Unravelling the 'Pacific Paradox'—the case of Kiribati

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The poor performance of the Kiribati economy during the 1980s and 1990s had little to do with the lack of capital or good policies but had more to do with the lack of incentives to be able to exploit those resources to the maximum. This paper examines the role that institutions play in the growth performance of Kiribati.
Unless the Kiribati authorities undertake appropriate institutional reform measures with the conditions necessary for a broad-based, sustained economic growth, Kiribati economy will continue to live out the 'Pacific Paradox'.

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The performance of the Kiribati economy over the past two decades has been characterised by economic growth rates that are low on average yet extremely volatile. This has been so despite favourable levels of marine and human resources, high levels of public investment and aid, and reasonably prudent economic management. Questions may be posed therefore as to what accounts for this poor performance of Kiribati, especially when other countries in the region and elsewhere of the same size and characteristics have registered impressive growth performance during the same period? Although the inherent structural constraints characterising Kiribati have a direct impact on the performance of this economy, one cannot dismiss the more fundamental constraints imposed by the policy and institutional environment in which the economy has hitherto been operating.

This paper examines the role that institutions play in the growth performance of Kiribati, having regard to the contributions of other growth variables. This is not an easy task for two reasons. First, it requires proper understanding of the determinants of, and their relative contributions to, economic growth, and how institutions fit into the

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whole process. Second, it presupposes a generally accepted definition of the term 'institutions' and the ability to identify components of it that are most crucial, as opposed to those that are less crucial, to economic growth and development. Both these issues are still unresolved in the literature and the subject of ongoing empirical research.

To place in perspective the role of institutions in the growth process, it is necessary to examine critically the relative contributions of the traditional determinants of economic success, namely, factor accumulation and policy, and analyse why the contributions of these variables tend to be less than optimal in the case of the Kiribati economy? Is it because of the level and quality of the institutions operating in this island economy? It would be logical, therefore, for the purposes of this paper to compare the relative contributions of the neoclassical production function approach, the policy approach, and the institutional approach.

Explaining the growth performance of Kiribati

The question posed about the dismal economic performance of Kiribati relative to other small countries of comparative standing calls for answers that necessarily involve value judgements on the part of an analyst. Indeed, the question as to why some countries are so 'rich' and others so 'poor' is often a difficult one to answer, given the multi-dimensional nature of the question and, by implication, the multiplicity of the answers that could be generated.

For expositional purposes, the answer to the question may fall into one of two lines of explanation. On the one hand, one could say that those other countries are so rich and we so poor because they are so good and we so bad. That is, they are hardworking, knowledgeable, educated, well-governed, efficacious, and productive, and we are the reverse. On the other hand, one could say that those countries are so rich and we so poor because they are so bad and we so good: they are greedy, ruthless, exploitative, and aggressive, while we are weak, innocent, virtuous, abused, and vulnerable. It is not clear, however, that one line of argument necessarily precludes the other. What is clear is that insofar as one may want to do something about the gap between rich and poor, these explanations imply different strategies. This in turn presupposes a clear knowledge of the complex forces at play behind the growth process.

The task of explaining differences in growth rates across countries remains a formidable challenge to economists. There are three approaches that can be adopted to assist in this task

- the neoclassical approach
- the policy approach
- the institutional approach.

One other approach that is not included here, for the reason to be explained, is the fatalism approach. The essence of this argument is that the Pacific island countries are doomed to perform poorly because of the unfortunate reality of their being small and the severe physical and resource constraints they face. This argument lacks substance as testified by the empirical research of Easterly and Kraay (1999) and others that has found no significant relationships between a country's size and its growth potential. In fact, as Duncan et al. (1999) argue, whatever the role of physical wealth and whatever the wealth of the Pacific island countries, such things as size, location, and climate are facts of life—they are the 'pot' in which alterable ingredients of growth (that is, physical capital, good policy, human capital, and institutions) are mixed. The Pacific islands must make the best of these facts of life and not resign to poor economic performance

because of them. Indeed, this is the stand that the present author takes in relation to the Kiribati economic situation.

The neoclassical approach

The neoclassical production function approach ascribes differences in growth performance across countries to differences in the level of factor accumulation and productivity. According to this approach, therefore, the Pacific island economies perform poorly because they lack the necessary physical and human capital, and have limited access to technology. But how realistic is this neoclassical explanation in light of the actual experiences of these island economies?

Consider capital first. While it may be true that most of the Pacific island countries, in particular the smaller island states, lack sufficient domestic savings, and hence capital, required for vigorous growth, the availability of other funding resources, with which most of these countries are blessed, would make this proposition untenable. Most of these economies have been enjoying levels of aid flows, which, in per capita terms, are the highest in the world (Table 1). For Kiribati, the average external grants for the period 1990–95 accounted for 39.3 per cent of real GDP, which is above the regional average. Also, Kiribati does not appear to have faced acute shortages of domestic savings. For 1992, domestic savings in Kiribati accounted for 23.3 per cent of GNP, which is quite a large figure by developing countries' standards. Despite these generous aid moneys and favorable levels of gross domestic savings, however, Kiribati still performed poorly during the past decade, with no signs of converging to the growth paths of the more successful developing island nations in the region or elsewhere.

On the other hand, if it is true that Kiribati really lacks capital, then in line with the law of diminishing returns, the return on capital in this economy should be many times higher than that in the capital-intensive (industrial) economies. Accordingly, one should expect a massive flow of capital from the industrial countries to Kiribati to take advantage of these higher rates of return. However, this has never been the case: the return on capital is far from its scarcity value, and the flow of

Table 1 **GDP growth, external grants and expenditure on education, 1985–97**

	Average GDP growth (per cent per annum)			External grants (% of GDP)	Gross domestic savings (% of GNP)	Education expenditure (% GDP)
	1987–91	1992–97	1987–97	1990–95		1990–95 (avg)
Fiji	2.4	2.5	2.45		12.7 (1996)	5.5
Federated States of Micronesia	4.4	1.2	2.8	59.7	..	..
Kiribati	2.9	1.6	2.25	39.3	23.3 (1992)	11.2
Marshall Islands	4.4	-0.3	2.05	55.2	..	9.4
Solomon Islands	3.2	4.4	3.8	14.6	..	..
Samoa	-1.8	1.7	1.45	13.4	..	3.6
Tonga	1.2	2.6	2.7	14.6	-12.8 (1992)	7.5
Vanuatu	2.8	2.6	0.4	14.6	9.5 (1993)	4.5
Average	2.4	2.4	2.4	30.2	..	..

Source: World Bank, 1998. *Enhancing the Role of Government in the Pacific Island Economies*, Washington, DC.

foreign direct investment into the economy of Kiribati represents nothing more than a trickle.[1] (The average return on capital in 1987, based on the savings deposit rates of the Bank of Kiribati—the only commercial bank in the country—is 5 per cent per annum, which is far less than the regional average of 6.4 per cent per annum in the same year.) Ironically, there is strong evidence that the flow of capital tends to be more from Kiribati to the richer countries, such as Australia and New Zealand.

So the argument that Kiribati performs so poorly because it lacks capital may not necessarily be true. There appears to be more than just the shortage of capital that accounts for the poor growth performances of this island economy.

Turning to the second factor of production—labour—again, this can be analysed on two fronts. In the first instance, if it is true that Kiribati performs poorly because it lacks human capital, then this would imply that the returns from possessing skills in this island country would be very high, compared with those countries where the supply of skilled manpower is excessive. But shouldn't this precipitate a massive migration of foreigners with skills into this economy to take advantage of the higher rewards on skills that this country should have offered? Also, shouldn't this discourage those few highly skilled and educated citizens from migrating to high-income countries? Evidence shows just the opposite: the inflow of skilled expatriates into the labour market of Kiribati is minimal, while there is an increasing trend for skilled labour to migrate to the more developed and bigger neighboring countries.

On the other hand, if we were to argue that the low ratio of resources to population (due to over-population) is the main constraining factor, the evidence available does not square well with this line of analysis. Some of the most highly populated countries (that is, in terms of population density), such as Singapore and Japan, are among the wealthiest countries in the world. Another counter-example that is more relevant to the Pacific island countries, and Kiribati for that matter, is the Norfolk Island success story.[2]

Thus, as with physical capital, the lack of human capital is hard to justify as a crucial factor responsible for the poor growth performance of Kiribati. In fact, the opposite is true. Of the Pacific island economies Kiribati has the highest level of government expenditure on education as a percentage of GDP for the period 1990–95 (Table 1). This means that Kiribati should be well endowed with human capital and, therefore, be well positioned to exploit the growth potential of this important resource. However, this has not been the case, which makes one wonder where all the education has gone?

On the question of the lack of technological progress as a key factor explaining the disappointing performance of Kiribati, this also is not convincing. The increasing globalisation of the world economies makes the world's stock of knowledge and ideas available at little or no cost to all countries. Governments and investors in poor countries can acquire these technologies, either freely or on commercial terms. Given the unrestricted transfer of technology across countries, the argument that Kiribati is poor because of its limited access to technology is, therefore, hard to justify also. In light of this reasoning, there appears to be no real ground to ascribe the poor economic performance of Kiribati to limited access to technology. The crucial question then is what restricts the transfer of technology from the more progressive countries to Kiribati?

All in all, the neoclassical explanation based on factor accumulation and productivity cannot resolve the puzzle surrounding the question of why the Pacific island countries in general and the smaller island nations in particular tend to under-perform. As discussed above, there is nothing

about being poor or small that denies the Pacific island countries access to resources essential for their growth and development. It is necessary, therefore, to extend the inquiry beyond this factor accumulation and productivity story and consider more fundamental determinants of economic growth. A first logical step in this direction is to ascertain whether the policy environment in which the Pacific island countries operate has a part to play in this whole state of affairs.

The policy approach

Certainly, appropriate economic policies would make a difference to the growth performance of the Pacific island countries. A number of studies (for example, ADB 1998, World Bank 1991) have attributed their disappointing performance to the ineffective macroeconomic policies that these countries have been following. This has compelled these countries to give considerable attention to policy areas, such as reducing the size and role of government in business activity, lowering barriers to trade, and liberalising investment regulations and markets.

The World Bank undertook in 1991 a landmark study that critically examined the role of policies in the growth performance of the Pacific island countries. In this study, the World Bank attributed the poor performance of these countries in the 1980s to an 'inability to adapt to needed structural reforms' (World Bank 1991:25). That is, growth during this period has been inhibited by inappropriate policies, and if these policies can be reformed growth will accelerate. But what exactly are these inappropriate policies?

The report argues that 'the dominant role of the public sector, a general lack of competitiveness, an inward orientation, a regulatory rather than a promotional approach to private investment, and weak financial sectors all combined to stifle private sector development' (World Bank 1991:42). There is then a need to reduce the public sector's relative command over the economy's resources. This entails the need to restructure the system of public enterprises with a view to liquidating and privatising those government-run corporations and companies that are more appropriately within the province of the private sector.

Moreover, the report recommends that a relatively undistorted incentive regime should be put in place that moves the islands away from their inward-oriented development and protection from foreign competition. This involves the dismantling of the remaining restrictions on external trade and the excessively regulatory environment that impedes foreign direct investment. Controls on the cost and allocation of capital need to be phased out and capital market development should be encouraged.

With respect to labour markets, there is heavy criticism of centralised wage-setting systems, which resulted in considerable downward rigidity in real wages—effectively severing the link between wages and productivity. Hence, there is a need to allow greater flexibility in the setting of private and public sector wages, and to place controls on wage and salary increases or the number of government employees in the public sector.

The implication of the World Bank prescriptions outlined above is that once all those restrictions that hinder private investment are removed, and the private sector is no longer stifled by over-regulation, the dynamic forces of the private sector will be unleashed and, combined with a surge of foreign investments, the rate of economic growth will dramatically rise. In other words, the cornerstone for the restoration of sustained growth, according to the World Bank, is greater participation of the private sector in investment and economic activity. The Bank even goes as far as providing the projected growth rates if these reforms are undertaken: they projected a doubling (Solomon Islands, Samoa), tripling (Kiribati,

Vanuatu), and even fivefold (Fiji) increases in annual growth rates of real GDP over the decade of the 1990s.

But do good policies really matter in the case of the Pacific island countries? How important have inferior policy outcomes been in the Pacific island context? Take the example of Kiribati. The level of per capita income for Kiribati is well below that of most island countries in the Pacific region, and the country faces enormous constraints: 33 atolls spread over a vast area of ocean; no exploitable mineral resources; small land area, and poor soil quality with a scarcity of fresh water; little manufacturing; and limited tourism potential.

In searching for ways to raise income levels, the orthodox solution focuses on getting rid of government-created distortions in the economy. But in Kiribati this search appears fruitless. It is a model of the following orthodox economic policies

- There has been a significant fall in government expenditure as a proportion of GDP.
- There are regular budget surpluses. The government has exercised fiscal restraint and made substantial cuts in public sector real wages.
- More flexible pricing policies, strengthened cost control and managerial capacity have considerably strengthened the finances and performance of the public enterprise sector.
- The tax/GDP ratio compares favourably with other countries in the region.
- Inflation is stable and moderate.
- Wage rates are among the lowest in the Pacific.
- There are no current account problems—indeed, surpluses exist.
- There are also no external debt problems: most of the aid is in the form of grants.
- An extremely open exchange and trade system exists, with a liberal policy towards foreign investment.

The Kiribati government has performed impeccably in all these standard policies. In addition, the country enjoys one of the highest level of aid in the region, as well as a high level of investment averaging 24.1 per cent of GDP. Yet, despite all of these good things, economic growth in Kiribati has been dismal. For the period 1989–93, the average real GDP growth rate was highly negative at –2.4 per cent. It appears, therefore, that the benefits of good policies in the context of Kiribati are marginal, if not negligible, given the conditions under which the economy operates. It provides a classical example of the 'Pacific Paradox', the term coined by the World Bank. From the normative point of view, it is far from clear what specific policies government should pursue beyond the standard set of policies aimed at getting the basics right in order to induce growth in the economy.

To exemplify further this 'Pacific Paradox' argument, consider the example of Samoa. In this case, the paradox is why Samoa has grown so slowly over the past decades, given the fortunate position, in many respects, that it finds itself in. There do not appear to be any significant handicaps imposed by factor endowments or the environment. There is an ample natural resource base complemented by a modest growth in population. Improvements in human capital have been considerable in the education and health sectors. There has been an abundant availability of capital. Infrastructure has not been a significant bottleneck. It is true that traditional exports have done poorly over recent years, but why has development in Samoa fallen so far below expectations? What has prevented the country from utilising its resource base to achieve a higher growth path?

Both the Kiribati and Samoa 'paradox' stories underscore the crucial point that it is not enough to get the basic economic policies on paper or the ground *per se*—other forces at play must also be recognised. This raises

the need to consider the final and most fundamental approach—the *institutional* approach, which may provide a solution to this puzzling question.

The institutional approach

If both the neoclassical and policy constraint arguments lack credibility and robustness in explaining the growth performance of the Kiribati economy, what could account for the dismal performance of this island economy? It is the fundamental proposition of this study that it is not the lack of natural or other resources and good policies that constrain the growth and development of Kiribati, but rather the *lack of incentives* to accumulate and acquire those resources or formulate good policies. This brings to bear the important role that institutions play in the provision of such incentives. This is not to say that resources and policies are not significant factors in the growth process. The point is that in the absence of workable and effective institutions, the potential contribution of these resources and policy reforms to growth may be severely hampered. More specifically, in the absence of secure property rights, enforceable contracts, and a relatively honest and competent bureaucracy, the full benefits and potential of these resources and policies may not be realised.

There are two main types of 'consumers' of incentives: private investors and bureaucrats, or more simply, public officials—that is, those with power to manage the nation's social and economic resources. Private investors, in particular foreign investors, require an environment that will give them the confidence to invest and apply their skills and technology. The most important of these incentives are secure property and contractual rights and an effective judiciary system. On the other hand, bureaucrats also require appropriate incentives in order for them to be able to carry out their functions as efficiently and effectively as possible in a responsive and predictable fashion, and with clear strategic focus and appropriate participation. Failure to have in place the right incentives for bureaucrats is likely to lead to a public service that is corrupt, dishonest and incompetent.

The structure of incentives depends, therefore, not only on what economic policies are chosen in each period, but also on the institutional arrangements: on the legal systems that enforce contracts and protect property rights, on an uncorrupt bureaucracy implementing these policies, and on political structures and constitutional provisions. Ultimately, improvements in the economic environment through policy and institutional reforms are necessary for creating maximum incentives to invest in physical and human capital, and to maximise returns to a nation's capital and natural resources.

While considerable attention has been given to policy reform in Kiribati, less attention has been given to the basic institutions that support the operation of markets and private sector development. Both the Development Plans (now called the *National Development Strategies*) covering the periods 1996–99 and 2000–03 did not make explicit reference to institutional building and development as part of the strategies to achieving long-term economic growth and well being. The Plans, in particular the latter one, place emphasis on the six strategic outcomes which include a sound macro-economic framework, stronger linkages between public and private sectors, private sector development and employment creation, a more competitive and diversified export base, enhanced capacity for human resource development, and a stronger international linkages. The key structural policy issues recommended in the Plans as the means to achieving the strategic outcomes and the long-term goal outlined above include public sector reform, creating an enabling environment for private sector

development, and human resource development.

Without denying the importance of the above strategies, the importance of interactions between these strategies and the quality of institutions in which these reforms will take place cannot be over-emphasised. That is, in the absence of a workable and effective institutional environment—meaning secure property rights, enforceable contracts, and a relatively honest and competent bureaucracy—the full benefits of such policy reforms cannot be achieved. For instance, what is the point of adopting policies that will promote private sector development, and hence capital accumulation, when the property rights regime is in shambles? What is the point of investing in human capital when job opportunities in the public sector are limited, and the development of the private sector, the only other source of employment, is constrained by weak institutional infrastructures? What is the point of having good laws and legal systems when they cannot be applied consistently and independently due to corruption and the lack of an appropriate incentive structure within the legal system? Therefore, unless these strategies and/or policy reforms are deployed within an effective institutional environment, maximum returns from them may not be realised.

As reported by the ADB (1998), the dismal economic performance of the Pacific island countries (Kiribati included) reflects the institutional environment, in particular the absence of appropriate property rights—or the absence of state protection of property rights—and of impartial third party enforcement of contracts by the state. The central theme of the ADB report is that per capita income in the Pacific island countries could move to levels several times higher than at present, if only they could put in place the institutions and policies that are fundamental to the effective operation of free enterprise economies.

If institutions are the key to development, the logical questions to raise are: what does the term cover, and what actions can be taken to encourage the development of appropriate institutions in the Pacific islands? As briefly outlined above, the most commonly used examples of institutions essential to economic growth are secure and transferable property rights, enforceable and impartially enforced contracts, a relatively competent and honest bureaucracy, and internationally acceptable accounting standards. Note, however, that institutions extend to an almost endless number of rules, sanctions, understandings, and customs which, in the context of the Pacific island countries, could be very complicated.

A brief survey of the institutional environment operating in Kiribati, focusing on the key institutional components considered most relevant to this economy, is in order at this point. These components include property and contractual rights security, a competent and honest bureaucracy, and an effective judiciary.[3]

Property and contractual rights

Effective property and contractual rights have three basic characteristics: public security and protection from theft; protection from arbitrary government actions, ranging from unexpected and ad hoc changes in regulations and taxes to outright corruption; and a fair, independent and predictable judiciary. A fully efficient property rights regime requires additional demanding conditions that involve complete and exclusive specification and effective enforcement of all entitlements and no restriction on transferability of property rights to others. Unless an effective property rights regime is in place, the evolution of market institutions will be impeded—making difficult voluntary exchange and specialisation.

In Kiribati, and indeed for the Pacific islands in general, nothing is more

concerning than the development of effective property rights over land. This is not only because of the scarcity and hence the greater developmental value of land throughout the Pacific, but also more importantly because of the unique system of common ownership of land that prevails in this largely traditional society. Like most of the Pacific island countries, there is a cultural predisposition in Kiribati toward common rather than private property of land. This system of land ownership poses problems for efforts to develop more secure individual property rights and title over land. This means that opportunities for individual initiative and entrepreneurship are stifled. Access to credit is also affected by this communal ownership system because of the connection between the lack of individual security of title to land and the poor development of a credit market.

This system of communal ownership also affects the transferability of rights/ title and the marketability of land. For instance, the sale and purchase of land is only allowed between I-Kiribati. Even then, it is subject to the approval of the land court, which should satisfy itself that (a) the land being sold is surplus to the needs of the seller and his family, and (b) the buyer has a genuine need for the land and does not have other suitable land available on that island.

Apart from the problem associated with the system of land ownership referred to above, there are two additional constraints on the development of an effective property rights regime: the government's commitment to ensuring security of such rights, and the effectiveness of the judiciary in protecting and enforcing those rights. That is, the assumption that legal title is secure title is too simplistic in practice. Also essential is security of tenure, not only in the sense of knowing that the register is accurate but also that the rights will be protected and that laws will not be arbitrarily changed to disadvantage investors. For instance, it has been reported that a certain politician, in collusion with one of the Lands Department officials, tried to change the land register to his own advantage and those of his close relatives. This politician, however, was never brought to justice to account for his fraudulent behaviour due to 'insufficient evidence' against him.

On the issue of arbitrary changes of law by government, Kiribati is not immune. For instance, disputes over lands were comprehensively investigated in the 1940s and 1950s leading to the Final Land Settlement. The colonial government consistently held that disputes with this settlement could not be re-opened by virtue of legislation passed at that time. Post-independence governments have taken a similar view on the basis of legal advice that the previous land settlement was final. However, recent discussion on the rights and legislative powers of Parliament have brought about a realisation that the matter is not necessarily closed for all time and that the matter could be reopened by legislation.

Thus, the strong attachment to ownership of land by kin groups and the apparent lack of state commitment to protecting rights appear to be one of the major constraints on growth in Kiribati because the insecurity of exclusive tenure retards investment and inhibits the development of a capital market. It is important, therefore, to consider what role the state can play in promoting and enforcing institutional change in this direction? What allowance should be made for the cultural preference of communal ownership in Kiribati?

Effectiveness of the bureaucracy

An effective bureaucracy constitutes a key component of the incentive regime to the extent that it plays a central role in the effective development of the overall incentive regime in the country. This is true especially for the Pacific island countries where the public sector is a key player in the economy,

controlling not only the management of the bulk of the nation's social and economic resources but also the rules and ways in which those resources are managed.

The essential elements of an effective bureaucracy include rule credibility, policy credibility, and resource adequacy and predictability.[4] Combined, these elements constitute the institutional environment in which bureaucrats operate. It is this institutional environment that drives the performance of the public officials insofar as it shapes their expectations of future constraints and incentives. For instance, an official who has come to expect that rules will not be enforced works in an environment of low rule credibility, and this will shape his behavior. Similarly, willingness to gear actions to support ministerial policies is somewhat greater if officials believe that policies will remain in force for a period of time, and will not be undermined by other policies of equal force. Finally, if public officials believe that government projects do not have adequate and secure resources in terms of finance, human resources, and institutional capacity, they expect that such projects will not last and this will determine their future performance and conduct in relation to that project.

The institutional environment—comprising rule credibility, policy credibility, and resource adequacy and predictability—therefore defines the incentive structure of public officials within the public service and drives their performance. Thus, if the institutional environment is strong and effective, then public officials are likely to be strong and effective as well, and, by implication, the policies and decisions they will make will also be effective. On the other hand, if the institution is weak, the opposite will hold. Corrupt behavior may develop, leading to a bureaucracy that is dishonest and incompetent. This in turn could undermine the integrity and effectiveness of the entire incentive regime. For instance, with a corrupt bureaucracy the policies and commitments towards the protection of property rights will be severely undermined. Likewise, with an incompetent and dishonest bureaucracy, the independence and effectiveness of the judiciary will be hampered, possibly because of improper recruitment procedures or due to the inadequacy and unpredictability of resources to support its effective functioning.

With the exception of Fiji, the government sector in Pacific island economies plays a dominant role, both in terms of its contribution to GDP and the share of formal sector employment. In Kiribati, this sector accounted for about 85 per cent of GDP for the period 1985–89. Apart from the effects of aid funds, the bloated size of the government sector is due to the tendency of the government to become involved in business activity either by means of government business enterprises, through joint ventures with domestic or overseas investors, or indirectly through the provision of tariffs and subsidies.

Kiribati has retained many of the administrative features of the civil service developed during a long period of colonial rule. In particular, the colonial response to a small population, widely scattered islands, and a lack of commercial potential was to use government resources to provide not only social services, but also basic infrastructure including transport and communications. Over the past decade, the size of the public service has increased at more than twice the rate of both the population and the national budget. As noted by ADB (1999), in an economy where the public sector plays a large economic role, there is the risk that the evolution of market institutions will be impeded. In this case, the government is likely to neglect its core functions, in particular the development of its regulatory function that must support the evolution of market institutions.

There are two key factors that bear significantly on the efficiency and

effectiveness of the public service in Kiribati. The first is cultural, and the second relates to the efficacy of the rules and policies operating within the bureaucracy. With respect to the former, it is 'unethical' in the Kiribati custom for one individual to ask another to do something more than once, to check if an instruction has been carried out, or to criticise for deficiency of performance. It follows that the government finds it difficult to provide service in more than a minimal way, and that government-owned commercial enterprises have difficulty in defining strategic objectives, making profits, or providing a designated service. While senior officials have a clear perception of the ideals of an independent public service, the performance of these ideals, and efficiency generally, often falls short of them.

On the second factor—operating rules and policies—a good illustration is government policy on promotion and remuneration of its public officials in the public service. The tendency by the authorities is to produce 'promotion by cohort', especially in the administrative cadre, and the absence of bonuses or performance-based pay effectively undermines individual ambition which is already rendered tentative by cultural mores. While the Public Service Commission (PSC) has no difficulty with suspending and charging those considered responsible for fraud or theft, it has no equivalent functioning mechanism for dealing with those who are under-performing in their positions. Cultural mores have an important influence on this.

One very important symptom of an ineffective institutional environment characterising most of the public services of the Pacific island countries is the prevalence of corruption. While corruption in Kiribati has not yet reached endemic proportions, it is on the rise and the authorities need to arrest it before it becomes deeply embedded within the system. Recent events such as the imprisonment of one of the members of Parliament and the dismissal of customs officials due to corrupt practices demonstrate the growing seriousness of this problem. It may be appropriate to postulate that these public figures are not necessarily rapacious rent-seekers; rather, their actions represent their response to the incentive structure that they face. That is, their behaviour at that time may be shaped by their expectations of the nature of the rules that constrained the behavior of public officials, the nature of the policies that they were asked to implement, and the manner in which they were provided with resources to carry out their functions.

A reliable and independent judiciary

The reliability and consistency of the application of law are as important as law itself. This condition is only possible if, and only if, the judiciary is reliable and independent, which can only come about if the rules and policies governing its set up and functions are credible and if the resources required to facilitate the effective execution of its functions are adequate and predictable. As highlighted above, the effectiveness of the bureaucracy has a lot to contribute towards this end, providing an incentive structure compatible with the effective functioning of the judiciary. Unless the judiciary secures these essential attributes, the whole system of law collapses which, from an economic perspective, is detrimental to investment and economic growth in terms of its adverse effects on the security of property rights and contracts.

While in most of the Pacific island countries the judiciary enjoys a fair degree of respect for its independence and integrity, for some countries the effectiveness and independence of the court systems are far from being unquestioned. This is particularly so when the legislature can overturn the court's decisions and rulings, or when the government has the exclusive rights to appoint judges and court officials. In Kiribati,

the Chief Justice, who sits in the High Court, is appointed by the President after consultation with the Cabinet and Public Service Commission. Other High Court Judges are appointed on the recommendation of the Chief Justice sitting with Public Service Commission. The judicial structure comprises a High Court, headed by a Chief Justice, and Magistrate's Courts; there is also a Court of Appeal, and the right of appeal to the judicial committee of the Privy Council in London.

The smallness of the judiciary and the often inadequacy of the resources to support the work of the judiciary, together with the fragmented nature of Kiribati, mean that judicial procedures will always operate under difficult conditions. In fact, the major criticism that is leveled at the system is the propensity for delay in cases of remand and of appeals. Indeed, this concern was vindicated during 1993–94 when delays in the system aroused serious public complaint. It was alleged that some 700 cases were pending over the period 1990–94. Additional difficulties were caused in 1994–95 by disputes between a former Chief Justice and the government, for his alleged involvement in the results of the political election of 1994, and subsequent delays in obtaining a replacement Chief Justice and Judge for the High Court.

The most damaging blow to the integrity and reliability of the court system in Kiribati was delivered in 1997 when all the members of the jury of the civil court were imprisoned for professional misconduct. In this case, the entire jury endorsed the sale of a land by person X to person Y even though it knew very well that X was not a *bona fide* owner of that land, a fact which Y was completely unaware of. About a year later, the real owner of the land found out about the illegal sale of his land and filed a court case, which he won, resulting in the imprisonment of all members of the jury. The jury acted in a fraudulent manner on the strength of the bribery given to them by X a day before the court proceedings. In the meanwhile, Y lost all his investment.

Instances such as outlined above could do a lot of damage to the effectiveness and integrity of the court system with consequent negative effects on investors' perceptions about the security and enforceability of property and contractual rights. This could discourage foreign investors from investing and applying their skills and technology in these economies, leading to lower rates of capital accumulation and economic growth.

What is the verdict?

Comparing the relative strengths and merits of the three approaches outlined above in explaining the economic performance of Kiribati in the 1990s, it is obvious that the institutional approach stands out as providing the most credible and robust framework of analysis. The approach recognises explicitly the important distinction between the proximate causes of economic success—capital accumulation and productivity (including good policies)—and the more fundamental determinant, namely, the institutional environment. As already argued, preference for the institutional approach does not imply that capital accumulation, productivity, and good policies are not significant factors in the growth process. The point is that unless the appropriate institutional underpinnings are in place, the returns from the deployment of these resources are likely to be less than optimal.

It is crucially important, therefore, that Kiribati authorities take measures to put in place an appropriate institutional framework that would provide the right incentives for the maximum deployment of its social and economic resources. The verdict then is obvious: the notion of a 'Pacific Paradox'—that is, a record of slow economic growth

despite relatively high levels of aid and investment, abundant natural resources for some countries, and reasonably prudent macroeconomic management—can only be explained in terms of the institutional approach discussed above. That is, Kiribati does not necessarily lack the resources and good policies necessary for economic success—the fact that it still performs poorly is because of the lack of incentives appropriate for the maximum utilisation and employment of those resources.

Conclusion

This analysis has highlighted the important point that development should not be thought of as just the accumulation of physical and human capital, and the adoption of superior technologies and policies, important as these factors are. These accumulations and adoptions depend crucially on the institutional environment of the country and the incentives that it provides. In other words, the crucial problem lies not in the scarcity of productive assets but in residents' lack of incentives to invest in socially productive assets, and in the lack of incentives for foreign investors to transfer capital, technology and managerial skills.

The poor performance of the Kiribati economy during the 1980s and 1990s had little to do with the lack of capital or good policies but had more to do with the lack of incentives to be able to exploit those resources to the maximum. Neither is there any justification in attributing this poor performance to the unfortunate circumstances that Kiribati finds itself in. In this scheme of things, unless the Kiribati authorities undertake appropriate institutional reform measures with a view to putting in place the conditions necessary for a broad-based, sustained economic growth, the 'Pacific Paradox' characterisation of its economic performance will continue to be a matter to be reckoned with in times to come.

Notes

1. For the period 1986–94, the average level of foreign direct investment flowing into the Kiribati economy was US$0.17million per annum.
2. Refer to Duncan et al. (1999) for full details of this success story.
3. It is difficult to prescribe the 'right' institutions. Indeed, one of the features of institutions in development is that there is no single driving force to determine either behavior or structure so that there are no easy generalisations or operational rules.
4. Some may argue that effectiveness of the bureaucracy should be identified with the four pillars of governance, namely, accountability, transparency, predictability, and participation. All these are encapsulated by the three elements of effective bureaucracy outlined in this paper.

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