

Pacific economic policy: to invest or to protect?

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Academics and international development agencies express growing concern about the lack of economic growth in the Pacific islands and the economic policies employed by these countries. Even where there has been growth, it has usually been dependent on a few industries such as minerals, tourism, tuna and forestry. This growth has been highly susceptible to external disturbances, and, in many cases, has provided limited benefits to the local economy.

The concern over policies in support of growth is the subject of the publications of Duncan (1994), Siwatibau (1994), and the *Pacific 2010* research project of the Australian National University. International agencies have also contrasted low growth with high levels of aid—the World Bank refers to this apparent contradiction as the ‘Pacific Paradox’ (World Bank 1993). In 1994, the South Pacific Forum turned the region’s attention to policies in support of sustainable economic management.

Sound macroeconomic policy?

If the broad goals of macroeconomic policy are economic stabilisation and the generation of savings in support of investment and employment, then it is possible to question

Duncan’s (1994) comment that the economic policies of the Pacific islands are diametrically opposed to what are now widely recognised as the requirements for sound economic development. While this comment is not far off the mark for some policies and countries under certain governments, other efforts must also be noted.

Some smaller governments, notably Kiribati and Tuvalu, have been especially fiscally prudent since independence, consistently foregoing consumption to save for future generations. In addition, many countries in the region retain hard foreign currencies as their medium of currency exchange, and while this practice limits the options for macroeconomic management it helps maintain relatively stable monetary environments.

Moreover, with a few exceptions, few countries have placed policy restrictions on the movement of foreign currencies, goods, or peoples, although the same countries have placed other obstacles to trade and investment. The World Bank’s Pacific member countries ‘have been more successful in achieving macroeconomic stability than in achieving growth’ (World Bank 1993:2).

Aid is a key factor influencing sound macroeconomic policy. Aid influences both

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the domestic fiscal and the international trade accounts. In both cases because aid is commonly tied to goods and services and is not provided as cash, fungibility is extremely limited, and the debits and credits of aid cancel each other out. Budget and trade deficits are not so much a reason for, as a result of, aid. This situation does not, however, mean that aid does not import other longer-term costs, apparent in the case of additional recurrent costs and expanded government activity.

There has not always been sound macroeconomic policy. The international indebtedness of the Cook Islands and Papua New Guinea, the recent policy inconsistency of the Papua New Guinea government, the increased fiscal deficits of American Samoa, Marshall Islands, and the Federated States of Micronesia, all prevent any such general argument.

But even where macroeconomic policy has been sound (or at least stable and conservative such as in Kiribati and Tuvalu), it has not led to value-added investment, trade and growth. There must therefore be more at issue than sound macroeconomic policy. The policy equation should be further dissected. An environment that is supportive of economic growth does not consist solely of setting appropriate macroeconomic policies. Equally important are relevant microeconomic policies, including factor market policies, as well as the implementation of these policies.

A vested microeconomy?

The region has enjoyed a profusion of projects, programs, and other facilities implemented by aid donors and regional organisations aimed at strengthening infrastructure, transportation, communications, trade, skills, health, education, development finance and more: all in support of economic

growth. But, despite all this assistance, island economies have not grown significantly, and in some instances they have stagnated (Browne 1995). There has been little 'pay-off to aid', which is partly the result of microeconomic policy (Duncan 1994).

If the primary goal of microeconomic policy is to remove domestic distortions in support of investment, employment and improved welfare then, unlike macroeconomic policy, the region has been slow to endorse the 'best' microeconomic practice. The operations of the domestic economy have been distorted by expansive government and the continued subsidisation of public utilities and public enterprises by many island governments, continued subsidisation of key services and staple commodities such as inter-island transportation and copra, uneconomic utility pricing, and tariff setting in favour of revenue generation. These distortions may have temporarily enhanced government employment and public sector and community welfare, but jobs and welfare have been achieved only at the cost of a climate that deters long-term private investment.

Hidden subsidies in the form of soft finance and underemployed government labour, low public sector labour productivity, and, in some cases, a lack of loan supervision and collection, hidden inter-public enterprise and inter-government credit, and a higher tolerance for tax arrears are further examples of a lack of financial discipline and poorly directed resources.

Government intervention has consistently favoured established interests of the traditional and government sectors at the expense of the emerging interests of private business. There remains a common requirement for both public and private enterprise reform incorporating greater enterprise accountability whether in the form of private profit or public output.

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Some reforms could be undertaken by island governments with minimal additional external assistance. Moving toward a full-cost user fees policy will help improve resource allocation. Adopting strategic output budgeting will enable policies and development strategies to be translated into policy-accountable budgetary practice, as the Government of New Zealand has proved. The same budgetary system will make performance-based staffing possible, aiding reforms of the public sector, public enterprises and the labour market.

Forgotten factor markets

In the case of the Pacific islands, public sector microeconomic reforms do not go far enough. Achieving economic growth is not just a matter of marshalling the standard macro and microeconomic policy environment. Economic growth also relies on supplying domestic factors (land, labour and capital) at a price and in a condition that will allow domestic economic gain. The factor market component of microeconomic policy has been underemphasised in the recent debate on economic policy. The aid industry has funded, and Pacific governments have implemented, many infrastructure, transport, communications, education, health, development finance and other supply-side support programs. The economic impact of these programs has fallen short of intended results because the supplies of Pacific islands' land, labour and capital remain protected and in some cases expensive and therefore uncompetitive.

Investment and trade are not only economic transactions; they are also important social and political transactions. Domestic factors of production (including complementary information, innovation and entrepreneurship) and indigenous businesses are subject to social and political valuation and influence.

In the Pacific, social and political influences over trade can be great. The demands of the community influence the availability and pricing of domestic factors, commodities, commercial services and business in general. Greater reserve prices are placed on the essential requirements of the modern economy.

Land is commonly committed to the requirements of a partially subsistence economy with many complex, personal, traditional and customary applications. The complex nature of land tenure in the region has been extensively documented. However, less well analysed, with some notable exceptions such as Fiji and Rarotonga in the Cook Islands, is the lack of a market for either freehold and /or leasehold land in the islands. This greatly restricts the development of a domestic property market. The lack of a domestic property market, in turn, curtails security for commercial credit. Pacific domestic commercial capital markets are commonly small, with excess capital exported and lost to the region's economies. While the export of excess capital from small, vulnerable economies must be expected, this excess could be reduced if a domestic capital market were to develop.

The reserve price for the second economic requirement, commercial capital, may be high relative to other economies where land can be employed for collateral purposes. Some may argue that as a result of the level of aid, the region does not have a capital constraint. However, this capital is usually tied to a particular use, it circulates little and little multiplies internally, obviating the need to create a domestic capital market.

Labour is subject to the continuing requirements of subsistence activities, limiting its availability and raising the price of labour to the non-subsistence economy. In some countries the expectations of remuneration are reinforced by welfare payments, especially in the French and

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US-linked territories and countries. In the same countries, wage expectations are greatly increased by a large and disproportionately remunerated government sector. Labour forces in still another group of countries may also consider the opportunities for higher paid employment overseas. The reserve price for Pacific labour can therefore be high relative to what the economy, or at least certain sectors of the economy, can afford. Noticeable exceptions are the labour forces of the resource-poor atoll economies where migrants have accepted relatively low paid unskilled employment on other islands. While the restrictions on labour availability and pricing may not be as extensive as land and capital, the phenomena may nevertheless be strong with respect to particular sectors or segments of the labour market.

In a number of countries indigenous business has been protected from foreign competition, more by practice than by tariff barriers, thereby driving up the reserve price of domestic commerce. The 'price' of foreign investment may also be further distorted by political interests, for example, by redirecting foreign investment in order to benefit a particular electorate.

Domestic factor markets and commerce are either undeveloped in the case of land and commercial capital or underdeveloped in the case of commerce. The domestic labour market may also be hampered by strong price preferences. The Pacific region's land, unskilled labour, capital and commerce are also relatively expensive in comparison with the same factors from other regions.

Although a proportion of indigenous Pacific businesses succeed, these businesses remain small, isolated and restricted by industry despite the protections from foreign investments (Pollard and Qalo 1994). Aid-supplied alternatives have probably helped to greatly lessen and to postpone the pressure to develop domestic factor markets.

Although relatively high domestic reserve prices have deterred private sector investment, they have not depressed public sector investment. In deterring private investment, the absorption of new information, technology and innovation, which can lead to further growth and investment, is also discouraged. Existing investment has tended to be short term.

National development plans, strategies and policies may have been thoroughly analysed (Siwatibau 1994), however, the reason these plans are not adequately implemented is not solely because a commitment to declared goals is lacking but also because these plans are based on flawed assumptions. Such plans commonly assume a ready availability of transferable land, labour, capital and services. Development plans assume labour constraints will be overcome by education and training, and capital constraints would be overcome by development finance. The plans do not reflect the true priorities and policies of both the leaders and the people who place high reserve prices on domestic factors and services. Focus on sectors such as fisheries, tourism, education, and health is also politically neutral and overlooks the prior need to mobilise domestic factors and services if domestic economic growth is truly desired.

It should present no surprise that Pacific economies have grown little, given the high domestic reserve prices, economic policies favouring the public and traditional sectors, and economies based on foreign rents rather than resource investments. Non-commercial kinship obligations, values and vested interests may also deter economic growth.

The lack of attention to factor pricing and mobility begs the question of why this issue is overlooked. The reason may not amount to a gap in information but rather a preference for current tenure and distribution. Aid and foreign investment may also mask this preference. By implication,

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the same reserve pricing may imply a desire to avoid, or not to commit to, economic growth and the implications of growth as embodied in national development plans.

Contrary institutional practices

Stable economic policy is vital to investor confidence (Duncan 1994). Any apparent policy inconsistency may be indicative of not only a lack of political commitment to explicit policy but also a commitment to other preferred policies. Non-economic and vested economic demands may have a greater influence over trade, investment, and factor markets, and this influence may be manifested in institutional practice.

Even where declared policies should have supported investment and growth, the institutional environment has often prevented the realisation of the benefits from policy implementation. Possibly all Pacific island countries declare support for long-term foreign investment and have a number of policy instruments, in the form of laws, taxes and investment missions, to attract it. But sound, sustained investment has commonly been deterred by institutional practice.

Other institutional deterrents include the lack of internal coordination within government, lack of equitable law enforcement, approval processes that favour discretionary as opposed to open universal treatment, a preference in some countries for government rather than private investment, a concentration of decision-making on hierarchy or consensus rather than delegation, and a preference for political over executive endorsement. The issuing of essential work permits and business licenses can also be subject to exacting regulations and interpretations.

Domestic investment is additionally curtailed in many close communities where, for example, relatives or other close

associates as officers of a land registration entity, a business licensing bureau, and / or a national development bank may have difficulty in objectively appraising local registrations, licensing and loan applications from influential domestic investors.

Not only are prospective investors deterred by contrary practices and protective pricing policies, but shorter-term exploitative undertakings are invited. The current investment environment attracts short-term and exploitative logging, drift netting, mobile processing, and plant and equipment sales disguised as investment.

In such circumstances sound private investment is also unlikely to materialise even if sound economic policy were a condition for international aid. If the goal is economic growth then institutional reforms are not merely essential complements to economic reform (World Bank 1991), they are essential pre-requisites.

Protection?

In the Pacific preferences lie more in protecting and maintaining the *status quo* than in risking domestic investment and change. The existing beneficiaries of the current factor and commercial regimes are unlikely to support any change in this situation. If the region wants more economic growth, to what extent should governments and peoples lessen this protection? Current development theory favours market deregulation, competition and free trade.

Encouragement of the private sector, complementary government investments in education and infrastructure, and stable governments have served other economies well, such as in South East and East Asia, but have not necessarily been supported by unfettered factor markets and free market practices. Protection was a feature in the development of the industrial economies,

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and still is. In lessening its protective stance the Pacific should observe the new world traders' practice as well as examine development theory. All societies and economies place some protection or 'reserve prices' on their domestic factors. Why shouldn't the Pacific?

The renewed emphasis on free trade can be misleading in that it neglects the context of policies and practices controlling domestic business and industry. While the more developed economies may have comprehensive regimes in place, controlling monopolies, cartels and other restrictive practices, the Pacific islands generally do not. This arena can be just as protective as international trade is supposed to be free. Today's economies do not need protective tariffs to protect domestic industry. Will the industrial economies allow the islands free and fair trade and investment? The industrial economies may be comparatively well positioned to take advantage of freer trade, but does this situation present a level playing field for Pacific producers?

In a small country with no free trade, industrial growth may be inefficient, however, with free trade a small country may experience no growth at all and may in fact deindustrialise (UNCTAD 1985:25).

Protection and investment are not alternatives; they are complementary facets of growth.

Whereas Asia, North America and Europe may have long protected their industries, sometimes beyond their comparative international economic viability, the Pacific islands are protecting factors of production preventing industrial development.

Rents or resources?

If the region's overall development policy and practice is viewed as one that protects the region's economic factors and interests, an alternative interpretation is placed on the MIRAB (migration, remittances, aid and bureaucracy) development equation or the theory of Bertram and Watters (1985). Rather than view the MIRAB economy as an economy where rents predominate and where alternate domestic resource development is redundant, the MIRAB economy should be viewed as simply one that results from factor protection, factor export and domestic private sector restraint, reinforced by aid and short-term foreign investment.

If economic management is focused on strengthening foreign rental earnings through remittances, overseas investments, licenses and aid, the need may be obviated to mobilise and to risk domestic factors in raising incomes from greater national resource development. The MIRAB experience has so far led to minimal national economic growth.

Some island governments may wish to lessen their economic dependence on aid and other foreign-sourced rents. Even if rentals could be strengthened through internationally invested trust funds and increased fish license fees, the resultant incomes that may help reinforce island welfare and cultural identity do not help economic independence through domestic investment and new domestic economic activity.

'Rentier economies' have not necessarily avoided the creation of greater individual inequalities. In the absence of land reform, informal land transfers are increasingly taking place in the region leading to more unequal distribution of land. The Federated States of Micronesia's second national development plan refers to 'large tracts of land being aggregated by individual private owners' (FSM 1993:248) with an increasing proportion of the population

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existing on small, inaccessible, leased plots or being landless. Such transfers are made with little protection of the rights and responsibilities of parties to the transfer thus adding to the complexity and uncertainty of the market. Land reform is needed to provide a new legal, administrative and economic framework that is both accepted and enforced and that protects all parties to formal transfers.

What reform?

If the Pacific desires domestic investment and economic growth, there may be no recourse save to lessen factor protection, revise reserve prices, and correct existing institutional practices. Complete removal of existing institutional protection is not politically feasible, and there may be little case for such an extreme.

Commitment to reform must be deep, comprehensive, substantially accepted by the community and long term. It must embody land reform and enterprise reform; be comprehensive in its coverage of policy, institutional practice, factor availability and pricing reforms; and be understood and agreed on by small, close communities.

Land reform may require repeating the kind of effort undertaken by Fiji's Ratu Sukuna who held extensive meetings with the community in the 1930s to convince the people of the wisdom of establishing the Native Land Trust Board. While this institution may now be outdated, the effort involved provides lessons for today. Enterprise (private as well as public) reform can be based on the efforts of successful indigenous private entrepreneurs as well as foreign investment.

There are a number of initiatives that the governments of the region could undertake that would support the required reforms. In the case of land, they could simplify

legislation, improve survey, registering titles, conduct independent audit and appeal, and maintain up-to-date records in support of a market in leased urban land. In public sector reform, the adoption of strategic output budgeting can effectively translate the prevailing policies and development strategies into budgetary practice. The concentration of government investments in education, especially in support of specific skills, needs to be continued. New tax regimes, strengthened public investment planning and general policy analyses are also still needed in many countries.

Many of these reforms are possible. Fiji has adopted a number of macroeconomic and microeconomic reforms. Kiribati, as other countries, has shown that investments in education can show returns. I-Kiribati have been trained as lawyers, pilots, economists, statisticians, accountants, doctors, nurses and other professionals as well as professional administrators. Output budgeting is being adopted by the governments of Kiribati and Tuvalu. Marshall Islands, Niue and Tuvalu are also working on public sector reform.

These efforts are incomplete, and if the experience of the transition economies in Central and Eastern Europe provides any guidance then the factor and enterprise reforms under consideration are likely to be prolonged if not postponed. As Roland (1994) suggests with respect to Europe, where political constraints exist, the process of privatisation will be slow and gradual.

The aid programs of the Asian Development Bank, Australia, the European Union and Japan may continue to spend in the Pacific islands while the United Kingdom, the United States, the World Bank and others now lessen their presence or withdraw. Some donors may press for a more accountable, if not acceptable, policy framework while others continue to fund unsound ventures. Whatever the aid industry's

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vogue, whatever its conditionality, or whatever trade or economic pact may be promoted from without (Duncan 1994), the export of island labour and capital to rim countries and corresponding import of commodities is likely to continue unless investment is favoured over protection. Aid has so far had limited influence over general economic policy and even less over institutional practice and domestic factor markets. Aid has alternatively helped island governments to maintain a policy of factor and commercial protection and factor export and to postpone the creation of an economy in support of domestic investment.

The international aid community should match the Pacific's commitment with professional assistance where required. Such assistance should support the barest form of economic protection, strengthening economic management. At the same time, capital aid must be reformed to take full account of the recipients' economic structure, including factor pricing and institutional practices.

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