Policy dialogue

Rolling RAMSI forward: some ideas from the literature

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A key challenge for the Regional Assistance Mission to the Solomon Islands (RAMSI) is accelerating the rate of growth of the economy. For this to happen, various economic reforms need to be implemented. While some of these are in train, many remain within the long and sometimes windy pipelines of the bureaucracy. Here we draw lessons from the extant literature on aid, economic growth and the political economy of reform. We also consider the need for the 'deep-rooting' of independent institutions that can mediate between vested interests as part of the reform process so as to ensure its sustainability. These lessons could be particularly pertinent given new administrations in Solomon Islands and Australia, who are keen for new ideas to accelerate the pace of development. Among our recommendations are the support of institutional structures that help build constituencies for reform and more effective types of assistance that are non-financial but which generate real economic benefits.

Motivations

The Regional Assistance Mission to the Solomon Islands (RAMSI) will mark its fifth anniversary on 24 July 2008. It is time to reflect on the gains and the lessons of the past. It is also an opportunity to introduce change, given a new and willing administration in Honiara and the call for new ideas from an equally new and willing government in Australia.

Within a very short time, the new Australian government has improved the previously strained relations with Solomon Islands. This success is due, in part, to the accident of simultaneous changes in governments in both countries. Equally important, however, has been the agreement by both prime ministers, Dr Derek Sikua in Solomon Islands and Kevin Rudd in Australia, that RAMSI can do better. The recent coup attempt in East Timor lends urgency to RAMSI's efforts to rebuild Solomon Islands.

The question currently facing the Australian government, therefore, is what are the major issues within RAMSI that need to be addressed in order to improve its effectiveness? Some commentators have recently been highly critical of the RAMSI intervention and its priorities. One of the main criticisms is that it has been too 'Honiara centric', with a large part of its efforts concentrated on rebuilding the country's ineffective institutions and governance structures and too little attention

Pacific Economic Bulletin Volume 23 Number 1 2008 © Asia Pacific Press

paid to delivering services to and alleviating the growth constraints on the country's rural poor, who make up approximately 85 per cent of the population.

Critics of RAMSI argue that the intervention should focus its efforts on a variety of important types of service delivery—such as rural development, infrastructure, health and education—rather than on the wages of Australian and New Zealand bureaucrats. These types of services are said to have a much bigger impact on poverty reduction and, in some cases, economic growth.

These criticisms have, however, been made without addressing the fundamental question about the nature of Australian assistance to the Solomons. Should Australia step into the role of service deliverer in the areas that the Solomon Islands so desperately needs, particularly in rural areas, or should it concentrate its efforts on equipping the Solomon Islands government with the resources and, more importantly, the capability to deliver these services for itself? A 'helicopter-drop' of resources and personnel produces short-term gains, but can be counter-productive in the longer term. Such an intervention also runs the risk of crowding out local capacity and enterprise and therefore taxing future growth. Depending on the magnitude of the short-term gains *vis-à-vis* the long-term losses and the society's discount rate, the net effect could go either way. If, however, sustainability of the State is the core concern, letting locals take the lead in improving service delivery and pushing for structural reforms would be preferred over any quick gains made purely by the assistance program.

The provision of resources for rural development, infrastructure, health and education projects must remain a central part of the reform and rebuilding effort. Helping the Solomon Islands government rebuild its central institutions of state and its ability to make effective policy decisions is, however, at the core of the development challenge. It will be a long, arduous and, at times, frustrating process.

Having said this, improvements can and should be made in how this type of assistance is being delivered. On the institution-building side, it is argued that one possible way forward is the diversification of assistance towards enhancing the effectiveness of *ex-ante* and *ex-post* policy review mechanisms. The Pacific Financial and Technical Assistance Centre (PFTAC) could play an increasingly useful role in this regard. On the service delivery side, Australia should play a leading role in the implementation of output-based aid initiatives. One practical example of where this could be initiated is the development of a progress-based education fund. Regional assistance to Solomon Islands also needs to be more mindful of the fact that current levels of financial transfers are likely to be well above the country's absorptive capacity. As such, new methods of aid delivery which do not involve the transfer of financial assets to the small island economy, but which improve income-earning opportunities for Solomon Islanders, are required. Enhancing labour mobility between Australia and the Solomon Islands is identified as the most obvious and effective way forward for this agenda.

Lessons from the literature and policy implications

The process of state rebuilding can be split into two strands: creating and supporting institutions that will support and sustain changes leading to increases in income and employment; and helping to deliver the services required for an adequate level of social stability so that institutional improvements can take root.

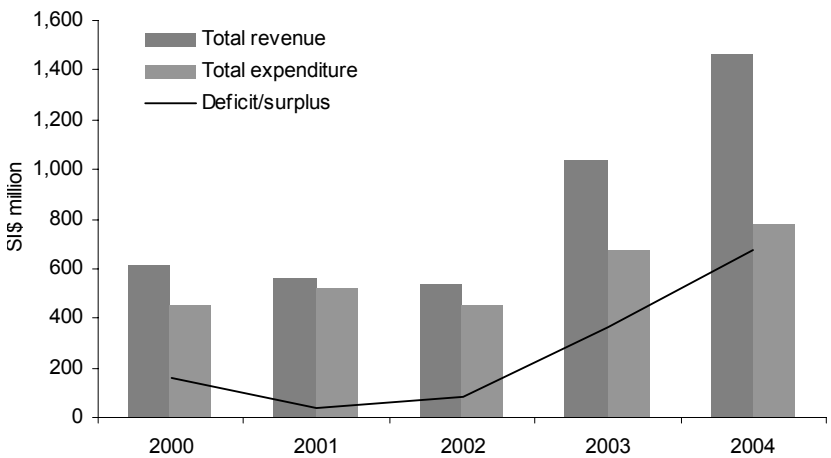
Supporting institutions that build the constituency for reform

Economic institutions are now the centre of attention in development economics, following an era when their effective functioning was simply assumed within the confines of neoclassical economics. A large number of analyses using a variety of techniques—including cross-country regressions—suggest that it is the quality of institutions, not variations in health, infrastructure, education or rural productivity, that is the single most important difference between those economies in the developing world that have grown strongly and those that have not. Examples of this research include Acemoglu et al. (2001), Rodrik et al. (2004) and North (1990, 1994).

These findings have, however, typically not produced particularly useful insights for foreign aid agencies in their search for how best to support the growth of recipient countries. It is one thing to recognise the importance of institutional quality but quite another to specify what determines quality and—more importantly—suggest how it might best be improved. One of the big challenges for RAMSI, then, has been to clarify what kinds of institutional support are most conducive to promoting structural reform efforts and—more importantly from a policy perspective—how to support the development of those institutions.

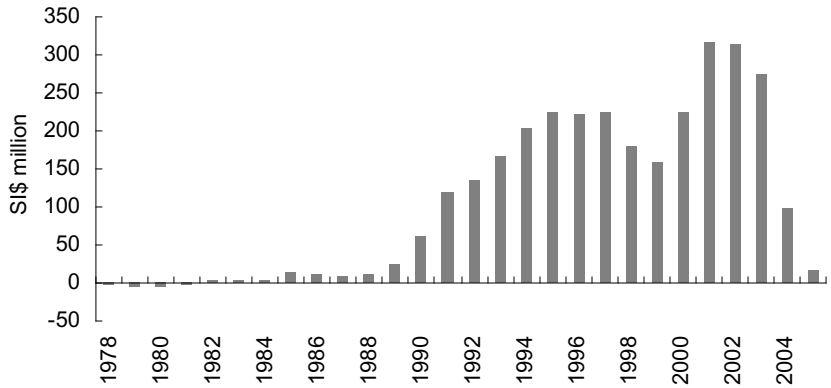
First of all, it must be said that RAMSI has achieved some major reforms since it began in 2003. At the macroeconomic level, the previously rampant government deficit has been brought into surplus (Figure 1), which, together with a restructuring of public debt, has allowed the government to reduce its debt burden significantly (Figure 2). These successes have been underpinned by important structural reforms, such as the new Foreign Investment Act (2006), removal

Figure 1 **Solomon Islands: government fiscal balance, 2000–2004**



Source: International Monetary Fund (IMF), 2005b. *Solomon Islands: selected issues and statistical appendix*, IMF Country Report 05/364, International Monetary Fund, Washington, DC. Available from http://www.imf.org/external/pubs/ft/scr/2005/cr05364.pdf.

Figure 2 **Solomon Islands: claims on government and public entities, 1978–2005** (current SI$)



Source: World Bank, 2007. *World Development Indicators 2007*, World Bank, Washington, DC. Available online at http://publications.worldbank.org/WDI (accessed 20 January 2008).

of import duties on major international transport methods, streamlining of business regulation procedures and the initiation of a process of tax reform and improved compliance measures.[1]

These reforms have contributed to a significant increase in foreign investment (Figure 3) and export earnings (Figure 4) and have helped to promote formal-sector employment growth (Figure 5). Increased foreign investment and export earnings have led also to a greater degree of exchange-rate stability (Figure 6). Macroeconomic and exchange-rate stability have been accompanied by a significant increase in crop production since RAMSI's arrival, with output levels now higher than they were before the conflict (Figure 7). All of this has helped generate moderate economic growth such that aggregate GDP is approaching its pre-conflict levels (Figures 8 and 9).[2] The challenge is to sustain these positive developments for the foreseeable future.

While RAMSI has made a conscious effort to include as many stakeholders as possible in the development of its major reforms, the primary carriage of these reforms has, however, remained with the large number of technical advisers working within the bureaucracy. At present, these advisors occupy roles in most major areas of the Solomon Islands government and they have been given the responsibility of not only helping to achieve reform gains but of helping train their local counterparts to perform the roles for themselves after RAMSI's departure.

Without doubt, this current technical and bureaucratic support has proven successful in achieving significant reform gains. There is, however, a broader question of whether it has helped (or is helping) to establish an institutional environment capable of pursuing reform once the donor presence is removed. Given the massive input of technical assistance

(Figure 11), has it been 'crowding in' or 'crowding out' local capacity? The evidence is mixed, at best, but knowing the answer to the above question is critical to building local capacity for continuing reforms.

Can RAMSI better support institutional development in Solomon Islands? Recent research has begun to help answer this question,[3] providing guidance on why and how economic policy reform occurs and how to develop institutional mechanisms that encourage governments to adopt good or better economic policies (Dee 2008). The challenge for RAMSI is one of 'deep-rooting' the processes of reform so that they remain after the departure of the donors. To date, efforts aimed at achieving this have focused heavily on the development of policy capacity and institutional support to Solomon Islands' central government and line agencies.

Given the central role of these agencies as the major driving force behind structural economic reforms, this focus has been prudent. Experience across the region shows increasingly, however, that what politicians have often needed to initiate reform is a credible independent agency to expose the various vested interests to public view. Moreover, central government agencies are rarely seen as independent arbitrators and assessors of economic reform options (Hosen 2007; Llanto and Gonzalez 2007; Wonder 2007).

In essence, this research shows the importance of independent institutions in an economy such as Solomon Islands. Developing an environment conducive to structural economic reform centres on the development of institutions capable of mediating these competing interests and which can build a coalition in favour of reform. A key strategy for achieving these outcomes is the development of independent policy review mechanisms. These types of institutions have been shown to help not only in providing a technical solution to the problem of identifying better policy reform options but by providing a

Figure 3 **Direct investment in Solomon Islands, 1989–2006** (US$ million)

Source: International Monetary Fund (IMF), 2007. *International Financial Statistics, CD Database 2007*, International Monetary Fund, Washington, DC.

Figure 4 **Solomon Islands: exports and imports, 1990–2006** (SI$ million)

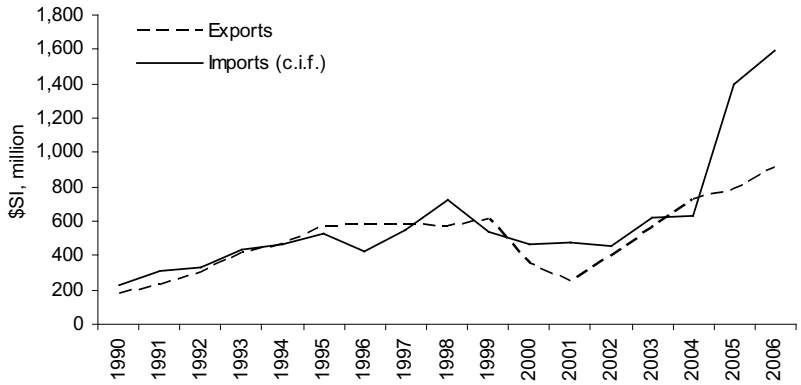


Figure 5 **Solomon Islands: formal-sector employment, 1999–2005** ('000 persons)

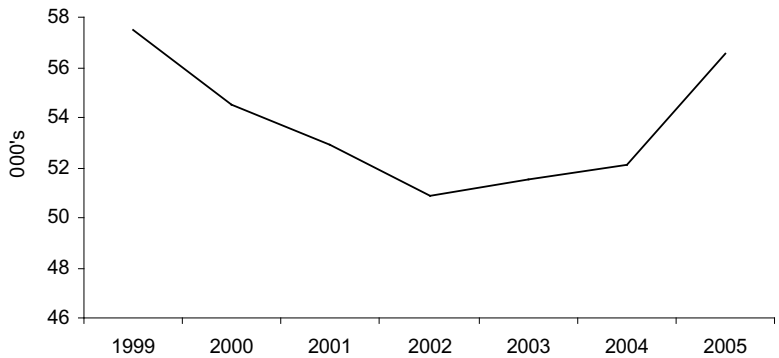
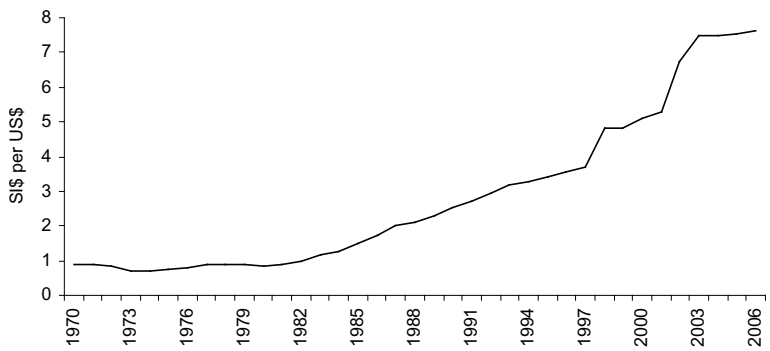


Figure 6 **Solomon Islands: official exchange rates, period average, 1970–2006** (SI$/US$)



Source: International Monetary Fund (IMF), 2007. *International Financial Statistics, CD Database 2007*, International Monetary Fund, Washington, DC.

Figure 7 **Solomon Islands crop production index, 1961–1998** (2001=100)

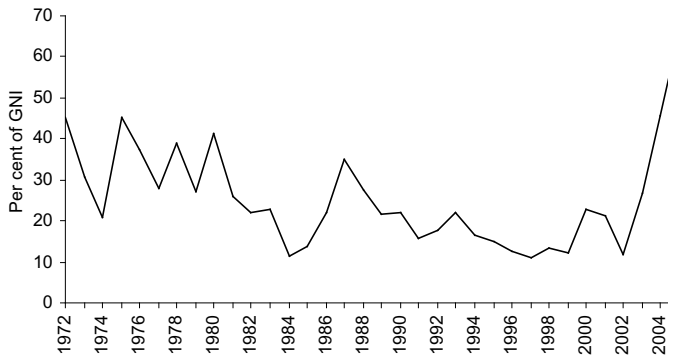


Figure 8 **Solomon Islands: GDP and GDP growth, 1968–2006** (constant US$)

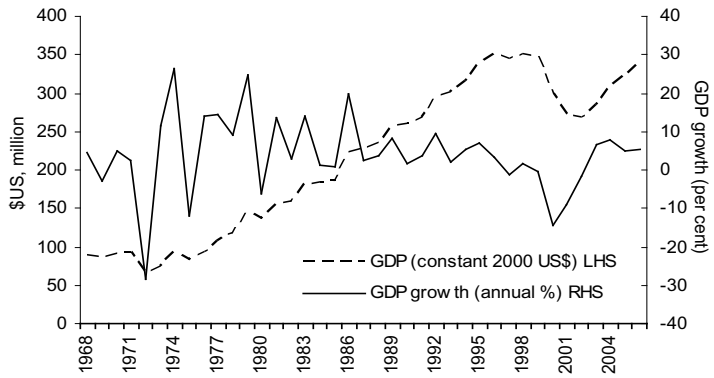
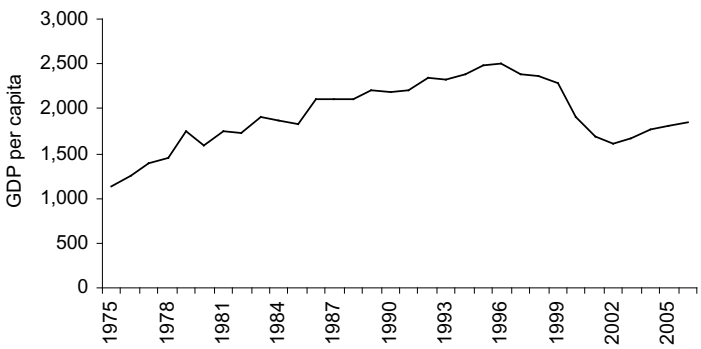


Figure 9 **Solomon Islands: GDP per capita, 1975–2006** (constant 2000 international $)



Source: World Bank, 2007. *World Development Indicators 2007*, World Bank, Washington, DC. Available online at http://publications.worldbank.org/WDI (accessed 20 January 2008).

Figure 10 **Solomon Islands: total ODA by donor, 1966–2006** (US$ million)

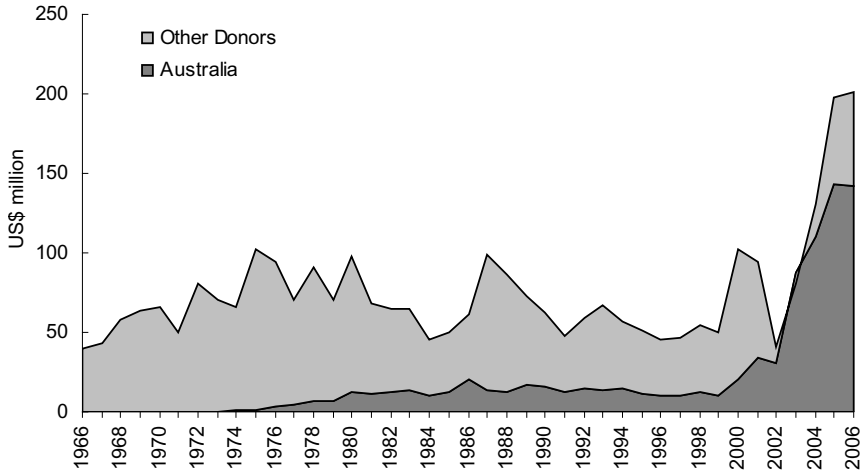
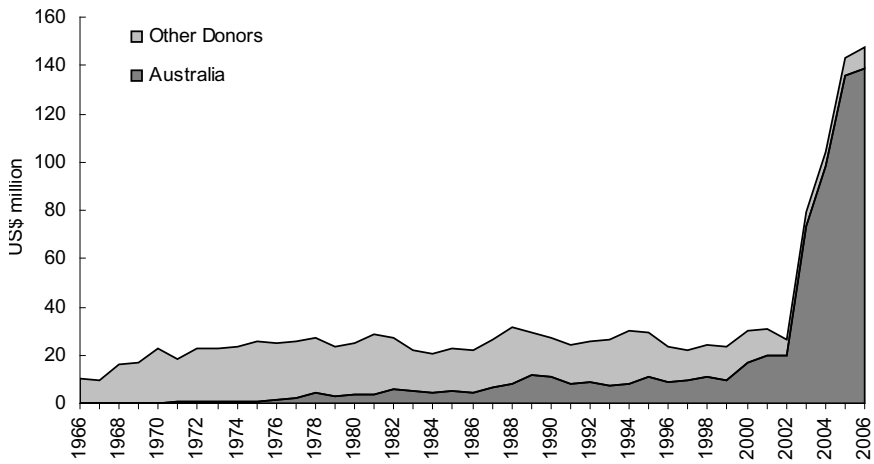


Figure 11 **Solomon Islands: technical cooperation ODA, 1966–2006** (US$ million, constant 2005)



Source: Organization for Economic Co-operation and Development (OECD), 2008. *Aid Statistics*, Development Assistance Committee, Organization for Economic Co-operation and Development, Geneva. Available online at http://www.oecd.org/dataoecd/50/17/5037721.htm (accessed 20 January 2008).

strategy for managing change. Effective policy review mechanisms do this by

- helping to set the policy reform agenda
- setting the parameters of the debate about policy reform—for example, by establishing analytical frameworks in which all interests are represented
- de-politicising and raising the level of the debate on reform issues
- making clear who will gain and who will lose from special arrangements
- marshalling countervailing interests against special interests, therefore helping to build a coalition for reform
- identifying policy reform combinations wherein everyone benefits—that is, building a grand coalition for reform.

For a policy review mechanism to be effective in achieving these objectives, it must satisfy several important criteria

- independence; it must not be bound by current government policies, or have an explicit or implicit stake in existing policies
- an economy-wide view; it must consider the economic effects of policy options on all stakeholders
- transparency; it must use transparent processes of consultation so that all players can hear all the arguments; and its own recommendations to government must be made public.

Promoting greater levels of policy contestability also allows the public to understand and compare the trade-offs of reform across sectors as well as within sectors of the economy. This process of domestic debate is every bit as important as the specific recommendations made to government, as public acceptance of the relative merits of structural changes to the economy is essential not only for promoting reform but for sustaining it. Of course, in any reform process political will is of the utmost importance. The development of policy review processes can, however, assist by putting pressure on the political process to attend to the problems that they expose. In this respect, independent, credible policy review processes can often be a valuable addition to central government agencies as they have a greater capacity to expose the deficiencies of existing government policy.

There is some anecdotal evidence to suggest that the public service in Solomon Islands remains highly politicised. It is therefore constrained in its ability to expose the vested interests of government and the urban élite, who yield significant power. A key task for RAMSI, therefore—given its renewed political relationships and mandate for reform—is to place an emphasis on identifying and developing institutional mechanisms capable of playing this external policy review role to build the country's long-term capacity for reform. International financial institutions already serve this role, but to a limited extent.[4]

Current institutional strengthening efforts are already contributing to the process of public awareness of and debate about these issues. For example, there is now an extensive range of public consultations held with regional and local authorities as part of the annual budgeting process and community-based lobby groups are being given support. The RAMSI outreach program also seeks to inform the general public about the intervention and how they can better participate in the political process, helping to create a better-informed electorate. These are positive developments.[5]

It is also important, however, that policy review processes are embedded outside the central bureaucracy to help create an institutional environment that is capable of exposing and mediating between the vested interests of the country's urban and political élite.

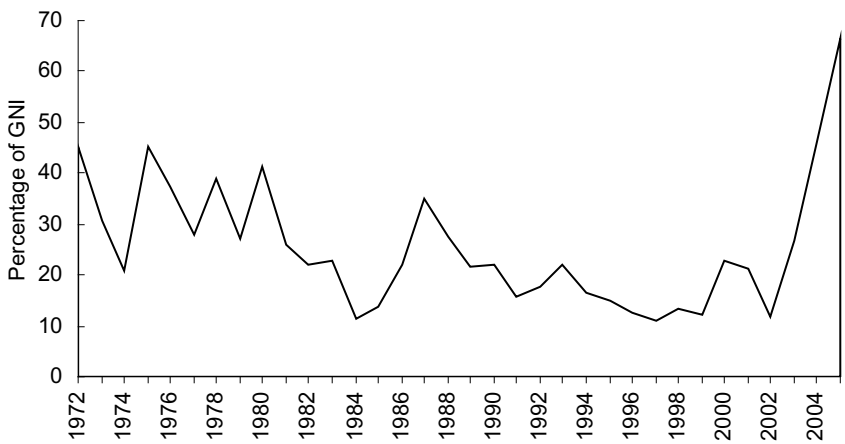
Where, then, should these external policy review mechanisms come from? As with all institutions, policy review mechanisms have their roots in history and are highly country specific. Given the power asymmetries in Solomon Islands, the simple creation of a new external policy review agency might easily be taken over by bureaucrats and politicians who have a vested interest in maintaining the *status quo*. Solomon Islands also has serious human capital capacity constraints, posing difficulties in filling the staffing requirements of any domestically based institution, particularly one requiring specialised skills.

The most obvious regionally based mechanism to perform this role would be the PFTAC, based in Fiji. To an extent, it is already doing this. PFTAC has, however, tended to concentrate its efforts in Solomon Islands on providing technical assistance,[6] addressing the problem of finding a technical solution to a reform challenge.

Institutional development in Solomon Islands

The major barriers to policy reform in Solomon Islands are, however, driven increasingly by a lack of political will rather than a lack of technical knowledge of what the best reform options are or how they should be carried out. Consider two major potential barriers to policy reform in Solomon Islands: the first is that the best policy options are not implemented because of a lack of capacity or technical knowledge about how to carry out reforms—that is, the government is unaware of the best policy option or is unable to implement it. The second is that good policies can be frustrated because of resistance from vested interest groups. The government itself might have a direct interest in keeping poor policies in place and/or the political parties in power have benefactors likely to lose from change. The second barrier is compounded by the

Figure 12 **Total overseas development assistance, 1972–2005** (per cent of GNI)



Source: World Bank, 2007. *World Development Indicators 2007*, World Bank, Washington, DC. Available online at http://publications.worldbank.org/WDI (accessed 20 January 2008).

presence of large information asymmetries in Solomon Islands, such as those between the public and the few, well-organised lobby groups. With the deployment of RAMSI and with the continued support of mechanisms such as PFTAC,[7] the cause of a lack of reform tends increasingly to fall into the latter of these categories.

As such, new institutional strengthening efforts need to focus more on building a constituency for reform rather than creating technical knowledge for what reform needs to occur. Policy reviews aimed at analysing the gains and losses to all players—not just the vested interests—can help in this regard by marshalling countervailing interests to strengthen domestic institutions in favour of the public interest (Dee 2008:50).

A 2005 review of PFTAC found that its activities should be defined more clearly in terms of an overall strategy that would acknowledge the three distinct types of assistance: *ad hoc* advice, capacity-building assistance and longer-term reform assistance (IMF 2005a). This type of continuing policy review assistance would provide a useful addition to the last of these categories and would help enormously with overcoming the large number of vested interests within the country and help to build a greater constituency for reform.

Such a function could be utilised also as a major capacity-building tool for RAMSI by allowing domestic bureaucrats to work within the review office at relevant points, gaining invaluable skills of policy review and analysis. In time—as locals built up the requisite skills—review teams could even be made up almost entirely of Solomon Islanders. By creating an environment of improved policy contestability and transparency and by crowding in rather than crowding out local capacity, this type of assistance is likely to provide a significant boost to the reform efforts being undertaken.

Perhaps the biggest challenge of this approach would be the ability of such a review office to generate the requisite political cooperation required for *ex-ante* policy reviews, particularly in an environment such as Solomon Islands where members of the government are sometimes the major beneficiaries of such reforms.[8]

Australia could play a key role in this regard by imposing constraints on the disbursement of further assistance conditional on the satisfactory provision of information to the review office, which enables it to carry out effective, timely review processes. Although there is significant evidence to suggest that aid is most effective when delivered to good policy environments,[9] trying to reward good policy decisions has been an inherently difficult process for donor countries given the subjective and political overlays in the decision-making process.[10] This has led to the creation of some elaborate ranking and scoring mechanisms by a number of research institutes, most notably by the Millennium Challenge Account.[11] These approaches (which rely on subjective perception-based indicators of policy performance) are, however, vague at best and many donors have shied away from using them to determine aid allocations. Linking performance payments to the satisfactory completion of policy processes (as opposed to outcomes) would still pose challenges, but could help to circumvent many of these difficulties.

In this situation, policy could be reviewed *ex-ante* and *ex-post* equally by central agencies and with the review office giving an annual, or bi-annual, assessment of cooperation by domestic policymakers providing a litmus test for government commitment to reform. The independence of the multilateral organisations would also add a degree of credibility to Australian efforts to reward good bureaucratic behaviour, or punish bad.

Aid effectiveness

It is now accepted within the aid-effectiveness literature that significant non-linearities exist with regard to the impact of aid on economic growth (Burnside and Dollar 2000, 2004; Hansen and Tarp 2001). Several cross-country studies show, for example, that the marginal return to aid tends to decline as the amount of aid increases, so that—after a certain level—additional aid has little or no effect on growth (Collier and Dollar 2002; Hansen and Tarp 2001; Radelet et al. 2005).[12]

This foreign aid 'saturation point' is generally considered to be a function of the recipient's economic, political and cultural circumstances, with factors such as macroeconomic conditions, institutional and policy performance, infrastructure (or physical capital) levels, level of human capital and a variety of socio-cultural constraints contributing to the amount of aid a country can absorb. For example, as binding constraints on capacity are reached, skilled labour costs rise, physical infrastructure congestion increases logistical costs, administrative bottlenecks become overwhelming, public sector fiscal behaviour begins to distort and assistance efforts begin to soak up or crowd out domestic capacity; therefore, the returns to aid fall.

For the majority of studies, the implied saturation point of aid ranges between 15 and 45 per cent of GDP. This provides an idea of the maximum level of aid flows that most recipient countries can absorb without the negative effects of foreign aid beginning to outweigh the positive (Clemens and Radelet 2003:7).

Since 2001, and accelerating with the RAMSI intervention in 2003, the volume of Australian assistance to Solomon Islands has increased dramatically, from approximately 12 per cent of gross national income (GNI) to more than 65 per cent of GNI. The largest part of the aid has been in the form of technical assistance (Figures 10, 11 and 12). While analytical work to determine the optimal level of aid flow has yet to be done,[13] recent levels are likely to be well above the desirable level given the country's weak institutional foundations and public sector capacity, low levels of human capital and limited physical infrastructure—particularly when such a large increase has occurred so quickly.

The rapid increase in foreign assistance to Solomon Islands poses some important macroeconomic risks for RAMSI. How can RAMSI improve the effectiveness of its support?

Incentives of aid delivery

A growing body of literature highlights the large range of adverse incentives faced by donor agencies and the impact that this has on the efficiency of their service delivery (Easterly 2003). The basic premise behind this argument is that the delivery of services is most efficient when the responsible organisation has an incentive structure that induces it to behave similarly to a firm in a free-market economy. Because this is often not the case in aid bureaucracies, they do not behave in a way that maximises the efficiency of their service delivery. There are various reasons for this.

Insufficient feedback from aid recipients to donors. While the private sector responds to price signals to provide goods and services that are in demand, the aid bureaucracy must adopt a supply-driven approach, which does not allow it to allocate resources to their most highly valued uses.

A lack of accountability to aid recipients. In a competitive environment, the private sector continually seeks out more efficient methods of production and service delivery, but aid donors are rarely held accountable for failing to achieve their objectives. Because of this, they have little incentive to improve the quality or efficiency of service delivery.

A lack of competitive pressures. While the private sector seeks to maximise profits by minimising operational costs, allowing firms to capture a larger market share from other producers, aid agencies operate in an environment that Easterly (2003) calls 'the cartel of good intentions'. Aid agencies generally do not compete to provide services to recipients of aid; therefore, more efficient organisations cannot capture a larger share of the aid delivery market—nor are inefficient suppliers squeezed out. As a result, aid agencies have little incentive to minimise costs (Chand and Batten 2007).

Improving aid delivery

One of the most promising methods for providing incentives for the delivery of aid in Pacific island countries—which has been achieving some of the most hopeful results in Africa and South America in recent years—focuses on providing greater clarity for the objectives of aid projects and increased transparency on progress regarding its achievements (and failures). This aid modality has taken on many forms, including 'output-based aid', 'payments for progress' and 'progress-based aid'; the basic principle underlying each is to link aid payments to specific measures of progress within each project (Chand and Batten 2007).

A payments-for-progress system, for example, would focus on tying the delivery of aid to the satisfaction of requirements for making advances in outcomes on the ground. Donors would bind themselves to pay a predetermined amount for clear evidence of progress against each one of the goals agreed to with the recipient government. The onus would then rest with the recipient government to present an independently audited statement reporting its progress on each of the measures. Payments would be determined as a function of the outcomes—not linked to the implementation of any particular policy, any other intermediate outputs or 'tied' to purchases from particular suppliers or companies. The key point is that when the recipient government finds a way to deliver a service in a cost-effective manner, it will be rewarded with more funding—therefore freeing up an even larger amount of resources.

The other important element in this type of system is that it gives a significant degree of flexibility and autonomy to local, ground-level institutions, which creates space for local institutional experimentation while ensuring that aid pays only for achievements. The benefits of such systems are being increasingly well documented, perhaps most prominently by researchers at the Centre of Global Development in Washington, DC (for example, Barder and Birdsall 2006).

This work highlights that these types of schemes impose increased levels of accountability on recipient governments. For example, if parents know that funding is available for their government to meet the costs of providing primary education for all children, unencumbered by any other conditionality, this permits them to hold the government accountable for public schooling. Such schemes also demand increased accountability of donors; if donors agree to be held jointly and severally liable for their commitment to pay for progress, they can exert peer pressure to bear the costs as they fall due. There are, of course, difficulties associated with these types of aid modalities, and it has been shown that simplicity in program design and transparency of outcomes are critical for this mechanism to deliver.

While improving policy performance and institution building should remain the core focus of RAMSI, there is still an important role to be played in delivering important services to the people of

Solomon Islands. Experimentation with new aid delivery modalities that harness the power of economic incentives should become a central focus of the Australian government. While AusAID has been an active supporter of global initiatives such as the Global Partnership for Output-Based Aid, it has been relatively slow in its own uptake. In part, this could be due to a degree of risk aversion surrounding the potential political consequences of failed projects; the delivery of foreign aid is a grey science at best. Experience shows, however, that experimentation is often the key to improvements in aid quality. Challenging the *status quo*—while occasionally resulting in failure—can lead to dramatic improvements in service quality. What is more, failure in one policy area can offer important lessons for the design of other policies.

One possibility that holds promise for Solomon Islands, as well as for other Pacific island countries such as Papua New Guinea, is the introduction of a progress-based education fund (PEF). Access to quality education for the people of Solomon Islands remains relatively poor despite the huge levels of assistance being received. There are several reasons for this, including deficient supply and demand for education services. A PEF could help correct both.

A PEF essentially mimics the positive incentive effects of the market, whereby a price is set for progress in education and funds are allocated on the basis of progress made by schools. Providing funds to schools for progress made in educational outcomes also places resources at the front-end of service delivery. There are, of course, detailed requirements relating to how such a system would work (which can be found in Chand 2007). These requirements could be adjusted and set in motion through a pilot scheme, which would allow 10 or so selected schools to access the program.

Potential long-term benefits of labour mobility

Another significant point to emerge from the economic growth literature is the important role that access to foreign labour markets can play in inducing improvements in living standards in the source country. There is a great deal of literature showing that the largest gains in global welfare would accrue from freeing up movement of unskilled labour (Winters et al. 2003; Martin 2003; Athukorala 2004) and the Pacific is by no means an exception. Income earned from workers abroad is likely to provide a sustainable source of revenue for the Solomon Islands government and relieve some of the resource constraints it currently faces. Remittances already constitute a significant part of the economies of Fiji, Niue, Samoa and Tonga (Narsey 2004). Easing conditions for the (temporary) movement of unskilled workers would give remittances an even greater role in the sustenance of the island economies—and remote communities—of the Pacific. Such flows—if temporary—would prevent depopulation of the smallest of such communities. Reverse flows of retirees, tourists and volunteers, moreover, would generate employment opportunities within remote communities. Allowing for reciprocal arrangements on temporary flows between developing and industrial-country partners will assist such a process while deepening cultural, economic and political ties across the region.

Policy debates about temporary worker schemes have highlighted that they entail risks. Concerns are often raised about 'brain drain', depopulation, depression of recipient country wages, overstaying, poor treatment of temporary workers, the migration of criminals and migrants' access to local services. Experiences across the region with labour mobility indicate, however, that many of the problems of

labour mobility are not as pervasive as once thought. Depopulation, for example, is the least of concerns for countries such as Samoa and Tonga, which have historically experienced large outflows of labour. This is because large islander communities already exist in the industrialised countries of the Pacific Rim. Samoans and Tongans living in Auckland, Sydney and Los Angeles maintain regular contact with their kin at home. These overseas communities form the basis of regular international trade and commerce.

Chand (2004) and the World Bank (2006) provide more detailed discussion of the remaining risks and how they can be managed. There is also a large and growing literature on the potentially large gains to Australia from allowing temporary movement of Pacific islanders into its labour market (Winters et al. 2003; Martin 2003). Deepening labour markets can therefore be welfare enhancing for the region as a whole. The challenge for the Australian government is to design a scheme that will maximise the benefits of a temporary worker scheme for Australia and the Pacific. The final section of this paper elaborates on the design of such an effective scheme.

A well-designed labour mobility scheme could also improve incentives for educational attainment in Solomon Islands. Clearly, in countries such as Papua New Guinea and Solomon Islands, parents withdraw their children from primary school because—with limited job prospects—they see little point in investing in their education. The idea would be to link temporary access to the Australian labour market to the achievement of a base level of education—for example, the Year 8 Certificate—a level that could equip the worker with the language skills to communicate in English. This type of scheme would offer benefits over and above a typical unskilled visa arrangement, including but not limited to

- providing an incentive for young Solomon Islanders to demand higher levels of educational attainment, thus increasing their propensity to stay in school
- improving the capacity of migrant workers to function effectively while working in Australia
- promoting a net 'brain gain' in Solomon Islands, as guest workers eventually return home and form part of a more skilled workforce
- not limiting Australian labour market access to élite Solomon Islanders, as is the case with the current skilled migration visa program.

Concluding remarks

While the political and economic gains made in Solomon Islands remain fragile, recent developments there give a sense of renewed hope in its ability to overcome its major development challenges. Recent criticisms of RAMSI have often been made without appropriate consideration of the longer-term implications of an Australian-led boost in service delivery aid. Rebuilding the central institutions of the State so that they can then themselves improve the quality of service delivery to the rural majority should remain the core focus of the intervention; better still would be the case where such an improvement is induced by demand from within Solomon Islands.

Moving towards a brighter economic future does, however, require a tweaking of convention in the approach to aid. Experimentation—and the risk of failure that this entails—is to be welcomed rather than avoided. Lessons from these experiments have the potential to contribute to improving

aid effectiveness. As outlined in this paper, a move away from project-based aid towards performance-based incentive schemes is worthy of consideration. At best, it has a chance of improving the quality of service delivery; at worst, it could provide lessons about what else could be done. Furthermore, a focus on strengthening the existing non-governmental institutions within the country as a means of embedding a process of continued rather than one-off policy review provides one way of overcoming the many obstacles to policy reform.

Finally, Australia needs to look at creative ways to develop Solomon Islands' economy without overwhelming it with huge inflows of financial and technical assistance. Australia must be careful, however, that in scaling back the large financial assistance of recent years it does not create excessive levels of financial volatility. One feasible way of assisting the development of Solomon Islands without placing further pressure on its capacity constraints would be increased labour mobility into Australia.

Notes

1 Detailed descriptions of these reform efforts can be found at www.ramsi.org

2 Albeit from a low base after the massive contraction of the economy in 2001.

3 This research is being discussed widely across the Asian region and is making a significant contribution to the Asia-Pacific Economic Cooperation (APEC) structural reform agenda first discussed in Sydney in 2007. The reform agenda will be discussed further at an APEC ministerial meeting in Melbourne later this year.

4 Examples include the World Bank's 'cost of doing business' surveys and the International Monetary Fund's *Article IV* reports.

5 Other efforts that have made a significant contribution to strengthening the accountability of policymakers have occurred through the Leadership Code Commission, the Ombudsman's Office and the Auditor-General's Office.

6 PFTAC carries out an average of more than 50 technical assistance missions each year to its 15 member countries with at least one capacity-building exercise embedded in every technical assistance intervention. PFTAC also focuses on organising a number of regional forums to share experiences and best practices. Shorter-term assistance includes attachments between member countries, PFTAC and relevant agencies as well as *ad hoc* responses to member requests on specific issues (see www.pftac.org for more information).

7 The ADB, in conjunction with funding from AusAID, has also contributed important technical reports at the bequest of the Solomon Islands Finance Department, such as *State-owned enterprise reforms and private sector participation* (ADB 2007) and *Diagnostic assessment of inter-island transport* (ADB 2006).

8 *Ex-post* policy review tends not to require the same level of political or bureaucratic cooperation given that the policy has already been made public.

9 See, for example, Burnside and Dollar (2000, 2004).

10 This process is made all the more difficult in countries such as Solomon Islands, where many subjective indicators of policy performance constructed by a variety of think tanks and research centres are not available.

11 See www.mca.gov.

12 While aid effectiveness refers to the total return on aid, a country's absorption capacity for aid is about the marginal rate of return to aid.

13 The economy-wide MAMS model developed by the World Bank to analyse 'Millennium Development Goal' scenarios—but now applied regularly to questions of absorption capacity—could be useful for this task. This would also offer a useful point of engagement for the bank, which is seeking to increase its assistance to fragile states. MAMS is a general equilibrium model that traces the impact of aid via its impact on markets for labour, goods and services, and foreign exchange and its impact on social welfare and economic outcomes. These outcomes flow back into the model to form a dynamic equilibrium. See Bourguignon et al. (2004).

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