



Is there a need for a Pacific Islands Development Bank?

James Mak and Seiji Finch Naya

James Mak is Professor of Economics and **Seiji Finch Naya** is Chairman of the Department of Economics, University of Hawaii at Manoa, Honolulu.

When people speak of the dynamic Asia-Pacific region with its impressive growth and rising economic interdependence, they almost never include the Pacific islands despite their central location in the Pacific Ocean. Frequent talk of the coming 'Pacific century' likewise overlooks the Pacific island economies. The existing institutions in the Asia-Pacific promoting regional economic cooperation, such as the Pacific Basin Economic Council (PBEC), the Pacific Trade and Development Conference (PAFTAD) and the Pacific Economic Cooperation Conference (PECC), pay hardly any attention to the problems of the Pacific island nations. Even the Asia-Pacific Economic Cooperation (APEC) forum, which held an unprecedented informal leadership summit in 1993 and is spearheading the effort to make the vision of an Asia-Pacific Economic 'Community' a reality, only included Papua New Guinea in 1993.

There are three basic reasons why Pacific island countries are bypassed in such discussions. First, the Pacific islands group is small in terms of population and economic strength. Second, the Pacific islands are remarkably diverse culturally,

politically and economically. Third, in sharp contrast to the economic dynamism of the Asian developing economies, the Pacific islands for the most part have shown little economic vitality. Per capita incomes in many of these island economies have declined since the 1980s.

The Pacific island economies encounter many handicaps in their efforts to achieve sustained economic development including the lack of resources, poor soil fertility, wide geographic dispersion, great distances to markets, frequent natural disasters, inadequate infrastructures, rapid population growth, scarcity of skilled labour, and small domestic markets. Most of the islands are beset with fiscal deficits, domestic resource gaps and limitations on indigenous capacities—skills, knowledge, and institutions. Some people believe that a regional development bank tailored to the needs of these island economies would go a long way towards overcoming these obstacles.

This paper argues against another regional development bank. Instead, it recommends the establishment of a Pacific Islands Development Fund. This Fund is intended to be broader and more

encompassing than the traditional long-term multilateral lending institution. The proposed Pacific Islands Development Fund would have the role of a development finance institution and, at the same time, serve as a resource centre and clearing house for development strategies and project studies in the Pacific islands. The focus of its operations would be the granting of technical assistance in the short term, by providing policymaking and development management advice to member governments and private institutions requiring expert services, and in the long term, by developing an indigenous critical mass of policy analysts and economic managers needed to ensure sustainability of policy reforms.

Development of the multilateral lending institutions

Since the founding of the World Bank in 1944, there has been a proliferation of regional multilateral development banks. The Inter-American Development Bank was established in 1959 by the United States and 20 Latin American countries. The African Development Bank (AfDB) was established in 1963 by 33 African countries to promote the integration of the economies of African nations. The Asian Development Bank (ADB) was founded in 1966 with 31 member countries, of which 14 were non-regional members. The Caribbean Development Bank (CDB) was founded in 1970 to cater to 10 less-developed island countries in the Caribbean as well as 8 additional island groups. The European Bank for Reconstruction and Development (EBRD) was established in 1991 with 55 countries, of which 23 are central and east European countries.

Concerned by the potential reduction and termination of US aid, in 1989 a group of US-affiliated Pacific island governments established the Pacific Islands

Development Bank (PIDB) with its headquarters located in Guam. Ten governments each committed US\$1 million in capital fund contributions to initiate the bank's operations. As of July 1993 only 6 of the 11 members—Chuuk, Commonwealth of the Northern Marianas, Palua, Pohnpei, Yap and Guam—had made capital contributions (totalling US\$1.4 million). PIDB is not a regionwide development bank of the Pacific. Moreover, its financial viability is still in doubt.

A procession of Pacific island countries joined the Asian Development Bank shortly after its founding—Fiji (1970), Papua New Guinea (1971), Tonga (1972), Solomon Islands (1973), Kiribati (1974), Cook Islands (1976) and Vanuatu (1981). Of the 13 independent or self-governing Pacific island countries, 11 are currently members of the Bank—the additional members include the Marshall Islands, the Federated States of Micronesia and Tuvalu. Thus, the Asian Development Bank is regarded as the Pacific region's principal multilateral development finance institution.

A few Pacific island countries are also members of the World Bank: Fiji, Kiribati, Solomon Islands, Tonga, Vanuatu, Western Samoa, the Marshall Islands, and the Federated States of Micronesia. There seems to be tacit agreement on the division of labour between the World Bank and the Asian Development Bank for co-financed loans in the South Pacific. The minuscule size of the operations in the Pacific, combined with its greater distance means that the ADB takes the lead role in selecting, processing, and administering ADB-World Bank co-financed loans in the Pacific. The Asian Development Bank has set up a regional office in Port Vila, Vanuatu.

Is there a need for yet another multilateral lending institution in the region? With less than 0.5 per cent of the population in the Asia-Pacific region, Pacific island member states have received

about one-tenth (or US\$70.2 million out of a total of US\$711.6 million between 1967–93) of all the technical assistance dispensed by the Asian Development Bank to its developing member countries. Collectively, they have received three and a half times more aid per capita from the ADB than other members countries (Wilson 1987:265). The World Bank (1991:84) believes that there is no need for yet another bank.

Review of recommendations of past studies

The first study dates back to 1970. At a Technical Meeting on Coordination of Economic Development sponsored by the South Pacific Commission a resolution was adopted with the United Nations Development Programme (UNDP) subsequently publishing a report in May 1972 (Cole and Thompson 1981). This was followed by a second UNDP study which determined that the South Pacific countries did have a 'net external capital gap' which could form the basis for 'bankable development loans' and concluded that a regional development bank could be a viable institution.

The issue was studied once again by Cole and Thompson in 1981 for the South Pacific Commission and the South Pacific Bureau of Economic Cooperation and promoted the following principles.

- the founding principle should be additionality, which means that essentially the bank must generate new sources of financial capital from outside the Pacific region
- the proposed bank must avoid duplication or conflict with existing bilateral and multilateral aid arrangements
- the proposed bank should be a Pacific islands initiative, managed, controlled and administered by and for Pacific islanders

- there must be benefits to all participating island countries and territories, but a special emphasis and concern for the smaller and more vulnerable countries in the Pacific.

The report concluded with a recommendation for the establishment of a Pacific Islands Fund as a mechanism for donor countries who may wish to provide more aid on a regional rather than bilateral basis (Cole and Thompson 1981:43–65). The proposed Pacific Islands Fund would

- provide special loans either too small or too risky for existing lenders
- provide technical assistance on financial and resource mobilisation
- provide regional infrastructure development by the presentation of disaster relief funds and operating assistance in transport and communication
- establish a regional price stabilisation fund, particularly for copra.

The case for a Pacific Islands Development Fund

The recent poor economic performance of the Pacific island countries cannot be attributed to the lack of investment funds. Investment ratios in the Pacific islands have generally exceeded 25 per cent of their gross domestic product, comparing favourably with other developing economies in the Asia-Pacific region (ESCAP 1993:74). Hence, another regional multilateral lending institution like the Asian Development Bank is not needed.

It is clear that the following initiatives will be critically important if the Pacific islands are to achieve long run sustainable economic growth: using aid more efficiently; promoting private sector development; implementing appropriate policy/structural reforms; and developing human resources and increasing

indigenous capacity in policy analysis and development management.

We suggest that a new, multi-purpose regional development institution in the Pacific be established that would channel aid funds from new and old donors into programs that enhance economic development and cooperation among the Pacific island states and territories by focusing on these four initiatives. The mandate would be broader than that of the Asian Development Bank.

Improving the efficiency of aid use

We propose that island governments establish a multilateral Pacific Islands Development Fund which would combine aspects of both a development bank and development finance institution. The latter has the advantage of borrowing a lump sum and then distributing the funds to smaller borrowers and specific projects. It could also be a conduit for bilateral donors. It will need to be flexible enough to deal with small borrowers dispersed over a wide area. Technical assistance will be its major task rather than only a minor supplement to its other functions.

There are reasons why a multilateral institution might dispense aid more efficiently than bilateral donors (Lee 1991:33–4). First, a multilateral institution would likely have a more informed and comprehensive view of overall economic conditions. Second, decisions of a multilateral institution are less likely to be influenced by political manipulations. Third, the cost per dollar of aid dispensed through a multilateral institution is likely to be lower than through bilateral aid. Fourth, by pooling resources, a multilateral institution can undertake projects and programs too large for individual donors. The proposed Pacific Islands Development Fund could be a mechanism for donor countries who may wish to dispense aid on a regional rather than bilateral basis and

also be a vehicle for donor countries to provide aid without undertaking their own comprehensive bilateral aid programs.

Promoting private sector development

The private sector, especially small emerging businesses, face difficulties in gaining access to capital (ESCAP 1993:125–6). The proposed Pacific Islands Development Fund could work more closely with the existing national development finance institutions to strengthen their lending policies and provide resources and technical assistance to train staff in order to improve their overall efficiency. The Pacific Islands Development Fund can also augment and complement the South Pacific Project Facility to promote private sector development.

National development financial institutions have been important players, channelling external development funds to private business development. They are mainly involved in medium and long-term lending and provide clients with some project management advice. The World Bank has noted that donor experiences with them have been disappointing. Weak lending policies and a high degree of politicisation have eroded financial discipline and have saddled governments with unsound portfolios (World Bank 1991:50). Almost all have suffered from high delinquency rates (ESCAP 1993:128).

The Pacific Islands Development Fund could also coordinate work with the South Pacific Project Facility (SPPF). Established in 1990, it is a significant new regional initiative by the International Finance Corporation to promote private development. Initially designed to operate for a five-year period ending in July 1994 it is expected to continue. It is supported by donor governments, including Australia, Canada, Japan, India and New Zealand, and provides advisory services to private entrepreneurs.

It also identifies promising South organising, diversifying and expanding their businesses. The Facility supports projects with individual total investment costs in the range of US\$0.25 to US\$5.0 million, but may consider smaller projects. It can also provide help to South Pacific country governments who wish to privatise public sector enterprises. However, the Facility does not provide project financing itself. With some kind of linkage with the Pacific Islands Development Fund, a financing scheme might be worked out so that SPPF-assisted projects could be eligible for financing by the Pacific Islands Development Fund. To date, the biggest problem with the South Pacific Project Facility appears to be its high cost.

Implementing appropriate policy reforms

Pacific island governments have received reform recommendations by the volume. The problem is that it is outsiders who are telling them what they must do. Pacific islanders are not necessarily convinced that these recommendations are appropriate for them. Policy initiatives should come from islanders themselves. The proposed Pacific Islands Development Fund should take on the role of building capacity for economic growth in the various Pacific island countries through enhancement of indigenous policy analysis capability.

Developing human resources and capacity building

It is important to strengthen the capacity of Pacific island governments in the areas of policy analysis and development management. While these policies are necessary, to be effective, they must be sustainable. Policy sustainability in the Pacific islands requires a strong sense of ownership, and there is no better way to foster this sense of ownership than entrust the development and implementation of these policies to Pacific islanders themselves. This will require a large-scale,

concerted, and coordinated effort by both donor and Pacific island countries. In response to similar needs in sub-Saharan Africa, an African Capacity Building Initiative was established in 1988. The Pacific Islands Development Fund could help spearhead such an effort in the Pacific islands.

We propose that a Pacific Islands Capacity Building Program be formed under the proposed Pacific Islands Development Fund with the Program setting the following goals.

- To build institutions or rehabilitate and improve selected national institutions by providing technical assistance and development management skills.
- To mobilise financial and technical resources for increased investment in human capital and capacity building institutions.
- To create a forum for full and active participation by islands representatives in the design and implementation of capacity-building programs.
- To strengthen or create government policy units in the Office of the President and other critical government offices.
- To provide fellowships to support selected Pacific island scholars/students in their research and training needs.
- To expand in-service training and work experiences for Pacific island professionals.
- To strengthen local consulting firms, professional associations, and other non-official organisations.

The need for a 'new' regional development institution

Many of these objectives are already incorporated in the work programs of various existing institutions. Among these existing institutions, the Asian Development Bank is best suited to assume the

responsibilities identified in this paper.

The fact that ideas being proposed in this paper have been earlier rejected at the ADB do not preclude the presence of compelling reasons why a new institution should be pursued to become a reality. We offer several reasons for a 'new' regional development institution.

First, the lack-lustre economic performance of the Pacific island countries suggests that existing efforts have not met the magnitude of the need for development assistance and capacity building. Second, the existing institutions are not well informed of what other institutions are doing. Third, a new institution, with well-defined objectives, could direct more focus on the specific needs identified. Fourth, a number of Pacific island states such as Guam, the Commonwealth of the Northern Marianas, American Samoa, Tahiti, New Caledonia, Tokelau, and Wallis and Futuna cannot gain access to the services of most international multilateral institutions such as the World Bank, the International Monetary Fund and the Asian Development Bank.

The proposal

In conclusion, we propose that a Pacific Islands Development Fund—a multilateral development fund—be established to foster capacity building in the Pacific island countries. The constraint on the development of the Pacific islands is not funding alone but lies in each country's (in)ability to

- use aid efficiently
- promote private sector development
- implement appropriate policy reforms
- develop human resources to build the capacity for policy analysis and development management.

The proposed Pacific Islands Development Fund can address these

needs in a way that no existing institution can. Building the capacity for indigenous policy analysis and management in the Pacific islands could be a lasting legacy of the Pacific Islands Development Fund. For only when Pacific islanders can articulate, analyse, and implement their development goals, can Pacific island nations gain control of their economic destiny.

References

- Cole, R. V. and Thompson, G. J. , 1981. Proposal for a Pacific Islands Fund: an evaluation, Report prepared for the South Pacific Commission, Noumea and the South Pacific Bureau for Economic Cooperation, Suva.
- ESCAP, 1993. *Pacific Island Countries: Pacific islands countries economic performance and selected issues in policy management and adjustment*, United Nations, New York.
- Lee, J. S., 1991. *External Finance and the Role of Multilateral Financial Institutions in South Asia: changing patterns prospects and challenges*, Asian Development Bank, Manila.
- Wilson, D., 1987. *A Bank for Half the World: the story of the Asian Development Bank*, Asian Development Bank, Manila.
- World Bank, 1991. *Pacific Island Economies: toward higher growth in the 1990s*, World Bank, Washington, DC.

The authors are indebted to Clarita B. Barreto for able research assistance and to Paul McCabe for helpful comments.

Comments on this proposal for a development fund for the Pacific islands are invited for publication in the next issue of the *Pacific Economic Bulletin*.

Please send to Maree Tait, Editor, National Centre for Development Studies by 30 April 1995.