVESTMENT

The Pacific island economies are so small and so open that virtually all major commercial investment is trade-related, and the costs of imports (plus the key prices discussed earlier) largely determine the viability of export-oriented capital investment. It makes sense, then, to do as several governments are now doing, and bring trade and investment policy together into one Ministry; and to administer the rules relating to them through one organisation, preferably separated physically from the Ministry in a commercially convenient location.

The islands' principal imports are petroleum fuels (5-25 percent of imports), machinery, vehicles and equipment, and staple foods; apart from fresh produce in the larger islands, most of what literate people now regard as the necessities of a reasonable life are imported. Overall, the value of merchandise imports of the ADB's Pacific island members in 1994 was close to $3 billion, equivalent to 35-40 percent of their estimated national income (and representing about seven ten-thousandths of world trade).

The direction of trade in the last fifteen years shifted significantly towards Asia, but with some marked local divergences. The following table, condensed from a recent ESCAP study, shows PNG's Asian trade as fairly steady, but a big uplift in exports (of minerals) to Australia and a fall in the share of trade with USA and Europe; while Fiji's exports (garments, minerals) to Australia rose, and its sugar trade with USA and Europe retained its leading position. Samoa's exports to Australia rose sharply with the Yazaki investment, while Tonga's exports to Australia and New Zealand dropped steeply with the closure of a number of factories targeted on those markets, as their preferential access was eroded by general tariff reductions. Tonga's successful agricultural exports to Japan show up, as do Solomon Islands' increased timber and fish exports to Asian markets[37].

[37] Both Solomon Islands and Vanuatu export very little to Australia and New Zealand,while they source 30-40 percent of their imports there. This gives rise from time to time to concern in the two island states over the "unfavorable balance of bilateral trade" and the making of misguided proposals to promote investments that would correct that, rather than those that would strengthen their overall balance of payments.

**Table 3: Trade of selected Pacific island states with major trading areas (percentage of total exports/imports)**

| 1991-95 | Exports 1981-85 | Exports 1991-95 | Imports 1981-85 | Imports 1991-95 |
|---|---|---|---|---|
| Fiji | | | | |
| Australian and NZ | 17.7 | 24.4 | 52.2 | 51.5 |
| Japan and Asia | 15.9 | 13.9 | 28.0 | 26.7 |
| USA and Europe | 36.7 | 37.4 | 13.3 | 12.9 |
| PNG | | | | |
| Australia and NZ | 11.2 | 39.2 | 45.4 | 52.9 |
| Japan and Asia | 40.9 | 39.7 | 34.8 | 34.4 |
| USA and Europe | 44.0 | 17.1 | 15.7 | 9.7 |
| Samoa | | | | |
| Australia and NZ | 35.4 | 69.8 | 46.4 | 57.1 |
| Japan and Asia | 4.2 | 3.8 | 23.6 | 16.1 |
| USA and Europe | 46.3 | 9.4 | 16.1 | 11.8 |
| Tonga | | | | |
| Australia and NZ | 77.8 | 9.8 | 64.9 | 53.1 |
| Japan and Asia | 1.5 | 52.1 | 15.9 | 11.1 |
| USA and Europe | 9.0 | 24.1 | 10.7 | 13.8 |
| Vanuatu | | | | |
| Australia and NZ | 0.7 | 5.8 | 39.5 | 29.7 |
| Japan and Asia | 10.0 | 27.3 | 22.9 | 41.9 |
| USA and Europe | 57.7 | 51.5 | 13.4 | 23.5 |

Source: ESCAP (1997)

During the period spanned by Table 3, the total imports of the countries listed rose in current prices from $1.9 billion in 1982 to $2.6 billion in 1994, and their exports from $1.2 billion to $3.3 billion, a turnaround in total trade balance from a deficit of $0.7 billion to a surplus of the same amount in twelve years. During the same period world exports grew by 160 percent in nominal value, compared with the listed countries growth of 175 percent. The great bulk of the movement in the Pacific is accounted for by PNG's rapidly growing mineral exports, which produced that country's positive trade balance of 26 percent of GDP in 1994.

These trade patterns have evolved in an environment of import and export licensing, protective tariffs, preferential access to overseas markets, promotional investment incentives, and heavy dependence by many island governments on import and export duties for general revenue. In the last five years that environment has come under increasingly heavy attack both from outside, where the industrialised and the fast-growing less-developed countries are hacking away at each others' protective barriers in the name of global free trade (see Box C); and from inside, as the impact on export-competitiveness of costly, inefficient (often subsidised) domestic production and government reliance taxes on international trade to finance the budget, has become better understood.

The World Trade Oganisation (WTO)-backed move to reduce import tariffs raises three problems for the Pacific island states, with varying degrees of severity. First, inefficient domestic industries will be exposed to sharper competition, perhaps to the first real competition they have ever had to face, with the risk that they may fail, reducing the wealth of their owners and throwing people out of work; second, government revenues from taxes on trade will fall (export taxes are also on the waj' out, for competitiveness reasons), resulting in budget deficits unless compensating revenues are found elsewhere; and third, the global nature of this trend means that tariff preferences enjoyed by Pacific islands exports around the world, where they are exempted from duty or charged specially low rates, will be eroded, and they will face tough competition from bigger, more efficient producers of similar goods. All these trends are already afoot, and their effects and the scope for useful policy responses are becoming apparent.

The first two problems have closely linked remedies. Inefficient domestic industry benefits nobody except perhaps the owner of theenterprise. High prices and low quality handicap domestic consumers and users of protected products as inputs to export production Numerous studies in the Pacific[38] have recommended reduction of tariffs to improve overall competitiveness. High tariffs are invariably associated with numerous and varied discretionary exemptions, awarded by Ministers or senior officials on arbitrary criteria in a non-transparent process. At the same time the enforcement of revenue collection is often inadequate. Estimates of 25-50 percent undercollection of due revenue have been made by sources within the island states themselves, while exemptions are estimated to deprive the revenue of similarly large slices of what might have been collected[39]. Study

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[38] Forum Secretariat, ESCAP, World Bank, ADB and more.

[39] A striking recent example, on the export side, was provided in ihe Central Dank of Solomon Islands 1995 Annual report, where the effective rate of export duty on logs was calculated to be around 12 percent, compared with a nominal (and budgeted) rate of 35-38 percent).

## BOX C
## **WTO, APEC and** the **Pacific islands**

Managing their relationships with the World Trade Organisation (WTO) and the Asia Pacific Economic Council (APEC) encapsulates issues faced by the Pacific islands as they balance the need for closer integration with a trade-liberalising world, with the wish to preserve autonomy in economic affairs.

WTO was created in 1995 as an outcome of the long-running Uruguay Round of multilateral negotiations under the General Agreement on Trade and Tariffs (GATT). It is designed to be a powerful force in the continuous expansion of world trade and investment, promoting transparency and equity in trade rules, settling disputes and facilitating negotiations. The main thrust of WTO is towards non-discriminatory reductions in tariff and non-tariff barriers to trade and investment barriers. It is constructed on the ‘single agreement’ principle: a country acceding to WTO has to accede to all WTO’s agreements (no opting out) covering trade in goods, services, and intellectual property, customs valuation, subsidies, antidumping and trade-related investment measures. A series of multilateral negotiations is envisaged that will periodically review progress and agree the next steps in a continuous process of trade barrier reduction. The biggest problems ahead for WTO relate to enforcement of its principles on the heavyweight players in world trade, in particular the US, EU, Japan and China (not yet a member), while the hundred or so mid-sized members get on with trading in an increasingly unrestricted global market.

In that setting, the first big WTO-related issues involving Pacific islands’ interests are likely to come up within the EU/ACP discussions of post-Lome relations, when the future of preferential access for sugar and canned tuna will be raised, and the ACP states will seek to preserve these arrangements in the face of WTO pressure for their removal. By mid-1997, Fiji, PNG and Solomon Islands had joined WTO, and Tonga and Vanuatu were in the process of joining. Those are the biggest traders among the island states. Others appear to have decided to wait and see; there is no reason to rush to join, and the island states for whom exporting is not a big economic activity may want to retain their freedom in tariff setting Joining is a lengthy process, and membership entails significant costs in money and official time. WTO is in Geneva, an expensive place in which to be represented, so the possibility of joint representation or other cost-sharing,

*continued next page*

*Box continued*

perhaps with Forum Secretariat, has been mooted. In any case, the Secretariat has an important role in helping island states to keep up with WTO and related trade issues.

APEC has 18 members from around the Pacific Rim. Australia, New Zealand and PNG are the only South Pacific Forum members who also belong to APEC, but the Forum Secretariat has observer status on behalf of all its member states. While APEC has a broad mandate to promote economic cooperation, a large part of its work concerns the liberalisation and facilitation of trade and investment, both among its members and vis-a-vis the outside world. Since the APEC member countries include all of the Pacific islands' sources of trade and investment (other than Europe), what goes on in APEC is of great interest to the island states. The Forum Secretariat has identified a number of areas of particular concern, where the three Forum members of APEC and the Secretariat would work together to ensure that the island states' interests are protected and promoted in APEC deliberations.

Developing closer and more effective relationships with both WTO and APEC is likely to become a major part of the Forum Secretariat's work in the next few years. Together with the potential for the MSG to evolve into a Pacific islands free trade area, this would be a substantial part of the island states' arrangements for dealing with global liberalisation.

of several Pacific island economies has shown that if a substantial part of existing exemptions were abolished, and revenue collection made significantly (but achievably) more effective, the general level of import duties could be reduced by as much as ten percentage points e.g. from 30 to 20 percent, with a **neutral** effect on total revenue collected[40]. As the process of tariff reduction proceeds, overall revenues can be protected and indeed increased, by the introduction of taxes on consumption of goods and services vaiue-added tax (VAT) or goods and services tax (GST), depending on the capability of the commercial community and the tax inspectors to handle the paperwork), and by generally tightening up on the collection of personal and business income taxes, where colossal leakages are widely believed to have developed in recent years.

Liberalisation in a Pacific islands context should not mean the abolition of import duties, but the orderly reduction of high tariffs designed to protect domestic industry from competition, a (low) general level of import duty for revenue purposes, and special duties imposed for social purposes, are not caught by the global purge; moreover, as mentioned earlier, tariffs on trade are a partial substitute for exchange rate policy in adjusting relative prices, for economies that do not have their own currency. Most island states have manufacturing industries that operate behind protective tariffs; infant industries have passed into comfortable middle age or senility at the expense of consumers (soap, paint, furniture, biscuits, tobacco, beer, boat building, metal fabrication). These firms now need to become more efficient and competitive. There is reason to think that most of them will survive a reduction in levels of protection, provided that the adjustment process is managed intelligently, and that general economic conditions are favorable to business. Fiji has made the greatest progress down this road, amid fears that liberalisation would undermine the domestic economy. A study for ESCAP in 1994[41] found that few firms had been permanently hurt by the scaling back of tariffs and other protection. While some had failed, most had been able to adjust to changing costs, and become more export-oriented, quicker to detect and exploit opportunities, more adept at using technology. There had been little effect on employment. There is, however, still a considerable level of protection in Fiji, as there is in most island states. The effective average import duty rate (duty collected over import value) was reported by the World Bank in 1995 to be still significantly higher than in Australia and New Zealand, who are well on the way to 5-10 percent general and 15-30 percent specific rates, while APEC is targeting zero and 5-10 percent rates by the year 2020. In island states with particularly heavy dependence on duty revenues, big compensating changes in tax structures will be needed if tariffs are to come down to global standards. Here smallness is useful. The Pacific islands are too small for their tariffs to be a major barrier to international trade (see Box B). There should therefore be no problem externally if in the larger island states an orderly programme of transition to lower tariffs is mapped out over ten years or longer, giving time for related internal adjustments to be made; and in the very small states, a significant level of import tariffs may remain in place indefinitely, functioning both as a revenue measure and a relative-price terms-of-trade adjuster.

[40] Forum Secretariat, Tariff Policy in Forum Island Countries, June 1996

[41] Lightfoot(1994).

The impending loss of tariff preference in overseas markets is more difficult to deal with. Pacific islands states enjoy on paper a wide range of preferential access : the 'generalised system of preference' (GSP) gives them the lowest tariffs on offer for entry to industrialised countries; eight of ADB's island members qualify under the Lome Convention for duty-free access to European Union markets; Fiji has special access to the EU for sugar at prices well above world prices, and has quotas for preferential garment exports to EU and US. FSM and Marshall Islands have special trade access to the US under their Compact Agreement. And all ADB's island members have duty-free access to Australia and New Zealand under either the SPARTECA or PATCRA (in the case of PNG) arrangements. In practice, however, most island states have made little use of this preferential access. Their trade with major trading areas is indicated in Table 3. The ESCAP report from which that Table was derived remarked that while trade preferences currently enjoyed by Pacific island countries are going to be eroded, since most Pacific island countries have not benefited much from such preferences, the erosion is likely to go unnoticed except in certain specific circumstances. While that is true, an element of the islands' potential for investment is disappearing, and the 'specific circumstances' pose serious adjustment problems for the enterprises and economies concerned.

Most use of preferential access has been made by Fiji (sugar and canned fish to EU and US, and garments to EU, US and Australia), Solomon Islands (canned fish, palm oil, copra, cocoa to Europe) and Samoa (automotive wiring harness to Australia). Fiji's garment manufacturers had distorted their procurement arrangements and so their costs, to take advantage of SPARTECA eligibility. Now they must re-orient their products to niche markets, exploiting locations, relationships and skills, and holding down costs, to compete successfully without benefit of tariff preferences. The cost structures of the fish canneries in Solomon Islands and Fiji, and the sugar industry in Fiji, are such that they could not survive without the present level of tariff preference. The disappearance of most of the foreign-owned small enterprises set up in Tonga in the 1980s targeting the Australian and New Zealand markets, when their margins of preference were eroded by general tariff reductions, is a warning against complacency. It is not clear how long the fish canneries and the sugar industry have to make the necessary' adjustments, but the nature of the changes required is such that even a 10-year period (the longest they can reasonably expect) will seem short, and they will undoubtedly be asking for government assistance in a restructuring they have so far been unwilling to confront.

In a world of falling tariff barriers, globalised markets, terms of trade moving against primary' producers, advances in communications technology, increased mobility of people and financial capital, the task of attracting foreign direct investment into the Pacific islands presents both greater difficulties and greater opportunities than ever before. The experience of island governments in dealing with transnational corporations over the last twenty years is briefly described in Box D. The difficulties are related to increased competition, the location of the Pacific islands out of the global mainstream, and the well-known tendency of island governments to shoot themselves in the foot over foreign investment. The opportunities are provided by rising skill levels and adaptability of Pacific islanders, the increasing scarcity (market value) of unspoiled environment and natural resources, and the rapidly falling costs[42] and rising quality of telecommunications and information technology, which are negating some of the traditional costs of remoteness. The difficulties can best be tackled and the opportunities exploited by intelligent promotion in an economic policy environment that is helpful to all legitimate business, whether local or foreign owned.

The key prices need to be competitive, the factors of production that the island state can bring to the party (people, land and natural resources, usually) need to be reliably available, and the procedures for obtaining licenses, permits and leases need to be clear, straightforward and stable. Unfortunately most Pacific island governments add to their other problems in pursuing sustained economic growth by the way they deal with foreign direct investment. Governments have generally put great emphasis on tax concessions as incentives to attract investment. It is difficult to assess the importance of such concessions in influencing investment decisions: many surveys indicate that the general political and economic environment is what matters, i.e., the medium to long term potential for profitable enterprise; and that tax concessions are just extra jam on the bread. But the Pacific islands see themselves as competing to attract the next footloose manufacturer who may be considering several island locations that look much the same. Samoa's success in attracting Yazaki, mentioned earlier, seems to bear this out. Naturally then governments put tax concessions on the table, and compete to drive down the tax threshold to lower than necessary levels. Proposals to harmonise investment incentives, so as to avoid beggar-thy-neighbour

[42] Real costs to the operators, that is. Tariffs in the Pacific islands, set by monopolies with government ownership, are among the highest in the world and appear remarkably immune to downward pressure.

BOX D

**Transnational Corporations and Joint Ventures**

As the Pacific islands grapple with the globalisation of trade and investment and the need to upgrade technology and compete in international markets, the role of transnational (or multinational) corporations (TNCs) comes naturally to the fore. The island economies are typically short of financial capital, technology and production know-how, and business connections in foreign markets: precisely the common factors that a competent TNC deploys in the several locations where it does business. The island states offer an investor variously specialised locations and natural resource endowments, generally friendly and trainable people, and (for a few more years at least) preferential access to major industrialised country markets: exactly what a TNC in the natural resources or light industrial sectors could profitably use. Some TNC presences go back to colonial days but an increasing number have come recently from countries that were once colonies themselves. As a result, TNCs from Asia, USA, Europe and Australia/New Zealand operate throughout the Pacific in mining, forestry, fisheries, agriculture, tourism, garment and footwear manufacture, tobacco and light engineering, motor sales and general trading. For different reasons, more to do with targeting market share and cross-border synergies, TNCs also operate in most island states in banking and telecommunications, with Bank of Hawaii and Cable and Wireless being the most prominent in their respective fields.

TNCs by definition operate in more than one jurisdiction, exploiting the economies of scale, variety and access to resources and markets this gives them. They may be huge, complex organisations, with sales many times greater than the total output of the Pacific islands (and indeed of many much larger countries); or they may be relatively small family businesses with operations in two or three Asian and Pacific island countries. In any case they seek to maximise the overall profitability of the total enterprise, and practice employment, transfer pricing and tax minimisation strategies accordingly. Such activities maybe within, across or outside the law, providing severe tests of island states' enforcement abilities. In forestry in PNG and Solomon Islands, TNCs have been responsible for the corruption of governments and community leaders and environmentally irresponsible logging at unsustainable production levels.

Globalisation may be a mixed blessing to TNCs. On the one hand the move to liberalise trade and investment and produce the famous 'level playing field' sounds like a TNCs' idea of heaven. But TNCs will have less opportunity to take advantage of differences between national taxation

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*Box continued*

and regulatory regimes, as these differences are eroded; and TNCs themselves will have to compete more transparently with each other. This may mean that some of their operations in the Pacific islands will fail, the fixed assets becoming cheaply available to national or regional entrepreneurs with more competitive cost structures.

In the 1970s several Pacific island governments deliberately sought TNC investment in their economies, and developed policies to deal with them. A favored strategy was the joint venture between a TNC and the island state (the government itself or a state-owned investment agency). PNG, Solomon Islands and Samoa in particular followed this route, with mixed results. They were successful in attracting investment, especially in natural resources in PNG and Solomon Islands and in a wide range of activities in Samoa, but less successful in obtaining the hoped-for flow of subsequent benefits: indeed in many cases the governments found themselves being called on for substantial injections of funds to keep the venture afloat. The immediate reasons were enterprise-specific and varied, but the underlying causes were lack of common goals, widespread use of transfer pricing, and the failure of the government side to put enough effort into the monitoring, implementation and, where necessary, amendment of agreements. This enabled management, invariably provided by the TNC side of the venture, to do pretty much as it wished, and led to the effective subordination of the government side's goals to those of the TNC. Such experiences led during the 1980s to growing disenchantment with the joint venture as a way of dealing with TNCs, and to the adoption of disinvestment or privatisation programmes to reduce government involvement, running parallel to corporatisation and privatisation of wholly state-owned enterprises.

As domestic investment funds have grown in the island states (especially compulsory provident and superannuation funds), they have provided another route to national part-ownership of major enterprises. In several states, such funds have replaced the government as co-owners with TNCs in 'strategic' business. At the same time, privatisation policies in PNG, Fiji, Samoa and Solomon Islands have begun to put state-owned enterprises on the market, providing further investment opportunities for TNCs, alone or with local co-investors. The pattern is becoming more varied and complex. Alliances between TNCs and local financial institutions in, for example, banking or telecommunications, may develop profit-oriented strategies that incur public criticism and make governments feel very uneasy: especially where the enterprise is a natural or legal monopoly, there will be need to show, by regulation or otherwise, that it is operating cost-effectively and in the public interest.

competition, have received lukewarm support because every government wants to be able to make a better offer, and will do so in secret if necessary.[43]

The permitting process that applies to foreign direct investment in all Pacific island states is one of the choke-points at which political control can be very effectively applied, for good or ill. Great political kudos can justifiably be won by successfully negotiating a major commercial investment, creating jobs and bringing development to backward regions. Unfortunately the temptation to arrange personal gain from the process in one form or another is often irresistible, frequently encouraged by the open expectation on the part of investors that they will be required to make payments on the side. The pattern of corrupt behavior that surrounds the permitting process compounds existing love-hate attitudes to foreign direct investment that stem from colonial and earlier experiences. Foreign investors are desired for the money, jobs, know-how and glamour that they bring, and disliked for their ethnic and cultural insensitivity, and the outright exploitation of local people and resources that is often the basis of the enterprise. These non-economic factors lie behind much of the heavy weather that Pacific island governments have made of cleaning up their investment permitting and promoting process.

Studies by the World Bank's Foreign Investment Advisory Service (FIAS) in many Pacific islands have shown that permitting procedures are generally slow, opaque, circular, and unpredictable, open to abuse both by investors and by the system's administrators. Access to land on secure tenure is problematic, especially outside of urban areas, and the array of fiscal incentives on offer is often complex and open to various interpretations. Analysis of the effectiveness of these arrangements is hampered by lack of data on actual investments. Compared with the fuss that is made by politicians and officials over applications and approvals for foreign investment, there has so far been an extraordinary lack of interest, and almost no coherent information, about what happens after an investment is approved.

Recently the ADB's island members have committed themselves to efforts to improve the investment climate in moves coordinated by the Forum Secretariat. There are many sensible, standard improvements that can be made, and 'peer pressure', together with polite pestering by FIAS and the Forum Secretariat will undoubtedly bring clearer and better-run procedures. But nothing will remove the feeling that in the real world, the island states

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[43] Thus behaving in much the same way as governments in Europe competing for Asian or US manufacturing investments in high-unemployment areas, or state governments in Australia or the US pursuing Japanese investment.

are competing with each other (as well as with more distant rivals) to attract and pin down as much foreign direct investment as they can; this means that governments will always be ready to cut special deals, whatever they say at regional meetings.

## 3.7 FINANCIAL SYSTEMS

The financial systems, institutions and markets of the Pacific islands naturally reflect the condition of their monetary economies They are structurally simple, lacking the complexity and diversity of bigger and deeper systems. Several of them are showing signs of strain for reasons related to social, political and economic change. The remedies will lie in becoming more complex, and thus at the same time more stable and more dynamic. For this discussion, the island states fall naturally into two groups: the first comprises the six states that have their own currency, and a central bank charged with currency issue and the overall care of money, banking and foreign exchange[44]. The second group use the currency of Australia (in Kiribati, Nauru and Tuvalu) New Zealand (in Cook Islands) and the US (in FSM and the Marshall Islands), and do not have a central monetary authority. A further subset discussed in Box D is those states that have offshore financial centres : these are Vanuatu, Cook Islands, Nauru and Samoa, two with their own currencies, two without.

Typically the financial institutions in a Pacific island state, apart from the central bank if there is one, include three or four commercial banks, of which one or two are locally incorporated, and one may be government-owned; a state-owned development bank, and one or two private merchant banks, perhaps with some government ownership interest; a housing or home finance corporation, in most cases at present owned by the state; a national provident fund, with compulsory membership for all persons in formal employment; and a handful of leasing and finance companies, locally incorporated and part-owned, or branches of overseas corporations. Savings and loan associations or credit unions exist in most island states; they are usually subject to some form of government supervision and assistance; despite, or perhaps because of this, they have many problems, which are further discussed below. At the bottom of the heap, but of great practical

[44] These are Fiji, PNG, Solomon Islands, Tonga, Vanuatu, and Samoa. The French territories issue their own currency but under the close supervision of the metropolitan central bank. Nauru is preparing to issue its own currency.

Box E

**Offshore Financial Centres**

The banks and trust companies doing business in offshore centres target corporate and private clients who want secrecy and freedom from income tax. The four Pacific states (Cook Islands, Nauru, Samoa and Vanuatu) that operate offshore financial centres do so to earn government revenue from fees, create jobs for nationals, and raise the international profile of the island state in the hope of attracting direct investment. In practice, revenues to government are modest and employment is small; while international publicity connected with the centres is as often bad as good, because of the scope for illegal behavior afforded by the centres' secrecy laws and lack of supervision. Vanuatu has had to go to some lengths to defend itself against allegations from the US and Australia that its centre harbors tax evaders and money launderers: while the Cook Islands centre has featured in a major tax fraud perpetrated on the New Zealand government with the alleged complicity of (he Cook Islands authorities.

The four Pacific centres are all 'booking' centres, i.e. both the sources and uses of funds that pass through the 'books' of registered entities lie outside the country. Precisely because these centres exist to provide an element of concealment, as well as freedom from taxation, for banks and corporations registered there, comparative information is scarce. Cook Islands, Samoa and Vanuatu each have 2.500-3.500 companies on the register, with small numbers of banks registered in Cook Islands and Samoa, and about 80 in Vanuatu. Nauru, with around 300 banks registered, requires all corporations registered there to have the Nauru government-owned corporation that operates the centre also appointed as nominee shareholder and director. Very few internationally known banks or their affiliates are registered in the Pacific centres, and there is effectively no prudential or other supervision of banking activity. In Cook Islands and Samoa the offshore centre law provides tax-free status for the corporations

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*Box continued*

registered in the centre, while domestic firms and individuals pay personal and business income tax In Nauru ami Vanuatu there are no domestic taxes on business or personal income. Estimates of the economic and financial benefits of the centres vary widely - very high in the view of their supporters, very low according to their detractors. In Vanuatu an ADB report in 1997 estimated that the centre contributed about 2.5 percent of Vanuatu's GDP and about 4 percent of government revenue. An area of persistent overestimation in Vanuatu is the benefit of employment claimed for the Offshore Finance Centre: of about 400 persons stated to be employed in the Centre, around 300 are employed in three commercial banks and a cluster of legal and accounting firms on work not attributable to offshore activities.

Small offshore finance centres providing only booking services are vulnerable to changes of attitude by their overseas clients, and to restrictive action by the regulatory authorities in their clients' home jurisdictions. Political or economic instability is bad news for clients, who fear changes to the tax or secrecy elements of the center's status. Overseas authorities are steadily moving to constrain the ability of offshore finance centres to protect personal or corporate assets from the enforcement of domestic law. Asset protection involves the transfer of assets to an overseas trust, with the intention of placing them beyond the reach of claimants in the home jurisdiction, even when the claim has the backing of a court judgment. Cook Islands, which has specifically targeted the asset protection market, is particularly vulnerable to a tightening of US law on the subject. In recent years the level of participation and activity in the Pacific island centres is reported to have been flat. This business is notoriously footloose, and can disappear as quickly as it came. It is important that governments be clear about the costs and benefits of financial centres, and not be drawn into costly efforts to sustain them bevond their natural life.

importance, is a rich variety of informal saving and borrowing mechanisms, well integrated into rural and urban life and largely unnoticed by officialdom.

Symptoms of stress can be seen in the failure or near-failure of state-owned banks in several Pacific island states; frequent complaints that development banks have ceased to be developmental and housing corporations only help the well-off; the chronically weak state of credit unions; high proportions of government debt in the asset portfolios of commercial banks and provident funds; and demands by provident funds to be allowed to invest overseas. The main causes of stress appear to fall into four categories:

- the extent of state involvement in the ownership, funding and management of financial institutions;
- oppression of the system to finance government budget deficits;
- lack of creditor-debtor understanding (a mis-match of attitudes) and difficulties in enforcing loan repayments; and
- the rapid growth of provident and superannuation funds in countries with few investment vehicles or capital markets

In looking for strategies to improve the stability and competence of the financial system, one must bear in mind the operational environment. The financial institutions in which people variously grapple with or create problems in the system are characterised by small size and high unit costs, extensive and increasing use of advanced communications technology and computerisation, the high costs (and in some cases physical risks) of providing financial services to scattered and remote communities, and the increasing sophistication of financial crime.

With those realities in mind, strategies to tackle the causes of stress and increase the resilience of the financial system may be found as follows:

### 3.7.1 STATE OWNERSHIP OF FINANCIAL INSTITUTIONS

Government ownership of development banks stems directly from the interventionist development strategies of the 1960s and 1970s. With the enthusiastic help of the ADB, most Pacific island states set up general-purpose development banks around the time they achieved nationhood. As noted earlier, those were exciting times. The banks started off with high expectations of accelerating the economic transformation that would surely come with political independence. Within a few years, a combination of the lack of a financial culture, the economic realities of remote locations and small populations, and political pressure to lend to projects (or borrowers) in favor with the government led to high loan losses and massive arrears of interest payments. The development banks were unwilling or unable to set their interest rates at levels that would reflect the riskiness of their business, or to enforce repayment by well-connected or hard-to-find borrowers. The ADB and other lenders to the development banks, distancing themselves from their earlier enthusiasm and protected by government guarantees against losses themselves, intervened to insist on extensive write-offs and reorganisation, linked to refinancing of banks' capital. The turnaround has taken time, and some have not yet reformed[45] but the difference can be dramatic. The development bank in Fiji, for example, having trodden a delicate line between being a symbol of ethnic Fijian nationalism and a prudent lending institution, is now competing openly for business with the commercial banks, and putting its considerable weight behind moves to develop financial markets in Fiji. In some states, government ownership still hampers the ability of development banks to price their loans according to risk; governments want their banks to make profits and stop asking for financial subventions, but they also want more and cheaper credit to be extended to entrepreneurs in remote areas, and the specter of political loans has not disappeared.

In the case of government-owned commercial banks, political influence is the most serious cause of their problems. The near-collapse of the National Bank of Fiji, the badly weakened state of the National Bank of Vanuatu, the officially "troubled" status of the Bank of Micronesia, and the so far unqualified problems of the Bank of Nauru, are all traceable to lending decisions by management that were directly or indirectly steered by political influence[46]. Once the internal rules are bent for political reasons, the bank's defenses against other attacks are reduced, and what amounts to theft of its resources by well-placed employees becomes common. The still-unfolding story of the National Bank of Fiji has sent Shockwaves into all the Pacific islands. Banking regulators and depositors alike have discovered that government ownership is no guarantee of financial prudence - more likely the opposite.

[45] The Development Bank of Vanuatu was reported in 1997 to be in such difficulties that an ADD report has recommended its closure.

[46] Solomon Islands has avoided this problem only because its National Bank is 51 percent owned and managed by the Bank of Hawaii, (successor to the Commonwealth Bank of Australia) and 49 percent by the National Provident Fund. This arrangement was chosen to protect the bank from political interventions, and so far seems to have worked. Indeed the bank recently sued the government over repeated non-payment of interest and principal due on treasury debt. The bank won, but foresees problems in enforcing the judgment.

The remedy is probably two-fold: privatisation, at least in part, by the sale of an ownership interest to overseas banks or other financial institutions and investors; accompanied by strengthened banking supervision by the appropriate regulatory authorities, usually the central bank but sometimes a separate banking supervisory body. But first the government-owned banks have to be put into a saleable condition. This involves re-capitalisation and the provision of good assets in place of bad to support the banks' liabilities to the public, a process that is set to cost their governments a lot of money[47] and provide a powerful warning to others.

Problems in government-owned non-bank financial institutions, such as housing corporations, have been simpler, related mainly to poor management, ineffective debt recovery and lack of funds to carry out the programmes that were expected of them. Where they have undergone successful internal reforms, and the programmes are big enough to support competent professional management and attract long-term outside funding (as in Fiji, and perhaps less certainly PNG), these institutions are performing a useful role. In the smaller states they have been a persistent burden on the government budget and have generally failed to address their functions effectively.

### 3.7.2 OPPRESSION OF THE FINANCIAL SYSTEM TO FINANCE GOVERNMENT BUDGET DEFICITS

When the government's fiscal position weakens, as happens from time to time in even the best-run economies, the Treasury turns to the domestic financial system to bridge the gap. If the financing need is temporary, domestic savings are enough for the needs of both public and private sectors, and the government goes to the market on arm's length commercial terms, no particular problems should arise. Treasury bills, overdrafts, even term loans and development bonds are normally a welcome part of the asset portfolio of banks, pension funds and the general public. But when, as has happened notably in the last ten years in Solomon Islands, the need for budget deficit financing is not temporary but chronic, the amount of government borrowing swamps the domestic market, and the government does not just refuse to pay market interest rates but fails to pay any interest at all, then the strain on the system can become pathological. Between 1986 and 1995 the

[47] The Fiji Government lost the $14 million it had invested in the capital of NBF, and is having to raise a further $150 million to repay depositors. Vanuatu faces similarly painful restructuring, though the absolute amounts will be much smaller.

proportion of central government debt in the commercial banks' domestic assets in Solomon Islands rose from 14 to 47 percent, while the share of lending to the private sector fell from 61 to 36 percent. In 1995 the Central Bank, having reached the legal limits of its own financing of the government, stopped paying interest on government debt on behalf of the patently empty[48] Treasury. The holders of government paper (by then amounting to around SIS250 million, ten times bigger than in 1986 and about a quarter of the total assets of the financial system) thereupon found themselves with a large non-performing asset and some difficult internal questions to address. The immediate result was that the government's credit, domestically and overseas, was destroyed. There is only one way out of this situation: a determined climb back to sound fiscal practices by the government, attended by the locked-in patience of its creditors. It remains to be seen if this will be part of a wider reform of economic management in Solomon Islands. Nauru has similarly oppressed its own commercial bank, and other island states (PNG, Samoa) have also had brushes with excessive use of domestic credit. The contrast with the fiscal prudence of Kiribati and Tuvalu, which do not have their own currency, is striking (see Box F). The Solomon Islands experience may serve as a grim warning of the damage that fiscal excess can do to the functioning of financial markets.

[48] Unnecessarily empty according to the Central Bank's 1996 annual report, which remarked on the generosity of revenue exemptions and remissions worth more than enough to clear public debt arrears and normalise the securities market.

Box F
**The Reserve Funds of Kiribati and Tuvalu**

These two small states, composed almost entirely of low atolls, have deservedly attracted favorable attention because of their prudent use of the income from reserve funds, to balance their government budgets and give them some elbow-room in the allocation of public funds. Other island states, notably FSM and Marshall Islands, wish that they also had such reserves, and are pondering how they might acquire them.

The two funds have quite different, though not unconnected, origins. The Kiribati Revenue Equalisation Reserve Fund (RERF) was established forty years ago in the Gilbert and Ellice Islands Colony, as a repository for colony government savings from taxation on phosphate mining on Ocean Island. The fund stood at about ASS million in 1971. The Colony's 1973-76 Development Plan set a target of government saving at A$l million a year in constant prices, from total domestic revenues of about A$5 million. Investment at this rate would produce a fund of A$20 million by 1979, when phosphate mining and the flow of tax from it would have ceased. The Plan assumed a 10% return on investment, of which 1/3 would be reinvested to maintain capital value and 2/3 (A$1.35m in 1972 prices) would go to balance the recurrent budget. This spendable income would be about equal, in constant prices, to the phosphate tax available for spending in 1972, after saving A$l million. In effect the plan was to be able to sustain real current expenditure at 1972 levels without foreign aid. This is recounted here because it reflects the tough line that the emerging political leadership in Tarawa was prepared to take with government finance. With few temporary aberrations, this line has been maintained through and since independence in 1979. In the event, phosphate prices were much higher during the rest of the 1970s than the Tarawa planners had assumed, and both consumption and savings able to grow faster than had been expected. By 1979, when mining ceased and Kiribati became an independent republic, the RERF stood at A$68m. Through sound professional management of the fund and adherence to prudent budget policy on the part of successive governments, the Fund had grown by the end of 1996 to about A$400 million. At this level it is providing a reliable source of funds to balance the budget (the planned drawdown for 1997 is around A$13m or 25% of recurrent expenditure), while sufficient income is being reinvested to maintain the Fund's real value per head of population.

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Tuvalu had separated from Kiribati in 1976 and became independent in 1978. Despite strong pleas from Funafuti for sharing of the RERF, it was decided that as Ocean Island was part of Kiribati rather than Tuvalu, the fund should remain intact with the Tarawa government. The government of Tuvalu was disappointed, but not deterred. Within a few years a campaign to set up a Trust Fund for Tuvalu, orchestrated by its forceful and articulate Finance Minister, was gathering support. New Zealand was the first government to make a firm offer to contribute. Britain and Australia followed. In June 1987 the Fund was established by agreement between those three donors and the Tuvalu Government. The initial contributions totaled A$27.1 million, of which just under $25 million came from the founding donors, $1.6m from Tuvalu, and $0.7m from Japan..

Unlike the Kiribati RERF, which is wholly owned and controlled by the Kiribati Government (which has contributed almost all the fund's capital), the Tuvalu Trust Fund (TTF) is governed by an International Agreement: this sets up a management board to oversee the Fund and an advisory committee to monitor Tuvalu's use of the distributed income from the Fund. The Agreement requires real capital value to be maintained before any funds can be distributed, provides for the appointment of fund managers, spells out the responsibilities of the Government of Tuvalu, requires timely audits and performance reports, and provides for accession of additional contributors. The founding aid donors saw the fund as a way of supporting current public expenditures without undertaking an open-ended commitment, and without seeming to interfere in the running of Tuvalu's affairs. At the end of 1996 the TTF stood at about A$45 million, with a further $7.5 million in a buffer fund of distributed but as yet unspent money belonging to the government. The 1997 government budget envisaged recurrent expenditure of A$10.2 million, of which AS1.2 million or about 12% would be drawn from the buffer fund, while new distribution income would be re-invested in the Fund to increase Tuvalu's share of contributions.

The two reserve funds, one created entirely out of government savings, the other set up by aid donors, similar in size per head of population at about AS5000, are performing similar functions in underpinning government expenditures. The instinctive frugality of atoll dwellers has had a lot to do with the successful creation and operation of these funds, and their success has added immensely to the self-respect of the two small, remote and independent states.

### 3.7.3 UNENFORCEABILITY OF REPAYMENT OBLIGATIONS

There is a well-understood tendency of borrowers, not confined to the Pacific islands, not to repay debt if they perceive that they will not be punished for it. The relationship of creditor and debtor is often a complex one, involving several other dimensions besides that of giving and receiving a loan. Enforcement of a repayment obligation can be difficult, and costly in time, money and reputations of both the lender and the borrower. Nowhere is this more true than in the Pacific islands, where the lenders in the financial system are commonly large, rule-bound institutions, often foreign-owned or managed, staffed by people reluctant to get their clothes muddy or their feet wet, and the borrowers can change names and addresses, slip away into the bush to reappear in another island, with no assets worth seizing, and perhaps a relative or two high up in the government to suggest that the bank should not pursue them too hard. The unenforceability of obligations can arise with debt borrowed by the government itself (see above in the case of Solomon Islands); with loans from a government-owned development bank, where the borrowers consider they have a right to the money as it was provided by the government and ought to have been a grant anyway; with loans from commercial banks, which are regarded as fair game, awash with money, unlikely to take legal action for small amounts, and not liking to foreclose on bigger, more influential customers; and with credit unions, where management may be self-interested, naive, or 'culturally inhibited' from taking loan recovery action against a neighbor, relative or hierarchical superior. This is quite apart from the normal occurrence of fraudulent borrowers, confidence tricksters and impersonators, whom the financial institutions are supposed to be able to handle.

Clearly financial markets cannot operate to bring together the surpluses and deficits of savers and borrowers unless the obligation to repay is firmly entrenched in moral and legal standards, and the means exist to enforce repayment : in other words, lenders have the ability to go after their money and get it, or the equivalent value, back. In the area of larger, more formal loans, part of the 'enabling environment' that needs to be in place for sustained growth is a prompt, affordable and uncorrupted legal and judicial system, capable of upholding and enforcing properly made contracts and causing bad debtors to go into liquidation or bankruptcy; the ability to give, receive and enforce security over valuable assets, including the right to occupy, use and dispose of land given as security, is a key part of that framework. In order to promote the entry of new borrowers there is some scope for government intervention to raise the level of confidence and willingness to lend on the part of commercial banks, by providing partial guarantees for loans in specific, well-supervised circumstances (full guarantees unhelpfully relieve the lender of all risk and eliminate the supervisor}' motivation). At the smaller, less formal end, the enforcement mechanism has to rely more on the multi-dimensional character of the loan relationship. The use of group responsibility and guarantees, the sanction of 'shaming' in the Maneaba or other public forum and exclusion from future financial relationships, and insistence on a significant contribution by the borrower to the total money at risk in a venture, all have a role to play in enveloping the borrower in a net of pressures to fulfill the obligations of the loan. The incidence of foolish or dishonest people is probably no different in the Pacific islands from anywhere else, but losses from loan fraud can cripple credit unions and large commercial banks alike, and lending institutions and their supervisors and regulators must be continually on guard (see Box F).

### 3.7.4 THE RAPID GROWTH OF PROVIDENT FUNDS

Compulsory retirement savings schemes, applying to all persons in formal employment and involving contributions by employee and employer, were introduced to the Pacific in the 1970s, based on models in Singapore, Malaysia and other, mostly Commonwealth, countries. There were two objectives, different in kind but probably equal in weight, in the minds of their creators: mobilisation of domestic savings for use in national development, and provision of retirement and resettlement moneys for persons leaving formal employment, and in many cases going home from town to the village economy. The funds have been remarkably successful on both counts. The oldest fund, set up in 1966 in Fiji, had grown to over F$1.5 billion by the end of 1996, with 85 percent of its assets in government and quasi-government securities and the rest in real property and bank deposits. By then the Fiji NPF was providing pensions, housing and business equity finance to its members as well as lump sum retirement benefits, and its real property projects were adding amenity to downtown Suva. Funds in six other island states, though starting later, have shown similarly strong growth and diversification. The existence of the NPF contribution account is now an important factor in family financial management in tens of thousands of households across the Pacific. The governance of these funds, in most cases the biggest single source of investible capital in the economy, has begun to attract public concern and discussion.

Among the points of concern are:

- The boards of management are too close to the government, and appointments of directors and managers are not made on grounds of professional competence and integrity.
- The funds have been an easy touch for governments, and have an excessive amount of government debt in their assets, some of it at less than market rates (in effect, a tax on compulsory retirement savings) and in the Solomon Islands case, a non-performing asset.
- There is no machinery for contributors to call directors and managers to account, e.g. at an annual general meeting, although it is the contributors' money that is being (mis-) used in the fund's operations.
- Too much money is spent on the comfort and security of the fund's staff and not enough on benefits to contributors.
- Suspicions of corrupt practices, contract kick-backs, purchase and sale of property at non-market prices, are not properly investigated and cleared up.
- Most funds lack professional investment managers and do not earn the optimum return on their investments.
- Some funds have failed to produce timely and clear reports and financial statements.
- Several funds have obtained government approval to invest overseas, claiming lack of investment opportunities within the country, at the same time as residents are unable to obtain affordable credit from the domestic banking system.

These concerns are now serious and widespread enough, and the provident funds are old enough, to justify a region-wide comparative study of their governance and their ability to respond to the changing needs of the Pacific islands.

## 3.8 FOREIGN AID

Aid to the Pacific islands has for many years been higher, in per head terms, than aid to any other category of developing countries. In 1994, except for Nauru, the island states that are members of ADB received together about $730 million of official development assistance (ODA) on concessional terms, of which Australia provided about one-half[49] Forty five percent of

[49] ADB Key Indicators 1996.

this went to PNG (three quarters of Australia's aid to the region goes to PNG). The amount of aid per head was $122 including PNG and $215 if PNG is excluded. The highest rates applied to the smallest countries and those receiving Compact Funding from the USA: Cook Islands received $708, Marshall Islands $887 and FSM $983 per head. PNG and Fiji are at the other end of the scale with $79 and $53 per head.

These amounts form significant proportions of estimated national income and balance of payments receipts. The ratio of aid to GNP ranged from Fiji's 2.3 percent and 6.7 percent for PNG, through 15-30 percent for Solomon Islands, Cook Islands, Vanuatu, Kiribati, Samoa and Tonga to over 50 percent for the Marshall Islands and FSM. Official transfers (net) in the current account of the balance of payments of the island states in the early 1990s have provided substantial import coverage, ranging from Fiji's low of 4 percent through 16 percent in PNG and Samoa to 30 percent in Solomon Islands and 70 percent in Kiribati[50].

Aid has been financing a large share of public sector investment (all of it in several cases). While this is explicitly the purpose of official aid, namely to increase the economy's ability to invest in excess of the domestic savings rate, it has had the unfortunate effect of enabling governments to forget about the need to mobilise domestic savings. Aid has tended to substitute for domestic savings rather than supplement them. Nowhere is this more starkly apparent than in Marshall Islands and FSM. These two Micronesian republics are looking over the edge of a cliff, as the 'step-down' phase of their 15-year compact transfers from the USA moves forward. A combination of unusually strong adjustment measures and continuation of relatively high assistance levels seems the most likely outcome from the negotiation process now beginning.

All the Pacific island members of the Bank except Fiji, and to some extent PNG, are eligible for technical assistance grants and highly concessionary loans from multilateral finance institutions, in particular the ADB's Asian Development Fund (ADF) and the World Bank's International Development Association (IDA), and some specialised institutions such as the International Fund for Agricultural Development (IFAD) and Arab development funds. The ex-colonial aid donors, Britain and the US, maintained their assistance after independence (France hesitated for some time with Vanuatu but then put in place a substantial programme), and were joined by Australia, New Zealand, Japan, and the EU as major sources, while

[50] South Pacific Economic and Social Database at ANU, Canberra.

Beijing and Taipei vied for diplomatic affiliations through their aid relations with the independent island states.

Most Pacific island governments have from time to time had more aid on offer than they were able to absorb efficiently, leading to poor project selection and wasteful management. The ex-members of the US Trust Territory are merely an extreme case of a widespread malaise. At the margins of their programmes, donor agencies have been hard pressed to disburse their allocations on well-conceived projects, while donors using aid to secure diplomatic support or access to natural resources have not been too concerned about project appraisal. A coincidence of bureaucratic interest between donor missions and officials of recipient governments tended to expand commitments to the level of aid available, resulting in aid-financed activities that not only failed to produce net benefits, but actually produced net costs to the recipient economies. Many aid-financed assets could not be maintained and have fallen into disuse. ADB's evaluation of its own projects in Pacific Islands rated only half as "generally successful", and 22 percent as complete failures[51]. Similarly disappointing outcomes have been recorded by those other multilateral and bilateral donors who have taken a hard look at the effectiveness of their aid.

The ADB's project failure rate is twice as high in the Pacific islands as in the Bank's overall lending. The borrowed money is invariably repaid by the recipient state whether or not the project succeeds; this implicit assertion by the Bank that it has no responsibility for the failure of projects in whose conception and design it was deeply involved, sits uneasily alongside the imbalance of appraisal and design skills between the Bank and its smallest borrowers. Bank missions in the past have sometimes pushed projects through in the face of inarticulate misgivings by borrowers, who then feel unable or unwilling to rectify design errors during implementation. This appears now to be coming under review, with signs of a more thoughtful approach to project evaluation in the Bank. Greater readiness to adjust design and implementation with the recipient is required in an atmosphere of continuing joint responsibility, extending if necessary to review of repayment obligations in the light of project outcomes.

The inability of national governments to use aid effectively (when there are glaring deficiencies in, for example, social and economic infrastructure) led donors to stress capacity-building in national institutions. Most aid programmes direct substantial resources to this. OECD data quoted by the World Bank for 1986-92 shows that about 45 percent of the official aid to

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[51] ADB, 1996 c.

the Pacific islands took the form of technical assistance (TA), country ratios ranging from 37 percent for Samoa to 53 percent in Solomon Islands and Vanuatu, in theory TA should reflect either a specific short-term need for a technical service not available in the country, or a longer-term capacity-building requirement that includes a substantial training component. In practice the short-term TAs seem to work reasonably well, provided they have feasible and clearly defined objectives, even though they may need to be repeated periodically until an associated system or equipment is operational. But longer-term TA runs a real risk of perpetuating dependency by stultifying the growth of local abilities.

The use of foreigners to perform quite senior government tasks has a long history in Asia, the Pacific and other societies. Such persons often work harder (fewer distractions), are unlikely to go on strike, and are less of a political risk than a local person. Mercenaries, slaves and shipwrecked mariners have worked for many successful empires and principalities, practicing warfare, statecraft, engineering, medicine and education on behalf of their rulers. What is new, in the last few decades, is the idea that you can get a foreign government or institution to pay the costs of employing these people, and even replacing them if they become personally unacceptable. But ready availability of foreigners under aid programmes reduces the incentive for local staff (who may be professionally as well qualified as the foreigners, but may be less experienced) to get stuck in, do the work and gam the experience. The fact that TA personnel are typically paid much more than their national colleagues is a further source of strain. TA personnel are frequently found to be doing the job themselves rather than training their local counterparts, who have retreated to the sidelines, or become in effect part-time workers. Too much TA can inculcate a passive attitude to problem-solving and fail to develop capability to work under pressure. The problems confronting the Pacific islands are often not very difficult or abstruse, in a technical sense; but making solutions work requires a lot of local knowledge and persistence, not qualities easily furnished by foreign aid. Greater readiness by aid donors to let island governments work out their own salvation would be more likely to produce home-grown, self-reliant solutions to problems: supported as necessary by short-term, skill-supplementing TA services.

Co-ordination among aid donors is much talked about, but rarely achieved. Efforts by the South Pacific Forum through an annual 'dialogue' with aid donors have so far borne little fruit in operational collaboration. Bilateral donors particularly cherish their individual freedom. The World Bank's involvement in the Pacific islands now includes lending only to PNG and Fiji, surveillance of economic trends in the region, and support for some regional TA activities; but internal reorganisation in the World Bank in 1996 has raised the profile of its Pacific involvement, and revived a latent tension between the World Bank and the ADB about their respective roles. The ADB is emerging as 'lead donor' in some of the more troubled island economies, convening donor-recipient consultations during 1997 as part of its support for structural adjustment programmes across Micronesia and in Cook Islands and Vanuatu. Sharing knowledge, if done frankly, should help to reduce waste of effort and avoid repeating mistakes.

This will become more important as and when the long-foreshadowed tightening of the aid environment takes effect. The islands states have so far been shielded from the coldest winds by the same factors as gave them high levels of aid per head: smallness (so the absolute aid amounts are not so big) and indivisibilities (aid programmes cannot be smoothly reduced). Published data[52] indicates only marginal reductions in overall aid to the Pacific, and most island states still have more aid on offer than they can use. But with the exception of some Asian donors and France, who for different strategic reasons have been increasing the range and amount of their aid commitments, the bilateral donors have been signaling the capping and subsequent reduction of ODA, while Australia has announced plans to tie its bilateral aid to specific improvements in economic management. The biggest multilateral source of grants, the EU, has clearly also shifted from its strongly expansionary mode of the last two decades to real-terms stability, with a strong possibility of a downwards trend (and greater conditionality) developing as the run of Lome Conventions draws to a close and Brussels targets recipient government performance more sharply. The older-established donors are showing interest in an enlarged role for NGOs within any aid programme, which will mean less aid simply going to governments.

The abundance of aid has encouraged its inefficient use. Less aid, more closely linked to performance, should cause governments to do more for themselves in analysing problems, designing solutions and mobilising resources. Bigger allocations of aid to NGOs, linked to accountability and planning requirements in the context of a larger role in governance for institutions of civil society, is likely to pay off in greater effectiveness of aid. In this context it would be unfortunate if the newer, increasingly-important, sources of aid such as Japan and China, did not also apply stringent criteria of cost-effectiveness, policy reforms and local contribution to their

[52] World Bank (1995).

programmes. If that is not done, easy access by governments to external assistance will continue to undermine appraisal procedures and prolong the condition of dependence.

It is possible that some aid programmes set out to perpetuate dependency. Just as important as improving the effectiveness of aid is the need to blow away the fog of rhetoric that surrounds it, and understand it for what it is. ODA to the Pacific islands is the overt expression of a complex set of relationships, with political, strategic, economic and humanitarian dimensions[53]. No serious practitioner believes that aid will enable a country to attain self-sustaining growth, if it is not already endowed with the natural attributes of physical resources, size, location and population to make sustained growth possible. And if a country is so endowed, there is reason to believe that aid, and particularly abundant aid, distorts priorities and encourages the waste or misappropriation of domestic resources, making autonomous growth less attainable. But aid continues to be given with the ostensible aim of bringing all countries to a common level of internationally respectable economic independence, where they can manage without aid; and it continues to be given to countries who manifestly misuse both foreign and domestic resources.

The reason is twofold: first, though it is widely understood that the smallest and least-endowed island states will need to be assisted by free transfers of resources indefinitely, if they are to maintain standards of welfare that the donors of the aid can bear to look at, there is still some reluctance to admit this at ministerial level, as if it were somehow shameful, or might cause a psychological collapse if it were openly said. Second, aid buys a certain kind of relationship between donor and recipient (exactly what kind depends on various aid and non-aid factors), and such relationships may have little to do with technically objective aid-worthiness. More important arc geographic proximity, access to natural resources or strategic locations (or denial of access to others), promotion of trade and investment, and maintenance of friendly coalitions in various international arenas - in other words, what does the aid donor get in return? The Pacific islands in this aid relationship vis-a-vis one or more major donors arc the Melanesian states,

[53] The humanitarian dimension is not much noticed at present, as Pacific islanders are perceived by aid donors as being relatively well off, by developing country standards. But humanitarian considerations will come to the fore if and when atolls are inundated by a rise in sea level and many thousands of people have to be found new homes. Australia, New Zealand and the bigger Pacific islands will be able to absorb the atoll dwellers provided the move is planned in plenty of time. But immigration is a prickly subject everywhere, and it may not be possible to win public approval for such a move until the humanitarian need for it is clear and present.

the larger Polynesian states with emigrants in Pacific rim countries, and the Micronesians strung out along the equatorial belt.

This reasoning is not confined to delivery of bilateral aid. The main multilateral institutions are largely controlled by the same major powers that provide bilateral aid to the Pacific. Though muffled by layers of policy and bureaucracy, the same concerns come through in the attitudes of the ADB, the EU and the World Bank as are apparent in the behavior of the bilateral donors. These concerns can be quite specific. When a donor government sees that its bilateral involvement in a specific country or project might mean exposure to a disagreeable degree of risk (of failure, or of criticism for interfering in sensitive matters), it may become a strong advocate of involvement by multilateral agencies. The US, Australian, British and French governments have all used this tactic on occasion, and these considerations seem to lie behind Australia's wish to see ADB taking the lead in the hazardous area of public sector reform.

## 3.9 POLICY COORDINATION

The common economic target of the island states is a sustained rate of real income growth significantly in excess of the rate of population increase, so as to make possible a raising of incomes and welfare throughout the community[54]. For policy-making this divides into two sets of aims, relating to the growth of output and the sustainability of that growth; and throws up the need for capable institutions with appropriate responsibilities. Growth of output requires efficient investment, whose outputs are competitive in quality and price. Such investment in turn requires confidence, stemming from reasonable stability of key prices; reliable access to financial, human and natural resources; and the use of competent infrastructure. Sustainability of growth requires conservation and replenishment of capital, both natural and financial; maintenance of produced and purchased assets; competent strategic planning, and managerial adaptability. It also requires equitable distribution of the costs and benefits of growth, in proportions generally regarded as fair in the community; failure to attend to this will restrict access to resources, feed instability back into the political economy and undermine the growth process.

[54] If real national income does not rise faster than population, the income of one segment of the population can only rise by taking income away from other segments, a process that can now be observed in several island states.

The policies that will affect the rate and sustainability of economic growth fall into two broad areas; macroeconomic policies aimed at the framework of financial balances, flows and key prices against which economic decisions and activity take place; and microeconomic or sector policies that seek to promote specific decisions and activities expected to be beneficial to sustained growth. Generally, macroeconomic policies are more concerned with short-run stability and long-run sustainability, while sector policies are more concerned to boost growth, either directly by increasing output of goods or services, or indirectly by improving social or economic infrastructure. Conflict can arise between macro and microeconomic policies, and ways of containing and removing this through institutional systems are required. In most island states, ministries and public sector agencies have considerable autonomy in development of sector policies, subject to their being fitted into an overall framework by a national planning office; and to budget allocations and release of funds by the finance ministry. Much ministry official effort goes into persuading the planning office and the treasury to accommodate favorite projects. Techniques include being 'economical with the truth' about the project's costs, and getting cabinet endorsement "in principle' before financial details are available.

For the four Micronesian states, Cook Islands and Tuvalu, who variously use US, Australian or New Zealand currency, macroeconomic policy is essentially fiscal policy, aiming at a stable, predictable taxation regime that works efficiently, pays for necessary services and infrastructure without incurring unaffordable debt, and promotes private sector investment and growth; while the government makes prudent use of domestic savings and foreign aid in its sector-focused investment budget. Policy coordination simply requires good discipline and communication among ministries and public sector agencies, and an effective means of regular consultation with the private sector.

For the six biggest island states, all of whom issue their own currency, macroeconomic policy-making is a more potent and more hazardous activity[55]. Policies at the macro level are required not only on fiscal matters, such as the overall budget balance and taxation in relation to GDP, but also

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[55] Much of the hazard stems from the temptation to misuse the money-printing capability of the central bank. Four of the 'big six' Pacific islands, apart from Fiji and Tonga, went straight to central bank status, missing out the less risky stage of having a currency board issue domestic currency on a fixed exchange rate against a specified hard currency. Cook Islands managed spectacularly to abuse the powers of a currency board by having the Treasury pay government employees with uncirculated bank notes, with the inevitable result that confidence in the currency collapsed and Cook Islands reverted to the use of the NZ dollar.

on monetary and exchange rate policy. Judgment is required on the potential for increasing domestic liquidity by financing a fiscal deficit, and so putting pressure on domestic prices, with flow-on consequences through import demand to the balance of payments, the external reserves and the exchange rate; or much more rarely, the reverse, and the choice of recycling a budget surplus through the banking system or sterilising it in the central bank.

Growth and stability, short-run and long-run, technical and political factors have to be weighed by the responsible policy-making institutions. These are typically the finance department or ministry, the central bank, and the economic planning office. In all six states these institutions employ some of the best and brightest of the nation's technocrats, but their effectiveness is much reduced by organisational and political constraints. Natural tendencies for friction and non-communication between politicians and officials, and specifically between the Prime Minister, Minister of Finance, Minister of Economic Planning (if this is a separate office), the Governor of the central or reserve bank, and senior Ministry officials. If the government is a coalition, and the Ministers from different parties, this can make matters worse. In these circumstances, large amounts of leadership attention and time have to be put into making the policy coordination machinery work. The technical support needs to be of high caliber, capable of prompt production of understandable, balanced but brief assessments and clear recommendations to put before policy makers. The design of formal structures such as the widely-used macroeconomic or development committee, can help or hinder, but the more vital factor is the institutional will to use them. Without that, formal arrangements decay and die. Sometimes it may suit a Prime Minister or President to keep the machinery of policy coordination in disrepair, or at least run it so that only he/she knows what is happening. This seems to have been the case in Nauru, Solomon Islands and Marshall Islands in recent years, to name a few examples. But this is unlikely to benefit the performance of the government: the tasks are too many and the resources too dispersed. In other cases, such as Vanuatu and for a time Fiji, key economic decision-making roles have been given to party caucuses or powerful lobbies, e.g., the military, with predictably chaotic and unproductive results. It is essential for effective economic management that the official policy coordination machinery works, is seen to work, and is openly supported and used by the political leadership.

# 4 Conditions below Decks: Expectations and Realities

Political independence and economic growth were universally expected to produce higher living standards. During the 1970s, when the move to independence was at its peak, this seemed an obvious connection. Throughout the Pacific, investment in social and economic infrastructure was under way, financed by foreign aid; public health was improving and school enrollments increasing; and private investment in natural resources, tourism and manufacturing was creating jobs and diversifying tax revenues. National elites moved into offices and houses vacated by the departing colonial officials, resolved to lead their countries to peaceful and prosperous nationhood. The rule of law was respected, and corruption was something that happened in other parts of the world, not the Pacific. During the late 1980s and early 1990s a more troublesome reality asserted itself, shot through with widening inequality of opportunity and incomes, resurgent public health problems, open unemployment, waste of human resources and financial capital, and alienation of national leaders from the people they are supposed to lead. This part of the paper looks at several aspects of stress on people in the island states, how they react to their economic and social circumstances, and the role of governance in determining the human condition.

## 4.1 THE IDEA OF HUMAN DEVELOPMENT

The six million people of ADB's island member states (four million of whom are in PNG) are ethnically diverse, culturally and linguistically fragmented, and possessed of widely different endowments of resources. Not surprisingly, there are wide differences in quality of life. There is a broad correlation between levels of income per head, population growth rates, and standards of education and health: slower population growth goes with higher incomes and better education and health, only Nauru displaying a perverse pattern of high income and poor health. As noted earlier, estimated national income per head in 1994 ranged from $700-800 in Solomon Islands and Kiribati, through $1000-1200 in Samoa, PNG, Tonga, Vanuatu and Tuvalu, to $2300 for Fiji and over $4000 for Cook Islands and Nauru. Population growth rates are high, with total fertility rates (average number of children per mother) ranging from 3.2 in Fiji through 5.4 in PNG to over 7 in Marshall Islands and Nauru, and the difference between crude birth and death rates per thousand ranging from 19 in Cook Islands and Fiji through 32 in Solomon Islands to 40 in Marshall Islands. The highest net annual growth rates are in Solomon Islands (3-3.5 percent), which at least has room for more people, and Tuvalu (4 percent) which has not, but has had to accommodate them nevertheless. Emigration holds down growth rates in Cook Islands, Tonga and Samoa to rates of less than 1 percent, and reduces the rates in Fiji, FSM and Marshall Islands by as much as one percentage point. The demographic transition identified in fast-growing Asian economies[56], in which falling death rates are followed by falling birth rates, reducing dependency ratios and allowing a rise in domestic savings and output per head, is not yet apparent in the island states.

The levels of education, health and quality of life of people vary considerably between states, and in the bigger states, between regions of the same state. The average years of schooling received, according to census data, ranges from 2.1 in PNG to 9.1 in Samoa, with school age enrollment percentages from 44 in PNG to the high 90s in the Polynesian states. Only about one-third of primary school leavers go on to secondary school in PNG, Solomon Islands and Vanuatu. Literacy rates are suspect because of definition and measurement problems, but the available evidence broadly fits with years of schooling. Average life expectancy at birth shows a similar pattern, at just over 50 years in PNG and over 70 years in Cook Islands, Fiji, Samoa and Tonga. Health services are far more accessible in the compact Polynesian states than in rural Melanesia. Disease patterns differ markedly, with Melanesian populations particularly exposed to malaria (except in Fiji), respiratory and fly-borne sicknesses. Polynesians and Micronesians are less exposed to infectious diseases, but more likely to suffer cardio-vascular or diabetic life-style diseases. About 650 cases of HIV infection, including 250 AIDS cases, had been reported at the end of 1996, almost 90 percent of them in PNG, but health authorities believe the actual incidence may be considerably higher in several island states.

Broadly the pattern is that in the Polynesian states people are better educated, live longer and are materially better off than in Micronesia or

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[56] ADD (1997).

Melanesia. They have assimilated immigrant communities by intermarriage over several generations, and are more actively engaged in small and medium-sized enterprises and in trading domestically-produced goods and services, linking their less scattered urban and rural areas. Higher levels of education make them better able to learn new skills, but they are also more able to emigrate, and many do. In Melanesia and parts of Micronesia, economic activity is more racially stratified than in Polynesia, with a distinctly Asian bourgeoisie and a European managerial class. In other parts of Micronesia, long and varied colonisation has blurred ethnic boundaries. In Melanesia, as small numbers of indigenous entrepreneurs move into the upper income strata, often combining business with brokering deals between foreign and local interests, a visible wealth gaps opens up between them and their fellow-nationals. This is tolerated by most Melanesians, whose tradition expects some people to out-achieve others, provided a reasonable amount of redistribution takes place[57] and the newly-rich do not cut themselves off from their origins. But redistribution does not normally extend very far. In the more heavily populated and poorer-endowed rural areas and in the urban squatter settlements, low levels of education, inadequate public health services and lack of legitimate ways to earn a living combine to produce conditions of relative and in some areas outright poverty, in which criminal activities and organisations can flourish. National and local authorities have been slow to recognise and come to grips with these problems; perhaps fixated on the tourist image of the happy isles ("Fiji -the way the world ought to be" as the pre-coup poster had it), they tend to think of rural areas in terms of 'subsistence affluence' existing happily under customary governance, and unruly urban settlements as somehow temporary phenomena.

Wage employment is the most direct form of participation in the cash economy. The number of people in paid jobs in 1990[58] ranged from 214,000 in PNG and 101,000 in Fiji, through 25,000 in Solomon Islands and 20,000 in Samoa, down to 10,000 in Vanuatu, 9,000 in Kiribati and 8,000 in Marshall Islands. These represented only 16 percent of PNG's labour force, and 19 percent in Solomon Islands and Vanuatu, but 60 percent of the labour force

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[57] Paying school fees for relatives children, accommodating visitors for extended periods, providing large donations to family feasts, marriage payments etc.

[58] ANU (1993)a. Inter-country comparisons and aggregates are again bedeviled by problems of definition (see above on national income) such as "economically active" and "labour force participation" and incomplete data collection. Within one country, time-series are of some use if one assumes the same definitions and collection methods are continued, so errors maintain the same relation to fact; but consolidated data is less useful.

in Tonga and 42 percent in Fiji and Samoa. Overall, about one in five persons in the labour force had a wage-earning job (this aggregate is affected by PNG's relative size).

However the labour force is defined, there is no doubt that it is growing faster than the overall population, because of the population age structure; and that the proportion of active job-seekers is rising too, because of the effect of education and communications on young people's ideas of what they want to do. People who will enter the work force over the next 15-20 years are already born, so a decline in fertility rates will not greatly affect demand for jobs for the next two decades. Estimates made by the Australian National University (ANU), referred to above, made assumptions about continued emigration from Tonga, Samoa and to a much lesser extent Fiji, and projected labour force growth over the period 1991-2011. The projected increases ranged from 102 percent in Solomon Islands and 95 percent in Vanuatu, through 55 percent in PNG and 43 percent in Fiji, down to 18 percent in Tonga and 10 percent in Samoa.

On those assumptions, Tonga and Samoa have a fair chance of sustaining economic growth (given sound policies, continued emigration and reasonable luck) at rates that would more than keep up with their labour force growth. But in the Melanesian and Micronesian states, including Fiji, the problem is quite different. In PNG around 36,000 young people are joining the work force annually, while the rate of wage job creation in the private sector appears to have been 2-3000 jobs annually, or around 7 percent of the work force increment: merely to maintain the 1990 ratio of wage job to workforce, job creation rates wouid have to double. In the 1970s and 1980s, public sector employment grew rapidly in most island states, associated with independence and the abundance of foreign aid. Times have changed, and public sector jobs are under threat now in most states. In Solomon Islands and Vanuatu similar patterns exist to that of PNG, raising the clear prospect that formal wage employment will absorb a decreasing share of the labour force in years to come.

It is inevitable then that informal activities must absorb most of the work force increment. If these pursuits are to be productive and peaceful, rather than violently redistributive, governments, business and civil society have a lot to do in a short time to enable such growth to take place: access to land and worksites, affordable transport infrastructure, technical and small-business training, help with marketing and design, access to small credits and linkups to supportive groupings, urgently need increased attention in all island states, but especially Melanesia and Micronesia. Informal financial systems exist to support informal, household-level enterprises and need clearer recognition as the most efficient way of mobilising small-scale savings and retailing credit. The investment costs per job in the informal sector are a tiny fraction of those for formal employment, amounting commonly to a kit of tools and a covered place to use them, a sewing machine and a table and cupboard, or a drum oven and a foodsafe, or a pushbike or handcart for deliveries, together with working capital for a small stock of materials. From these grow repair shops, sewing businesses and bakeries, linked by pick-up trucks and vans, and the capital accumulation that leads on to bigger enterprises.

The chronic neglect of women's potential in social and economic development is only slowly being put right. The situation is worst in Melanesia, where women and girls have far less than their due share of access to education (and so are less successful family managers/mothers/wives, producers or entrepreneurs than they otherwise could be), and are vulnerable to physical abuse by men seemingly unable to adjust to a more equal relationship. In Polynesia school numbers and literacy rates are much more even, and chiefly and other exceptional women have long been eligible for public office and business careers. There is abundant evidence that investment in women's education pays off in reduced fertility, healthier families, better managed households and businesses, and the advent of talented and imaginative persons to public service. But the males now occupying school places and jobs in male-dominated PNG, Solomon Islands and Vanuatu are not going to give them up for females. The leveling-up process will take a long time, as the effect of more even-handed access at the entry level works its way through the system. Meanwhile, in all the island states, concerned and educated women are making themselves more effective in civil society, taking charge of key issues of environmental and social management left aside by men as unmanly or unrewarding, and women are emerging as owner-managers of a wide range of small businesses in tourism and other sectors.

The conditions in which island peoples make their lives thus vary according to access to land and sea, traditional constraints, contact with outsiders, proximity to town and market opportunities. The difference between the top and bottom of the scale of well-being is judged by most observers to be steadily widening. At the same time, the spread of education and the mobility of people and ideas are raising awareness, ability to form judgments and express views about social and economic injustice. Increased attention is also being paid to these conditions at national and international level. The term 'human development' has come into use in recent years to mean the level of physical and mental well-being of people, and their ability to exercise choice about how they will live. The term embraces both the present human condition, seeing development as the product of an evolutionary process; and efforts to change it, seeing development as a set of activities that people do. The shift of focus onto human development has been led by UN agencies, notably UNDP, as a reaction to what they saw as excessive concentration on economic growth by a World Bank/IMF-led alliance of institutions and governments. Economic growth was necessary for human development (this was not a no-growth philosophy) but the new focus looked wider than increase of incomes and wealth. It looked at health, education, access to resources and opportunities, rights and freedoms and participation in the governance process.

The concept of human development at first resonated rather comfortingly with the island governments. They saw that they already embraced most of its objectives and criteria in their development plans, and there was a widespread assumption in policy-making circles that the continued strength of custom and the subsistence sector somehow made up for otherwise worryingly low levels of economic growth per head. There was a feeling among people at the top that the Pacific islands were pretty good at human development, whatever their other shortcomings.

This complacency has been disturbed by several factors, internal and external. During the latter part of the 1980s it became clear that open unemployment was rising, as large members of school leavers failed to find jobs and hung around in town. Crimes against persons and property rose, alarming the resident bourgeoisie and tourists alike. Muggers and beggars began to appear on the streets of the larger towns, and children were seen scavenging on municipal rubbish tips. Squatter settlements grew rapidly, outstripping investment in urban infrastructure and services. Great disparities of income, now including not only foreigners but also wealthy nationals, became apparent in large houses and luxury cars, creating growth industries in security services and erection of high fences. It became apparent that custom, in the sense of what people regard as behavioral norms, was changing fast, to accommodate a degree of concentration of wealth that would have been impracticable in a non-cash economy. Money could be hoarded, concealed, redistributed, relocated and invested or consumed in ways that yams, pigs and mats could not.

Governments were blamed for failing to come to grips with these problems. In the larger Melanesian states, with a more egalitarian tradition and fewer inhibitions about expressing dissatisfaction with top people, public criticism of government failure was articulate and well-informed. Politicians were depicted as pre-occupied with enriching themselves and their cronies, abandoning their responsibilities to their electorates. Vigorous and innovative non-government organisations, such as the Solomon Islands Development Trust and Vanuatu's Wan Smol Bag Theater, developed to provide alternative philosophies and equip people with a better understanding of their condition and prospects. In the Polynesian states with a hierarchical society and a stronger tradition of deference to people in high places (Tonga periodically jails journalists for saying rude things about the government), in the ocean vastnesses of Micronesia, and in Vanuatu where the media had been effectively under government control since the upheavals at independence, criticism of governments by their people was less open, but in private and when meeting overseas it was just as well-informed and articulate.

In 1993 ANU's National Centre for Development Studies released a series of demography-based reports under the title 'Pacific 2010'[59]. These gave a conceptual framework to the growing unease among the island states that all was not well with the development process. The reports used projections of population growth and national income to highlight the crisis in education and health services, employment and urban settlement. The prospects and problems were starkest in Melanesia, where the present poor quality of social and economic infrastructure combined with rapid population growth meant that it would be extremely difficult to raise standards of well-being and access, even if the economies achieved better rates of economic growth. The Micronesian states also faced intractable problems in creating sufficient growth in the economy to improve wealth i.e. well-being and access per head, in the context of the atoll environment and the imminent decline in levels of external transfers (FSM and Marshall Islands). Polynesian states were generally better placed, because of the better quality and coverage of existing education and health services, and because population growth was continuously relieved by emigration; provided Cook Islands[60], Tonga and Samoa could continue to export people on a long-term remittance-transferring basis, their domestic economies had a good chance of looking after those who remained. Everywhere, though, and particularly in Melanesia, ANU argued that the pressure of increasing population meant that strongly growth-oriented economic policies were essential, involving more efficient public sectors, more flexible price structures, and greater openness to international trade.

[59] ANU(1993)aandb.

[60] Though the seed of the fiscal crisis that struck Cook Islands in the early 1990s had been planted, at that time the economy was still growing strongly.

The economic policy message was not new, but the use of demographic projections to drive it home was. The studies themselves contain numerous caveats about the quality of the data and the reliability of the projections, but these were overlooked in the publicity surrounding the publication of Pacific 2010 and subsequent public discussions. Rowan Callick, a financial journalist specialising in the Pacific, provided a doomsday scenario for the year 2010 that struck many readers as all too probable - indeed parts of it were already reality. But the message that serious stmctural changes were needed if doomsday was to be avoided lost some of its effectiveness by being closely identified with Australia's bilateral aid policies. In 1993-94 the Australian government became increasingly concerned at the poor performance of the island economies on its doorstep, whom it was committed to assisting, and it was not shy about saying so. Australian aid funded the 2010 studies and subsequent efforts to get the results into the hands of the public and policy-makers. Signs of audience fatigue began to show, the dire predictions being discounted by some island leaders as unnecessarily gloomy, and criticised by others as part of an Australian agenda to open up the islands to greater foreign influence.

Into this debate, UNDP launched its 1994 Pacific Human Development Report[61]. This reviewed the human condition in the Pacific islands, asserting "whilst income growth is fundamental, human development demands that income be distributed equitably and that basic human needs be met for all people." The report articulated the links between social and economic progress, relating population growth to environment, education and health to economic capacity, public sector performance to growth of output, and public participation in governance to the equity and sustainability of the development process. Scoring on a global index of human development using life-expectancy, educational attainment and national income per head as the indicators, most island states came into the medium category, with the unsurprising exception of PNG, Solomon Islands and Vanuatu, who were in the bottom group.

It is not clear how much impact the UNDP report had on Pacific island policies and actions. The picture it presented probably meant less to governments than the daily complaints about lack of school places, no medicines in clinics, increased malaria, failed water supplies and school leavers unable to find jobs. But it helped aid donors to see how their assistance

[61] UNDP (1994).

could be better targeted if they want to improve the human condition in the islands; and with regular updating and national follow-up it provides a benchmark for monitoring progress. The report's immediate role was as the background to an intergovernmental meeting on Sustainable Human Development in Suva in 1995 leading to a Declaration (subsequently endorsed by the Forum) with 15 strategy options and 107 recommendations. It was a feel-good declaration that rocked no boats. Most of the strategy options already formed part of governments' published plans, some of them five or ten years old. The call to put people at the centre of development was not difficult to endorse in regional or national forums. But the question remained, which people? There was not room for everyone at the centre; some people were already much closer to it than others, and unlikely to move over for newcomers. As political power and personal wealth either coincided or supported each other, where would the will to make substantial reallocations be found?

## 4.2 CUSTOM AND LAND TENURE

Custom, in the sense of ageless traditions that guided behavior, allocated resources, bestowed or withheld power and resolved disputes, now seemed an unreliable touchstone for the development process. Custom was difficult to define because it was essentially oral, a collectively remembered structure of relationships and events that shed indirect light on principles, rather than making explicit statements of them; and it was inherently flexible, evolving over many generations of occupation of territory by related groups of people, adapting to the realities of population pressure, warfare and, perhaps most traumatically, the advent of foreign missionaries, traders and governors.

Like physical parameters of the human condition, custom varies widely between islands and even between parts of islands[62]. There are broad distinctions between more structured, hierarchical Polynesian societies where authority and access to resources is commonly (though not always) determined by descent, and the Melanesian societies where authority is commonly (though not always) contestable by achievement and display, access to generally more abundant resources is more fluid and, from the standpoint of would-be modernisers, more chaotic. But these generalisations are at once undermined by evidence that people are everywhere modifying

[62] Among a wealth of material, see most recently Ward and Kingdon (1995) and ADB (1996 b).

custom, in the sense of what they actually do and tolerate others doing, to accommodate their current (and changing) economic and social needs; while at the same time talking about custom, in the sense of a known set of rules handed down from the past, as if it still governed their behavior. The more individualistic attitudes of Melanesia, perhaps by giving freer rein to people to succeed or fail, seem to be openly accommodating greater extremes of wealth and poverty than the somewhat more restrictive and status-centered societies of Polynesia (see Box G).

Strategies to promote growth have to take account of the chaotic but dynamic flexibility of the way people actually arrange their lives. They are not as tightly bound by customary obligations as they sometimes make out. At the same time, if they want to retain access to the network of customary relationships, they ignore those obligations at their peril. This duality is apparent throughout the Pacific. It applies to kin and in-law relationships, family planning, caring for young and old people, house design and furnishing, conduct of businesses, crime and punishment, use of production surpluses, management of savings and loans, wage-employment ethics, contributions to extended-family needs, church donations, parliamentary elections, choosing of chiefs, farming practice, village and urban hygiene - the whole range of the human condition exhibits unstable and evolving characteristics as custom variously adapts to new needs or fades away.

Nowhere is the gap between what custom says and what custom does wider than in land tenure. The description in Box G stresses the continuing importance of formal recognition of customary relationships. But evidence from land tenure studies in all three cultural zones of the Pacific[63] has shown how the ways in which people occupy and use land, and the bundle of use rights they are able to assert vis-a-vis other families and individuals have changed under pressure of introduced crops, technologies, more people and monetisation. Enterprising persons have developed balancing skills that enable them to respect custom for its unifying, identity-strengthening properties while modifying its details to accommodate individual investment, accumulation and distribution of wealth on a more or less permanent basis: a kind of informal perpetual leasehold, .vhere tenure is uninterrupted provided reasonable obligations are fulfilled.

Attempts to preserve custom by codifying it, or to preserve some of its institutions, such as chiefs, by giving them statutory authority, are bound to

[63] For example, Ward and Kingdon (1995).

Box G

**Maintaining Customary Territorial Rights**

The Pacific islands are divided into hundreds of small territories under the control of groups of people with a common identity and culture. These territories are internally divided into estates controlled by landowning groups usually linked together by kinship, hi the larger islands of Melanesia the territorial system divides the land like a patchwork quilt. Territorial groups control different zones such as coastal plains, areas of foothills, river valleys and highlands valleys. A certain degree of ecologically determined economic specialization in particular crop mixtures developed over time, as well as pre-colonial trade between territorial groups in daze blades, salt, pottery, woven goods, special woods, shell goods, decorative feathers, and food stuffs. Political organization was usually based on groups of men sharing a men's club house amongst whom there was competition for leadership roles. Rights in land involved complex sets of overlapping claims, often including primary and secondary rights among different groups and individuals. In the high volcanic islands of Polynesia (e.g., Rarotonga, Mangaia and Atiu in the Cook Islands, the Samoa islands) and Micronesia (e.g., Ponape and Kosrae) and the larger raised coral islands (e.g., Tonga), territories were usually larger than those of Melanesia due to the more extensive political outreach of the ranked, hereditary chiefdoms under which the islands were once governed Typically territories followed valley systems and extended from the central mountain ridge to the outermost offshore reef. Each island was thus divided like a sliced pie. Each territory contained approximately the same range of resources, thus large-scale gift-giving between political entities was more common than trade; however inter-island trade existed in valued commodities and goods. Atolls, being narrow strips of coralline land encircling a lagoon, were divided into territories based on islets or groups of islets and subdivided into household plots; each plot extended in a "slice" from the ocean side across to the lagoon side of the islet.

Most Pacific island societies have firmly established traditions of gift exchange and property redistribution practiced to the present day, and in many cases integrated with Christian and other introduced social institutions. From an ecological and economic standpoint, this common and widespread practice in Oceanic societies redistributes non-storable,

*continued next page*

*Box continued*

perishable surplus commodities such as meat, fish and root crops. However, the practice also has many additional complex functions including the recognition of political authority and land rights. The pooling and redistribution of food, other property, and nowadays of cash, assists the maintenance of leadership roles in which chiefs or headmen or persons aspiring to increase their socio-political status sponsor feasts or ceremonies involving large exchanges of property between groups, to mark marriages and funerals and other important occasions. The "givers" compete to present more than can be given back in return, in order to win personal and collective prestige. Individuals contributing food and other goods to a common pool for presentation on behalf of their kin-group are thus able to validate and demonstrate their membership of the kin-group, and thus their rights in the common property of the group. Where land is held in common, the validating function of gift-giving and contribution to the kin group is even more important today, when people are more mobile, than in the past.

Note: This description is gratefully borrowed almost verbatim from ADB (1996 b).

defeat themselves (though they may serve other purposes, possibly beneficial in other ways). As soon as the process of codifying custom begins, the nature and content of custom itself is changed. The observer/recorder unavoidably intervenes in the evolution of what is being recorded. It is impossible to observe all aspects of complex systemic change. Those parts that are observed are captured and frozen in the codification. Others continue to evolve, but with a changed relationship to the codified parts. Interests that present themselves for codification are enshrined and formalised, losing their ability to evolve. If society still needs the informal version, it will re-emerge and continue to evolve, shrugging off its codification like a discarded skin. Other precepts that are left out of codification do not cease to exist, but remain informal, flexible, adaptive.

The best example of this in the Pacific is Fiji's native lands legislation. In the name of protecting the customary land rights of the Melanesian Fijians, and after a massive field study, the law defined the extent of native lands, registered their ownership, classified the land for tenure and development purposes and established a Tnist Board to hold and deal in developable land on behalf of the customary owners, paying them rent that would be distributed according to a formula recognising several levels of chiefly rank. Whatever its merits as a way of bringing agricultural land onto the market in an organised manner to support the sugar industry (and it seems to have substantially succeeded in this), land legislation in Fiji did not protect or preserve customary land tenure. It set in statute an approximation of the state of land rights at the time it was enacted. Further evolution became legally impossible except as provided by law. In practice, as time has passed, many pragmatic and necessary modifications have been made, to tenants' rights, boundaries, distribution of rents; but none of this is legal, and its illegal status has almost certainly handicapped its evolution while depriving the process of transparency and accountability (both of which seem to have been present in pre-statute custom). On a much smaller scale, a similar fate has overtaken experimental tenure conversion work done in PNG and Solomon Islands in the late 1960s, where 'neo-customary' informal tenure practices have reasserted themselves in most of the tenure conversion schemes carried out at that time to test the practicality of changing from a customary to a registered title system. In that case, total neglect of the areas by the authorities since the survey, dispute settlement and registration work was done has no doubt contributed to the lack of any discernible results.

The post-customary turbulence of family and community relationships is exacerbated by the big difference in educational attainments between children and their parents. This is most marked in Melanesian communities, but occurs throughout the region. Children in full-time education are absorbing non-traditional values and information that make it harder to settle in a village when they leave school. Compounding this effect, video cassette players projecting onto big screens are bringing uncensored images of the outside world into the remotest villages (operating a village cinema is a common form of rural business, and if the movies had some educational content it could be a socially useful one). Ideas of moving from the village to the city (in Polynesia the city may be Auckland, Sydney or Los Angeles) are thus part of the mental currency of adolescence across the island states. Considerable stress can result from the gap between what young people dream of doing and what they can do, and parents are sometimes unable to handle this problem except by rejecting it. Suicides among young people are a wonying phenomenon in Samoa, and teenage crime is increasing in most island states.

## 4.3 EMIGRATING AND MOVING TO TOWN

As in other countries, Pacific islanders have long reacted to social and economic frustrations at home by moving away. In the 19th century, many young men and a few women went off (many thousands were forcibly taken, but many others went looking for prestige and adventure) to work on ships and plantations in places of which they had only the vaguest notion. The labour trade mostly affected Solomon Islands and Vanuatu, but all the Pacific islands were touched by it in some way. For the past forty years people have been emigrating from Tonga, Samoa and Cook Islands to the Pacific rim countries where they have citizenship, right of entry, or relatives they can visit and with whom they can ‘overstay’, albeit at some risk of being caught and sent home. Emigration has enabled many thousands of Polynesians, along with smaller numbers of Micronesians and Melanesians, to improve their cash incomes and re-organise some of their customary obligations. Emigrants range from school children and semi-skilled laborers to entrepreneurs and senior professionals. Emigration from Fiji, a trickle until 1987, became a more significant flow of several thousand persons a year after the coups of that year. There are over 150,000 Pacific islanders in New Zealand alone, and close to half a million in all the Pacific rim countries together, half as many as the populations of Fiji and the Polynesian island states added together. Private remittances in the balance of payments (a net figure is normally given in official statistics) in Kiribati in the early 1990s were the equivalent of total export earnings at around 15 percent of GDP. In Tonga, remittances from the 45,000 or so Tongans living abroad (half as many people as in Tonga) were measured at the equivalent of 70 percent of merchandise imports and 30 percent of GDP[64]; but it is believed that substantial remittances are unrecorded, being carried by the 8-9000 Tongans who visit their homeland each year. In Samoa, officially recorded private transfers (net) in 1990-94 averaged one-third of GDP and were six times bigger than exports. As in Tonga, significant unrecorded resources are believed to be transferred by the 27-28000 persons who visit friends and relatives in Samoa annually. In 1997 Kiribati had about 1600 sailors and 200 fishing vessel crew, 2.5 percent of the population, away on overseas vessels, in a well-established and closely-managed operation run jointly with

[64] For references to a considerable literature and debate on conclusions see Ahlberg, (1991) and Brown (1994). Among many helpful insights, Brown points out that remittances are better seen in the context of GNP, not GDP, regarding emigration as an overseas investment of the domestic economy.

the foreign employers. Tuvalu had 600 sailors overseas, around 6 percent of the population, and a further 200 at home on leave or waiting for a crewing vacancy to come up. For both Kiribati and Tuvalu, the export of ships' crews to ocean-going vessels will be even more important if, as seems likely, employment opportunities in Nauru are reduced over the next few years. Remittances are crucial to the balance of payments of these states, and stability-seeking economic policies need to target their maintenance and increase.

The motivation for remittances and their economic effects have been studied in the last ten years with interesting results for policy makers. Physical distance does not mean that customary obligations are necessarily reduced, but they can be converted to the supply of cash or imported goods, and are less pressing in a day-to-day sense (except when accommodating over-stay visitors). Telephone and money-transfer services provide the lifelines of these extended families. Remittances may be seen as returns on a family's investment in education of the emigrant, part of a two-way flow of resources between parents and their offspring; as a payment to discharge obligations and maintain rights in the community at home against a future return of the emigrant (extending to church-building to ensure participation in an after-life); as an income support to less well-off family members at home, an internal redistribution of income within a family's total consumption needs. But remittances also function as an investment of savings generated by the overseas branch of the extended family, deciding where to hold its short-term balances and make its long-term investments, which often include the establishment of businesses at home, by sending cash and goods. As emigrants build up capital and skills overseas, they are well placed to open business at home, without losing their place in Australia or New Zealand. Like the Overseas Chinese, emigrant Pacific islanders may play a valuable role in economic growth 'back home'. These motivations are relevant to the making of policies that would stimulate and sustain remittance flows well into the future: investment at home must provide a return, in socio-economic terms, competitive with spending or keeping the money overseas. Interest rates, exchange rates and controls on the movement of funds will all influence family investment decisions: easy movement of capital in and out will be essential to emigrant investment at home.

Besides these continuous flows of voluntary emigrants, which also generate a significant level of visitor traffic back to the ancestral home, there are substantial old-established communities descended from indentured or abducted Melanesian workers who settled (i.e. they chose not to return home, and avoided forcible repatriation) in Fiji, Samoa and Queensland.

More recently there have been several one-off relocations of island people in response to sharp changes in circumstances at home. Ocean Islanders (Banaabans) moved to Rabi Island in Fiji under pressure from the British administration to make room for more phosphate mining, while people from Vaitupu in Tuvalu bought an island in Fiji as an extension of their community. A move with wider repercussions was the resettlement of about five thousand people from the drought-stricken Phoenix Islands to government-owned land in Solomon Islands[65]. The move took place in two waves, in 1956 and 1963. This pre-independence infusion of Micronesians into Melanesia was carried out by the two colonial administrations, under Britain's Western Pacific High Commission. The settlers were physically and culturally distinctive, and in the way of immigrant communities, soon began to do disproportionately well in education and employment, to the irritation of their Melanesian hosts. In the run-up to Solomon Islands independence there were calls for the immigrants to be sent home, and the terms of the independence settlement with Britain were improved (and the citizenship rights of the immigrants circumscribed in respect of land ownership) to buy off this demand. The settlers are now well into their second generation, and intermarriage is gradually blurring the ethnic boundaries, but some racial sensitivities remain. This relocation, despite its humanitarian basis, would probably have been unacceptable to an independent Solomon Islands government, and points to questions that will arise if and when climatic or economic hardships force further resettlement of atoll communities.

For the great majority of those people who live in Melanesia (other than Fiji) and in the Micronesian atolls, emigration is not an option. Their escape route from the rural areas, as and when the combination of customary constraints, cash-cropping enclosures and growing population denies them economic space, is to the rapidly expanding towns. The pace of this expansion is remarkable. In a region of fast-growing populations overall, except where the increase is vented by emigration, towns are growing two or three times faster than the overall rate. Much of this growth is concentrated in the capital city and one or two other towns. In PNG in the early 1990s, when about 15 percent of PNG's population lived in 79 urban centres[66], Port Moresby and Lae, with about 300,000 people, accounted for half of the urban population. The towns are now much bigger, and Port Moresby alone contains more

[65] The islands they left in the Phoenix group are now the subject of study by the Kiribati Government, looking for opportunities to market their remoteness and exclusivity.

[66] ANU(1993)b.

people than the populations of Tonga and Samoa combined. Greater Suva with about 200,000 people accounts for half of Fiji's town dwellers. Fiji, which had 43 percent of its people in urban areas in 1994, is the most urbanised island state except for Cook Islands, Tuvalu and the Micronesian atoll states, where typically half or more of the population is squeezed into the capital town. In Vanuatu and Solomon Islands the towns of Port Vila and Honiara are estimated to be growing at 6-7 percent annually, doubling in less than ten years. As in Port Moresby and Suva, new settlements are springing up in and around these capital towns, outstripping the ability of water, power, road construction and waste disposal to reach them, and housing incoming families in shacks of salvaged materials.

Government policies before and after independence have failed to bite the bullet of urban growth. Priority in development plans has been given to decentralisation and the promotion of rural-based activity, with very mixed results in terms of economic growth and no noticeable effect on the rate of migration to town. The economic planners' attitude to towns seems to have been to hope they would look after themselves, performing a useful economic function without causing social problems. Where manufacturing has been promoted, little thought has been given to the consequences for the urban infrastructure where the industries would be located. The management of the complex connections between private and public investment, transport systems, housing, waste disposal, education and health services, law and order and the institutions of civil society has generally not attracted political or administrative high-flyers. The consequences of years of mismanagement or sheer neglect are apparent in most Pacific towns[67].

These conditions are a drawback to economic growth. Towns are potentially a powerful positive force in economic and social development. The gathering together of large numbers of people, of varied skills and capacities, in a climate that does not require much weather protection, offers great scope for productive interaction. Much of this springs up spontaneously once the critical mass of producers and consumers comes together; but a number of undesirable phenomena spring up too in communities that are adrift from their accustomed behavioral anchors. People need a job and a place to live. It is already clear that informal economic activity must provide the livelihood for most of the Pacific islands workforce now and in future.

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[67] There are occasional bursts of activity, when years of un-done maintenance is rolled up into a hasty rehabilitation project. This is the Royal Visit syndrome, or nowadays perhaps the Forum Meeting syndrome.

Urban management has to find the right amount of intervention, and the right way of intervening, to lay down a basic grid of services and standards in water, power, health, education, security, and provision of land for living, producing and selling goods and services: and of getting people to own and operate as much as possible of this network themselves. It is not as if nothing was known about the solutions. Time and again, a secure title to a piece of land, however small, together with affordable access to services, has been shown to be the key to self-help housing and urban community development. The necessary revolution in Pacific towns is partly a technical process of infrastructure and commercial investment; but equally a social process of liberating and dignifying people who are now regarded as a nuisance by their countrymen who live in big houses behind security fences.

Increased investment in the planning and management of urban areas is in many ways more urgent, and will produce higher socio-economic returns, than a similar investment in the rural areas. Governments and aid donors alike have been slow to recognize this. On the one hand, the consequences of continued neglect and mismanagement in terms of public health, poor living and working conditions, disintegration of families, break down of law and order, rising costs and frustration of manufacturing and processing industry and interruption of transport and communications, will impose enormous costs on the already fragile economic prospects of the island states. And on the other hand, the returns available on a million dollars spent in repairing, renovating, un-blocking and releasing the social and physical energy stored up in urban communities greatly exceed the returns on the same sum spent extending services into remote and lightly populated areas. This is not to deny the need to invest in rural development; but to insist that the whole economy will be strengthened, and better able to distribute opportunities and welfare more widely, if the political economy of the towns can be got right. There have been a number of nods in the direction of this proposition in the last few years, but so far no adoption of it as a deliberate strategy.

## 4.4 ENVIRONMENT AND SUSTAINABILITY

All forms of economic activity have an impact on the environment, by drawing inputs from it, disposing of outputs into it and setting up systemic ecological reactions that may be only partly understood, but certainly cause changes in the environment's capacity to support life. The environment in turn has an impact on all forms of human activity, sometimes violently, sometimes gradually. Among the Pacific islands the most important forms of human impact on the environment are in natural resource use and waste disposal; while the generally benign environment nevertheless delivers storms, earthquakes, landslides, volcanic eruptions and the creeping effects of global warming and associated sea level rise. Much of Micronesia and PNG lies outside the cyclone belt, but Polynesia and the rest of Melanesia are frequently crossed by these destructive storms. Not all cyclones hit populated or developed islands, but when they do, considerable damage results to dwellings, infrastructure and crops. The World Bank observed in 1995 that exports had fallen by one quarter to one half in the years immediately following cyclone damage in Fiji, Vanuatu and Samoa. Overseas assistance is promptly extended to help in rescue and immediate relief, but longer-term reconstruction diverts substantial resources from other maintenance and investment needs.

The smaller the islands, the more immediate and severe are the consequences of mismanaging the relationship of activities to environment, and the greater the risk of cumulative collapse or catastrophic damage from climatic events. But in all island states people live in close proximity to nature, and the traditional ways of managing that interface are crumbling under pressure of population growth and the use of imported technology. Examples of deterioration can be found in all sectors. Agricultural methods are in uneasy transition from shifting fallow to intensive cultivation of fixed plots, with nutrients depleted and yields declining. Logging of the forest is causing widespread damage to surrounding and downstream areas and to the forest's regenerative capacity. Intensive fishing of near-shore and lagoon stocks, particularly by non-residents, leads to declining yields and threatens the collapse of the fishery[68]. Manufacturing industries create nuisances and pour out toxic effluents into ground water reserves and nearby lagoons. Tourist hotels block off beaches and deprive poorer town residents of recreation space. Mining creates river pollution and the risk of catastrophic damage from collapse of tailings dams and other earthworks. Informal settlements in towns lack water and waste disposal systems and create substantial fire risks. Tax concessions on vehicle imports create traffic jams of air-polluting vehicles and help to destroy under-funded public roads.

[68] There are a some positive developments that may have wider application. Experience in Vanuatu, cited in World Bank (1995), indicates that collaboration between fisheries extension staff and traditional authorities can successfully use customary marine tenure systems to enforce closed seasons on trochus and beche-de-mer. Fiji is embarking on an ambitious programme of registering customary title to inshore marine areas, to promote sustainable management. Palau is also moving to harness customary knowledge and methods to manage its vulnerable inshore fisheries.

Urban water and sewerage systems fail through under-investment and lack of maintenance. Municipal and village rubbish dumps lie uncontrolled and untreated, creating health risks and attracting poor people as scavengers. Putting those together does not read like the typical tourist brochure's island paradise. Yet they all occur in some islands, and some islands have them all. In the bigger islands the lower overall population densities (more environment per head) help to hide what is happening, but in the atolls, and above all in the urbanised atolls, the environmental crisis is unmistakable in sights, smells and public health statistics.

Global warming, and an expected rise in the sea levels and temperatures and the frequency of violent storms, have been hanging over the Pacific islands for a decade. A high proportion of island people live on or close to the high-water mark. In the high islands, they mostly moved to the coast from more easily defended inland sites when tribal warfare was ended by colonial and missionary influence. They could move back inland, but the economic and social costs would be high. For the atoll peoples, where a one-meter rise in sea levels would inundate whole islands and there is no protection against violent storms, migration to high islands or Pacific Rim countries would be necessary. Island governments have been active in getting their concerns onto the agenda at world environmental fomms, and in the last five years have made some progress internationally in describing the problems and elbowing out space for Pacific issues in global policy statements. Policy responses at home have been less impressive, partly because of uncertainties about the accuracy of the predictions and the gradual, politically unexciting nature of the process, and partly because of the sheer difficulty of knowing what to do about it. Sustainability itself is a more complex and elusive concept than it first appeared (Box H). There are always plenty of reasons for prolonging discussions and undertaking further analysis. It is hard to see real changes in the way people, governments and corporations behave, despite the rhetoric.

A potentially valuable step was the preparation in the early 1990s of National Environmental Management Strategies (NEMS) for all the island states, and their adoption by governments. These provide baseline data and guidelines for action on environmental issues. The level of awareness and commitment in governments remains in some doubt, but NEMs provide useful reference points and some policy leverage for pushing governments into action. A joint report in 1996 by SPREP and ESCAP described progress in the Pacific Islands on implementation of a programme agreed in Barbados in 1994 to enhance the sustainability of small island states. It reported that

Box H

**Whose Sustainability?**

Examination of sustainability itself requires definition of the system or subsystem whose ability to be sustained is in question. Is it the firm, the individual sector, a bounded ecosystem, the national economy? Unsustainability can be externalised, and frequently is: my benefit, your cost. One policy or set of actions may be sustainable only at the expense of others; this is implicit in the dynamics of market-oriented economies. A system may outlive its usefulness, and sustaining it may be a waste of resources. The relative social value of competing activities may not be represented by market prices. Consumption and investment may be valued diiTerently by today's market participants, and by an external sustainability monitor considering future needs.

It is clear that sustainability does not imply resistance to change. Observation of all kinds of natural systems shows that change, decay, conflict and the emergence of new forms and new relationships is going on all the time; if this is not so, the system is dead or dying. Sustainability of a system does not mean that all its parts must or will be sustained: they consume, procreate, replace each other continuously, at many levels and in complex ways, some in micro-seconds, some over eons of time. In a social and economic sense too, change is essential to survival: technology, relative costs, human skills, resource availability are all in a state of perpetual change, and continuously cause the rise and fall of firms, social classes and nations.

Equally, sustainability does not mean self-sufficiency, but that any elements of dependence must themselves be sustainable. Systems commonly regarded as sustainable routinely operate under stimulus from external forces, or by drawing resources from elsewhere. The flow of resources needs to be assured. The heat of the sun powers the earth's climate. World demand for manufactured exports drives the Japanese economy. The sun's sustainability is for practical purposes not in question (or if it is, there are no policies for fixing it). But world trade is a phenomenon requiring constant attention so that it can continue to power a myriad of inter-linked economic systems. Moreover, to say a system is sustainable is not to say it will necessarily be sustained, only that it is capable of so being, if certain conditions are fulfilled, i.e., other systems that it depends on are in turn sustained.

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There is a natural tension between the desire for stability, often thought of as akin to sustainability, and the desire for change. In politics, well-placed people may advocate stability, perhaps in the name of sustainability, because they fear change will redistribute costs and benefits to their disadvantage. Poorly-off people may advocate - even die for -change, on the grounds that anything, including what the rich people castigate as unsustainable, would be better than what they have now. In the technical area, central bankers in developing countries have long had to advocate 'stability with growth', while their development planner colleagues espoused 'growth with stability'. Both have been conscious that growth and stability are conflicting objectives, but they have been understandably cautious about specifying the trade-offs implicit in their statement.

Explicit concern about sustainability came to public notice in the context of the interaction between population and environment: awareness that the planet's natural resources are effectively finite, and under mounting pressure from a hungry, wasteful and growing population. It quickly became apparent that even here sustainability is not a simple concept.

Technology, education and costs change the volume and value parameters of resource use for a given population. Simple ratios of tons or cubic meters per head are inadequate criteria of sustainability. At one extreme, it is argued that correct pricing will restore supply-demand equilibrium. Experience with oil prices and fuel consumption offers some support for this, but the required market reforms have in turn been politically unsustainable. The concept of sustainability has to be redefined for each context in which it is applied.

climate and sea level change is being more effectively monitored, and preparedness for natural disasters has improved. Waste management is unsatisfactory, though the idea that it can make good business sense seems to be spreading, with a number of firms now actively engaged. Toxic wastes are a serious concern. Proposals to use remote islands to store such wastes from industrialised countries have been aired from time to time. The 1995 Waigani Convention seeks to ban such impoi Lation, and has been signed by most Pacific governments, but the Marshall Islands, with several of its atolls earlier made uninhabitable by US bomb tests, is still thinking about it, amid a vigorous domestic debate. Fresh water resources are generally in need of protection. Coastal and marine resources are of extreme importance to the islands but few governments have given much thought to integrated coastal management, which is a complex and long term undertaking. Comprehensive, detailed legislation, which would be difficult and costly to administer, has been prepared in Fiji, and is under consideration elsewhere.

In the context of growing world interest in natural sources of genetic material, the biodiversity of the Pacific islands is widely acknowledged and is attracting both conservative and exploitative attention. The ADB's island members (except Tonga) are signatories to the UN Convention on Biological Diversity, and have a strong interest in conserving their stocks of diverse creatures, plants and organisms, and in obtaining fair returns for giving access to these stocks to outsiders such as international pharmaceutical companies and research institutions. But they have no money (according to current priorities) to do much about this, and the record of PNG and Solomon Islands in forestry does not augur well for their management of biodiversity resources. There are signs, though, that this time Pacific universities and research-oriented institutions in Australia and New Zealand may help to awaken island communities and usefully broaden the debate.

Meanwhile governments have been trying, without much enthusiasm, to 'mainstream' environment issues in policy making. This involves assessing the environmental implications of a policy or project at a very early stage, before it acquires momentum that makes it difficult to change. For very large projects, a detailed environmental impact analysis is now routinely required and the standards are pretty well understood, but for most projects and activities oniy lip service is paid to environmental concerns. The lack of enthusiasm for mainstreaming seems to relate to a common weakness of the decision-making system itself, namely that technical inputs to policy and project choice do not carry much weight at the political level[69]. When environmental impact has been identified, usually in the form of social costs perceived by the project sponsor as external to the project, the question arises of who will pay. The idea that the community, as owiier of the environment, is entitled to be compensated by persons causing environmental damage is gaining acceptance, but is not yet widely implemented. The costs can be substantial. The enormous cost of repairing environmental damage caused

[69] The wider malaise of development planning, that has led to the exclusion of economic planners from the process of policy-making in many island states, has begun to receive attention from the Foruni Secretariat, ESCAP and others. See references earlier to relevant features of effective decision-making machinery.

by noxious mining waste disposal in PNG has been successfully laid at the door of the mining companies. If the external costs of destructive logging had been quantified into an additional tax in PNG and Solomon Islands (and the tax enforced), logging practices could have been greatly improved. Rising public awareness, appropriate (i.e. simple and low-cost) legislation, and governments really seeing themselves as guardians of the environment, not just mediators in disputes after the damage is done, are all needed if there is to be significant progress.

## 4.5 GOVERNANCE AND REFORM

The forms and institutions of government and civil society in the Pacific islands are the product of their recent colonial history, and the constitution-making and economic processes described earlier. So they are mostly imported, much like the notion of the nation-state itself, from a world with longer traditions of monetised commerce and economic specialisation among states. But the statutes and contracts are one thing: the way people use them and behave within and between the institutional systems, is another. Governance, in the sense of the way authority and control is actually exercised in social and economic development, is strongly affected by cultural parameters, by the way people regard themselves and their relationships with others. These are also in a natural state of continuous evolution. It is not surprising that the performance of the formal apparatus of government seems to outside observers at times erratic or inefficient, and disappointing to its own people, who are hoping for a more or less mechanistic output of social and economic goods from the machinery of the state[70].

The reality in the Pacific is that governments can only govern, and the machinery of the state can only operate, within a broad consensus among the general population that it should do so. People generally may be dissatisfied with the state's performance, but they have no intention of doing away with the state as an institution, and the state has no means of coercing people at large to do something to which they strongly object. The state and its institutions are generally understood as machinery of collection and

[70] To dilute the connection between elected representatives and government failure, politicians in office in PNG, Solomon Islands and Vanuatu have developed various forms of 'constituency development fund' so that identifiable good things can be paid for by identifiable politicians, using public funds. If the public think the money comes from the politician's own pocket, so much the better. This was intended to reduce the turnover rate at general elections. It is reported to have had some success (that is, it has made it harder to dislodge the incumbent politicians) but at considerable cost to the government budget and standards of accountability.

redistribution: collecting taxes, organising civil servants and assembling assets of various kinds in order to distribute a range of services to people at large, and in the process to alter, for better or worse, the natural balance of people to resources. But the aspects of governance, the details of the way authority and control is actually exercised that people agree or disagree with, will vary according to their ideas of what is good or bad: what kind of distribution of wealth, privilege, access, patronage, and opportunity among age-groups, gender, parts of the country, citizens and foreigners, even (as in the case of environmental degradation) present and future generations, is right or wrong.

Governance is broadly what governments do, though they do not do it alone, and they have not been used to thinking much about it. The island states have gone through several decades, covering the achievement of independence, creating institutions of governance without analysing the total cost and the systemic efficiency of the resulting structure. In recent years, the mounting cost of operating the structure and the disappointing output in terms of economic activity and well-being per head has turned attention to the process of governance itself. Institutions set up for purposes valid at one time may have outlived their usefulness. The need for new or better institutions may be overlooked or improperly denied. People in positions to do so, the high priests in the development temple, have captured parts of the system and diverted resources to their own benefit. Structures may have become too complex and too well protected by obscure ritual to be understood and called to account by the people they are supposed to serve. Poorly managed or under-funded organisations may be failing to reach the people they should be helping. And the way the system's costs and benefits are actually being distributed may be diverging substantially from the ideas of good and bad allocations espoused by people at large. All these things have happened elsewhere and it is unlikely that the Pacific islands are somehow different. Growing concern voiced by domestic observers has been echoed by aid donors, becoming increasingly uneasy that they may be helping to finance economic mismanagement on a massive scale (see Box I). It happened that among the bilateral donors, Australia, New Zealand and Britain had all been engaged in the last ten years in deep structural reforms at home, driven by the need to cut government deficits and improve their international competitiveness. They thus had direct experience of a public sector reform process, and were ready and willing to export their practical experiences to the Pacific islands.

Box I

**World Bank and ADB Approaches to Governance**

In 1994 the World Bank published a brief account of its experience in applying concepts of good governance to its operations in developing countries around the world. The Bank had earlier defined governance as “the manner in which power is exercised in the management of a country’s economic and social resources for development”. The Bank explained that its interest in governance derived from its concern for the sustainability of the programs and projects it helped to finance. For sustainable development to occur, a predictable and transparent framework of rules and institutions for the conduct of private and public business had to exist. Good governance was epitomized by “predictable, open and enlightened policy-making..; an executive arm of government accountable for its actions; and a strong civil society participating in public affairs; and all behaving under the rule of law”.

Though the World Bank currently has little or no direct involvement in the Pacific islands except for PNG and Fiji, it has put substantial resources into analysing and confronting governance issues, and its conclusions have strongly influenced other institutions and aid donors such as the ADB, the EU and the Australian and British aid programmes. The Bank itself steers clear of overtly political questions, because its mandate restricts it to economic considerations, but in practice governance issues are deeply colored by issues of power, access and distribution, the essence of politics in any society. The Bank has handled this by restricting its formal agenda to four headings: (1) public service management (2) accountability (3) the legal framework for development and (4) transparency and information. Under these headings, the Bank has been able to address issues ranging from the reform of budgetary systems and public service pay structures, to the empowerment of women and the reduction of opportunities for corruption.

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The ADB's approach to governance, crystallized in mid-1995, examines the "institutional environment in which citizens interact among themselves and with government agencies/officials", and seeks to improve the capacity of this environment to support sustained economic growth. It recognises that even in market economies, governments are expected to maintain macroeconomic stability, develop infrastructure, provide public goods, prevent market failures and promote equity. 'Good governance' is required to see that policies in all those areas are effective and consistent. ADB has adopted a somewhat clearer analysis than the World Bank; it identifies four key elements of good governance as accountability, participation, predictability and transparency, recognising the manifold interactions among these concepts. Accountability relates mainly to management of the public sector, public enterprises and the public service; participation, to the involvement of the private sector and NGOs in policy formulation, and decentralisation of government functions to the local level; predictability relates to legal frameworks and application of the rule of law; and transparency to disclosure of information to enable the other aspects of good governance to be effective.

Both the World Bank and ADB are attempting to promote good governance by funding activities that specifically target its component parts, and by checking that their own operations generally are in line with good governance concepts. It hardly comes as a surprise to development practitioners that the honesty and competence of governments turns out to be crucial to the development process; but it is helpful that both these institutions have at last felt able to put these issues squarely into their 'policy dialogue' with member countries. What experience outside the Pacific really suggests, though, is that standards of governance do not rise because of outside interventions, but as a result of domestic pressure: the emergence of better educated, informed and organised public opinion demanding more transparent and accountable government is what brings about lasting improvement. So it is likely to be in the Pacific islands.

At the same time the US was using its influence in multilateral institutions to promote a more generalised but also more dogmatic idea of public sector reform, linked to the collapse of centrally-planned economies and the perceived victory of capitalism in the Cold War.

The result has been to put public sector reform on every island state's agenda, but with very differing degrees of commitment The process is socially painful and can be politically costly, so the degree of commitment depends on the opportunity cost: is there a politically more palatable alternative? Governments will go to great lengths and spend a long time trying to find one, postponing as long as possible the need to change what are often rather comfortable arrangements for distributing patronage and receiving support. Skillful prevarication and ineffective but dressed-up half-measures can postpone needed reforms for a surprisingly long time, particularly if a buoyant sector of the economy (e.g., timber in Solomon Islands, minerals in PNG), is generating enough income to pay the essential bills at home and abroad. But eventually a fiscal, monetary or balance of payments crisis will force adjustment and reform upon the government, at a time not of its choosing, and with political fall-out it cannot control. Box J outlines the elements of such reform in a small-country context.

In the Pacific the ADB, urged on by bilateral donors, has emerged as the leading proponent of a comprehensive approach to reforms in economic management. The Bank has responded to a fiscal and monetary crisis in Cook Islands, the unreadiness of FSM and Marshall Islands for the end of Compact funding, and a gradual slide into fiscal weakness and economic stagnation in Vanuatu, by providing technical assistance in the design of structural, financial and political reforms, in collaboration with other donors. Various ways have been tried to build national 'ownership' of the reform programmes, involving Summits, Retreats, Task Forces and countless consultative missions. With so much political and institutional capital being invested in public sector reform, and so many reputations at stake, it is worth considering how the outcomes are to be judged: how to decide if the programme has succeeded, both on its own terms and against external criteria, such as greater influence by Pacific islanders over the direction of their own affairs. Typically, the reform programmes put in place by ADB-funded TA are the result of several weeks' intensive activity by Bank staff and consultants interrogating national officials to establish base-line data, and consulting as widely as time allows to collect views on the purpose and content of reform. Inevitably the outcome is strongly influenced by ADB's procedures and assumptions, and requires the employment of large numbers

Box J

**The Elements of Public Sector Reform**

Reform of the public sector lies at the centre of all prescriptions for faster and more sustained economic growth in the Pacific islands, and it comprises a number of common elements. The principal components are:

- stability has to be restored to government finance: the almost universal trend to widening budget deficits, especially just before or just after a general election, and recourse to central bank financing or the drawdown of strategic reserves to finance them, has to be stopped in its tracks, and balanced or near-balanced budgets restored:
- revenue needs to be enhanced: the burden of balancing the budget cannot be laid on expenditure cuts alone: cuts across-the-board or cuts in 'soft' areas such as infrastructure maintenance or school/hospital supplies, undermine economic growth. Sources, forms and levels of tax have to be reviewed, combining income-elasticity with simplicity of collection, shifting emphasis to consumption taxes, abolishing exemptions (especially discretionary exemptions), and fees introduced or increased for those who can afford to pay. People need to know that the alternative to increased tax revenues is a debased currency or a collapse of vital services.
- expenditure controls have to be strengthened and enforced. Programme budgeting is good, output budgeting is better; but the absolute minimum is that budgeted expenditures, even old-style input budgets, must not be routinely exceeded.
- relations between political leaders and technocrats have to be improved, by clearer understanding of each others' roles, better-quality briefing and joint participation in policy formulation and performance monitoring.
- development planning at macro-economic and policy coordination levels has to be strengthened, plan documents simplified and made widely accessible, and project planning/management skills in executing agencies upgraded.

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- basic financial rules, accounting and auditing procedures and regulations governing procurement, disclosure of interest and public notice of tenders have to be strictly enforced.
- the public service has to be cut back where it is too big (usually in political advisory posts and general clerical support staff) and strengthened where it is weak (usually technical staff in natural resources, teaching, public health, infrastructure planning and financial administration). Where public service employment has been pumped up for political purposes, massive cuts may be required to get it down to an efficient size. Where financial retrenchment has cut out essential developmental services, these need to be restored, or ways found of providing them equitably and accessibly outside the public service.
- remaining and new public servants need protection against politically-motivated dismissal (e.g. by contracts of service longer than the period between elections), but conditions of service should be driven by private sector standards of pay levels, merit-based rewards, less rigid relativities.
- state-owned enterprises (SOEs) have to be governed by formal agreements defining goals, functions, autonomy and performance standards, setting financial ratios to be achieved and prescribing the treatment of surpluses/deficits. ‘Soft budgets’ and open-ended subsidies have to go, and managements have to be held responsible for meeting agreed targets, in return for non-interference by politicians or officials, except as spelled out in the performance contract.

Full privatisation i.e. transfer of ownership and control of SOEs to local or foreign private investors, is a legitimate goal when it is achievable for a fair price and with adequate consumer protection (by competition or regulation): but more generally and immediately, all SOEs should be required to behave *as if*’they were competing for customer loyalty in a real market.

of consultants to help design and implement the reforms. National staff are invariably judged to be too few and too inexperienced for this task, and those that are available quickly disappear overseas to further their education. The resulting reform programme is expressed in detailed lists of action required to be taken by specified agencies by certain dates: what the Bank refers to as a "time-bound action matrix", which may extend over two years or more. Access to tranches of a Bank programme loan is normally tied to completion of key actions. The principal uses of the loan are to finance consultant services, recapitalise failed institutions and make compensation payments to public sector employees who are to be 'rightsized'.

The amount of detail in the prescriptions bears a strong resemblance to the way IMF/IBRD structural adjustment and stabilisation programmes were drawn up in the heyday of such programmes in the 1980s. Apart from the sense of awe produced by reading them (can such order be produced from such chaos?), the assumptions and the method need more examination. Is it really the case that an effective programme of reform could not be drawn up by national staff? Or were they just lazy, or fearful of responsibility? The eagerness of aid donors to assist may be too readily filling the void that would otherwise force the home team to take on the task themselves. The usefulness of mercenaries was discussed earlier, but if 'ownership' of reforms is thought to be important, heavy reliance on foreign consultants can hardly be helpful. Domestic responsibility may be crowded out, much in the way that abundant financial aid crowds out domestic savings: why do it if someone else wants to do it for you? Moreover, extreme precision in a planning process raises questions of sustainability. The intelligent use of chance is a necessary management skill. Overspecification of the reform process can hamper intellectual participation by the national managers in shaping, timing and driving the reforms: participation that is essential to its durability. The ADB's approach may focus too much on improving governance and economic performance by fixing what the Bank considers needs to be fixed, as opposed to creating an environment in which national politicians and technocrats have to work out for themselves what needs to be fixed, and then do it, enlisting external help only at the project and programme level. Reform should be a dynamic process, feeding on complex interactions between systems, and its course cannot be precisely forecast. It seems likely that less detailed programmes, aiming at fewer, more critical but more generalised goals of a kind that liberate reforming initiative rather than fencing it in, may provide a more helpful frame for promoting durable progress.

But apart from checking off specific actions taken, how is success to be judged? After a year or two of reform effort, is the budget more sustainable, the balance of payments stronger, inflation under control, profitability of public corporations rising, are public utilities more competitive, public health indicators improving, is private investment picking up, participation in governance increasing, public confidence in the civil service returning, and are politicians and officials less corrupt? And if there are improvements, are they likely to be sustained - how dependent are they on continued foreign intervention? These questions should be answered by a periodic review undertaken by as independent an auditing process as can be found (not a report by the national government or the lead agency assisting the reforms). Reform programmes ought to be judged by the quality, not the quantity, of change that they produce: a few truly strategic improvements that take root and open the way for other, unprogrammed and home-grown developments are more likely to be sustained than more detailed but less well-rooted changes. The political dimension of reform is dominant and complex; by contrast, at least in the Pacific islands, the economic dimension is usually straightforward but subordinate. Often the reform agents will need to settle for a second-best solution for the present, biding their time until natural or political mortality removes powerful opponents of change, and public awareness becomes strong enough to enforce accountability and performance.

It is still too early to evaluate the effectiveness of the reforms which are in full swing in Cook Islands, at an early stage in FSM and RMI, and just being launched in Vanuatu. But some factors that are likely to be important in determining success or failure can be identified from experience so far. They are:

- reforms need to be based on a consensus in the community about what should be changed, why and how: in the absence of a comprehensive failure making drastic reform unavoidable, considerable preparation is needed to build such a consensus, and continued effort to sustain it.
- the process and machinery of reform should not be seen as outside and additional to the 'normal' machinery of governance, but as an integral part of it.
- the reform process has to be led by a person or persons with strong personality, unquestioned integrity, excellent communication skills, and solid support at the highest political level.

- the use of foreign consultants at the design or implementation stages of a reform process requires very careful definition of their roles, and active management of their involvement by the process leader.
- any significant reforms will produce winners and losers; the programme should be so designed and presented that even losers can identify with its goals and reasonably expect in the longer run to benefit from its outcomes.
- the published reform programme should not be too ambitious or complicated: certain crucial and achievable goals should be set and accomplished, before moving on to the next phase, building momentum and support by successful achievement phase by phase.
- the machinery of consultation set up for designing a reform programme should become a permanent part of the machinery of economic and social policy making..
- a reform programme should be about reform, i.e. changing attitudes, rules, practices and relationships so as to produce better outcomes, not about convincing aid donors to maintain (or increase) their donations. Reform is essentially an internal affair.

While substantial reform of the public sector is likely to be a key factor in improving governance in the island states, governance involves more than the government itself, and more than the public sector. Authority and control in social and economic development is also exercised by powerful institutions in the private sector, such as commercial banks and trading companies, multinational corporations in natural resources and manufacturing, and increasingly by international print and electronic media organisations. The policies and operations of these institutions are not under government control; indeed the boot is often on the foot, with governments on some issues clearly under the influence of large corporations. This is as true in the Pacific islands as in Australia or Japan, with the qualification that many medium-sized corporations are financially much bigger than island governments. The truth is that government and business need each other: each has strengths that complement the other's weaknesses. Governments need tax revenues and jobs for people. Business needs physical security, enforceable contracts and access to resources. In the end some kind of accommodation is reached, openly or in secret, or a bit of both. The government retains its overt political authority, and business is allowed to get on with making money. This pattern is clearly visible in the island states, and raises obvious concerns for accountability and transparency of government dealings.

Something similar happens with the third, and essentially stabilising, leg of the governance structure, the institutions of civil society[71]. These include persons of chiefly rank, with customary titles and some forms of traditional authority, along with the Christian churches and other religious organisations, trade unions, small business associations, women's organisations and other developmental or welfare-oriented NGOs. This cluster of institutions reaches out to influence or involve virtually every person in the island communities. They are capable of acting as a countervailing third force with government and business to produce the overall impact of governance on society. Community leadership in urban and peri-urban settlements often reflects the structure of the villages from which the town-dwellers originate. People move easily between kin-group settlements in town and village, and similar authority and responsibility systems operate, albeit modified by the urban environment. This pattern occurs in all three of the Pacific's cultural zones.

Traditional chiefs (albeit often in modern clothing) and the churches are potentially the keepers of ethical standards, society's ideas of what is good and bad in the behavior of government and business in concentrating or sharing political power and wealth. They are able, by mobilising their followers, to give or withhold the political support or access to resources that government and business require to survive. If they put their minds to it they can have a powerful moderating, alleviating, redistributive and growth-supporting effect on the performance of government and big business. So far their performance has been erratic. Persons of chiefly status have often been bought off by politicians or deal-makers, particularly in land transactions. The Christian churches have been variously at the centre of political upheaval, as in Fiji where the Methodist Church closely identified itself with Fijian nationalism and the military coups of 1987; or outspoken advocates of democratic reforms, as was the Catholic Church in Tonga under the late Patelisio Finau; or strangely silent on issues such as the rapid spread of commercialised gambling (main-street casinos, scratch lotto, poker machines) into the lives of their congregations[72]. There are signs of change:

[71] The triangular model of social and economic organisation has been used to good effect in Colebatch and Larmour (1993), which has references to its origins in earlier work by political science writers.

[72] The half-dozen old-established missionary churches that penetrated the Pacific in the 19th and early 20th centuries, and eventually reached an accord over rival territorial claims that (more or less) precluded their converts from sectarian warfare, are now having to deal with an influx of well-organised and well-funded 'new' churches, mostly US-based. Struggles over allegiance and interpretation of the Bible are diverting attention and resources from caring for the casualties of the development process.

the Methodist Church in Fiji moved in 1995 to put space between itself and the military-business alliance, the work of Father Barr on behalf of the urban poor in Suva is attracting support, church-based anti-gambling and anti-corruption lobbies are emerging in several countries, and churches in Solomon Islands jointly issued guidance to their members on selection of candidates in the 1997 general election.

Along with community leaders and the organised churches, trade unions, small business associations and women's groups all have strong interests in the way economic activity is organised, and the distribution of its cost and benefits. They rarely make common ground, and are vulnerable to being picked off and fixed up one by one by government and/or big businesses. Yet they have essential economic roles to play in engineering faster and more equitable growth, and together they can exert substantial leverage if they put their minds to it. Both government and big business need their support - or at least their acquiescence - in the way governance operates. Institutions of civil society, operating as individuals or organisations, many with foreign connections, can bring to bear information and the ability to communicate at all levels of society to uplift levels of understanding, debate and participation in influencing how and where things will happen.

This suggests a kind of dynamic equilibrium in the governance structure, with the government itself, big business, and civil society all held in a triangle of forces, each needing the other two, each defending its territory and from time to time encroaching on that of the others. If any of its components collapses or is effectively captured by one of the others, unsustainable re-distribution of power and wealth will occur - too much or too little accruing to the policy-making, wealth-creating or distributive poles of the system.

The triangle of forces or tripod model of governance (government, business, civil society) is useful for explaining events or designing policies, but like other categorisations (subsistence/cash, urban/rural, politicians/civil servants) in practice its internal boundaries are often difficult to define, and participants ignore them or move the markers around. Institutions, households and individuals have multiple roles, whether they perceive of themselves like that or not. Governments and churches are involved in business. Churches provide public goods (education, health services). Business sponsors civil society. Private firms provide security services. Trade unions run investment funds. Individuals function simultaneously as elected politicians and ordained priests; civil servants and entrepreneurs; army officers and traditional chiefs; or some other combination of roles that blur the lines between government, business and civil society.

This multi-role versatility helps to explain why the norms applying to one role or another can be infringed with no apparent sense of wrongdoing, and not much public disapproval; the person concerned was following the norms of another of his or her multiple roles. Role versatility is one reason why formal machinery in government, business and civil society does not always work as its designers, local or foreign, may have hoped: the operators have other issues, other roles, on their minds at the same time. But it also facilitates capture of parts of the governance system by skillful and unscrupulous operators. A recent commentary[73] on Samoa remarked that instead of doing their respective tasks, "government, chiefdom and business tangle in each others[7] affairs". Blurred boundaries and multiple roles make it more difficult to enforce accountability, and easier for flows and stocks of public resources to be conjured away to private and illegitimate benefit. So both the operators and the regulators have to be able to understand and manage multi-role versatility.

The system is not inherently stable. The balance of power at the margin shifts all the time among the three poles and the cluster of satellites around them. But there arc three main sources of stability providing a framework within which the people of the island states may be able to combine the turbulence of development with the strengthening of self-respect.

First, there are constitutional provisions limiting the term of governments, providing for public audit and accountability, an office of ombudsman, freedom of speech and association and the right to legal process. As events in Fiji in 1987 showed, even in the Pacific constitutions can be overthrown, but for this to succeed and be sustained requires the acquiescence of a large part of the population, or effective means of coercion. There are no governments in the island states at present commanding such widespread popular support, or repressive capability. Governments obey the rule of law or face loss of legitimacy and acceptance by their own people[74].

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[73] Fay and Vaiao Alailima (1994).

[74] Eventually, that is; the immediate record is mixed. In Samoa the government used its large majority in Parliament to amend the constitution, so as to remove the Auditor-General from office for strongly criticising the government's financial management, hi PNG, a powerful and respected Ombudsman Commission has long provided at least a partial defense against the spread of corrupt practices. In Solomon Islands the Ombudsman in the late 1980s led the attack on malpractices associated with the logging industry, but subsequent Ombudsmen have left the loggers and their government connections alone, hi Vanuatu the Ombudsman (recently appointed, fourteen years after the Independence Constitution provided the office) has resolutely criticised the conduct of senior politicians and officials in government and opposition, triggering various schemes to remove her from office. In **Fiji,** by contrast, the Ombudsman has adopted a low profile role and a narrow interpretation of the office's functions, thus avoiding conflict with the government.

Second, the people of the island states are becoming more aware, more articulate and more mobile. It is becoming steadily more difficult for any one part of the governance system - the government itself, big business, the neo-traditional leaders or the churches - to hoodwink people at large and get away with it. The technology of instant access to news, opinion and advice by computer link-up is only just reaching the Pacific islands, but within a few years it will transform the parameters of governability there like everywhere else, raising standards of accountability and making abuse of power ever more difficult to conceal.

And third, the increasing intellectual integration of the Pacific islands into the outside world, slow and interrupted though it is in detail, is steadily stitching them into a network of relationships that brings with it not only high-speed mobility of people, ideas and capital, but also peer pressure. Sources of comparative data such as international NGOs, the UN system and the Forum Secretariat are providing the information needed for higher standards of regional self-regulation. The July 1997 meeting of Economic Ministers of Forum member states (including Australia and New Zealand) adopted a set of standards of accountability in public finance that they would aim to meet. Though the standards themselves are unremarkable, the act of commitment is a significant advance. Governments, and those who support or depend on them, are increasingly expected to conform to a set of minimum rules of conduct that range from not oppressing minority groups, to publishing details of loans and contracts and not running unsustainable deficits on the government budget.

# 5 Stars to Street by: Sustained Growth and Self Respect

Any enterprise requires a sense of where it is trying to go, what corporate planners refer to as the ‘vision’, around which the plan is built. So it is with the voyage on which the Pacific islands are embarked. Leaders and followers need to share substantially the same vision, or at least their visions need largely to coincide, even if they differ at the margins in ways important to them. This paper suggests that the common ground between leaders and followers in the Pacific islands is the desire for sustained economic growth, and the efficient, equitable management of the costs incurred in achieving growth and the benefits that flow from it, in such a way that when they think about the development process, or hear others talking about it, they feel good about themselves; in this way their self-respect (and so their capacity to act) is enhanced.

It is possible to achieve sustained economic growth while suffering a loss of self-respect: this could occur where a country was conquered by a hated invader, who nevertheless ran the economy very effectively. Less dramatically, it could occur if most economic activities in the country, though prosperous and efficient, were owned and controlled by foreigners. Either case has overtones reminiscent of colonial days. On the other hand, it is possible to have self-respect without sustained growth, if levels of income and welfare are already high, and a decision is taken to conserve resources, slow down investment and stabilise consumption levels. The Pacific islands have only recently achieved political freedom from colonial control, and nowhere, except perhaps for a time in Nauru, have consumption levels reached a point of satisfying people’s hopes for a better life for themselves and their children. So it seems probable that the goal of sustained growth and self-respect is shared by many leaders and most followers in the Pacific islands, even if they do not use exactly those words or think about the future in quite those terms.

This concluding part of the essay therefore looks for ways in which the island states can retain, or regain where they have lost it, a substantial degree of influence over the economic and social processes discussed earlier, and at the same time stimulate and guide the processes of economic activity to increase output and welfare. What are the stars to steer by, such that calms, storms, sightings of mermaids and encounters with uncharted reefs do not destroy the venture or divert the voyage from where it is trying to go? They can be divided into the attitudes of mind most likely to succeed in handling the pressures of growth and change, and certain rules of thumb for economic management so as to minimise risk and maximise the chances of success.

## 5.1 ATTITUDES OF MIND

The island states are in the throes of pervasive domestic changes driven by demography and information, at the same time as they are being borne along by a turbulent tide of global economic developments. Governments have no choice but to broadly ‘go with the flow’, at home and abroad, but they can influence the timing and distribution of the impact of macro-level change; while individuals, households and businesses look for the niches and quirks of development that give them an opportunity for self-improvement at the micro level. The attitudes most likely to serve leaders and followers best are those that add up to the quality of coolness beloved of jazz musicians. Coolness does not lack energy, commitment, even passion; but it observes and assesses dispassionately, remaining slightly apart, nobody’s fool, defining its own goals and writing its own score, even while blending skillfull}’ with others in an overall melody. Coolness in economic management involves:

**Being skeptical of dogma.** It takes anything from twenty to fifty years for a rule of economic management to pass through the cycle of formulation, fashionable acclaim, universal adoption, discovery of inadequacy, loss of support, and abandonment (pending possible reformulation and rehabilitation after a period of dormancy). This has happened, during the time when the present generation of Pacific islands leaders was being educated, achieving and exercising power, to (for example):

- state participation in the 'commanding heights' of the economy
- state funding of social services to ensure access and equity
- state sponsorship of key financial institutions
- tariff protection to promote domestic diversification
- marketing boards to protect small producers
- state-funded extension services and subsidies to producers
- All of those notions grew easily out of the colonial experience, and were strongly supported by bilateral and multilateral donors in the 1960s and 1970s. As those precepts have been criticised for poor results and have fallen into disrepute, new mantras have taken their place, again with enthusiastic support from the now born-again aid donors; for example:
- transfer of state-owned assets to private enterprise
- drastic cuts in public sector scope and activities
- liberalisation of trade and opening up of investment
- abolition of producer subsidies and non-commercial services

In due course, perhaps quite soon, the policy pendulum will be found again to have swung too far, leading to the plundering of public assets, the collapse of governance and the marginalisation of indigenous enterprise. At that point strong government, state regulation of market excesses and provision of social safety nets for the less fortunate again become respectable[75]: this time with improved accountability and awareness of market forces. Pacific leaders can save themselves and their people a lot of trouble by not swallowing whole the prescriptions written for them by trendy consultants or aid donors, and refusing to subscribe to fashionable dogma just because it is being repeated all over the place. When wisdom becomes conventional it is time to re-think it. It is the task of leaders to work out policies that fit the needs of their own societies and economies, while first analysing and bearing in mind the lessons of experience at home and in the rest of the world.

**Avoiding frequent policy changes.** Excessive changes of policy create administrative chaos, waste resources and breed cynicism among officials and the general public. Instant policy-making to satisfy a presidential whim or the demands of a persuasive lobbyist is doomed to fail. The direction of policy should be arrived at by a thoughtful consultative process that weighs

[75] Adam Smith, the canny Scottish father of modem economics, has the distinction of being quoted in support by lesser mortals whichever way the pendulum is swinging.

alternatives. Once a policy is decided, strong perseverance is required to carry it through (or to prove by practical implementation that the policy needs to be modified). Most economic policies need coherent, persistent effort over a substantial period before they show results.

**Being wary of those who come bearing gifts.** Bilateral aid donors bringing offers of free money, goods and services; financial intermediaries offering instant transformation of national and personal wealth; or prospective commercial investors offering to build social infrastructure for nothing; all these versions of the mythical free lunch should be treated with utmost caution, and their motives, antecedents, capabilities and track record thoroughly examined before a decision is made, even in principle, to accept or reject the offer: and then read the small prim of the detailed proposal very carefully.

**Keeping in touch with the roots.** Going physically and metaphorically barefoot to the people who live by the sea, in the hills and in the squatter settlements, and listening at length to what they say, is the best way for leaders to refresh themselves and attune their policies to the needs of their people. Few modern politicians do this. Usually they say they have no time: the overseas trip, the diplomatic reception, the necessary relaxation with their cronies in the pub or the kava bar, and of course the busy schedule of meetings with aid donors and foreign investors, regrettably keep them away from their people. But they make a great mistake by not staying in close, humble and intellectually receptive contact with their roots: they miss out both on mental refreshment and potentially good ideas, and on the chance to give an account of themselves and the outside world to an increasingly inquiring audience.

**Being accountable for performance.** A vast change is spreading across the Pacific, in the ability of people to call their governments to account. People are rapidly becoming better educated, better informed, more conscious of the behavior of leaders and its effect on their own well-being. The power of the domestic and regional press, radio and (increasingly) television, political satire in the performing and visual arts, and the well publicised investigative reporting of ombudsman offices and commissions of inquiry, all add to the pressures on leaders to act transparently and give a full account of their activities. Leaders who respond gladly to this challenge, and implement changes towards fully accountable government, will be more likely to be re-elected. They will also be better placed to carry through difficult programmes of reform, by being trusted to tell the truth and to share the costs of growth equitably among their people.

**Discounting optimistic forecasts.** It is a human tendency to adopt the more hopeful of two scenarios, and to underrate the risks of a venture that offers the prospect of high gains. Truly objective appraisal of projects or policies is all but impossible: the bias of the appraiser (or the appraiser's paymasters) is always there. Very rarely does a consultant recommend against proceeding with the proposal under study: too much face and anticipated income is at stake among the project's sponsors. Yet decision makers need to use common sense and experience, and apply understanding of the unseen biases built into the appraisal, before making a choice: rose-colored spectacles have no place in a planning office or a Cabinet room, whether the subject of review is a fiscal stimulus to smallholder production, or a billion-dollar loan guarantee proposal with "no risk" to the government.

**Developing a sense of priorities.** Most Pacific islands governments are overloaded with commitments. Promises vastly outweigh resources. Everything cannot be done at once. Complex policy matrices and action plans commonly assume the executive capacity of a much bigger and more expert bureaucracy. Over-detailed planning kills initiative and hampers response to changes in related systems. Leaders need a clear sense of which actions are crucial to the overall programme, building further capacity and opening the way to wider, more effective action. All too often, trying to do too much leads to nothing being sustainably achieved.

## 5.2 RULES OF THUMB

To assist the skeptical, wary, in-touch, accountable, persevering and realistic leader with a strong sense of priorities to set about the task of economic management, a number of rules of thumb emerge from the discussion in this paper, that can form the building blocks of national strategy. Naturally this proposition is itself to be treated with appropriate skepticism; nevertheless these elements appear crucial to success in the Pacific islands context:

**Maintain macro-economic stability.** To provide a basis for growth-inducing investment, and to ensure resilience in the face of periodic shocks, the island states must give top priority to stability of the economic framework. Mismanagement of public finance is the quickest and surest way to destabilise the economy and destroy its prospects for sustained growth. The only way to avoid the political and social costs of enforced adjustment is to avoid instability in the first place. Government deficits and private savings, domestic money and external reserves, must be managed so as to stabilise domestic prices and the exchange rate - not by regulation, but by keeping supply and demand in reasonable equilibrium, and cushioning shocks by prudent use of reserves. Moreover, states that are seen to have done their best to preserve stability will more readily attract assistance in case their efforts are overwhelmed by external shocks.

**Target growth by promoting competitiveness.** Fast-growing populations and rising expectations means that faster economic growth is stability's Siamese twin. This will come only if the island economies improve their ability to compete internationally in goods and services markets, in providing a reliable, competitive environment for investment, and in mobilising domestic savings (including remittances from emigrants) to finance a bigger share of investment. Progressive trade liberalisation will reduce costs generally, and expose over-protected local firms to competitive pressures. Management of key prices (taxation, exchange rate, interest rates, labour costs, access charges) and the efficiency of government and public sector investment and operations are critically important. Across-the-board transparent competitiveness has to replace behind-doors selective subsidies and exemptions.

**Do more with less aid.** Attitudes and structures that depend on repeated transfusions of foreign aid have to change, as the aid climate cools, and continuing aid becomes more conditional. Balance of payments projections done with and without aid; multi-year budget projections based on declining real aid inflows; more rigorous appraisal of aid proposals/projects; strategic commitment of domestic savings to phase out aid; fully public tendering and accounting for the use of aid: these steps should flow from a joint recognition by donors and recipients that aid in excess of sharply-defined need damages a country's development performance.

**Learn about Asia.** The Pacific islands urgently need more of their nationals who hold or will hold key posts in public and private sectors, to be able to speak Japanese and mandarin Chinese. Writing is less urgent (and takes longer to learn) but is also needed. In-service language training, cultural exposure by attachment to Asian firms and government departments, and training in Asian studies, business practices and trade/investment objectives and strategies are all required. Curriculums in secondary schools and colleges should adjust accordingly and student exchanges should be promoted. In-service high-flyers should go on intensive courses overseas. Learning about Asia is critically important for successful handling of the Asia-driven economic transition.

**Strengthen regional cooperation.** The Pacific region will remain a theater of international contention, involving some heavyweight and unscrupulous players. Regional cooperation must therefore remain a keystone of development strategy. The systems and attitudes of mind needed for cost-effective cooperation should be kept in good order. The tuna fishery presently occupies centre stage, with mounting pressure on fish stocks and the prospects of real price rises generating increased economic rents. FFA provides a remarkable example of what can be done by cooperation. The Pacific islands can only protect their national and common interests in the tuna fishery by acting together on resource conservation, economic development, and the financial regime for foreign access. They need to strengthen their ownership and financial support of the FFA and widen its role in Pacific fisheries management.

**Invest in agriculture.** More productive, profitable and sustainable agriculture is the surest way for the island states to improve the well-being of both rural and urban people, and strengthen their balance of payments. Governments should pay attention to the profitability of small-holder production, by investing in transport systems and technical services in production, quality control and marketing. Development banks should return to agricultural lending, wiser than before, this time avoiding subsidised interest rates and political projects, and integrating credit with extension services. Foreign investment in crop development and processing, bringing know-how and market access to complement smallholder land and labour, should be strongly encouraged. The natural evolution of land tenure should be assisted, with registration/conversion of tenure e.g. lease of customary land by a member of the land holding group, available on survey and confirmation of entitlement.

**Make conservation operational.** National income accounts should be adjusted for depletion of natural resources and damage to the environment, and more effort should go into checking environmental costs (as much as labour or financial costs) of all investment proposals, public or private. Physical planning and economic planning should be integrated, and environmental impact and sources of preventive investment or insurance made explicit in policies and plans. Forest management and replanting plans should be enforced, and fines (environmental taxes) imposed for non-compliance, with the proceeds funding remedial action. Fisheries management should be similarly enforced, and customary conservation measures adapted and reinforced.

**Invest in urban management.** As more people move to town, the economic and social potential of urban areas needs to be understood and brought to reality. Concentration of persons and institutions at high density not only puts a heavy load on people and the environment, but also creates a dynamic interaction, releasing energy that can be harnessed to raise community well-being, or become a divisive and destructive force. Difficult issues of community participation, physical planning, infrastructure investment, transportation, privatisation and financial viability mean that management of towns is an urgent need for the Pacific islands, requiring skills of a high order. The crucial importance of the task is not yet recognised by most governments (or aid donors), but the returns to well-run investment in urban management, in terms **of** social and economic development, will be very high.

**Temper the effect of market forces.** Deregulation philosophy and government budget pressures advocate increased reliance on market forces to allocate resources. This is expected to be more efficient than allocation by administrators: who gets what depends on who can pay how much. But market forces unaided cannot allocate goods and services to people who are unable to pay the cost of producing them. Governments are necessarily involved in providing education, health services, law and order and other public goods essential to growth and stability. Market disciplines are needed to drive down costs and reward efficiency. But across-the-board privatisation of such activities on a user-pays basis will result in poorer and more remote communities being denied access to social and economic services unless their costs are subsidised e.g. school fees, health charges, sea transport, public utilities. Within any broad privatisation strategy, specific equity-focused subsidies are needed, and should be transparently budgeted, targeted and monitored.

**Protect governance against capture.** Equity and sustainability will both suffer if the mutually countervailing elements of the governance system - government, business and civil society - are able to capture or incapacitate each other. Each needs to be alert to threats against their joint equilibrium. As traditional structures weaken and mutate, and new alliances form based on wealth and education, the mass of stakeholders in the development process need strong, independent institutions of inquiry, audit and calling of leaders to account. Corruption imposes costs and inequities that the island states cannot afford, and increasingly will not tolerate. Newspapers, radio and television are themselves open to capture and subordination: the irreversible spread of fax and Internet will defeat any censor, but the media themselves can be perverted by special interests wielding financial power[76]. Collectively, Government, business and civil society need a robust, new tradition of free and open debate, to publicise what would otherwise be concealed, and thus protect them each against the other two. And the people at large need it to check up on all of them.

Applying those rules of thumb, taken together, will compel decision-makers to confront the trade-offs that are required between growth and sustainability, in the making of policies aimed at sustained growth. And by making the issues and choices a matter of public participation and debate, national cohesion and self-respect may be strengthened. Such outcomes are not certain; but they are far more likely under conditions of public accountability and understanding, than when key economic decisions are made behind the closed doors of the ruling party caucus.

This essay has looked at aspects of the task and process of economic management as if it were a sea-voyage, because there are pleasing similarities between the interaction of the skill and tenacity of the crew, the construction and repair of their vessel, and the power of wind and sea, and the interaction of the many factors that determine economic growth. But this is not the place for more metaphors. The purpose of the argument is to promote the sustained economic growth of the Pacific islands, and the degree of positive influence on that growth exercised by island peoples. The central proposition is that better economic management by Pacific islanders can make a real difference to their future well-being, and the way they do it can strengthen and sustain their self-respect.

[76] Pacific islanders are already heavily exposed to Rupert Murdoch's view of the world, for example, by News Corporation's ownership of newspapers and television channels.

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