



# **The Political Economy of Economic Reform in the Pacific**

Edited by Ron Duncan

Asian Development Bank

ADB

Pacific Studies Series

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# Foreword

In late 2009, the Asian Development Bank (ADB) launched a new Pacific Approach, a framework for its role in the development of its 14 Pacific developing member countries (DMCs). The Pacific Approach requires a high level of understanding of the political economy of each DMC. For its assistance to be most effective, ADB should have a good appreciation of how economics, politics, and culture interact within each country. This publication, prepared as background for the Pacific Approach, comprises a set of studies by researchers who examine the political economy of the Pacific DMCs within different disciplinary frameworks. Some studies look at why economic reform attempts are, or are not, successful. Others investigate how politics, economics, and culture interact to discourage change, lead to poor governance and growth, or encourage corruption.

The project is set within the context of the recent global interest in understanding the political economy of economic reform in developing countries. It confirms many of the conclusions that have been drawn from that research and provides additional insights on the political economy challenges of economic reform. The report points to ways in which ADB and other development partners can use this knowledge to provide more effective assistance to the Pacific DMCs.

The studies reported here were undertaken under the leadership of Ron Duncan, emeritus professor, Crawford School of Economics and Government, The Australian National University, Canberra, and were supervised by Steve Pollard, principal economist, Pacific Department.



Robert Wihtol  
Director General  
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# Abbreviations

ACP	African, Caribbean, and Pacific
ADB	Asian Development Bank
AMP	Aliança para Maioria Parlamentar (Alliance of the Parliamentary Majority, Timor-Leste)
APODETI	Associação Popular Democrática Timorense (Timorese Popular Democratic Association)
ASDT	Associação Social Democrata Timorense (Timorese Social Democrat Association)
AusAID	Australian Agency for International Development
BAPPEDA	Badan Perencanaan Pembangunan Daerah (Indonesian Regional Development Planning Board)
CAVR	Comissão de Acolhimento, Verdade e Reconciliação (Commission for Reception, Truth and Reconciliation, Timor-Leste)
CCLD	Committee on Customary Land Development (Papua New Guinea [PNG])
CEO	chief executive officer
CFA	Central Fiscal Authority (Timor-Leste)
CLRC	Constitutional and Law Reform Commission (PNG)
CNRT	Concelho Nacional da Resistência Timorense (National Council of Timorese Resistance)
CPA	country performance assessment (ADB)
CPIA	Country Policy and Institutional Assessment (World Bank)
CSR	Colonial Sugar Refining Company (Fiji)
DFID	Department for International Development (United Kingdom)
DLPP	Department of Lands and Physical Planning (PNG)
DOC	Drivers of Change (DFID)
DPEIDC	Department of Public Enterprises, Information and Development Cooperation (PNG)
DSG	district support grant
DVL	determined value of logs
EC	European Community
EMC	Economic Ministerial Committee (PNG)
ERP	economic reform program
ESI	estimated sustainable income
EU	European Union
F\$	Fiji dollars
FAS	freely associated states
F-FDTL	FALINTIL (Forças Amadas de Libertação Nacional de Timor-Leste)—Forças Defesa de Timor-Leste (East Timor Defence Force)
FRETILIN	Frente Revolucionária de Timor-Leste Independente (Revolutionary Front for an Independent East Timor)

FSC	Fiji Sugar Corporation Limited
GATS	General Agreement on Trade in Services
GDP	gross domestic product
GMM	generalized method of moments
GSP	Generalized System of Preferences
ha	hectare
HATAC	High Administrative, Tax and Audit Court (Timor-Leste)
HOMs	heads of ministries
HRPP	Human Rights Protection Party (Samoa)
IFC	International Finance Corporation
IAD	Institutional Analysis and Development
IEG	Independent Evaluation Group (World Bank)
IPBC	Independent Public Business Commission (PNG)
ILG	incorporated land group
ICCC	Independent Consumer and Competition Commission (PNG)
ICT	information and communication technology
IGR	institutional and governance review
IMF	International Monetary Fund
JDP-BPC	Joint District Planning and Budget Priorities Committee
K	kina
km	kilometer
LPV	limited preferential voting
m	meter
MFN	most favored nation
MP	member of Parliament
NIE	new institutional economics
PAE	politician-allocated expenditure
PIC	Pacific island country
PNG	Papua New Guinea
MAF	Ministry of Agriculture and Fisheries (Timor-Leste)
MAFF	Ministry of Agriculture, Forestry and Fisheries (Timor-Leste)
MED	Ministry of Economy and Development (Timor-Leste)
MOF	Ministry of Finance (Timor-Leste)
NCRT	Congresso Nacional de Reconstrução de Timor (National Congress for Timorese Reconstruction)
NCP	National Coalition Partnership (Solomon Islands)
NEC	National Executive Council (PNG)
NLDAG	National Land Development Advisory Group (PNG)
NLDP	National Land Development Program (PNG)
NLDT	National Land Development Taskforce (PNG)
NLS	National Land Summit (PNG)
NLSCC	National Land Summit Coordinating Committee (PNG)
NLTB	Native Land Trust Board (Fiji)
NRI	National Research Institute (PNG)
NGO	nongovernment organization

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NZ\$	New Zealand dollars
NZAID	New Zealand Agency for International Development
ODA	overseas development assistance
ODI	Overseas Development Institute
OECD	Organisation for Economic Co-operation and Development
OLIPPAC	Organic Law on Political Parties and Candidates (PNG)
PASS	People Against Switching Sides (Samoa)
PFTAC	Pacific Financial Technical Assistance Centre (Fiji)
PNTL	Policia Nacional de Timor-Leste (Timorese National Police)
RAMSI	Regional Assistance Mission to the Solomon Islands
RCDF	Rural Community Development Funds (Solomon Islands)
RDTL	República Democrática Timor-Leste
RIF	reduction in force
SI\$	Solomon Islands dollars
SIAC	Solomon Islands Alliance for Change
Sida	Swedish International Development Cooperation Agency
SIDS	small island developing states
SPS	Special Preferential Sugar (Agreement)
SSR	security sector reform
SUNGO	Samoan Umbrella of NGOs
TCC	Tonga Communications Corporation
TCU	Timber Control Unit (Solomon Islands)
UDT	União Democrática Timorense (Timorese Democratic Union)
UNITECH	University of Technology (PNG)
UNPG	University of Papua New Guinea
UNTAET	United Nations Transitional Administration in East Timor
VAT	value-added tax
WDI	World Development Indicators
WTO	World Trade Organization

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# 1 The Political Economy of Economic Reform

by *Ron Duncan*

## 1. Introduction

The policy reforms attempted in developing countries over the past 3 decades have yielded varied results, with some, such as in East Asia, leading to very good outcomes in terms of economic growth. But, there are many others where it has not been possible to implement reforms or where reforms have achieved poor outcomes. The record in Papua New Guinea (PNG) and the Pacific island countries (PICs) has been similar, with good responses to reform attempts in some countries and disappointing results in others. During this period, ideas about what is important for growth and development have changed significantly, from the early focus on the notion that the lack of development was due to a shortage of capital and the need for transfers of savings from wealthy countries to poor countries, to the subsequent focus on correcting price distortions through structural adjustment programs, and to the recent focus on the basic institutions underpinning the economic and political performance of countries (for a discussion of the changes in development thinking over the past 30 years or so, see Duncan and Pollard 2002).

Within the past decade, development agencies have expressed awareness of the need to undertake development assistance only when it is underpinned by a good understanding of the local context of the individual countries. However, until recently little emphasis has been placed on gaining this kind of understanding, which presumably relates to an appreciation of a country's economic, political, social, and cultural characteristics and the interactions between them. Within the communal societies of the Pacific, cultural characteristics are more important than they appear to be in the more advanced societies. Therefore, increased attention needs to be given to understanding the cultural characteristics of Pacific economies and how they relate to economic and political factors.

Economic reform can mean changing existing institutions, policies, legislation, and regulations. Generally, such change will not be easy, since these elements have been shaped by existing political, economic, and cultural forces. Hence, understanding the "local context" to provide assistance in the design, acceptance, and implementation of reform also implies some knowledge of how to change the status quo.

Understanding the economic, political, social, and cultural characteristics of a society and the interactions between them is broadly the field of political economy. Because of the different

aspects of society that are involved, political economy is inevitably a field of interdisciplinary study. Economists, political scientists, lawyers, sociologists, and anthropologists—and perhaps other disciplines—can usefully collaborate in developing the needed understanding.

This project on the political economy of PNG, PICs, and Timor-Leste therefore draws on the views of economists, political scientists, sociologists, and others. The Asian Development Bank (ADB) funded the study to increase the effectiveness of the assistance that it provides to these countries by improving understanding of their political economy.

An increasing amount of research on the political economy of developing countries has recently been undertaken. Even more recently, research has been initiated on the political economy of reform processes. However, very little research has been conducted on the political economy of reform processes in the PICs. This project was established to fill these gaps.

## 2. The Role of Political Economy in Economic Reform

Adrian Leftwich's (2008) definition of what he calls "politics" (but earlier called political economy) is a good description of political economy for our purposes:

... all the many activities of cooperation, conflict and negotiation involved in decisions about the use, production and distribution of resources. (p. 6)

As Leftwich notes, these activities may be formal or informal, public or private (or a mixture of both), and undertaken at every level of society, from individual households and businesses to all strata of government.

As a field of study, political economy dates back to at least the 17th century, with writers such as Adam Smith, David Ricardo, Thomas Malthus, and later, Karl Marx, being some of its most influential English-language proponents. The field now very broadly refers to interdisciplinary studies, drawing mainly on the disciplines of economics, politics, and law, to explain how institutions, politics, and the economic system interact, whether nationally or internationally, to produce economic outcomes. Other disciplines such as sociology, anthropology, and human geography also make contributions to the broad field of political economy.

There are many more analytical approaches to the study of political economy than the number of disciplines involved, as the practitioners of each discipline usually bring their preferred theoretical framework to their research. For example, economists doing political economy studies may have a classical, neo-classical, neo-Marxian, or new institutional economics view of economic behavior, while political scientists may use rational choice theory or traditional inductive approaches.

The new institutional economics (NIE) approach pioneered by North (1990) has played an important role in recent studies of the political economy of developing countries with respect to economic reform. The NIE approach focuses on the basic institutions and the rules of behavior that they establish. These rules provide the incentives to which the various actors involved in the process react. In this context, institutions may be formal, such as constitutions, electoral systems, and property rights, or informal, such as the norms of traditional societies or the behavioral norms of groups such as accountants and real estate agents.

The recent focus on institutions (used in the broad economic sense) has to a large extent been forced upon analysts and development agencies. As Acemoglu (2008) points out,

... understanding [by the economics profession] on the importance of institutions has been reached as a result of a large body of theoretical and empirical work. In the policy world, it has been reached more painfully, as a result of a long stream of

reforms around the world that failed mainly because they did not pay sufficient attention to institutions and governance issues.

Besides stressing that “institutions matter,” Acemoglu also argued that while institutions do change, we do not know how to change them; however, “our best hope is to understand what internal dynamics of countries drive institutional changes.”

In an effort to understand how it may be possible to change institutions, Elinor Ostrom and her research colleagues in the Workshop in Political Theory and Policy Analysis at Indiana University have placed the NIE in an analytical framework they call Institutional Analysis for Development (IAD) to gain an understanding of the behavior of the groups that have an influence, for better or worse, on economic development within a country (Ostrom et al. 2001). The IAD framework is based on the assumption that most problems in development result from the inability of people to take the necessary collective action. The delivery of public goods and the effective management of common-pool resources require collective action by society. However, if the established incentives, or rules of behavior of the society, provide weak or perverse incentives to individuals or groups to act collectively for their common good, the delivery of public goods and management of common-pool resources will be adversely affected.

As Ostrom et al. (2001) correctly point out, it is difficult, if not impossible, to change the characteristics of public goods or services or to change the culture of a society. Trying to change the incentives (institutions or rules) faced by the people involved is usually the only avenue open by which to achieve a different outcome. But as they also point out, any transformation of the “rules in use” needs to take full account of the characteristics of the community and the physical, economic, political, and social circumstances. Most importantly, it must be understood that those presently advantaged by the status quo will resist any changes in the rules that do not benefit them. Further, aid agencies should be careful not to reinforce perverse incentives or to weaken government incentives to find better policies and institutions.

The purpose of the so-called “Drivers of Change” approach, largely developed by the Department for International Development (DFID) of the United Kingdom (UK), is also to assess the prospects for and constraints on development from a political economy perspective. This approach also draws to some extent on the NIE framework to study the interactions among the economic, political, and cultural characteristics of countries by thoroughly examining the society’s institutions and the incentives they create.

The analytical framework designed by Hausmann, Rodrik, and Velasco (2004, 2005, and 2006) to uncover the “binding constraints” to economic growth in developing countries is closely linked—and could even be considered a precursor—to the study of the political economy of reform. The Hausmann et al. framework focuses on the economic constraints to growth and development. This approach recognizes that there may be many constraints to economic growth in a country but that some constraints will dominate others; therefore, unless the dominant or most binding constraint(s) is overcome, it is useless to attempt to remove others. The framework is similar to the economic logic of linear programming, which identifies the most binding constraint as the one with the highest shadow price or opportunity cost. Therefore, relaxing that constraint will have the highest payoff. Once it is relaxed, another constraint will become the most binding. The expected outcome of this diagnostic approach is a listing of priorities of where to focus economic reform efforts when attempting to establish a favorable environment for investment and growth.

The framework Hausmann et al. (2004) suggest for diagnosing the most limiting constraint is in the form of a decision tree. Recognizing that investment is the most critical factor in growth, the purpose of the decision tree is to identify whether the most binding constraints on growth are factors contributing to inadequate returns to investment, poor private appropriability of the returns to investment, or the high cost of finance for investment. Within each of these categories of possible limiting factors is a subset of factors, any of which could be the main obstacle to investment and growth.

This diagnostic framework has been extended from identifying the economic constraints to growth as suggested by Hausmann et al. to investigation of the possible underlying causes of those constraints. Recognizing that underlying institutional factors may be the binding constraints to growth rather than the more obvious proximate factors affecting investment and growth, Sugden (2008) suggests extending the decision tree to include an additional “institutional branch,” rather than including institutional factors at the bottom of their decision tree, as do Hausmann et al. Sugden suggests that more emphasis be given to institutional determinants (such as effective constitutions, well-defined and enforced property rights, impartial enforcement of contracts, and law and order) as underlying causes of poor economic performance than do Hausmann et al. (2005, p. 7), who place emphasis on proximate causes. This extension of the framework essentially takes the analyst to a study of the political economy.

Sugden’s “preliminary, subjective assessment” (2008, pp. 234–235) of the importance of proximate factors and institutional factors in affecting economic performance in PICs is that “only Cook Islands and Samoa could be thought of as having an institutional environment conducive to economic growth,” so that for these countries “the binding constraints are more likely to be at the proximate level.” For Fiji, the Marshall Islands, Palau, Tonga, and Tuvalu, the necessary institutional environment for private investment and economic growth may exist, so that the constraints to economic growth are more likely to be proximate constraints on private sector development. For the Federated States of Micronesia, Kiribati, PNG, Solomon Islands, Timor-Leste, and Vanuatu, Sugden’s preliminary assessment is that “the institutional environment is so weak that the binding constraints to economic growth are very likely to be found at the underlying level.”

However, it could be observed that the existence of some of these obstacles to good economic performance needs to be explained. What explains why an effective constitution is not in place? What explains why a country is aid-dependent, or why aid is ineffective? It appears that we have to dig deeply into a country’s psyche to explain these issues.

The IAD framework of Ostrom et al. (2001) provides a framework within which the influence of the broader institutional or political economy issues on economic performance may be examined. Therefore, Duncan (2009) and Bulatale and Duncan (forthcoming) have combined the IAD framework with the diagnostic framework of Hausmann et al. (2005) to analyze the possible economic constraints in Kiribati and the broader political economy issues in Fiji that may be inhibiting economic performance. The results of these recent studies of PICs are discussed below.

### 3. Early Studies of the Political Economy of Reform in Developing Countries

Two early political economy research projects on economic reform in developing countries were Bates and Krueger (1993) and Williamson (1994). In the Bates and Krueger project, eight pairs of economists and political scientists examined the history of economic reform in eight developing countries, some of which had been successful reformers (Chile and the Republic of Korea), some which had been reasonably successful (Ghana and Turkey), and others that had little success with reform despite several attempts (Brazil, Ecuador, Egypt, and Zambia). For each country, the researchers were asked to examine the impact of interest groups on the success of the reforms and the institutional context in which the reforms were carried out.

In the Williamson project, nine economists (most of whom held key government positions) wrote about the experience of policy reform in developed, developing, and transitioning countries. The economists were asked to focus on how they managed to get the reform programs accepted. Subsequently, a conference was held where political scientists who had been writing on economic reform programs (and most of whom had been involved in the earlier Bates and Krueger project) were asked to comment on the country papers. The country authors were also asked to discuss the applicability of 13 often-competing hypotheses in explaining when policy reform is possible. These hypotheses included the idea that policy reform is most likely following a crisis, when opposition to the reform is discredited, when the reforming government has won a mandate for change, when there is a visionary leader, or when there is an authoritarian or rightist government.

The Williamson volume concluded that the evidence strongly supported the hypotheses suggesting the need for a strong political base, for visionary leadership, and for a coherent economic team. It also concluded that authoritarian or right-wing governments are not necessary for successful reform. However, there is little in the way of insights provided into the political processes or the institutional arrangements that make effective implementation of reform possible (Duncan 1995).

The Bates and Krueger volume is somewhat more insightful. In response to the observation that interest groups appeared to have little or no role in initiating reforms, they suggest that the outcome of reform is subject to such uncertainty that interest groups' decisions are influenced more by ideology than by statements about the incidence or impacts of policies. It is concluded that because of uncertainty about the future size and distribution of the benefits of reform, and the more immediate and concentrated nature of its costs, the status quo is likely to be maintained unless there is a change of government. However, there are exceptions to this finding, such as Mexico. The structure of political competition is also examined. For example, in countries with one-term presidents, such as Mexico, the president may undertake reforms that would not be considered if running for office again. Compare this situation to democracies where the political term is not fixed and leaders struggle to remain in power.

Bates and Krueger find that reform efforts lead to the restructuring of interest group representation and to changes in political institutions. One change that they highlight is the strengthening of the executive branch of government and of the finance ministry. An important role of this restructuring is to protect the technocrats within these core ministries from pressure from interest groups—except, of course, from the pressure of the interest groups that benefit from the reforms. Bates and Krueger also point to the importance of a well-trained team of policy advisers who are somehow protected from interest-group pressure. This conclusion highlights the importance

of education in developing cadres of highly skilled, local advisers, as well as the need to understand countries' political, cultural, and institutional systems.

## 4. Recent Research on the Political Economy of Reform

Following the Krueger and Bates and Williamson projects, there was little in the way of political economy studies of the factors underpinning economic reform and why some reform attempts fail, until the 1990s' realization of the importance of institutions in explaining behavior related to development, and of understanding the local context, if development assistance was to be successful. Interest in these issues has led to the extensive use of political economy studies of economic reform in developing countries over the past decade. Initially, the studies focused on the interactions between economics and politics in the reform process. But these studies led to staff frustration in the development agencies, particularly officers in the field, who argued that these political economy issues were reasonably well understood; what they really wanted to know was how to bring about change. The most recent studies have been more focused on this particular question, which is also the main question behind this project.

Early in the new millennium, major development agencies began to take more interest in the interaction between a developing country's politics and its success in attempts at reform. The main agencies involved were DFID, the Swedish International Development Cooperation Agency (Sida), and the World Bank. DFID's approach to the issue became the Drivers of Change (DOC) framework; Sida's approach focused on power relationships within an economy and how they affected the success of development projects; and the World Bank, which began its Institutional and Governance Reviews in 1999, was relatively narrowly focused on the institutional roots of government performance, while still taking account of the country's political realities.

The first DOC study funded by DFID was on Bangladesh and published in 2002 (Duncan et al. 2002). All nine of the potential DOCs identified by the study were entities, such as the media, reform-minded public officials, nongovernment organizations, rural-based organizations, and business organizations; compared with later studies, this was a rather narrow interpretation of DOCs. The main recommendations in relation to the study's political economy aspects were concentrated on how to improve the capacity of these actors to influence change. The impact of the report is reflected in a 2006 review of the use of DOC analysis in Bangladesh, where it was concluded that "the political-economy focus of drivers-of-change analysis has had modest apparent impact overall" (Batkin et al. 2006).

In June 2003, DFID established a dedicated but temporary DOC team within its policy division to support country-led work on DOC studies. Rather than attempting to set out a particular methodology, the team set out a series of questions around which to frame analysis of the political economy of the developing countries (DFID 2004). The DOC team was disbanded in September 2004. Up to 2005, DOC reports were prepared for more than 20 countries. Most of these were sub-Saharan Africa countries.

In 2005, the Organisation for Economic Co-operation and Development's Development Assistance Committee commissioned the Institute of Development Studies Sussex to undertake a review of the Power and Drivers of Change analyses in development cooperation (Dahl-Østergaard et al. 2005). Given the early stage of the development of thinking about these issues and the different points from which they began, it is unsurprising that the report concluded that there was not a common approach among the agencies toward examining how the policy environment is shaped by political, economic, social, cultural, and institutional factors.

The Dahl-Østergaard et al. (2005) report found that within DFID there was tension between the emphasis on DOC analysis of political processes and the perceived need for longer timescales for fundamental change versus the pressure to increase spending in Africa and to pursue short-term interventions to achieve Millennium Development Goals. Within the World Bank, political analysis was not yet mainstream but there was growing recognition that many desirable policies were not politically feasible. Hence, there was the question of identifying steps that would eventually lead to change. At the same time, undertaking country political analysis was resisted because it was seen as contravening the bank's articles. At an operational level there was skepticism about the usefulness of "high level" analysis that did not generate operational recommendations.

The earliest of the political economy studies into reform processes, funded by the UK's Overseas Development Institute (ODI), was an analysis of the reforms in India's state of Andhra Pradesh (Mooij 2003). This study was described as being a blend of political science, sociology, and anthropology and followed the political science body of literature known as the Conceptualization of Policy Processes (COPP). Reforms in Andhra Pradesh, primarily to improve governance, were claimed by the authorities to have been implemented in a process that was largely free of politics. The study challenged this claim and argued that in fact the whole process had been fundamentally political and that the ruling party, under a strong leader, had achieved the reforms by "establishing the dominant discourse." That is, it set the framework and logic upon which the discussion of the reforms was undertaken.

Consistent with the COPP criticism of the "linear model" of the policy process, Mooij (2003) argued that the reforms had not followed the accepted stages: agenda setting, policy formulation, implementation, and evaluation. This linear model was said to be commonly followed by the major development agencies, who believed that once a policy decision was made, execution should follow, and that lack of success should be blamed on bottlenecks or, most commonly, "lack of political will." This criticism of the role of development agencies had been made earlier by Thomas and Grindle (1990).

Contrary to the linear model, Mooij (2003) said that the policy reform in Andhra Pradesh illustrated that policy processes should be seen as the working out of interactions between interest groups and that the outcomes cannot be established in advance. However, those with more power (influence) are more likely to have their way. Further, institutional arrangements may affect the bargaining process between groups and may favor some groups more than others.

ODI followed the research in Andhra Pradesh with a study of public policy making in Ghana (Booth et al. 2005). This was the first of ODI's DOC studies. DOC analysis was seen as a way "to describe in a robust, evidence-based way the underlying factors which shape the incentives for economic, social and political change." In particular, it was an attempt to explain the "lack of political will" commonly seen as being the main obstacle to economic reform.

Ghana's state was described as "neo-patrimonial," effectively serving the "interests of the particular groups and individuals that have captured it." The relationship between business and government was "very much in the patron-client mould." After describing the interaction between social, political, and economic forces that had constrained investment, openness to competition, and growth, the *economic* DOCs were identified as (i) increased international trade and competition, (ii) greater competition and efficiency among financial institutions, (iii) foreign direct investment, and (iv) stronger employment generation.

But these changes would not happen unless *political* DOCs were in place. These were identified as (i) intensified competition between political parties, (ii) the free flow of information and

an increasingly critical mass media, (iii) an increased role in Ghana's political and economic life of its diaspora, and (iv) the vigorous growth of civil society. It was argued that progress in any one of these political areas would stimulate progress in others and in the economic drivers. However, there were no suggestions as to priorities for action or for how progress in any one of the political or economic DOCs could be brought about. In fact, here, as elsewhere in DOC analysis, there is no analytical basis within the DOC framework from which the identification of priorities for action or the means to bring about changes can be derived.

The next DOC study by ODI was of the political economy of Malawi (Booth et al. 2006). From this research it was seen that the Malawi state had been captured by patronage networks and that there was "no sign of democratisation generating a more issue-based, performance-oriented politics." The main issue facing reformers was that politicians "have disempowered and corrupted the civil service, undermining the capacity to generate coherent, technically-grounded policy approaches."

The economic DOCs were identified as (i) policy consistency, (ii) long-term vision, (iii) strong leadership, (iv) prioritization of objectives and resources, and (v) improved performance of the civil service. The political DOC was seen as gradual progress in democratic government. The following implications for development agencies and aid donors were also suggested: (i) more realism about the long-term nature of the development challenges that Malawi faces, (ii) less certainty and more humility about the solutions, (iii) more willingness to compromise and support joint efforts, and (iv) more emphasis on political economy as a central issue.

While the pointers toward improved performance by development agencies were useful, the DOC analysis did not offer practical recommendations on the priorities for action or on *how* to bring about the desired reforms. Thus, the reason for frustration on the part of development agencies' operational staff is obvious.

In 2005, in its *Economic and Social Progress in Latin America 2006 Report* (Stein et al. 2005), the Inter-American Development Bank also showed interest in "what determines the ability to design, approve and implement effective public policies" (p. 5). The report described the outcomes of an extensive exercise in what was described as an interdisciplinary (economics and political science), cross-country analysis of Latin America. The analysis had a strong flavor of new institutional economics in its "detailed look at the institutional arrangements and political systems at work in Latin America, as they shape the roles and incentives of actors that participate in the policy making process."

Ten lessons were identified. Broadly, these captured the now fairly well-accepted notions that the policy-making process is complex and needs to be country-specific. Effective political parties, a strong policy-making legislature, an independent judiciary, and a well-developed civil service were seen as essential institutions. Moreover, keeping these "good" institutions in place depends upon political incentives for positive behavior. Further, leaders can play a vital role as catalysts in the development of such institutions. But, again, there was no direction given as to how to bring about the needed changes.

A 2006 World Bank study of a successful effort to reform the legal infrastructure governing public procurement in the Philippines, the Government Procurement Reform Act 2003, did generate some useful operational recommendations (Campos and Syquia 2006). While this reform relates to the passing of a particular piece of legislation, it does have lessons for how to generate successful policy reform. The main lesson is the necessity to create a coordinated team capable of responding to events, unforeseen or anticipated, as the reform process unfolds, including

mechanisms able to deal with uncertainty on a day-to-day basis. Other elements seen as important in having the legislation passed were the production of in-depth technical studies of the implications of the legislation, a well-thought-out communication strategy to mobilize public action, and the fostering of support from knowledgeable legislators.

The year 2007 saw a larger number of development agencies become interested in these political economy issues. The Australian Agency for International Development (AusAID) commissioned a DOC study on Vanuatu (Cox et al. 2007), which identified various economic and political obstacles to better economic and development performance, but without any prioritization of the changes needed or advice on how to achieve them.

Also in 2007, under a regional technical assistance project, Strengthening Country Diagnosis and Analysis of Binding Development Constraints in Selected Developing Member Countries, ADB initiated a series of studies on binding constraints. Following the Hausmann et al. (2005) framework, the purpose of the studies was to “establish priorities among many candidate policies and institutional reforms aimed at sustained and broad-based growth.”

The first ADB binding constraints study was of the Philippines (ADB 2007). The report identifies several constraints on economic growth and poverty reduction, such as the tight fiscal situation, high-cost infrastructure, and poor governance and corruption that saps investor confidence. However, the report does not attempt to prioritize these constraints for removal, as the Hausmann et al. (2005) framework implies, nor does it examine how the political economy environment may be constraining change or give directions on how to bring about change.

In retrospect, it seems that the design of ADB’s work in this area could have been improved—by focusing on the political economy constraints to overcoming the economic binding constraints—if attention had been paid to a 2002 report from its Economics and Research Department (Abonyi 2002). This study asked why policy-based lending had made such a limited contribution to policy reforms and how to implement the extensive changes usually necessary in policy reform. It concluded that “the design of policy-based initiatives should reflect an assessment and understanding of the policy reform environment as is, including implementation conditions, constraints, and requirements” (p. 2).

The next study in the ADB binding constraints series was on Nepal, which was undertaken in collaboration with DFID and the International Labour Organization (ADB 2009b). This report goes further than the Philippines report in that it has a chapter that examines the political and governance constraints to improving growth prospects. Problem areas such as political instability, rent seeking and clientelism, corruption, and crime are identified. But no recommendations are made as to how to overcome the constraints.

There are useful hints for development cooperation partners such as (i) recognizing the governance and political economy constraints to bringing about change to the status quo, (ii) do no harm, (iii) identify quick wins, (iv) avoid overloading the government, and (v) help to develop national ownership. There are also suggestions on how further research may answer the question of how to overcome binding constraints:

Any discussion of the way forward will need to be informed by further analysis of the political economy... to explain more fundamentally why things are the way they are and what policy options might appeal sufficiently to different stakeholders before agreeing on further action. This will require further mapping of the institutions involved, understanding each stakeholder’s interests and incentives and the potential drivers of change. (p. 117)

A draft ADB binding constraints report has been prepared on Indonesia in collaboration with the International Labour Organization and the Islamic Development Bank (ADB 2009a). The report identifies the following critical constraints to economic growth, poverty reduction, and environmental sustainability: (i) inadequate and inefficient infrastructure, (ii) weaknesses in governance and institutions, (iii) corruption and terrorism, (iv) unequal access to and poor quality of education, and (v) insufficient mainstreaming of environmental concerns in development plans. There is no attempt to identify priorities for relaxing the binding constraints, nor does it attempt to map the political economy and use that understanding to find ways to overcome those constraints. However, perhaps the authors do see this as the way forward, as the report concludes that further studies are needed to "... explore the constraints in greater depth. The in-depth studies will also help identify options that policymakers can adopt in overcoming the constraints to inclusive and green economic growth."

## 5. How Far Have We Come?

A recent study by ODI, funded by DFID, illustrates the progress that has been made in thinking about the role of political economy analysis in assisting with the implementation of economic reforms (Booth and Golooba-Mutebi 2009). This study adopted what it called a "layered" approach to the political analysis of road reform in Uganda; it added a wider range of political economy tools than had previously been used in DOC analysis. The layers used were

- identification of systemic constraints arising from the institutional context (typical of DOC and binding constraints analysis, which has produced little of operational significance);
- analysis of the pattern of stakeholder interests, direction, and extent of their influence, and the factors influencing their choices (essentially, what incentives are they responding to?); and
- assessment of the "room for maneuver," or scope for different outcomes, created by dynamic aspects of the change process.

This approach recognizes that political economy analysis must go beyond describing the relationships between economic, political, social, and cultural factors, and move toward identifying the incentives to which the stakeholders are responding and determining whether the incentives can be changed in order to generate different behavior. The "room for maneuver" analysis is drawn from the work of Grindle (2002) on social reform in Latin America.

The report examines whether there is scope for movement on the needed reforms with respect to (i) a shift in presidential priorities, (ii) recent institutional changes opening opportunities for reform, or (iii) the dynamics of the reform process. It was decided that (iii) offered the most realistic possibilities for donor-supported action to "tip the balance in a pro-reform direction." While there is no formal analysis of the incentives that various stakeholders respond to, the overall approach has taken research in this area further toward the goal of generating operationally useful recommendations.

The point that political economy studies have reached, as expressed through the ODI report on Uganda, is similar to that reached by Duncan (2009) in a report on Kiribati. An earlier study carried out for the World Bank (Duncan and Nakagawa 2007) had identified the binding constraints to economic growth in Kiribati as being clientelist politics, which results in nepotism, corruption, and conflicts of interest in contract awards rather than the provision of widespread public goods. It was argued that politicians operating in such an environment will prefer not to support security of

property rights and contract enforcement—*institutions that encourage private sector development*—as their establishment will undermine the payoff from rent-seeking activities.

Therefore, in the Duncan (2009) study for ADB, the Institutional Analysis for Development (IAD) framework developed by Ostrom et al. (2001) was used to investigate the role of political economy in preventing collective action leading to the provision of public goods. IAD analysis provides a framework within which to analyze the incentives (both positive and perverse) to which the various stakeholders are responding. Similar to the ODI report on Uganda, Duncan's report on Kiribati identified that the “room for maneuver” for reform was provided by the President's interest in reforming the many state-owned enterprises dominating the economy and the presence of a small group of senior public officials who understood and sympathized with the need for reform. The report also recommended providing technical assistance to develop material to promote public understanding about the reforms, and providing continuing support to the President and his team.

In a March 2008 World Bank–hosted workshop on sequencing public financial management (PFM) reform, Edward Hedger of ODI summed up what that organization had learned from its many political economy studies about the factors contributing to the success of PFM reform. He identified six success factors:

- political commitment (leadership),
- senior technocratic leadership,
- organizational strategic management capability within the public sector,
- domestic demand for reform from outside the executive,
- appropriate and coherent external technical advice (and pressure), and
- logic and coherence of technical reforms.

With the exception of the fourth factor (domestic demand for reform from outside the executive), these lessons replicate those that can be drawn from the Bates and Krueger (1993) and Williamson (1994) projects. The fourth factor is now generally understood as the necessity of promoting domestic “ownership” of reforms if they are to be successful.

Are there other lessons that can be drawn from the many political economy studies on reforms that have been undertaken over the past decade? The World Bank study on the passage of public procurement legislation in the Philippines (Campos and Syquia 2006) has some useful lessons, as well as confirming the importance of in-depth studies for informing politicians and the general public about the impact of the reform and the need for political leadership. These lessons are the need for a well-coordinated support team capable of responding to events as the reform process unfolds and a well-developed communication strategy to mobilize public action. In the report on Kiribati, Duncan (2009) identified the same lessons and also highlighted the desirability of (i) finding ways to change stakeholder incentives to positively influence desirable collective action on reform and (ii) analyzing what “room for maneuver” may be available to implement reform.

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# 2 An Overview of the Research on the Political Economy of Reform in the Pacific

by *Ron Duncan*

## 1. Introduction

The individual studies reported in the following 13 chapters took many different “cuts” at the political economy of the countries involved. There are region-wide, country-specific, and sector-specific studies, as well as studies of specific reforms and the activities of particular individuals and individuals in particular positions. There was an attempt to have a representation of Melanesian, Polynesian, and Micronesian countries. No uniform analytical framework was imposed; researchers were free to apply the analytical framework that they saw as most productive in studying this phenomenon. By examining the interactions between the political, economic, social, and cultural characteristics of the countries from different angles and through different disciplinary lenses, the intent was to deepen understanding of the political economy of these countries and improve the effectiveness of any development assistance provided.

This chapter provides an overview of the research undertaken and situates it within the context of the political economy studies undertaken around the developing world over the past decade, as reviewed in Chapter 1. The chapter also draws out the operational lessons for developing countries considering or attempting economic reform and for development cooperation agencies assisting in the process. In some cases, the studies confirm lessons that have already been learned elsewhere; in others, new lessons have been learned, particularly those relevant to the special circumstances of the Pacific island countries (PICs) themselves.

## 2. Factors Underpinning Successful Reform

Several of the studies analyze successful economic reforms in the PICs. The revision of land legislation, particularly that relating to the leasing of customary land in Papua New Guinea (PNG), is discussed by Charles Yala in Chapter 3, “A Political Economy Analysis of the Customary Land Tenure Reforms in Papua New Guinea.” In Chapter 4, “Telecommunication Regulatory Reforms and the Credibility Problem: Case Studies from Papua New Guinea and Tonga,” Siope ‘Ofa

examines the struggle over the recent opening of the telecommunication market in the Pacific, particularly in PNG.

The Cook Islands and Samoa undertook successful macroeconomic reforms in the mid-1990s in the wake of financial crises. In Chapter 5, “Political Economy and Championing Reforms in the Cook Islands and Samoa,” Emele Duituturaga looks into the factors that were important in ensuring the success of these reforms.

On 19 March 2009, two pieces of legislation aimed at mobilizing land held under customary tenure for development in PNG were passed unanimously by Parliament. The passage of this legislation was in sharp contrast to the two earlier attempts to reform land legislation relating to customary land. Protests opposing customary land tenure reform, led by students, nongovernment organizations (NGOs), and trade unions, resulted in the destruction of property worth millions of kina in 1995 and 2002 and four deaths in 2002.

The PNG government, through the minister for lands and physical planning, began the land reform program in 2005. The government saw this as a fundamental reform initiative aimed at achieving the growth target set in its Medium Term Development Strategy 2005–2010. The land reform program was focused on four objectives: improving the system of land administration, improving the system of land dispute settlement, developing a framework for mobilizing land held under customary tenure for broadly based economic growth and development, and the development of institutions that would form the basis for a viable land and properties market.

In 2005, the government launched a National Land Summit, which was to seek a mandate on land reform following intensive public discussion. The land reform program was deliberately designed as a PNG initiative to foster ownership. The conceptual and technical papers presented at the summit were written by PNG academics, bureaucrats, and participants from other stakeholder groups such as businesses and NGOs. Donors were deliberately excluded from the very sensitive proceedings, although the Australian Agency for International Development (AusAID) played a key background role in providing financial support to the reform program activities. While donors did not provide technical assistance, they were briefed throughout on progress.

The government accepted the recommendations from the report of the summit in October 2005 and established the National Land Development Taskforce, which began work in February 2006. An integral contribution to the success of the reform process was the public relations exercise. Stakeholder groups were identified and considerable efforts were made to understand their interests and concerns, and, where necessary, to accommodate them. Students and NGOs had been major opponents of previous land reform efforts, so special attention was given to involving them; for example, essay competitions were held for secondary and tertiary students. The findings from the summit were widely disseminated, and task forces were formed to consult with the country’s many linguistic groups.

Another important dimension of the land reform program was the political and intellectual leadership. The then-minister for lands and physical planning—and later the deputy prime minister and minister for lands and physical planning—provided political leadership throughout the whole process. There was also stability in the intellectual and technical leadership provided by members of research institutes, the bureaucracy, and academia.

The parallels between how this land reform program was carried out and the successful effort to reform the public procurement legislation in the Philippines discussed in Chapter 1 (Campos and Syquia 2006) are striking. Both have similar lessons on how to generate successful policy reform. First, there is the importance of champions; in both cases these were in the political,

bureaucratic, and academic arenas. Moreover, the stability of this leadership during the reform process was essential, as was the leaders' influence in widening support in various arenas. Second, there is the necessity to create a support team capable of responding to events over the life of the reform process. Third, the production of in-depth studies supporting the reform is critical. Fourth, a comprehensive communications strategy to generate public understanding of the reforms, allow concerns to be expressed, develop ownership of the reforms, and mobilize public action was also central to reform success.

Siope 'Ofa's chapter on telecommunication reform in PNG and Tonga confirms one of these lessons and raises the possibility of others. Leadership was critical to telecommunication reform in both countries. In Tonga, the king's divestment of his interest in the monopoly mobile phone provider, TonFon, and his commitment to liberalizing the sector were critical in overcoming political and public resistance. In PNG, the leadership was provided by other means.

The PNG government had made a commitment in 1996–1997 to opening the telecommunication sector through its World Trade Organization (WTO) telecommunication commitments. The cabinet, through the National Executive Council (NEC), followed up on this commitment with its decision in December 2005 to introduce competition in mobile telephony services. In this decision, Telekom PNG Ltd, the government monopoly telecommunication provider, was to terminate its mobile phone service by 31 March 2006. The Independent Consumer and Competition Council (ICCC), the economic regulator, was to then select two new mobile phone licensees. March 2007 was the date set for open competition in the mobile phone market.

However, in September 2006, Telekom PNG refused to relinquish its monopoly. The government simultaneously released a new information and communication technology policy that reneged on the December 2005 NEC decision. Despite the new policy, ICCC went ahead and selected two new mobile phone providers through public tender and announced these in accordance with the timeline previously set. In March 2007, telecommunication technical regulator Papua New Guinea Radiocommunications and Telecommunications Technical Authority (PANGTEL) attempted to revoke the spectrum license that it had issued to Digicel PNG Ltd, an Irish-based mobile phone company that was one of the two new licensees. Digicel launched its mobile phone service anyway in May 2007 (a few months after the deadline for open competition set by NEC).

Besides taking court action to prevent PANGTEL from revoking its spectrum license, Digicel received support from a visit to PNG by the Irish ambassador to Australia and PNG, who no doubt reminded the government of its WTO commitments to telecommunication liberalization. In September 2008, the PNG government also received a letter from the European Commission reminding it of its WTO telecommunication commitments.

Mobile phone competition has proceeded in PNG despite further attempts to prevent full competition by delaying interconnection between Digicel and B-Mobile, Telekom PNG's mobile phone provider, and allowing Telekom PNG to maintain its monopoly over the international gateway. Interconnection did not occur until July 2008. Prior to this, most people had been carrying two mobile phones.

ICCC championed the telecommunication reforms throughout this long route, although it suffered in the process by the government taking away its role as regulator of the telecommunication sector and handing it to another body that is dominated by government officials. This action may well present future risks of regulatory capture. These events demonstrate that a champion of reform need not be an individual but may be an organization. They also demonstrate that an independent regulator of utilities is subject to regulatory capture and may prove to be a fragile foundation for

reform. On the other hand, the WTO telecommunication commitments that PNG had undertaken proved to be a strong means of locking in the reforms.

Siope 'Ofa argues that Tonga's WTO telecommunication commitments were also important in underpinning the reform in that country. Hence, international treaties that have "teeth," such as the WTO with its dispute settlement provisions, can be helpful in initiating and sustaining reforms.

Another helpful lesson from these reform processes is that the demonstration of widespread consumer benefits can also help initiate and sustain reforms. As 'Ofa illustrates, mobile phone services have become more widely available and considerably cheaper in both countries following open competition. It is likely that many existing and potential telephony consumers in Tonga were aware of the benefits of competition because of the extensive emigration of Tongans to metropolitan countries, where they had the opportunity to compare the cost, quality, and availability of services with services at home.

This was clearly not the case in PNG, a country where most people have little contact with others in their own country, let alone in other countries. Obviously realizing this, Digicel immediately made mobile phones and services widely available when launching its mobile phone service. This action had the enormously important effect of preventing the government from backsliding on its commitment to open competition. This reaffirms the lesson from Charles Yala's chapter about the importance of disseminating information about the benefits of the reform.

Emele Duituturaga's chapter on the factors important in the success of the mid-1990s' macroeconomic reforms in the Cook Islands and Samoa confirms several of the success factors identified in the previous two chapters. Strong, visionary, and stable leadership was a common central ingredient. In Samoa, there was such leadership at the highest levels of politics and the civil service. In the Cook Islands, the leader was the Prime Minister. The reform process in Samoa was underpinned by linking it strongly to the local culture, giving a blend of *Fa'a Samoa* (the Samoan Way) and adoption of western institutions.

Local ownership of the reforms was achieved through the use of public consultations. National retreats or summits, together with the widespread distribution of statements of intent and discussion of reform proposals, helped to build ownership in the face of considerable opposition. Evidence of the benefits of reform in Samoa, in the form of infrastructure such as roads, bridges, and airports, also helped to sustain the reforms. In both cases, NGOs were used to provide support for the reforms, especially in the remote areas that government services have difficulty in reaching.

### 3. Leadership in the Pacific

The importance of leadership in driving reforms comes across clearly from the successful cases discussed. This is particularly true of leadership at the highest political and civil service levels, and leadership that can provide consistency over the lengthy periods that are needed for some, perhaps most, reforms to be implemented. In Chapter 6, "Presidential Perspectives on Political Economy in Micronesia," Giff Johnson and Ben Graham provide insights into the thinking of five former presidents of the Micronesian nations—the Federated States of Micronesia, the Marshall Islands, and Palau—about the political economy of their countries.

These leaders stressed that reform proponents need to be cognizant of the long-standing "welfare state" attitudes in these Micronesian countries and how they shape public perceptions about the role of government and influence governance and decision making. The countries face major challenges to increased economic independence as a consequence of the heavy reliance on aid flows

from the Compact of Free Association with the United States, which encourage the welfare mind-set, patronage politics, and nepotism.

Other views from the leaders reinforce conclusions already drawn about the importance of development partners treating reforms as a long-term process. They must move step-by-step in reform programs rather than taking large leaps, and conduct extensive public consultation to overcome resistance to reform and promote local ownership, especially in the more remote areas where media coverage is not very strong. National summits to discuss reform proposals were also seen as important, as was the formation of task forces to make the discussions more inclusive. Further, reforms should be consistent with the local culture. In this respect, identification of the major influences on political decision making—for example, traditional leaders, religious leaders, landowners, business owners, and wealthy families—is important. It was remarked that religious groups and wealthy families appear to be gaining influence in Micronesia, including those from outside the countries.

Earlier fiscal reforms to meet the challenges of the decline in Compact funding have been reversed, with public expenditure again increasing at a faster rate than revenues. This problem magnifies the challenge on the horizon from the ending of Compact funding. There is potential for instability and social unrest if the private sector does not grow sufficiently to replace a considerable portion of the development aid being lost.

#### 4. What Can Explain Unsuccessful Reform Attempts?

In Chapter 7, “Governance Reform in the Public Sector in Pacific Island Countries: Understanding How Culture Matters,” Roderick Duncan looks into why governance reform in the PICs over the past decade or so has been so unsuccessful. He concludes that despite development agencies acknowledging the importance of understanding the local context, they have done little to inform themselves about the political economy, particularly the political culture, of these countries. Duncan argues that many of the political cultural values that were in place before colonization remain in place and heavily influence governance in these economies.

ADB has emphasized the importance of better governance in its Pacific Strategy papers going back to 1996. In its 2005–2009 Pacific Strategy paper, governance was placed at the center of the bank’s reform agenda. For AusAID and the New Zealand Aid Programme (NZAID), governance reform has been an increasingly important priority since the early 1990s. Duncan asks, “What is not clear is whether improvements in governance are a priority of Pacific politicians, public servants, and influential individuals?”

In attempting to explain the apparent lack of enthusiasm for governance reform in the Pacific, Duncan focuses on the political aspects of Pacific culture, specifically concepts of leadership and obligations within political hierarchies. He points out that modern institutions, such as public service departments, elected politicians, and central banks, have to coexist with a Pacific political culture that largely determines how politicians and public servants will behave. Most of the current political leaders and other influential members of the PICs grew up in pre-independence times, and their actions are still guided by the norms and expectations of the Pacific political culture.

While Duncan believes that “big man” political culture is currently the main obstacle to governance reforms in the Pacific, it could also be part of the solution to the Pacific’s development problems, given properly designed institutions. In making this argument, he draws on three features of Pacific political culture: the importance of distribution, the public nature of gifts and the obligations that flow from them, and the competitive nature of big men.

In distributing public resources, the big man acquires the same status and influence as when distributing village resources. The context has changed, but the values have not. Diversion of public resources is often labeled “corruption,” but many of these activities are expected of big men. As long as the local big man is diverting public resources to his supporters, and not hoarding them for himself, it is appropriate behavior under traditional cultural norms.

Because gifts are a means of gaining status for the big men, gift giving has to be public and preferably splashy. The public aspect of gift giving means that the gift recipient’s supporters know what was exchanged, and that the gift and the obligation on the person receiving the gift are acknowledged.

In today’s Pacific societies, the big men have moved into influential positions in the government, either through politics or in the public service, and aim to use their positions to divert government spending or control the awarding of lucrative contracts. Voters expect big men to divert public resources for their benefit. Corruption is perceived to be a problem by a Pacific islands voter only when a big man in another network is diverting public resources away from that voter, or if the diversion is carried out in secret.

Duncan argues that big-man cultural values explain the relative successes and failures in governance reform in the Pacific. If the problem was lack of capacity or lack of a local champion, then it could be expected that all public sector reforms would succeed or fail. Instead, reform programs succeed in public finance ministries such as finance and treasury, but fail in other ministries such as forestry, fisheries, public works, education, and health.

One possible answer, which fits with a big man culture but not with other explanations, is that reforms fail in the ministries controlled by big men. The public finance ministries write the checks, but ministries such as forestry, fisheries, public works, education, and health distribute resources and award contracts. It is simply not in the interest of Pacific big men for proper oversight to exist in the ministries that control distribution, as that would hinder their task of distributing resources to their supporters.

Duncan rightly points out that little can be done to change culture from the outside. To try to affect cultural norms, aid agencies might focus on empowering domestic groups that can push for reform. Agencies can also try to strengthen internal government bodies such as the ombudsman and auditor general, while recognizing that reform of these agencies will receive very little domestic support and will even invite difficulties.

Aid agencies could also attempt to change culture by shifting the cultural norms and expectations of leading politicians and public servants. Overseas training of public servants and other individuals might begin this process. A longer-term strategy would be to improve primary and secondary education in the PICs and to promote greater openness to international trade. However, these efforts are not likely to bring about change in the near future. Aid agencies should therefore attempt to develop institutions in the Pacific that are a better match with Pacific values. Development of appropriate institutions has for a long time been a theme in the reports of the international development agencies, but the work required has never been done.

Duncan argues that if we wish to see an efficient public sector in the Pacific, we would have to keep the big men out. This can only be done if the distribution of resources is carried out at the political level, so that prospective big men are attracted to politics rather than to the public sector. This is admittedly an impossible task, as many functions in the public sector are distributive; but reforms might attempt, as much as possible, to have resource distribution done by elected officials outside the public sector.

Further, to the extent possible, distribution of resources inside the public sector should be separated from the daily administration of the ministries. The awarding of jobs, promotions, and contracts will always take on a political dimension in a Pacific context. Distribution of resources such as these should not be left under the direct or indirect control of the minister, as the minister will use them for his own political gain.

For example, Duncan argues that development banks should never be set up in the Pacific. The problem is not that development banks are alien to Pacific culture; rather, “development banks look exactly like a very Pacific concept—the chief’s storehouse or the pile of gifts at a feast. The fact that no development bank has ever succeeded in the Pacific should not be a surprise when considered in this light.” Likewise, cash given to politicians to distribute to their constituents, or slush funds such as the Rural Constituency Development Fund in Solomon Islands or the Electoral Development Funds in PNG, fit perfectly into the distribution role of big men. Once introduced, these schemes will prove impossible to undo and will likely only grow in time.

In an interesting twist, Duncan says that the public display of gift giving is a feature of Pacific political culture that could be used to improve governance. Transparency is a Pacific cultural value—if not quite the same sort of transparency as might be considered appropriate in a developed country context. Transparency in a Pacific context requires that the big man openly distribute resources. If distribution were to be moved out of the public service and into the political domain, then all distribution should be required to be out in the open. In the Pacific context, this would be an appropriate action for a politician. In the case of slush funds, it could be required that all funds be exchanged in public and that all transfers be recorded, but not to insist that the auditor-general track down funds and look for evidence of corruption.

Another feature of Pacific political culture that might work toward improved governance is the competition between big men. A better governance system might be to institutionalize the big man networks at the district level, as the big men are still the legitimate political figures in that arena. Instead of relying upon public service administrators to deliver funds to a district, local distribution might be moved into the local political sphere. A more culturally appropriate system would be to have a local council of elected big men to oversee, together with the local member of parliament, the delivery of resources from the central government.

In Chapter 8, “Achieving Revenue Reform in the Pacific: Taking Revenue Policy and Administration Advice from Intent to Reality,” Margaret Cotton analyzes the generally poor record of revenue policy reform and its administration in Pacific countries to see what explains the successes and the failures.

In an earlier study of the effectiveness of technical assistance in the reform of revenue policy and its administration in the PICs, Cotton (2008) identified a relationship between the magnitude of the reform recommendations and their implementation: the larger the reform was perceived to be by the country, the less likely it was to be implemented. Conversely, reforms that were perceived as small were almost certain to be completed. Availability of skills, cost, time frame, taxpayer feedback, and impact were all found to influence the perception of the size of a reform. Political factors were also found to influence the implementation of the recommendations. However, Cotton did not address the question of why the larger reforms were harder to implement.

Chapter 8 picks up this question to determine if there are revenue reform recommendations made to Pacific Island revenue administrations that are commonly considered difficult to implement. The study also identifies obstacles leading to the implementation difficulties.

Reforms of revenue policy and administration have typically promoted a four-pronged approach to improving fiscal sustainability and operational efficiency and effectiveness: (i) the introduction of a broad-based, low-rate income tax, with few exemptions and discretions; (ii) the introduction of a broad-based value-added tax (VAT) with few exemptions and discretions; (iii) a reduction in reliance on trade tariffs and sales taxes; and (iv) the introduction of comprehensive revenue administration legislation that standardizes the rights and obligations of the revenue administration office, taxpayers, importers, and exporters.

Eight categories of reforms were identified as commonly facing difficulty in implementation. These categories split evenly into reforms of a policy nature and reforms of a revenue administration nature. Policy reforms causing the most difficulty in implementation were (i) the introduction of a VAT, (ii) the introduction of revenue administration legislation, and (iii) tariff rate changes. Administration reforms commonly facing difficulty in implementation were in the areas of (i) audit and communication strategies, (ii) the adoption of self assessment and post-clearance audit principles, and (iii) the adoption of business analysis techniques. Recommendations addressing the removal of exemptions and associated discretionary decision making faced challenges in both the policy and administration areas.

The Cotton (2008) study had found that perceptions of the size of reform recommendations varied considerably between the advisers recommending the reforms and those of the technical assistance recipients. According to the technical assistance providers, most (97%) of the reforms were assessed as minor or “transactional” when using conventional definitions of transactional and transformational change. However, when the same recommendations were rated by the recipients, the majority of the reforms recommended were considered to be large or “transformational.” Only 30% of the reforms perceived as large were implemented, while 97% of the reforms perceived as small were completed and 48% of medium reforms were completed. As Cotton notes in Chapter 8, this point should not be lost on aid agencies, “which typically engage consultants with different cultural, academic, and organizational backgrounds from the recipients of the technical assistance.”

The common constraint to adoption of recommendations relating to the need to reduce or remove exemptions and limit the number of individuals with discretion to grant exemptions was the political environment. This constraint was said to be particularly challenging where the government is unstable and there are few, but very influential, lobbyists in the business community. Countries that had successfully implemented changes had typically made internal changes first, often establishing a committee to review applications and create greater transparency. Further, decision makers were often not well equipped with prepared responses supporting a “no” decision. It was also noted that reforms to exemption regimes were easier to implement when accompanied by taxpayer-friendly reforms, such as tax rate reductions.

Reasons given for challenges to the recommendation of a VAT included the general “mystery” surrounding a VAT—more so for the American-influenced Pacific islands than the Anglo-influenced countries. The perceived negative impact of a VAT on consumer prices and the belief that tax administrations do not have the capacity to administer a VAT were also constraints. Improved communication, awareness, and education of policy makers and legislators were seen as essential to addressing their concerns and strengthening their understanding of the benefits, impacts, and administration issues surrounding a VAT.

Implementation challenges to revenue administration reforms fell into two groups: challenges faced by countries that were implementing revenue administration policies as part of

wider tax reform (usually involving implementation of a VAT and an income tax), and those where the legislation was being implemented in isolation. Where revenue administration reform was part of a wider reform package, the revenue administration component was seen as a lesser part of the package. Comprehensive reform packages require significant coordination of all stakeholders and understanding of many new concepts; consequently, the revenue administration components received less attention. It was suggested that a more piecemeal approach might have made the magnitude of the changes less overwhelming and given more focus to revenue administration reform.

The underlying concern about the introduction of administration reforms—such as self-assessment, post-clearance audit, the use of data analysis techniques for risk profiling, and the introduction of a range of audit techniques to address identified risks—was the perceived level of compliance in the community. Self-assessment and post-clearance audit principles require an attitudinal change that accepts that the response to compliance risks needs to be balanced against the resources available and costs of compliance. Recommendations for improving implementation in this area relate to communication strategies for improving compliance, the development of public information material, and developing proactive relationships with the business community. These recommendations would also help shift attitudes from a strong enforcement focus to a balance of enforcement and service.

The study's findings suggest that poor communication and lack of understanding are key constraints to implementing revenue reforms; that is, the change leaders are not equipped with the depth of understanding needed to convincingly articulate the “what, how, and why” of the reforms in a variety of forums after the technical assistance provider has departed. Moreover, it may be easier to communicate and implement reforms in a more piecemeal approach. Small changes informed by an overall strategic direction might face fewer constraints at both the political and operational levels.

Political instability has been a feature of many Pacific island societies since independence, particularly Melanesian societies. The lack of strong political parties and ideologies, resulting in governments comprised of volatile coalitions, is widely seen as the cause of the instability. It is also a popular notion that political instability makes it difficult to carry out economic reforms. In Chapter 9, “Island Parties: How Has Political Instability Impacted on Regulatory Quality in the South Pacific?,” Aaron Batten studies how political instability in Pacific countries has affected the implementation of economic reforms, specifically reforms aimed at improving the quality of their regulatory controls. Regulation to ensure effective competition and robust growth within the private sector and the efficient operation of public utilities is one of the most important roles of government and has been a component of economic reform programs in the Pacific.

This chapter reports on an empirical examination of the impact of political instability on the quality of business regulation, both in the PICs and in small island-developing states (SIDS) more generally. The statistical analysis covers 13 PICs and 17 SIDS and measures changes in regulatory quality between 1996 and 2008. Attention is given to the possibility that endogeneity exists between regulatory quality and political instability, as political stability may lead to higher economic growth and the higher economic growth may make regulatory reform more likely.

The statistical analysis shows that higher levels of political instability and political party fractionalization are associated with poorer levels of regulatory quality across the region. This effect is highly robust, occurring in various measures of political instability, a wide range of control variables, and in different samples of PICs and SIDS. Batten argues that this outcome reflects the clientelist and rent-seeking behaviors that weak party systems have encouraged and their consequent impact on the ability, and desire, of PIC governments to battle vested interest groups. “Attempts to remove the

rent-seeking opportunities of existing businesses may easily result in a destabilization of the government as lobbyists seek out means to protect their rents.”

Batten asks, what can be done to strengthen the region’s political systems to encourage a greater degree of policy coherence and more effectively provide these types of public goods? He sees the strengthening of political parties as part of a possible solution, but acknowledges that this is not something that development partners can attempt. Political change must be a domestically led process. Development agencies have to be cognizant of the fact that their efforts to raise levels of economic activity are likely to be thwarted by the region’s current political systems. They should also have realistic expectations about what can be achieved by weak coalition governments. However, development agencies could play an important role in developing the region’s political capacity to undertake reforms that strengthen domestic political institutions. Efforts to promote reform may be most effective during periods of relative political stability, while aid resources may be more effectively applied elsewhere during periods of instability. In this sense, seeking to adapt the uses of aid, rather than attempting to alter the prevailing political environment, is likely to be the most prudent donor response to the challenges highlighted in this study.

East Timor, or Timor-Leste, is a new country facing huge challenges with respect to establishing the conditions for robust, inclusive economic growth. In Chapter 10, “Timor-Leste: Change, Stagnation, and Questions of Political Economy,” Rod Nixon traces the history of Timor-Leste and describes the challenges that the country faces in achieving this goal. Nixon uses the Drivers of Change framework described in Chapter 1 to identify a range of opportunities for change to improve the country’s development prospects and the levers that development agencies could use to bring about such change.

The challenges that Nixon sees the country facing are almost endless and include (i) low-fertility soils, erratic rainfall, and difficult topography; (ii) the majority of people living in rural areas at very low levels of income; (iii) very poor infrastructure, particularly roads; (iv) considerable ethnic diversity; (v) severe skill shortages; (vi) a high proportion of youth and high unemployment; (vii) substantial rural–urban migration in search of work; (viii) martial arts traditions associated with political unrest; (ix) high levels of corruption; and (x) a semi-presidential system that has created two centers of political power.

Nixon identifies the absence of internal security as the most immediate priority. Previous attempts to firm up law and order under the United Nations have largely failed and external military and police forces are required to maintain the existing tenuous order. But with the continuing threat of civil unrest, efforts to generate private sector growth will fail. The government does not appear to be serious about reforming the security sector, as it is unwilling to punish high-level offenders who have already been identified. Nixon does not offer any ‘levers’ for improving the security situation in the near future but says that the next incident of civil unrest that needs the intervention of external forces should be used as an opportunity to require serious action on the part of the government.

Corruption is entrenched, and improved transparency and public sector management are seen as the next areas in line for reform attention. The government is said to be interested in funds for major infrastructure investment in rural areas, where poor public sector management is a particular problem. Nixon says that such funds should be made available subject to conditions leading to improved transparency.

Private sector development and the lack of jobs in rural areas are the third priority, but the investment risks are high. Therefore, development agencies could offer backing for a political risk

insurance scheme, subject again to conditions requiring improved government management practices.

The fourth priority is a more effective agricultural extension service and a broader approach to agricultural development, to include attention to upland farming, estate crops, and livestock. The government is said to have a strong interest in accessing overseas work programs to provide relief for the high youth unemployment. Participation in programs such as Australia's Pacific Island guest worker scheme, which could give workers experience in better agricultural production systems, could also be a lever for upgrading agriculture policy.

The huge government revenues being generated by Timor-Leste's oil reserves provide development opportunities, but effective expenditure of these funds is proving a significant challenge, as it has in so many developing countries. Moreover, the availability of these funds reduces the leverage that development agencies may be able to apply in order to assist in promoting development.

## 5. Patronage Politics and Corruption

Chapter 6 contains claims by former presidents of Micronesian countries that patronage or clientelist politics is alive and well in the Pacific. In Chapter 8, the point is made that tax administration reform is particularly challenging because of the difficulty of removing the scope for discriminatory behavior by politicians and bureaucrats in setting tax rates. In Chapter 11, "How Pervasive is Clientelist Politics in the Pacific?", Ron Duncan and Graham Hassall attempt to measure the extent of clientelism in Pacific countries and compare their clientelist behavior with that of other countries.

Drawing on the economic theory of contracts, Duncan and Hassall define clientelism or patron-client relationships in politics as existing when the only credible (enforceable) pre-election promises (contracts) are those made between politicians (patrons) and voters (clients). These may be the only viable forms of political contracts because of the high costs of enforcing contracts between political incumbents and voters. The high costs of contract enforceability may arise because of the cost of organizing voters and the need for repeated face-to-face interaction between the politician and voters to ensure that the voters vote for the politician and can see that the politician delivered on the promises made.

From this economic interpretation of patron-client politics, Duncan and Hassall draw out various hypotheses to be empirically tested. These include behaviors such as (i) an emphasis on targeted transfers to voter groups rather than the provision of public goods that benefit the wider community; (ii) little interest by politicians in establishing secure property rights and impartial contract enforcement (the two pillars of market economies), as doing so undermines the politicians' ability to create rents and distribute targeted transfers; (iii) little interest in making the bureaucracy more efficient, as this also undermines the politicians' ability to deliver rents to their voters; (iv) little interest in establishing controls over the expenditure of revenues from the exploitation of natural resources, as again this makes rent seizure and distribution more difficult; and (v) the creation of monopolistic government business enterprises as a means of creating and distributing monopoly rents. (Appointments to senior management positions and boards of directors in government business enterprises provide governments with means of rewarding political supporters or enticing politicians to join the government.) Because some of these forms of clientelist behavior are not easy to measure directly, their measurement necessarily involved the choice of less direct indicators.

The indicators assembled by Duncan and Hassall suggest that Kiribati, the Federated States of Micronesia, and Solomon Islands exhibit behavior that is most consistent with the clientelist model. They also have some of the lowest per capita incomes and poorest economic growth in the Pacific. Thus the answer to one of the questions may be that clientelist politics leads to slower economic growth. However, one has to ask whether the causality runs in the other direction, or if there is some additional factor(s) causing both. It is difficult to think of a convincing reason for poor economic growth to lead to clientelist behavior. It is more convincing to argue that the communal nature of these societies results in both clientelism and poor growth.

Still, the compilation of indicators of the various forms that clientelist behavior can take does appear to add up to a fairly convincing, though circumstantial, conclusion that clientelism is alive and well in some Pacific island societies. Therefore, the possibility for this kind of behavior has to be taken into account by development agencies in assessing the risks to the potential benefits from their assistance.

Corruption is believed to be quite widespread in the Pacific. It is also believed to be a deterrent to economic growth and to the realization of the full benefits from development assistance. One area in which corruption is believed to be having a significantly detrimental impact is in the logging of forests—particularly in PNG and Solomon Islands. In Chapter 12, “The Political Economy of Logging in Solomon Islands,” Matthew Allen explores the political economy of the logging industry in Solomon Islands and looks for the reasons why the industry is so fraught with corruption involving foreign logging companies.

Corruption in the forest industry has taken the form of bribes to government officials and politicians and direct involvement of politicians in the industry, resulting in transfer pricing, illegal exemptions from export duties, and avoidance of export duties through undervaluation of log exports and underreporting of log volumes. Consistent with the clientelism model of Duncan and Hassall in Chapter 11, these corrupt practices have been enabled through lack of clarity about property rights over forest resources as well as weak monitoring and enforcement through under-resourcing of the responsible government agencies.

The close association between the logging industry (consisting mainly of landowners and foreign logging companies) and politicians has been responsible for much of the political instability that has occurred in Solomon Islands over the past 2 decades. It has also been responsible for the unsustainable level of logging of Solomon Islands’ forests, to the point where logging is expected to decline sharply in the near future.

Allen argues that while the corruption can be seen in part as economically rational, there is more to it than this. He draws upon literature on social embeddedness and political culture to develop a framework that emphasizes the importance of social and cultural influences on the behavior of elected representatives, government officials, and village big men in Solomon Islands. Similar to Roderick Duncan in Chapter 7, Allen stresses that, like all Melanesians, Solomon Islanders are enmeshed in networks of obligation and reciprocity. Therefore, the cultural expectations of their kinsmen compel politicians, government officials, and village big men to access and distribute resources, with the logging industry affording significant opportunity for such patronage.

Allen is pessimistic about the prospects for improved behavior, given the extremely slow rate at which culture changes. He sees grassroots demand for improved governance as providing the best chance for desirable change and urges research on ways in which such grassroots change can be stimulated.

The politicians' slush funds that exist in PNG and Solomon Islands—and to a much lesser extent in Vanuatu—are considered by many to be a form of political corruption. Jon Fraenkel in Chapter 13, "The Atrophied State: A Supply-side Perspective on Politician 'Slush Funds' in Western Melanesia," takes a close look at the allocation of these funds. In particular, he examines the claim that the funds are a manifestation of patron-client, or clientelist, politics. He concludes that they are more likely a function of attempts to hold governing coalitions together, with such attempts being assisted by the availability of increased government revenues coming from natural resource revenues or donor aid.

Fraenkel has carefully collected data on allocations of the Rural Constituency Development Fund in Solomon Islands, the Members of Parliament Allocation in Vanuatu, and the District Support Grants (more recently, the District Services Improvement Programme) in PNG. A comparison of the data shows that in Vanuatu the politically allocated expenditures (PAEs) are much smaller than in the other two Melanesian states, both in terms of monetary amounts and as a share of national government expenditure (in 2009, PAEs totaled 0.9% of government expenditure in Vanuatu, 5.5% in PNG, and 6.2% in Solomon Islands). Also, the amounts allocated to politicians fluctuate significantly over time, especially in the two larger states.

Fraenkel relates the fluctuations in the amounts allocated to individual politicians to the timing of elections and fluctuations in windfall resource revenues and donor funds to test whether the PAEs are an outcome of patron-client politics or due to governments using them to hold fractious coalitions together. He argues that the latter is more likely the case (increases in PAEs tend to occur after elections rather than before) and that such use has been facilitated by increases in windfall resource funds and aid. That Vanuatu has had more volatile governments but made much less use of PAEs is attributed to the fact that it has received little in the way of windfall resource revenues.

Whether PAEs should be seen as generating stagnation or deterioration in government service delivery (because the funds are being used for direct payments to politicians rather than being a response to weakening bureaucracies and declining public services) cannot be determined due to the absence of data on PAE disbursements. However, Fraenkel argues that even if donors choose, for pragmatic reasons, not to place conditions on loans that require the reduction of the large PAEs in PNG and Solomon Islands, they should at least avoid endorsing the kinds of analysis that depict such schemes as potentially positive instruments for improving the delivery of services.

Fraenkel sees PAEs as one part of a "pervasive personalization of the management of state finances in Western Melanesia" that is undermining the building of effective states. In particular, schemes in which volatile government surpluses, whether arising from aid or natural resource industries, are recycled through politicians should be avoided.

## 6. Political Economy and Aid

It has been argued that aid can have impacts similar to that of natural resource windfalls, such as the potential loss of competitiveness of industries through exchange rate effects or raising non-traded, particularly labor, costs ("Dutch disease"), or poor use of aid funds because they reduce pressure on governments to use revenues wisely and to perform well because the revenues are not raised from taxes (resource curse). Further, aid can be fungible; therefore, governments can fund projects that do not have highest priority, or the aid can be corruptly appropriated by politicians or bureaucrats. The possibility of adverse impacts from aid is of particular concern in the Pacific, as several of the PICs receive some of the highest levels of per capita aid in the world.

Chapter 14 by Jonathan Gouy, “Aid, ‘Dutch Disease,’ and the Pacific,” tests the impact of foreign aid flows on Pacific government behavior, in particular on the raising of tax revenue. This is only one of the possible adverse impacts of aid. However, it is the only one of the possible impacts mentioned above for which the necessary data to undertake econometric analysis is available. Gouy uses cross-country regression analysis to explain tax revenue–GDP ratios for samples covering many different country groupings. The hypothesis that the presence of aid is negatively correlated with revenues during 1990–2007 is rejected for the samples from all countries, middle-income countries, East Asia and Pacific countries, and island states, while no reliable relationship is found for the impact of aid on revenues in the PICs, the low-income countries, and sub-Saharan African groups.

Gouy notes that the fact that revenue has an unclear relationship with aid in the PICs leaves open several possibilities. One is that aid and revenue are partially endogenous to each other. Another is that the cause and effect primarily goes in the other direction, such that a change in a country’s circumstances (such as a natural disaster or rapid terms of trade deterioration) impacts revenues, which leads to donors altering aid levels. This outcome is plausible in very high-aid countries. A third possibility is that the volatile year-to-year macroeconomic shifts that the small, open, and relatively undiversified PIC economies experience could overwhelm any revenue effects that arise from changes in aid.

However, given the likely increases in aid flowing to the Pacific, in particular because of the large increase in future Australian aid, Gouy lists a number of areas where development partners should take care: (i) increase aid flows carefully to avoid swamping domestic markets and bureaucracies with a mix of Dutch disease and governance impacts; (ii) recognize that imported capital goods that expand the capital stock have a greater chance of catalyzing private investment than government consumption, which generally crowds out private investment; (iii) slow or reduce the proliferation of aid activities by increasing sector and country specialization and rationalizing activities among donors; and (iv) avoid drawing recipient governments into policy engagements that entail expenditure commitments with uncertain returns.

In Chapter 15, “The Political Economy of Sugar Rents in Fiji,” Satish Chand analyzes a form of aid that clearly appears to have fostered rent seeking and political instability in recipient countries. This study relates to the aid provided by the European Union (EU) countries to former colonies and territories through the Sugar Protocol with the African, Caribbean, and Pacific countries. The agreement essentially provided aid in the form of preferential prices for sugar exports from these countries to the EU. Chand estimates that for the 10 years to 2001, the sugar aid or rents received by Fiji amounted to nearly half the total value of its sugar exports—equal to approximately 5% of gross domestic product.

The key findings of the chapter are that the rents provided through the preferential prices have fueled damaging political competition in Fiji; that competition over the rents has led to the dissipation of the rents; and that the externalities of this competition include deleterious impacts on interethnic relations, national politics, and policy making.

The competition over the sugar rents has been basically between the indigenous Fijian landowners and the tenant farmers, who are predominantly Indo-Fijian descendants of indentured Indian labor brought to the country by the sugar miller Colonial Sugar Refinery Ltd. However, additional stakeholders have come into the picture, including the Native Land Trust Board (NLTB), which was established in 1940 and given a monopoly over the issuing of agricultural leases; the government, which acquired the sugar mills at Fiji’s independence in 1970; the unions representing the smallholder farmers; and the mill workers and their unions—all significant political players.

Chand describes the political economy of the contest over the sugar rents in the following terms. The rent-seeking NLTB monopoly has an incentive to appropriate all of the rents, given the competitive nature of its franchisees. As a result, NLTB has been active in national politics, serving as a focal point for discussion of issues of interest to landowners and the indigenous population. The close links NLTB has had with the Great Council of Chiefs has given them political clout parallel to that of Parliament.

The Growers' Union, representing the tenants, has a symmetrical incentive to convince tenants that security of access to land, particularly conditions of leases and lease renewals, can be achieved via the political process. That is, the Growers' Union will lose its legitimacy should lease renewals become independent of the political process. Because it is funded via levies, its existence depends on continuing political support from farmers. Such support is also critical for winning communal Indo-Fijian seats in national elections within the sugarcane growing districts.

The political parties that draw support from the two sides of the ethnically divided electorate have an incentive to preserve the status quo. Consequently, the impasse over reform of the agricultural land-leasing system—which has inhibited productivity growth in the sugar industry and investment more generally—attracts considerable rhetoric but little action from the leaders of the two major political parties. Ethnic polarization increases during elections, when grievances regarding the division of the proceeds from sugar exports are debated by aspiring politicians. The nurturing of this divide has adverse ramifications for race relations and for policy making as a whole.

It is argued that the sugar rents have been dissipated in various ways. First, the rent component of incomes from profitable farms has been capitalized into their prices. Second, because of the artificially increased sugarcane prices, fields have been expanded into marginal land and remote areas, so rents have been dissipated through rising production and transport costs. Third, milling inefficiency has risen with the price of sugar. Fourth, landowners have claimed some of the rents, as land values within the sugarcane growing districts have risen with the expansion of the area under sugarcane cultivation. Finally, unionized labor has claimed some of the rents through wage increases that exceed productivity growth.

The EU's preferential prices are being phased out due to pressure from the World Trade Organization. Chand argues that the erosion of the preferential prices will diminish the incentives for rent seeking and thus has the potential to improve intercommunal relations, national politics, and policy making in general. In fact, this process may have already begun, with the recent dissolution of several of the sugar industry organizations.

## 7. Conclusions

These studies have confirmed or added to the lessons garnered from the political economy research undertaken over the past almost 20 years, which indicate the importance of

- political and senior civil service commitment (leadership);
- organizational strategic management capability within the public sector, such that it can respond to events as the reform process unfolds;
- a well-constructed communication strategy designed to inform the public and develop and sustain its support (“ownership”) of the reform; and
- appropriate and coherent external technical advice (and pressure).

The experience of successful reforms in the Pacific strongly supports these lessons. For example, they have demonstrated the importance of reform champions in both the political and bureaucratic arenas. Moreover, stability in this leadership during the lengthy reform processes was critical, as was the leaders' influence in widening support among the various stakeholders. The reform process also benefited from having a support team capable of responding to events over the life of the process; in-depth studies to support the reform leadership; and comprehensive communications strategies to generate public understanding of the reforms, allow concerns to be expressed, develop ownership of the reforms, and mobilize public action. National summits, or retreats, involving all stakeholders have also featured prominently in public consultations in the Pacific.

Additional reform lessons from the studies are as follows:

- The reform champion need not necessarily be an individual—it may be an organization, as in the PNG telecommunication reform.
- An international treaty with “teeth” can be a useful mechanism for initiating and sustaining (locking in) reform.
- Local actors will perceive the changes involved in reforms as much larger than do the development agencies or consultants providing technical assistance; therefore, consideration must be given to local perceptions of reforms, and it may be helpful to take a piecemeal approach.
- The demonstration of widespread consumer benefits from earlier reforms or reforms in other countries can stimulate current reform efforts; this point ties in with the importance of generating in-depth studies to demonstrate the benefits of the reform.
- It may be important to ensure that the reforms are in harmony with cultural practices.

The studies also have some general lessons for development agencies. Corruption and clientelist politics exist in the Pacific and can present substantial obstacles to improved economic growth and development. If those holding power within a country will lose from a reform, it will be very difficult to implement the reform unless the incentives affecting their behavior are changed. The cultural norms and values of Pacific countries appear to play a large role in these perceived problems. Agencies must realize that these cultural values will be resistant to change. Although it may be possible to bring about some change in culture, expectations about the extent of such change should be realistic. It may also be possible to adapt institutions and policies to have a better fit with the existing culture.

The studies offer some specific suggestions as well. Because an understanding of the political economy of undertaking reforms in developing countries is clearly desirable, it is equally desirable that agencies employ, directly or indirectly, specialists with expertise in this area. Development agency staff should have a reasonable understanding of the political economy of economic reform, both in developing countries in general and in the particular economies with which they are engaged. It is also clear that an appreciation of the political economy of reform should be an integral part of the design of projects involving any sizable (as perceived by locals) reform effort.

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# 3 A Political Economy Analysis of the Customary Land Tenure Reforms in Papua New Guinea

by Charles Yala<sup>1</sup>

## ABSTRACT

The land reform program initiated in 2005 has successfully proceeded to implementation. A significant achievement is the passage in March 2009 of two pieces of legislation aimed at mobilizing land held under customary tenure for development. Passage of this legislation is significant because past attempts at land reform have failed. The successful outcome provides useful lessons about the political economy of Papua New Guinea, how to undertake sensitive reforms in other sectors of the economy, and how external agencies can engage with reform programs.

## 1. Introduction

The passing of two pieces of legislation aimed at mobilizing land held under customary tenure for development by the Papua New Guinea (PNG) Parliament on 19 March 2009 was a significant milestone in PNG's endeavors to undertake fundamental microeconomic reforms aimed at achieving broad-based economic growth and development. These laws underpin fundamental reforms to the customary land tenure system. Their passing also marks a significant achievement for the broader land reform program, which was initiated in 2005.

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<sup>1</sup> Yala provided the academic leadership throughout the PNG Land Reform Program. Ron Duncan, Satish Chand, Thomas Webster, Esekia Warvi, and Kathryn Apelis, who provided useful comments on an earlier draft, are gratefully acknowledged. The views expressed in this paper are those of the author.

The Somare government (in the previous Parliament from 2002 to 2007), through the lands and physical planning minister, initiated the land reform program in 2005. The government saw this as a fundamental reform initiative aimed at achieving the 5% annual growth target set in its Medium Term Development Strategy 2005–2010 (Department of National Planning and Monitoring [DPNM] 2005). At the same time, both the minister and the government were mindful of the fact that land reform remains a sensitive and difficult policy issue in many parts of the developing world, including PNG. Past land reform initiatives in PNG largely failed. Protests led by students, nongovernment organizations (NGOs), and trade unions opposing customary land tenure reform resulted in four deaths in 2002 and the destruction of property worth millions of kina in 1995 and 2002.<sup>2</sup> The political implications were extreme, as the incumbent Morauta government was decimated in the 2002 national elections.

Customary land tenure reform was therefore a politically sensitive and unpopular policy matter for individual politicians, political parties, and incumbent governments. Politicians have been very cautious about pursuing policies that advocate customary land tenure reform in a society where customary land tenure is deeply rooted in the cultural, social, political, and economic fabric. At the same time, opponents of customary land tenure reform have advanced the argument that customary land supports more than 85% of the national population, which is predominantly rural, and that any reforms to customary land tenure would result in a land grab by educated, wealthy, and well-connected citizens and foreigners. Once land was registered, people could lose their land very easily as it could be sold and traded, causing upheavals in the social life of tribal communities. People would be pushed into extreme poverty as their source of security in providing food, water, and shelter would be lost forever.

In the face of this opposition, it became extremely difficult to pursue policies aimed at reforming the customary land tenure system. However, the need for broad-based economic growth motivated the government and the minister to initiate a PNG-championed land reform initiative in 2005, in which national institutions and experts played a leading role.

Since 2005, the broader land reform process has undergone three distinct phases: conception, formulation, and implementation. The conception phase saw the staging of a National Land Summit in 2005, aimed at seeking a mandate from the people of PNG to undertake land reform. The formulation phase saw the establishment of the National Land Development Taskforce (NLDT) in 2006, with three expert committees formed to implement the recommendations from the summit. The government adopted the recommendations in 2006 and the National Land Development Program (NLDP) was launched in 2007 to begin the implementation phase.

The Prime Minister launched the NLDP in February 2007. Given that 2007 was an election year, the willingness of the incumbent Prime Minister, the lands and physical planning minister, and the government to launch the program was a testament to the success of the process and the type of land reform formulated. This progress was significant, given the negative experiences from 2002, which was also an election year.

The launch of the NLDP made it official government policy to implement the findings, recommendations, and implementation framework formulated by NLDT. The findings and recommendations focused on four areas: improving the system of land administration, improving the system of land dispute settlement; developing a framework for mobilizing land held under customary tenure for development; and developing institutions for a viable land and properties market. Land reform has become part of the mainstream public policy debate in PNG. Several political parties and

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<sup>2</sup> K1 = \$0.3729 on 14 September 2009.

candidates that contested the 2007 national election advocated land reform policies in their party and individual campaign manifestos.

On 19 March 2009, the PNG parliament unanimously passed two laws aimed at mobilizing land held under customary tenure for development. The principles underlying this legislation were conceived at the National Land Summit and formulated by NLDT. The discussions at the summit provided the following guiding principles: that, under any form of registration, the customary ownership of the land was never to be lost but remain with the traditional landowners; and that any system of titling was as good as a state title. The first principle was demanded by PNG customary landowners and the latter by financial institutions.

The successful passage of the two laws marks a significant achievement in the broader land reform program. This success provides useful lessons in understanding the political economy of PNG, how to undertake sensitive reforms in the other sectors of the economy, and how external agencies can engage with reforms.

This chapter is organized as follows. Section 2 describes the process behind the broader land reform program and the key features. Section 3 describes the conception, formulation, and implementation of the customary land tenure reform component. Section 4 analyzes the main factors behind the successful passage of the two laws. Section 5 uses lessons drawn from the preceding analysis to describe external agency engagement in PNG.

## 2. The Broader Land Reform Program

The passage of the two laws has initiated successful reforms to customary land tenure in PNG. This is an important achievement for the broader land reform process, which began in 2005. Both the broader reform process and the customary land tenure reform initiatives have been through their own systematically structured and executed processes. This section describes the process and key features of the broader land reform program.

### Process for the Broader Land Reform Program

The broader land reform program has been through three distinct phases: conception, formulation, and implementation.

#### *Conception—National Land Summit (2005)*

The conception phase of the land reform program began with the staging of the National Land Summit (NLS) at the University of Technology (UNITECH) in Lae, in 2005. To prepare for the summit, the government invited the state-owned National Research Institute (NRI) to lead a team comprised of three line departments (Departments of Lands and Physical Planning, National Planning and Monitoring, and Justice and Attorney General), two universities (University of Papua New Guinea and UNITECH), and two research institutes (NRI and the Institute of National Affairs). This group formed the National Land Summit Coordinating Committee (NLSCC). NLSCC met regularly and deliberated on the theme, program, papers, presenters, and participants. The lands and physical planning minister was provided regular updates throughout. Details of the summit were published in the media.

The staging of the summit was important for the government in seeking a mandate from the people of PNG to pursue the land reform agenda and seek direction on the type of land reform required. It provided a process to hear each other's views, recognize barriers, and identify opportunities for developing further. There was no predetermined agenda except to discuss the

challenges and opportunities that land reform presented and to gain the community's confidence that the government had no ulterior agenda. The government and NLSCC were committed to a process-driven outcome. Therefore, they were prepared to allow the outcome of the summit to determine the direction of the land reform initiative. Communicating this to the stakeholders was an important aspect of the public relations strategy leading up to the summit.

The program was structured to demonstrate PNG political and technical leadership over the process. Political leadership was demonstrated through presentations made by the deputy prime minister (keynote address), lands and physical planning minister (setting the agenda for land reform), and the treasurer (closing speech). Constitutional and Law Reform Commission Chairperson Dr. Alan Marat, Lands and Physical Planning Minister Dr. Puka Temu, and Justice Minister and Attorney General Bire Kimisopa participated throughout the summit.<sup>3</sup>

Following the presentations by the deputy prime minister and the lands and physical planning minister were two conceptual papers, presented by PNG academics, aimed at providing the framework for subsequent papers and discussions. The first focused on economic arguments, especially the impending poverty implications of not engaging in a quality land reform program that ensured security of tenure aimed at improving agricultural productivity to feed the growing population. Without land reform, increasing poverty was seen as inevitable (Yala, Chand, and Duncan 2010). The second paper focused on the irreversible changes already occurring in customary land tenure, which have significant social, political, and economic implications. These changes are driven by the rapid social and economic changes occurring in the country (Kalinoe and Kanawi 2010).<sup>4</sup>

The rest of the presentations were by the public sector, the private sector, NGOs, students, a landowner, and banking and finance sector representatives. These presentations focused on the problems, issues, strategies, and options from practitioners' viewpoints.<sup>5</sup>

Only two external speakers were formally invited to speak at the summit. One was an Australian academic of aboriginal background who discussed the land reform debate involving indigenous Australians (Dodson and McCarthy 2010).<sup>6</sup> This was a crucial paper. It helped Papua New Guineans to understand that even Australia, with its economic size, large number of universities, and considerable technical and intellectual capacity, continues to struggle with this issue. Given the lead role that Australia plays in PNG through its aid arrangements and the extensive interest in the PNG customary land tenure debate by academics and consultants in Australia (see section below), this presentation strengthened PNG's resolve to pursue its own reform initiative, to be driven by PNG institutions and experts. The message was clear: if Australian experts and the Australian government continue to struggle to resolve customary land tenure issues within Australia, then Papua New Guineans had to be skeptical of proposals from Australian experts. The PNG government had already decided that while Australia could provide financial support, the design of a framework for land reform, including reforms to customary land tenure, had to be owned and developed by PNG. The paper endorsed this approach.

The second international speaker was an academic, Professor Ron Crocombe, with long-standing knowledge of previous failed attempts at land reform within PNG and across the Pacific

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<sup>3</sup> Alan Marat has a PhD in law. Puka Temu is a medical doctor by training and was knighted in 2009.

<sup>4</sup> While both papers were coauthored, Yala and Kalinoe were the respective presenters.

<sup>5</sup> Selected papers from the summit proceedings are contained in Yala (2010). The abstracts of the papers presented at the summit are contained in the NLSCC report (2006) to government on the NLS, later reproduced as Special Publication # 39 by NRI.

<sup>6</sup> Professor Mick Dodson presented the paper. Dodson was the Australian of the Year for 2009.

islands region. He provided cautionary advice on how PNG could move ahead and what pitfalls to avoid (Crocombe 2010).

The summit was well attended, with ample opportunities for views and perspectives to be expressed by a wide cross section of the community. A total of 67 recommendations were submitted. Subsequent review of these recommendations revealed four thematic issues. These were (i) improving the system of land administration; (ii) improving the system of land dispute settlement; (iii) designing a framework for developing land held under customary tenure; and (iv) improving the security of tenure so that transactions involving all types of land (land owned by the state, freehold land, and land held under customary tenure) are bankable.<sup>7</sup> The last issue emerged as the overriding theme. Capturing all these issues was the question, how can we access land for development? This question provided the overall framework for subsequent analysis and discussion.

NLSCC prepared a report on the summit, distilling the issues and options and developing a framework within which the government could implement the recommendations. People were greatly concerned about the appalling state of land administration (which is the management of state land) and the system of land dispute settlement. The main message regarding customary land registration was that before this was pursued, the government had to improve the system of land administration and land dispute settlement. The proposed implementation framework consisted of a task force with three expert committees covering the thematic areas of land administration, land dispute settlement, and customary land development, reporting to the Economic Ministerial Committee (EMC), a committee of the National Executive Council (NEC). The three committees were to undertake in-depth analysis of the issues and make recommendations.

NLSCC first presented the draft report to the lands and physical planning minister and then to EMC. Having received their endorsement, NLSCC submitted the final report to the government in October 2005. The government adopted the summit report and its proposals, establishing the National Land Development Taskforce (NLDT) and the three committees as recommended. The Prime Minister launched the task force and the report from the summit (which NRI had produced as Special Discussion Paper #39) at the Parliament conference room in front of invited guests and the media.

### *Formulation—National Land Development Taskforce (2006)*

NLDT began work in February 2006. The core team from NLSCC was retained as NLDT. Three expert committees, headed by NLDT members, were established to undertake detailed analysis of recommendations within the three thematic areas that emerged from the NLS. Experts from the private sector with practical experience in dealing with land (valuation and land administration), legal firms, financial institutions, academics, and representatives from the NGO coalition were invited to be part of these expert committees.

The three committees met regularly. Chairpersons of each committee reported to NLDT during its monthly meetings. The NLDT secretariat, located at NRI, in turn prepared a monthly brief for the minister. The minister provided briefs to his colleague ministers known to have sympathetic views toward land reform, and to EMC. This process continued until June 2006 when the three committees completed their work.

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<sup>7</sup> See NLSCC (2006) for the full list of recommendations.

In July 2006, a workshop was organized for NLDT and members of the three committees to deliberate on the findings and recommendations from the three committees, which by this time were packaged into one report by NLDT secretariat. At this workshop, the chairpersons presented their committee's findings and recommendations. The verified set of findings and recommendations were endorsed by NLDT, also in July 2006. NLDT then progressed to the next crucial phase of selling the findings and recommendations to the wide group of stakeholders through a well-structured and executed consultation process.

At the end of the stakeholder consultations, NLDT and members of the three committees gathered at a workshop in September 2006 to review the comments, questions, and suggestions gathered from the public consultation process. The lands and physical planning minister attended this workshop and encouraged NLDT to prepare an NEC submission for presentation to the cabinet. The outcome of this workshop constituted the final findings and recommendations from NLDT to government.<sup>8</sup> NLDT submitted the final report to the government through the minister in October 2006. Also contained in the report was a proposal defining the implementation structure under the National Land Development Program (NLDP).

The final report contained 54 recommendations. The overwhelming majority of the recommendations (47) were concerned with improving the system of land administration, six recommendations outlined the process for designing a framework for the development of land held under customary tenure, and a single recommendation related to land dispute settlement.

### ***Implementation—National Land Development Program (2007 Onward)***

The NLDP has four thematic components: (i) improving land administration, (ii) improving land dispute settlement, (iii) designing a framework for developing land held under customary tenure, and (iv) designing the institutional frameworks to support the development of a viable land and properties market. These four thematic issues had their origins in the NLS and NLDT.

The governance structure of the NLDP comprised (i) a ministerial committee (EMC) to provide political leadership, through which the NLDP reports to NEC; (ii) a management committee made up of department heads of the key implementing agencies, to provide technical and administrative leadership and direction; (iii) an outsourced program management unit, to provide technical guidance and oversee implementation at the project and activity levels across the different implementing agencies (private, quasi-private, and public sector); and (iv) an independent National Land Development Advisory Group (NLDAG), formed of representatives from academic institutions, the private sector, and the NGO coalition, to provide independent oversight of the land reform implementation phase.

The Department of Lands and Physical Planning (DLPP) was assigned to lead the implementation of the recommendations aimed at improving the land administration system. The Department of Justice and Attorney General was tasked with implementing the recommendation to establish a single land court through Magisterial Services. The Constitutional and Law Reform Commission (CLRC) was entrusted to provide leadership in implementing the recommendation for developing land held under customary tenure. The fourth thematic issue is an overarching theme for all implementing agencies to work toward. However, the Independent Consumer and Competition Commission, as the promoter of competition in PNG, is expected to play a lead role by establishing the ground rules that will enable the land program to achieve its aim of developing a viable land and properties market in PNG.

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<sup>8</sup> See NLDT (2006) for full details.

NLDT estimated that a minimum of 100 million kina (K) would be needed over a 10–20 year period to fully implement the NLDP. A consultancy team was assembled in 2007, with funding support provided by the Australian Agency for International Development (AusAID), to design a concept design document to firm up the implementation framework, identify activities, and objectively cost the land program (NLDP 2007). The concept design document identified and estimated costs of activities for the first 5 years at K83 million.

Since then, the idea of implementing the land program within a 5-year framework was adopted. This process is useful for systematically phasing the implementation process, prioritizing activities, and synchronizing the implementation of the land program with the annual budgetary cycle. With respect to the latter, PNG has two annual budgets: recurrent and development. The recurrent budget is administered by the Department of Treasury while the development budget, which funds projects of longer than 1 year, is administered by DNPM. Given the program nature of the NLDP, the concept design document was adapted to meet the requirements of the development budget cycle. Moreover, the main thrust is to get the important things done first so that subsequent cycles build on the success of the preceding cycle.

Implementation has been slower than expected, as illustrated by the following:

- The NLDP has not been implemented as a coherent package.
- As yet the program management unit has not been established to support the Program Management Committee.
- The NLDP was not incorporated into the 2008 or 2009 development budgets.
- The first concept design document, which was expected to cover the period 2008–2012, has not been completed. A final version is currently being prepared.
- There was considerable delay in establishing the management committee. However, the committee began meeting in 2009, chaired by the secretary for DLPP. An active technical committee has since been meeting regularly to provide direction to the management committee.
- The NLDP is currently working through the responsible ministers.
- Although NLDAG has been established, it has met only once.

However, progress has been made in some important areas, largely because influential individuals who support the land reform initiative are taking ownership of components that fall within their administrative and legal jurisdictions. The following examples demonstrate this:

- DLPP has undertaken restructuring to accommodate the administration of land currently held under customary tenure with the establishment of a new Division of Customary Land Management (previously a section) to be headed by a deputy secretary, upgrading the status of customary land management within the department.
- The Office of Urbanisation has identified pilot project areas in different parts of the country to accommodate urban expansion of cities and towns on land currently held under customary tenure using the new laws.
- The Law School of the University of Papua New Guinea (UPNG) is preparing to offer a graduate diploma in land tenure.
- NRI is developing a land research framework to coordinate land research as part of the NLDP.
- DNPM is including the NLDP in its long-term development strategic plan. The strategy is expected to be implemented over the 2010–2030 period.

- Magisterial Services has adopted the recommendation to establish a single land court. A report and draft legislation has been completed and Magisterial Services is currently undertaking a nationwide consultation.
- Perhaps the most important achievement for the NLDP is the passing of the two pieces of legislation dealing with customary land tenure reforms on 19 March 2009 by the PNG Parliament. CLRC pursued and achieved this outcome.

The achievements highlighted above are significant. This experience demonstrates the need to be pragmatic. Core components could be implemented where support for reform exists. Individuals in positions of influence who support the land reform agenda are prepared to implement components that fall within their administrative and legal jurisdictions. The lesson from this experience is the need to identify individual champions within the various implementing agencies and provide them with the necessary support, whether financial or technical, to help implement components of the land reform program that fall under their jurisdiction. This strategy also has the potential to institutionalize the implementation of the land reform program.

### **Key Sustaining Factors**

Three factors that sustained the land reform initiative and ensured that it progressed from conception through to implementation are discussed in this section.

#### *Analysis of information and dissemination*

There has been an extensive academic and policy debate over land reform in PNG, largely driven by foreign academics and donor agencies. This debate has largely been targeted toward customary land tenure reforms. Unfortunately, the discussion failed to translate into policy, law, and implementation (Larmour 1994). Two years before the current land reform initiative was conceived in 2005, Larmour (2003) concluded that land reform remained a failed policy in PNG.

This debate was still active, both in PNG and Australia, as the new initiative was being conceived. The *Pacific Economic Bulletin*, as of the early 2000s, became an academic forum for this discussion. The contending arguments were, on one side, the need for abolition of customary land tenure (that is, to privatize) for development to take place and, on the other, the need for maintenance of customary land tenure.<sup>9</sup> An edited collection published by the Australia Institute (Fingleton 2005) pursued the case in defense of customary land tenure while Lea (2009) continues to argue in favor of individual land rights or interests in land.<sup>10</sup> An edited collection by Sullivan (2002) documents some PNG contributions to this academic discussion. However, overall, there has been limited PNG engagement in this debate at the academic level.

At the policy level, there has been some interest in both Australia and PNG. AusAID (2006) identified land reform as an important area of intervention in its *Pacific 2020* report. This led to the Pacific Land Program, which aims to support governments from the Pacific islands (which includes PNG) and Timor-Leste, in their pursuit of land reforms. A report and a series of case studies have

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<sup>9</sup> David Lea, Tim Curtin, and Helen Hughes advocated privatization of customary land while Jim Fingleton argued for the maintenance of customary land tenure. The series of articles can be accessed online: [http://peb.anu.edu.au/peb/search\\_issues.php](http://peb.anu.edu.au/peb/search_issues.php) (Accessed online 1 September 2009)

<sup>10</sup> Selected papers from Lea's earlier publications can be found in Lea (2008).

since been published by the Pacific Land Program (AusAID 2008).<sup>11</sup> Within PNG, DLPP had initiated a public consultation process, promoting the idea of voluntary customary land registration (Kemas 2010).

This debate had a polarizing effect on the land reform initiative in PNG. If poorly managed, the debate had the capacity to undermine the new land reform initiative. In recognition of this, the technical team behind the PNG land reform initiative engaged in an extensive survey of the literature covering theoretical, policy, and empirical analyses. The team settled on the literature on the economics of land titling to draw on the instruments useful for the design of a framework that ensured security of tenure for all land with formal titles. This was consistent with the aim of the PNG land reform initiative: mobilize land for development.

Feder et al. (1988) provided the initial conceptual framework depicting the economics of land titling. The framework shows land titling impacting on productivity through two different but complementary channels: one is through the borrower's side and the other through the lender's side. The borrower's (investment/demand) link shows title security increasing demand for investment and variable inputs. The supply side (credit) link complements this with increased supply of long-term investment and short-term credit. The positive impact on productivity (higher output per hectare) subsequently translates to higher incomes and land prices.

A review of empirical research that applied this framework for over a decade (Feder and Nisho 1998) showed that policy initiatives in Southeast Asia, and to some extent in Latin America, were in agreement with the theoretical predictions. However, the results from Africa were mixed. While the central argument presented by de Soto (2000) that the issuance of a land title breathes life into "dead" capital supported the arguments for land titling initiatives, it was clear that land titles per se were not sufficient. Complementing the titling process was the need to have an efficiently functioning system of land administration and ensuring that the land titles were bankable. The World Bank's (Deininger 2003) review of the empirical and policy literature reported regional trends similar to those reported by Feder and Nisho (1998) and stated that the bank was abandoning its original land policy (World Bank 1975), which emphasized individual land titling in favor of frameworks that provided security of tenure. Also, the report highlighted the significance of social legitimacy in the type of land reform a country pursued. On an issue with direct relevance to PNG, Fitzpatrick (2005) applied the World Bank (Deininger 2003) approach to a dozen countries and concluded that there was no "best practice" model for customary land tenure reform. Context mattered; each country should design a land tenure regime that suited its particular circumstances.

The key message from the literature review undertaken by the PNG team was that PNG had to design (conceive, formulate, and implement) a land reform program that reflected the PNG context and its level of development, and gain the endorsement of the wider stakeholders. Ensuring security of tenure had to be the overall aim. This issue was seen as crucial for the development of a viable land and properties market.

To draw lessons from the application of existing legislative and administrative frameworks dealing with customary land within PNG and the Pacific islands region, NRI organized a workshop in Port Moresby in October 2006 focused on understanding transactions on customary land. Invited speakers from Fiji, New Zealand, and Vanuatu provided detailed analysis of how land held under

<sup>11</sup> The report and case studies are available online: [www.ausaid.gov.au/publications/pubout.cfm?ID=3363\\_9223\\_6836\\_1452\\_8140](http://www.ausaid.gov.au/publications/pubout.cfm?ID=3363_9223_6836_1452_8140) (Accessed on 1 September 2009)

customary tenure is developed in these countries. Presentations from PNG covered case studies analyzing (i) transactions accommodating the expansion of urban centers; (ii) industrial, commercial, and agricultural projects; (iii) the use and abuse of the Incorporated Land Groups process; and (iv) informal sector transactions.<sup>12</sup> Although the task force report had already been submitted to the government, this workshop provided the empirical base to contextualize the findings and recommendations.

The level of analysis, contextualization, and dissemination carried out was made possible by the availability of local expertise; access to the broader literature; and the technical capacity to review, analyze, and contextualize the global literature and draw lessons from practice within PNG and neighboring countries that have institutions facilitating access to land held under customary tenure for development. Without this capacity, the discussions would have remained highly polarized, leading to greater confusion, and with biases dictating policy outcomes.

### *Public relations*

Public relations were a key consideration throughout. A major challenge was the country's high level of illiteracy, which is compounded by the existence of over 800 distinct spoken languages in PNG. Selling ideas conceived and packaged in English to this linguistically diverse audience was a challenge. There was considerable scope for misinformation, which highlighted the importance of investing in education, communication, and transport infrastructure so that people would be able to receive, analyze, and respond to the new ideas. In addition to selling the ideas, it was important to create forums so that people felt that they had been consulted and understood that the ideas were not conceived and formulated in isolation in Port Moresby.

The public relations strategy was to identify the stakeholder groups, understand the interests of each, and, where possible, accommodate the concerns raised by the stakeholders. Consistency in packaging and delivering the information was also crucial. Further, care was taken to ensure that the information content was relevant to the respective phases: conception, formulation, and implementation.

At the conception phase and leading up to the NLS, the focus was on highlighting the need for rethinking how PNG could better manage the country's vast land resources, with the view to improving the individual and collective well-being of her citizens. Highlighting the core problems—such as the growing incidence of land disputes; inefficiencies within the system of land administration for land held under both formal and customary tenure; and the impact that the modern economic, social, and political systems are having on the traditional customary land tenure system—greatly assisted in these efforts.

The proactive role of the government in assuming leadership and using PNG institutions and experts to address the land reform issues were important points highlighted throughout the process. It was made clear from the start that the summit would be the sounding board for the land reform program. The government wanted to seek both a mandate and direction on the land reform program by staging the NLS. The NLS was publicized through the media and participation was open to all. The summit report containing the findings, recommendations, and suggestions for the way forward was published as a special discussion paper (#39) by NRI. The Prime Minister launched the publication in the Parliamentary conference room and announced the establishment of NLDT to implement the recommendations of the NLS.

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<sup>12</sup> Except for the informal sector transactions, NRI contracted DLPP and UNITECH to undertake these case studies.

The high level of publicity, such as the launch by the Prime Minister, captured the imagination of the public. The public increasingly became aware that the NLS recommendations provided the basis for a national land reform program that was owned by the government and in which PNG institutions and experts played leading roles. Further, publishing the recommendations as a special discussion paper by NRI ensured that the recommendations remained permanently in the public domain.

The public relations strategy at the formulation phase was that the findings from the three expert committees would be compiled into a single collection and disseminated as a single package to stakeholders through a systematically structured and executed public consultation process. In implementing this idea, the findings and recommendations were repackaged into four different formats:

- an information brief for the National Executive Council (NEC);
- a standard PowerPoint presentation for use in all public consultations with stakeholders;
- a paid advertisement in English in the two dailies, and in Pidgin English in a weekly paper;
- a current affairs program on a local television station (EMTV), in which the chairpersons of NLDT and the three committees were interviewed; and
- a weekly radio program titled “Man on the Land” on the National Broadcasting Commission was used to inform the wider public on the findings, recommendations, and activities of NLDT.

Detailed public consultations focused on a dialogue with targeted stakeholders. With respect to politicians, a presentation was made to EMC and then a briefing paper was submitted to NEC. With respect to senior bureaucrats, the task force made presentations to the Central Agency Coordinating Committee, which is headed by the Chief Secretary, and the Public Sector Reform Advisory Group, which is located within the Department of the Prime Minister.

The broader stakeholder consultations were divided between those within Port Moresby and regional consultations. Stakeholders within Port Moresby were organized into the following groups: professional groups, funding agencies, state-owned enterprises, business houses, interest groups, provincial administrations, media, international donors, and UPNG.

For the regional consultations, NLDT divided itself into four teams (with a media crew embedded where possible) and dispatched to two main towns in each of the country's four regions. The Highlands team visited Mt. Hagen and Goroka. The Momase team targeted Lae, Ramu, and Madang. The Islands team visited Rabaul and Kimbe. The Southern team targeted Popondetta and Kiunga.<sup>13</sup> The schedule for each visit was widely published in both daily newspapers. In some instances, local radio stations were used to promote the consultations. At least three groups—business houses, provincial governments, and the broader community—were targeted at each of the regional consultations.

Throughout, the layout and information content was consistent. All the presentations were made in a workshop format. NLDT representatives presented the findings and recommendations and then allowed for interactions with the participants via comments, questions, and suggestions. Hard copies of the PowerPoint presentation used were also given out at each of these meetings. Because the main findings and recommendations were published in the print media before the wider public consultation, participants were able to bring the clipped newspaper articles with them into the

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<sup>13</sup> The Kiunga trip was aborted after the airline canceled the flight.

consultations. This prior access to the findings and recommendations improved the level of discussion and the exchange of ideas.

At the end of the consultations, a meeting was held to review regional reports in relation to the recommendations proposed. There was overwhelming support for the recommendations, except for some minor additions from the Islands region to maintain the land tenure conversion process of land registration and the Highlands region where they also proposed individual titling to give security to family-owned land.

The start of the implementation phase was marked by the launch of the NLDT report and the NLDP by the Prime Minister in the national Parliament conference room in February 2007. While the program-level consultation framework remains to be conceived, formulated, and executed, individual implementing agencies are investing in public relations and communications initiatives.

Consistency in packaging, disseminating, and publishing the information for public access helped considerably. The public relations strategy was so effective that land reform has now become part of the mainstream public policy domain. This was evident when the Prime Minister launched the NLDP in February of 2007, an election year. The public outrage against land reform in 2002, leading to the death of four protestors, was not repeated. Political parties and candidates talked freely about land reform in a proactive and positive manner during the 2007 national elections.<sup>14</sup>

This is no excuse for complacency, however. Implementation has its own process and is expected to generate challenges and risks with the potential to derail the entire land reform program. There is no doubt that land reform remains a sensitive issue within PNG. Public relations will therefore need to remain an important component of the NLDP.

### *Institutionalizing the land reform program*

Its low skill base, the high staff turnover, and the heavy dependence on fly-in fly-out advisors and consultants starve PNG of institutional memory in policy conception, formulation, and implementation. Being aware of this, the land reform initiators decided to invest in a process that ensured broad-based institutional ownership. It began with the involvement of three key line departments, two leading national universities, and two leading national research institutes in NLSCC in 2005 and in NLDT in 2006. As of 2007, these agencies and the individuals involved began to play leading roles in driving reforms from within their respective departments and agencies.

### *Passion, commitment, and funding*

From conception (2005) to the successful passage of the two laws dealing with customary land tenure reform (2009) has taken a total of 5 years. Passion, commitment of individuals, and timely provision of funding have all been helpful.

Lands and Physical Planning Minister Temu provided political leadership throughout. Having worked as a medical doctor and served as the secretary for the Department of Health, Temu had seen firsthand the plight of ordinary people. He entered politics in 2002, determined to make a difference. He believed that land reform could play a major role in improving the welfare of the average citizen.

Technical leadership was provided by NRI Director Dr. Thomas Webster. A team of national academics provided technical expert advice to NLSCC and NLDT under Webster's

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<sup>14</sup> This was evident from the presentations made by political parties at the weekly seminar series organized by NRI in 2007. The presenters were either leaders or senior members of political parties contesting the national elections in 2007. This seminar series was broadcast live on national radio.

leadership. Webster served as the chair of NLSCC in 2005, NLDT in 2006, and NLDAG as of 2007. Webster's knowledge of the public policy and decision-making processes in PNG and his personal conviction of the importance of land reform for the betterment of the country were invaluable factors. Webster and his team continue to lead in this area.

The individuals who worked as part of NLSCC and NLDT provided unpaid services. This demonstrated a collective commitment of the land reform advocates to passionately pursue the land reform agenda, with a collective view toward making a difference in PNG.

Although funding has been committed by the government, disbursement has been a problem.<sup>15</sup> NRI approached AusAID to see if funds appropriated for research support could be used for funding the work of the land reform program. AusAID's timely approval to use these funds to pay for the summit, the work of NLDT, and some expenses related to components of the NLDP helped to bankroll the program. Unlike its other programs and projects in PNG, AusAID provided financial support to the land reform initiative without technical assistance and advice.

The timely combination of passionately committed Papua New Guineans, together with the financial support of AusAID, enabled PNG to succeed in undertaking customary land tenure reforms. It is a rare moment in history to find benevolent leaders, technocrats, and external agencies working in a spirit of partnership and commitment. This is the kind of partnership that needs to be cultivated in order to pursue reforms in other sectors of the PNG economy.

### 3. Customary Land Tenure Reforms

This section outlines the conception, formulation, and implementation of the customary land tenure reform component of the broader land reform program.

#### *Committee on Customary Land Development*

The Committee on Customary Land Development (CCLD) was tasked to design a framework for mobilizing land held under customary tenure for development. The main thrust of the committee's work focused on Recommendation 4 from the list of recommendations from the NLS (National Land Summit Coordinating Committee 2006, p. viii). Recommendation 4 states, "Reform the Incorporated Land Groups (ILGs), and/or the land tenure conversion system, to ensure that: it represents genuine claims by clans; and landowners are free to decide, and therefore have the absolute rights to determine all land-user rights." More specifically, CCLD was directed to offer appropriate and workable suggestions on customary land registration and reform of the Land Groups Incorporation Act 1974, Land Tenure Conversion Act 1963, and Lease-Lease-Back provisions of the Land Act 1996. CCLD also drew on other recommendations that were relevant to its work.

The special challenge for CCLD was that any customary land mechanism had to guarantee that the land would not be lost to the customary landowners and that the land title would be bankable—that is, commercial banks would agree to use the land title as security for loans. These challenges guided CCLD in conceiving a framework that ensured landownership was retained by the social unit that claimed right to land held under customary tenure but at the same time ensured security of tenure for the users of the land.

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<sup>15</sup> A total of K33 million to date.

### ***Processes used in designing the customary land development framework***

CCLD took on the most controversial and sensitive aspect of the land reform initiative. However, the committee was willingly chaired by Dr. Lawrence Kalinoe, then professor and dean of the UPNG School of Law. The committee comprised members representing a wide variety of interest groups. These included state implementing agencies, the NGO coalition, and disciplines relevant to the development of customary land. The selection of committee membership balanced gender, disciplines, and interest group representation.<sup>16</sup>

CCLD adopted an academic approach to its work, with workshops and reviews of the literature and legal frameworks. The first of the two workshops reviewed the literature dealing with customary land tenure reforms within PNG and the application of the existing legal frameworks. The objective of the second workshop was to establish concrete resolutions on developing a secure framework for mobilizing customary land for development.

### ***Discussion, resolutions, and recommendations***

In the first workshop, the NGO representatives expressed strong views against customary land registration: “They were suspicious of the government’s intention in that they did not trust the Government, in its capacity to properly and effectively manage customary land, if such land was registered” (NLDT 2007, p. 99). This declaration had an immediate effect because, “After the NGO representatives expressed doubts, and spoke against this proposal, not much progress was made. The general consensus was to defer the registration of customary land, although the workshop did not make a resolution to this effect” (NLDT 2007, p. 99).

In the second workshop, the reservations expressed in the first workshop were acknowledged. However, CCLD decided to pursue the development of a framework for customary land because its work was guided by the recommendations from the summit. CCLD was established primarily to “...consider and recommend workable approaches to implement the recommendations of the National Land Summit, and should not deviate from those recommendations” (NLDT 2007, p. 102).

CCLD settled on the constitutional provisions relating to land provided for under section 56 “...as it was the enabling enactment for the Land Groups Incorporation Act 1974, to make recommendations for further amendments to this Act, and for such amendments to be consistent with the Constitution” (NLDT 2007, p. 87). CCLD recommended (i) substantial amendments to the Land Groups Incorporation Act 1974, (ii) a new law to facilitate the voluntary registration of customary land, and (iii) the repeal of the Land Tenure Conversion Act 1963. It was also thought that rather than creating new laws, it would be better to work around existing laws in strengthening the operations of these regulations, as people were already familiar with them.

The committee adopted a two-step process to develop land held under customary tenure:

**Step 1.** The social unit that claims rights to land by customary law is incorporated and made the vehicle for developing customary land by making substantial changes to the Land Tenure Conversion Act 1974.

**Step 2.** By introducing a new law titled the Customary Leasehold Act, the portion of land that the incorporated land group (ILG) agrees to deal on can be surveyed, boundaries demarcated with cement pegs, and the area of land registered.

The title over the registered land is owned by the ILG, but customary law ceases to apply. Instead, statute law, the Land Act 1996 being the principal, applies to the access and use of this

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<sup>16</sup> See full report from CCLD in NLDT (2006, pp. 87–107).

registered portion. Because the ILG owns the land, the stream of income generated from developing the registered portion accrues to the ILG. Amendments aimed at improving the accountability and transparency of the ILG, the assets it owns, and the streams of income generated have also been incorporated.

Other recommendations included the repeal of the Land Tenure Conversion Act 1963. However, the Lease–Lease–Back and Acquisition by Negotiation or by Compulsion provisions of the Land Act 1996 were retained. The latter was retained to ensure that the state has the ability to access land for public purposes, especially for the delivery of basic goods and services.<sup>17</sup>

The recommendations were adopted and marketed by NLDT via the NLDT-managed public consultation process. Except for the proposal to repeal the Land Tenure Conversion Act 1963 and the need to cater for the introduction of individual land titling (Highlands), the remainder received overwhelming support and endorsement from the wider consultation process. The East New Britain Province objected to the repeal of the Land Tenure Conversion Act 1963 during the public consultation within the province but later rescinded their position in writing. However, given this difference of opinion, the committee agreed to retain the Land Tenure Conversion Act 1963 in its final report to NLDT. These recommendations were contained in the report submitted to the government by NLDT in October 2006. The government accepted the NLDT report findings and adopted the recommendations submitted by CCLD on developing customary land.

### **Constitutional and Law Reform Commission (2007)**

As part of the NLDP, the Constitutional and Law Reform Commission (CLRC) took on the responsibility of implementing the recommendations designed to develop customary land. The following is a description of the CLRC-commissioned process that ultimately led to the passage of the two laws dealing with customary land in March 2009.

#### *Process commissioned by the Constitutional and Law Reform Commission*

In 2007, CCLD Chair Kalinoe was appointed secretary to CLRC. The CLRC chair was the member for Rabaul, Dr. Alan Marat. Marat was interested in the initiative because he attended the summit in 2005 and participated in the NLDT consultations in the East New Britain Province. The justice minister and attorney general, under whose jurisdiction CLRC operates, Bire Kimesopa, also attended the summit. Professor Betty Lovai from the UPNG Department of Anthropology and Sociology, who was a member of the CCLD, was now a CLRC commissioner.

People who were keen followers and participants of the land reform initiative were holding responsible positions at an opportune time. This enabled CLRC to initiate a process to implement the NLDT recommendation to develop a framework for mobilizing land under customary tenure. Minister Kimesopa issued a reference to CLRC to review the laws and processes dealing with ILGs and design a system of voluntary customary land registration, utilizing ILGs as a corporate vehicle, based on the recommendations from the NLDT report in July 2007. This reference paid particular attention to recommendations 49–54 from NLDT, which is the two-step process described earlier.

The commissioners appointed Professor Lovai to supervise this reference. Under Lovai's supervision, CLRC established a working committee comprising representatives from key organizations, most of whom were either members of NLDT or the three committees of NLDT, to guide and supervise the work in this reference. The CLRC-instituted committee resumed work

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<sup>17</sup> See NLDT (2007, pp. 87–107) for details on the deliberations that led to these proposals.

immediately and released its draft report for public consultation in October 2007 (CLRC 2007).<sup>18</sup> The report provided a detailed review of land tenure laws, existing laws in accessing and acquiring customary land, customary land development proposals reforming the ILGs, customary land development proposals to establish a voluntary land registration system, the process from incorporation of ILGs to the registered land titles, and the impact of the proposals on the law and practice. Attached to the report were two draft bills: the Draft Land Groups Incorporation (Amendment) Act 2007 and the Draft Land Registration (Customary Land) (Amendment) Act 2007.

One of the committee members, Professor Rudy James from the UPNG Law School, who has extensive knowledge of law, land law, and land policy in PNG, submitted a discussion paper (James 2007) arguing that the committee should consider changing the original idea to introduce a new law titled Customary Leasehold Act to facilitate the voluntary registration of customary land, as developed by CCLD of NLDT. He proposed the inclusion of a new chapter in the Land Registration Act 1974. Compared with the direct granting of interests to deal on land as per the original proposal, the indirect means via the Land Registration Act 1974 had three distinct advantages, highlighted by James as:

- (1) It is multi-purpose and provides for registration of State leases, trusts land etc;
- (2) it protects third party rights and interests in the land; and (3) The system is free from technicalities, the forms to be used for dealings are simple and easily understood and land transactions are effected speedily. This simplified method of dealing in land could accelerate the rate of economic development by creating a favourable image for foreign and local investors (CLRC 2008, p. 36).<sup>19</sup>

The committee adopted the James proposal because it was consistent with the intention to develop an efficient framework for mobilizing land held under customary tenure for development.

#### *Public consultation*

The draft report, which was made widely available in printed copies and in soft form on the CLRC website (as Draft Report 5) by October 2007, was the basis for a wider consultation process. Apart from direct and written submissions, the main consultation involved the staging of a major workshop, organized in consultation with the Papua New Guinea Law Society, in Port Moresby in November 2007. The general public was invited to this workshop through a public advertisement in the two daily newspapers. The National Broadcasting Commission transmitted the entire discussion live throughout the country. The proposals were systematically covered in a step-by-step process. Comments, suggestions, and questions were noted by the secretariat for the working group.

A targeted workshop was organized by the Land Research Group based at NRI in August 2008 covering a broad range of public sector implementing agencies. DLPP, Magisterial Services, CLRC, Registrar of Births and Deaths, the Department of Provincial and Local Level Government, and the Office of Urbanisation attended this workshop. A detailed matrix was formulated defining the procedural and administrative requirements for the various stakeholders within the public and private sectors and the customary landowning social unit at every stage defined in both laws.

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<sup>18</sup> Available online: [www.clrc.gov.pg/pdfs/review\\_of\\_ilg\\_first\\_draft.pdf](http://www.clrc.gov.pg/pdfs/review_of_ilg_first_draft.pdf) (Accessed on 1 September 2009)

<sup>19</sup> The initial advice was submitted by Professor James to CLRC in a discussion paper titled *Land Registration* and dated 14 June 2007. James was the principal lawyer involved in the Commission of Inquiry into Land Matters (1973) undertaken just before independence in 1975.

Members of the CLRC working committee briefed members of the NGO coalition at a major conference organized by the NGO coalition at UPNG in November 2007. Finally, a presentation was made to provincial governors at the Parliament building, also in November 2007.

#### *Passage through Parliament*

In May 2008, the committee prepared its final report for the government, taking into account all the comments, suggestions, and views gathered through the stakeholder consultation process (CLRC 2008). The final report included a section covering the analysis of the comments, suggestions, and views. This was to maintain the spirit of transparency and openness adopted by the broader land reform program throughout. Attached to the final report were the two draft bills.

The final report was submitted to the government through Justice Minister and Attorney General (in the new government formed after the 2007 national election) Dr. Alan Marat. The National Executive Council accepted and adopted the findings, recommendations, and draft bills in October 2008. The bills were then submitted to the legal draftsman in November 2008, and on 19 March 2009, the Lands and Physical Planning Minister and Deputy Prime Minister Dr. Puka Temu stood in for Dr. Marat and presented the bills to Parliament. Parliament unanimously passed both bills.

## 4. Factors Underpinning the Successful Reform of Customary Land Tenure

From the preceding analysis, the following key factors emerge as providing the underpinning of the successful reforms to customary land tenure: (i) customary land tenure reform was part of a broader land reform program, (ii) the processes adopted were inclusive and transparent, (iii) there was consistency in the personalities involved, (iv) understanding stakeholder interests and incentives was crucial, and (v) there was measured external involvement.

### **Customary Land Tenure Reform was Part of a Broader Land Reform Program**

In contrast to the present process, the World Bank–sponsored reform initiative in 1994 and the Mekere government initiative in 2002 singled out customary land tenure reform. Narrowing the focus to customary land tenure understandably elevated fears about potential land grabbing by wealthy and well-connected locals, nationals, and foreigners. The perceived social and welfare implications from such outcomes for the great majority of Papua New Guineans living in the rural sector and relying on customary land for their livelihoods were significant. It has long been argued that customary land tenure serves as the social safety net for the great majority of Papua New Guineans. Furthermore, a discussion focused on customary land tenure reform raises concerns about the exclusion of the marginal and poor within society. The need to ensure gender equity in a changing society and the diverse cultural and language differences add further complexities. In a country with low literacy levels and more than 800 distinct languages, this creates opportunities for misinformation and capture by interest groups.

The approach taken allowed for these issues to be discussed and options to be explored. It was an inclusive and transparent process, thus providing an objective environment for developing a framework for mobilizing customary land. The work of CCLD and CLRC complemented the framework on developing customary land. The whole program was neatly packaged, marketed, and

implemented within a framework that aims to deliver security of tenure and achieve a win-win outcome for customary landowners and users of the land.<sup>20</sup>

### **A Nationally Owned, Inclusive, and Transparent Process**

The process was initiated by the government and led by PNG institutions and experts, who were tasked with leading in the conception (summit), formulation (task force), and implementation (the NLDP) of the broader land reform program. The same applied to conceiving (summit), formulating (CCLD), and implementing (CLRC) the customary land tenure reform laws.

For the broader land reform program, NRI played the lead role in providing support to the secretariat and the academic leadership, with assistance from UPNG, UNITECH, Institute for National Affairs, and the three line departments (DNPM, Department of Justice and Attorney General, and DLPP). For the customary land tenure reform component, CLRC played the leading role, with inputs from UPNG, NRI, DLPP, and the Office of Urbanisation.

The process was inclusive and transparent. Through the summit, the government was given the mandate and the direction to undertake customary land tenure reforms. The views of the student body, the NGO coalition, landowners, investors (both foreigners and nationals), professionals with interests in the land sector, and financial institutions were gathered and analyzed at every stage: conception, formulation, and implementation.

At every stage, findings and recommendations were documented and copies made available to all the stakeholders. The government was kept informed through the direct briefs that were provided to responsible ministers, EMC, and the cabinet. The public service and other major stakeholders were kept informed through presentations. The general public was kept informed through the media. Each milestone was publicized with the launch of a publication by the Prime Minister in the Parliament conference room in front of the national and international media, heads of missions and departments, and other stakeholders.

The processes for the broader land reform program and the customary land tenure reform were distinct but complementary. After seeking a mandate and directions for undertaking customary land tenure reforms, the task force, through CCLD, formulated the ideas and the legal framework. After the government accepted and adopted the ideas formulated by CCLD, CLRC implemented the recommendations by initiating another process, sanctioned by the justice minister and attorney general. A committee chaired by a CLRC commissioner formulated the ideas conceived by CCLD into an implementable package, drafted the legislation, undertook public consultations, and submitted it to the government for presentation to Parliament.

Following the spirit of the broader land reform program, CLRC released a draft report (2007) and a final report (2008). The draft report was used for public consultation. The final report was released to place in the public domain the findings and recommendations; analysis of comments, suggestions, and responses; and the draft legislation.

The release of published reports at every stage provides a record of the ideas, considerations, analyses, and justifications for the final decisions. These publications are useful reference documents for academic and policy analysis, both now and in the future.

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<sup>20</sup> See Fairhead, Kauzi and Yala (2009) for an elaboration on this point.

### Consistency in the Personalities Involved

The customary land tenure reform program benefited immensely from the involvement of the same personalities in positions of influence at various stages of the process. The discussion here is confined to continuity at the political, bureaucratic, and technocratic levels.

At the political level, Temu remained lands and physical planning minister from 2005 until recently. Kimisopa, who lost his seat in the 2007 national elections, attended the land summit in 2005; in 2007, as justice minister and attorney general, he issued the reference for CLRC to implement the recommendations relating to the development of customary land. In 2005, Marat, as the CLRC chair, attended the summit and actively participated at the East New Britain Provincial consultations by NLDT, and in 2007 he facilitated the issuance of the reference. In 2008, Marat received the final report from CLRC in his capacity as justice minister and attorney general and facilitated the process for the report to be submitted to and discussed by cabinet, and for the findings, recommendations, and draft legislation to be adopted by the government. It was Temu who introduced the bills in Parliament on 19 March 2009, which were passed unanimously.

At the bureaucratic level, the key players have been Dr. Lawrence Kalinoe and Professor Betty Lovai. Kalinoe was a core member of the summit coordinating committee in 2005, presented one of the concept papers at the summit, and chaired CCLD in 2006. In 2007, as CLRC secretary, Kalinoe took it upon himself to ensure that the CCLD recommendations were implemented. It was Kalinoe, in his capacity as CLRC secretary who initiated the issuance of the reference and establishment of the working committee, prepared the draft reports and legislation, coordinated the consultations, prepared the submissions to cabinet, and ensured the bills were ready for tabling in Parliament. Lovai, who was a CCLD member in 2006, took charge of the CLRC process in her capacity as CLRC commissioner in 2007.

At the technical level, NRI Director Dr. Thomas Webster played a significant role in both the broader land reform program and the customary land reform process. Webster chaired the National Land Summit Coordinating Committee (NLSCC) in 2005, NLDT in 2006, and NLDAG in 2007. From 2007 to 2008, he was a core member of the CLRC committee that implemented the NLDT recommendations relating to the development of customary land tenure. Webster was supported throughout by a cadre of PNG academics and administrative support staff based at NRI.

There was consistency at the political, bureaucratic, and technical levels from 2005 to 2009. This is more than just coincidence. This consistency in the personalities was crucial for both the broader land reform program and the customary land tenure reform initiative.

### Understanding Stakeholder Interests and Incentives

There are interests and incentives that define every stakeholder's interest or engagement in an issue. This general principle applies equally to land reform, particularly customary land tenure reform. Understanding the incentives of each stakeholder that showed interest in the land reform agenda in PNG assisted in the successful passage of the two laws dealing with customary land tenure reforms. Here we focus on the incentives for the following stakeholders: political, technical, students and the NGO coalition, the business community, externally based interest groups, and customary landowners.

Political leadership for land reform was provided by Temu throughout the entire process. He had seen the plight of ordinary Papua New Guineans throughout his working life. He entered politics in 2002 with a clear motivation to make a difference. Land reform that enabled the mobilization of customary land to create wealth for landowners appealed to him. Committed to this

conviction, he invested in a PNG team, equally motivated to make a difference, to provide the technical input to help articulate the case for land reform within PNG. He used the regular briefs provided by NLSCC and NLDT to generate support at the political level.

At the technical level, Webster provided the leadership throughout. Webster was a former provincial administrator in the Western Highlands Province. As the provincial administrator, he had facilitated customary land registration as part of a provincial government initiative. He also chaired the provincial physical planning committee and dealt with illegal allocations of reserved recreational land for commercial development within Mt. Hagen. He had dealt with customary landowner claims over alienated land housing important state institutions. His background training as Catholic clergy had a part in motivating him to pursue policy agendas that would help improve the well-being of Papua New Guineans. His work experience and graduate studies were in policy formulation and implementation. The latter equipped him to guide the land reform program, embedding it solidly in a process that generated dialogue, partnership, and institutional ownership. Webster's ability to facilitate the generation and discussion of divergent views and ideas was invaluable in ensuring that decisions were made and that the process progressed.

There was a team of committed and technically qualified Papua New Guineans and PNG-based experts who served in NLSCC (2005), NLDT (2006), and the CLRC-initiated working group (2007). Yala (author of this chapter), for instance, provided academic leadership and intellectual guidance that helped maintain focus and relate the PNG program to international developments. This grasp of the international literature gave confidence to the work in arguing with external interest groups who criticized and attempted to undermine the PNG land reform program. Yala's return to NRI after completion of his PhD studies at the end of 2004 coincided with the initiation of the land reform program by the lands and physical planning minister, and the government's invitation to NRI to lead the coordination of the NLS in early 2005.<sup>21</sup> Kalinoe's understanding of PNG laws dealing with customary land tenure and Webster's knowledge and skills in providing the oversight for the entire process proved invaluable.

The commitment of this cadre of PNG professionals was demonstrated by their willingness to work unpaid for 5 years! That speaks volumes about their commitment and passion for reform.

Students and the NGO coalition had been passionate opponents of land reform, particularly any move to reform customary land tenure. Engaging with the students to educate them about the importance of undertaking a comprehensive land reform program greatly assisted. Engaging academic staff from UPNG and UNITECH in NLSCC, NLDT, and the various committees also helped. More significant, though, was the essay competition organized for tertiary and secondary students.<sup>22</sup> Allocating time for students to present their views and ideas about land reform at the summit was also useful. Collectively, these interventions constituted objective ways of engaging students and confronting misinformation and prejudices.

The NGO coalition had to be engaged as a collective body of highly heterogeneous entities with divergent interests and objectives. Further, many of the PNG-based NGOs have international links, funding for their local operations is mainly sourced externally, and it is a sector that provides employment opportunities for many Papua New Guineans and foreigners. These links and incentives warranted the land reform advocates engaging the NGO coalition.

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<sup>21</sup> Yala drew on his thesis (Yala 2004), which explored the cost of funds and access to credit by smallholder oil palm growers in PNG under three land tenure arrangements: customary tenure, state lease, and customary purchase.

<sup>22</sup> See a description of this in NLSCC (2006, p. 2).

The NGO coalition was invited to the summit to state their collective view. The speaker was selected by the coalition. There was continued dialogue and engagement throughout. For instance, a workshop was organized in November 2008 for the NGO coalition, at their request, to allow them the opportunity to provide written submissions on the NLDT findings and recommendations and the NLDP itself. Over time, it became clear that on many of the issues, such as gender equity, corruption, protection of customary land, proper identification of landowners, and inefficiencies within the system of land administration, there was common agreement between the NGO coalition and the proponents of land reform. The NGO coalition will continue to play an active role through their involvement within NLDAG.

The business community has a vested interest in accessing land for private enterprise. Inefficiencies within the land administration system have undermined their access to and optimal investment in land held under both state and freehold ownership. Repeated claims over land and compensation for land held under state and freehold ownership—the latter mainly within the plantation sector—by a new generation of customary landowners undermines security of tenure over these lands. Inefficiencies within existing legal frameworks for accessing customary land have restricted access to such lands to large-scale businesses. Small- to medium-scale enterprises have been left out. These factors have collectively raised the cost of borrowing and undermined private sector investment. Reforms to the systems of land administration, land dispute settlement, customary land tenure, and the enforcement of property rights are areas that the private sector strongly supported.

The permanent presence of the private sector in the land reform program was via the Institute for National Affairs (NLSCC in 2005, NLDT in 2006, and NLDAG as of 2007). A wide range of private sector participants attended and also made presentations at the summit. They were consulted both in Port Moresby and at the regional consultations in 2006. The lands and physical planning minister spoke at various forums such as the Port Moresby Chamber of Commerce Business Breakfast (2006) and the Australia–Papua New Guinea Business Forum in Cairns, Australia (2005).

The banking and finance sector had a special presence throughout the reform process. Three sector representatives made presentations at the summit and within the Committee on Land Administration as part of NLDT; they were also consulted independently on the proposals dealing with the development of customary land at the NLDT consultations in Port Moresby (2006) and under the CLRC-initiated process (2008). With respect to the latter, in 2008, before submitting the report and draft laws to cabinet for approval, the lands and physical planning minister wrote to the banking and financial institutions seeking their views and concerns, if any, on the draft laws. The views of the banking and finance sector were seen as vital because the reform was aimed at developing a viable land and properties market. This would require active interest in and funding of projects by the banking and finance sector. For this, security of tenure and bankability of land titles is crucial. However, it remains to be seen if these land reform initiatives will make the asset (land title) bankable.

Externally based interest groups have had substantial influence in both the discussion and land policy developments, and through interventions on land reform in PNG. The influence the externally based players have had to be acknowledged and dealt with appropriately. The three major groups are the overseas-based academics, international NGOs, and donor agencies.

There is a large Australia-based academic and consultancy community with long-standing interests in land, agricultural, anthropological, resource management, and economic development in PNG. This community has been debating for and against land reform for many years, especially

about customary land tenure. This debate is highly polarized and differentiated by discipline. The arguments can be best grouped into abstract, descriptive interpretations of customary land tenure systems and practices, and in defense of certain ideas, policies, and/or laws.

Being aware of this debate, the decision of the government, which was implemented by NLSC and NLDT and the CLRC-instituted committee, was to rely on PNG institutions and experts to independently review this material and contextualize it for the PNG situation. This could only be done by PNG experts who have an awareness of the broader literature; a lived knowledge, experience, and awareness of their own customary land tenure; and a desire to contribute to the development of their country. While Yala (this author) provided the academic leadership on the economics of land titling, and Kalinoe provided the intellectual leadership on the legal framework for developing customary land, the entire team was motivated to get it correct because they and their kin will face the consequences of their actions. This has meant denying direct foreign engagement but, where appropriate, drawing on ideas from the literature.

The second team of external influences is the international NGO movement. The NGO coalition within PNG has direct and indirect connections with the international NGO movement. Because of the influence that international NGOs have on the local NGO coalition, their involvement was facilitated through the active engagement of the PNG-based NGO coalition. The PNG-based coalition and their international counterparts were free to analyze and compare international land reform experiences.

The third externally based community was the donor agencies, both bilateral and multilateral. PNG has a large international donor presence, led by the European Union at the multilateral level and by AusAID at the bilateral level. International financial institutions such as the Asian Development Bank, the International Monetary Fund, and the World Bank have offices in Port Moresby. All the international donor agencies agree on the importance of secure property rights and the need to undertake land reform in PNG. However, given the sensitive nature of the land reform issue and the widely known World Bank-sponsored reform attempt in 1995, which triggered strong antireform protests, their direct involvement was sanctioned. The PNG government ownership of the reform agenda and PNG leadership of the entire process had to be maintained throughout. However, AusAID's permission for NRI to use some of the research grant to fund the land reform program helped fund the work of NLSCC, the staging of the summit, the work of NLDT, and some costs associated with the NLDP.

All donors were treated as important stakeholders. They were provided briefs during the public consultation phase and were informed that their involvement would be at the invitation of the PNG government, especially at the implementation phase. Donors respected that stance.

Customary land owners are important stakeholders in the discussion on customary land tenure reform. However, defining customary landowners as a stakeholder group and understanding their incentives and interests is practically difficult. To begin with, every indigenous Papua New Guinean is a customary landowner by customary law. Customary landowners as a stakeholder group are therefore highly heterogeneous, being distinctly defined by culture, education, economic activity, location, and exposure. Adding further complexity is the fact that there are more than 800 distinct spoken languages, illiteracy rates are high, and customary land tenure supports the livelihood of the more than 85% of the total population that reside in rural areas. Marketing the idea of customary land tenure reform, a modern concept packaged in English, to this highly heterogeneous stakeholder was, and will continue to be, a challenge.

In recognition of the complexity, the land reform advocates instituted a process that facilitated the analysis of issues and options by PNG customary landowners—whether as politicians, policy makers, academics, business people, subsistence farmers, people living in project-impacted areas, and residents within peri-urban areas—with a view to collectively defining a framework for mobilizing customary land for development.

The membership of the land reform team also gave credibility to the reform agenda, the findings, and the proposals. The participants in the process were not foreign consultants who could write reports, make recommendations, and remove themselves from the implementation and its impacts. They were high-profile individuals with standing in the PNG community and would be held accountable if things went wrong. Papua New Guineans were looking for solutions to address the problem. Whatever they did, they would have to live with the consequences. If successful, there would be benefits for them, their children, their relatives, and collectively, their country. If they failed, they would have to cope with the ridicule and criticisms that would follow.

The Land Groups Incorporation (Amendment) Act 2009 ensures that land ownership remains in perpetuity within the social unit that claims rights to the land by customary law. The Land Registration (Customary Land) (Amendment) Act 2009 ensures that the land titles issued from the portions released for development are bankable. This framework is beneficial to the customary landowners because their claim to land by custom is formalized and they stand to benefit from the income streams generated from the developments that occur on their land. This framework struck a chord with the views of the broader customary landowning community as a stakeholder group.

Delivery of the land reform program as a package also helped. Inefficiencies within the land dispute settlement and land administration systems were being addressed concurrently. Furthermore, the application of laws was voluntary. All of the above helped customary landowners as a stakeholder group to buy into the proposals for customary land tenure reform.

## 5. Lessons for External Agency Engagement

Experiences from the land reform initiative demonstrate that vested interests can be a binding constraint to economic growth and development in PNG. The reform initiative that began in 2005 and has succeeded in having the two laws dealing with customary land tenure passed in 2009 was successful because the proponents recognized the capacity of reform opponents to undermine and even derail the initiative. The team designed strategies to effectively manage the opposition. Moreover, new strategies and tactics will need to be employed throughout the implementation phase.

The success of the customary land tenure reform provides the following useful insights on how external agencies can engage in PNG:

- **Broad and long-term.** External agencies need to think broadly and long-term about their engagement in PNG. Their entry point should be to invest in sustainable processes and programs initiated by indigenous “champions.” These champions could be in politics, the bureaucracy, academia, NGOs, or the private sector. In a country that suffers from chronic poverty in skill and institutional capacity, it is the individual champions who stand to make a difference. Identifying champions across different sectors and agencies and supporting them to work as a team has the potential to make a difference. This is what enabled success in the case of the customary land reform initiative in PNG. While Temu championed the political agenda, Webster and Kalinoe led the technical and bureaucratic teams, respectively. At the institutional level, the Ministry of Lands and Physical Planning provided the political

leadership, NRI provided the technical leadership, and CLRC provided the bureaucratic leadership. AusAID provided the funding.

- **Skill and capacity development.** Invest in skill and capacity development within the country. In-country institutions and skilled locals understand the domestic contexts—political, social, and economic. They also understand the social, economic, and political interactions that define the political economy. They have personal and social links with the key players and stakeholders. With respect to the land reform initiative, the key players had postgraduate training in Australia, New Zealand, the United Kingdom, and the United States, and were in positions of influence at the opportune time. The local institutions that played key roles were the country's major academic and policy-making institutions. The ability to access the international literature and analyze the information drawn from the broader global debate enabled the team to contextualize the kind of reform suited for PNG, given her diverse cultural heritage and level of economic development. Without this, the debate could have remained polarized and generated confusion and resentment against land reform.
- **Political and policy stability.** External agencies should support the development of institutions that help develop political and policy stability. The motivation for this comes from the fact that Temu was the lands and physical planning minister from 2005 to July 2007 under the previous parliament and from September 2007 to July 2010, under the current Parliament, both led by the same political party (National Alliance Party) and Prime Minister (Somare).<sup>23</sup> This stability has greatly helped in pushing the customary tenure reform laws. The Organic Law on the Integrity of Political Parties and Candidates and the Limited Preferential Voting System, both laws enacted by the Morauta government in 2002, played a role in ensuring political stability, and thereby policy stability. The two laws are complementary and, if supported, they have the potential to support the development of stable political parties, policies, and government (Yala and Sanida 2010).
- **Contestability of ideas.** External agencies should invest in processes that encourage contestability of ideas. All stakeholders and individuals have their own biases and interests. These biases, whether they are officially sanctioned or not, influence policy advice, formulation, and implementation, and ultimately determine developmental outcomes. The land reform program invested in a process that objectively reviewed the literature, analyzed the ideas therein, and adopted those ideas that best suited the PNG context.
- **Education, communication, and transport infrastructure.** For the medium to long term, external agencies should encourage and support investment in education, communication, and transport infrastructure. It was a challenge for the team advocating land reform to translate ideas packaged in English to a population speaking over 800 different languages. Improved education, communication, and transport would enable access to and analysis of information and an understanding of its practical applications.

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<sup>23</sup> Temu was also deputy prime minister and minister for mining in the current Parliament until July 2010.

## 6. Conclusion

This paper describes the broader land reform program in PNG, gives an analysis of the customary land tenure reform process, identifies and analyzes the main success factors, and draws lessons useful for external agency engagement in PNG.

Despite the high level of sensitivity about land reform, especially that dealing with customary land tenure, combined with the complexities associated with low skill levels, high illiteracy rates, and scarce financial resources, land reform has so far succeeded in PNG. Land reform is now within the mainstream of public policy discussions. Individual agencies are beginning to implement core components of the program. The two laws aimed at mobilizing customary land for development, under the stewardship of CLRC, were passed unanimously by Parliament, marking an important achievement for the PNG land reform program. This constitutes a milestone in establishing the foundations for sustained, broad-based economic growth and development in PNG. However, the need to maintain political and public interest as the NLDP proceeds toward full implementation remains a greater challenge.

The broader land reform program, started in 2005 through the staging of the NLS, was formulated through the work of NLDT in 2006 and began implementation under the NLDP in 2007. Given the mandate and direction from the summit, CCLD formulated the ideas for customary land tenure reform in 2006 and CLRC began implementing them in 2007. On 19 March 2009, the Parliament unanimously passed two laws that introduced changes to customary land tenure. These laws provide a framework for mobilizing land held under customary tenure for development.

Undertaking microeconomic reforms is difficult because there are always losers and winners. Understanding the political economy of PNG and the role various parties play in promoting or undermining fundamental microeconomic reforms is crucial. This has been demonstrated by the successful passing of the customary land tenure reform laws. The champions of the land reform program invested in a well thought-out, inclusive, and transparent process. This process enabled divergent ideas to be discussed and initiatives to be conceived, formulated, and implemented. The involvement of a core group of motivated players in the political, technical, and bureaucratic arenas, in positions of influence at the opportune time, assisted in this successful outcome.

The role of a cadre of technically competent Papua New Guineans with the necessary contextual awareness, supported by strong leadership throughout each stage (conception, formulation, and implementation) was crucial. In response to the question of how land can be accessed for development, the team initiated a clearly defined conceptual framework within which to analyze the international debate on the economics of land reforms, develop policy, and undertake the analysis to visualize the kind of land reform needed for PNG, given its cultural diversity and level of development. Without this, the whole process would have remained vulnerable to capture by interest groups.

Identifying stakeholders and understanding their incentives and their role in the reform program was useful. The process facilitated their objective engagement in a manner that allowed individual stakeholders to state their positions, explore options, make decisions, and progress to the next phase. Generating factual data and information that best illustrated the realities assisted in distinguishing myths from facts. Consistency in the personalities involved, demonstration of knowledge, and packaging and delivering the message at every phase institutionalized trust, commitment, and national ownership.

Lessons useful for undertaking sensitive reforms in other sectors of the economy and the role that external agencies can play, given the political economy of PNG, have also been discussed. External agencies need to (i) think broadly and long term; (ii) invest in skill and capacity development; (iii) invest in institutions that will help develop political and policy stability; (iv) promote the contestability of ideas; and (v) invest in education, communication, and transport infrastructure.

Unlike the previous failed initiatives, the present PNG land reform program, especially the customary land tenure reform component, has been making satisfactory progress so far. However, given the sensitive nature of customary land tenure reforms, successful implementation of the broader reform program and the newly enacted laws aimed at mobilizing land under customary tenure for development remains a great challenge.

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# 4 Telecommunication Regulatory Reforms and the Credibility Problem

Case Studies from  
Papua New Guinea and Tonga

by *Siope V. 'Ofa*

## ABSTRACT

Reform of telecommunication regulations is a recent policy phenomenon in small island developing states, including in five Pacific island countries over the past 5 years. While there has been much fanfare about the early outcomes of the telecommunication reforms, little attention has been given to the regulatory pitfalls the Pacific island reformers encountered. In particular, regulatory capture has compromised the credibility of announced liberalization programs due to domestic political pressures in the early stages of the reform programs.

The paper's analysis is based on interviews conducted with telecommunication policy experts in Papua New Guinea (PNG) and Tonga during September–December 2008. The domestic policy restraints imposed by independent regulators were found to be vulnerable to political interference. It was also found that World Trade Organization (WTO) telecommunication commitments constrained governments against policy reversals and provided greater policy certainty. The paper proposes that the credibility of Pacific governments' announced liberalization policies for the telecommunication sector will be enhanced if governments undertake WTO accession commitments relating to the sector.

## 1. Introduction

Do multilateral policy restraints enhance the credibility of telecommunication regulatory reform in Pacific island states? This paper examines two propositions. First, multilateral policy restraints enhanced the credibility of telecommunication regulatory reforms in PNG and Tonga. Second, successful domestic political adoption of multilateral policy restraint is easier when telecommunication technology overcomes some of the inherent challenges of isolated small island states. The case study evidence from PNG and Tonga is found to support these propositions.

Field work was undertaken in PNG and Tonga on the telecommunication policies implemented since the introduction of mobile phone services to examine the impact of WTO commitments on the credibility of the telecommunication reforms. Evidence was found to support the proposition that WTO commitments provided policy restraint in an uncertain regulatory environment. Evidence was also found that new technology for wireless telephony networks directly addresses the challenges of being small and isolated. Directly addressing the challenges of small and isolated states reduces opposition from vested interest groups and the general public toward policy reform.

The qualitative evidence draws on 26 semi-structured interviews with experts conducted in the capitals of the two countries. Analyses of secondary sources such as parliamentary reports, government reports, and media releases were also undertaken to provide supporting evidence.

The chapter is structured as follows. Section 2 gives a brief review of concepts and theories related to the so-called “credibility problem.” Section 3 discusses the context of WTO telecommunication reform commitments in PNG and Tonga. Section 4 analyzes controversial regulatory behavior argued to induce policy uncertainty. Section 5 examines the policy implications of WTO telecommunication commitments and the credibility of the telecommunication reforms.

## 2. The Credibility Problem

The idea that the outcome of government policies can be crucially affected by their perceived credibility is well established (Srivastava 1994, p. 449). When enormous financial and capital investments are at stake, the credibility of domestic policies is very important. This is particularly the case in the telecommunication sector, where investment involves large sunk costs in asset-specific infrastructure that cannot be redeployed (Garcia-Murillo and Kuerbis 2005, p. 785).<sup>1</sup> Therefore, telecommunication investments require careful risk assessment of the sociopolitical, institutional, and economic environments of potential markets.

Levy and Spiller (1996, p. 3) identified three important characteristics of telecommunication markets. First, there is often only a handful of major telecommunication operators.<sup>2</sup> The small number of operators has potential implications for collusive behaviors. Second, the assets are usually not redeployable, with very little technological usability in other utility sectors. Third, telecommunication services are as relevant to structured interest groups as to the general public. Therefore, regulatory behaviors and policies affecting the sector will often be politicized. These three characteristics demand cautious business strategies.

If governments were able to announce future policy reforms and comprehensively implement them—assuming that all other political and socioeconomic factors remained constant—

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<sup>1</sup> See section 5 for further discussion on the nature of the telecommunication sector.

<sup>2</sup> Usually one to three telecommunication operators.

the credible policy literature<sup>3</sup> suggests that credible policies result in higher productivity<sup>4</sup> and growth.<sup>5</sup> Yet, governments frequently encounter domestic and international pressures that compel policy makers to renege on previously announced policies. This uncertainty about policies is often termed the “time inconsistency problem.” In their seminal work, Kydland and Prescott (1977, p. 487) highlighted the importance of credible commitment to announced policy. They argued that “policymakers should follow rules rather than have discretion. The reason is that they are not stupid or evil, but rather, that discretion implies selecting the decision which is best, given the current situation.” In other words, a case can be argued for fixed over discretionary regulations to instill credibility and certainty about reforms.

Governments often announce policy reform programs in advance to influence the expectations and investment behavior of the private sector. The introduction of competition in mobile phone services has generally been the first step announced by developing countries in reform programs aimed at liberalizing telecommunication markets. In the Pacific, five island states announced telecommunication reform programs beginning with the introduction of competition in the mobile service sector. Independent regulators were established to ensure minimal conflict of interest and clear demarcation between policy makers, regulators, and state-owned telecommunication providers.

The role of independent regulators in providing certainty for reform policies is well established.<sup>6</sup> Bertelli and Whitford (2009, p. 520) best capture the role of independent regulators:

... put simply, a government's commitment to a regulatory rule creates the expectations of a predictable investment environment; regulatory independence helps to supply that commitment. Firms can contract to deliver goods and services at lower risk if they believe regulators are unlikely to change the rules of the game during the period of the contract. This diminution of risk can be seen as reducing transactions costs.

The regulator should be independent from government control (Ros 1997, p. 40), which enhances the efficient and fair allocation of resources in the telecommunication sector (Lee and Levendis 2006, p. 407). However, even with the best-intentioned reforms, with domestic restraint policies such as an independent regulator in place, the time inconsistency problem may still create credibility problems. The independent regulator is vulnerable to political interference through legislative amendments that cater to interest group pressures. Melody (1997, p. 195) argued that “the regulator either lost, or never had the independence to make professional decisions on their merits because of undue influence either from politicians, politically driven Ministries, or the regulated monopolies.” The outcome of such uncertainty for potential private investors is hesitation about investment. Rodrik (1991, p. 230) suggested that rational behavior on the part of the private sector calls for withholding investment until much of the residual uncertainty regarding the success of the reforms is eliminated. The uncertainty drives up prices of services or leads to the withholding of a

<sup>3</sup> See Kydland and Prescott (1977), Blackburn and Christensen (1989), and Cottarelli and Giannini (1997) for influential research on the credibility of policy.

<sup>4</sup> Telecommunications development generates substantial positive externalities economy-wide (Roller and Waverman 2001, pp. 909–911).

<sup>5</sup> Brunetti, Kisunko, and Weder (1998, pp. 353–356) found that policy surprises and reversals, uncertain contract enforcements, and high levels of corruption most likely translate into lower investment and growth.

<sup>6</sup> See also Tyler and Bednarczyk (1993), Levy and Spiller (1994), Ros (1997), Melody (1997), Noll (1999), Baudrier (2001), Stren and Trillas (2003), Wallsten (2003), Lee and Levendis (2006), and Bertelli and Whitford (2009).

part or all of the investment until the investor can be sure that a reform policy is irreversible (Aryeetey 1994, p. 1212).<sup>7</sup>

Rodrik (1989, pp. 758, 770–771) argued that adopting a gradual pace on policy reform may give negative signals about government's real intentions. Therefore, genuine, reform-minded governments need to "overshoot"<sup>8</sup> policy to address the uncertainty posed by the time inconsistency of policies.<sup>9</sup> At the broadest level, overshooting policy implies a case for credible fixed rules that bind governments. The multilateral policy restraint provided by WTO telecommunication commitments provides such binding rules. The main difference between this multilateral policy restraint and the domestic policy restraint provided by an independent regulator is the domestic and international costs of policy reversal by governments.<sup>10</sup> Commitments on telecommunication liberalization reforms in the WTO are legally binding and failure to adhere to the commitments can be challenged by other member countries through WTO's Dispute Settlement Body. Bosworth and Duncan (2002, p. 10) best capture this argument by suggesting that

... the main economic benefit to be gained by a country from WTO membership is help in facilitating policy reforms that liberalize trade and, as a by-product, support a market economy... By 'locking in' such reforms internationally, WTO accession [commitments] provide governments with a defence mechanism against future policy backsliding or "de-liberalization" in response to domestic protectionist pressures.

### 3. Papua New Guinea and Tonga: World Trade Organization Telecommunication Commitments

#### The Multilateral Trading System

International trade is important for development and poverty alleviation (Hoekman, Michalopoulos, and Winters 2004, p. 481). The WTO promotes trade and in that sense is therefore pro-development (Hoekman 2007, p. 267). In pursuing freer global trade, the WTO is a mechanism through which binding policy disciplines are negotiated and enforced to help address "negative spillovers" that are imposed by governments on each other's trade regime (Hoekman 2007, p. 269). The WTO has evolved since 1948 into a highly legalistic institution for establishing multilateral trade rules and settling trade disputes. Keohane (1990, p. 731) defined multilateralism as "the practice of coordinating national policies in groups of three or more states, through ad hoc arrangements or by means of institutions." Most nations are members of the multilateral trading system.

One of the core principles<sup>11</sup> of the WTO system is predictability of trade and investment rules through binding and transparency. Throughout WTO's agreements, predictability stems from legal binding rules. This is crucial for minimizing trade costs through removing unnecessary barriers to trade. WTO secretariat's (2007, p. 12) document on understanding the WTO best captures this

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<sup>7</sup> Hesitation to invest in infrastructure on the part of Indonesia's mobile phone company, Greencom, which was granted a mobile license in PNG, lends support to this argument.

<sup>8</sup> Rodrik (1989) discussed the size of the reform as one signal.

<sup>9</sup> However, the costs of overshooting policy may act against government's real intentions.

<sup>10</sup> International reputation, borrowing capacity, aid programs, and political and socioeconomic partnerships of countries are at stake when renegeing on international rules.

<sup>11</sup> See WTO (2007) for a discussion of the WTO's principles.

predictability point as “to make countries’ trade rules as clear and public (‘transparent’) as possible. Many WTO agreements require governments to disclose their policies publicly with the country or by notifying to the WTO.” Hence, the predictability and transparency of information assist private investors to adopt informed trade and investment decisions.

### General Agreement on Trade in Services: Telecommunication Commitments

The General Agreement on Trade in Services (GATS) was launched in 1995 with the objective of establishing rules that ensure that WTO members’ domestic regulations do not discriminate against other members—the most-favored nation (MFN) principle.<sup>12</sup> The main discriminatory measures prohibited by GATS are (i) limitations imposed upon the number of services; (ii) limitations on the number of foreign nationals; (iii) limitations on the forms of legal entity (for example, the requirement of a partnership with a local business in a particular sector); and (iv) limitations on foreign equity participation (for example, a percentage participation requirement for a particular form of commercial presence).

Trade in services are categorized according to four different modes of delivery:<sup>13</sup> (i) cross-border services supplied from the territory of one member to the territory of another member (e.g., Digicel Tonga selling international connections to Telstra Australia); (ii) consumption of services supplied in the territory of one member to the consumers of another (e.g., a Tongan national making a telephone call in Port Moresby through Telikom PNG’s fixed-line network system); (iii) supply of services by one member into the market of another member (e.g., establishment of a Digicel branch in PNG); and (iv) temporary movement of natural persons (i.e., services supplied by nationals of one member in the territory of another; for instance, a foreign national from Digicel’s Jamaican branch posted as country manager to Digicel Tonga’s branch).

Negotiations toward liberalizing limiting measures among members were operationalized through the use of the GATS Schedule of Commitments document. The document requires that each member schedule (offer to commit) all limitation measures currently imposed upon service sectors. These initial offers have been the basis for further rounds of negotiations since 1995.

The services schedule consists of four main sections. First, the horizontal commitments are general limitations that apply to all sectors, including business and foreign investment regulations requirements, any limitations on land tenure, and immigration requirements for the movement of workers. Second, there are the specific vertical limitations applying to each sector (as regulated by domestic regulations). These specific commitments produce the most valuable information in terms of which sectors are included and what types of limitations are imposed upon each mode of delivery. Third, the telecommunication reference paper, which is one of the important outcomes of the telecommunication service negotiations completed in February 1997. The paper describes a set of pro-competitive regulatory principles on competition conditions, including safeguard measures and interconnection. The paper is legally binding once adopted by a WTO member. In practice, some members have adopted the reference paper partially or wholly as part of their commitments in the telecommunication sector. Fourth, the Article II MFN exemptions allow a member to not follow the MFN principle under GATS. In principle, the GATS legal document provides for a 10-year time frame. However, most WTO members have kept these limitations in place for more than 10 years.

<sup>12</sup> Each government is required to accord, immediately and unconditionally, to services and service suppliers of any other member, treatment no less favorable than what it accords to like services and service suppliers of any other country (WTO 2002, p. 287).

<sup>13</sup> See Altinger and Enders (1996) and Egger and Lanz (2008) for detailed discussions of GATS.

The limitation measures are classified in the schedule under two categories. The first is market access measures, which are limitations that discriminate between one foreign service supplier and another. The second is national treatment limitations, measures that discriminate against foreign service suppliers in favor of local service suppliers. Specific limitations for each mode of delivery under the two categories are commonly classified into three main measures: (i) “None” indicates that the member concerned does not impose any limitations restricted by GATS on that particular sector; (ii) “Unbound” indicates that the member does not make any commitment to liberalization and is free to impose any of the GATS-prohibited measures; and (iii) “Unbound except as indicated under horizontal commitments” indicates that the member has committed subject to limitations indicated under the horizontal commitments. Commonly, Mode 4 commitments (“movement of natural persons”) are mostly unbound, as immigration law is a sovereign issue of member countries. In addition, Mode 4 measures are only concerned with temporary movement of workers to other markets, rather than migration.

Overall, the schedule of specific commitments had facilitated transparent communication of member countries’ regulations on trade in services. The services schedules of most WTO members are publicly available from the WTO, which gives business communities and governments an instant regulatory window into each member’s rules and regulations on trade in services.

The next section analyzes the telecommunication commitments made by PNG and Tonga through the schedule of specific commitments.

### Papua New Guinea

PNG is one of three Pacific islands that became founding members of the WTO in 1995. PNG submitted an offer on telecommunication services during the WTO’s 1996–1997 telecommunications negotiations (WTO 1997). It made commitments to not implement any domestic policy measures that may impose limitations on foreign participants to mobile and fixed telephony (Table 4.1).

However, the commitments contained four important conditions. First, the normal trade-related rules and regulations of the country relevant to any business entity will be imposed on any foreign operator. Second, under the commercial presence of foreign investors, all telecommunication services were subjected to a 5-year (1997–2002) monopoly for national operator Telikom.<sup>14</sup> PNG also committed not to put in place prohibited restrictions<sup>15</sup> discriminating between foreign and local service providers (Mode 3, National Treatment). Third, foreign operators must deliver telecommunication services across the border into PNG through Telekom PNG’s network. Fourth, PNG subscribed to the telecommunication reference paper outlining international best practice telecommunication regulatory principles.<sup>16</sup>

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<sup>14</sup> The WTO multilateral negotiations on telecommunication services began in 1997. As first offers, several members submitted offers that reflected the status quo (monopoly). However, it was seen as a positive move toward liberalization.

<sup>15</sup> Article XVI of GATS lists six prohibited market access restrictions including limitations on (i) numbers of suppliers, total value of transaction of assets, total number of service operations, and total number of people; (ii) legal restrictions on type of joint venture; and (iii) limitations on the participation of foreign capital.

<sup>16</sup> Refer to the discussion on GATS for further information.

**Table 4.1: GATS Schedule of Commitments—Voice Telephone and Digital Cellular Services, Papua New Guinea**

<b>Modes of Supply</b> (1) Cross-border supply (2) Consumption abroad (3) Commercial presence (4) Presence of natural persons			
Sector or Subsector	Market Access Limitations <sup>a</sup>	National Treatment Limitations <sup>b</sup>	Additional Commitments
<b>I. Horizontal Commitments</b>			
All Sectors Included in this Schedule	(3) Normal government approval and registration is required for all foreign investors, based on several criteria. (3) Companies incorporated outside PNG must register the company's name with the Investment Promotion Authority in PNG. (3) Foreign nationals and foreign-owned companies may not purchase land but may lease land.	(3) Foreign employees are required to provide on-the-job training to local employees.	
<b>II. Specific Commitments</b>			
Communication Services <ul style="list-style-type: none"> <li>• Telecommunication services</li> <li>• Voice telephone services</li> </ul>	(1) Only through the network of Telikom. (2) Alternative calling or call backs are not allowed. (3) All telecommunication services are subjected to a 5-year exclusivity period (1997–2002) to PNG Telikom as the monopoly service provider.  The issuance of additional operating licenses and their terms and conditions will be considered and announced at least 2 years prior to the end of the exclusivity period.  Telikom is designated as signatory to the INTELSAT Operating Agreement.	(1) None (2) None (3) None	PNG subscribes to the regulatory principles annexed to this schedule.
<ul style="list-style-type: none"> <li>• Digital cellular services</li> <li>• Mobile data services</li> </ul>	(3) Under the Articles of Association and Memorandum of Articles of Telikom, Telikom reserves the right to set up subsidiary companies in business ventures on particular services of telecommunications. (4) Unbound except as indicated in the horizontal section.	(4) Unbound except as indicated in the horizontal section.	

GATS = General Agreement on Trade in Services.

<sup>a</sup> Restrictive measures between foreign service suppliers.

<sup>b</sup> Restrictive measures against foreign service suppliers.

Sources: Adapted from World Trade Organization 1997, GATS/SC/118/Suppl.1; and World Trade Organization 1995, GATS/SC/118.

## Tonga

Tonga is one of three Pacific islands countries that applied for WTO membership after 1995. Tonga undertook bilateral service negotiations with members of the WTO Working Party prior to accession. The process was lengthy, costly, and complex. Tonga's accession took place at the WTO Ministerial Meeting held in Hong Kong, China, in December 2005.<sup>17</sup> Table 4.2 outlines the telephone and mobile service commitments made by Tonga.

Tonga also made commitments on fixed-line telephone and mobile services. Three issues are worthy of note. First, the inclusion of taxation measures committed for nondiscriminatory treatment across all service sectors is rare in WTO members' service schedules. In addition, the normal requirements of the investment regulations apply to foreign and domestic providers alike. Tonga also notified members through its schedule of the prohibition on the acquisition of land except through leasing arrangements. There were also certain categories of workers to which Tonga committed not to apply discriminatory measures between non-residents of different members. Second, Tonga adopted the telecommunication reference paper, which detailed key international best practice regulatory principles on telecommunications. Third, Tonga notified members via its schedule that some service subsidies may be made available only to Tongan citizens.

Overall, both PNG and Tonga committed to liberalize fixed-line telephones and mobile services.<sup>18</sup> Both countries committed to liberalize, without limitations, Mode 3 commercial presence (foreign direct investment). Furthermore, both adopted the telecommunication reference paper emphasizing commitments to pro-competitive practices.

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<sup>17</sup> Tonga's accession package was submitted to the General Council and accepted by both parties (WTO and Tonga) in the Hong Kong, China Ministerial Meeting in December 2005 subject to ratification before 31 July 2006. However, the ratification was delayed due to domestic political and economic challenges and was eventually submitted and accepted by the WTO on 27 June 2007.

<sup>18</sup> Although, as the schedules show, both adopted transition periods for the monopolies' exclusivity to end.

**Table 4.2: Schedule of Commitments—Voice Telephone and Digital Cellular Services, Tonga**

Modes of Supply			
(1) Cross-border supply (2) Consumption abroad (3) Commercial presence (4) Presence of natural persons			
Sector or Subsector	Market Access Limitations <sup>a</sup>	National Treatment Limitations <sup>b</sup>	Additional Commitments
<b>I. Horizontal Commitments</b>			
All Sectors Included in this Schedule	<ul style="list-style-type: none"> <li>• Taxation measures               <ul style="list-style-type: none"> <li>(1) None</li> <li>(2) None</li> <li>(3) None</li> <li>(4) Unbound</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>(1) None</li> <li>(2) None</li> <li>(3) None</li> <li>(4) Unbound</li> </ul>	
All Sectors Included in this Schedule	<ul style="list-style-type: none"> <li>(4) Unbound except for measures affecting the entry and temporary stay of nationals of another member who fall into the categories listed below:               <ul style="list-style-type: none"> <li>• salespersons</li> <li>• intra-corporate transferees</li> <li>• managers</li> <li>• executives</li> <li>• specialists</li> <li>• personnel engaged in establishment</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>(1), (2), and (3) Unbound with regard to subsidies</li> <li>Government approval, under the Foreign Investment Act, is required for foreign investors to invest into the kingdom.</li> <li>The Tongan Constitution prohibits the sale of land to foreigners. Foreigners can only attain land through leasing, with the right to lease land for up to 99 years as well as sublease.</li> <li>(4) Unbound except for measures listed under market access</li> <li>Subsidies available to natural persons may be limited to Tongan citizens</li> </ul>	
<b>II. Specific Commitments</b>			
Communication Services	(1) None as of 1 January 2008	(1) None	Tonga subscribes to the principles set forth in the Reference Paper.
<ul style="list-style-type: none"> <li>• Telecommunication services</li> <li>• Voice telephone services (7521)</li> </ul>	<ul style="list-style-type: none"> <li>(2) None as of 1 January 2008</li> <li>(3) None as of 1 January 2008</li> <li>(4) Unbound except as indicated under horizontal commitments</li> </ul>	<ul style="list-style-type: none"> <li>(2) None</li> <li>(3) None</li> <li>(4) Unbound except as indicated under horizontal commitments</li> </ul>	
• Others	<ul style="list-style-type: none"> <li>(1) None as of 1 January 2008</li> <li>(2) None as of 1 January 2008</li> <li>(3) None as of 1 January 2008</li> <li>(4) Unbound except as indicated under horizontal commitments</li> </ul>	<ul style="list-style-type: none"> <li>(1) None</li> <li>(2) None</li> <li>(3) None</li> <li>(4) Unbound except as indicated under horizontal commitments</li> </ul>	Tonga subscribes to the principles set forth in the Reference Paper.

<sup>a</sup> Restrictive measures between foreign service suppliers.<sup>b</sup> Restrictive measures against foreign service suppliers.

Source: Adapted from World Trade Organization Document - WT/ACC/TON/17/Add.2; and WT/MIN(05)/4/Add.2, 2 December 2005.

## 4. Credibility Problems in Telecommunication

### Regulatory Reform

This section draws upon evidence of regulatory changes during the telecommunication reform process in PNG and Tonga. As demonstrated, the early regulatory changes undermined the credibility of the reform process. Most importantly, it is argued that the WTO multilateral commitments provided certainty to the reform processes, whereas domestic (and bilateral) restraints provided limited or no certainty.<sup>19</sup>

#### Papua New Guinea

##### *Pre-Reform Policies (December 2005–March 2007)*

Since the December 2005 National Executive Council (NEC) decision to introduce mobile competition, the regulatory reforms saw several policies and pieces of legislation drafted, amended, or repealed. Prior to introduction of mobile services, only two pieces of information and communication technology (ICT) legislation had been implemented. The first was a communication policy drafted as a result of a communication policy seminar in 1978. In 1992, the Department of Communication and Information (DCI) was instructed to begin formulating a coherent national ICT policy (DCI 2008a, pp. 2–3), which resulted in the National Policy on Information and Communication of Papua New Guinea passed in 1994. The 1994 ICT policy was more comprehensive in setting out general policy guidelines on defining ownership, access, and content. It also emphasized the role of the state-owned telecommunication operator in providing access to rural communities and extending the network to complement economic development. Privatization plans for the state-owned incumbent operator were clearly stated whereas the introduction of competition was not mentioned. A 1999 WTO secretariat report (1999, p. 121) confirmed this position by stating that the government's policy intention "is to gradually privatize Telikom PNG... by divesting up to 49% of ownership."

A gradual policy shift toward liberalization of telecommunication services began when three key pieces of legislation were passed in 1996. The three bills created three legal entities: Telikom, as the exclusive monopoly provider of all telecommunication services; the Independent Consumer and Competition Commission (ICCC) as the economic and social regulator; and Papua New Guinea Radiocommunications and Telecommunications Technical Authority (PANGTEL), to act as the technical authority for telecommunications services. Internet services were introduced in 1997, with five internet service providers (Kelegai and Middleton n.d., p. 3) using the Telikom network and international gateways. Most importantly, PNG, as a founding member of the WTO, participated in the telecommunication service negotiations, which were completed in 1997.

Telikom continued to be the sole provider of all telecommunication services. Through a regulatory contract with ICCC, the state-owned incumbent telecommunication operator was granted another 5-year monopoly, from 2002 to 17 October 2007.<sup>20</sup> The capacity of Telikom to serve rural and isolated communities was severely constrained, however. The acting secretary for PNG's Department of State Enterprise and Information at the time, Iduhu Henao (2004, pp. 2–3), outlined the challenges to the development of telecommunication services, which basically pointed to the difficult geographic terrain, the largely rural population, and the diversity of language and culture

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<sup>19</sup> Members' WTO commitments and obligations are usually triggered only when another member raises concerns in the WTO.

<sup>20</sup> On fixed-line service, mobile phone service, and international gateway.

as the fundamental deterrents to network deployment. One telecommunication policy expert interviewed in Port Moresby stated that Telikom's operation "as a monopoly for the last 52 years was inefficient with poor infrastructure. It is a company run by engineers. It is not a company that is run by people with business mentality in terms of marketing, accounting, quality of services, innovations, and so on...".

But geography and the largely rural population were not the main reasons for Telikom's underperformance. When Grand Chief Sir Michael Somare was elected Prime Minister in 2002, his administration set out to rehabilitate Telikom. Poor management was seen as one of the major contributors to inefficiencies. Somare reported to Parliament in 2005 that Telikom at one time had six managing directors over an 11-month period (Office of the Prime Minister 2005). The government stabilized the management structure and hired experts to assist in providing strategic direction to the chairman and the board. The results were a series of positive business initiatives, including appointment of international firms to formulate strategic policies and further network expansion of fixed-line services.

The first major competition policy development was reached in December 2005 when an NEC decision was made on the introduction of competition in mobile services. The main objective of the national ICT policy approved in 2005 was for the use of telecommunications for economic development in PNG. The government stated in the 2005 NEC decision a preference to establish electronic connectivity for disseminating information to the general public and as a means of reaching out to the public and outside world (e-government, e-commerce, and e-education). Telikom's infrastructure through which these services were to be provided was limited and in need of major modernization. Therefore, rehabilitation of Telikom was stated to be one of the government's priorities. However, according to the same NEC decision, competition was to be introduced in the mobile service sector. A telecommunications policy expert in Port Moresby argued that

To be able to rehabilitate Telikom PNG, they need a good stream of revenue and also need to attract finance for its developmental programs. Hence, the argument therefore was that, we can't do that if we have an inefficient Telikom company competing with an efficient multinational foreign telecom operator. Telikom argued that while it is trying to establish its network to the whole of the country, they cannot afford for a mobile company to come in and "cherry pick" on the most profitable areas (Port Moresby, Lae, Mt. Hagen, and Kakapu). This meant that Telikom would have to cross-subsidize<sup>21</sup> the rates in non-profitable areas, meaning that its tariff rates will be more expensive than any other operator that operates in the profitable areas only.

Two issues relating to Telikom's operations arise from this discussion. First, Telikom has had exclusive monopoly rights for more than 50 years. There have been no incentives for the incumbent operator to develop and invest in infrastructure services during this time. Second, when the incentive presented itself—competition—Telikom was inadequately prepared. Telikom's inability to operate effectively in a competitive market may have been the issue that drove much of the political interference in the reform program, which led to regulatory uncertainty in 2007 and 2008.

A telecommunication policy expert in Port Moresby described Telikom's pre-competition era as follows:

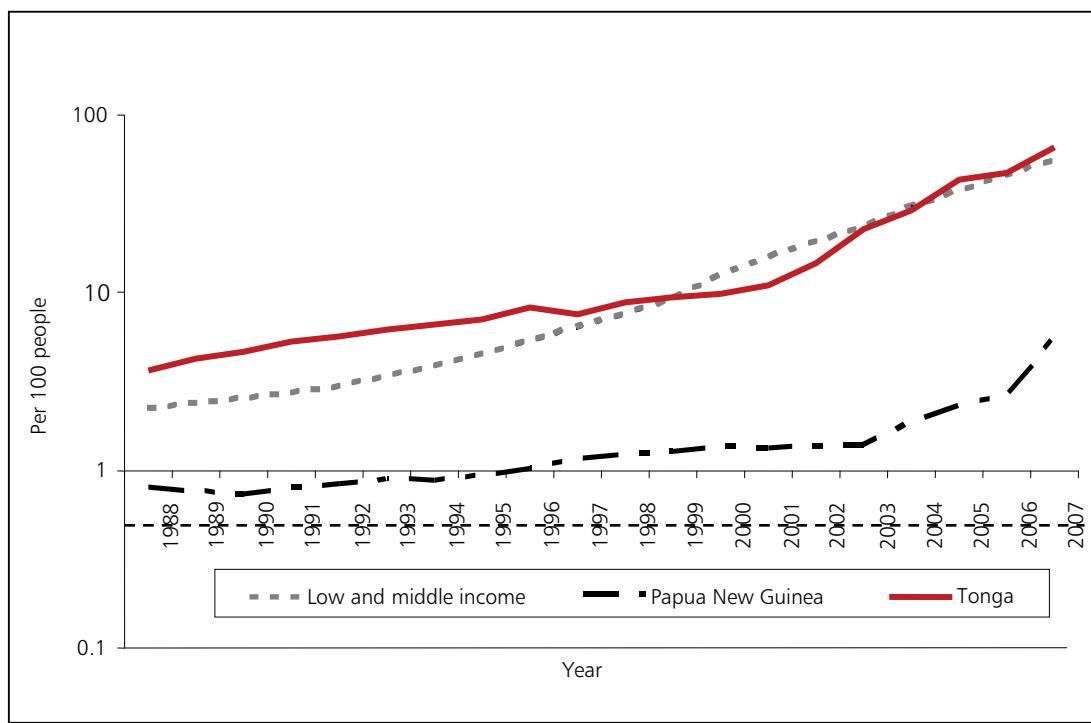
<sup>21</sup> As of July 2009, universal service coverage and funding policies had not been implemented.

As is the case with many state owned entities, the infrastructure had deteriorated over the years as a result of ineffective management, constant political interference, tariffs not being cost-reflective, massive underinvestment and lack of incentives to improve services or roll out network. The infrastructure was outdated, unreliable, and network coverage was low.

The low level of fixed-line and mobile phone subscribers per 100 people in PNG is captured in Figure 4.1 in a comparison with Tonga and the average of low- and middle-income countries as categorized by the World Bank.

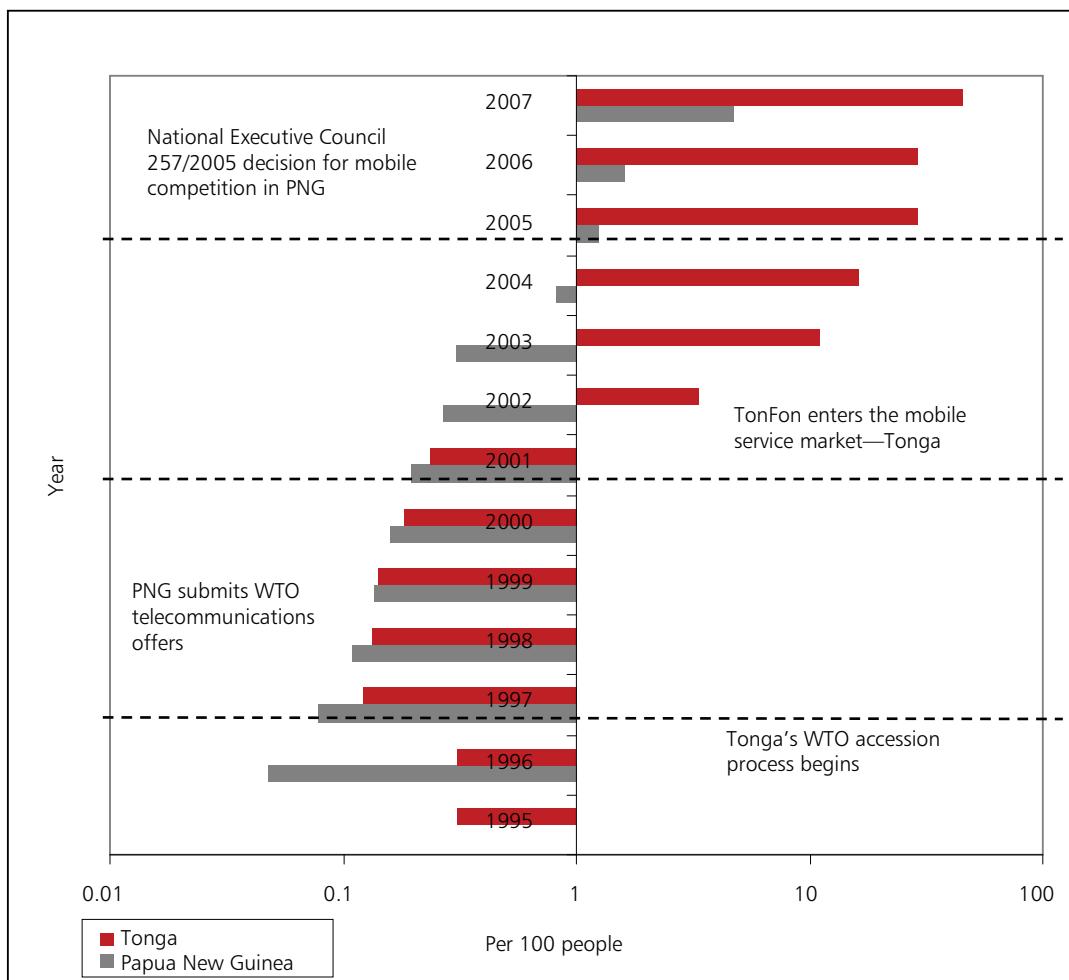
However, network deployment and coverage in PNG has improved significantly since Digicel PNG entered the mobile phone market in July 2007. Figure 4.2 shows the association between key policy changes and mobile phone subscriptions per 100 people for PNG and Tonga. Before competition policies were introduced, mobile phone subscriptions were relatively low in both Pacific countries and there were significant increases shortly after competition policies were announced (or actual competition began).

**Figure 4.1: Total Fixed-Line and Mobile Subscribers per 100 People—Papua New Guinea and Tonga**



Sources: World Bank, *World Development Indicators 2009*; and World Trade Organization online sources.

**Figure 4.2: Total Mobile Subscriptions per 100 People—  
Papua New Guinea and Tonga**



Sources: World Bank, *World Development Indicators 2009*; and World Trade Organization (WTO) online sources.

Three key statements in the December 2005 NEC decision are worth mentioning. First, through its regulatory contract with ICCC, Telikom was to agree to terminate its mobile phone monopoly by 31 March 2006. Second, ICCC was mandated to select, via public tender, two new licensees to compete with Telikom's B-Mobile. Third, March 2007 was the date set for open competition in mobile services. Following the government's decision to introduce competition, ICCC released a press statement in January 2006 (ICCC 2006, pp. 1–2) outlining the processes it would follow to fulfill its obligations.

The media release from the Office of the Commissioner, ICCC, on 18 January 2006 outlined four main steps. First, the public tender process would begin on 7 March and submissions would close in May 2006. Second, assessment of the applications would be undertaken by ICCC and the two new mobile providers announced by mid-October 2006. (Contrary to the announced timeline, the licensees were announced earlier in September 2006.) Third, construction of network infrastructure for the two new mobile entrants was tentatively scheduled for December 2006.

Fourth, licenses would be issued (these were issued on 27 March 2007). Licenses were issued to Digicel PNG and Greencom. Digicel PNG began operations on 17 July 2007, while Greencom has not yet begun operations.

ICCC was also required to consult with Telikom on procedures to terminate its monopoly over mobile services by end of March 2006. ICCC sought Telikom's approval in early January and received consent from Telikom via a letter on 20 February 2006. In surrendering its exclusivity rights, Telikom required ICCC to fulfill several conditions. ICCC claimed that these were addressed and amended the contract agreement between Telikom and ICCC to reflect the termination of exclusive rights over mobile services.

However, in September 2006, Telikom claimed that the conditions were not fulfilled and that it did not consent to the release of its monopoly rights (ICCC 2007b, p. 1). Importantly, the government released a national ICT policy in the same month that generally reneged on the December 2005 NEC decision for liberalization of mobile services. Against Telikom and government opposition, ICCC kept to its timeline and announced the two new licensees. ICCC's position on the government's September 2006 ICT policy is best captured by its commissioner and chief executive officer (CEO), Thomas Abe, who said that "it is the prerogative of the Government to make and change policies but this is a situation where Government wanted the game to be replayed when the full time whistle had already gone" (ICCC 2007b, p. 2). The government maintained that "refinements" to the policy were due to the need for Telikom to rehabilitate to cope with a more competitive environment. On the other hand, ICCC's interpretation was that the effects of any new policy must only come after March 2007, when the old policy ended. In addition, legal advice to ICCC suggested that the licenses issued in March 2007 could not be legally challenged just because of a sudden government policy change (ICCC 2007b, p. 2).

Three public entities pressured ICCC to stall the mobile liberalization program (Abe 2007a, 2007b). First, Telikom commenced three separate judicial proceedings to challenge ICCC actions: one through an appeal panel and the other two through the court system.<sup>22</sup> However, the appeal panel ruled in favor of ICCC, and the first court decision dismissed Telikom's claim for abuse of process (Supreme Court of Papua New Guinea 2008, p. 1). Telikom voluntarily discontinued the second court proceeding.

Second, as noted in a public speech by ICCC Commissioner Abe, the Independent Public Business Commission (IPBC)—the sole shareholder of Telikom—advocated a position that would have prevented the introduction of mobile competition from March 2007, or at all (Abe 2007a, p. 4).<sup>23</sup>

Third, the minister responsible for the Department of Public Enterprises, Information and Development Co-operation (DPEIDC), Arthur Somare, pushed for policy reversal to allow time for Telikom's capacity to be rehabilitated so that it could compete effectively. Alfredo Henandez of the *National*'s online edition reported that "the order to cancel the telco's [Digicel's] license to operate in PNG came from the Prime Minister's son, Arthur Somare, Minister of Public Enterprise, Information and Development" (*e-National* undated). ICCC's Commissioner, Thomas Abe, stated in his press release of 30 July 2007 that "Minister Arthur Somare has also been trying for over a year

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<sup>22</sup> Authorized by the Telecommunications Act.

<sup>23</sup> IPBC is a 100% state-owned statutory corporation. The major objective of IPBC is to hold the majority of state-owned commercial assets in trust and to manage those assets prudently to improve commercial performance and economic development. For further information, visit IPBC website: [www.ipbc.com.pg/index.html](http://www.ipbc.com.pg/index.html)

to stop ICCC and PANGTEL from giving effect to this [December 2005 NEC decision] Government Policy" (ICCC 2007b, p. 2).

A telecommunication expert in Port Moresby recalled the ICT task force's frequent tense negotiations over ICT policy.<sup>24</sup> While 10 members of the task force accepted that competition should continue, two members consistently argued to stop competition. One was Minister Somare's DPEIDC and the other was IBPC, also within his portfolio.

Minister Somare's objection to ICCC granting licenses for competition in the mobile sector was given in Parliament, where he claimed that "ICCC has failed to perform its functions under section 19 of the Telecommunications Act, by not implementing ICT Policy" (Abe 2007b, p. 5).<sup>25</sup> This statement refers to the September 2007 ICT policy, which stated that Digicel should not be granted a license for immediate competition but rather there should be a staged competition. However, the license that ICCC granted in March 2007 was based on the December 2005 NEC decision, which the government should have amended well before Digicel began to establish its infrastructure network in September 2006. Although there was an ICT policy that was passed (but not implemented) in September 2006, coinciding with the announcement of the result of the tender process, it was rather late as ICCC had followed its public tender process mapped out from January 2006, soon after the December 2005 NEC decision.

DPEIDC drafted an ICT policy in September 2006 to reflect its position on competition and the rehabilitation of Telikom. The September 2006 ICT policy contained two fundamental regulatory departures from the December 2005 NEC policy. The first was the government's recognition of the need to rehabilitate and upgrade Telikom's network capabilities, strengthening its ability to compete. It was stated that 500 million kina (K) to K1.4 billion would be required over 5 years to rehabilitate the network (DPEIDC 2006, p. 23). In particular, the rehabilitation program should involve internal restructuring of Telikom to maintain its exclusive rights to network infrastructure services (NETCO) while at the same time "addressing" the competition elements of the 2005 NEC decision through service companies (SERVCOs).<sup>26</sup> Second, it was anticipated that any new mobile entrants would be allowed to apply for a SERVCO license to operate in the mobile services but must use the infrastructure NETCO provides. It was recommended that the government "postpone or cancel [the licenses for Digicel and Greencom] for 18 to 24 months" (DPEIDC 2006, p. 25).

Two reasons for the policy reversal were put forward in the September 2006 ICT policy. First, that Telikom's network was technically incapable of interconnecting to another carrier's network and therefore customers of one carrier would not be able to call customers of another carrier. Digicel requested interconnection with Telikom 3 months before its official launch in May 2007 (Joku 2008).<sup>27</sup> Digicel only began testing interconnection with Telikom on 31 January 2008 and it was another 6 months before nationwide connection in July 2008. Much of the delay had been focused on the technical capacity of Telikom to allow interconnection (Digicel media release, 30 January 2008). Also, there was a numbering plan in Telikom's network that limited subscribers to 400,000 numbers.

<sup>24</sup> The ICT task force was established following a NEC decision in 2006 to develop new ICT policies with the main purpose of delaying or stopping competition in the mobile sector to allow for the rehabilitation of Telikom (fieldwork interview, 13 September 2008).

<sup>25</sup> Section 19—Functions and Powers of the Commission.

<sup>26</sup> Network services include the international gateway and fixed-line and mobile service infrastructure.

<sup>27</sup> ICCC issued the Telecommunications Interconnection Code of Practice to facilitate interconnection negotiations earlier on 17 November 2006.

Second, the September 2006 ICT policy claimed that “ICCC has both a regulatory function under the ICCC Act (2002) and the regulatory authority to issue and revoke licenses under the Telecommunications Act (1996)... [which] is a conflict of interest and ought not be allowed to subsist” (DPEIDC 2006, p. 32). To highlight the point, the September ICT policy stated that ICCC was to “move to issue mobile licences ahead of schedule in the knowledge that the National Executive Council is reviewing ‘Government Policy’ as defined by the Telecommunications Act (1996) and therefore, may put it beyond the power of the Commission to issue the mobile licenses in accordance with section 57 (2) of that Act” (DPEIDC 2006, p. 32). The ICT policy recommended that ICCC’s power to issue and revoke licenses be returned to a committee comprised of representatives from PANGTEL and ICCC, chaired by a former chief justice. This recommendation would effectively return licensing power from an independent entity back to government control.<sup>28</sup>

The claim of “bringing forward” the ending of Telikom’s monopoly over mobile services deserves further discussion. Under the regulatory contract ICCC and Telikom agreed to in 2002, Telikom was given an exclusive license until October 2007. However, the December 2005 NEC decision ruled that introduction of mobile service competition should begin in March 2007. This effectively hastened the end to Telikom’s exclusive rights over mobile service by about 8 months. Both of these decisions were formulated and approved by government. A telecommunication policy expert in Port Moresby stated that “the Chief Executive Officer of IPBC, Glen Blake, and the Commissioner of ICCC, Thomas Abe, were called by government and were told to implement this decision [December 2005 NEC Decision].”

The September 2006 national ICT policy was never implemented. No publicly accessible document is available to shed light on why it was never implemented, although its timing does provide hints about the purpose of the policy. The ICT policy was finalized at the same time that ICCC announced the winners of the public tender process for the introduction of two new mobile service providers. Since ICCC pressed on with the announcement and the timeline set for March 2007 was based on the December 2005 NEC decision, the usefulness of the September 2006 ICT policy diminished, as it clearly contradicted earlier policy. There is also evidence that this policy document was not made publicly accessible, as shown by the lack of mention in either the government’s later policy documents or the regulator’s press releases.<sup>29</sup>

In March 2007, Digicel launched several mobile stations. In accordance with its legislative mandate, PANGTEL issued Digicel a spectrum license. However, several days later it withdrew the licenses, stating “amended ICT policy” as the reason for withdrawal. The e-National online (*The National*, 25 July 2007) reported that “[Arthur] Somare notified PANGTEL of the ‘amended’ government Information Communications.” PANGTEL Acting Director General Charles Punaha was also reported as saying that under the amended ICT policy, access to spectrum would be restricted to NETCO, the proposed new operator of all telecommunication infrastructure. Digicel obtained a court order shortly afterward that overrode PANGTEL’s action and allowed Digicel to operate.

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<sup>28</sup> The latest ICT policy (March 2009) indicates that the power over issuing and revoking licenses is granted to a new authority, National Information and Communication Technology Authority, which is primarily made up of PANGTEL officials and assets.

<sup>29</sup> The September 2006 ICT policy may be confused with NEC Decision 188/2007 that resulted in a comprehensive ICT policy that was never implemented. The characteristics of NEC 188/2007 are identical to the mysterious September 2006 ICT policy. Interestingly, it was another national ICT policy (February 2008) that made this statement. It is also useful to note that in 2007 there were two new ICT policies passed by government that were implemented.

This section has shown how lobbying pressure to reverse telecommunication liberalization policy between December 2005 and when Digicel commenced operations in early 2007 severely interfered with the regulator's (ICCC) independence. The next section looks at the impact of lobbying pressure since that time.

### ***Post-Reform Policies (March 2007–August 2009)***

The government reviewed ICT policy yet again in early 2007. A telecommunication blueprint was developed in May 2007, which was the basis for the May 2007 national ICT policy. The May 2007 ICT policy generally reflected the recommendations of the September 2006 ICT policy in three crucial regulatory areas. First, there was a recommendation for the adoption of the “NETCO/SERVCO model” in which Telikom retains an indefinite monopoly over NETCO infrastructure, whereas SERVCO will be opened for new licenses. Second, competition (SERVCO services) will only commence after 1 June 2008. Third, government, through DPEIDC, establishes new committees to oversee licensing issues and the overall ICT policy. The authority of ICCC to issue and revoke licenses will be “removed and will rest with the Minister for the DPEIDC” (DPEIDC 2007, p. 12).

The May 2007 ICT policy was never implemented due to pressure from key stakeholders, including Digicel.

### ***Multilateral Policy Restraints***

Digicel PNG was methodical but diplomatic in how it dealt with the policy uncertainties. Digicel pressured the government through two main channels. First, Digicel negotiated directly with the government on ensuring security for its investment. The Pacific Islands Broadcasting Association on 26 July 2007 reported that Digicel Group Board Director Seamus Lynch had met with the Prime Minister in early March (2007) and was assured that Digicel's investment and license to operate in PNG were protected. Digicel continued to engage in regulatory dialogue with Telikom, ICCC, and PANGTEL, and the government to ensure that its initial license, based on the December 2005 NEC decision, was protected. When PANGTEL withdrew Digicel's spectrum license in March 2007, Mr. Lynch was quoted on Digicel's website (25 July 2007) as saying that “Digicel obtained a National Court injunction to prevent PANGTEL from doing so and that PANGTEL acted illegally... the actions of PANGTEL yesterday appear to be very politically motivated.”

Second, as an Irish investment, Digicel protected its investment through government-to-government dialogue channels between the Irish and PNG governments. The Irish ambassador to Australia and PNG, His Excellency Mairtin O'Fainin, reportedly flew to Port Moresby to talk with PNG government officials following the government's moves to revoke Digicel's Spectrum license (*Island Business* 2007). The ambassador was reported as saying that he was assured by PNG officials of their government's continued commitment to competition in the telecommunication sector.

Digicel's main investment concerns up to the May 2007 ICT policy were basically twofold. The first was the withdrawal of Digicel's spectrum license by PANGTEL in March 2007. The second concern was the NETCO “model” in which Telikom controlled the international gateway. Digicel PNG CEO Kevin O'Sullivan was reported as saying that “with only one gateway operating, people will experience higher calling rates, lower quality of calls due to network congestion as well as limited international roaming services” (Digicel in the Media 2008). He also added that “to remove Digicel's international gateway would be a step backward from the current open market approach.

The people have tasted the benefits of competition and have the right to continue to enjoy those benefits—lower prices, better quality, increased coverage and introduction of new services.”

There is evidence that Digicel may have exploited other international legal avenues for the protection of its investments in PNG, including invoking PNG’s WTO commitments on telecommunication reform. A member of the Manufacturers Council of PNG<sup>30</sup> said that

There was a monopoly for telecommunications when we negotiated the WTO telecommunications commitment. It had a lapse time of 5 years (2002). The sensible thing was to make an application for extension and they [PNG government] would have got it. They did not do it. What has happened now, we got a letter from the EU [European Union] notifying us of their interest in our WTO commitments in September 2008. The commitment has lapsed and it was triggered by a “private sector” of course.

Thus, a multilateral commitment pressured government to refrain from policy reversals on telecommunication reform.

Two crucial aspects of the telecommunication reform strengthen the case for this point. First, the latest ICT policy released in March 2009 stated that the model proposed was consistent with PNG’s WTO obligations (DIC 2009, p. 22).<sup>31</sup> This statement indicates that the government ensured that its ICT policy is compatible with PNG’s WTO commitments. The statements referring to WTO obligations since the February 2008 national ICT policy may not have occurred by accident. Prior to this, the September 2007 ICT policy had announced that competition will continue but all mobile operators must use Telikom’s international gateway. It was during this time that the Irish ambassador to Australia and PNG flew to Port Moresby and also when the PNG government received the EU letter referring to PNG’s WTO commitments.

Second, the September 2007 ICT policy directed a phased liberalization in which Telikom retained its monopoly over the international gateways in Phase 1. The two ICT policies in 2008 adopted similar frameworks. There was no time frame indicated in the 2008 ICT policies as to when Phase 2 would begin. However, the March 2009 ICT policy came up with a clear time frame and set milestones to be achieved. More interestingly, the international gateway was tentatively scheduled to be liberalized by October 2009, or as soon as practical thereafter. Throughout the 2007–2009 ICT policies, the government stated its commitments to competition—staged competition, that is.

Several scenarios based on the September 2007 ICT policy (and subsequent ICT policies) can be challenged via the WTO legal dispute system. Depending on the impact of the policy on foreign operators, several cases can be developed. The international gateway issue is a case in point. It is not clear whether the telecommunication license granted by ICCC to Digicel in March 2007 included the right to operate its own international gateway. Based on the press releases, media dialogue, and interviews conducted by the author, ICCC and the government interpreted the international gateway right differently. Digicel understood that its license to operate in PNG included the right to operate its own international gateway. Digicel PNG CEO Sullivan was quoted on Digicel’s website (26 March 2008) as saying, “with only one gateway operating [Telikom’s

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<sup>30</sup> This person has been heavily involved in the PNG government’s WTO and regional trade agreement negotiations over the past 20 years.

<sup>31</sup> The national ICT policies released in February and April 2008 also mentioned the importance of competition in the telecommunication sector and that “the WTO will put PNG under pressure to open its telecommunications sector to competition.”

gateway], people will experience higher calling rates... to remove Digicel's international gateway would be a step backward from the current open market approach." A telecommunication policy expert in Port Moresby stated that

Clause 2.4 of the Digicel license requires that Digicel use an international gateway operated by a general carrier, unless the ICCC consents to Digicel using its own or another gateway. The ICCC gave its temporary consent to Digicel under the license to carry international communications using its own international gateway until connection to the Telikom PNG [international] gateway was achieved.

On the other hand, the government's interpretation was that it did not grant international gateway rights to Digicel. A government official in Port Moresby stated that

It was never intended under the [December] 2005 mobile competition policy that these rights [international gateway] or other general carrier reserved rights would be granted to the new mobile carriers. Those rights were to remain with Telkom PNG at least until October 2007 and any subsequent change was to be a matter of government policy.

The government's interpretation is backed by section 45 (Rights to reserve line links and ancillary facilities) and section 46 (Supply of telecommunications services by satellite based facilities or microwave facilities) of the Telecommunications Act 1996. These two provisions state that no operator other than the general carrier holds the right to operate a "reserve link within Papua New Guinea and a place outside Papua New Guinea." Section 46 states the international linkage rights of a general carrier through satellites or microwave facilities.

The current ICT policy (March 2009) states that the operation of international gateways (since September 2007) is the exclusive right of Telikom. The most likely scenario for Digicel was to request the Irish government (or the EU, of which Ireland is a member) to challenge PNG's actions in the WTO on three potential derogation scenarios.<sup>32</sup> First, as a matter of principle, any foreign supplier that deems itself adversely affected by the measures of a host government can request its home country authorities to raise the issue with that government through the WTO.<sup>33</sup> Hence, depending on the nature of the measure in question, the governments concerned can discuss solutions or, if a deadlock is reached, raise it at the WTO's dispute settlement body.

Second, under PNG's WTO telecommunication commitments, Telikom's monopoly was scheduled to end in 5 years, in 2002. One potential interpretation is that there is a case for market liberalization after that end date. Hence, under this scenario, PNG's telecommunication sector should have been liberalized in 2002.

One important issue needs to be considered under this scenario. PNG did not request an extension in 2002 and this option could have been exploited. In PNG's case, 5 years were not sufficient to allow telecommunication reform, particularly, the rehabilitation of Telikom. An ambitious reform program with a short, fixed timetable increases the risks of future policy interference. A similar problem occurred in Albania in 2003. It applied for a waiver in the WTO and was granted one when the privatization of its telecom monopoly, Albtelecom, ran into difficulties. The waiver postponed the commitment's implementation date by 1 year (Adlung 2007, pp. 254-

<sup>32</sup> The PNG government tentatively scheduled liberalization of the international gateway by October 2009.

<sup>33</sup> Many thanks to Rudolf Adlung for clarifying this point.

255). Similarly, Tonga through its accession process, requested a waiver on the ratification deadline for its WTO commitments (including telecommunication commitments) due to economic and political difficulties in July 2006. It was granted a 1-year waiver, with ratification to take place on July 2007. The 12-month delay also pushed back the implementation of Tonga's commitments on telecommunication liberalization.

Third, in its WTO telecommunication commitments, PNG scheduled no limitations discriminating between foreign and local services suppliers. The granting of exclusive rights over the international gateway to Telikom may be deemed a violation of its 1997 telecommunication commitments. If PNG develops a case to justify the potential derogation, legal disputes can be formally established in which financial and human resources costs may be issues.

### ***Domestic Restraints***

Local business communities in PNG also put pressure on the government. *Island Business*'s Dionsia Tabureguci (2008) reported that public pressure resulted in government scrapping the controversial NETCO/SERVCO competition model. Port Moresby Chamber of Commerce General Manager David Conn was quoted in *Island Business Online* (2008) as saying that they were unhappy because government did not consult with them on the policy. He also criticized the government and Telikom for failing to attend a public workshop held in January 2008, attended by a wide spectrum of stakeholders.

There was also limited political pressure from within government as "there was much political lobbying going on between those who supported competition and those who opposed it." A telecommunication policy expert in Port Moresby stated that, "eventually, an ICT policy [May 2007 ICT Policy] was adopted by the PNG government, which was not agreed to by the majority of the task force, but held the views of the minority who thought that competition would be detrimental for Telikom PNG."

ICCC also had difficulties with the government's May 2007 ICT policy. ICCC Commissioner Abe, in a press statement on 30 July 2007, said that "ICCC was informed by Minister Somare at the end of June 2007 that, in a decision taken on the 21 June during the election period, the government had reversed its previous policy of introducing mobile competition, and wanted the ICCC to revoke the licenses issued to Digicel... ICCC sought legal advice... and has been advised that the licenses already issued to Digicel are proper and valid, and cannot now be legally canceled because of a change in government policy" (Abe 2007b).

Since ICCC's involvement with the reform program in December 2005, its position had been to act as the independent regulator for telecommunication services (without any political interference) and provide competition in the mobile service sector through granting of a license to Digicel. This position was reflected in several public statements by Commissioner Abe in 2007 and 2008. (Abe 2006, 2007a, 2007b). The provision of ICCC's functions in accordance with its legislation was effective during the reform program on one key regulatory aspect—independence. Maintaining independence amid commercial and political interference was achieved by ICCC, although it may have contributed to the later loss of its power to grant and revoke telecommunication licenses.<sup>34</sup>

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<sup>34</sup> The latest ICT policy (March 2009) stated that a new regulator, National Information and Communication Technology Authority (NICTA), would be established and that all powers to grant and revoke licenses would be moved from ICCC to the new regulator. Although not clear at this stage, the new regulator is likely to be heavily influenced by government with respect to members of the board and funds.

## Tonga

Tonga's successful introduction of mobile phone competition in late 2002 was swiftly backed by a comprehensive reform program. Telecommunication competition began when Tonfon entered the mobile phone market as the second provider in July 2003. During that time, Tonga was negotiating its service commitments as part of its accession to the WTO. As a result, Tonga's domestic and multilateral policies were aligned and locked in Tonga's telecommunication reform intentions.

Tonga finalized its WTO accession package in December 2005. In November 2007, Digicel entered Tonga's market via acquisition of Tonfon. Digicel Tonga has been providing mobile phone services since May 2008. Since that time the telecommunication sector has realized improved sector performance and reduced prices through intense competition. The motive behind the selling of Tonfon, according to the Shoreline Group, was "part of the program for His Majesty to withdraw from commercial interests in Tonga" (*Tonga-Now* 2007).<sup>35</sup>

Since the expiry in 1999 of the franchise agreement between Tonga government and British Cable & Wireless, the provider of international services in Tonga,<sup>36</sup> the government's intention of reforming the sector was made clear in the swift move to draft and pass the Communications Act 2000. The motive behind the reform is not clear, although two pieces of anecdotal evidence shed some light. First, according to a telecommunication policy expert in Nuku'alofa, "the expiry of the franchise agreement with Cable & Wireless provided an ideal commercial opportunity for government to exploit... during those days the cost of an international call was US\$3.30 per minute but now [December 2008] it's down to about 30 US cents per minute... also the need for introduction of new services to Tonga via mobile services and internet connection." Second, the close business affiliation of then Crown Prince Tupouto'a<sup>37</sup> with the Shoreline Group (Tonfon) and the fact that he assented to the bill provided strong political support from within government's executive branch to the successful implementation of the reform program. From the outset the Communications Act was drafted in a manner to reflect the key stakeholder's interest in establishing the legal framework for a competitive telecommunication sector.

Two regulatory aspects of the Communications 2000 Act therefore deserve further discussion. First, telecommunication reform in Tonga had clear objectives from the beginning, as reflected in the Communications Policy Statement of 2000 that signaled three regulatory priorities for the reform program: (i) develop the telecommunication infrastructure because it is essential to economic development; (ii) introduce competition to encourage growth across the sector, fulfill universal coverage connectivity, improve the quality of services, and lower prices. The introduction of competition for a second provider was considered as the "first stage in a wider liberalization process." The policy statement made clear that government reserved the right to permit any further new entrant; and (iii) in an attempt to consolidate provision of all telecommunication services, a new public telecommunication operator, Tonga Communications Corporation (TCC), was established to

<sup>35</sup> Tonfon was acquired by Digicel in 2008, as was Shoreline Electricity. The Shoreline Group of companies, of which the crown prince (now king) was the major shareholder, owned Tonfon. The Shoreline Group also operated the electricity utility in Tonga. Since the November 2006 riots, which resulted in the closure of Shoreline's main office in Nuku'alofa, the company has had a very limited presence in Tonga.

<sup>36</sup> The international service component of the telephony market was the most profitable, as compared with domestic and fixed-line services.

<sup>37</sup> Now King Siaosi Tupou V.

replace the services previously provided by Cable & Wireless (international) and Tonga Telecommunications Commission (domestic).

Second, the creation of the Department of Communications as an independent regulator, as stipulated by the Communications Policy Statement and the Communications Act, indicates government's policy intention of creating a predictable environment for investment closely affiliated with the regulatory aspects. As indicated in the policy statement, "the Minister's role has a particular emphasis on policy making, the Department is primarily concerned with policy implementation." The department, however, is accountable to the minister responsible for communications and funded by the government. The regulator has continued to pursue regulatory neutrality and opted for market forces to regulate the market. It has so far been effective but testing times are ahead.

The comprehensive reform program has raised policy challenges for several key stakeholders, including TCC. A telecommunication policy expert in Nuku'alofa said,

When the government deregulated the market, going from a monopoly situation to a competitive environment is quite a challenge; one of the major policy challenges for TCC was the short transitional period (7 months) it was granted by government to prepare for competition. At the same time, TCC was also going through internal restructuring on merging of the two companies (Cable & Wireless and TCIL [Telecommunications Consultants India Limited]). In addition, there was tense competition in a small market; TCC had to balance out reducing tariff on services while attempting to expand network at the same time.<sup>38</sup> Further, Digicel Tonga as part of a global company has more power in terms of purchasing, trainings, etc than TCC, a small local company with limited funding sources. For example, if you buy 100,000 headsets you can receive 50% discount whereas if you buy 1,000 similar headsets you get only 5% discount. However, it's not doom and gloom for TCC since the good thing for us is that we know our market very well. It will take some time for Digicel to gain in-depth knowledge and public brand trust, a time which TCC can use to its advantage.

Similar to the PNG case, there was an interconnection dispute between Digicel and TCC that originated in 2003. A telecommunication policy expert in Nuku'alofa said,

[i]nterconnection disputes between the two providers began in 2003 to 2004. The department has not put in place an arbitration policy and therefore had to call in experts to draft guidelines for the department to use. The guidelines for arbitration were completed in April 2005. An arbitrator was appointed, ... and we started the process of submissions of interconnections fees and reports. The department also brought in an economic advisor to advise the arbitrator. But at the end of 2005, we received communications from the two operators that they have solved their interconnection disputes bilaterally outside the arbitration system.

As of December 2008, there have been no disputes or legal proceedings against any key stakeholder in the sector.

The case of Tonga shows a regulatory reform program wherein objectives were clearly set from the beginning and were reflected in domestic policies. The monarchial system of government

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<sup>38</sup> Universal service coverage commitments and funds are included in the Communications Act 2000. As of July 2009, Tonga government was drafting regulations and detailed policies on implementing those commitments.

provided the much-needed political commitment, coupled with the support from the crown prince's business interests. The multilateral commitments undertaken by Tonga in the WTO added credibility to the reform program. As a result of the clear reform objective and policy reform lock-in through the WTO, the reform program in Tonga has been successful.

## 5. World Trade Organization Implications and Credibility of Telecommunication Regulatory Reform

### Policy Makers and Regulators

The multilateral policy restraints imposed by the WTO telecommunication agreement provide credibility for telecommunication reform programs. Bosworth and Duncan (2002, p. 10) argued that "the importance of this [WTO] international commitment should not be underestimated. The political and bureaucratic systems of most countries are biased toward providing protection to influential inefficient industries, thereby adversely affecting the economy in general, and efficient exporters and consumers in particular."

The PNG government's press releases, various ICCC communications and media reports, telecommunication policies, and the interviews<sup>39</sup> conducted by the author provide anecdotal evidence of the importance of the WTO commitment in supporting the telecommunication liberalization. The government was reminded of its commitment by the Irish ambassador's visit to Port Moresby in late 2007 for discussions with Prime Minister Somare and the reported communication by the European Commission to the government reminding it of its WTO telecommunication commitment. These external pressures are reflected in the changes in the telecommunication policy in late 2008 and early 2009, making particular reference to respecting WTO commitments.

The latest ICT policy recognizes that open competition provides the best means of delivering benefits to consumers over the long term. For the first time, it recognizes that alternatives (closed or limited competition) "are unlikely to be acceptable to the PNG consumers or to the wider international community where multilateral liberalization through forums such as APEC [Asia-Pacific Economic Cooperation] and the WTO will put PNG under increasing pressure to open its telecommunications sector to competition" (Government of Papua New Guinea 2007, p. 1).

The structural separation of Telikom to the NETCO/SERVCO model was rescinded. This amendment imposed an important forward-looking regulatory step: the recognition that Telikom is in need of serious rehabilitation and therefore there is need for a staged introduction to full competition in the telecommunication sector. The introduction of competition in the telecommunication sector was planned to take place in two phases. Phase 1 (effective from 11 October 2007 but with no end date) is the current arrangement, in which Telikom is still the general carrier providing mobile services and has a monopoly over fixed-line services and the international gateway. Digicel PNG was to operate through the Telikom international gateway to connect outside PNG. Phase 2 was the introduction of full competition in all telecommunication sectors.

In March 2009, the Department of Communication and Information released the final report of its latest national ICT policy: *National ICT Policy Phase 2 Reforms*. The report is clear in terms of key objectives and a tentative timeline is set for the path to open competition. Two issues in the March 2009 ICT report are important. First, licensing responsibilities were taken from ICCC

<sup>39</sup> Several requests for an interview with Digicel PNG's country manager were unsuccessful.

and given to a new ICT regulator known as the National Information and Communication Technology Authority. Licensing procedures are to be transparent and regulatory barriers to market entry reduced. The role of ICCC as far as the telecommunication sector is concerned is sidelined. Second, the last stumbling block from the previous anti-competition ICT policies was the regulation of the international gateway. The March 2009 policy is reported to set a tentative deadline of October 2009 ("or as early as practicable") for the liberalization of the international gateway. If fulfilled, this promise will be a major breakthrough in telecommunication reform since the 2007 ICT policy.

The Tongan case also shows the significance of WTO telecommunication commitments for telecommunication reform. However, the motives of the stakeholders may differ since Tonga's reform program has progressed in the same direction as its WTO commitments. The pursuance of a liberal stance on trade in services was historically due to Tonga being a small island with limited commercial and capital resources. Being a small island economy, it depends heavily on the global economy for trade in goods and services, and therefore Tonga's trade in services regime was relatively open. Hence, the WTO telecommunication commitments that Tonga<sup>40</sup> made were easier to implement since domestic and multilateral policies were moving in the same direction—liberalization.

However, the impact of certain domestic actors was equally instrumental in setting a clear objective for liberalization. The most noticeable factor was the political commitment offered by the Government of Tonga and the crown prince to the telecommunication reform process.

The incumbent state-owned telecommunication providers in both PNG and Tonga were ill-prepared for operating in a competitive environment. The privatization programs adopted in both countries had only advanced part way—to corporatization. Limited financing was available to both incumbents for modernization and rehabilitation and they were given a short transition period to prepare for competition. On top of this, the incumbents plan to fulfill universal commitments to provide services in rural and remote areas.

### Telecommunications Operators

In both countries the state-owned incumbents behaved in a similar manner. Both had relied on government for protection while gearing up for competition. However, both operators recognized the importance of the telecommunication reform program in introducing competition. Since the introduction of competition, both incumbents have had to adapt or risk losing market share. Telikom PNG adapted by selling 50% of the equity in its mobile service (B-Mobile) for K130 million. The 50% equity investment was contributed by a "consortium of companies including United States-based Trilogy International Partners LLC (20%), GEMS Ltd (20%), PNG's National Superannuation Fund (5%), and Nambawan Super Ltd (5%)" (*Post Courier* 2008). With separate ownership and management of the mobile service, government anticipated that B-Mobile could compete with new entrant Digicel.

Tonga's TCC coped with the competitive environment by swiftly bringing its range of services up to par with the new entrant. These included international roaming and various texting programs.

As a result of competition, the mobile network in PNG has expanded significantly. The two main operators in the sector have rolled out mobile services in new areas, including remote areas,

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<sup>40</sup> See 'Ofa (2008) for a discussion on the trade in services regime in Tonga.

attracting significant numbers of new subscribers. Digicel coverage in Tonga is almost nationwide (more than 90%). By mid-2007, competition in Tonga had increased mobile phone ownership from 3.4% to 30%. In PNG, there has been a sharp increase in coverage and a doubling of mobile phone services in a short period of time (Commonwealth of Australia 2008, p. 43). The Pacific Economic Survey 2008 reported that the prices of mobile calls (US\$ per minute) in Tonga was the lowest in the Pacific since the introduction of competition (Commonwealth of Australia 2008, p. 43).

### **Politicians, Nongovernment Organizations, and the General Public**

Opposition to the introduction of mobile services<sup>41</sup> in Tonga was remarkably muted, considering that several nongovernment organizations (NGOs), the Public Servants Association, the pro-democracy movement, the Tongan Small Business Association, Friendly Islands Teachers Association, the Tongan Women's Action for Change, and several members of Parliament actively protested against the terms of membership and eventual WTO membership of Tonga. Opposition to free trade is widespread throughout the Pacific. Duncan (2008, p. x) suggested that "within the Pacific, opposition to open markets is very strong and supported by vested interests, ideology, and cultural beliefs. Economic issues also constrain the response to changes in the terms of trade through trade liberalisation, such as insecurity of land tenure and poor access to credit."

Discussions in Tonga's Parliament in the lead-up to the December 2005 WTO signing also reflected anti-free trade concerns. However, the parliamentary minutes do not show any opposition to the liberalization of the mobile service sector. The remarkably small degree of concern about the liberalization of the mobile service sector prompts one fundamental point. Since Tonfon entered the market in 2003 and Digicel in 2008, the general public, including rural areas and remote islands, benefited from the wireless technology. The interconnectivity gap between the five major island groups in Tonga was dramatically reduced, as was the linkage between Tonga and the outside world. Competition provided incentives for the state-owned incumbent to improve efficiency. Hence, it is unlikely that any political pressure against the development of this sector would not have been supported by the general public. Similarly, as reflected in the PNG case, once the wireless technology benefited rural and isolated areas, the general public's support for the liberalization of the mobile service sector increased dramatically. Therefore, convincing the public that services will improve and prices will be reduced is critical to gaining their support for the introduction of competition.

## **6. Conclusion**

The telecommunication regulatory reforms in PNG encountered challenges that the independent regulator dealt with to the best of its ability. The frequent policy changes over the past 5 years point to the limited ability of the domestic independent regulator to provide credibility to the reform process. Actions instigated through various channels by the Irish-owned Digicel operator, including the European Commission reminding the PNG government of its WTO obligations, provide evidence that multilateral policy restraints can provide credibility to the telecommunication reform process. Revisions to PNG's ICT policy in late 2008 and early 2009 also show that the government is recognizing its WTO obligations. Further, the relatively muted public opposition to the liberalization of mobile services in Tonga and PNG provides evidence that once an economic reform program directly addresses the challenges of being small and isolated, policy adoption encounters less political pressure.

<sup>41</sup> Both the entrance of Tonfon in 2003 and Digicel in 2008.

One of the main lessons from the PNG case study is that regulatory capture provides incentives for government to renege on commitments on telecommunication reform. The eventual “internal reform” of ICCC since its involvement in the telecommunication reform process in 2005, culminating in the removal of its autonomous power to grant licenses and reverting this back to the minister responsible for telecommunications, shows the vulnerability of domestic policy restraints to vested political interests.

The state-owned telecommunication operator, Telikom, needed significant rehabilitation time and funding to prepare for open competition. The government may not have been clear about the needed rehabilitation following the 2005 NEC decision. Since the December 2005 decision, seven national ICT policies have been passed in a time span of about 3 years. The frequent policy changes have created significant uncertainty about investment regulations. Nevertheless, when PNG’s WTO telecommunication commitments were queried by the EU, the PNG government, through its latest ICT policy, realigned its policies to its WTO commitments. The multilateral policy restraints therefore provided credibility to the reform program.

The Tongan case provides equally important evidence on the support that multilateral policy restraints can provide to the credibility of the telecommunication reform processes. Although the reform encountered less policy uncertainty in Tonga, the WTO commitments strengthened Tonga’s unilateral reform initiative by locking in its liberalization policy intentions.

The paper provides three important insights for the donor community. First, the possibility of regulatory capture is always present and can undermine the credibility of telecommunications and other reforms in the Pacific island countries. Domestic policy restraints relying on independent regulators are vulnerable to political interference and continue to be hampered by limited financial and technical expertise. The development of technical assistance programs tailored to the enhancement of credible domestic telecommunication regulatory frameworks is vital.

Second, the recognition of the crucial role of pro-competitive policies leading to liberalization of the telecommunication sector increases the credibility of telecommunication reforms. The regulatory experience of PNG and Tonga emphasizes the need for regulatory regimes that are immune from domestic political pressure. Investment confidence and sustainable competition in the sector has been enhanced through the respect PNG and Tonga granted to its WTO telecommunication commitments. The regulatory outcome highlights the need for the international donor community to support unilateral liberalization and privatization reform programs of Pacific islands countries in the telecommunication sector to encourage private investment in the sector.

Third, technical assistance in making the case for reforms is vital. Once it was seen that competition would have significant benefits, including for those in rural and isolated areas, the general public’s support for the liberalization of the mobile service sector increased dramatically and it became much more difficult for the government to resist or reverse the reform. Therefore, convincing the public that services will improve and prices will be reduced is critical to gaining their support for the introduction of competition.

### Appendix 4.1: List of Interview Respondents

#### Interviews in Port Moresby, Papua New Guinea

Respondent	Function/Organization	Date	Duration (minute)
1	Small Business Association of PNG	8 September 2008	58
2	Manufacturing Council of PNG	9 September 2008	21
3	Government official	9 September 2008	41
4	Government official	9 September 2008	55
5	Business operator	10 September 2008	27
6	Telecommunication policy expert	10 September 2008	47
7	Telecommunication policy expert	11 September 2008	52
8	Business operator	11 September 2008	19
9	Telecommunication policy expert	13 September 2008	155
10	Business operator	16 September 2008	22
11	Business operator	17 September 2008	35
12	Government official <sup>a</sup>	6 May 2009	–
13	Telecommunication policy expert <sup>a</sup>	7 May 2009	–
14	Telecommunication policy expert <sup>a</sup>	8 May 2009	–
15	Government official <sup>a</sup>	8 May 2009	–

#### Interviews in Nuku'alofa, Tonga

Respondent	Sector	Date	Duration (minute)
16	Government official	27 November 2008	32
17	Government official	28 November 2008	58
18	Government official	28 November 2008	37
19	Telecommunication policy expert	24 November 2008	49
20	Telecommunication policy expert	24 November 2008	53
21	Telecommunication policy expert	23 November 2008	50
22	Telecommunication policy expert	25 November 2008	24
23	Telecommunication policy expert	26 November 2008	32
24	Business operator	2 December 2008	34
25	Business operator	4 December 2008	17
26	Business operator	4 December 2008	29

– = not applicable.

<sup>a</sup> Interview questions and responses were communicated via e-mail.

Note: Telecommunication policy experts were officials from the incumbent operator, competitors, the regulator, the ministry/department of communications, and other relevant institutions.

Source: Author.

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# 5 Political Economy and Championing Reforms in the Cook Islands and Samoa

by *Emele S. Duituturaga*

## ABSTRACT

The Cook Islands and Samoa have been among the best-performing Pacific economies in recent years. They have been heralded for their success in achieving economic growth by undertaking comprehensive reforms after economic crises. This investigation into the social, economic, political, and institutional factors that contributed to the successful implementation of their economic reforms shows that political leadership at the highest level was critical. The chances of success were increased by continuity in the political leadership and a stable political environment in which the champions of reform could remain focused and did not have to risk jeopardizing the aims of reform in order to retain power. Technically competent and supportive senior public servants also played an important role, as did the public support generated through nationwide summits or retreats and the sustained public dialogue that followed them. In both countries, the sense of self-determination and taking ownership of their development featured prominently.

## 1. Introduction

The Cook Islands and Samoa have been among the best-performing Pacific economies in recent years. They have been heralded for their success in achieving economic growth as a result of undertaking comprehensive reforms. The locally driven and determined program of economic reforms initiated during the 1990s earned Samoa the reputation of the Pacific's model economy, and placed it among the fastest-growing of the Pacific island economies. The Cook Islands, having experienced a major economic crisis in the mid-1990s, introduced comprehensive reforms in 1996 that led to almost immediate revival of the economy. This chapter reports the results of an investigation into those social, economic, political, and institutional factors that acted as constraints to economic growth in the two countries and those factors that contributed to the implementation and success of their economic reforms.

There is information readily available on the nature of these reforms. This study pays particular attention to the key actors who championed the reforms, their motivation for the reforms, the context within which the reforms were undertaken, and the lessons that can be drawn from the two countries. The information on which this report is based was mostly collected from in-depth interviews and discussions with people in Apia and Rarotonga during field visits in February 2009. The report is in four sections. Section 2 looks at the political and cultural contexts in which past reforms have taken place and the circumstances leading to the need for reforms. Section 3 focuses on the key actors and their motivation for the reforms. Section 4 looks at factors contributing to the success of the reforms. The final section is about looking forward: what reforms have yet to be completed and the lessons learned from reforms in the Cook Islands and Samoa.

## 2. Context

### Samoa

Since gaining independence in 1962, Samoa has had a Westminster-style parliamentary democracy with a parliamentary term of 5 years and a unicameral legislative assembly consisting of 49 members, 47 of whom are *Matai*<sup>1</sup> elected by citizens aged 21 years and over, and two of whom represent the part- and non-Samoan population. The Prime Minister, who is chosen by Parliament and appointed by the Head of State, leads a cabinet of 12 members.

The governing Human Rights Protection Party (HRPP) dominates Samoan politics. It first came to office in 1982, led by the late Tofilau Eti Alesana, and has been in power on a continuous basis since 1991. Tuilaepa Lupesoliai Sailele Malielegaoi was appointed Prime Minister in November 1998 after Tofilau resigned due to failing health.

Samoa's Parliament presently does not have formal opposition. The main opposition party was the Samoa Democratic United Party, but Parliament withdrew that recognition after infighting in late 2006 among opposing members of Parliament resulted in a split, leaving the party without recognition under parliamentary standing orders.

In April 2008, two HRPP members resigned from the party and became independents. They banded together with other independents (former members of the Samoa Democratic United Party) to form a new political party, the Tautua Samoa Party. The party's founders describe their aim as providing parliamentary opposition to the ruling HRPP and targeting the next general election in 2011 (Wikipedia Online: Tautua Samoa Party).

In July 2008, another new party called the People's Party was established on the back of the People Against Switching Sides (PASS) lobby group (Wikipedia Online: The People's Party). No sitting Parliament members are members of the People's Party. The PASS group formed in opposition to the government's controversial decision that the country would switch from driving on the right-hand side of the road to the left. After several protests and petitions, PASS also filed a legal challenge alleging, among other things, that the switch was a breach of the right to life (enshrined in Article 5 of the Constitution). This challenge was rejected by the Supreme Court. A last-minute plea from PASS to postpone the switch was rejected by the cabinet, and, as of 7 September 2009, cars drive on the left in Samoa, the first country to switch the flow of traffic from one side of the road to another since Iceland and Sweden did so in the 1960s.

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<sup>1</sup> The Samoan term for a chief.

## The Human Rights Protection Party Drive for Reforms

The HRPP was established in 1979 and, at its inception, became the official opposition party to the government of the day led by Prime Minister Tupuola Efi. That government, through its deliberate use of the powers of a commission of inquiry as a political instrument to cause the arbitrary and prejudicial dismissal of senior public servants, gave rise to the name of the new political party—the Human Rights Protection Party (2011). In 1981, with government finances exhausted, a wage increase sought by the public servants could not be met. This resulted in a Public Servants Association general strike in 1981, which lasted for 3 months. Basic foodstuffs were in acute short supply. Samoans were forced to stand in long queues to buy basic necessities such as rice and canned fish. At the time, the only meat that could be imported in any quantity was chicken backs, which are mostly bone and fat and nutritionally unacceptable. This period is referred to as the formative years of the reform (Kelekoli 2009). The low pay of civil servants and the hardships faced by the general populace influenced their perception of what was wrong and their growing discontent with the Tupuola Efi government. In December 1982, when the HRPP took over government under the leadership of Tofilau Eti Alesana, it was faced with the massive task of rebuilding the national economy and replenishing the government's coffers.

Later, there were further setbacks to the economy as a result of several major natural disasters. In 1989, heavy floods caused extensive damage to the country's roads and bridges infrastructure. This was followed by the cyclones Ofa in 1990 and Val in 1991, and the gale force winds of Lyn in 1993, which caused unprecedented devastation within the space of a few years to the whole of Samoa. In 1993, taro blight wiped out the taro industry, the country's most important export.

The HRPP placed greater emphasis on villages and rural districts, economic development, and safeguarding the integrity of the Samoan culture and traditions. The thrust of the HRPP reforms was to achieve good roads, electricity, piped water, and overall improvement of life in the villages and rural areas. Indeed, the well-known foundation motto of the HRPP (2011) was “What is good for people who reside in Apia, is most assuredly also good for people living in all parts of Samoa.” This saying was reiterated in the author’s interview with Prime Minister Tuilaepa as he spoke passionately about still being a “village boy” at heart and was adamant that “what is good enough for Apia has to be good enough for the rest of Samoa.” He illustrated this with the example of being born in the village and having to carry coconuts for long distances. This motivated him to ensure there would be sealed plantation access roads.

The long and continuing dominance of the HRPP in the Samoan political landscape was a subject often encountered during the interviews. While there has been some discontent and questioning about whether there is true democracy at play and the extent of clientelist politics, there was acceptance that political stability has contributed to economic growth and the enabling policy environment for reforms. This is the first key lesson of this study: Political stability is a precondition for the successful implementation of reforms. This point was emphasized by the deputy governor of the Central Bank of Samoa, who argued that while reforms are ongoing, the government’s continuity is a critical issue because it has in the past provided policy stability (Bourne 2009).

## Samoan Culture

The study found that the strong Samoan identity featured prominently as a foundation for sustaining the reform program. Samoan culture is referred to as *Fa'a Samoa*. This is the “Samoan Way,” an all-encompassing concept that denotes the obligations that a Samoan owes to family,

community, and church, and the strong sense of pride in Samoan identity and the respect that it commands.

*Fa'a Samoa* is also evident in the existing dual legal system—the Western-style legal system administered by the police force and the justice department as part of the central government, and the traditional system administered at the village level through the village councils, considered as local government. Members of the village council (*fono*) are elected from and by members of each village. A government representative, called the mayor, presides over the village council. The 1990 Village Fono Act gives village councils authority over village law and order, health, and social issues. There have been instances where the two systems come into conflict, but generally things work smoothly.

Traditional leaders with *Matai* titles are heads of their family units and hold the land titles. They are also the only people eligible to serve in Parliament. They wield the most influence when they are in government, and consequently hold power over government decisions regarding development. Within each village, every family has a *Matai* who is a member of the *fono* and represents the interests of the family. The role of the *Matai* is very important in Samoan society, interwoven deeply into the fabric of Samoan culture and history. A *Matai* is the chief or head of an *aiga* (extended family group). The *Matai* is responsible for everything that involves the family: land, assets, disputes, and well-being. There are some 18,000 *Matai* in Samoa, both men and women. In the past, only *Matai* could vote in parliamentary elections. It thus became a relatively common practice for prospective parliamentary candidates to ensure that members of their constituency received titles to make certain that they could increase their share of the vote.

Samoan cultural tradition hinges on reciprocal obligations between extended family members and between the *Matai* and their people. This strong sense of reciprocity has often come under scrutiny from the Western perspective of corruption, nepotism, and clientelist politics. Nonetheless, the strong Samoan cultural foundation has been given credit for the reform agenda and successful development. Prime Minister Tuilaepa confirmed that the reform changes are based on the Samoan way of life. All those who participated in this study acknowledged that Samoan culture played a crucial role in the success of the reforms. The public service reform champion, Faamausili Matagialofi Luaiufi, was adamant that the reforms were successful due to their united front and collective pride in *Fa'a Samoa* and staunch belief in their cultural values and identity. Acting Public Service Commission (PSC) Chief Executive Officer (CEO) Mika Kelekolio agreed that culture played a large part in making the hard decisions more palatable and helping people buy into the vision.

These views are supported by Deputy Prime Minister Misa Telefoni (2007), who stated that Samoan culture is based on deep-rooted and timeless traditions that are fundamental to its sustained political stability and economic strength; and while Samoa did go through short periods of economic and political turmoil in the late 1970s and early 1980s, the strong Samoan culture was the binding factor that imposed normalcy and stability and provided the climate for constructive change. In his budget address in 2002, Mr. Telefoni made this often-quoted remark about globalization: “Samoa will not allow its culture to be sacrificed at the altar of globalization.”<sup>2</sup> This is the second key lesson of this study: Culture can provide a strong foundation for sustaining reforms.

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<sup>2</sup> Government of Samoa. 2002. *Strategy for the Development of Samoa 2002–2004: opportunities for all*. Treasury Department, Economic Policy and Planning Division, Apia.

## The Cook Islands

The Cook Islands became self-governing in 1965, in free association with New Zealand. The free association status, which is distinct from that of full independence, allows Cook Islanders to maintain New Zealand citizenship. The key features of the free association relationship are set out in the Cook Islands Constitution Act 1965. These are that the Cook Islands has powers to make its own laws; the Cook Islands government has full executive powers; the Queen in Right of New Zealand remains the Head of State of Cook Islands; and New Zealand retains responsibilities for the external affairs and defense of the Cook Islands.

The Cook Islands has a unicameral Parliament with 24 elected members and a parliamentary term of 4 years. There is full adult suffrage, and although registration is compulsory, voting is not. There is also a 15-member House of Ariki (Chiefs) established in 1966, composed of six Ariki from Rarotonga and nine from the outer islands (House of Ariki Act 1966). The Ariki advise the government on land use and customary issues (House of Ariki Act 1966, pp. 6–7). Of note is that in June 2008, a small majority of members of the House of Ariki attempted to dissolve the elected government and to take control of the country's leadership to regain some of their traditional prestige and authority. "Basically we are dissolving the leadership, the prime minister, and the deputy prime minister and the ministers," Chief Makea Vakatini Joseph Ariki explained. Prime Minister Jim Marurai described the takeover move as "ill-founded and nonsensical" and eventually members of the House of Ariki accepted to return to their regular duties (Wikipedia Online: Politics of the Cook Islands).

The Cook Islands Party governed from 1965 to 1978 under Sir Albert Henry and then again from 1989 to 1999 under Sir Geoffrey Henry. The party's dominance came to an end in November 1999 with the resignation of Prime Minister Joe Williams. Williams had led a minority government since October 1999 when the New Alliance Party left the government coalition and joined the main opposition Democratic Party, which led to Democratic Alliance party leader Dr. Terepai Maoate being sworn in as Prime Minister in November 1999. He was succeeded by his co-partisan Dr. Robert Woonton in February 2002. When Dr. Woonton lost his seat in the 2004 elections, Jim Marurai took over and has remained the Prime Minister until now.

## The Cook Islands Party's Drive for Self-Determination

Similar to the dominance of the HRPP ideology in Samoa leading the charge on comprehensive reforms, the Cook Islands Party's drive for self-determination dominated Cook Islands politics and led the charge on radical and sweeping reforms. Continuity in leadership and a determination to take charge of one's own affairs were the underlying sentiments of these reforms.

The party was formed by Sir Albert Henry, the first Prime Minister of the Cook Islands, who ruled from 1965 until 1978 when Sir Tom Davis and the Democratic Party came to power (Davis 1979). The Cook Islands Party returned to power 6 years later under the leadership of Sir Geoffrey Henry and maintained control for another decade.

Throughout his time in office, there was one beacon guiding the leadership of Sir Albert Henry: "The Cook Islands for the Cook Islanders." According to Libby (1979), Henry's first question on any action by government was, "Is it good for the people of the Cook Islands?" His strong leadership instilled pride and gave confidence that they, the Maori Polynesians, were capable of running their own country.

His is a wisdom and a shrewdness gleaned from working with and coming to deeply understand his fellow man. There is only one way to do that and that is to get out and work with them, share their struggles to make a living for themselves and their families, find out what it means to have one of the children become seriously ill when there is barely enough money to pay the current bills ... Live it and learn it. (Davis 1979, p. 25)

Participants in the discussions in the Cook Islands reported that Sir Albert Henry was indeed a visionary and dynamic leader. He was fervently committed to his country and his people and very much a shrewd negotiator. Sir Geoffrey Henry, who was to follow in his footsteps, referred to him as "my hero."

The sentiments of self-determination continued to echo throughout the Cook Islands Party manifesto and policies and, as the study found, in later years the quest for self-determination was to the detriment of the economy; Sir Geoffrey admits in his own words, "I was driving too hard, wanted change too hard; I lost touch of financial management."

### *Cook Islands Culture and Society*

The study noted that culture did not necessarily feature strongly in the Cook Islands. Nevertheless, it is important to note that people in both countries are of Polynesian origin and share similar cultural values. There is a common language in both countries and both males and females hold chiefly authority.

Cook Islanders are Polynesians commonly known as Cook Island Maoris. The people are broadly divided into two groups: those from the northern Cook Islands speak Pukapukan and their descendants came from Samoa and Tonga to the west; those from the southern Cook Islands speak Rarotongan and their descendants are reported to have come from the Society Islands and Marquesas to the east. Of the permanent Cook Island residents, 63% live in Rarotonga, 25% in the Southern Group islands, and 12% in the Northern Group islands (Statistics Office 2003). Cook Island society is based on an association to a village and its chief. Chiefly titles, Ariki, and land rights are passed through both the male and female lineage but at the discretion of the senior family member.

Wichman (1998) observed that despite the advent of a monetized economy and high mobility of Cook Islanders to Rarotonga and overseas, the basic fabric of family and community is treasured and still exerts influence over Cook Islanders. The family provides a social safety net for most Cook Islanders and remains the basic economic and social unit in the economy. There is a strong and important interconnectedness of land, culture, and family. Each island practices its own form of community control and social organization and there is no uniformity in the application of customary practices from island to island or even among the communities on the main island of Rarotonga (Wichman 1998, p. 11). Reciprocity is a key feature of family obligations. Just as families and tribes gather together to enjoy company and social functions, an important cultural trait of Cook Islanders is that they rally together to support each other in times of hardship, such as when there is destruction of food crops and shelter during devastating hurricanes. This customary obligation of Cook Islanders to support each other is also extended to village and church activities and programs and in the outer islands through semi-subsistence activities in agriculture, handicraft, and coastal fisheries.

### 3. Past Reform Efforts

#### **Samoan Reforms**

The home-grown reform process, which began in the late 1980s, was revitalized in 1993 following recovery from the 1990/91 cyclones, when Samoa's first Statement of Economic Strategy presented the framework for an economic and public sector reform program aimed at promoting private sector development and improving the efficiency of the public sector. As observed by Knapman and Saldanha (1999), the reform program was implemented in a gradualist, sequenced manner. The reforms encompassed (i) tax and tariff reforms, (ii) finance sector liberalization, (iii) the introduction of performance budgeting and the devolution of financial management, (iv) new governance frameworks for public financial management, (v) state-owned enterprises and private corporations, (vi) restructuring of government departments including devolution of responsibility for human resource management and development, (vii) institutional strengthening of government departments and state-owned enterprises, (viii) education and health sector reforms, and (ix) telecommunication and postal sector reforms (Sialaoa 2003).

#### ***The Key Actors***

This study found leadership to be the key. The reforms were led by outstanding, committed, and visionary leaders supported by professionally qualified and technically competent executives. Herein lies the third lesson from this study: Successful reform requires shared leadership between visionary leaders with political will together with competent, professional implementers.

The period of leadership of the late Prime Minister Tofilau was associated with significant constitutional reform. He was a member of the 1960 constitutional convention that paved the way for independence from New Zealand rule in 1962. He returned to Parliament in 1967 and became deputy prime minister and finance minister in 1982 and leader of the HRPP. He introduced universal suffrage with the 1991 elections and made wholesale changes to his cabinet, bringing in Fiame Naomi Mata'afa as the first woman to serve in a Samoan cabinet.

Tofilau Eti was described as a visionary and decisive leader and, although he had limited education, he was someone who listened well (Tafuna'i 2009). Under his leadership as Prime Minister, the reform period from 1991 to 1998 was considered as "the years of sacrifice" no frills, no benefits, no increments. He asked civil servants to sacrifice their entitlements for the benefit of the country. His vision was focused on rebuilding the country and the economy, and strong on everyone receiving and enjoying the benefits of economic growth (Faamausili 2009). Due to Tofilau's ill health, Tuilaepa assumed leadership and continued with the economic and public sector reforms.

Prime Minister Tuilaepa is considered to be the real driving force of the reforms. He is an economist by profession, having obtained a master of commerce degree from the University of Auckland, the first Samoan to do so (Wikipedia Online: Tuilaepa Aiono Sailele Malielegaoi). He was the deputy prime minister and finance minister under Tofilau Eti. This smooth leadership transition contributed to continuity in the reform policies. Those interviewed for this study described Prime Minister Tuilaepa as a visionary and decisive leader. They also mentioned his emphasis on *Fa'a Samoa* initiatives such as the revival of the Samoan fine mat and his discouragement of the lavish commercialization of *fa'alavelave* (cultural exchanges at birth, marriage, and death rituals).

In the interview, Tuilaepa referred to himself as a technician, making it easy for him to understand the issues. As finance minister in 1998, he pushed Prime Minister Tofilau for reforms and he credited Tofilau for having full confidence in his advice and the smooth handover when he became Prime Minister. He said that it was relatively easy to push through reforms such as the corporatization of telecommunications, which he considered as his major reform achievement. By retaining the finance portfolio after taking over the prime ministership and championing the finance sector reforms, Tuilaepa pushed through with reform commitments in this area supported by senior management in the treasury.

A leading treasury official who championed the economic and financial reforms was Epa Tuioti, financial secretary from 1990 to 1999. In reflecting on his motivation for supporting the reforms, he mentioned having attended international meetings where references were made to the “Pacific paradox” and finding it uncomfortable to be at the receiving end of the criticism. This made him quite determined to “break away from the pack” (as he put it) to do something different. His motivation was to demonstrate that Samoans could implement the reforms. In this regard, he realized it would not happen overnight and that it was best to start with his own portfolio in financial management; as a central agency, he would then be able to demonstrate the value of reforms to line agencies. He felt strongly that he could not tell other ministries to change without first reforming his own ministry.

The reforms commenced with the introduction of the value-added goods and services tax in 1993. There was opposition through public demonstrations but the reforms had solid support from the Prime Minister and the cabinet. Resistance to reform came from opponents from within who questioned the need for wholesale changes rather than fine tuning. Tuioti reflected that there were numerous internal discussions and that he had invested in developing good relations with other CEOs. This, he stressed, was a key lesson: For the reforms to be successful, they needed the cooperation of stakeholders and ongoing efforts to ensure that line ministries were engaged. A lot of time was spent with the Prime Minister and the finance minister. He encouraged the move, participated in all the discussions, and was a persuasive proponent for reform with cabinet members. Tuioti concurred that Prime Minister Tuilaepa was the driving force and that the Prime Minister encouraged staff to give the best quality technical advice.

Accompanying the economic reforms were reforms to restructure the public service: the reduction of ministries from 27 to 14 and the introduction of employment contracts for the top two layers of management. The PSC chair at the time was Fiame Naomi Mata’afa. Fiame Naomi was education minister for 15 years (three terms) and is the current women, community, and social development minister. She is one of the most senior members of Cabinet and the only female member. She is the daughter of Samoa’s first Prime Minister and was pursuing studies in New Zealand when she was recalled by her extended family to take up one of her father’s titles, Fiame from Lotofaga. Following her father’s death, her mother became member of Parliament for the constituency of Lotofaga. Subsequently, Fiame Naomi took over the reins.

As the PSC chair and education minister, Fiame Naomi drove the education reforms. Her motivation for supporting the reforms was that the country was faced with a very serious financial crisis and needed change. After the strike of 1981, there was a move toward rationalization, which continued throughout the reforms. She viewed Tofilau as a strong leader and Tuilepa as technically competent. Fiame Naomi stated that it was a partnership that drove the reforms, assisted by the executives who worked closely together in managing the crisis and who made a big push for tangible evidence of the benefits.

Implementing the public service reforms at the executive level was reform champion Faamausili Dr. Matagialofi Luaiufi, former PSC CEO, who had been handpicked by Prime Minister Tofilau Eti in 1998 to drive the public service reforms. Dr. Matagialofi considered Tofilau to be visionary in recognizing her leadership potential and entrusting her to drive the public service reforms. She had studied in the United Kingdom and was greatly influenced by Margaret Thatcher's reforms. But she was determined that the Samoan reforms would be driven from within; she believed that ownership was a strong factor in the success of the reforms. She stated that they did not take anything for granted. In her words:

The reforms proposed had to suit our culture, beliefs, and values. What made our reforms successful are cultural values and beliefs: unity, pride in Fa'a Samoa—language, identity—what defines who we are. In making presentations, we used our own language. In this way the palagis would not be able to pick our brains.

What motivated Dr. Matagialofi was being a change agent. She had been in the civil service for 23 years and found displeasure in the centralized structures and what she saw as the inefficiency of the public service and abuses of power. Having the backing of the Prime Minister and of the PSC chair, she was able to drive the reforms through. She stated that it helped that parliamentarians were supportive, as they wanted to see changes in the public service. Taking advantage of the parliamentarians' support, they conducted numerous public consultations to inform the public of the reforms.

Another reform champion identified by this study was Brenda Heather-Latu, former attorney general, who worked closely with Dr. Matagialofi and Epa Tuioti in providing support to the reforms and led the development of the necessary enabling legislative frameworks such as deregulation. She was a member of the Cabinet Steering Committee and gave day-to-day support to the executives leading the legal and regulatory aspects of the changeover. She reiterated that, politically, they had a Prime Minister who was very keen on having something better. The whole government was in a fever of reform and even though they would hit obstructions from ministers and ministries, the reform fever and political support from the Prime Minister meant they were able to push the reforms through.

Brenda Heather-Latu stated that one of her incentives was the availability of donor funding support, especially from the Australian Agency for International Development (AusAID). They were able to maximize all the opportunities provided by donors, such as having access to consultants in Canberra to assist in drafting legislation. Demonstrated benefits such as completion of airports, roads, and bridges helped. She also credits the success of the reforms to culture—their strong sense of identity. She admitted that donors who tried to roll out a template received a strong negative reaction. A lot of trouble was taken to negotiate and customize: this, she said, was the main reason for success.

### Cook Island Reforms

The Cook Islands economy enjoyed an unbroken period of growth from 1978 to 1994. Real growth in gross domestic product (GDP) averaged 12.4% over the decade 1984–1993—which must rank as one of the most outstanding periods of economic growth anywhere, and certainly in the Pacific. The growth was driven by tourism and an expanding public sector that relied heavily on aid and foreign borrowing. For many years, successive governments used public sector employment as a means of delivering political patronage and, especially on the outer islands, a form of social security. The

unsustainability of this behavior was masked by the buoyancy of the tourism industry, generous aid flows, revenues from the offshore finance industry, and borrowings (Wichman 1998).

However, the economic growth came to an abrupt halt in 1995 when real GDP declined by 3.2% after increasing by 10.6% in 1994. The economic contraction was triggered by a loss of confidence in the local Cook Islands currency, whose rapid growth had underpinned rapid government expenditure and growth in fiscal deficits and national debt. Between 1987 and 1995, the Cook Islands government issued its own currency in parallel with the New Zealand dollar. At the beginning, the local currency was backed by 100% foreign reserves holdings in a currency board arrangement. But in 1989 the foreign reserves requirement was lowered to 50% for most notes and coins and to only 5% for the CI\$3 note. As a result, there was basically no discipline over the supply of local currency (see Burdekin 2008 for a history of the operation of the Cook Islands currency board).

The accelerating currency issuance and increasing fiscal deficits led to a loss of confidence in the local currency in 1994. The two foreign banks, ANZ and Westpac, tightened credit in mid-1994 and by the end of 1994 both banks refused to convert Cook Islands dollars to New Zealand dollars. The Currency Amendment Act of 1994–1995 was passed and the New Zealand dollar was made the sole monetary unit. With the withdrawal of the Cook Islands currency, the money supply fell sharply and deflation resulted. The loss of confidence and deflation resulted in a severe decline in economic activity. The fiscal and monetary crises, and a sharply increasing national debt,<sup>3</sup> led to calls for assistance with reform.

At the beginning of March 1996, an assessment was made of the country's financial and economic situation. It became clear that the government would not be able to meet its financial commitments through the end of the fiscal year. The critical situation provided the impetus for a thorough approach to public sector reforms, development of a new economic strategy, and the cabinet's adoption of the *Path to Recovery: Reform Agenda*, the first comprehensive document outlining the government's intention for economic reform.

The *Path to Recovery* report outlined the Economic Reform Program (ERP), which included downsizing the public sector; strengthening financial and economic management; stimulating private sector growth; reforming the leading productive sectors (tourism, agriculture, and marine resources); and addressing sustainability and social equity issues.

### ***The Economic Reform Program***

The ERP involved a three-pronged strategy:

- achieving and maintaining macroeconomic stability, with a strong focus on attaining fiscal and external sector balances and reducing debt;
- ensuring structural reforms, with policies to reduce the role of government and to promote private sector-led output expansion in the key productive sectors; and
- mitigating risks, especially with respect to social risks.

To a large extent the reform design was adopted from the New Zealand model and driven by external advisers. The person who was mentioned frequently in the interviews was Lloyd Powell, a New Zealander who had reformed the Bank of New Zealand. Clearly, a commercial sector approach had been applied in New Zealand, even though the Office of the Public Service Commissioner and

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<sup>3</sup> The national debt rose from NZ\$24 million in 1990 to NZ\$245 million in mid-1996, which was equivalent to 133% of 1996–1997 GDP and to NZ\$12,285 per capita (ADB 1996).

the Office of the Prime Minister were responsible for implementing the reform program, with the assistance of the Ministry of Economic Management and Finance (MFEM) and the Office of the Solicitor General.

To support the momentum of the Cook Islands ERP—in terms of facilitating private sector growth and curbing government control—core reform legislation was passed that covered the Public Service Act, the Public Expenditure Review Committee and Audit Act, the Ministry of Finance and Economic Management Act, The Local Government (Rarotonga) Act, and The Value Added Tax and Income Tax Acts. These important acts were reviewed, revised, and passed within a span of 1 year—a monumental task (Wichman 1998).

As a result of this process, a number of radical changes took place that resulted in

- a reduction of the powers and responsibilities of the public service commissioner;
- downsizing of the public service;
- changes in the salary scale for the public service;
- hiring and firing of public servants becoming the responsibility of heads of ministries (HOMs) and CEOs;
- HOMs and CEOs receiving increased powers and becoming responsible for administering their individual agencies;
- a business orientation for government agencies;
- budgets based on service delivery and outputs; and
- a changeover from cash accounting to accrual accounting.

### *The Key Actor*

It was the view of those interviewed that the key architect of the reforms was Sir Geoffrey Henry. Sir Geoffrey had entered politics in 1972 under the reign of Sir Albert Henry and eventually took over leadership of the Cook Islands Party. Although initially he stood as an independent member of Parliament, Sir Geoffrey later joined the Cook Islands Party. Sir Geoffrey continued Sir Albert Henry's passion and drive for self-determination.

In the interview, it was clear that Sir Geoffrey Henry was driven by the absolute belief that the Cook Islands was for Cook Islanders and not an “outpost of Wellington.” His strong belief was that the Cook Islands was, in actuality, governed by Wellington. He recalled that even as recently as 1973, Cook Islanders could not mingle with the Papaas (white people). This made him more determined to change matters. The ultimate aim was for Cook Islanders to manage their own affairs in Rarotonga. He was so driven by this vision of “crystallizing their image on the international stage to be recognised as a sovereign nation and not as a province of New Zealand” that, in pursuit of this goal, he shifted his focus to foreign affairs.

He wanted a parliamentary system that had at its core Cook Islands customs and the country's own style of representation. He had love and passion for his country and saw that they were at a crossroad. Beginning to lose their language, they were becoming more New Zealand citizens and less Cook Islanders. He was intent on developing the pride of his people in themselves—the beginning of nationhood and nation building. Three factors that stand out with Sir Geoffrey are his decisiveness, his vision for the nation, and his love and passion for the country and the people.

Sir Geoffrey stated that the reform process was clear in his mind. It was an economic and fiscal necessity but he wanted Cook Islanders to participate, decide for themselves and own their decisions, and have pride in sorting out their problems by themselves. His oft-used phrase was, “the

best-governed are the least-governed.” He said, “We had successfully dismantled Wellington but were colonizing our own people in the islands. We were worse than ‘mummy government.’<sup>4</sup>

In the interview, Sir Geoffrey stated that basically he was at fault for the development of the crisis by allowing finances to drift through, leaving matters in the hands of his financial secretary, although he described himself as having no time for sloppiness. When he became Prime Minister and finance minister, he was determined to make a significant change to the pattern of administration. He was determined to break down the colonial pattern of administration.

There were four icons of colonial administration that he targeted: the treasury, the public service commission, the premier’s department, and the public works department. He set about to dismantle public works, changed the status of the treasury to be just another department and not “overlord of the country,” and did the same with PSC. All this happened during the 1996 reforms.

## 4. Success and Constraint Factors

### Leadership

Prominent in the reform perspectives described above are strong, visionary, leadership and the alignment of purpose and, in Samoa’s case, partnership between public sector leaders at political and senior civil service levels. These are clearly the key contributing factors to the success of the reforms in both countries. All the key players had common backgrounds: they were technically qualified, had studied overseas, were convinced of the need for reforms, and, in the case of Samoa, were strong in their cultural identity as Samoans. They worked as a tight team. It is also important that the reforms were internally driven by the Cook Islanders and Samoans themselves.

### Culture

References to culture were used to make the reforms more palatable—not as much in the Cook Islands as in Samoa. In Samoa, there was a successful blending of *Fa’ā Samoa* (Samoan cultural values) and the Western model of reform. Samoans are a proud people and there is a lot of pride displayed in asserting *Fa’ā Samoa*. Cabinet papers are written and parliamentary debates are conducted in the Samoan vernacular. It was reported in the interviews that, during the reform process, discussions were held in the Samoan vernacular even in the presence of non-Samoan consultants. The consultants would be asked questions in English and the discussions would revert to Samoan.

### Overcoming Resistance to the Reforms

In Samoa, the reforms were primarily resisted by civil servants, who were under the threat of job losses resulting from the reduction of ministries. Ten CEOs lost their jobs as a result of the reforms. When the HRPP government introduced the value-added goods and services tax, it was met with street protest marches. Further protest marches were held in 1997 and 1998 in efforts to oust the HRPP government. However, due to the political will and support of the cabinet and parliamentarians, the reforms were pushed through.

Redundancies were minimized by redeployment. Although there was resistance to the use of employment contracts for senior management, opening up the top two levels of CEO and assistant

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<sup>4</sup> A term used to describe expectations of government to continually provide as in the role of a mother.

CEO by putting people on 3-year performance contracts created career paths. Pay increases as high as 46% have also made public service positions more attractive.

Poor performance by government workers has hindered the implementation of reforms and development projects. The introduction of performance contracts for the top two management levels of government and a robust appraisal system were introduced to promote better civil service performance. External advertising of job vacancies made these positions more competitive and not exclusive to civil servants. Earlier in the reform process, there was an explicit strategy to recruit young graduates and New Zealand-born Samoans as part of the strategy of opening up to competition.

Most of those interviewed in the Cook Islands recalled the reforms as a very painful part of their history. They considered that the government had put national interest over families and individuals. Many had begun to resist the reforms but were threatened with removal if they did not “toe the line.”

A lot of problems were experienced. New CEOs were expected to take up their positions without training. There was confusion and conflict in the changing responsibilities of PSC and the powers devolved to the HOMs. There was devolution of services to the outer islands with the appointment of an island secretary; but, again, with no training, it broke down in the first year.

The study found that many had at first welcomed the introduction of the reforms, but then realized the problems that came with the process. The HOMs and CEOs were given substantial powers and responsibilities in terms of public resources and public funds. They could approve their own travel, approve purchases of goods and services, engage consultants, hire and fire, reward staff with bonuses, accept tenders, and so forth. The HOMs are appointed by the cabinet but have an employment contract with the Public Service Commissioner. Their performance agreement is signed with the minister. This led to conflict between contractual obligations and political patronage. There were allegations of the HOMs abusing and mismanaging public resources and recruiting employees based on nepotism rather than merit. Employees who did not follow instructions given by the HOMs, engaged in corrupt practices, or reported corrupt practices were threatened or, in most cases, were fired. Other current areas of concern are the lack of legislation, financial instructions, and guidelines, and the need to develop financial management procedures that make the HOMs accountable for their actions. For example, there are no provisions in the Finance Act that penalize the HOMs for overspending budgets or deviating from priority needs. This encourages the HOMs to do whatever they wish, as they know that they will not be held accountable for their actions. Consequently, all of these factors had a detrimental impact on the delivery of goods and services to the public.

Many people lost their jobs in the public sector. Redundancy reached 60%. A key component of the ERP involved the establishment of a transition service with ancillary projects funded through New Zealand assistance. Transition services included retraining assistance, small business advice, other private sector initiatives, and a community action program that mobilized village-level community support structures. The transition assistance measures were implemented from March 1996 to June 1997 to respond to the first round of redundancies in July 1996. However, it was reported that most Cook Islanders receiving redundancy packages did not take advantage of the transition assistance but left for New Zealand.

### **Public Consultation, Participation, and Ownership**

In Samoa, wide public consultations and an effective public relations strategy contributed to broad acceptance of the reforms. There was strong communication of the purposes and nature of the

economic reforms, specifically the formulation and dissemination of the Statement of Economic Strategy. This involved a public information campaign with the participation of the local financial community, which generally approved of the finance sector reforms and expressed satisfaction with the consultative process. Meetings were held in Samoan to explain the benefits of the reform program. Evidence of infrastructure development such as airports, roads, and bridges helped to convince the public of the benefits of the reforms.

Processes were undertaken to plan, design, and implement the reforms. There was a Cabinet Steering Committee that provided oversight and kept the cabinet well informed. The close liaison between the officials, including ensuring that supporting legislation was aligned to the reforms, worked well.

In the Cook Islands, a marked feature of the reform approach was the effort to achieve collective ownership of the reforms through national retreats. In March 1996, aware of the impending cash flow crisis, the government called together a grouping of concerned private sector and community representatives to discuss the issue. Out of that meeting came a clear signal from the community that they would cooperate in finding a solution to the economic crisis if government would consider their views and concerns in developing a reform package. This meeting heralded the beginning of annual national retreats to discuss common concerns and reconcile differences.

The first national retreat was a 3-day national “brainstorming” held at the Rarotongan Hotel in March 1996, tasked among other things to consider the speed of public service reduction and cutbacks in government expenditure. Participants included various stakeholders—businesspeople, trade unionists, traditional leaders, government officials, and representatives of the wider community. They formed working groups to generate proposals to deal with the crisis. The working group of businesspeople suggested ways of reducing government expenditure; the Cook Islands Public Service Association-led group developed an efficient public service; and a third group submitted proposals for labor market and public sector reforms.

During the retreat, it became apparent to the government that they could not afford the luxury of a 3-year period during which to cut back government expenditure. The expenditure reductions would have to be achieved within one financial year. Salaries and wages would have to be cut by over 50%, and across-the-board cuts were proposed for all government departments in the latter part of the 1995/96 financial year. As a result, the government endorsed the fast tracking of the ERP.

From this locally owned process a broad consensus was reached on actions to deal with the crisis. This process also led to the preparation of the reform document *Path to Recovery: The Reform Agenda*.

In the interview, Sir Geoffrey made reference to the retreat:

We envisaged the creation of a national development council with representatives from the private sector, businesses, Ariki, sub-chiefs, and NGOs [nongovernment organizations]. This was an open budget process. In the past, the budget was a secret; no one knew until budget night. At the retreat, we all looked at it, tore it apart before the formal budget document went to Cabinet. It became clear to me that we had for some time been following the New Zealand process. So what we actually did was talanoa,<sup>5</sup> consulted, sought differences, shared our common vision, and shared the journey. In undertaking reforms, it is always important to go to the people—the ones feeling the pain to speak up.

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<sup>5</sup> A Polynesian term for telling stories and exchanging ideas in a nonconfrontational setting.

In 1997, the government, acting on community recommendations, set up the National Development Council, which comprised representatives from the broad spectrum of society. Among other policy and advisory responsibilities, it became a prime concern of this body to oversee the annual budget appropriations to the various ministries. In effect, this action affirmed the government's commitment to better transparency and accountability in managing national affairs.

The main benefit of these opportunities for broader community consultation has been the increased social contact between government and the community on affairs of the state.

### **Contributions of Nongovernment Organizations and Civil Society**

NGOs in Samoa operate under SUNGO—the Samoan Umbrella of NGOs. There is general agreement on the importance of a well-led and fully empowered umbrella organization and SUNGO has earned recognition as a strong, vibrant organization providing excellent leadership, resources, and essential human resource development and training for all NGOs. SUNGO's efforts have been recognized for increasing NGO accountability and record keeping and enabling access to essential funding from donors including AusAID, the European Union (EU), Japan, New Zealand Aid Programme (NZAID), and many other international institutions and NGOs. For example, SUNGO has been actively involved with Oxfam in advising the government on the country's continuing World Trade Organization (WTO) accession, as well as the Economic Partnership Agreement negotiations with the EU.

While NGOs contribute to shaping strategies adopted by the government, SUNGO feels that although there has been a greater attempt by the government to consult with NGOs, it is largely to rubber-stamp what the government has already decided (Fa'atavaa-Vavatau 2009).

As the process of government reform continues and ministries implement their mandates around policy and planning activities, partnerships are being formalized with nongovernment implementation agencies. NZAID's provision of institutional strengthening and financial management programs for NGOs provides a sound foundation for these partnerships, as does the government's review of funding arrangements and its consideration of establishing a pooled fund of donor contributions for NGOs.

The downsizing of the Cook Islands public service led to an increased role for service providers in the private and community sectors. For instance, NGOs such as the Red Cross, Child Welfare, National Council of Women, and the Punanga Tauturu (a women's counseling and refuge center) stepped in to offer key services and programs that once were the responsibility of government ministries. The National Council of Women worked alongside the Women's Division to implement the National Policy for Women on the outer islands and in the three main villages on Rarotonga. The Child Welfare organization supported and managed the public health arm of community clinics for mothers and babies in villages and islands. The Red Cross and other health-related NGOs conducted health training workshops throughout the country.

The Cook Islands Association of Non-Government Organisations is not functioning effectively; it has little recognition and funding support from government and donors.

### **Potential Sources of Instability**

The study found that the HRPP's hold on power in Samoa since 1985 is leading to some disquiet. There is a view that the government has been in power for too long and does what it wants. The recent road switch is a classic example: despite strong opposition from the public and the business community, the government is said to have railroaded it through. Only time will tell whether the

HRPP is able to withstand such opposition, as it has over the past 18 years. The recent formation of the PASS movement and the new political parties reflect mounting public opposition and it will be interesting to see how this will be manifested in the 2011 elections.

Another potentially explosive issue that has raised opposition, especially from NGOs, is the land lease project, which is exploring options for the leasing of land, including customary land. A strong view expressed, upon which opposition is based, is that land will be lost to big businesses. Although there have been public consultations, it is hard to persuade villagers to give up their land for investment and there is growing opposition to land registration.

This study found the shared view that there are aspects of the financial reforms that have neither been fully undertaken nor completed, such as the privatization of state-owned enterprises and complete decentralization of the authority exercised by the Ministry of Finance and Treasury. In particular, CEOs in the line ministries have not been given the full financial delegation promised.

There are questions of whether the benefits of the reforms have trickled down to the villages and communities. Some of those interviewed argued that a social impact assessment study is warranted to gauge this. The institutional strengthening of the Ministry of Women, Community and Social Development is intended to roll out capacity strengthening activities to the village councils in support of the reforms. This will be an interesting development to watch.

## 5. Looking Forward

### Samoan Outlook

Samoa continues to enjoy political stability and demonstrate an ongoing commitment to good economic management. Given the positive results from its reform program, Samoa appears to have laid much of the groundwork for continued good economic performance. The challenge is to build on its achievements to enhance the environment for private sector-led growth.

A review of the private sector development issues in Samoa (Holden and Darcy 2007) concluded that most of the macroeconomic reforms are complete and the key issues identified to be addressed for further growth are as follows:

- Expand private sector participation to promote growth and reduce the role of the state, which still plays too large a role in the economy and raises the cost of doing business.
- Strengthen property ownership within the land leasing framework, which affects large areas of the economy, particularly finance, agriculture, and tourism.
- Simplify procedures for foreign investors; introduce a new Arbitration Act that provides for low-cost enforceability of foreign arbitral awards; reduce barriers to employing skilled foreign workers, who bring vital knowledge into the economy; make land leases easily available to foreign investors; eliminate investment incentives; and compete for foreign direct investment by making Samoa a low-cost country in which to do business.
- Continue with extensive consultations and expand formal discourse between the government and the private sector.

Ongoing reforms are included in the framework for economic and social development outlined in the Strategy for the Development of Samoa 2008–2012. The strategy identifies seven key development priorities: (i) sustained macroeconomic stability; (ii) private sector-led economic growth and employment creation; (iii) improved education outcomes; (iv) improved health

outcomes; (v) community development, including improved village governance; (vi) improved public sector governance; and (vii) environmental sustainability and disaster risk reduction.

### Cook Islands Outlook

While there were positive results from its earlier reform program, the economic outlook indicates that the Cook Islands will be struggling to maintain its good performance. Its narrow economic base (underpinned by tourism and marine resources) makes it vulnerable to external shocks, including the global economic crisis. Many still question the value of the economic reform program with respect to delivery of services, especially to the outer islands. Depopulation continues as a major problem, with Cook Islanders continuing to leave for abroad, especially to New Zealand. The government now faces the challenge of building on its achievements to enhance the environment for private sector-led growth. In August 2009, Standard and Poor's downgraded its outlook for the Cook Islands from stable to negative due to uncertainty about prospective tourism numbers and the country's increased debt exposure.

As in Samoa, the study found that there are questions as to whether the benefits of the reforms have been fully realized and trickled down to the outer islands and to local communities. A number of study participants advocated for a social impact assessment study to determine this.

The people on the outer islands lead a largely subsistence lifestyle and outer islands development is a priority for the current government. Economic growth is restrained by the geographic isolation and dispersion of small population centers among many remote islands. The distance from markets and high transport costs restrict export activity.

The National Sustainable Development Plan (2007–2010) set out to achieve the 15-year visionary framework called Living the Cook Islands Vision: A 2020 Challenge. The plan sets out the national vision and identifies strategic outcomes and priority goals for implementation. The plan recognizes the importance of private sector-led economic growth to meet the government's goal of economic growth averaging at least 3.5% per year over the medium and long term to double GDP (to NZ\$600 million) by 2020. It is recognized that the economy is based only on a few industries and is highly susceptible to external forces. The Cook Islands has limited scope to expand or diversify its economic base, although there may be potential for deep-sea mining of manganese nodules. At the time of the field study, a public presentation was held by Ministry of Finance and Economic Management with Commonwealth Secretariat legal advisers commenting on the resource management implications of this resource.

## 6. Conclusions: Lessons Learned

The important lessons drawn from this study are as follows:

### *Reforms are championed by determined and visionary leaders*

In both the Cook Islands and Samoa, strong political leadership saw the reforms through. Additionally, continuity in leadership is crucial for an enabling reform environment. The chances of successful implementation are increased in a stable political environment in which the champions of reform can remain focused and do not have to risk jeopardizing the aims of reform to retain power. Shared leadership is also important. There must be political will for the reform policies and, equally important, they must be supported by technically competent and professionally qualified executives

and managers who can drive the reforms from the top down and operationalize them through the machinery of the government, as was the case in Samoa.

#### *Local ownership is vital for successfully implementing reforms*

In the Cook Islands, the process was locally owned through sustained dialogue with multiple stakeholder groups. Shared responsibility for the reforms was achieved through participatory public consultations and national retreats. The national retreats brought stakeholders together to determine the implementation of the reforms. In Samoa, culture was the foundation for sustaining reforms. Samoa developed its own model of development in which they have been able to package reform with a strong and proud Samoan identity. In both countries the sense of self-determination and taking ownership of their development featured prominently.

#### *The "big bang" versus the phased approach*

While both countries achieved improved economic growth as a result of the reforms, there were two distinct approaches. Samoa followed the Australian model of sequencing and pacing public sector reforms in a phased rightsizing approach with minimal redundancies, while the Cook Islands followed New Zealand's "big bang" radical downsizing approach that halved the public service virtually overnight, leading to mass emigration, an exodus of skills, and continued depopulation, primarily due to New Zealand citizenship.

#### *Size matters*

The design of reform programs needs to pay more attention to the consequences of small size and the unique features of each country's economic and social structures. It should also be aware of the diverse views and experiences in the area of public sector management and assess their relevance for small states.

#### *Civil society has an essential role in economic reforms*

The study found that civil society has an essential role to play in sustaining reforms, particularly in advocating and meeting community needs. This is especially true at the village and community levels where the state and the business sector are limited in their reach. Reform should not be the exclusive domain of the state but rather a shared and collective responsibility, as was effectively mobilized in the case of the Cook Islands.

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# 6 Presidential Perspectives on Political Economy in Micronesia

by *Giff Johnson and Ben Graham*

## ABSTRACT

In this landmark study, five former presidents of three Micronesian countries—the Republic of the Marshall Islands, the Federated States of Micronesia, and the Republic of Palau—were interviewed to gain an appreciation of their insights into the political economy of these states and their experiences with attempts to implement economic reforms. The former presidents stressed that reform proponents need to be cognizant of the pervasive and long-standing “welfare state” attitudes developed over many years of the United States’ (US) Compact aid and the way in which these attitudes shape perceptions about the role of government and the direction of national development. Because the challenges to reform and economic development in Micronesia are so significant, development partners should consider the need for longer horizons on reform and development projects. Coupled with this, consultative processes are extremely important throughout all stages of the reform process, from initial planning and design of reforms through to implementation and evaluation. Congruence and alignment in understanding and expectations among the key stakeholder groups can help facilitate reforms and change.

## 1. Study Background, the Presidents, and the Countries<sup>1</sup>

The political economy landscapes of the three Micronesian states of the Republic of the Marshall Islands, the Federated States of Micronesia (FSM), and the Republic of Palau are relatively unmapped. Navigating this unfamiliar territory has frustrated and challenged a number of reform efforts (and their proponents) over the past 2 decades. The aim of this analysis is to explore and chart out the key political economy issues in Micronesia and to address the important question—how does the political economy of Micronesia impact on its economic growth and development?

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<sup>1</sup> Country background information from the Asian Development Bank (ADB) website’s ([www.adb.org](http://www.adb.org)) country information pages.

To help answer this question, the authors took the unusual approach of documenting the opinions and experiences of five former Micronesian presidents. Having served as the chief executives and heads of state of their countries, the presidents are in the special position of being able to provide detailed insights into the political economy of change in their societies. The authors conducted structured interviews, guided by a set interview questionnaire.

The five presidents interviewed were

- The Honorable Joseph J. Urusemal, the FSM's sixth president from 2003 to 2007;
- The Honorable John R. Hagelgam, the FSM's second president from 1987 to 1991;
- The Honorable Tommy E. Remengesau, Jr., Palau's sixth president from 2001 to 2009;
- The Honorable Imata Kabua, the Marshall Islands' second president from 1997 to 2000; and
- The Honorable Kessai H. Note, the Marshall Islands' third president from 2000 to 2008.

Palau is located in the Western Pacific on the western end of the Caroline Archipelago, about 900 kilometers (km) east of the Philippines. Situated in the Micronesian group of islands, the Caroline chain consists of six island groups totaling more than 300 islands. The islands vary geologically from the high mountainous main island of Babeldaob to low coral islands usually fringed by large barrier reefs. Only nine of the islands are inhabited. Babeldaob is the largest island and accounts for 78% of the country's total land area of 458 square kilometers (km<sup>2</sup>). A bridge links Babeldaob to the capital, Koror. Koror is the largest urban area in Palau and home to more than 70% of the population of 19,000.

The FSM is a grouping of 607 small islands in the Western Pacific, about 4,023 km southwest of Hawaii, and lying just above the equator. Generally speaking, the FSM comprises what is known as the Eastern and Western Caroline Islands. While the country's total land area amounts to only 701.4 km<sup>2</sup>, it occupies more than 2.5 million km<sup>2</sup> of the Pacific Ocean. The FSM's 107,008 people inhabit its confederation of four states—Chuuk, Kosrae, Pohnpei, and Yap. Each of the four states centers around one or more "high islands," and all but Kosrae include numerous atolls. Each state has its own government, language(s), culture, and identity.

The Marshall Islands is located in the central Pacific Ocean, some 5,960 kilometers southwest of Hawaii. It is composed of two nearly parallel chains of low coral limestone and sand islands known as the Ratak (sunrise) group and the Ralik (sunset) group. There are 1,152 small islands and 30 atolls in all, dispersed over an exclusive economic zone of 1.2 million km<sup>2</sup> of ocean. The total land area is only 181 km<sup>2</sup>, but 70% of its 57,000 population of ethnic Micronesians is concentrated on the atolls of Majuro and Ebeye. The remainder lives on 19 outer islands, with most having fewer than 500 residents.

## 2. Introduction: Setting the Stage

Pervasive and long-standing "welfare state" attitudes are a challenge that shapes voter perceptions about the role of government and national development, and influences the decision making of leaders in the US-affiliated members of the Pacific Freely Associated States (FAS): the Marshall Islands, the FSM, and Palau. These attitudes developed as an outgrowth of World War II and US military largesse, and were heightened by US government development policies in the 1960s and 1970s. Thirty years after the three island nations achieved self-governing status, the attitudes persist—supported by highly aid-dependent economies. In the three countries, US funding accounts for a majority of the government's budgetary support. In the Marshall Islands, for example, US

grants, federal programs, rental payments for use of the Kwajalein missile range, and contributions to a trust fund account for nearly two-thirds of the fiscal year (FY) 2010 budget. All donor aid (including funding by the European Union [EU] and Taipei, China) accounts for 75% of the FY2010 national budget.

In the FSM, policies encouraging a dependency mentality are not uniform: while some islands provide health care virtually free, Yap, for example, charges a \$60 per day inpatient fee. In the Marshall Islands, a majority of government services—shipping, health care, electricity, and water, to name a few—are heavily subsidized.

One of the presidents commented: “A welfare state... became an institutional expectation... We’ve been stuck with all these freebees for a long time. The problem today is twofold: (i) lack of resources and money [to sustain the subsidies]; and (ii) it is hard to eliminate those freebees—even though they may be able to live without them, people now seem to expect them. That’s the transformation that needs to take place.”

Another president said, “Many people do think that resources are unlimited,” and added that government-appropriated discretionary funds “help fuel the cycle of patronage.” But dependence on government may also be exacerbated by unfounded perceptions of elected leaders. The president observed, “Sometimes politicians think people need something when they actually don’t.” A third president cited “nepotism” as a problem throughout government.

Still, all five presidents recognized the need for change. “People know we have to change and to provide more for ourselves... How fast we can do it, that’s the challenge.” Another president commented, “It’s up to us to change.”

The presidents agree that despite stated goals to promote development and economic self-sufficiency, the Compact of Free Association (COFA) with the US is having a limited impact on economic development. Primary concerns are the lack of capital in the compact for private sector development and the unsustainable spending on education and health care. A significant challenge facing the local private sector in its attempts to develop or expand is access to capital. In Compact I, there was funding specifically designated for private sector development that was channeled through development banks, but at the time there was little local expertise and capacity to guide economic development. The record of the first compact shows few results from the development capital injected into the economy. Nevertheless, during Compact I, from 1986–2003, many FAS citizens went to college in the US or gained employment, expanding their knowledge and experience. Now that capacity levels have increased in FAS populations, there is no development funding available in Compact II for the private sector to access.

One president believes that his nation is worse off in 2009 than it was before donor-supported reform programs were launched in the 1990s. Another believes that elected representatives need to be held more accountable for their election promises. “That’s the reform I’d like to see: people held accountable for what they promised or said they’d do. At some point, some kind of review process.” The independent media is also essential in this process. “This is where the media is very important. We have free access to the media to criticize and grade people,” the president said.

Another president said dwelling on the past is not productive. “Yes, we can reform,” he said. “We can’t blame anyone else or expect others to do it for us.” But he made an important point about using consultants and advisors: “We can bring in outsiders to help us, but we can’t let them be ‘boss’ in our own country.” Commenting on fragmentation among leadership in his country, the president said, “Those who know—traditional leaders, religious leaders—they should speak up about the need

for improvements. Stronger cooperation between government, traditional, and religious leaders will help.”

The issue of local ownership of change at the grassroots level cannot be neglected. One president pointed out that reform programs require public understanding and that the public must be convinced that change is required.

In past reform projects, the objectives of the reforms sometimes conflicted with objectives of other donor-supported projects or with the goals of the national government. For example, a reform program in the late 1990s focused on cutting about 30% of the government workforce in one FAS country to reduce the payroll burden in line with decreasing aid from the US. But this was at odds with the government’s focus on the education and health sectors. So while reduction-in-force targets of the reform program were reached within a year, the number of government employees was increasing in these two ministries to meet shortcomings in service delivery. “In lieu of the \$10 million public sector reform program, wouldn’t it be better to put in a cannery that could employ 600 people?” the president asked. “Now we’re stuck with \$10 million in loan payments... Most businesses want government involved, to provide security for establishing themselves. This is the role the government should have played.”

An important question is, who drives development and reform-project decision making? Because donors have their own aid priorities, they frequently make the decisions about specific amounts of money to provide to each nation, timetables, and deadlines for implementation. The effectiveness and sustainability of development projects can be jeopardized by a range of factors, including donors accepting a country’s “yes” at face value, a lack of understanding of subtleties of the local sociopolitical environment, and misinterpretation of the expectations and needs of aid recipients.

The lack of ownership of projects at the implementing and receiving end often dooms them to failure or, at best, to modest and unsustainable results. Two presidents expressed concern about short-term (3–4 year) development projects that provide funding for government staff to implement the work, but leave the FAS government stuck with a personnel bill at the end of the project because those staff must be rolled onto the government’s payroll when the project period ends.

“There is a problem with short-term grants,” said one president. “A 3- to 4-year grant is accepted and implemented. When it ends, we can’t just lay off the people hired under the grant. While the grant is here, it is helpful. But then we are stuck with the bill [to hire staff onto the government’s payroll].”

Parity between FAS nations and donors is another issue. One president believes the COFA—a bilateral treaty underpinning the relationship between the US and the three FAS member states—encourages dependence, despite its stated objective to increase self-reliance. This, he said, is the result of inequality in the relationship. “The compact promotes dependence,” he said. He continued that while the compact establishes the relationship, it “is not an equal relationship; one is higher than the other,” and so there is a built-in dependence in the pact.

The same president raised concerns about the focus of development projects and government priorities. Although there is often talk about assisting development of remote outer islands, budgets and donor aid rarely address development needs in “rural” islands where a high degree of self-reliance still exists. Projects that are aimed at outer islands sometimes deliver infrastructure that is not sustainable or adequately thought out. “A good example of that is fishery ice plants,” said another president. “They put up infrastructure in some of the villages, but in some there

are only two or three fishermen, so the ice plant ends up being used for social functions rather than for the primary purpose of fishing.”

Development work in the FAS tends to neglect outer island populations, agriculture, and young people—who account for disproportionately large segments of the FAS populations. “We need to prioritize outer island development, agriculture, and development projects that raise our self-reliance,” said one president. “We need to also focus on our youth and their challenges with youth-targeted projects. There’s a lot of neglect.” He pointed out that on one island, “I see young children playing by themselves near the road, and sometimes vehicles come along and hit them because no one is watching for them.”

The “Compact Road” in Palau—an 85 km road around Babeldaob, Palau’s largest island—was identified as a major factor for the future development of the country. “Look at the \$150 million Compact Road from the United States,” said one president. “Who can argue what the impact of this is going to be?” Other important infrastructure work includes a fisheries dock, power plants, and roads. “No question they are a critical part of our progress,” said the president. The type of aid provided by Taipei, China is significantly more beneficial than that provided by the People’s Republic of China (PRC), said two of the presidents. Taipei, China provides funding for agriculture and fisheries development involving local farmers and fishermen, and provides grants to the national government for construction projects using local construction companies. In contrast, aid from the PRC is mostly in the form of low-interest loans or construction work accomplished entirely by PRC firms, labor, and supplies, to the virtual exclusion of any local benefit of the aid other than the final product.

### 3. Hindsight and Insights: Reflections on Past Reforms

#### **The Reasons and Incentives for Reform**

Reforms in all three nations were largely in response to fiscal pressures. In the Marshall Islands and the FSM, reforms were undertaken to adjust to imminent and significant downturns in compact funding during the compact’s second funding step-down in FY1997. “We knew we had to reform, there was no choice,” said one president. Another explained, “The incentives? It was clear that if no reforms were made, the government couldn’t afford to support the same number of posts, due to the step-down on the horizon. There was uncertainty on the horizon, and concerns that the compact would end, so reforms made the adjustments less painful.”

#### **The Relevance and Overall Success of Past Reforms**

The presidents had mixed feelings about the overall relevance and success of past reform efforts, in particular the major public sector reform programs that took place in the Marshall Islands and the FSM in the late 1990s and early 2000s. While the immediate objective of fiscal adjustment, achieved mostly through expenditure reductions, was met in the Marshall Islands and the FSM, the presidents believed that there was less success in other areas, and also that some of the reform objectives did not fully capture other necessary important reform requirements—such as raising civil service productivity and improving state-owned enterprises. As one president stated, “I think [the reforms were] generally successful. Under the reduction-in-force [program] we did a good job in reducing employees and wage costs, but the transition from public sector to the private sector for some was less successful, especially the efforts of government to help individuals during their transition to establish good businesses. Some started businesses but most didn’t succeed.”

Another president pointed to political self-interest as having been a problem. “This [the Public Sector Reform Program] was a real chance for us to introduce major reforms. But some politicians used the reforms as a means to grant favors, for example, the Early Retirement Program. This was used politically... The opportunity for major reforms was lost due to political self-interest.”

A third president acknowledged that while the immediate goal of the reform programs was to reduce spending, there were other goals that were not met. “The purpose for the loan was accepted: the aim was to bring down the payroll and the number working in government... [But] the Public Sector Reform Program did not support other goals of the government.”

### **The Effects and Effectiveness of Reduction-in-Force Actions**

Reduction-in-force (RIF) actions had significant social, economic, and political impacts and were considered the most sensitive and painful component of the reforms. One president felt that reducing wages may have been a more useful way to reduce expenditures, versus cutting jobs outright. “I think the RIF exercises were not an easy thing. It would be easier to reduce salaries. At least the person has some level of income that he can use to sustain his family, versus losing his job altogether. What about their loans? Their store credits?” The reforms and RIF actions “resulted in some politicians being voted out of office,” according to one president.

Social and cultural factors may not have been considered sufficiently in reform and RIF timetables. This was particularly so in the RMI [Republic of Marshall Islands], as explained by one president: “Many factors affected the reform program, including Marshallese culture. When we design a program [of reform], it takes time. It may take longer to do, but if it’s bringing change, it needs to be step-by-step. If we have to lay off people, then do it slowly. Otherwise, people will become rebellious. There is not much of an economic safety net in the RMI. There is no welfare or unemployment system here. If you lose your job, that’s the end of the road. This is why we saw big out-migration to the United States when people got their RIF money in 1999 and again when the big Nuclear Claims Tribunal payment was made in 2001.”

### **Resisting Reforms**

Resistance to reforms came from a range of sources, with some outside of government expressing skepticism over the fiscal adjustment component of the reforms being only a temporary solution. “There was major resistance, but we had to do it!” said one president. Another stated, “Many people expressed concerns about the reforms being a short-term fix.” Elected officials who felt that their political careers would be jeopardized also resisted reforms; for many, the reforms, especially the RIF, were seen as “political suicide.” Some civil servants also resisted reforms, with one president explaining, “The public service is very slow moving. You can feel resistance to change... The parliamentary system of government contributes to it. The ministers are only there for a short time, Secretaries are there forever [so they may feel they do not need to implement policy changes they disagree with as the ministers may not be there long enough to oversee the change].”

### **Consultations Helped Overcome Some Resistance**

Despite the resistance, there was a general consensus, especially in the Marshall Islands and the FSM, that reforms were unavoidable. Nevertheless, public consultations helped overcome some anxiety and resistance. “Good programs are not always popular,” said one president. “You have to sell it to the public and seek public understanding.” Another president added that public hearings are an effective medium to explain why difficult decisions have to be made.

However, there were mixed feelings on the extent and effectiveness of public consultations leading up to the reforms, with one president stating that the consultative process in his country was insufficient, both for the general public and within the government itself.

### **Congruence in Understanding and Expectations Helped**

Where there was congruence in understanding and expectations between leaders and the public, reforms seemed to have progressed more smoothly. This was the case even with smaller reform efforts versus larger structural reform exercises, such as ongoing efficiency-raising reforms that Palau undertook. “We and the people knew that to increase efficiency in government, some of these policies needed to be in place. So it was a popular thing for us to sell. When we introduced it, we told the people, explained it to the ministers and directors, and people were basically on board and the more they knew about it, the more excited they were.”

Common road maps helped align expectations. In the Marshall Islands and the FSM, national summits helped align expectations, and in Palau this was brought about by the adoption of a management action plan. “That was the Bible for each of the ministries in government. They saw this performance budget as a tool to address the [action plan] goals. Everything was synchronized toward the objective. It made acceptance easier.”

But at the same time, despite widespread acknowledgment of the need for reform, there were those who supported reforms so long as they (themselves) were not directly affected. One president elaborated on this sentiment, found among some in the public and in government: “It was good as long as the change didn’t affect me, as long as you don’t lay off my relative.”

### **Economic Summits, Task Forces, and Effective Technical Advisors were Key**

In all three Micronesian states, economic and social summits and other forms of public consultation were particularly helpful in gathering public input and participation. “The summits helped, along with the leadership meetings [at the state and national levels], in getting the public involved as much as possible, even in the remote islands, and educating citizens on the need to review progress and readjusting.”

Some presidents saw the summits as opportunities to reaffirm their own thoughts on reforms and priorities. As one explained, “The National Economic and Social Summits were important politically... These reaffirmed what I already knew concerning the priorities for education, health, outer islands services, infrastructure, etc. I already knew what was needed, but I wanted people to say it. Through National Economic and Social Summits, people felt part of the process and contributed ideas, different experiences.” Public consultations were especially important in areas where media coverage was not very strong, especially in the FSM. “Consultations continue to be very important, especially in the FSM where an independent media is not readily accessible. The FSM lacks media to cover issues, so summits and consultations are important.”

In Palau, task forces were used to address issues and come up with policy recommendations. These task forces, which included traditional chiefs and representatives from the private sector, were an effective way to ensure that government leaders considered the community’s views. “We used a lot of task forces to make the idea be felt like a community idea, that it didn’t just come from the president or a minister. People know about it. The task force membership was the very important to getting these kinds of reforms off the ground... When people got together, they echoed the same problems and solutions and so it was easier to tie those expectations to the initiatives.”

Technical advisors were used to help plan and implement reforms, although the experience with these advisors varied widely across the islands—with the FSM and Palau presidents generally more satisfied with the performance of their reform advisors compared with the Marshall Islands presidents. As one president described the performance of one of his country's chief reform advisors who was based in-country, “[He] was one of the reasons why the Public Sector Reform Program worked. [He] put it straight to you. [His] knowledge of the area and what needed to be done. This won the support of several key leaders in government.” Another president added, “[The technical advisory team] was successful in showing the leaders the impacts if nothing was done.”

### **The Reemergence and Underlying Causes of Fiscal Instability**

Expenditure and financial management reforms in all three nations helped stabilize fiscal systems; but pressures to expand spending have been strong and fiscal stability has reemerged as a key political economy challenge. Two presidents were fairly bleak in their assessments of current spending patterns in their countries. “There was money saved by the RIF (reduction-in-force), but some of it was rechannelled,” said one president. “For example, to the entertainment/representation funds for [the legislature]... In an economy like this, this is berserk! We’re worse off than before. Spending is completely out of hand.” Another added, “We are not frugal. We spend a lot on travel and parties.”

The presidents pointed to several underlying factors that have led to the reemergence of instability. “Economic conditions, the need to find work for our people, especially our younger generation,” said one president, “these are factors. It’s difficult to find jobs in the private sector. The challenge... is to strike a balance between the need to find work for our people and the sustainability of government to find funding for positions. This is a very difficult challenge, as there is pressure to provide jobs.” Another president added, “We need to determine our immediate wants versus our needs... It’s hard for presidents to be frugal because they think that doing so will lower their status or title... A lot of presidents can’t do this because they think it will make them look less presidential.”

But even where economic and private sector growth has been seen, there is still pressure for fiscal expansion. “We’ve certainly grown, from \$12 million local revenue in 1998 to \$40 million in 2008,” said one president. “However, the rate of growth has not been commensurate with the operations cost of the government. It’s just enough for salaries. Who takes care of the roads, power plant, health, scholarships for our students to go to school?”

### **The Sustainability of the Reforms**

The general feeling among the presidents was that the reforms had limited sustainability, especially with the fiscal pressures that have reemerged. As one president put it, “Now, we’ve resorted back to past practices. The reforms did not have a lasting impact.” But as another president noted, while re-expanding spending was not consistent with the reform objectives, this re-expansion was justified, at least in some areas. “To achieve our goals in education and health we had to add people and resources... When Compact II was implemented, we needed more people in the Ministry of Finance to meet reporting requirements. Finance is now the third largest ministry... These needs conflicted with the Public Sector Reform Program goals. The goals were contradictory: how can we provide better services without bringing more people in to provide the services?”

## 4. Contemporary Political Economy Dynamics in Micronesia

### Collective Choice and Decision Making When Good Economics Is Bad Politics

Political leaders often face conflicting situations wherein “good” economic decisions are not necessarily “good” political decisions. The presidents considered this to be a fundamental political economy challenge.

“This is a very difficult issue,” said one president. “I’ll use the social security program as an example... This decision [to reform the program] was made on a fiscal and economic basis. We have a \$200 million unfunded liability. Only 16% of our liability is funded. We’ve had 2 years of public hearings on this. There’s strong pressure... with people demanding that Congress should put money into social security. So this is an economic need, but it’s political suicide.”

Sometimes, as one president illustrated, culture and people’s expectations often exacerbate this political–economic conflict. “On the islands there is always going to be conflict of culture and reality, culture versus efficiency. Because culture is a broad way to describe how things can be done inefficiently. The culture requires when you have an occasion, there must be plenty of food—even if the food is going to be wasted and fed to the dogs; that is a successful function. If you have a function and people only eat coffee and donuts, or ramen, or there is less fish and taro, that is not a successful function... This conflicts with the idea of government efficiency.”

“Even when cabinet makes good economic decisions, culturally and politically it is a problem,” said another president.

Reaching collective choice and gaining public support on an issue that makes good economic sense on one hand, but may have negative political consequences on the other, requires a range of approaches, including proactive consultations, perseverance, and sometimes plain, hard-nosed negotiation. Efforts must also be made to correct and clarify any misinformation about an issue or a decision, as this is often a key deterrent to reaching collective choice and gaining public understanding and support. The presidents elaborated on these points:

“Good programs are not always popular. You have to sell it to the public and seek public understanding.”

“You need to educate the public to be able to accept [hard choices] because it’s for the good interest of everyone in the long run.”

“When it comes to difficult political decisions, public hearings should be held so that people can understand the challenges and why tough decisions have to be taken.”

“When we make decisions, we think what is important for the country as a whole. These decisions may not be very popular with the public and grassroots level. But the cabinet thinks they are important. Sometimes cabinet does something that is unpopular and gets criticized. But people don’t understand—often because of misinformation, which is rampant [here]...”

“More negotiations and dialogue among leaders is needed. Congress must stand strong.”

In one president’s view, however, doing all of these things may not be enough. Structural arrangements in his country’s Constitution lead to perennial political–economic dilemmas. “Whatever you do, you have to face the consequences. We need fundamental changes in government, including the Constitution... If we change the government system, we won’t have to sit in Parliament and be grilled like we’re in court. Fundamental changes to government will make it easier to implement change and development without the parliamentary system.”

### Some Constraints to Collective Choice

Leaders often struggle to reach a collective decision on an issue, especially when it is a politically sensitive issue like reforms. This was best described in an example from one of the presidents concerning one island: “Nobody wants to take a leading role. Everyone is afraid of not getting reelected, so nobody does anything. There’s a clientelistic system... where voters are the clients [and dictate what politicians do]. Families demand goods and favors from politicians.”

Another president cited too much bureaucracy, which, in his opinion, diluted the decision-making process and created delays. “It’s a ‘duplicity’ situation. The states are a mini-federal government. In hindsight, we just bureaucratized ourselves.”

A third president took the opposite view, stating that leaders outside of the executive branch and cabinet were too weak and accepted whatever collective decisions cabinet made. “There are some local government leaders, and even some traditional leaders, who are too subservient to the cabinet. There may be too much concentration of authority in cabinet.”

### The Most Powerful Influence Groups in Micronesia

Election outcomes and government decisions and policies, including those regarding development, are influenced by a range of groups across the islands of Micronesia. “It differs by state,” explained one president.

The most powerful sources of influence today, according to the presidents, include traditional leaders (who are especially powerful in places such as the Marshall Islands, Palau, Pohnpei, and Yap); religious leaders (in most islands, but especially in Kosrae); landowners (again in most islands; in some cases traditional leaders and landowners are one and the same, but in some cases they are distinct groups); business owners; and wealthy individuals or families (who sometimes also belong to one of these other groupings, such as business owners). In several islands, a growing number of individuals from these different power groups are entering the political arena.

In the Marshall Islands, religious groups and wealthy individuals and families (both local and nonlocal), appear to be gaining influence. “Church leaders and people with money are really influencing politicians and politics in the Marshall Islands today,” said one president. Moreover, many also suspect that outside political interests are gaining influence (or at least attempting to) by various means.

Nongovernment organizations (NGOs) and community groups are increasing their voice in public matters, but they remain lower on the influence scale relative to these other groups.

### Influence Group Dynamics

In some islands, there is strong competition between and among various influence groups and many people see the lack of collaborative leadership as a major constraint to development (see Box 6.1 for a description of nongovernment activities in Micronesia). As one president described the situation on one island: “There are several centers of power. But when one rises, the others try to knock it down.” Another president described the rivalries between churches: “Religions are influential, but they need to work together more. I like to use the example of the cooperation that went on between Father Hacker [a Jesuit priest] and Mother Wilson [a Protestant missionary]). That was a great example of religious leaders working together for the common good. Today, the religions are not working together.”

### Box 6.1: The Role of Nongovernment Organizations

Whereas civil society groups or nongovernment organizations (NGOs) may not yet wield as much influence over political and economic affairs as do other groups, their voices are growing across most of Micronesia. “NGOs are increasing their influence in several different areas, including conservation efforts,” explained one president. In several islands, political leaders have sometimes considered NGOs to be a threat (including in the Marshall Islands where one outspoken Parliament member actually advocated the idea of the government itself establishing an NGO so as to capture some of the new donor funding streams that are bypassing government and flowing directly to NGOs).

One president described the situation in his country. “Everyone seems to see NGOs as a threat to government advancement. From day one, we recognized that NGOs could actually do some of the work that the government is required to do and if they become a partner, it’s a win-win for everyone. If they become involved, they pursue an area of their concern, while we will be saving money that our [Environmental Protection Agency] or our conservation officers would be doing. The key word here is partnership.”

Partnerships and cooperation between NGOs and government are also on the rise. For example, one president described a partnership that led to conservation of a valuable resource, Jellyfish Bay, in Palau. “NGOs were the ones to say at Jellyfish Bay there is too much traffic. It was detrimental to the natural habitat. So for \$20,000 a floating dock and office was set up to monitor who is coming in. But the government didn’t have \$20,000. So we said, you do what is needed to be done. They spent their money to do the dock. We admitted that ‘yes, you are right. We needed to do something.’ Compare that to the past, we’d just say ‘no,’ and nothing gets done—government didn’t have money.”

In the Marshall Islands, the rise of organized women’s groups has had a profound impact. “They have a lot of influence when encouraging the national government to take steps, demanding [the] RMI [Republic of Marshall Islands] comply with international conventions on women, health, children, poverty, etc. NGOs play a very important role and provide services with government funding. They are not just demanding change, but providing services to local communities. We should encourage this.”

Most presidents were strong advocates for the growth of NGOs as part of the overall development process. “I support NGOs 100 percent... I have supported NGOs not only through government, but personally, out of my own pocket.”

Source: Authors' discussions with the Presidents.

### Strong Institutions Remain Crucial

The presidents attached great importance to properly functioning institutions (most especially the courts and offices of the attorney general and auditor general), checks and balances within government, oversight functions and accountability, and the overall rule of law.

“Those are the cornerstone of what needs to be in place for any country to move forward and to be able to give the sense of stability and confidence that is required for economic development to go forward... if we didn’t have steady, reliable courts that are seen as fair, and other institutional support so people have confidence, nobody would be willing to take the risk to come here,” said one president. Another echoed these sentiments: “These are very important. The court needs freedom to function without fear of being penalized for decisions. We support an independent judiciary, not just for our people. In a globalized world, the donor community looks at us very closely to see how we are performing.” Another president added, “The public auditor and attorney general are especially important offices,” while another agreed with “the importance of strengthening these institutions.”

One of the presidents stressed heavily the importance of a free and fair judiciary, especially for investment and development. “We know our history when past presidents attempted to influence the court to make certain rulings for the COFA. Despite threats of violence on the court, it really applied the rule of law. Business suits that have been heard before our court have been interpreted based on what the court has before them and not necessarily favoring a local over a foreigner. The court has been seen as issuing fair decisions. All of these give a secured feeling for investments and businesses.”

### **Civil Service Performance Remains a Key Development Constraint**

There was unanimous agreement among the presidents on the need to strengthen performance and raise productivity in the civil service and across the public sector. Numerous analyses have shown that while the Micronesian states spend more per capita on health, education, and other basic services relative to other developing countries, their social and economic indicators remain generally weak. In the presidents’ view, this is due in large part to the underperformance of their government workers.

In the blunt words of one president, “This is a big problem. Lots of workers are just there to collect a paycheck.” Another president noted that this “is a monumental issue. Our businesses are more effective than the government. It’s about habits. People don’t work, but they still get paid. Why they come to work is to get paid. It really hampers development projects. The unreliability affects businesses, too... It hampers progress.” Another president casted a wider net beyond just government workers, identifying low productivity as a problem “in both the public sector and the private sector. Many government employees are safeguarded and protected under the PSC [Public Service Commission], it’s difficult to weed out people.”

Another president lamented the abuse of public positions. “Some people use their positions within government to benefit themselves or their private businesses... People do these things because they know they can get away with it.”

The presidents offered a range of ideas on how to raise performance and productivity:

“[As president] I instructed cabinet to conduct annual evaluations by supervisors and to use these to improve performance and even compensation. Performance evaluations are one way to improve productivity. Service is not at the level that it should be. Personnel offices in national and state governments should be supervising and mid-management needs to improve. One area of resistance under the amended compact is the restrictions on the sector grants and performance-based management. This should be required of not only the compact but of other revenue sources. Performance-based management should be a proactive process to raise services and performance... Congress should be able to hold the executive branch to their work. Internal accountability [checks and balances], we need it here.”

“Leadership and setting an example are ways to improve this.”

“If you stay here for a week and listen to media stations, you’ll hear people call into the station saying, ‘I saw a government vehicle over the weekend at a funeral, or I saw a government vehicle at a bar or restaurant after hours.’ Those kinds of things are really helping to keep the government at bay.”

“In the public service, employees should be on contracts, even secretaries. That is a mistake in the Constitution. If they’re on contract and they don’t perform, they fire themselves. It’s easy: you just don’t renew their contracts. If they fire themselves, it makes it easier [to remove underperforming government workers].”

“All problems have solutions. The responsibility here lies with the secretaries and the PSC... People do these things because they are taking advantage of the absence of any punishment. I agree with the discussion of reforms within the civil service and PSC.”

One president concluded that despite these dire assessments, he himself has seen progress in recent years. “The government... has always been criticized for taking five people to do a job that maybe one or two people can do, or putting off work that could be done today until tomorrow, or getting paid for 8 hours when you are only working 5 or 6 hours. But things have really changed... The participation of the community in holding their officials to a high standard and a level of productivity is the key here. It ties into performance output. The more people know what their expectations should be, they can hold the workers and managers to those expectations.”

### How Presidents Obtain Economic Advice and Their Assessment of the Quality of Advice

Political leaders rely on the advice of others regarding economic, development, legal, and other matters. The presidents relied on advice from a range of sources, but several expressed concern over the availability and quality of advice over the years:

“The Department of Economic Affairs was my main advisor. But it had no real economist. The quality of the advice in my opinion could have been better, but I was satisfied.”

“The government is regressing in terms of lawyers, economists—the quality of legal and economic advice.”

“I had an economic council that reviewed economic legislation. Sometimes it was very critical of things I wanted to do. But that was the check and balance I needed. Many things I wanted to do, they said it was too much. Sometimes I took their advice, others I tried to strike a middle ground. Congress never really had an economic advisor. They have lawyers. Unfortunately, they rely too much on those lawyers to do everything. When it comes to Congress, they don’t really have the resources and whoever was a businessman in the Congress takes the lead in the discussions.”

“We didn’t have economic advisors. But we should have permanent economic advisors—not one person, but a team.”

“When I was president, I relied primarily on three ministers... I agree with the need to bring in outside advisors if we need them, but again we must not let them be ‘boss’ in our own country. I can have a lawyer provide me legal advice, but in the end I am still in charge.”

Several presidents also offered useful insights into what worked and what didn’t work with respect to economic planning processes:

“One thing government is always guilty of is we do so many economic plans and development plans and they gather dust on the shelf. One of the resolving things we decided to do was to get technical assistance to review the plans that we had, and then give us a meaningful review of whether they were achievable during the 4-year period we had. Definitely, we found out some of those plans were obsolete and had to be revised. That is why we came up with a... management action plan. This was actually an implementation thing of what our review of the master plans and other reports. Early on, I noticed in my dealings with Japan that they provided the most realistic technical and economic advice. So we asked JICA [Japan International Cooperation Agency] for a grant assistance to come in and do an economic assessment of where we were and what we needed and a timetable. So they came in and did what we came to refer to as the ‘JICA Economic Plan.’ When they finished, our cabinet reviewed it and said it was achievable. So I had Congress formally adopt it by resolution. So that became the blueprint for Palau.”

“What is available within government are reports and analysis from ADB, [the] World Bank, [the] IMF [International Monetary Fund], UNDP [United Nations Development Programme], and other countries as well as statistical reports from Economic Policy, Planning and Statistics Office. It is this compilation that forms the basis [for decision making]. We have to look at all of these reports to get a grip on the economic situation. Local business people provide important information to government. Should government have an economic development policy? Yes. We need to bring everyone to contribute to that. An issue for us is how to establish a systematic economic development policy? With the compact, there is coordination of grants and federal funding. Now there is funding from the EU. We began directing different donor money to different areas. But a comprehensive economic policy should have been compiled. It’s not easy when our fragile economy depends on outside sources of funding.”

The same president added, “When... decisions need to be made, we must go to the technical people at the ministries involved to give assessments of the impact and options... Government workers, in spite of their shortcomings, have a lot of experience and can provide good advice.”

### **Are Reforms Imposed or Homegrown?**

Reforms are sometimes seen as being imposed from the outside, but for the most part the presidents felt that reforms were recognized locally as being necessary.

“A few looked at it [the reforms] as an outside imposition, but [the technical advisors] and these key leaders helped convince most leaders that it was needed and timely.”

“There are some people who see it as a good thing regardless of who suggested it, and others see it as a good thing but it’s not from us so therefore it is not appropriate for us.”

“Some people in leadership feel that way, that it’s being imported from outside. When we get ADB and other donors to focus on reforms, we find the reforms they are trying to do are what we know needs to be done. But because the report comes from outside, people think it is being imposed from outside. Some reform ideas are a foreign concept so they are not readily implemented at lower levels. Whoever provides aid needs to understand the local culture to understand the perceptions of what’s expected to happen when the program is implemented.”

“Some decisions have been seen as imposed from outside... But if we think that we need fiscal reform now, then what are we waiting for?”

### **Government Employment as Wealth Distribution?**

Historically, the provision of government jobs in Micronesia has been viewed by many as the best way to spread the wealth. While most presidents agreed that this perception exists and is strong throughout most of the islands, most also agreed that it is wrong and must now change:

“Attitudes regarding the US and the role of government, those of us that grew up in the generations after World War II know that government started as a welfare idea. After the war, there was nothing... no economy, no food, no jobs. The Naval Administration had to come in to do a welfare state through some kind of government system. That became an institutional expectation, that the government would provide you with education, with health—provide you not with food stamps, but some kind of assistance, and you’re very lucky if you get a job with the government as you’ll be able to afford things money can buy.”

“This perception is very strong. People see government jobs as for their benefit. It is really holding us back. The government gives too much, even my administration. Ministers hire their

wives, nephews, and nieces to government jobs. It will take quite a while to get rid of this mentality. It exists and we need to deal with it.”

“Yes this is true. That’s why we need to develop the outer islands and the private sector to take over the role of the government as the provider of jobs.”

“We do not always hire the most qualified people. Nepotism is still an issue everywhere.” “Giving people jobs is the easiest thing to do if there’s money, but we can’t afford that.”

## 5. The Road Ahead: Reinvigorating the Reform Agenda

### Reform Progress: Where To from Here?

The presidents see progress in some areas as a result of past reform programs. But the size of government, skill levels of employees, and policies of government weigh heavily against ongoing change. For example, while the Marshall Islands initially met workforce reduction targets in the late 1990s, the government workforce has since increased by 60%.

One president sees improved capacity in certain areas, including significant improvement in financial management and audit performance, as a result of the focus on reforms. “Our audits have improved, as have our bidding and procurement procedures,” he said.

Changing spending patterns or cutting the size of the government workforce doesn’t need outside technical assistance—it needs political will of elected leadership. “A homegrown plan can be done,” said one president. “Identifying areas to cut is easy.” In other areas, however, technical assistance and expertise can be helpful. “We need outside and objective evaluations,” said the president. “An objective review of the structure of our governments, efficiency, maintaining or eliminating positions, organizations, and departments, etc. Organizational reviews, job evaluations, and organizational evaluations are needed.”

The presidents agreed more reforms need to be carried out across a range of areas.

### Potential Sources of Future Instability

High expectations among FAS populations for government service provision, coupled with stagnant or declining local revenues, portend an uncertain future. Of concern to several of the presidents is the level of the government trust funds that are being capitalized largely by funding from the COFA, and their ability to replace current high levels of US grant funding under the compact. For the FSM, there are concerns about the long-term viability of the four-state federation once the compact with the US ends in 2023—a political issue with economic ramifications. The visa-free access to the US that the FAS enjoy as a result of the compact is an important safety valve offering education and job opportunities to thousands of FAS citizens. This compact provision has been well-used, particularly since the mid-1990s, by citizens of the three FAS nations. But a range of unresolved political, economic, and social issues could threaten these otherwise stable small island communities.

Concern about political unity in the FSM has been an issue for many years, and the presidents suggested that the end of the compact could remove the glue that binds the federation. “Will our federation hold [after 2023]?” asked one president. “Leadership (especially the president) must be very mindful of this. We must be very wary of what might happen if assistance levels reduce. Will this dismantle the federation? There’s already talk about this.” Another said, “The compact is holding us together, it seems. There is a real threat of instability [without the compact] and breakaways [by the states]. In a sense, political problems can cause economic problems in the FSM.”

Internal political divisions in the Marshall Islands—from October 2008 to October 2009 three motions of no confidence in government were introduced into Parliament, with the final one succeeding in ousting a sitting president for the first time in 30 years of constitutional government—have led to intermittent disruption of routine government operations as employees wait for leadership struggles to be resolved. There are also issues within the wider society, with divisions between government and landowners over agreements for use of privately held land, and divisions among the multitude of Christian-based religious groups. “All of these groups are split up and working against each other,” commented one president. Another pointed to instability in government. While stating that “for now, people are content,” he said “there could be possible problems. Instability in government, like [in] Nauru, could cause it. Members of the Nitijela base their decision for president on whether they are satisfied with decisions of government. They’re the ones who decide because of the Constitution. There is supposed to be a nonpolitical public service to be stable. But top political people are subject to instability.”

Employment opportunities and the ability of government to continue providing essential services such as power, water, and sewerage are key issues for ongoing stability in the FAS. “There’s no doubt we are facing hard times unless we help ourselves,” said one president. In the absence of increased local revenue, “the pie is still going to be the same size and there are more public expectations, and higher cost of living and for running the government,” he continued. “People want medical coverage; we’re talking about universal coverage. People also want higher social security. If the government does not do anything meaningful to address this you can expect unrest. People have loans to pay off. Anyone who gets laid off today is going to find things very hard.”

There is a fundamental disagreement between the FAS and the US State Department over the purpose of the trust funds established for the three FAS nations. FAS leaders view the purpose of trust funds as replacing US grant funding when their compacts end, while the US views the trust funds as future economic assistance without the requirement of matching the level of US grant funding. Based on performance of the trust funds in recent years, the earnings will fall short of the expectations of FAS leaders. Since the mid-2000s, investment results have been mixed, with the trust funds losing more than one-fourth of their value during the global economic crisis in 2008. “How we make adjustments in our trust fund shortfall is a critical part of our future,” said one president.

“When you put all of these challenges on the table,” said one president, “we really have no one to look to except ourselves. This is why the environment [is so important]. It is our ace in the hole. If we are not careful about protecting and sustaining it, then it will just be another island and no one will want to come.”

### **The Compacts of Free Association and Economic Development**

In 2009, in the Marshall Islands and the FSM, over 70% of the education and health budgets were paid for by US grants. In late 2009, 6 years into the 20-year agreement, US and Marshall Islands officials agreed that the Marshall Islands must develop by 2010 a plan for addressing declining US grant funding.

Presidents in the Marshall Islands and Palau were blunt in their observations that the compact is not a vehicle for economic independence. “The compact promotes dependence,” said one. “It establishes our relationship with the US, but this is not an equal relationship; one is higher than the other.” “The honest answer is it [the compact] is not doing enough,” said another.

“The compact is doing its share in promoting education and health of our people,” said one president. “And that is important. These are important nation-building pillars, to promote health

and education. When it comes to investments, if it weren't for Taipei, China and Japan [there would be no foreign investments]. There are really no American investments here. Most of the [US] assistance is institutional assistance, for the government to deliver basic services. When it comes to how we can promote the private sector, it falls squarely on the people. If there was a strategy, it should have been education and health in the initial compact and then economic focus on the second."

"Compact funds go to areas that do not directly create growth and jobs [especially education and health]," said another president. "The education and health budgets and spending levels are clearly not sustainable—we can't afford to continue at these same levels, especially with the annual compact decrements."

The first compacts for the Marshall Islands and the FSM, implemented in 1986, included provisions to support private sector growth and investment. Originally, as noted by one of the presidents, negotiators agreed to give the islands access to US markets for goods manufactured in the islands. But protectionist members of the US Congress removed those provisions and provided development funding as "compensation" for removal of the tax and trade benefits before approving the agreement. But only a fraction of the promised funding was ever provided. "The idea of Compact I providing development is the US would provide access of the Marshall Islands to engage in the US market and for Marshallese to move back and forth for employment and educational opportunities," said one president. "But we're still trying to get money for tax incentives that were taken out of the first compact."

The compact's confirmation of the FAS countries' status as sovereign nations made them eligible for membership in ADB; the EU; Africa, Caribbean and Pacific group (ACP); and other development aid agencies. "In a sense, the compact encourages development by making [the FAS] eligible for these institutions and markets," said one president. But loan debt to ADB has put significant strain on the Marshall Islands government's national budget and the projects funded have had relatively little impact on productive sectors.

"There have also been efforts by the Department of Interior [to] sponsor business conferences trying to encourage American companies to invest," said the president. "The compact provides protection for US businesses. I'd like to see US direct investment in the Marshall Islands economy. We need to work on that. Bringing back domestic US postal service was very important to business development. But there are only very small amounts of funding available for business development."

### **Preparation for the End of Compacts of Free Association with the United States**

The presidents were in agreement that time is of the essence, given the end of compacts for the FSM and the Marshall Islands in 2023 and Palau's compact in a renegotiation period (in late 2009). Several believe that US assistance will continue when the current compacts expire, but that the FAS should not count on it. The lack of focused development plans is also an issue for some of the FAS nations. Development of local resources—such as agriculture, fisheries, and aquaculture—remains an elusive goal for most of the islands. "The question is, what do we do now?" said one president. "Let's not wait until 2023." Observed another, "We need a renewed sense of commitment to build a strong nation that is economically self-sufficient. The compact and foreign aid have killed people's initiative. I don't see any real drive to grow ourselves. We need an economic plan, and we need to stick with it and implement it."

“Between now and 2023, the business sector must grow so more resources are generated from within the Marshall Islands,” said another president. “When the compact ceases to provide funding, there will be a huge gap that needs to be filled. If we are not moving fast enough to fill the gap, it will force some difficult financial decisions. Even if the trust fund gives us the same level of funding as in the compact in 2023, there will still be difficult financial challenges.”

“We have no choice but to envision a future that is able to maintain itself despite compact funding diminishing or being eliminated,” one president said. “That’s the only hope we have. Short of US assistance after the end of Compact II, Palau has no choice but to open itself up to foreign investment. Because you have to replace something with something. It’s not going to be enough expecting natural growth of Palau to offset the millions of dollars that are going to be not available.”

But another president believes the focus should be on developing local resources for self-reliance. “We need to develop our primary resources that can’t be taken away: the ocean and land,” he said. “Tourism depends on outside conditions. But fisheries and agriculture we can sustain.” These comments were supported by another president: “To prepare for the future, we need to help the outer islands by developing agriculture and greater self-reliance.”

One president summed up the challenge facing leaders who must respond to declining foreign aid in countries that have been aid-dependent for three generations: “What are the options except to entice a whole slew of investments to come in, or to dramatically increase foreign assistance not from the US but maybe Japan or Taipei, China, or to dramatically cut the size of the government. But that third option... I don’t know who has the guts to do that.”

### **How to Solve the Challenge of Dependence on United States Aid**

The challenge is to expand the local economy, agree most of the presidents, along with diversifying the base of international donors that provide aid to the FAS. Most acknowledge that the FAS will require continued foreign assistance when the compacts with the US end.

“Growing the economy is basically it,” said one president. “If we don’t have a private sector, don’t talk about financial sustainability.” But a critical missing element identified by this president is the lack of capital for local business development.

“The main thing to go with education and training is capital,” he said. “Everyone has some natural business instincts. But unless you have that help to get off the ground, you’ll continue to be ‘illiterate’ economically. The main challenge is how do we get more Palauans involved in development opportunities; how do we get more Palauans in the business sector and not just seeking employment in the government?”

Two additional suggestions offered by one of the presidents were more aggressive diplomatic efforts to generate foreign aid and increasing capacity of legislators in the FAS.

### **The Freely Associated States “Sovereign Model” of Development**

While development plans and economic reports frequently talk about goals of increasing self-reliance, and mention agriculture and fisheries as important sectors, the notion of a sovereign model for national development has not yet developed in the FAS. But the presidents agree with the need for island-centered development that emphasizes quality of life, subsistence, and commercial coastal fishing and commercial agriculture opportunities involving FAS citizens.

“The Marshall Islands,” said one president, “just needs a good plan and strong support from our development partners. Fisheries and agriculture development are essential. Taipei, China’s demonstration farm has proved we can grow agriculture products here. There is a several million

dollar industry in imported vegetables. We've talked about turning the entire island of Arno or the main island of Wotje into a farm. If I had to make a choice, I'd go agriculture instead of fishing so I could work on a farm rather than going to sea."

### **Development Requires Engaged and Proactive Leadership**

The presidents agree that successful development requires engaged, honest, and proactive political leadership, but point out that political systems and attitudes are a hurdle.

"We need leaders who are committed and have foresight and strength to take the lead on development projects to ensure they are implemented to meet their goals," said one. "Political leadership is very important in any development project. Especially with our parliamentary system of government, if political leadership is not there, the project will fail. There must be a strong commitment of our top leaders."

Another president said honesty and engagement of leaders is a fundamental element of a stable and democratic government. "The last thing we want to be is perceived as a country where only corrupt people can do business in government or the private sector," he said. "You want to promote success based on the rule of law, transparency, and fiscally responsible policies. Confidence and stability are important factors to any business, especially foreign capital."

Two presidents described factors that prevent engaged, honest, and proactive political leaders from coming to the fore, and why development policy decisions can be skewed to personal or other interests. "There's too much emphasis on titles and not on accomplishments," said one president. "Being able to speak English is not a sign of wisdom. There are lots of Marshallese who don't speak English who are very smart." Another said, "The Congress–executive branch friction makes it hard to make policy. We don't have good governance. Most leaders are like cowboys, they shoot from the hip [instead of using data and analysis]."

One president said that "timetables" are essential to successful outcomes. "One important thing is that once goals of a development project are set, we need to also set the time frame," he said. "Target dates are important. Without them, the level of effort will decline."

Another president suggested term limits for elected politicians, as exist in Kosrae and Palau.

### **Gaining Public Support for Political Change**

Every president emphasized the need for engagement with the public through summits, public hearings, and other means of dialogue at the grassroots level. In the Marshall Islands and Palau, independent newspapers and radio stations help increase public awareness. But one president pointed to a less accessible independent media in the FSM that underlines why national summits and other consultations with the public are crucial to the success of reforms and development projects in the FSM. Addressing details of the programs with the public and also ensuring continuity of action were other factors emphasized by the presidents to engage the public. One president shared his experience of the importance of qualified resident consultants able to engage on a day-to-day basis to inform and influence leadership.

The presidents talked about the need not only to engage the public on the "big picture" plans but also on the details. "There is a need to get people involved," said one president. "Participation is essential. To make projects succeed, government, donors, and people need to participate every step of the way. Lending agencies can ensure a project meets its benchmarks by getting people on board, by going to the villages, and getting everyone to talk about it. It is very

important to have community consultations even on minor details. The plans must be understood and accepted.”

Another said, “The national summits helped, along with the leadership meetings [at the state and national levels], in getting the public involved as much as possible, even in the remote islands, and educating citizens on the need to review progress and readjusting.”

“Decision making by participation is essential,” said another. “Don’t underestimate the intelligence of people these days. The electorate is very literate. One of the success stories for us in Micronesia is we are all literate. Education is mandatory; we all read and write. The young generation is in tune with what is going on. This generation and the next generation are smart people. The computer age, media access, and information access: people here know what a good government should be. They know. It is when the government distances itself from the grassroots people, so people feel it is the government’s own decision, not theirs, that they won’t support it. Participation in government is the only way to achieve needed reforms. In most cases, it is the other way around. People expect reform, but those responsible for doing the reforms are very slow to do it or do not actually do it.”

### **Focusing on Reform Opportunities in the Freely Associated States**

Several important points were raised by some or all of the presidents about reforms that need to happen. Enabling and expanding the private sector is important to expanding the revenue base of the islands to replace some of the US grant funding that will end soon. There is also a need to reform and diversify the ministries of foreign affairs to expand opportunities for partnerships and aid beyond the “traditional” donors (Australia, Japan, and the US).

But how can public ownership and buy-in of needed reforms be achieved, particularly when these involve potentially unpopular changes, such as cutting or eliminating subsidies for copra production and school lunch programs? A number of presidents pointed to greater public involvement and consultations to explain why difficult decisions have to be made. One president spoke about the key role that auditors, special prosecutors, media, and rule of law play in curbing corruption in government, another problem in need of action. In this regard, the president credited the public for playing a critical role in preventing elected leaders’ attempts to roll back earlier reforms that required higher standards of accountability and ethics.

Lax attitudes toward education have produced poorly performing public schools in most islands. One president believes a critical unmet need is greater focus on technical and vocational training. “I’d like to see people stay here, but if they are leaving then we should prepare them better,” he said. “The priorities should be to (i) increase the private sector to employ people here, (ii) help outer islands with assistance they need (not always jobs), (iii) equip people to go abroad by improving the education system and training, and (iv) diversify our sources of assistance through diplomatic relations.” Another president offered a slightly different list of priorities to promote reform: “leadership training, policy analysis, voter education, transparency, and media.”

Virtually all the presidents interviewed stated the need for an engaged public and greater transparency in government, whether through the provision of higher-quality education or training, through media, or through participation in national development issues by nongovernment organizations and community groups.

One president argued that private sector support needs to be a top priority. “If ADB wants to help, it should help the private sector,” he said. “In the past, ADB has focused on infrastructure,

roads, water, etc. But they should also help bringing in industry and manufacturing, and developing agriculture and fisheries."

While most of the presidents ranked private sector development high on their list of needed reforms, the FAS are not generally noted for their investment-friendly policies. There have been some recent reform efforts in the foreign investment sector, but the FAS do not rank high on the World Bank's annual *Ease of Doing Business* reports. "We've been heavily criticized [by donors] that we're overly protective in our policies and legislation," acknowledged one president. "That's coming from a majority of the small population who fear every day that there will come a time when we become a minority in our own islands. So our economic policies have always been conservative." These concerns, however valid, don't address the economic reality, he said: "The truth of the matter is we'll never have enough capital from our own people to support advancement of the economy. Foreign capital/investment is a critical part of our future. How do we attract them to a very limited opportunity is of course the challenge. So our smallness, our fragile environment contributes to a very limited option, that is, tourism. There is a little bit of fisheries here, but as you know stocks are dwindling and most are migratory fish. So aside from tourism, fishing, and a little farming, basically tourism is the thing. It's our 'fish and taro' industry. The opportunities for foreign capital and investment will continue to be in those areas."

### Specific Areas in Need of Reform

Increasing the revenue base of the FAS by expanding private sector opportunities and foreign investment, as well as privatizing state-owned enterprises, was high on the priority lists of most of the presidents. Several also agree that action to improve the business environment needs to be coupled with improved performance in public sector operations. Among reforms recommended by the presidents were the following:

**Investment and business reform.** "We need to expand the revenue base, to find new ways to generate taxes for government services," said one president, who recommended being "innovative to find new ways to bring in revenue." He continued, "We have to grow the economy. That's the big reform. So investment and business legislation need to be reformed."

**Corporatization of agencies of government.** In the Marshall Islands, this could include Air Marshall Islands, Marshalls Energy Company, National Telecommunications Authority, and transportation services to outer islands. In the FSM, this could include the National Fisheries Department and FSM Telecommunications Authority, among others. In Palau, water and sewer services were identified as good opportunities for privatization. By privatizing, these agencies could be providing resources to government if they are run well and without political interference. In the Marshall Islands, the Marshall Islands Marine Resources Authority and the Marshall Islands Ports Authority are examples of functioning government agencies that can run on their own without subsidy. For the FSM, it was suggested that plans and proposals for revamping state-owned enterprises and other government services need to be revisited. An outside entity is needed to recommend solutions and to help with implementation.

**Privatization of some health services.** In the Marshall Islands, some Ministry of Health programs could be privatized. With institutional reform, such ministries could focus on improving and maintaining core services. For example, the hospital could bid out operations for its morgue to a private organization that can do it more efficiently. Then the hospital could focus on its core program of delivering health care.

**Control subsidies.** The level of service provided by government should be based on need to reduce overall dependency of the public and state-owned enterprises on subsidies; for example, if there is an inadequate volume of passengers and cargo for Air Marshall Islands to provide regular commercial service to a remote outer atoll, the government could provide a limited subsidy to ensure the minimum needed service.

**Expansion of diplomatic partnerships.** Policies of the Ministry of Foreign Affairs should be reformed to emphasize exploration and expansion of bilateral partnerships beyond traditional donors to the FAS. “Aligning so closely with the US prevents us from cooperating with others,” observed one president.

**Financing for private sector development.** ADB should consider supporting private sector development by facilitating financing for private sector initiatives in areas such as fisheries, tourism, and air and sea transport.

**Constitutional reform.** In the FSM, a review of the federalist system of government was suggested. “Is it working?” asked one president. “What about a parliamentary system?” In the Marshall Islands, which has a parliamentary system of government, one president observed, “We need to change the system of government. This is the biggest reform needed. Why other countries are better at implementing reforms is because their government system allows them to do it. The FSM and the Marshall Islands are in the same situation. They need greater independence in the executive branch of government. That would benefit both.”

## Recommendations to Donors

The presidents’ advice to development partners includes the following:

**Consultation.** For projects to be successful, there needs to be broader consultation. “They need to make people understand what’s going to happen and they need to know if people accept the reforms planned,” said one president. “Consultation needs to be broader and deeper. Years ago, Amata Kabua would call me to get my support to pass a bill. But some projects here, senators were not consulted. So when I asked for their support, they ask, ‘why—what’s this all about?’ They don’t even know. On the Public Sector Reform Program, ADB came to my office to discuss it. I wanted them to meet with all senators. I wanted them to do it, but it didn’t work out. Two years later, people not consulted became cabinet ministers and then asked, ‘why are we laying off hundreds of workers?’ Consultation is important with senators who will eventually be in government. Otherwise, they come into cabinet and have no idea what’s going on.”

**Performance benchmarks.** Key points in Compact II are benchmarks, performance-based budgeting, and capacity building. These three go together. “ADB should do the same thing,” said one president. “People said the US was interfering in our sovereignty. But it is important how money is spent. More efficient and effective spending means higher quality delivery of education and health. I hope the next ADB project follows what we did in the compact. The EU also demands meeting certain benchmarks or it won’t release money.”

**Private sector.** If ADB wants to help small islands develop, it should help develop the private sector. The islands need to find new sources of revenue, jobs, and ideas. For example, if the islands maintained the level of employment demanded by ADB in the late-1990s Public Sector Reform Program, they would not have the new schools that have opened. “That’s a fact that can’t be disputed,” said one president. “One point about the saying, ‘it takes money to make money’—ADB has to employ that concept also. It needs to look at what are the areas of opportunity, the areas of help where if we help this nation, they can be more capable to actually realize more benefits. More

and more that has to be a strategic focus of ADB: assessing what are the strongest points for the FAS. If they invest in this, then the country is going to come out in a better situation. It's not just technical assistance to fix this or fix that. Of course these are important. But what are the good things that if you pour in more money will develop the economy? Now that we know there are more entrepreneurs, more educated people, why not help the development banks by putting some funds into them with basic guidelines? At least help the institutions that have a better track record and record of returns by investing money to make money."

**Loans.** "Unless we really need loans, don't accept them," said one president. "Some loans we could have done without. Now we have to repay \$60+ million in loans. We are saddled with these loans. ADB was very aggressive in loan promotion. The ADB talks about poverty reduction but those loans are causing us difficulties. This year, Marshall Islands has to pay about \$4 million [more than 10% of locally generated revenues] to ADB. It reduces flexibility to explore other programs because we are saddled with these loan repayments."

## 6. Conclusion: A Window of Opportunity

Development and reform proponents need to be cognizant of the pervasive and long-standing "welfare state" attitudes that shape perceptions about the role of government and the direction of national development, and influence governance and decision making in Micronesia. These countries face major challenges to increasing economic independence as a consequence of the abundance of (and thus heavy reliance on) aid flows, risky environments for foreign investment, and COFAs with the US.

Because the challenges to reform and economic development in Micronesia are significant, development partners should consider the need for longer horizons on reform and development projects. Coupled with this, consultative processes are extremely important throughout all stages of the reform process, from initial planning and design of reforms through to implementation and evaluation. Congruence and alignment in understanding and expectations among the key stakeholder groups can help facilitate reforms and change: consultative processes and commonly agreed-upon road maps and plans with timetables are the most effective means to maximize congruence and alignment. In general, reforms that aim to bring about significant change, particularly in the public sector, must be taken step-by-step and be implemented over a medium-term horizon so as to allow sufficient time for change processes and adaptation to take place.

RIF exercises that formed part of previous reform efforts were extremely sensitive and are considered the most "painful" types of reform. Future reform efforts that include RIF-type actions must be very carefully planned so as to minimize their socioeconomic impacts, and should carefully consider the political impacts.

Understanding who influences political decision making—and what influences political leaders respond to—in each country is critical to the success of reforms, and to development projects more generally. Major reform efforts in Micronesia must include consideration of and consultation with the key influence groups, including traditional leaders, religious leaders, landowners, business owners, and wealthy individuals or families. The influence these groups have over governance and development issues varies from island to island. These differences confirm the point that although the three Micronesian states are small in size and population, share a close relationship with the US, and are dependent on high levels of aid, there are a multitude of differences—ranging from cultural traits to availability of independent media to geographic location—that do not lend themselves to a "one size fits all" plan for development and reform. Each has special features that must be

understood for donor-supported reforms and development projects to be successful. The availability of independent media and citizen engagement in development decisions through NGOs are important elements in changing attitudes and influencing political decisions, and similarly vary from island to island.

A challenge on the horizon is the potential for instability and social unrest as aid levels decline if a productive economy does not emerge to replace a considerable portion of the development aid now being received. The young democracies in the Marshall Islands and the FSM are faced with potentially serious governance issues that affect development progress: the long-term sustainability of the federation of the four states that compose the FSM is an increasingly important issue as the compact's end in 2023 approaches; while in the Marshall Islands the push for changes to the parliamentary structure of government is gaining steam, including the need for direct election of the president and stronger separation of the executive and legislative branches of government.

The twin pillars of the subsistence economy in the Micronesian islands, agriculture and fisheries, can also be the foundation for future development and greater economic self-reliance. A second point concerning economic development emphasized by the presidents is the current lack of capital needed for citizens to expand private sector activity. Business sectors must grow between now and 2023—when the compacts for the FSM and the Marshall Islands end—if there is to be any hope of the islands maintaining basic government services for their citizens. Limited access to capital is still cited by islanders as a key constraint.

There is a fairly strong consensus across Micronesia on the need to revisit the reform agenda and to reignite the flame of greater self-reliance. Despite this, reaching a collective choice on how to move forward remains a major challenge, due in large part to capacity and governance challenges.

What is absolutely clear is that there are two linked necessities to development progress across Micronesia: improving public sector effectiveness and performance, and revving up the economy through expansion of the private sector. Maximizing government use of resources and strengthening core institutions that support the rule of law, transparency, and accountability are the key prerequisites to development progress.

The Micronesian nations and their development partners are faced with a critical deadline. By 2023, when compact funding ends for the FSM and the Marshall Islands, these nations must be ready—or at least significantly better prepared than they were in 2009—to function in the absence of the large-scale US aid that they have been accustomed to receiving since the late-1960s. This deadline provides the people of Micronesia and their development partners a limited window of opportunity in which to bring about needed reforms and development progress. Time is of the essence, but just as important is the need for well-conceived, homegrown road maps for change driven by leaders in these islands in consultation with their development partners.

# 7 Governance Reform in the Public Sector in Pacific Island Countries

## Understanding How Culture Matters

by *Roderick Duncan*

### ABSTRACT

International aid agencies have emphasized governance reform in Pacific island countries for more than a decade. Despite this, there is little evidence that governance reform programs have improved public sector operations in most of these countries. Past reviews of governance reform programs by international aid agencies have stressed the importance of understanding local culture, but there has been a failure to follow up with research into Pacific culture, especially its political culture. Current Pacific political culture shares many of the same values that were in place prior to contact with European societies. Three Pacific political values are identified: distribution, transparency, and competition. Working with these values, rather than against them, could lead to better design of international aid efforts in the Pacific.

### 1. Introduction: What Are We Doing Wrong?

During the crisis of the early 2000s, Solomon Islands briefly became a “failed state.” Its score on the World Bank’s Governance Matters index of government effectiveness, which is a general measure of the capability of the government, fell from  $-1.04$  in 2000 to  $-2.5$  in 2003 (see Figure 7.1 and discussion below). The result of  $-2.5$  gave Solomon Islands the lowest worldwide score for government effectiveness, below even Somalia at  $-1.9$  and  $-1.8$  for the Democratic Republic of Korea. The government of Solomon Islands had effectively ceased to exist.

With the combined effort of local leaders, 15 other Pacific nations, international development agencies, and nongovernment organizations (NGOs), the government of Solomon Islands was put back together. In 2006, the World Bank’s Government Effectiveness assessment of Solomon Islands was  $-0.64$ , in 2007 it was  $-1.06$ , and in 2008 it was  $-0.79$ . Thus, despite a relatively large amount of freedom, years of effort, and enormous amounts of domestic and international resources, the general governance indicators of Solomon Islands were no better after the crisis than they were before, and have failed to improve since.

It is as though a hurricane swept through a village, flattening all the grass huts, and then huge amounts of resources were spent, using lots of fancy equipment and hundreds of the world's best consultants, to rebuild the grass huts in exactly the same shape they were in before the hurricane. It would be a comedy routine—just not a very funny one. Why is progress on governance so difficult to achieve in the Pacific?

## 2. Is Governance a Priority in the Pacific?

In his foreword to *Governance and Development*, a book that did much to place emphasis on governance in less-developed countries, Lewis Preston, then World Bank president stated (1992, p. v),

Good governance is an essential complement to sound economic policies. Efficient and accountable management by the public sector and a predictable and transparent policy framework are critical to the efficiency of markets and governments, and hence to economic development.

The 1997 *World Bank Development Report: The State in a Changing World* was the first development report to take the quantity and quality of public sector institutions explicitly into account. With the development of the World Bank's Governance Matters indexes and publication of strategy documents since the 1997 report, such as the 2000 *Reforming Public Institutions and Strengthening Governance: A World Bank Strategy*, the World Bank moved to emphasize governance reform in its aid efforts.

The World Bank's Independent Evaluation Group's (IEG) *Public Sector Reform: What Works and Why?* estimated that 11% of all World Bank loans approved between 1990 and 2006 had significant public sector reform elements (IEG 2008). Clearly, public sector reform is a growing priority for the World Bank. IEG estimated that for the period 2002–2006, the percentage of projects with public sector reform elements constituted more than 16% of all World Bank projects.

In the Pacific, the Asian Development Bank (ADB) has emphasized the importance of better governance in its Pacific Strategy papers back to the 1996 Pacific Strategy (ADB 1996). In its *2005–2009 Pacific Strategy*, governance was placed at the center of the ADB reform agenda (ADB 2004, p. v):

... while natural constraints are real, the quality of policies and institutions are vital to the economic growth, social development and poverty reduction prospects of the PDMCs [Pacific developing member countries]. It is here that ADB should focus its attention.

While previous ADB Pacific Strategy papers had included governance as one of a number of strategic objectives, this was the first time that governance reform was labeled as the “focus” of ADB efforts.

For the Australian Agency for International Development (AusAID) and the New Zealand Aid Programme (NZAID), significant bilateral aid agencies in the Pacific, governance reform has been an increasingly important priority since the early 1990s. AusAID (2008) estimated that governance reform projects accounted for more than 30% of total overseas development assistance for Australia. This figure understates the emphasis on governance within the AusAID budget, as AusAID also estimated that 30% of the value of its aid to education and 50% of its aid to the health sector included “significant governance components.”

Thus, governance is clearly a priority, and a growing focus, for development agencies within the Pacific. What is not clear is whether improvements in governance are a priority of Pacific politicians, public servants, and influential individuals. If governance reform is the key to development, why is it so difficult to achieve?

### 3. What Progress Do We See on Governance?

There is little evidence of much improvement in governance in the Pacific island countries (PICs) despite the decade-long efforts of domestic civic groups, international groups such as Transparency International, and aid agencies. The index of government effectiveness index from the World Bank's Governance Matters VIII database (2009) measures perceptions of the quality and independence of the public sector. From 1996–2008, aid agencies made governance reform increasingly central to their efforts, in both words and lending. Figure 7.1 shows the evolution of these indexes for 13 members of the Pacific Islands Forum. Apart from the collapse and recovery of the public sector in Solomon Islands, the only feature that stands out is the apparent lack of any improvement in the perceptions of the public sector during this time, when enormous amounts of resources were being spent on governance reforms.

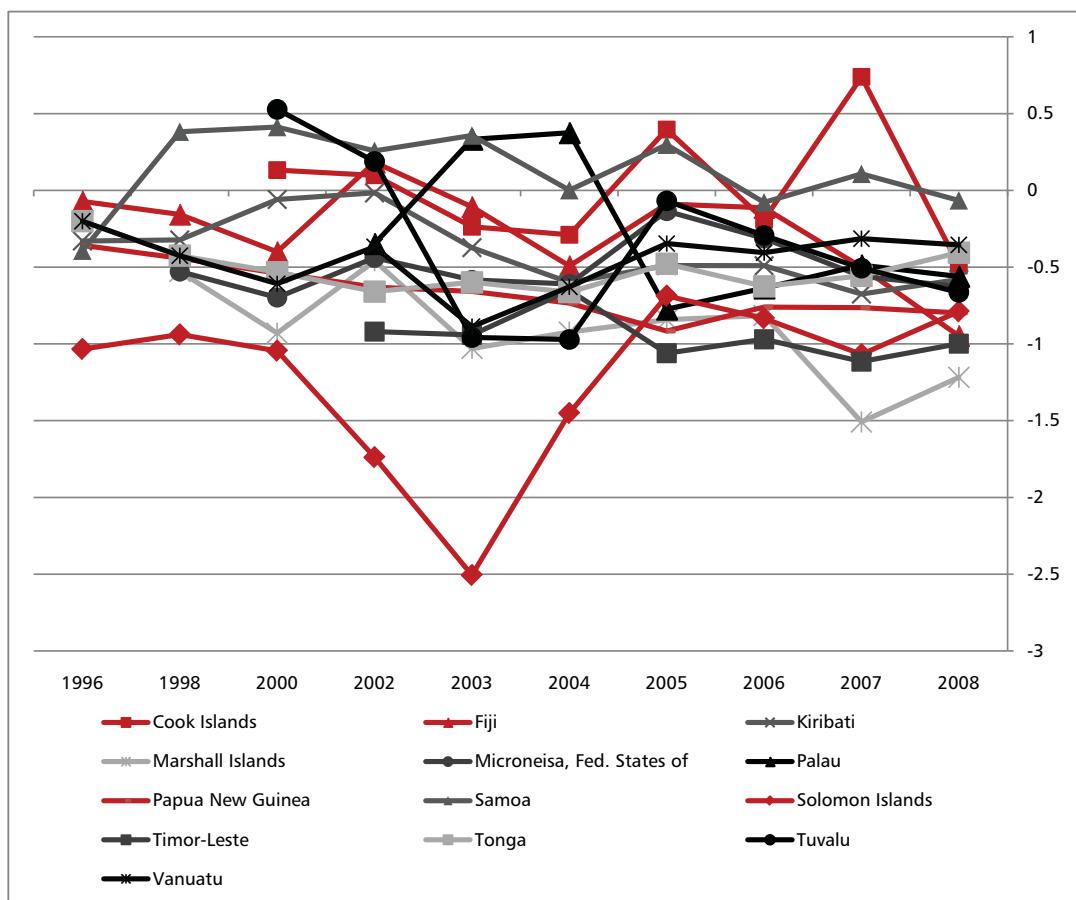
Any of the other governance indicators of the effectiveness of the public sector or of the ubiquity of corruption could have been used from the Governance Matters VIII database: indexes of regulatory quality, rule of law, or control of corruption would show roughly the same picture. In fact, these four indexes are cross-correlated across countries at greater than 0.90.

A criticism of the use of the Governance Matters indexes to measure progress on governance is that the indexes are measuring perceived corruption, which may not be an accurate reflection of real progress in institutions within the public sector because public perceptions may be slow to adjust to reforms. IEG (2008) made this argument and preferred to use their own Country Policy and Institutional Assessment (CPIA) indexes, which represent opinions of the World Bank staff working in each country. The CPIA was developed in the 1970s as a set of criteria against which to evaluate World Bank lending practices for internal use by World Bank staff. In 1998, the CPIA was revised to include governance—matching the growing emphasis on governance in the reports by the World Bank and the development of the Governance Matters database (World Bank 2008).

The CPIA indexes of governance are grouped in Cluster D “Public Sector Management and Institutions,” Indexes 12–16. As an example, for “Property Rights and Rule-based Governance,” World Bank staff working in the country are asked to assess (World Bank 2008, p. 32)

... the extent to which private economic activity is facilitated by an effective legal system and rule-based governance in which property and contracts rights are reliably respected and enforced.

Figure 7.1 Government Effectiveness, 1996–2008



Source: World Bank Governance Matters database.

For this index, World Bank staff are requested to provide a rating of 16 different aspects of property rights and governance in the country and then to provide a justification for that determination. These opinions are compiled into an aggregate score between 1 (very weak) and 6 (very strong) for each criteria in each country.

Table 7.1 presents the change in the value of CPIA criteria 12–16, along with the average change for each country, for the years 2005–2008 for the seven PICs included in the CPIA. Unfortunately, these are the only years publicly available for the CPIA. Moreover, CPIA indexes exist for Timor-Leste only for 2006–2008, so this change is used instead.

**Table 7.1: Country Policy and Institutional Assessment:  
Public Sector Management and Institutions**

Country	12 Property Rights and Rule-Based Governance	13 Quality of Budget and Financial Management	14 Efficiency of Revenue Mobilization	15 Quality of Public Administration	16 Transparency, Accountability, and Corruption in Public Sector	Average
Kiribati	0.0	(0.5)	0.0	(0.5)	(0.2)	(0.1)
Papua New Guinea	(0.5)	0.0	0.0	0.0	(0.2)	0.1
Samoa	0.0	(0.5)	0.0	0.0	(0.1)	0.0
Solomon Islands	0.5	(0.5)	0.0	0.0	0.0	(0.1)
Timor-Leste	0.5	0.0	0.0	0.0	0.1	0.1
Tonga	0.0	0.5	0.0	1.5	0.6	0.3
Vanuatu	0.5	0.0	0.0	0.0	0.2	0.2

(-) = negative number.

Source: World Bank. Country Policy and Institutional Assessment database.

Although these indexes measure the impact of governance reform over only a relatively short period, there is little evidence of systematic improvement in governance during the period.

ADB produces a set of indicators, the Country Performance Assessment (CPA), similar to the World Bank's CPIA. Opinions of the ADB country teams are collected for 16 indicators of public sector policies and performance. Under the CPA, five measures of public sector performance are compiled into a broad index of "Public Sector Management and Institutions." As with the CPIA, the CPA is a relatively recent exercise and the index is only publicly available for the period 2005–2009. The results for 13 PICs are reported in Table 7.2. As with the CPIA, we are interested in the change in the governance index over the period covered by the CPA exercises.

As with the CPIA, there is no clear evidence in this table that the various governance reform efforts have led to improved public sector performance in the PICs. Just as many countries saw an improvement in their performance indicator as saw their indicator fall.

A further criticism of the indexes in these databases are that they are normalized around zero for each year and that the CPIA and CPA measure opinions of staff, so that a lack of improvement in the Pacific indexes might be because governance around the world is improving, and that governance in the Pacific is keeping track with global improvements. Therefore, a more concrete measure of the impact of governance reform might be to look at the costs that are imposed on citizens in regulatory compliance. We might assume that governance reform that is focused on producing a more efficient and more transparent public sector would deliver a system with lower compliance costs.

**Table 7.2: Country Performance Assessment—Public Sector Management and Institutions**

Country	Years Covered by the Assessments	Change in the Public Sector Governance Index
Cook Islands	2005–2007	0.1
Kiribati	2005–2009	(0.3)
Marshall Islands	2005–2009	(0.4)
Micronesia, Federated States of	2005–2009	(0.7)
Nauru	2007–2009	0.1
Palau	2008–2009	0.0
Papua New Guinea	2006–2009	0.5
Samoa	2005–2009	(0.4)
Solomon Islands	2006–2009	0.2
Timor-Leste	2007–2009	(0.3)
Tonga	2005–2009	0.8
Tuvalu	2005–2009	(0.2)
Vanuatu	2005–2009	0.1

( ) = negative number.

Source: Asian Development Bank. Various years. Country Performance Assessment Exercise annual reports.

The World Bank's Doing Business project has been compiling measures of compliance costs around the world since 2004. The Doing Business database records the number of documents and the number of days that are required for citizens to perform various business-related tasks such as opening and closing a business, registering property, and importing and exporting products. While these indicators are not directly tied to governance, we might argue that they are an indicator of administrative capacity of PICs' public sectors. Public service reforms should lead to reductions in the length of time required to administer many of these tasks, while efficiency efforts might lead to a decline in the number of procedures needed to accomplish a task such as registering a business.

Just to take an indicative subset of the Doing Business database, for example, we are interested in the regulatory burden for a small business owner who intends to export product overseas. Has the recent emphasis on governance reform led to any reduction in the regulatory burden? Our business owner might be interested in knowing the costs of opening the business, the costs of exporting, and the costs to close the business. These indexes are reported in Table 7.3 for 11 PICs for 2004 and 2010 to see whether the regulatory burden has been declining. While this table presents a subset of the Doing Business database, any other choice of indicators would reveal the same story.

The assessment of the regulatory burden in Singapore in 2010 is included as a benchmark of best practice. Singapore is usually in the top five countries in terms of lowest regulatory costs from the Doing Business annual survey. If governance reforms have had an impact on administrative capacity in the PICs, we might expect to see their numbers move closer to Singapore's levels.

**Table 7.3: Doing Business: Measures of Regulatory Burden**

Country	Year	Starting a Business		Exporting <sup>a</sup>		Closing a Business
		Procedures	Days	Procedures	Days	
Fiji	2004	7	45	13	24	1.8
	2010	8	46	13	24	1.8
Kiribati	2004	6	21	6	21	–
	2010	6	21	6	21	–
Marshall Islands	2004	5	17	5	21	2.0
	2010	5	17	5	21	2.0
Micronesia, Federated States of	2004	7	16	3	30	5.3
	2010	7	16	3	30	5.3
Palau	2004	7	24	6	29	1.0
	2010	8	28	6	29	1.0
Papua New Guinea	2004	8	56	7	26	3.0
	2010	8	56	7	26	3.0
Samoa	2004	9	42	7	27	2.5
	2010	5	9	7	27	2.5
Solomon Islands	2004	7	57	7	24	1.0
	2010	7	57	7	24	1.0
Timor-Leste	2004	10	92	6	25	–
	2010	10	83	6	25	–
Tonga	2004	4	32	7	19	2.7
	2010	4	25	7	19	2.7
Vanuatu	2004	7	39	7	26	2.6
	2010	8	39	7	26	2.6
Singapore <sup>b</sup>	2010	3	3	4	5	0.8

– = no information available.

<sup>a</sup> The Exporting procedures and days are for 2006 and 2010, rather than for 2004 and 2010.<sup>b</sup> Singapore in 2010 is included as a benchmark of best practice.

Source: World Bank. Doing Business database.

There have been some marginal improvements in the costs of opening a business between 2004 and 2010 (with one outstanding improvement for Samoa), but there have been as many cases of increased regulatory burden. For the costs of exporting (which here is only for 2006 to 2010) or closing a business, there has been no change in the costs for the small business owner. Across the PICs covered in the Doing Business database there is no evidence during a period in which governance reform was a priority for aid agencies that this emphasis has led to any sustained improvement in the administrative capacity of the PICs' public sectors.

However, there have been some success stories in governance reform in the Pacific. In 2009, ADB conducted a review (ADB 2009) of its 11 loans to the PICs over the period 1996 to 2002. The loans chosen for the review supported public sector reform in eight Pacific DMCs. ADB's own evaluation of the success of the reform programs was "modest." Reforms in the finance sector in Samoa were singled out as a success.

Interestingly, the ADB analysis broke down the list of eight Pacific DMCs into cultural groupings of Melanesia, Micronesia, and Polynesia (p. vii):

By region, program loans in Pacific DMCs in the Polynesian countries were “successful” overall. Results were overall “partly successful” in the Melanesian and Micronesian countries that received ADB support for reforms.

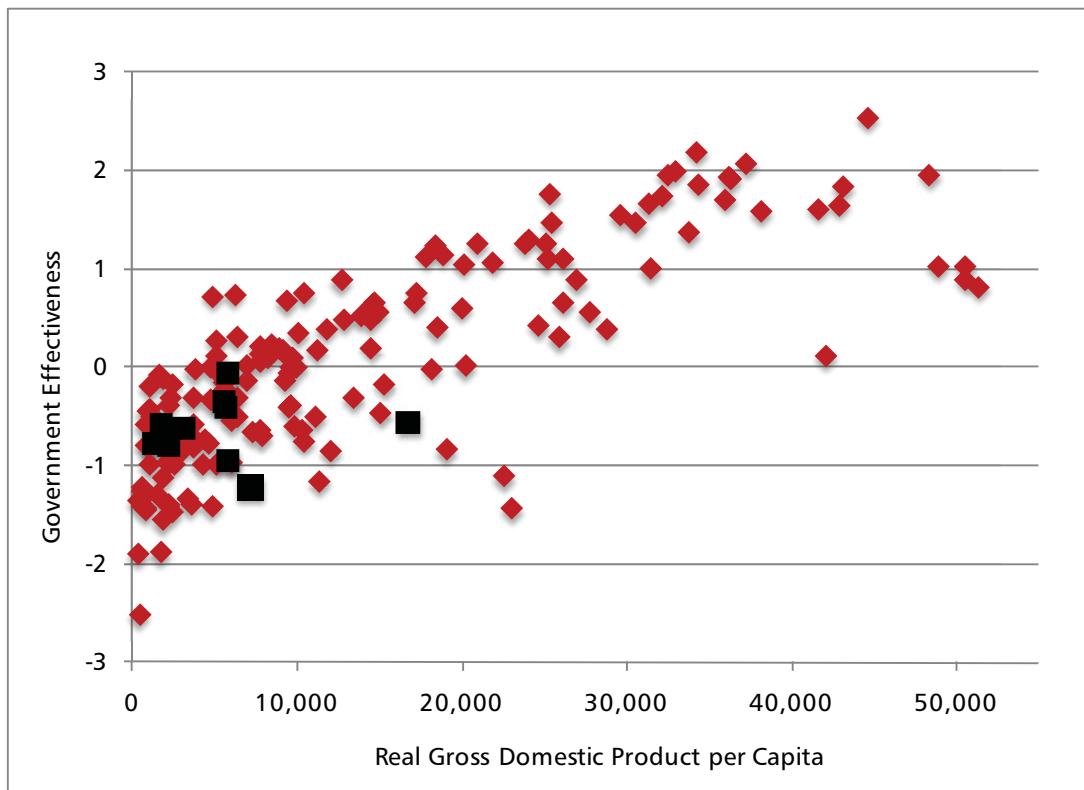
Unfortunately, the ADB review did not attempt to explain why these differences might exist across cultures. That the outcomes of reform programs can differ across cultures suggests that culture may partially explain the outcomes of reforms. These cultural groupings are discussed later in the paper and a cultural explanation for this diversity of reform outcomes across the Pacific proposed.

Also among the findings of the ADB review was that the results of the ADB reform programs differed among the areas of the public sector in which reform was undertaken. Programs in public financial management and public sector budgeting were more likely to be successful, while broad reforms of the public sector to improve efficiency and cut costs were unlikely to be successful. Reforms to finance ministries were more successful than reforms of other ministries.

#### 4. Should We Be Surprised about the Lack of Progress on Governance in the Pacific?

On a very naive level of analysis, we should not be surprised at the lack of progress on governance indicators in the Pacific. Perceptions of corruption across the world track country per capita incomes quite closely. Figure 7.2 shows the relationship between real gross domestic product (GDP) per capita (using the 2007 figure from the Penn World Tables database 6.3) and the 2008 government effectiveness value from the Governance Matters database for 184 countries, with an estimated linear regression line added for emphasis. Ten PICs are indicated by squares in the figure, and the observations for Luxembourg and Qatar have been omitted as their real GDP figures were severe outliers.

With the PICs real GDP per capita generally lying in the \$2,000 to \$10,000 range, we would expect to see an average government effectiveness level of -0.5 for these countries, which is what we can see in Figure 7.1. Thus, governance figures are about where we would expect them to be, given the range of incomes in the Pacific; and perhaps governance levels are not rising because income levels in the Pacific are relatively stagnant. This observed relationship does not tell us anything about the causal relationship between governance levels and income, but it does add a further concern to the low real GDP growth rates in the Pacific. Do these low economic growth rates in the PICs make progress on governance less likely?

**Figure 7.2: Government Effectiveness, 2008**

Source: World Bank Governance Matters database and Penn World Tables PWT 6.3 database.

If the Pacific governance levels are about where we might expect them to be based on cross-country comparisons, there is still the bright news that governance levels can lie in a relatively wide range for a given income level. There is potential for improving governance, even though governance does seem to be related to income.

Another feature of governance reform in the Pacific that should not be surprising is the relative success of public finance programs along with the relative failure of broad public sector reforms, as pointed out in the ADB review. In fact, this ADB finding for the Pacific mirrors the results of a World Bank review of its loan programs worldwide released in the previous year.

IEG (2008) published a review of all World Bank and International Development Agency support for public sector reform for 1990–2006. The review found that two-thirds of countries that borrowed to fund programs focusing on financial management showed improved public finance systems. The survey also found that countries that attempted broad public service reforms saw improvement in less than half of the cases.

IEG was particularly severe in its criticism of programs to cut public sector payrolls and employees through retrenchments and salary adjustments (2008, p. xv):

This approach typically failed to improve public administration, as noted in a 1999 IEG evaluation. Since then, the Bank has advocated the same approach, with a similar lack of success...

These cost-cutting features were also part of the least successful ADB loan programs reviewed in the 2009 survey in the Federated States of Micronesia and the Republic of the Marshall Islands.

The IEG review also found that taxation administration reform loans by the World Bank have typically been successful, but that anticorruption and transparency programs in the form of anticorruption bodies and laws “rarely succeeded.” In a background paper to the IEG report on anticorruption reforms, Fjeldstad and Isaksen (2008) advised,

Direct measures to reduce corruption, such as the establishment of anti-corruption commissions, tend not to succeed when they lack the required support from political elites and the judicial system.

They suggested that any anticorruption reforms be tailored to an individual country’s circumstances.

But this is something ADB has known, or should have known, for a long time. The ADB 2009 review repeated the themes from the 1999 ADB report by Knapman and Saldanha (1999). Two of the themes presented by Knapman and Saldanha were domestic ownership of the reform program and the need to understand domestic culture. It is unfortunate that Knapman and Saldanha have these themes in their chapter titled “Lessons Learned,” because 10 years later we find the 2009 review repeating the statements that reforms need to gain domestic political support and that

[c]ultural traditions permeate society and social processes that affect decision-making and actions of public servants; particularly where newly proposed systems clash with traditions (e.g., wantok systems of social obligations towards kinsmen). Culturally sensitive participatory approaches to introduce reform measures are needed (ADB 2009, p. 9).

It is not only these reports that have made these statements. Mellor and Jabes (2004) drew out the findings from the country assessments for the ADB Medium-Term Action Plan 2000–2004. The first finding was that

[t]he scope and content of past reforms were complex and, in large part, foreign to traditional Pacific culture and value systems (p. x).

The second finding was that the lack of domestic support for governance reforms was one of the reasons for the failure of reforms in the past. Looking back to the 2000 Pacific Strategy report by ADB (2000, p. 9), the first two “key lessons” learned from past reform programs were ensuring domestic political commitment and involving key stakeholders. The third key lesson learned was accounting for local culture.

This combination of themes—failure to gain domestic political support and the need to tailor reforms to the culture of a particular country—are constant throughout ADB evaluations since the 1990s. Each report stated that the reasons for the failures of past reforms included lack of domestic support and failure to account for domestic culture; and then stated that future reform efforts would certainly assure that there was domestic support and account for local culture. And then the next generation of reports would make exactly the same statements. Where are the lessons learned?

I argue that these two themes are really two sides of the same problem. Knapman and Sandalha (1999, p. 173) get it precisely wrong when they write that, “[t]he greater the internal

ownership of the reform program, the better it is suited to take account of cultural factors.” It is because aid agencies have failed to put forward reforms that fit well with the political values of developing countries that the reforms have failed to generate the domestic political support required to make them a success.

But sadly these lessons should have been learned from the failure of the previous generation of reform efforts conducted by the World Bank in the 1980s. In a review of 124 loans by the World Bank in 32 countries between 1980 and 1997, Girishankar et al. (1999) found that only 33% of completed loan projects achieved satisfactory outcomes, and that, even when desirable outcomes were achieved, the reforms were often not sustainable. One of the complaints of the review was that there was no evidence that reforms aimed to produce local ownership of the reform culture. In a statement that is far too much like the statements in the latest ADB review, Girishankar et al. (1999, p. 2) wrote:

Downsizing and capacity building initiatives failed to produce permanent reductions in CS [civil service] size and to overcome capacity constraints in economic management and service delivery. There was no evidence that civil servants began to “own” and follow formal rules such as codes of ethics in any meaningful way. As a result, institutional reforms could not substantially limit arbitrary action by bureaucrats or politicians.

In its reports, ADB has been stating for over a decade the need to understand domestic culture in the PICs. But what is noticeable in the reports is the lack of any depth in the analysis of Pacific political culture.

## 5. Understanding Pacific Culture: How Pacific Political Culture and the Modern World Intersect

If these are the views of the major development agencies, we should expect to see political, sociological, and anthropological assessments of reform efforts. However, these types of analyses seem to be entirely lacking within the aid community—except on the fringes and in NGOs. To understand the limited success of recent governance reform efforts, aid agencies need to develop a far better understanding of the motivations of the decision makers within Pacific political regimes and the public sector.

In this study, I focus only on the political aspects of Pacific culture: concepts of leadership and obligations within political hierarchies. Modern institutions, such as public service departments, elected politicians, and central banks, coexist with a Pacific political culture. It is the Pacific political culture, with its norms and expectations of behavior, that largely determines how politicians and public servants will behave. Failure to account for Pacific political culture has undermined much of the recent governance reform efforts in the Pacific.

The developed country anticorruption commissions and governance bodies will not be successful in a political culture that does not have the same developed country norms. Successful public sector reforms in developing countries will probably not simply be a matter of making those public sector institutions look more like developed country institutions. Evans (2008), in a background paper for the recent IEG review of World Bank programs, noted that copying public service employment models from developed countries has not worked (p. 6):

... although the civil services of many developing countries have been legally organized following the basic model outlined above, in practice they perform differently than their developed country counterparts. Thus, most developing countries have instituted merit selection rules, but in practice selection continues to be clientelistic and political.

Research such as Nurnberg's (1995) *Managing the Civil Service: Reform Lessons from Advanced Industrialized Countries* may be headed down precisely the wrong path for developing countries.

Pacific political culture remains much the same as it was in pre-colonial times. Of the population of the PICs, 80% still live a rural or island village lifestyle. Moreover, most of the political leaders and other influential members of the PICs grew up in pre-independence times. The norms and expectations that guide the actions of these influential individuals are still those of the Pacific political culture.

There are writings on "big man" political culture and its influence on the behavior of modern Pacific politicians in political economy literature on "clientelism" from researchers such as Kurer, Standish, and Fraenkel. The recent works of Fukuyama (2004, 2007a, 2007b, 2008) have correctly concentrated on culture in the Pacific—particularly *wantok* networks and the big man<sup>1</sup> concept—as one of the obstacles to development. I believe that although big man political culture is currently the main obstacle to governance reforms in the Pacific, there are elements of this culture that are beneficial even today and that, given properly designed institutions, big man political culture could be part of the solution to the Pacific's development problems. Appropriately designed institutions could leverage Pacific political values to achieve improved governance; but first, we have to understand the political values involved.

## 6. The Tradition of the Big Man in Pacific Culture: Key Aspects from a Governance Perspective

My emphasis here is on the proper role and behavior of leaders as perceived by Pacific cultures. The terms that have traditionally been used in the anthropological and sociological literature are "big man" for Melanesian cultures and "chief" for Polynesian cultures, although this usage has been flexible. I will use the term "big man" to cover all Pacific cultures, as I wish to concentrate on the commonalities of leadership norms across Pacific cultures, and because I wish to avoid preexisting notions that readers might have with a term such as "chief."

However, there were differences in how leaders behaved in different Pacific cultures and in how different leaders behaved in the same Pacific culture. Within a culture a big man could arise due to his skills as a hunter, a warrior, a public speaker, a store of cultural knowledge, or a political organizer. My interest here is in the values that have survived the move from pre-European contact societies to existing democracies. Some roles for big men, such as a hunter, a warrior, or a wise man, have not survived this transition; but other roles, especially the orator and the political organizer,

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<sup>1</sup> The use of the term "big man" here is not intended to exclude women, as some of the "big men" are women. The term "clientelism" is sometimes used in this context, but I wish to explicitly link the behavior of Pacific leaders back to traditional Pacific cultural practices and "big man" is the term traditionally used to describe this political culture.

have thrived. It is these big men roles, and the values and expectations of society for them, that I will concentrate on.

The tradition of the big man in Pacific cultures is one of a leader who distributes resources to his network of supporters and in exchange derives status and influence from his supporters. The “big man” system is quite unlike a feudal system in European history, although chiefly societies such as Hawaii, Samoa, and Tonga were closer to a feudal system.

The concept of *wantok* can be related to the concept of the big man. *Wantok* is pidgin for “one talk,” meaning a person who speaks the same language as oneself. For that reason, *wantoks* are usually related by birth or by marriage. The supporters of a big man would certainly include many *wantoks*. However, the concept of *wantok*—tied as it is to the clan—is much too narrow for modern Pacific cultures. Today’s big men do not seek supporters only from within their clan. In fact, even in traditional Pacific cultures, big men built relationships and sought support from people far outside their clan.

The big man gains most of his political and social position by competitively vying against other big men for supporters, rather than gaining a position by birth—although being from a powerful clan certainly is an advantage. It is far less likely in a big man society that leadership will automatically devolve from father to son. The leadership position is far less secure in a big man society than it was for feudal lords, and even a Hawaiian chief’s hold on power was only maintained by delivering resources to his supporters.

The big man has fewer powers to compel or coerce supporters, apart from threats to withhold resources in the future. The big man is not materially as far above an average villager as a lord was in a feudal society, although again the eastern Polynesia societies tended to have more assets concentrated in the hands of big men.

A broad description of some of the variation among Pacific cultures is contained in Sahlins’ (1958) *Social Stratification in Polynesia*. Sahlins surveyed the political systems of 13 cultures from Ontong Java and Tikopia in the now Solomon Islands to the Hawaiian islands and Easter Island. He ranked these cultures according to their degree of social stratification—that is, the extent of the differentiation between lower and upper groups. From most hierarchical to least hierarchical, he ranked the different cultures into four groups:

- I. Hawaii, Tonga, Samoa, Tahiti
- IIa. Mangareva, Mangaia, Easter Island, Uvea
- IIb. Marquesas, Tikopia, Futuna
- III. Pukapuka, Ontong Java, Tokelau

The most hierarchical cultures were in the eastern parts of the Pacific (Polynesian), while moving west (Melanesian) saw less hierarchical societies. Sahlins later spoke of an “upward west-to-east slope in political development in the Pacific” (1963, p. 204).<sup>2</sup>

<sup>2</sup> A possible area for future research is the fact that the pattern of governance reform successes and failures in the ADB review of 2009 matched Sahlins’ (1958) delineation of political hierarchies. The success stories in the ADB review, in Samoa and Tonga, took place in societies that are the most hierarchical. In societies that are more traditionally hierarchical, it may well be easier to push forward with reforms that produce developed country institutions. The failures recorded in the ADB review took place in the less hierarchical cultures of the Federated States of Micronesia and the Republic of the Marshall Islands.

Underlying these different Pacific political systems is a surprisingly large set of shared Pacific political values that hold true across the spectrum of Pacific political systems. It is these commonalities in Pacific cultural values and expectations of leaders that I wish to develop. The literature I draw upon here are ethnographic studies by anthropologists and secondary analyses by anthropologists and sociologists. I emphasize three features of Pacific political culture: the importance of distribution, the obligation that flows from public gift giving, and the competitive nature of big men.

### **Status Is Gained by Distributing Resources, Not by Producing or Hoarding Them**

Sahlins (1958) argued that big men across the Pacific derived their status from their position as distributors of goods, rather than as producers (p. 5):

As dispensers of food and other goods... chiefs gained in prestige and extended their political and ceremonial prerogatives.

In Pacific societies, production methods were inherently very small scale (e.g., small landholdings or small fishing operations), even for the leaders of communities. Big men were not far more productive than their neighbors, as compared with feudal lords in European history who would personally own enormous amounts of land and labor. So Pacific leaders did not control production, but they might have controlled how goods would be distributed.

A big man today can readily move into the role of a politician allocating public resources in his district or a public servant awarding contracts. A big man would be much less likely to move into a role as a merchant, a producer, or an investor in the Pacific, as these activities do not come with the same status as a distributor. By distributing public resources, the big man acquires the same status and influence as by distributing resources at a village level. The context has changed, but the values have not.

This diversion of public resources is often labeled “corruption,” but these activities are generally expected of big men. As long as the big man is diverting the resources to his supporters, and not hoarding them for himself, it is an appropriate activity for a local big man under traditional cultural norms.

Big men are also expected to be generous with their wealth. In the words of Malinowski talking about his experiences in Papua New Guinea (PNG) and, particularly, the Trobriand Islands (1932, p. 97),

A man who owns a thing is naturally expected to share it, to distribute it, to be its trustee and dispenser. And the higher the rank the greater the obligation.... So that a man of rank will have to hide away any surplus of these articles which he wants to preserve for his further use.... Thus the main symptom of being powerful is to be wealthy, and of wealth is to be generous.

While a big man does have control over a resource, he is not allowed to hoard the resource for himself but should share it among the network. The more senior the big man, the greater the obligation to provide and the larger the network of supporters to provide for.

Having control of a resource in a Pacific community is itself a political act and will bring on the owner of the resource claims on the resource from the wider community. The literature on Pacific entrepreneurship has identified the struggle to balance the needs of a small business with the

demands of the wider community in which the small business operates. In a survey of Palau small businesses, Pollard (1995) wrote of steering a path between the success of the business and the demands of the community. The small businessman, as the controller of a productive enterprise in the community, will find himself a big man, whether that role is desired or not.

Describing a society in Moala in Fiji, Sahlins (1960) used the local term *kerekere*, which is to ask for resources from a relative, but could be used in any kind of relationship. Sahlins described the problem of refusing a request for resources as follows (p. 79):

... the only legitimate reason for refusing a request—except by lack of the solicited item—is that the donor, by giving, would place himself in need. Even in that case a refusal is sometimes difficult and is usually awkward.

Pacific societies have stories of big men killed by their own supporters over accusations of hoarding, and Polynesian chiefs could only hoard resources by holding them in storehouses in public view. The yam house of the big man serves a similar function in the Trobriand Islands described in Malinowski (1921). The yam house is constructed with gaps in the beams so that supporters can see the store of yams inside. The big man could not secretly store resources, as then he would be suspected of unfairly distributing them.

Big men were expected to provide resources for their supporters, even at a cost to themselves. To not be able to provide resources would constitute proof that a person was not a big man.

## 7. Gifts Are Given in Public and Are Not Gifts but Loans with Interest

The decision by early anthropologists to use the term “gift giving” for the exchange of resources in the Pacific context was a distinctly inappropriate one. A gift in a Pacific political culture does not come without obligations. A gift from a big man to a supporter comes with the obligation from the person who receives the gift to repay the gift—usually with interest. By receiving the gift, the person who receives it takes on an obligation to repay. This concept was termed “reciprocity” by Malinowski (1926). Again, the choice of the term “reciprocity” is unfortunate, as reciprocity usually means equal for equal, whereas gift giving in this context generally requires a larger repayment in the future. This is also the *moka* system of the Hagen province in PNG, described in Strathern (1971), and the *kula* ring in the Vitiaz Strait in northeastern PNG, described in Harding (1970).

A gift bestows status on the big man giving the gift. The gift bestows obligation on the *wantok* who receives the gift, as it will have to be repaid with something even larger. Because the gifts are means of gaining status for the big men, gift giving has to be public and preferably splashy. The gift giving in the Pacific was done at large communal feasts with the village looking on.

Brown (1978) described the *mogena biri* or vegetable heap in the Chimbu province of PNG, where one village invites another village to a feast. The village holding the *mogena biri* produces a pile of vegetables “perhaps 50 to 200 feet in diameter and six feet high in the center” (p. 220), which is made up of individual gifts from one person in the village to a person in the other village. The *mogena biri* is usually planned with villages that produce foodstuffs that cannot be produced locally, so that when the exchange *mogena biri* is held by the other village, the first village can receive produce it cannot provide itself. Both villages assemble and each gift is announced and delivered.

The public aspect of gift giving means that the supporters of the person who receives the gift also know what was exchanged. Those supporters will approach the person who receives the gift for their share, and it will be difficult to refuse these demands. The public aspect of gift giving also means that the gift and the obligation that the gift produces on the person receiving the gift are acknowledged.

Thus there are two kinds of gifts in the Pacific. A gift among equals is more of a delayed exchange. The receiver of the gift has to reciprocate the gift with his own gift—preferably an even larger one. Then there is a gift from a big man to a supporter. As with *kerekere* in Moala, there is less of an expectation that the supporter will be able to reciprocate. To accept a gift without being able to reciprocate is an acknowledgment that the person who made the gift is a social superior.

The purpose of gift giving is often to gain advantage. As Lawrence (1971, p. 17) wrote, “New Guinea ethnography affords many examples of local groups working hard to place their rivals under obligations through prodigal contributions of work and co-operation in important undertakings or through lavish hospitality.” Oliver (1955) describes a culture in Bougainville in PNG where the giving of feasts in honor of others was a means of competition. To not be able to reciprocate the feast would be to suffer shame. Big men were individuals best able to organize their groups of supporters to provide resources to distribute at feasts.

## 8. The Big Man Position is Competitive and Political Supporters are Fickle

With the high status for big men comes an obligation to provide resources for his network. To maintain status, a big man has to continually find resources for his network or risk losing those supporters to a competing big man.

In Dorney (2000), we see former PNG Prime Minister Sir Julius Chan talk about the pressure on big men to deliver resources to supporters (p. 47):

Ideology is a luxury marginal members cannot afford. It becomes a case of delivering the goods—a pragmatic approach... The Australian parties play Santa at every Federal and State election. For us it is a full-time job!

There was variation across the Pacific, as noted by Sahlins, in the extent of political hierarchies. However, even the Hawaiian kings were compelled by their supporters to distribute resources. Sahlins (1963, p. 211) quotes David Malo's *Hawaiian Antiquities*:

It was the practice of kings to build store-houses in which to collect food, fish... and all sorts of goods. These store-houses were designed by the Kalaimoku [the chief's principal executive] as a means of keeping the people contented, so that they would not desert the king.

In an interview that Sean Dorney (1999) recorded of a local big man, Sol Taro, in the Highlands PNG district of Lagiāp–Porgera in 1977, Mr. Taro discussed the 10,000 kina (K) in cash he had received from the local member of Parliament for delivering the votes in his village: “I have a big family and that K10,000, I couldn’t hold onto it.”

Even the form of the bribe is indicative of the nature of Pacific political culture. The bribe to gain the votes of the village in this case was K100,000 worth of vehicles, money for a church, and only K10,000 in cash. And even that cash could not be held onto by the big man who received it.

Here, a powerful local man, who could guarantee the votes of his village for a politician, could not stop his own supporters from taking from him all that he had received. The fact that the gift from the local Parliament member was K100,000 worth of vehicles and only K10,000 cash was also a sign that this was a big man gift. No doubt, the whole village would have shown up to see the local politician hand over the vehicles to Mr. Taro in a lavish ceremony. An event like this guaranteed to the politician that Mr. Taro acknowledged the gift in front of his own supporters. To back out on his promise to the politician after a big display of gift giving would be shameful for Mr. Taro—unless, of course, another politician came to the village with an even bigger pile of gifts to distribute.

In big man societies, the position of big man is a contested one, gained competitively, rather than an inherited position of leadership gained by birth or election. This contest means that big men are constantly vying to obtain resources to maintain or increase their network. Any person can become a big man simply by force of personality and success at attracting supporters. This competition between big men and the lack of any permanent hierarchy is a contributing factor in the current failure to establish stable political parties in the Pacific.

In Pacific societies such as Samoa that were more highly stratified before European contact according to the Sahlins' ranking, modern political parties and governments have been more stable. It seems likely that more hierarchical societies would have placed a higher value on traits such as political loyalty that today support a more stable system of government in those countries.

## 9. Does Big Man Political Culture Explain the Failure to Move Forward on Governance?

While the political institutions of the Pacific have changed to mimic the government systems of modern democracies, the political culture of the Pacific is still the same as it was before European contact. The norms and expectations of behavior are those of big man systems housed in European-style office buildings. On the whole, buildings change faster than cultures.

In today's Pacific societies, the big men still exist but they have moved to where they can seek to control the centralized resources in the modern government systems. The big men have moved into influential positions in the government, either through politics or in the public service, and aim to use their positions to divert government spending or control the awarding of lucrative contracts.

But the indicators of governance in the Pacific are not much worse than other less-developed countries at similar income levels. As Fukuyama (2008) pointed out, the "*wantok* problem" is not unique to the PICs. All countries have individuals who seek to divert public resources to their own interests. The only difference between countries is the selection of who to divert the money to—political campaign contributors, fellow clan members, family members, or business associates—and how the corruption is perceived. It is here that political culture matters.

The perception of corruption by Pacific islanders is governed by the norms and expectations within Pacific societies. Big men's diverting public resources to their own uses is expected by voters, as that's what big men do. Corruption is perceived to be a problem by a Pacific islands voter only when it is a big man in another network diverting public resources away from that voter, or if the diversion is carried out in secret. One's own big man diverting public funds to hold a party in a voter's town is never seen as a problem. It's the other big men who are corrupt.

So, we see the seemingly contradictory case of voters complaining about corruption but yet voting for the same politicians to get back into power. Standish (2007) expressed puzzlement about

the PNG voters' seeming indifference to poor performance by politicians. But it is simply an expression of Pacific cultural values. Pacific voters are only unhappy that it might not be their big man who is bringing in the resources to distribute.

Big man cultural values also explain the relative successes and failures that we observe in governance reform in the Pacific, for example, from the 2009 ADB review. If the problem were only lack of capacity or lack of a local "champion," then we would expect public sector reforms to all succeed or all fail in a country. Instead, what we observe is that reform programs succeed in public finance ministries such as finance and treasury, but fail in other ministries such as forestry, fisheries, public works, education, and health. Why does reform work in one ministry but not in others?

One possible answer, which fits with a big man culture but not with other explanations, is that it is the ministries controlled by big men in which the reforms fail. The public finance ministries write the checks, but it is ministries such as forestry, fisheries, public works, education, and health that distribute resources and award contracts. It is simply not in the interest of Pacific big men that proper oversight exists in the ministries that control distribution, as that would hinder the big men's task of distributing resources to their supporters.

Thus, big man political culture provides an explanation for the failure of post-crisis governance reform in Solomon Islands, where extensive resources only managed to restore the original low level of government effectiveness after the political crisis. The answer is that the big men of Solomon Islands do not desire an effective public sector with full accountability, accurate financial accounting, and effective governance, as that would limit their ability to distribute resources, which is the source of their political legitimacy.

## 10. What Can Be Done? Changing Culture or Using Culture?

Little can be done to change culture from the outside. To try to affect cultural norms, aid agencies might focus on empowering domestic groups that can push for reform. Agencies can try to strengthen internal governance bodies within the public sector, such as ombudsmen and auditors-general, while recognizing that these agencies will receive very little domestic support and even will invite difficulties. Building anticorruption bodies in developing countries does not appear to have had much success, however.

Aid agencies could also attempt to shift cultural norms and expectations of leading politicians and public servants. Overseas training of promising public servants and other individuals might start this process. Moving individuals to overseas institutions where norms and expectations are different has been credited with some of the successful reform programs in Central and Latin America. This might also be done by taking individuals out of the Pacific—a reverse Enhanced Cooperation Program—and placing them in a developed country public sector position as a training opportunity, but also as a way of shifting values.

A longer-term strategy would be to improve primary and secondary education in the PICs and to promote greater openness to international trade. However, these efforts are not likely to bring about change in the near future. Although they could be useful, it may be better to work with existing political values in the Pacific in the short term, having in mind that it is the political culture of the whole society that is mostly relevant and that culture takes a very long time to change.

Too much of the current governance reform effort consists of installing developed country institutions, such as anticorruption bodies, in the hope that Pacific political values will change to such an extent that these bodies will function as they do in developed countries. But Pacific culture

will not change to fit institutions. Rather, it is the institutions that need to change to fit the existing values.

Given that Pacific political values are likely to remain the same for the next generation at least, aid agencies should attempt to develop institutions in the Pacific that are a better match with Pacific values. Development of appropriate institutions has for a long time been a theme in the reports of the international development agencies, but the work required to develop appropriate institutions has never been done. What makes this task even more difficult is that culturally appropriate institutions for the Pacific may not work well in sub-Saharan African countries, or even that culturally appropriate institutions for Melanesian countries may differ from those for their Polynesian counterparts.

## 11. Conclusion

Current governance reform efforts in the Pacific by international aid agencies are not working. These efforts to improve governance rely to a large extent on bringing developed country institutions, such as ombudsmen and auditors-general, into Pacific societies. A major stumbling block facing these efforts is the differences in political values between the developed countries whose institutions are being copied and the political values of the Pacific societies into which the institutions are being introduced.

Past reviews of governance reform have identified a lack of understanding of local culture and a lack of local support as key reasons for the failure of governance efforts. But these findings have not generated efforts to research Pacific political culture in international aid agencies. Unfortunately, it is these same Pacific political values that are preventing the developed country institutions from operating as they do in developed countries.

A better path to follow is to develop public institutions that reflect existing Pacific political values. There are aspects of Pacific political values that would promote more effective governance if they were used in the right manner. An advantage of this approach for international aid agencies is that local support is far more likely to be forthcoming if governance reforms align with existing cultural norms.

Pacific societies were very heterogeneous prior to contact with Europeans, and remain so; but there are some political values that cross all Pacific societies. Distribution of resources remains a key role of Pacific political leaders, and current big men will maneuver into positions of control over the distribution of public funds. Bureaucracies in the Pacific have not been able to keep big men (either inside the public service or outside) from distributing resources, and anticorruption bodies have not been able to improve this situation—as could have been predicted from the 2008 IEG report. Resource distribution is an inherently political act in the Pacific.

If we wish to see an efficient public sector in the Pacific, we would have to keep the big men out. This can only be done if the distribution of resources outside the public sector is carried out at the political level, so that prospective big men are attracted to politics rather than to the public sector. Admittedly, this is an impossible task, as many functions in the public sector are distributive; but reforms might attempt, as much as possible, to have resource distribution done by elected officials outside the public sector.

As much as possible, distribution of resources inside the public sector—jobs and contracts—should be separated from the daily administration of the ministries. The awarding of jobs, promotions, and contracts will take on a political aspect in a Pacific context. Distribution of

resources such as these should not be left under the direct or indirect control of a minister, as the minister will use them for personal political gain.

Aid agencies should be careful to structure their development policies to take account of the “big man problem.” National development banks, as ready distributors of cash, should never be set up in the Pacific. The problem is not that development banks are too alien to Pacific cultures to work; rather, development banks look exactly like a very Pacific concept—the chief’s storehouse or the pile of gifts at a feast. The development bank is a collection of goods to be distributed by a big man to shore up his support. The fact that no development bank has ever succeeded in the Pacific should not be a surprise when considered in this light.

Likewise, direct cash payments to politicians to distribute to their constituents (“slush funds”) such as the Rural Constituency Development Fund in Solomon Islands or the Electoral Development Funds in PNG, fit perfectly into the distribution role of big men. The local member is given a sum of money to distribute to the district he represents. In the Pacific context, the big man will distribute this money to maximize his political support among his existing supporters or potential supporters. Once introduced, these schemes will prove impossible to undo and will likely only grow in time.

Second, there is a feature of Pacific political culture that can be used to improve governance—the public display of gift giving. Transparency is a Pacific cultural value—if not quite the same sort of transparency as might be considered appropriate in a developed country context. Transparency in a Pacific context requires that the big man openly distributes resources. The gift giving should be done at a public event, such as a feast or a ceremony. If distribution is moved out of the public service and into the political domain, then all distribution should be required to be out in the open.

But this is not the same as it would be in a developed country. A Pacific politician might deliver resources to a supporter in exchange for political support; but in a Pacific context, this is a perfectly appropriate action for a politician as long as it is done openly. It is necessary that the exchange be publicly viewed and recorded.

In a case such as the Electoral Development Funds in PNG, we might require that all funds be exchanged in public and that all transfers be recorded, but not insist that the auditor-general track down funds and look for evidence of corruption. Admittedly, this is not quite what Transparency International would wish to achieve in PNG, but it is surely an improvement on the current administration of the Electoral Development Funds in which, it seems, spending is not being tracked at all.

This emphasis on public gift giving and suspicion of private gifts in Pacific political culture also provides a possible basis for an anticorruption campaign that fits into Pacific values. An anticorruption campaign could focus on secret bribes as corruption, rather than big men delivering resources to their supporters. If much of the distribution of public funds can be moved to a political sphere and handled openly, then secretive bribery can be attacked as contrary to Pacific values.

Third, a feature of Pacific political culture that might work toward improved governance is the competition between big men. A better governance system might be to institutionalize the big man networks at the district level, as the big men are still the legitimate political figures in that arena. Instead of relying upon public service administrators to deliver funds to a district, local distribution might be moved into the local political sphere. A more culturally appropriate system would be to have a local council of elected big men oversee, together with the local member, the delivery of the resources from the central government.

Fukuyama (2007a) questioned whether we should have such a negative view of the slush funds in the Pacific. Slush funds are, as mentioned above, very much in line with Pacific political culture. Rather than attempting to get rid of slush funds, a better response may be to recognize the big men and include them explicitly in the process of government through the distribution of the district funds. If the distribution of funds were to be conducted in the open and decisions about distribution involved many local leaders, then the process would be an improvement over current processes, as well as being a process that Pacific cultures would recognize.

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# 8 Achieving Revenue Reform in the Pacific

## Taking Revenue Policy and Administration Advice from Intent to Reality

by *Margaret Cotton*

### ABSTRACT

Technical assistance on revenue policy and its administration for Pacific island countries has been based on a common framework for the last decade. Notwithstanding the broad commonality of advice on reform of revenue policy and administration, many Pacific countries have difficulty implementing the reforms. This research provides guidance on issues affecting achievement of revenue reforms in Pacific island countries.

Cotton (2008) found there was a relationship between recipients' perception of the magnitude of revenue reforms and the outcomes. This research expands on the Cotton study and identifies the common revenue reforms across the Pacific that have met with difficulties in their acceptance and implementation. It also identifies common constraints to achieving these reforms and offers suggestions for addressing them. Understanding the common challenges and their causes will inform the debate on aid effectiveness and political economy in the Pacific.

The opinions and conclusions expressed in this chapter are those of the author and are not necessarily representative of opinions and conclusions of the Pacific Financial technical Assistance Centre or the International Monetary Fund.

### 1. Introduction

Fiscal reform is on the agenda of most Pacific island countries (PICs) and has been for many years. Trade reforms, including the move to free trade agreements, the pending changes in compact funding for northern Pacific countries, and the recent volatility of remittances and tourism have hastened the need for the PICs to review their fiscal policy and operational frameworks. Technical assistance for revenue policy and revenue administration typically promotes a four-pronged approach for improving fiscal sustainability and operational efficiency and effectiveness: (i) the introduction of a broad-based, low-rate income tax, with few exemptions and discretions; (ii) the introduction of a broad-based value-added tax with few exemptions and discretions; (iii) a reduction in reliance on trade tariffs and sales taxes; and (iv) the introduction of comprehensive revenue administration legislation establishing and standardizing the rights and obligations of the revenue administration

office, taxpayers, importers, and exporters. This advice has been extant for nearly a decade, yet many PICs are still grappling with its implementation.

In a study of Pacific countries, Cotton (2008) identified a relationship between the magnitude of the reform recommendations made in relation to revenue policy and revenue administration and the implementation of the recommendations: the larger the reform was perceived to be by the recipient of the technical assistance, the less likely it was to be implemented. Larger reforms, although likely to be accepted and the changes commenced, were not likely to be completed. Conversely, reforms that were perceived by the recipients as small were almost certain to be completed. Availability of skills, cost, time frame, taxpayer feedback, and impact were all factors found to influence the perception of the size of a reform. Political factors were also found to influence the implementation of the recommendations. Cotton (2008) did not address why the larger reforms were harder to implement, but recommended further research be undertaken to ascertain if there are similar perceptions between recipients of the magnitude of common reform recommendations and if there are similar outcomes and status of common recommendations.

This study picks up the question raised in Cotton's research to determine if there are revenue reform recommendations made to Pacific island administrations that are commonly considered to be difficult to implement. The study also provides findings on the constraints creating the implementation difficulties. By identifying constraints to achieving revenue reform, it is intended that the findings will inform the debate on aid effectiveness and the political economy of the Pacific. The findings should also provide guidance to aid agencies on how revenue administrations can best be assisted to address these constraints.

The source data for the current study were obtained from recommendations made to ministers of revenue and chief executive officers of revenue administrations by tax policy and administration technical advisors from the Pacific Financial Technical Assistance Centre<sup>1</sup> (PFTAC) from 2002–2007. The recommendations given to the three countries with the highest level of technical assistance were subjected to detailed content analysis that built on the findings from the Cotton (2008) study. A combination of content analysis and group workshops was used in the current study. The content analysis was undertaken to identify and categorize the revenue reforms that commonly meet challenges in acceptance and implementation. The findings from the content analysis were presented to members of the Pacific Islands Tax Administrators Association (PITAA) and a group workshop to identify the common features of these reforms and constraints that make their implementation difficult.

The research shows that a wide range of revenue reform recommendations were made in the period 2002 to 2007, few of which were common to the three countries researched. Eight categories of common reform recommendations were identified as commonly facing difficulty in implementation. These eight categories split evenly into reforms of a policy nature and reforms of a revenue administration nature. Policy reforms causing difficulty in implementation were (i) the introduction of a value-added tax (VAT), (ii) the introduction of revenue administration legislation, and (iii) tariff rate changes. Revenue administration reforms commonly facing difficulty in implementation were in the areas of (i) audit and communication strategies, (ii) the adoption of self-assessment and post-clearance audit principles, and (iii) the adoption of business analysis techniques.

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<sup>1</sup> Based in Fiji, PFTAC is staffed by technical advisors on the International Monetary Fund's roster of experts and is funded from aid monies provided by the governments of Australia, Japan, the Republic of Korea, and New Zealand, and the Asian Development Bank.

Both policy and administration recommendations addressing the removal of exemptions and associated discretionary decision making faced challenges in implementation.

The constraints causing delays in accepting and implementing these reform recommendations were identified in an effort to help predict future recommendations that might face similar implementation challenges. Suggestions are made as to how technical assistance can be adapted to improve the effectiveness of aid aimed at improving the implementation of revenue reform.

## 2. Contextual Background

The Pacific islands region has had both American and Anglophone influences on the development of its fiscal policy frameworks. For the purposes of this study, the Pacific islands region includes the following countries: the Cook Islands, Fiji, Kiribati, Nauru, Niue, Palau, Papua New Guinea (PNG), the Marshall Islands, the Federated States of Micronesia (FSM), Samoa, Solomon Islands, Tokelau, Tonga, Tuvalu, and Vanuatu. All 15 countries are low or low-middle income countries. Notwithstanding the diversity of the Pacific islands region, it is possible to identify subregional groupings that put revenue reform technical assistance into context. This study does not cover the French-influenced PICs.

### Overview of Revenue Policy and Administrative Frameworks in Pacific Island Countries

Generally speaking, the American-influenced Micronesian countries (the Marshall Islands, the FSM, and Palau) have rudimentary tax systems using a mix of gross revenue tax and presumptive tax in place of business income tax, and are heavily reliant on import duties and payroll taxes. The more Anglo–Australian influenced Micronesian countries (Kiribati and Nauru) are also heavily reliant on payroll taxes and trade tariffs, although Kiribati does have a simple business income tax. Conversely, the Anglo–New Zealand influenced Polynesian countries (the Cook Islands, Niue, Samoa, Tokelau, Tonga, and Tuvalu) have more comprehensive tax systems comprising business income taxes, VAT, and payroll tax in their policy frameworks: they are increasingly less reliant on trade tariffs. The Melanesian countries are, perhaps, the most diverse in terms of their revenue frameworks. Fiji and PNG have comprehensive policy frameworks and each has established its revenue agency as an independent authority. Solomon Islands has a plethora of goods and sales taxes and a rudimentary income tax, while Vanuatu, operating an offshore investment center, largely relies on VAT and trade taxes. Of all the PICs, only Tonga has all-inclusive revenue administration legislation consolidating and standardizing the powers and obligations of taxpayers, importers and exporters, and the revenue administration office. Table 8.1 outlines the high level of diversity of the Pacific's revenue policy framework.

**Table 8.1: Summary of Pacific Island Countries' Revenue Policy and Administration Frameworks**

	Income Tax			Indirect Tax		Administration				Imports
	Business	Personal	Gross Revenue	Sales Tax/ Goods Tax	Value Added Tax	Independent Revenue Authority	Within Ministry of Finance	Combined Tax Customs Agency	Revenue Administration Act	
Cook Islands	✓	✓			✓		✓	✓		
Fiji	✓	✓			✓	✓		✓		✓
Kiribati	✓	✓					✓			✓
Nauru							✓	✓		✓
Niue	✓	✓			✓		✓	✓		
Palau		✓	✓	✓			✓			✓
Papua New Guinea	✓	✓			✓	✓		✓	<sup>b</sup>	✓
Marshall Islands		✓	✓	✓			✓	✓		✓
Micronesia, Federated States of		✓	✓	✓			✓	✓		✓
Samoa	✓	✓			✓		✓	✓		✓
Solomon Islands	✓	✓		✓			✓			✓
Tonga	✓	✓			✓	✓ <sup>c</sup>		✓	✓	✓
Tokelau	—	—		—	—	—	—	—	—	—
Tuvalu	✓	✓			✓		✓			✓
Vanuatu					✓		✓	✓		✓

— = not applicable.

<sup>a</sup> Or the equivalent of this ministry.<sup>b</sup> Separating in 2009/2010.<sup>c</sup> The revenue agency is independent of the Ministry of Finance; however, the chief commissioner is the minister of finance.

Source: Author's compilation.

### Pacific Financial Technical Assistance Centre

To overcome difficulties in meeting the technical assistance requests of small island countries, the International Monetary Fund (IMF), in collaboration with donor agencies from Australia, Japan, the Republic of Korea, and New Zealand, and the Asian Development Bank, established in 1993 the Pacific Financial Technical Assistance Centre (PFTAC). Based in Fiji, PFTAC, provides technical assistance in four core areas: public financial management, macroeconomic and financial statistics, finance sector supervision, and tax policy and revenue administration. The IMF engages long-term advisors to provide full-time technical assistance in each of these four areas to the PICs served by the center. Short-term advisors are also engaged as needed. The data for the current study were obtained from revenue reform recommendations provided by PFTAC technical assistance advisors.

The IMF and PFTAC are not the sole providers of revenue reform technical assistance in the Pacific. However, they are recognized, arguably, as the primary providers of tax policy advice and for that reason were chosen as the source of the recommendations used in this study. It is recognized that technical assistance for tax administration and customs is provided by a range of agencies including, but not limited to, Australia and New Zealand revenue agencies, the Asian Development Bank, the World Customs Organization, the Oceania Customs Organisation, and the Pacific Islands

Forum secretariat. To the extent that customs recommendations are addressed in this study, it has been acknowledged by the Oceania Customs Organisation that the recommendations reflect regional best practice.

### 3. Literature Review

This study brings together three complementary disciplines: aid effectiveness, change management, and cross-cultural management. This section briefly canvasses salient literature from these disciplines and outlines in some detail the Cotton (2008) study, and then draws the theories together in the context of revenue reform technical assistance in the Pacific islands region.

#### Aid Effectiveness Literature

Aid effectiveness literature suggests technical assistance typically recommends “big push” transformational changes and that this approach to development assistance is not appropriate for developing countries. An approach that begins with where the countries are and sees the changes through their eyes is claimed to be more effective in achieving the desired changes (Ellerman 2007). To be helpful, the technical assistance requires autonomy and ownership on the part of the recipient, and the leader must understand the change and take responsibility for implementing the change (Abonyi 2002; Bucknall, Allan, and Vaai 2004; Ellerman 2004a, 2007; Organisation for Economic Co-operation and Development 2005; Pronk 2001, 2003; Sobhan 2002; World Bank 2005). Abonyi (2002) suggests that at the government level this translates into three dimensions: understanding, intent, and capability. Without these dimensions, governments are often accused of lack of commitment to the reform. Like Ellerman (2004a, 2007), Abonyi suggests that a perceived lack of ownership or commitment may actually be a result of differences in understanding from the aid agency, or lack of capacity to proceed due to political resistance or institutional capacity constraints (p. 41).

#### Change Management Literature

Change management literature divides change into two categories: transactional and transformational. Transactional changes are small, continuous changes that occur gradually. They are small scale, are less drastic, enhance efficiency, and do not affect the core of the organization (Devos, Buelens, and Bouckenooghe 2007). Transformational changes are big, episodic, more radical changes, which can be disruptive and result in a complete change in the fabric of the organization. In a business context, transactional changes relate to, among other things, structure, management practices, and systems (policies and procedures), whereas transformational changes relate to the external environment, leadership, mission and strategy, and organizational culture.

Change management theorists suggest people can be overwhelmed by big transformational changes to such an extent that they do nothing. However, where changes are small and transactional in nature, people are not overwhelmed and are able to make a series of small changes leading to a bigger overall change (Bryson 1988; Weick 1984). This process leads to a “success breeds success” outcome. Thus, a strategy of small wins informed by an overall strategic direction is most likely to be successful (Bryson 1988, p. 41).

#### Cross-Cultural Management Literature

Cross-cultural management literature suggests it is inappropriate and ethnocentric to assume that theories and models developed in one cultural context will apply in other cultural contexts (Adler

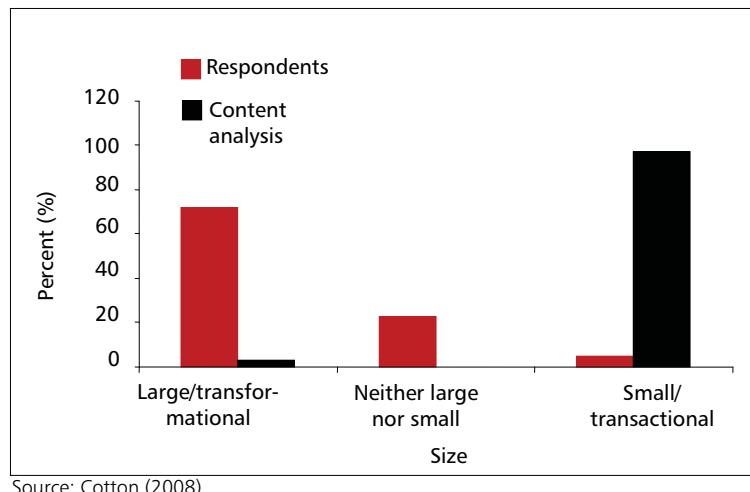
1983). This literature is of tangential importance only, but warrants mention because many technical assistance providers engage consultants who are not from the same cultural, academic, and organizational backgrounds as the recipient of the technical assistance, and therefore may not perceive the nature of the changes through the same lens as the recipient.

The proposition drawn from these three disciplines is that where the recipient sees the change contained in technical assistance recommendations as large (transformational), they may feel so overwhelmed by the changes required that they do nothing. With the added dimension of different cultural, academic, and organizational backgrounds, it is probable that the technical assistance provider's perception of the changes required will be different from the recipient's.

### **Summary of Cotton (2008)**

Against that theoretical background, Cotton (2008) examined whether the degree of the change content in revenue reform recommendations made by PFTAC revenue advisors in the period 2002–2007 affected the implementation of the recommendations. The study assessed whether the recommendations were of a transformational or transactional nature, using conventional definitions of those terms. As part of the study, the recipients of the recommended reforms were asked to rate the size of the reforms from their perspective. To ascertain whether the size of the reforms affected their implementation, the recipients were also asked to rate the outcome of the reform recommendations (accepted, rejected, or no decision yet) and the status of the recommendations (completed, started but not yet finished, and not yet started). The author was then able to compare the differences in perception between the recipients' perspective of the size of the reforms and the consultant advisors' perspective, as deduced from conventional definitions of the size of the changes recommended. The study also included analysis of the impact the perceived degree of change had on implementation of the recommendations.

The Cotton study found the majority (97%) of the reforms were transactional reforms when assessed using conventional definitions of transactional and transformational changes. At face value, this finding belies the idea that most technical assistance recommends transformational “big push” (Ellerman 2004b) change. However, when the same recommendations were rated by the recipients, the majority of the reforms recommended were considered to be large. This difference in perspective was graphically depicted in the Cotton study (p. 51) (Figure 8.1).

**Figure 8.1: Difference Between Respondents' Perspectives of Size and Content Analysis**

Source: Cotton (2008)

Thus, notwithstanding that the revenue reform recommendations were not transformational in the traditional North American academic context, they were seen as large by the recipients. This point should not be lost on aid agencies which, as noted previously, typically engage consultants with cultural, academic, and organizational backgrounds that are different from those of the aid recipients.

The Cotton study did not find that the recipients were so overwhelmed by the magnitude of the reforms that no action was taken. However, only 30% of the reforms rated as large by the recipients had been implemented. Conversely, the smaller the perceived size of the reform the more likely it was to be implemented. Table 8.2 shows the impact of size on the implementation status of revenue reform technical assistance recommendations (see Cotton 2008: p. 44).

**Table 8.2: Status of Reform Recommendations, by Size**

Reform Recommendations	No.	% share
<b>Large<sup>a</sup></b>	<b>389</b>	
Accepted, completed	117	30
Accepted, not yet started	35	9
Accepted, started not yet finished	83	21
No decision yet	134	35
Rejected	20	5
<b>Neither large nor small</b>	<b>124</b>	
Accepted, completed	60	48
Accepted, not yet started	7	6
Accepted, started, not yet finished	39	32
No decision yet	10	8
Rejected	8	6
	<b>31</b>	

Small <sup>b</sup>		
Accepted, completed	30	97
Accepted, not yet started	1	3
Accepted, started not yet finished	0	0
No decision yet	0	0
Rejected	0	0

<sup>a</sup> Large includes more large than small.

<sup>b</sup> Small includes more small than large.

Source: Cotton (2008).

Cotton found that 30% of the recommendations assessed as large (transformational) had been implemented. The study concluded that the size of the recommended reforms as perceived by the recipients had a clear effect on the implementation of the recommendations. It is worth noting that these implementation rates are consistent with the 30% implementation norm for transformational reforms in developed countries (Beer and Nohria 2000).

The Cotton study did not address causality nor did it consider whether the recommendations that were found to be large, or were otherwise not yet implemented, were common across the recipients. The current study addresses these points and identifies the revenue reforms that are commonly considered to be difficult to implement. To a lesser extent, this study also provides details on the constraints creating the implementation difficulties.

## 4. Study Design

The specific questions addressed in this study are as follows:

- Which revenue reform recommendations are common to the participant countries?
- Have common recommendations achieved the same outcomes and status in the PICs?
- What are the constraints affecting the outcomes and status of these common recommendations?

### Population and Sampling

The population for this research comprises all technical assistance recommendations made in tax and policy administration missions from 2002 to 2007 to the 15 PICs to which PFTAC provides assistance: the Cook Islands, Fiji, Kiribati, Nauru, Niue, Palau, PNG, the Marshall Islands, the FSM, Solomon Islands, Samoa, Tonga, Tokelau, Tuvalu, and Vanuatu.

A preliminary review of the technical assistance reports issued during the review period showed the total number of missions for each country ranged from none to 15 and the number of recommendations per country ranged from one to in excess of 300. Given the focus of this research on common reforms that have faced common difficulties, purposive sampling was undertaken to identify the countries with the highest number of recommendations. This approach was considered most likely to give a greater range of recommendations from which a higher degree of commonness would likely be identified.

Purposive sampling identified the FSM, Solomon Islands, and Tonga as the countries receiving the highest number of technical assistance missions. One advantage of this selection is that it allows observations to be drawn across subregional groupings (i.e., Polynesian, Micronesian, and Melanesian).

## **Data Collection and Analysis**

Data were collected in two stages. First, a document review was undertaken to identify the common technical assistance recommendations and the outcome and status of these common recommendations. Second, a group workshop was held with the heads of revenue administrations from 13 of the 15 PICs. The purpose of the workshop was to identify common constraints affecting the outcome and status of the common challenging recommendations.

Content analysis, “the systematic, objective quantitative analysis of message characteristics” (Neuendorf 2002, p. 1), is a recognized technique for analyzing large volumes of qualitative data for similarity of messaging. The wording of the recommendations given to each country was unlikely to be identical, making it necessary to use an analytical method recognized for describing the form characteristics and substance of text (Berelson 1952). Content analysis is a recognized tool and is, therefore, considered useful in the current study to identify recommendations of similar substance. Care was taken to set clear parameters for defining commonality. Early indications of commonality were tax type, tax policy, tax administration, and subsets within those high-level groupings. The content analysis codebook ultimately used is in Appendix 8.1.

The most effective reliability testing of coding decisions (Krippendorff 2004; Lombard, Snyder-Duch, and Campanella-Bracken 2002) is assessed by intercoder percentage agreement (Lombard et al. 2002) and this approach was adopted in the study. Intercoder reliability percentage agreement is the extent to which coding by two different coders of the same text achieves the same result. The incumbent PFTAC tax policy and revenue administration advisor was asked to code the recommendations to increase confidence in the coding scheme used in the study.

Preliminary findings from the content analysis were presented to the heads and senior staff of Pacific tax administrations at PITAA’s 2009 conference in Nuku’alofa, Tonga. Discussions and workshops about the findings were held to identify if other countries in receipt of similar recommendations experienced the same difficulties with their implementation. Delegates were also asked to comment on the cause of the implementation difficulties.

Simple statistical analysis was used to analyze the data obtained from the content analysis. Descriptive data were computed to summarize PFTAC activity in member countries in the review period and the content analysis data.

## **Assumptions and Limitations**

For the purposes of this study, it was assumed that the recommendations of the three countries selected for in-depth review are representative of the recommendations given to other PFTAC member countries. However, it is acknowledged that focusing on common recommendations and constraints at a regional level may overlook common recommendations and constraints that exist at a subregional level. For example, a wider range of commonality may have been detected at subregional level, particularly for the Micronesian countries facing implementation of comprehensive direct and indirect tax policy reforms and revenue administration reforms.

The study focuses on perceptions of the constraints affecting implementation of technical assistance reforms and does not take into account differences in tangible measures such as organization size, human resource skills, reform budgets, and geography.

## **5. Findings**

This section outlines the findings from the document review, content analysis, and group interviews with the delegates at the 2009 PITAA conference.

## Findings from Document Review

A preliminary review of all the revenue technical assistance documentation was undertaken to identify the number of revenue technical assistance missions made to each country,<sup>2</sup> the duration of the missions, and the number of recommendations given in the review period. Table 8.3 outlines the findings from this review. Many of the recommendations outlined significant policy and operational changes for the revenue administrations involved, a fact that is, arguably, reflected in the number of recommendations. An early question raised by this finding concerns the time frame over which small revenue administrations (only Fiji and PNG have revenue administration offices with more than 100 staff) are, realistically, able to manage change on this scale.

**Table 8.3: Summary of Revenue Sector Missions 2002–2007**

Total countries with technical assistance	13
Total technical assistance missions	61
Average missions per country	5
Maximum missions	15
Minimum missions	1
Total mission days	706
Average mission days per country	54
Average mission days	12
Longest mission (days)	38
Shortest mission (days)	2
Total number of recommendations	1,455
Average number of recommendations	91
Maximum number of recommendations	143
Minimum number of recommendations	1

Source: Author's compilation from PFTAC files.

## Findings from Content Analysis

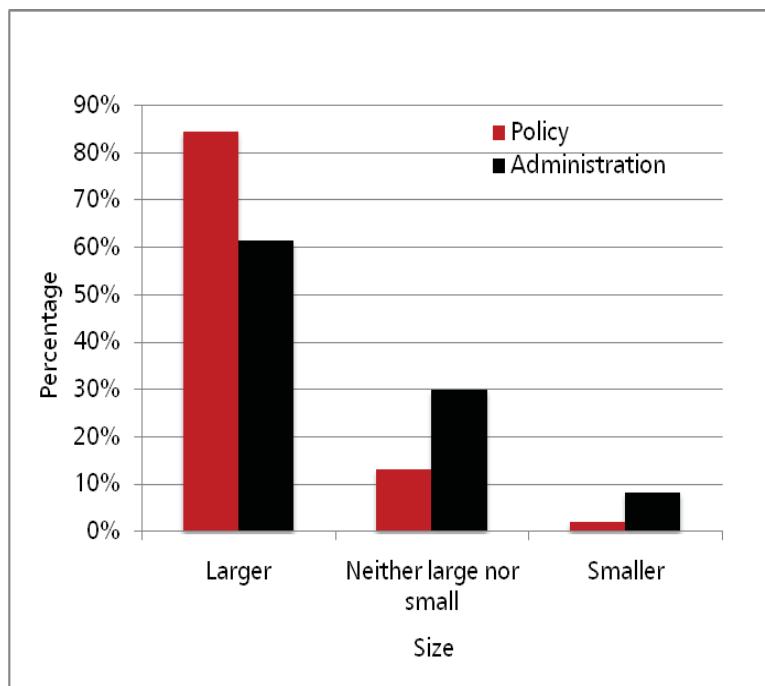
The recommendations provided to the FSM, Solomon Islands, and Tonga from 2002 to 2007 were analyzed using content analysis techniques to identify recommendations of a similar nature. The findings from the content analysis are a combination of original data from the Cotton (2008) study (specifically, the recipients' perceptions of the size, outcome, and status of the reform recommendations) and data obtained from additional content analysis categorizing the nature of the recommendations. The balance of this section sets out the findings from the content analysis.

In the initial review, the recommendations were categorized into two types: policy and administration. Policy recommendations were defined as recommendations outlining how the government should approach taxation and the principles that should be applied when setting taxes. These included recommendations for the repeal, enactment, or amendment of specific laws. Administration recommendations were defined as recommendations outlining how the revenue policy should be administered by the revenue agency, including people, processes, systems, time frames, training, communications, and structures.

<sup>2</sup> Only PFTAC technical assistance missions were counted. Missions directly from IMF headquarters were not included in this data review.

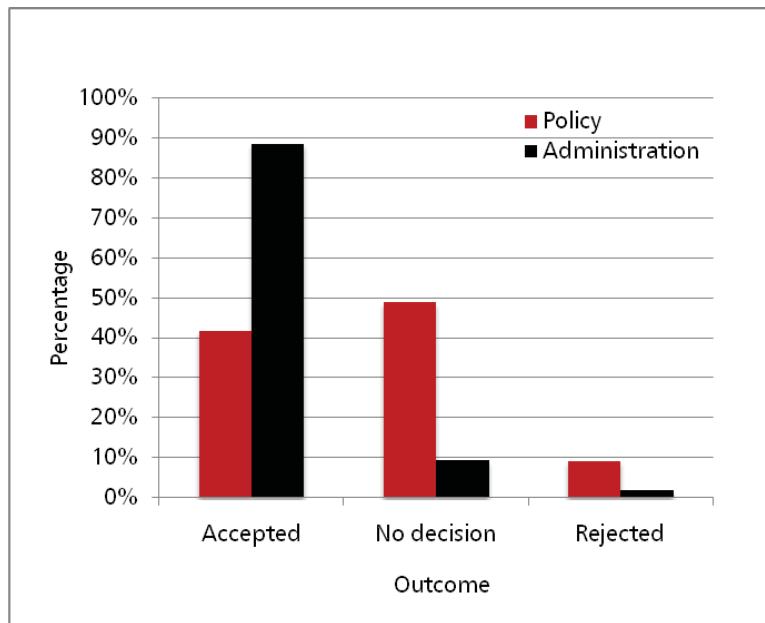
Figure 8.2 shows the breakdown of the recommendations into policy and administration by the perceived size of the recommendations. Of the 544 recommendations reviewed, 235 (43%) were classified as policy reforms, and 309 (57%) were classified as administration reforms. Nearly 85% (199) of the policy recommendations were considered to be large by the recipients, and slightly more than 60% (190) of the administration recommendations were considered to be large. About 30% (93) of the administration recommendations and 13% (31) of the policy recommendations were thought to be neither large nor small. The data used is summarized in Appendix 8.2.

**Figure 8.2: Size of Reform Recommendations by Category**



Source: From surveys by the author.

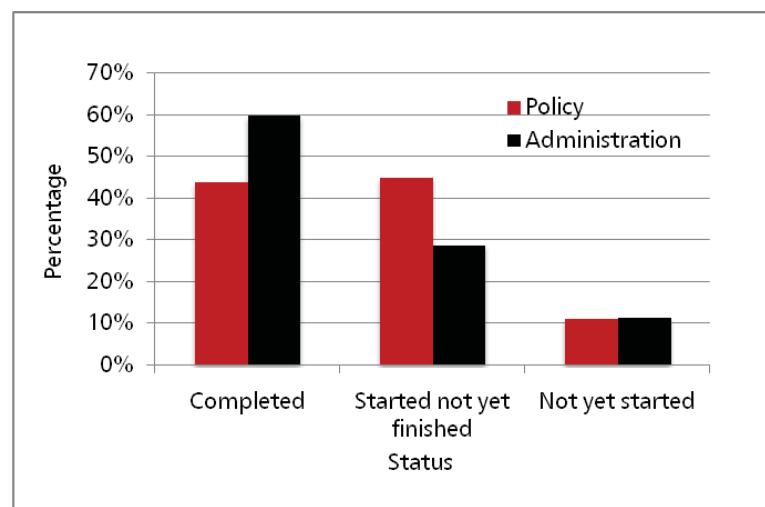
Nearly 90% (274) of the administration recommendations were accepted by the recipients but only 41% (98) of the policy recommendations were accepted. Nearly 10% (22) of the policy recommendations were rejected and the balance (50%, 115) are still awaiting decision. All the recommendations awaiting decision relate to Solomon Islands. Solomon Islands appears to have taken an approach whereby the decision to accept a recommendation is made only once officials are ready to commence implementing the recommendation. Whereas the FSM and Tonga have made upfront decisions to accept the recommendations but may not have commenced implementation of those recommendations at the time of this study. Because this difference in approach affects the findings from this study, the “no decision yet” recommendations have been removed from analysis of the current status of the recommendations. That is, only recommendations that have been accepted have been analyzed further for status. Figure 8.3 shows the outcome of the recommendations by category. A breakdown of these findings is in Appendix 8.2.

**Figure 8.3: Outcome of Reform Recommendations by Category**

Source: From surveys by the author.

The findings suggest that 56% (207) of the accepted recommendations have been completed. Administration recommendations are more likely to be completed (60%) than policy recommendations (40%). Equal percentages (11%) of administration and policy recommendations have not yet been started, and more policy recommendations (45%) than administration recommendations (29%) have been started but not yet completed.

Figure 8.4 shows the status of accepted recommendations. A breakdown of these findings is in Appendix 8.2.

**Figure 8.4 Status of Accepted Reform Recommendations by Category**

Source: From surveys by the author.

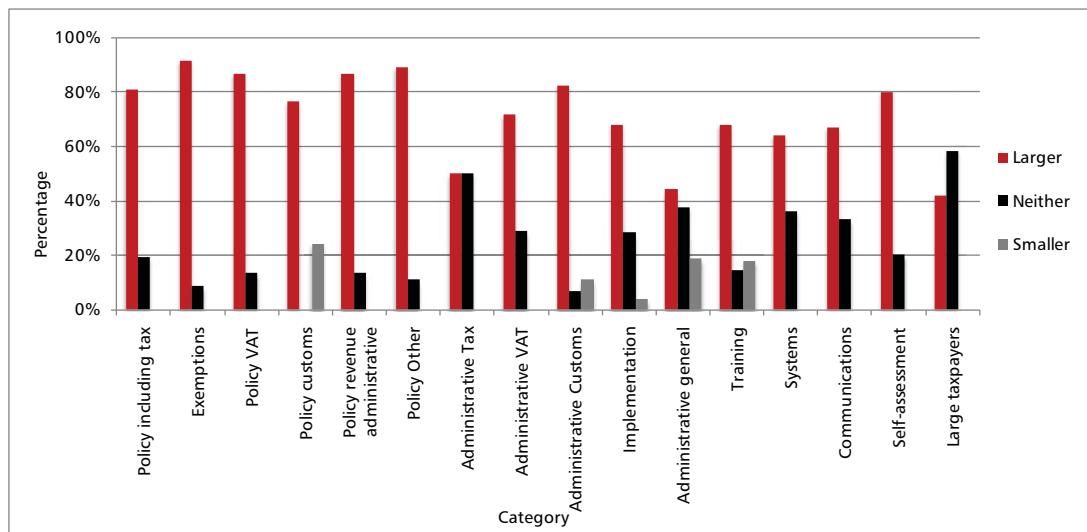
These findings suggest that if the success of technical assistance is measured in terms of acceptance and implementation of the recommendations, revenue administration recommendations are more likely to be successful than revenue policy recommendations. This finding is, arguably, too general to be of value in understanding why policy recommendations meet difficulties in their implementation, and which of the administration recommendations are harder to implement. To help understand whether there are recommendations that commonly meet difficulties in their implementation, a second content analysis exercise was undertaken to break the recommendations down further within the policy and administration categories.

The policy recommendations were divided into the following subcategories: income tax, VAT, customs, revenue administration, and other. The administration categories were also subdivided: tax, VAT, customs, implementation, general, training, systems, communication, self-assessment, and large taxpayers. Another category, exemptions, was added, containing both policy and administration recommendations. The definitions attributed to each of these subcategories are outlined in the coding dictionary in Appendix 8.1.

Analyzing the recommendations by subcategory and the size attributed to them by the recipients gives a more informative picture of the policy and administration recommendations considered to be large and therefore potentially difficult to implement. Recommendations focusing on tax administration, general business administration, and large taxpayer activity were most evenly spread between “large” and “neither large nor small” recommendations. Of the policy recommendations, only those relating to customs were considered to be “small.” The recommendations in all the other subcategories were generally considered to be “large.”

Figure 8.5 shows the recipients’ perspective of the size of the recommendations in each subcategory. A breakdown of these findings is in Appendixes 8.3 and 8.4.

**Figure 8.5: Size of Reform Recommendations by Subcategory**



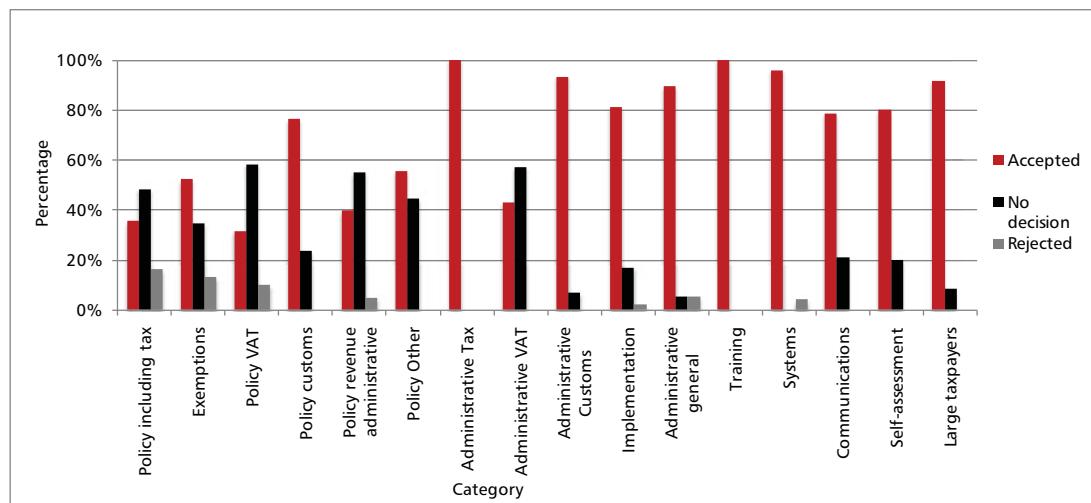
VAT = value-added tax.

Note: Exemptions contain both policy and administration recommendations.

Source: Author’s compilation.

Figure 8.6 shows the outcome of the recommendations in each subcategory. Both policy and administration recommendations relating to VAT were more likely to be still awaiting a decision, whereas income tax and revenue administration recommendations were only likely to be awaiting decision if the recommendations were policy oriented. As noted earlier, the recommendations where there has been “no decision yet” relate to one country, reflecting the position of the Solomon Islands government that it is not yet ready to make a decision on these recommendations. A breakdown of these findings is in Appendixes 8.3 and 8.4.

**Figure 8.6: Outcome of Reform Recommendations by Subcategory**



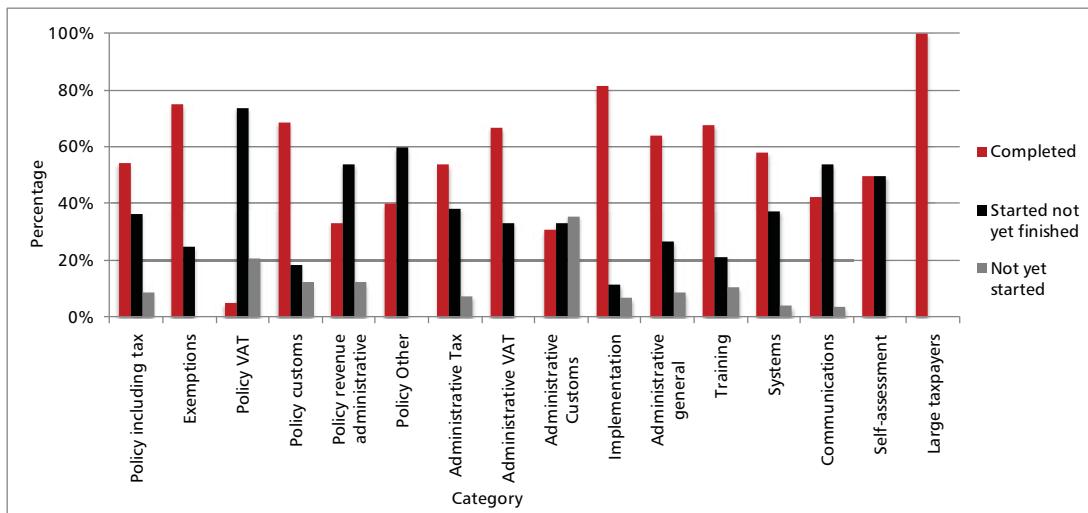
VAT = value-added tax.

Note: Exemptions contain both policy and administration recommendations.

Source: Author's compilation.

Recommendations that relate to general revenue administration issues, management of large taxpayers, training, and implementation of the technical assistance are more likely to be completed than other administration recommendations. When accepted, VAT administration recommendations are also more likely to be completed. Conversely, VAT policy recommendations, when accepted, are least likely to be completed. Policy recommendations relating to customs are more likely to be completed than other policy recommendations. Nearly 80% of the recommendations relating to exemptions have been completed.

Figure 8.7 shows the status of the accepted recommendations. A breakdown of these findings is in Appendixes 8.3 and 8.4.

**Figure 8.7: Status of Accepted Recommendations by Subcategory**

VAT = value-added tax.

Note: Exemptions contain both policy and administration recommendations.

Source: Author's compilation.

A final review of the recommendations was undertaken to identify recommendations that were not accepted by at least two of the three countries, or if accepted were not yet completed. Table 8.4 shows those identified as common challenging reform recommendations.

**Table 8.4: Common Challenging Reform Recommendations**

Category	Subcategory	Recommendations
Policy	Customs	<ul style="list-style-type: none"> <li>• Tariff rate changes</li> </ul>
	Value-added tax (VAT)	<ul style="list-style-type: none"> <li>• Introducing a VAT</li> </ul>
	Revenue administration	<ul style="list-style-type: none"> <li>• Introducing a revenue administration act</li> <li>• Standardizing and consolidating powers</li> <li>• Allowing information sharing between revenue agencies</li> </ul>
	Other	<ul style="list-style-type: none"> <li>• Removal of sales taxes and other minor taxes</li> </ul>
Administration	Tax	<ul style="list-style-type: none"> <li>• Developing an audit strategy</li> <li>• Developing a range of audit products</li> </ul>
	Customs	<ul style="list-style-type: none"> <li>• Introducing post-clearance audits</li> <li>• Using valuation databases</li> <li>• Using data analysis techniques</li> </ul>
	Communications	<ul style="list-style-type: none"> <li>• Developing a communications strategy</li> <li>• Developing public material including rulings</li> <li>• Improving the relationship with the private sector</li> </ul>
	Self-assessment	<ul style="list-style-type: none"> <li>• Using self-assessment techniques, particularly for large business</li> </ul>
Exemptions		<ul style="list-style-type: none"> <li>• Removing legislative provisions for exemptions</li> <li>• Limiting discretionary exemptions</li> </ul>

Source: Author.

These findings were presented to the heads of Pacific islands tax administrations at their 2009 annual conference and a workshop was held to explore in more depth the constraints affecting implementation of these recommendations. The next section outlines the findings from the workshop and the feedback from the heads of tax administrations.

## Findings from the Workshop

### *Exemptions*

The common exemption-related recommendations concerned the need to reduce or remove exemptions and limit the number of individuals with discretion to grant exemptions. Nine of the 13 countries represented<sup>3</sup> at the workshop commented on the challenges with recommendations relating to exemptions. The common constraint for all countries was the political environment. This constraint was said to be particularly challenging where the government is unstable and there are few, but very influential, business lobbyists. Those countries that had implemented changes to their exemption regimes had typically made internal changes first, often by establishing a committee to review applications and create greater transparency.

Communication was also seen as a factor underlying the challenge of removing exemptions and limiting the number of discretionary decision makers. Delegates commented that decision makers were often not well equipped with prepared responses supporting a “no” decision. Delegates also noted that exemption reforms were easier to implement when accompanied by taxpayer-friendly reforms, such as tax rate reductions.

### *Policy: Value-Added Tax*

Seven of the countries commented on challenges with recommendations to implement a VAT. Reasons given for the challenges included the general “mystery” surrounding a VAT, particularly for the American-influenced Pacific islands, more so than the Anglo-influenced countries. For the FSM, constitutional issues have also proved a significant challenge to accepting and implementing a VAT. Delegates noted that the perceived negative impact of a VAT on consumer prices and the belief that their tax administrations do not have the capacity to administer a VAT were also constraints.

Communication, awareness, and education of policy makers and legislators were seen as essential to addressing their concerns and improving their understanding of the benefits, impacts, and administration issues surrounding a VAT. One delegate commented that the principles of income tax were hard for many countries new to the concept, and where a country is trying to implement a VAT without preexisting knowledge of income tax principles, the VAT concepts are not readily comprehensible. In many cases the delegates indicated their countries preferred to focus on improving the administration of the existing revenue agency before committing to a fundamental new tax like a VAT.

### *Policy: Revenue Administration*

The common challenging reform recommendations under the subcategory revenue administration concerned the implementation of a revenue administration act that would standardize and consolidate administration powers and procedures, and allow information sharing between tax and customs agencies. Six delegates commented on the challenges of implementing a revenue

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<sup>3</sup> The countries represented were the Cook Islands, Fiji, Kiribati, Nauru, Niue, Palau, PNG, the Marshall Islands, the FSM, Samoa, Solomon Islands, Tonga, and Vanuatu. Tokelau and Tuvalu did not have delegates at the conference.

administration act. Challenges to implementing a revenue administration act fell into two groups: challenges faced by countries that were implementing revenue administration policies as part of a wider tax reform (usually involving implementation of a VAT and an income tax) and challenges where the legislation was being implemented in isolation. Where revenue administration reform is part of a wider reform package, the revenue administration component was seen as a lesser part of the package. Comprehensive reform packages require significant coordination of all stakeholders and understanding of a plethora of new concepts; consequently, the revenue administration components received a lesser degree of attention. The suggestion was made that a more piecemeal approach might have made the magnitude of the changes less overwhelming and given more focus to revenue administration reform.

Countries that were implementing revenue administration reforms in isolation commented that the primary challenges faced were internal disputes over whether, and how, to standardize powers and procedures between different parts of the organization. These internal disputes were particularly challenging where the revenue agency operated a combined tax and customs function and is trying to standardize powers and procedures and share information across and between the two functions.

One American-influenced country noted that state and national constitutional issues concerning rights to tax posed a significant constraint in implementing the revenue administration reforms.

#### *Policy: Other*

Common recommendations in these categories related to removal or reduction of trade tariffs and other minor taxes. Delegates noted that constraints to the removal or reduction of trade tariffs and other minor taxes arose because these recommendations were directly linked with other reforms facing implementation challenges. Decisions on reductions in tariff rates and the removal of minor taxes hinged largely on decisions being made in relation to VAT, and until VAT policy decisions were made and implemented these other reforms could not be implemented.

#### *Administration: Self-assessment, Customs, and Tax*

Self-assessment, post-clearance audit, the use of data analysis techniques for risk profiling, and the introduction of a range of audit techniques to address identified risks were the most common recommendations under this heading. The underlying concern reflected by nearly all delegates with the introduction of these reforms was the perceived levels of compliance in the community. Self-assessment and post-clearance audit principles require an attitudinal change that accepts that the response to compliance risks needs to be balanced against the resources available and costs of compliance. Delegates expressed much concern with these recommendations and commented that revenue might be lost if these reforms were implemented.

Delegates noted the introduction of technology and revenue management systems to aid with return and payments processing, built-in return checking, and macro risk analysis was often seen as a prerequisite for adopting self-assessment and post-clearance audit principles. A second policy initiative that was also raised as precursor to self-assessment was making wage and salary tax a final tax. Revenue agencies that had taken this approach are delaying implementing self-assessment principles and a range of audit responses until these preconditions are met.

Lack of staff skills and training opportunities covering self-assessment, risk profiling, and post-clearance audit principles were also cited as constraints in implementing these recommendations.

#### *Administration: Communications*

Recommendations related to communications strategies for improving compliance, the development of public information material, and developing proactive relationships with the business community also posed a common challenge. These recommendations were considered to involve an attitudinal shift from a strong focus on enforcement to a balance of enforcement and service, which requires time and training. Delegates noted they faced communication difficulties arising from their island geography. They also commented that shifting enforcement staff to “softer” service-based activities when staff numbers are low may adversely impact revenue collected. This concern is compounded because the ability to measure compliance improvements and dollar return from service activity is difficult.

Countries that had made changes in this area tended to have either an individual staff member with the requisite interpersonal skill, or an expatriate or returning staff member who had experienced the benefit of these services in a developed revenue administration.

## 6. Discussion

Three key themes were noted in the scholarship behind this study:

- To be effective, development assistance requires recipient ownership and autonomy (Abonyi 2002; Ellerman 2004a, 2004b, 2007; Pronk 2001, 2003).
- From the recipients’ perspective, the degree of change required by revenue reform recommendations is large (Cotton 2008) and can be overwhelming if the recipients are not equipped to manage the changes (Weick 1984).
- A strategy of achieving several small wins might be preferable to trying to manage large-scale change (Bryson 1988; Weick 1984).

These themes are borne out in the current study.

### To be Effective, Development Assistance Requires Recipient Ownership and Autonomy

The empirical findings of this study suggest that policy recommendations are less likely to be implemented than administration recommendations. Notably, two of the three recipients of the reform recommendations reviewed were in public sector senior management positions; one was a minister in the government of the day. Ownership and autonomy for implementing administration changes is much higher than for policy changes, for a senior public sector manager. Even if the recipient is a member of the government, policy changes, particularly revenue policy, have a reach beyond the immediate minister responsible; the minister may have ownership but autonomy is compromised. This difficulty arises because policy changes involve multiple stakeholders, each with their own priorities and partialities, who need to be engaged and well-versed in the policy if the changes are to have a modicum of success.

It is notable that the findings from the workshop suggest communication and understanding on the part of politicians is a key constraint to implementing revenue policy changes. This is not to cast aspersions on the intellect of the politicians; rather, it is a reflection of the wide

range of subjects competing, on a daily basis, for their attention. Even if the politicians responsible have a good understanding of the changes necessary, and the requisite ownership and autonomy, these factors must still be balanced against wider questions of relevance, timing, and their personal desire for political survival (Abonyi 2002). Administration reforms, on the other hand, are more likely to be within the jurisdiction of the change leader and can be implemented more easily. There is, however, a qualification to this finding arising from the second key theme.

### **From the Perspective of the Recipient, the Degree of Change Required by Revenue Reform Recommendations is Large and Can Be Overwhelming If People Are Not Equipped to Manage the Change**

Cotton (2008) found that the majority of revenue sector technical assistance recommendations reviewed were large from the recipients' perspective, although the study did not find that the recommendations were overwhelming. Nevertheless, it is apparent from the workshop findings in this study that there are instances where common constraints hamper implementation of the recommendations. The findings suggest that inadequate communication and understanding is a key constraint in implementing revenue reforms; that is, the change leaders are not equipped with the requisite depth of understanding to be able to adequately and convincingly articulate the "what," "how," and "why" of the reforms in a variety of forums after the technical assistance provider has departed, which can result in little or no progress.

In the case of policy reforms, the findings suggest that a greater degree of communication and understanding is necessary at the political level. In the case of exemption regime changes and administration reforms (particularly self-assessment and post-clearance audit principles and customer service communications), the findings suggest that inadequate communication and understanding is a key constraint at operational level within the revenue agencies and with the agencies' key stakeholders. To the extent that change leaders do not fully comprehend the concepts and nuances of the reforms recommended, they are not equipped to promote and lead the changes confidently. Again, this is not a reflection of the intellect of the change leaders involved; rather, it is suggested, this is a reflection of the differences in perspective of the size and complexity of the changes being recommended.

Cotton (2008) clearly showed differences in perspectives between traditional definitions of large and small changes and the recipients' perspectives of the size of the revenue reform changes recommended. To that end, technical advisors and aid agencies may consider a change leader who understands the changes enough to adequately and convincingly communicate and implement them. However, the PITAA delegates have indicated that the necessary degree of understanding is unlikely to be the reality. Delegates noted ongoing access to guidance and mentoring is invaluable as their understanding and appreciation of the nuances of the changes deepen.

A practical example of this difference in perspectives arises with the recommendations on self-assessment and post-clearance audit principles. These principles are well established in developed revenue agencies, reflect international best practice, and are adopted to enable revenue agencies to balance resources available with risks identified. Delegates at the workshop indicated that a common constraint to implementing these recommendations is the current low level of compliance in their countries. Consequently, they feel constrained against adopting a more risk-focused approach that they believe may not maintain revenue collection levels. Paradoxically, the principles behind these recommendations suggest that focusing on risk compliance will improve collection levels, with

corresponding increases in revenue. This reflects a situation where the differences in perspective and understanding of minutiae are adversely affecting implementation.

### **A Strategy of Several Small Wins might be Preferable to Manage Large-scale Change**

This theme is also borne out in the findings, particularly in relation to policy and exemption regime changes. Underlying the implementation challenges of these changes were political, communication, and comprehension constraints. Many delegates expressed concern that the reform packages they were trying to implement were too big to manage in one package, and in hindsight may have been easier to communicate and implement in a more piecemeal approach. This reasoning appears to be behind the approach taken by Solomon Islands in its “no decision yet” stance on VAT-centered recommendations. One delegate noted that politicians have a vast array of subjects vying for their attention, and that it is often easier to present and debate a single manageable concept than a wide-ranging reform package where debate over any one item within the package may derail implementation of the whole package. The average number of recommendations given to Pacific islands region’s revenue administrations in the 6 years from 2002 to 2007 by PFTAC was 91. All except two of the revenue administrations have fewer than 100 staff members, with many having less than 50. Therefore, it is perhaps not surprising that the scale of reform is perceived as large, and that delegates believed that an incremental approach might have been more manageable. To that end, a series of small changes informed by an overall strategic direction (Bryson 1988) might face fewer political and operational constraints.

## **7. Conclusion**

The purpose of this study was to identify technical assistance recommendations for revenue reform across the Pacific islands region that face common constraints and challenges to implementation. The study reviewed the recommendations made to ministers of revenue and chief executive officers of revenue administrations by PFTAC tax policy and administration technical advisors from 2002 to 2007. The recommendations made to the FSM, Solomon Islands, and Tonga were selected for detailed review. A workshop was also held with PITAA delegates at their 2009 conference.

The findings from this research suggest a wide range of revenue reform recommendations were made from 2002 to 2007, but few specific recommendations were common to each of the three countries researched. Nine categories of common reform recommendations were identified as facing difficulty in implementation. These eight categories split evenly into reforms of a policy nature and reforms of a revenue administration nature. Policy reforms causing the most difficulty in implementation were the introduction of a VAT, introduction of revenue administration legislation, and tariff rate changes. Administration reforms commonly facing implementation constraints were in the areas of audit and communication strategies, the adoption of self-assessment and post-clearance audit principles, and the adoption of business analysis techniques. Reforms addressing the removal of exemptions and associated discretionary decision-making powers faced implementation challenges irrespective of their nature.

The common constraints causing delays in accepting and implementing the common recommendations involved a combination of political economy, ownership, understanding, and autonomy. Underpinning all of these constraints were communication issues that affected the change leaders’ ability to convincingly communicate the changes to diverse audiences. This was most obvious in the case of exemption regime reforms where decision makers, in the face of strong

opposition, were not well equipped with scripted responses enabling them to advocate for the changes. Typically, those countries that had implemented changes to their exemption regimes had either first made administration changes to improve decision making and transparency or had aligned exemption regime changes with taxpayer-friendly reforms.

One of the study's limitations derives from the purposive sampling method used. As noted earlier, the policy and operational frameworks in which Pacific islands region's revenue administrations operate vary widely; there are, however, a number of similarities in the subregional frameworks. This study used purposive sampling to identify those countries that had received the greatest level of technical assistance, on the assumption that this would give the widest range of recommendations. The sampling method used achieved that desired outcome; over one-third of the recommendations made by the PFTAC revenue sector were reviewed. However, there was limited commonality, notwithstanding the wide range of recommendations. If the sampling had been conducted at the subregional level, it may have resulted in a greater number of common recommendations because of the greater level of similarity between policy and administration frameworks at the subregional level. This is most noticeable from the absence of common recommendations related to income tax.

At the subregional level, the Micronesian countries are facing implementation of comprehensive direct and indirect tax policy reforms, trade reforms, and revenue administration reforms. There would be value in repeating this study focusing on that subregion, particularly the American-influenced countries (the Marshall Islands, the FSM, and Palau) to increase understanding of the constraints on implementing a value-added tax in their political and business environments.

Further, the study focuses on perceptions of the constraints affecting implementation of technical assistance reforms and does not take into account differences in tangible measures such as organization size, human resource skills, reform budgets, geography, and political environment.

The constraints identified potentially could be addressed with a few simple measures. Cross-pollination of skills and knowledge between revenue administrations is possible and should be encouraged. For example, now that many PICs have established a VAT, key staff from revenue administrations that have implemented the reforms could assist those who are currently implementing or considering such reforms. This may overcome some of the difficulties posed when technical assistance providers do not see the changes through the eyes of the recipient. The same opportunity presents, although to a lesser degree, for cross-regional implementation assistance and guidance on revenue administration act reforms and internal administration reforms. At the regional level, PITAA and the Oceania Customs Organisation provide opportunities for the exchange of skills and knowledge.

As a final observation, it is worth noting that none of the delegates suggested the policy or administration reforms were not relevant: the implementation constraints were their main concern. To that end, technical assistance providers should not only provide advice on "what" needs to be done but also sustained assistance on "how" to implement the advice. If comprehensive revenue reform recommendations are warranted, additional assistance and support, even executive mentoring, may be needed to increase the likelihood the recommendations will be implemented. Technical assistance recipients have a corresponding responsibility to help providers see the changes through their eyes.

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## Appendix 8.1: Content Analysis Coding Dictionary

**Administration customs**—administration recommendations specifically outlining how the customs agency laws should be implemented and administered, but does not relate to general business administration of the agency.

**Administration general**—recommendations relating to the general business administration of the revenue agency, including staffing, infrastructure, structure, establishment of operational business policies but does not include recommendations specifically relating to training, systems, communication, self-assessment or large taxpayers.

**Administration recommendations**—how the tax policy should be administered by the revenue agency including people, processes, systems, time frames, training, communication, and structures provided the recommendation relates to legislating for the action.

**Administration tax**—administration recommendations specifically outlining how taxes should be implemented and administered, including verification of assessments (audits), but does not relate to general business administration.

**Administration VAT**—administration recommendations specifically outlining how the value-added tax (VAT) should be implemented and administered, but does not relate to general business administration.

**Communications**—recommendations relating to communications between the revenue agency and staff, taxpayers, importers, private sector agencies, government agencies, and the wider community.

**Exemptions**—policy and administration recommendations specifically referring to the repeal or amendment of legislative provisions relating to exemptions and tax holidays; discretions for granting exemptions and tax holidays; extension of existing exemptions and tax holidays; and the administration, both intra and ultra vires, of legislative provisions relating to exemptions and tax holidays.

**Implementation**—recommendations outlining how the proposed revenue reforms should be implemented, including engagement of advisors, timeframes, obtaining donor assistance and establishing project reform teams.

**Large taxpayers**—recommendations relating to the administration of policies and processes for large taxpayers including the establishment of a large taxpayer unit.

**Policy income tax**—policy recommendations specifically relating to principles and features of income tax, but does not include how the income tax should be administered.

**Policy customs**—policy recommendations specifically relating to principles and features of customs and excise law, but does not include how the customs and excise law should be administered.

**Policy other**—policy recommendations specifically relating to principles and features of other tax laws, but does not include how those taxes should be administered.

**Policy recommendations**—how the government should approach taxation and the principles that should be applied when setting taxes, usually reflected by recommendations for specific laws to be enacted, repealed, or amended.

**Policy revenue administration**—policy recommendations specifically relating to principles and features of revenue administration legislation, including registration, assessment, return and debt collection, objections and appeals, penalties, access to information, and the rights and obligations of taxpayers and the revenue administration agency.

**Policy VAT**—policy recommendations specifically relating to principles and features of VAT, but does not include how the tax should be administered.

**Self-assessment**—recommendations relating specifically to implementation and administration of a self-assessment model, but does not include recommendations relating to legislating for self-assessment.

**Systems**—recommendations relating to information technology and computer systems and to the registration of taxpayers.

**Training**—recommendations relating to the training of revenue agency staff, taxpayers, importers, private sector agencies, government agencies and the wider community.

## Appendix 8.2: Summary of Content Analysis Findings

	Number of Recommendations	Larger	Neither Large nor Small	Smaller	Accepted	No Decision	Rejected	Accepted and Completed	Accepted, Started, Not Yet Finished	Accepted, Not Yet Started
<b>Raw Data</b>										
Policy	235	199	31	5	98	115	22	43	44	11
Administration	309	190	93	26	274	29	6	164	79	31
Total	544	389	124	31	372	144	28	207	123	42
<b>Percentage of Total (%)</b>										
Policy	43.2	84.7	13.2	2.1	41.7	48.9	9.4	43.9	44.9	11.2
Administration	56.8	61.5	30.1	8.4	88.7	9.4	1.9	59.9	28.8	11.3
Total	100	71.5	22.8	5.7	68.4	26.5	5.1	38.1	22.6	7.7

Source: Author's compilation.

## Appendix 8.3: Breakdown of Recommendations—Raw Data

	Number of Recommendations	Larger	Neither	Smaller	Accepted	No Decision	Rejected	Accepted and Completed	Accepted, Started, Not yet Finished	Accepted, Not Yet Started
Policy										
Income tax	62	50	12	0	22	30	10	12	8	2
Value-added tax	60	52	8	0	19	35	6	1	14	4
Customs	21	16	0	5	16	5	0	11	3	2
Revenue administration	60	52	8	0	24	33	3	8	13	3
Other	9	8	1	0	5	4	0	2	3	0
Exemptions	23	21	2	0	12	8	3	9	3	0
Administration										
Tax	26	13	13	0	26	0	0	14	10	2
Value-added tax	7	5	2	0	3	4	0	2	1	0
Customs	45	37	3	5	42	3	0	13	14	15
Implementation	53	36	15	2	43	9	1	35	5	3
Administration general	75	33	28	14	67	4	4	43	18	6
Training	28	19	4	5	28	0	0	19	6	3
Systems	25	16	9	0	24	0	1	14	9	1
Communications	33	22	11	0	26	7	0	11	14	1
Self-assessment	5	4	1	0	4	1	0	2	2	0
Large taxpayers	12	5	7	0	11	1	0	11	0	0
Total	544	389	124	31	372	144	28	207	123	42

Source: Author's compilation.

### Appendix 8.4: Breakdown of Recommendations—Percent (%)

	Number of Recommendations	Larger	Neither	Smaller	Accepted	No Decision	Rejected	Accept-ed and Comp-leted	Accept-ed, Started, Not Yet Finished	Accept-ed, Not Yet Started
Policy										
Income tax	11	81	19	0	35	48	16	55	36	9
Value-added tax	11	87	13	0	32	58	10	5	74	21
Customs	4	76	0	24	76	24	0	69	19	13
Revenue administration	11	87	13	0	40	55	5	33	54	13
Other	2	89	11	0	56	44	0	40	60	0
Exemptions	4	91	9	0	52	35	13	75	25	0
Administration										
Tax	5	50	50	0	100	0	0	54	38	8
Value-added tax	1	71	29	0	43	57	0	67	33	0
Customs	8	82	7	11	93	7	0	31	33	36
Implementation	10	68	28	4	81	17	2	81	12	7
Administration general	14	44	37	19	89	5	5	64	27	9
Training	5	68	14	18	100	0	0	68	21	11
Systems	5	64	36	0	96	0	4	58	38	4
Communications	6	67	33	0	79	21	0	42	54	4
Self-assessment	1	80	20	0	80	20	0	50	50	0
Large taxpayers	2	42	58	0	92	8	0	100	0	0
Total	100	71.5	22.8	5.7	68.4	26.5	5.1	38.1	22.6	7.7

Source: Author's compilation.

# 9 Island Parties

## How Has Political Instability Impacted on Regulatory Quality in the South Pacific?

by Aaron Batten

### ABSTRACT

The political instability created by weak party systems and fractionalized governments is often cited as a key constraint facing the adoption of policy settings in the Pacific that are more conducive to broad-based private sector development. This paper empirically analyzes whether these political characteristics have impacted levels of regulatory quality in the Pacific islands. Using the system-generalized method of moments (GMM) procedure, estimates are made from a dynamic panel of 13 Pacific island countries and 17 other small island developing states between 1996 and 2008. High levels of political instability and party fractionalization are shown to have been key determinants of the poor levels of regulatory quality across the region. This is argued to reflect the clientelist and rent-seeking behaviors that weak party systems have encouraged and their consequent impact on the ability, and desire, of Pacific island governments to battle vested interest groups. A number of policy implications follow.

### 1. Introduction

Pacific island governments have struggled to create vibrant business environments capable of creating sufficient formal sector employment levels to absorb their expanding populations. Although experiences across the region have been diverse, formal sector economic activity has tended to remain focused on either extractive industries for those with natural resources or low-value-added agricultural production. These forms of development have had important implications for the quantity and quality of employment available to Pacific islanders, with significant proportions of the populations of almost all countries still living semi-subsistence lifestyles with few income-earning opportunities.

Numerous reasons have been advanced to explain this situation, with many explanations focused on the unique economic, institutional, and bureaucratic challenges faced by small island developing states (SIDS)—a global grouping common to all of the Pacific islands.<sup>1</sup> Characterized by

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<sup>1</sup> For the purposes of this paper the Pacific islands are classified as the Cook Islands, Fiji, Kiribati, the Marshall Islands, the Federated States of Micronesia (FSM), Nauru, New Caledonia, Niue, Northern Marianas Islands, Palau, Papua New Guinea, Samoa, Solomon Islands, Tonga, Timor-Lesté, Tuvalu, and Vanuatu. These countries are all members of the United Nations Small Island Developing States network (Appendix 9.1).

undiversified production capacity, SIDS are seen as vulnerable to external and domestic shocks. Foreign trade is also frequently undermined by high transport costs, as SIDS are often in remote locations, with generally poor infrastructure and limited scope for scale economies. Adding to these effects is the high frequency of natural disasters such as cyclones, floods, and earthquakes (Briguglio 1995; Armstrong et al. 1998; Armstrong and Read 2002; McGillivray et al. 2008).

Compounding these economic challenges are the pressures that SIDS face in developing well-functioning bureaucracies. Public sector managers are exposed to a much higher degree of conflicting pressures arising from close interpersonal relations, limited promotion opportunities, and senior officials having to act in multifunctional roles (Farrugia 1993). SIDS also face difficulties recruiting high-quality civil servants due to the limited supply of candidates and the tendency of the most capable individuals to seek employment in larger markets (Streeten 1993).

Another feature of Pacific SIDS that has gained increasing attention is the relatively high levels of political instability experienced by many of these countries since they gained independence. This instability has taken on many forms, but most often it has resulted from political structures that are categorized by weak party systems and fragile government coalitions formed from a large number of political parties. Political instability has also been attributed to the politicization of the public service as governments use bureaucratic processes to solidify their political power and sideline their opposition.

This instability has led to discontinuity of governments, with many failing before completing their term in office. Government discontinuity and high levels of party fractionalization while governments are in power has disrupted policy-making processes in the Pacific islands. It has reduced the predictability of policy regimes and consequently the efficiency of fiscal administration. Perhaps the most important consequence of political instability is the adverse impact it has had on both the ability and the desire of Pacific island governments to battle vested interest groups and pursue productive economic reforms.

Weak political parties can reduce the incentives for politicians to undertake coherent, long-term policy decisions and encourage policy making that is directed at specific interest groups or political constituencies. Fragile ruling coalitions can also mean that reform efforts are highly destabilizing for incumbent governments, particularly if they are attempting to overcome politically influential vested interest groups. Weaker public sectors are also less capable of effectively implementing those reforms that are undertaken.

This raises the important question of whether the region's political systems have been a key constraint on more effective policy decision making. In particular, have fractionalized political systems reduced the effectiveness of Pacific island governments in creating vibrant employment-generating business environments? This paper empirically examines these questions by focusing on the impact of political instability on the quality of domestic business regulation, both in the Pacific islands and SIDS in general. Policy implications are drawn from the findings.

## 2. Background

### The Origins of Pacific Island Countries

The process of establishing national boundaries within the Pacific islands was dominated by colonial powers who, for their own interests and convenience, combined numerous and previously largely autonomous communities into single national identities (Crocombe 2001). Western forms of government were transplanted into these new countries along with national constitutions and parliamentary systems largely following those of the administering European power.<sup>2</sup> Most countries obtained their independence during the 1960s and 1970s, following a broader global trend by colonial powers.<sup>3</sup>

Despite somewhat ambiguous beginnings, the Pacific islands have been unusually successful in establishing competitive and participatory democracy. Regular, freely contested, and highly competitive national and local elections have been held across the region. With the exception of Samoa and Tonga, where traditional chiefs still maintain constitutionally mandated positions within the executive, participation in politics has remained for the most part unrestricted. There have also been relatively few instances where unconstitutional or violent means have been used, or threatened, to enforce changes of government.<sup>4</sup> As Reilly (2000, p. 261) highlights, the United States' (US) private foundation Freedom House places the entire Pacific islands region in the "free" category (bar the "partly free" Fiji) on its index of political and civil liberties—a distinction shared with only one other region in the world, Western Europe.

While the success of these democracies in overcoming the unique challenges facing SIDS has varied, the overall economic performance of the Pacific islands has been poor. Countries such as Nauru, Papua New Guinea (PNG), and Solomon Islands have recorded long-term declines in per capita incomes since they gained independence. These countries have also made limited progress on social indicators. PNG and Solomon Islands have infant mortality rates more than twice as high as other countries in the region at 55 deaths per 1,000 births (World Bank 2008).<sup>5</sup> More progress has been made in countries such as Fiji and Vanuatu, which have, for example, reduced levels of infant mortality well below the lower- to middle-income country average of 40 deaths per 1,000, with rates of 29 in Fiji and 15 in Vanuatu (World Bank 2008). However, slow and volatile growth rates since 1980 have meant per capita income levels have increased only by an average 0.5% per year in Fiji

<sup>2</sup> For example, countries administered by Australia, New Zealand, and the United Kingdom favored the Westminster system, while the US-controlled territories of the Marshall Islands, the FSM, and Palau adopted variations of the presidential system.

<sup>3</sup> Samoa was the first to obtain its independence in 1962, albeit with Niue voting to separate from the island and become an overseas territory of New Zealand. The Cook Islands pioneered the concept of "associated statehood," forming an agreement with New Zealand in 1965 (Lemon 2001, p. 39). Nauru obtained full independence in 1968, while Fiji and Tonga obtained theirs in 1970 (although, by maintaining a monarchy, Tonga had already been largely independent from British colonial rule). Niue followed the Cook Islands example and formed associated statehood with New Zealand in 1974. PNG gained full independence from Australia in 1975, while Solomon Islands and Tuvalu obtained theirs in 1978. Independence in Kiribati was gained soon after in 1979 and then by Vanuatu in 1980. The US-administered territories gained independence later than the rest of the Pacific islands, with the Marshall Islands and the FSM receiving theirs in 1990, and Palau in 1994; although these states still share a common association with the US.

<sup>4</sup> The most obvious exceptions to this being the 1987, 2000, and 2006 coups in Fiji; the threat of a PNG coup leading to the fall of the Chan government during the Sandline crisis in 1997; the civil conflict in Solomon Islands culminating in 2001; and more recently, the military threats to the Timor-Leste government in 2008–2009.

<sup>5</sup> PNG also has the worst educational statistics in the region with a 56% gross enrolment rate for primary education in 2006 (World Bank 2008).

and 0.4% Vanuatu. Even the relatively successful Polynesian states of Samoa and Tonga<sup>6</sup> are still heavily reliant on remittance and aid income and face significant economic and social challenges, as highlighted by the 2006 riots in Tonga's capital, Nuku'alofa (Batten 2009).

It is unsurprising then that the Pacific islands region has made slow progress toward achieving the Millennium Development Goals (MDGs) espoused in the 2000 United Nations (UN) Millennium Declaration (UN 2000),<sup>7</sup> particularly in the areas of health and HIV/AIDS, water and sanitation, and education. Indeed, according to the 2008 UN MDG monitoring report, "of the five sub-regions of Asia-Pacific the success of Pacific Island developing countries in implementing the MDGs has been the least impressive" (UN 2008, p. 12).

So why have the region's relatively robust democracies not achieved the gains in economic prosperity that may be expected from representative political systems?

This paper examines one possible cause: that the region's political characteristics have adversely impacted the ability, and desire, of Pacific island governments to formulate and implement sound policies and regulations that promote private sector development.

### Political Systems in the Pacific Islands

While the process of independence brought once disparate peoples under single, autonomously governed national banners, the notion of national identity has been largely restricted to small groups of urban-based elite. The majority of people have continued to think of themselves primarily as members of their village, clans (*wantoks*), or, at its broadest level, their islands (Rich 2008, p. 22). This dominance of local over national identity, combined with strong cultural and personal affiliations, has contributed to the continued influence of local leaders or "big men" in the administration of local townships and villages. It has also contributed to voting patterns being heavily influenced by ethnic or clan ties rather than on the basis of economic policy or ideology.

Political parties in the region have reflected these types of personal affiliations and have rarely been formed around any ideological foundation. Rather, the formation of political parties has relied on politicians binding together through mutual interest in their pursuit of gaining public office.<sup>8</sup> In this sense, political parties have been as much a matter of convenience as they have been about achieving any specific social or economic goals for their respective countries. As Duncan and Nakagawa (2006, p. 5) explain,

[t]he strong local community demands and the lack of ideological positions with respect to political activity, and the resulting lack of ideologically based political parties, result in a high level of "individual flexibility" with regards to political allegiance...

The lack of strong ideological party systems has thus had some important consequences for the policy-making process in the Pacific islands. In particular, political parties have tended to play

<sup>6</sup> Both these countries have, for example, almost 100% primary school enrolment and have more than halved their infant mortality rates over the past 2 decades to approximately 20 deaths per 1,000 births by 2006.

<sup>7</sup> The eight MDGs break down into 21 quantifiable targets that are measured by 60 indicators. These goals are (i) eradicate extreme poverty and hunger; (ii) achieve universal primary education; (iii) promote gender equality and empower women; (iv) reduce child mortality; (v) improve maternal health; (vi) combat HIV/AIDS, malaria, and other diseases; (vii) ensure environmental sustainability; and (viii) develop a global partnership for development.

<sup>8</sup> Perhaps the best example of these loose political coalitions in a Melanesian context was the 1990 decision by Solomon Islands Prime Minister Solomon Mamaloni to switch parties and form a coalition with opposition members of Parliament following an open revolt against his leadership (Fraenkel et al. 2007, p. 4).

only a minor role in political debate, with limited levels of party loyalty among elected members of government and with few parliamentarians being compelled to vote along party lines (Morgan, Baker, and Hamblly 2005). It has also been commonplace for candidates to run as independents and join political parties after determining who will form government, and even for political parties to have members both in government and in opposition (Chand and Duncan 2007, p. 8).

With a lack of ideological mandates and the allure of enhanced political positions and other benefits, members of ruling government coalitions are often easily drawn to siding with the opposition in parliamentary votes (Fraenkel et al. 2007, p. 5). This behavior has contributed to a high degree of instability among the membership of political parties and even more so within coalition governments. Votes of “no confidence” have been one of the most common methods of obtaining early turnover of governments by opposition parties. PNG is a leading example of this, with the electoral term between 2002 and 2007 being the first time a government has served its full 5-year term in office since independence.<sup>9</sup> Indeed, there have been more changes of government on the floor of Parliament in PNG than at elections. Similarly, Solomon Islands has recorded 25 motions of no confidence in its prime ministers since independence (Haywood-Jones 2008).

Under these circumstances, Pacific island governments have become particularly susceptible to patronage politics. This has occurred both through the provision of inducements to other members of Parliament to build political loyalty and political support, as well as via the implementation of policy settings that are favorable to existing private enterprises that supported the government’s election efforts. A lack of party discipline has also encouraged parliamentarians to pursue policies focused on delivering benefits to themselves and their direct constituents. As Chand and Duncan (2007) highlight, by enforcing block-voting patterns and offering the benefits of membership, strong political parties help to ensure members act to preserve the value of the “party brand” by providing broader social goods and reducing (but by no means removing) the tendency to deliver benefits to specific constituents. In contrast, individual members focusing on their own special interests contribute to a broader lack of coherence across government policy making (Reilly 2000, p. 264).

Another consequence of fragile government coalitions is that to avoid votes of no confidence, governments have often delayed or minimized parliamentary sitting times. When parliaments do convene, sessions are commonly dominated by political jostling to obtain, or maintain, majorities. As a result, the consideration of new legislation and reviews of existing legislation and regulations have suffered.

High levels of patronage politics have also been associated with a more widespread predatory rent-seeking model of governance within the region. This has contributed to politicians’ tendency to make policy decisions that are more conducive to bringing benefits to individual constituents within a short time frame than on policies that deliver public goods that have diffuse benefits over the long term.<sup>10</sup>

Not all Pacific island countries (PICs) have experienced the same degree of political instability and party fractionalization since gaining independence; for many, domestic political

<sup>9</sup> Although often cited as a positive development in PNG politics—and attributed by some to the enhanced party structures formed under the Organic Law on Political Parties and Candidates (OLIPPAC) reforms in 2001—this claim of political stability is somewhat misleading in the PNG context, given that it has really only been the Prime Minister who has survived the full term in office, with the bulk of government ministers changing during the electoral term (Fraenkel et al. 2007, p. 5).

<sup>10</sup> Exacerbating this situation has been the often short time frames within which highly fragmented governments are able to hold on to power—with members of government having to repay their constituents quickly; or in the case that they are removed, not at all.

reforms, external and domestic economic conditions, and evolving democratic processes have led to significant changes.<sup>11</sup> One method of measuring the impact of these trends on levels of political stability in the region is through the political stability index developed by Kauffmann et al. (2009). This index measures perceptions of the likelihood that the government will be destabilized either by external forces or from within, including through politically motivated violence and terrorism. While not directly related to the degree of government fractionalization, this index gives a preliminary insight into how the region's various political systems have been able to establish a sense of political stability within each country. The data shown in Figure 9.1 for the Pacific islands—as well as a number of other SIDS—measures the current level of political stability in each country against recent changes in each country's index between 2003 and 2008. The index ranges from -2.5 (poor) to 2.5 (good).<sup>12</sup>

The region's microstates have the best perceptions regarding the stability of their political systems, with the Marshall Islands, the Federated States of Micronesia (FSM), Nauru, Palau, and Tuvalu all perceived to be at relatively low risk of major, politically driven unrest. Samoa is also in this upper group of countries, although its position has been falling in recent years. Solomon Islands and Tonga rank slightly lower in the index, following a small increase in Solomon Islands' ranking since 2003<sup>13</sup> and a large decline in Tonga's following the Nuku'alofa riots in November 2006. Fiji has also experienced a large decline in its political stability index over the past 5 years, particularly after the successful military coup by Commodore Bainimarama in 2006.

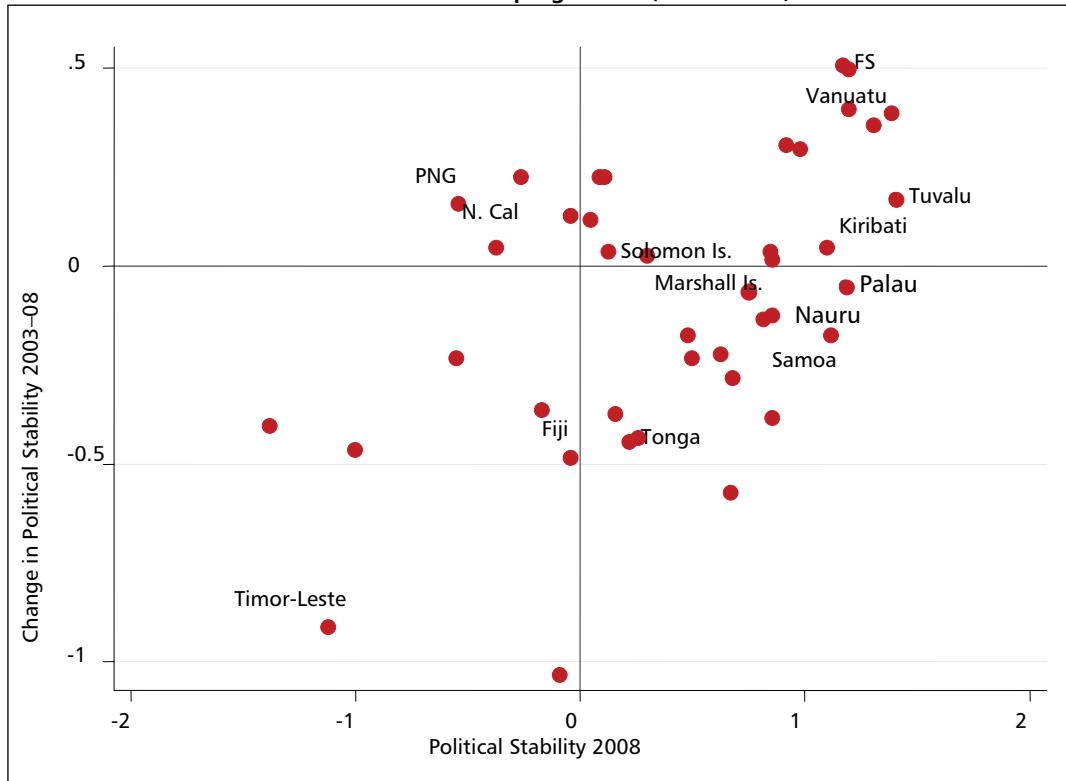
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<sup>11</sup> See Fraenkel and Grofman (2005) for a discussion of the various types of political and electoral systems that exist within the Pacific islands.

<sup>12</sup> The political stability and the perceptions of regulatory quality variables are discussed in more detail in section 5.

<sup>13</sup> This follows a much larger increase since the cessation of ethnic conflict following the commencement of the Regional Assistance Mission to Solomon Islands (RAMSI) in 2001.

**Figure 9.1: Perceptions of Political Stability in Pacific Islands and Small Island Developing States (2003–2008)**



FSM = Federated States of Micronesia, Is. = Islands, N. Cal = New Caledonia, PNG = Papua New Guinea.  
 Sources: World Bank (2009) and author's calculations.

New Caledonia and PNG remain in the negative half of the index distribution, despite both having made small improvements over recent years. For PNG, this small improvement is no doubt due to the continuation of favorable external economic conditions and the successful completion of a full electoral term between 2002 and 2007 by Prime Minister Somare (the first since independence) and his subsequent reelection.

Vanuatu is currently regarded as the Melanesian state least likely to suffer from serious political instability and now has a similar index value as the relatively stable microstates of Kiribati, the FSM, Palau, and Tuvalu. Easily the worst performer among the group of PICs is Timor-Leste. Following the significant optimism at the time of its independence in 2002, it has fallen considerably over the past 5 years—in particular, following recent threats against the government by its military and a presidential assassination attempt in 2008.

How, then, have these types of changes in political stability impacted the ability of Pacific island governments to create business and investment environments conducive to widespread wealth and employment creation?

## Political Instability and Regulation in the Pacific Islands

An effective regulatory state implies that, in the presence of competitive markets, production decisions are left to the private sector; and where significant market failures exist, sufficient regulatory structures are in place to ensure a welfare-maximizing outcome (World Bank 2001). Effective market regulation is thus a broad social public good. Improvements to the regulatory environment, such as removing impediments to new entrants to a market, lowering trade barriers, or reducing subsidies to state-owned enterprises, all have the potential to bring wide-scale benefits to an economy. Indeed, an effective regulatory regime has increasingly been shown to be a key factor in determining long-term rates of economic growth across the developing world (World Bank 2004; Jalilian et al. 2007). However, the benefits of regulatory reform tend to be highly diffused across stakeholders: consumers benefit from lower prices and new and improved products and services, new firms and their employees take advantage of emerging market opportunities, and existing firms expand. In contrast, the costs of regulatory reform tend to fall overwhelming on the narrow group of existing business enterprises that are benefiting from the status quo.

The political characteristics of the Pacific islands create significant challenges to the creation of more effective regulatory regimes. For governments that are struggling to maintain weak coalitions, the potential for overcoming highly motivated vested interest groups is low. Attempts to remove the rent-seeking opportunities of existing businesses could easily destabilize a government as lobbyists seek out means to protect their rents. This can lead to the entrenchment of business and regulatory models that favor incumbent producers at the expense of new, more efficient enterprises.

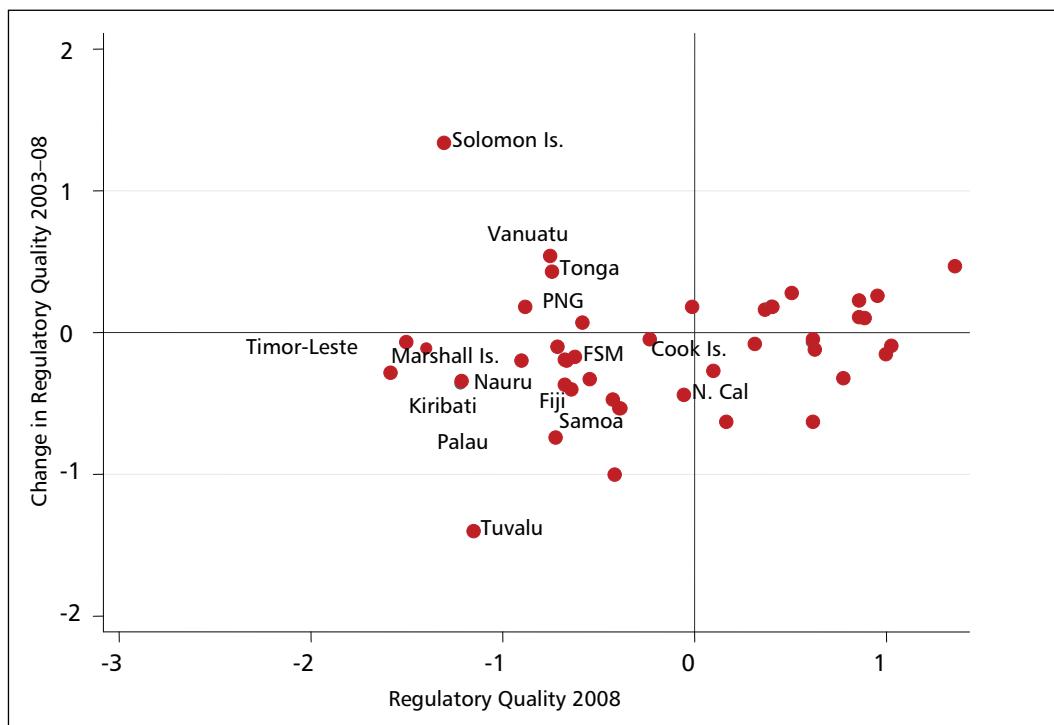
As discussed, weak party systems are also likely to offer politicians little incentive to consider the broader public good, but rather to focus their efforts on delivering benefits to those constituents who will be responsible for their reelection or for keeping them in power. In addition, developing the types of regulatory institutions required for a vibrant, secure, business environment—encouraging new entrants, promoting corporate and public accountability, and protecting private property rights—has the potential to undermine the rent-seeking opportunities of both politicians and existing businesses. This again creates a strong incentive for incumbent politicians to maintain the status quo.

It is perhaps no surprise that the Pacific islands have consistently underperformed in terms of the quality of domestic regulation they been able to establish. This record is illustrated in Figure 9.2, which shows perceptions of regulatory quality indexes (developed by Kauffmann et al. 2009) for PICs and other SIDS. The index ranges from -2.5 (poor) to 2.5 (good), with the figure showing the current level of regulatory quality in each country against changes in each country's index between 2003 and 2008.

It can be seen that in 2008 all PICs, except the Cook Islands, scored within the negative half of the index—indicating below-average perceptions of their regulatory environments. Another significant trend is the deteriorating perception of regulatory quality in the Pacific islands, with a majority of countries (10 out of 15) recording a decline in their index values over the past 5 years. Timor-Leste is the worst performer. The only country in the positive half of the index is the Cook Islands—although New Caledonia is near zero. Solomon Islands has recorded the biggest gains in its regulatory quality index over the past 5 years, albeit coming from a very low base following the ethnic conflict and still ranking among the bottom PICs.

The remainder of the chapter examines the extent to which the region's political systems have affected these poor and declining regulatory standards in the Pacific islands.

**Figure 9.2: Perceptions of Regulatory Quality in Pacific Islands and Small Island Developing States (2003–2008)**



FSM = Federated States of Micronesia, Is. = Islands, N. Cal = New Caledonia, PNG = Papua New Guinea.  
 Sources: World Bank (2009) and author's calculations.

### 3. Literature Review

There is rich and varied literature analyzing the impact of political stability on economic performance. Alesina et al. (1992) found that for a sample of 113 countries between 1950 and 1982, rates of economic growth were significantly lower in countries with a higher propensity for government collapse. They also found that political instability leads to lower growth, but there was no evidence that lower rates of economic growth affect the probability of a change of government—although latter result was challenged by Blomberg and Hess (2002), who argued that poor economic performance increases the probability of domestic conflict.

In his seminal paper on the determinants of economic growth, Barro (1991) found that for a cross section of 98 countries between 1960 and 1985, a variety of measures of political unrest, including the number of political assassinations, violent revolutions, and military coups, all had a significant impact by lowering average rates of economic growth.

Other studies have focused attention on the impact of political instability on government policy choices and, in particular, on their ability to maintain expenditure control in light of the numerous competing special interest groups. For example, Cukierman et al. (1992) found that political instability has a significant effect on levels of inflation, although these authors do not address the problem of the endogeneity between their measures of political instability and rates of economic growth. However, this effect is supported by the results of Roubini and Sachs (1989) who found that fractionalized governments (i.e., those formed from coalitions of minority parties) tend to

incur higher budget deficits. This, they argue, arises from the greater need for these types of governments to engage in collective pork barrel spending to maintain fragile party coalitions.

This result was extended by Berument and Heckelman (2005) who found that for a sample of 10 Organisation for Economic Co-operation and Development (OECD) countries between 1975–1997 and 1975–2003, fractionalized governments tended to collect more seigniorage revenue than those less fractionalized—again as a basis for funding a more diverse range of prioritized expenditures. Alesina and Perotti (1996) examined the mechanisms through which political instability can affect economic performance by devising an index that measures the occurrence of more violent phenomena related to political unrest. The authors show that for a sample of 71 countries between 1960 and 1985, income inequality, by fueling social discontent, increases sociopolitical instability. The resulting uncertainty reduces levels of domestic investment, which negatively affects income growth.

A common feature of the literature assessing the impact of political instability on economic performance literature has been its focus on measuring political instability via indicators which record transfers of power between Government and opposition. As discussed, for most Pacific island states violent revolutions and military coups have tended to be the exception rather than the norm within the political landscape and for changes of political power. Rather, despite high levels of fractionalization within government, transfers of power within the Pacific islands have occurred predominantly through highly contested elections and other constitutional means such as votes of no confidence and formal dissolutions of parliament.

What has been more important to the policy-making environment in the Pacific islands than violent overthrows of government are the characteristics of government coalitions while they have remained in power. Therefore, rather than measuring changes of government through either military or civil coups, this paper focuses on the assessment of less dramatic forms of political instability that, while not necessarily being sufficient to cause a change of government, may lead to sufficient incentives for an incumbent government to be unable, or unwilling, to pursue helpful economic reforms. As discussed below, these include variables such as the parliamentary majority enjoyed by the ruling coalition and a number of indicators of party fractionalization.

This study makes a number of contributions to the literature. It is the first study to test the impact political fractionalization has had on the ability of Pacific island governments to establish private sector environments conducive to widespread wealth creation. It also draws on new measures of government fractionalization that more accurately reflect the types and causes of political instability faced by Pacific island governments. These include a perceptions-based index of aggregate political stability; the construction of a “Herfindahl” index of government power, a measure of government fractionalization based on the probability that two deputy ministers are from the same party; and a measure of the proportion of seats held by the coalition government relative to the opposition. The paper also reports a data collection exercise that generated an unbalanced dynamic panel of 13 PICs and 30 SIDS. This data is statistically analyzed using the system–generalized method of moments (GMM) and robust system–GMM estimation procedures to account for potential endogeneity among the explanatory variables.

## 4. Model and Estimation Method

As used in a wide variety of studies analyzing the cross-country determinants of institutional performance, the basic model to be estimated can be represented by

$$RQ_{i,t} = \beta_0 + \beta_1 PS_{i,t} + \beta' Z' + \gamma_t + \eta_i + \varepsilon_{i,t} \quad (0.1)$$

where  $RQ_{i,t}$  represents the level of regulatory quality for country  $i$  at time  $t$ ,  $PS_{i,t}$  represents the level of political stability for country  $i$  at time  $t$ ,  $Z'$  represents a vector of other control variables that influence the level of regulatory quality,  $\gamma_t$  is unexplained variation that remains constant across countries but varies across time,  $\eta_i$  are country-specific and time-constant (fixed) effects, and  $\varepsilon_{i,t}$  is the usual white noise error with zero expected mean. A key issue when estimating models of economic performance and political stability is that the core explanatory variable of interest—political stability—is potentially endogenous with the dependant variable. For example, while political stability may have a positive impact on economic reform, it is also probable that economic reform may lead to stronger rates of gross domestic product (GDP) growth, which in turn may strengthen the government's political position. As discussed shortly, the same can be said for other explanatory variables included in the model, such as GDP growth and the amount of overseas development assistance (ODA) received from donors—with positive reform outcomes likely to stimulate higher levels of donor loans. Controlling for this endogeneity is thus a key issue in the estimation of the specification in Equation 1.1.

Another important question to consider is how levels of political stability have influenced rates of regulatory reform vis-à-vis levels of regulatory quality. In this instance, an alternative specification to Equation 1.1 can be written as

$$\Delta RQ_{i,t} = \beta_0 + \beta_1 RQ_{i,t-1} + \beta_2 PS_{i,t} + \beta' Z' + \gamma_t + \eta_i + \varepsilon_{i,t} \quad (0.2)$$

where  $\Delta RQ_{i,t}$  is the change in regulatory quality between periods. This specification also includes the lagged level value of regulatory quality to control for the possibility that countries with higher levels of regulatory quality may find it easier to undertake reforms, given that they have greater institutional capacity to manage the change, or that those countries starting from a poor regulatory base may find it easier to make initial improvements.

Given that Equations 1.1 and 1.2 are estimated with a dynamic panel dataset, it is also important to control for country-specific effects (fixed effects). In the presence of country-specific effects, ordinary least squares (OLS) estimates may be both biased and inconsistent since the lagged value of regulatory quality will be correlated with the error term.<sup>14</sup> The first-differenced GMM estimator developed by Arellano and Bond (1991) is one method to control for these issues.<sup>15</sup> In the case of Equation 1.1,<sup>16</sup> for example, the dependent regulatory quality variable is estimated in first differences ( $X_{i,t} - X_{i,t-1}$ ) such that

$$\Delta RQ_{i,t} = \beta_0 + \beta_1 \Delta PS_{i,t-1} + \beta' \Delta Z' + \Delta \gamma_t + \varepsilon_{i,t} \quad (0.3)$$

<sup>14</sup> In addition, it has been shown that this correlation cannot be removed as the number of countries in the sample increases as the time period of estimation increases (Coviello and Islam 2006, p. 22).

<sup>15</sup> While a simple fixed-effects panel data approach to estimating Equation 1.1 would account for the existence of country-specific effects, the coefficient estimates will remain biased because of the presence of endogeneity. In addition, the fixed-effects estimator would remove a number of control variables, which, as discussed below, are also of interest as they are time invariant; hence the focus on the system-GMM estimation procedure.

<sup>16</sup> However, the estimation of Equation 1.2 is carried out in much the same way; given that the dependent variable is already in differences it will be estimated in second differences. As in the estimations of Equation 1.1, all of the explanatory variables are estimated in first differences.

where the country-specific effects,  $\eta_i$ , are canceled out by the difference operator. Difference-GMM also controls for the endogeneity of the regulatory quality and political instability variables by using internal instruments that are based on the lagged values of the endogenous explanatory variables (Coviello and Islam 2006, p. 23). For consistent estimation, it is also required that  $\varepsilon_{i,t}$  have the typical *i.i.d* properties in addition to each of the explanatory variable satisfying the assumption of weak exogeneity. Weak exogeneity requires that variables must be uncorrelated with future unanticipated shocks to the dependent variable but could be influenced by both past and present levels of the dependant variables—which means that they are uncorrelated with  $\varepsilon_{i,t}$  such that

$$\begin{aligned} E[RQ_{i,t-s}(\varepsilon_{i,t} - \varepsilon_{i,t-s})] &= 0 & \forall t = 3, \dots, T; s \geq 2 \\ E[Z'_{i,t-s}(\varepsilon_{i,t} - \varepsilon_{i,t-s})] &= 0 \end{aligned} \quad (0.4)$$

where  $T$  is the number of time periods in the sample and  $Z'$  represents the vector of all the weakly exogenous explanatory variables. Bond et al. (2001) show that when estimating persistent time series (such as measures of regulatory quality), the first-differenced GMM estimator can be unreliable since lagged levels of the series provide only weak instruments for subsequent first differences.<sup>17</sup> A solution to this problem is provided by Arellano and Bover (1995) and Blundell and Bond (1997), who developed the system-GMM estimator. The system-GMM approach also uses lagged values of the dependent and independent variables as internal instruments but these are derived from the estimation of a system of two simultaneous equations. The first is in levels with lagged first differences as instruments and the second is in first differences with lagged levels as instruments. By using this approach, this paper addresses the issue of weak instrumentation, which can occur as a result of using first-differenced GMM estimations when estimating highly persistent time series (Elbadawi et al. 2007, p. 15).

However, the system-GMM procedure requires a number of additional conditions. Firstly, it requires both of the original orthogonality assumptions of the first-differenced GMM estimator (shown in Equation 1.4). It also requires that the equation in differences has no correlation between the differences of the variables and the country-specific effects<sup>18</sup> such that

$$\begin{aligned} E[(RQ_{i,t+\kappa} - RQ_{i,t+q})\eta_i] &= 0 \\ E[(Z'_{i,t+\kappa} - Z'_{i,t+q})\eta_i] &= 0 \quad \forall \kappa, q \end{aligned} \quad (0.5)$$

For the equation in levels, two additional moment conditions are also required to ensure that the internal instruments gain a sufficient degree of identification with the dependent regulatory quality variable given its persistent nature, such that

$$\begin{aligned} E[(RQ_{i,t-s} - RQ_{i,t-s-1})(\eta_i + \varepsilon_{i,t})] &= 0 \\ E[(Z'_{i,t-s} - Z'_{i,t-s-1})(\eta_i + \varepsilon_{i,t})] &= 0 \end{aligned} \quad (0.6)$$

One downside of using the system-GMM procedure is that while the estimators are asymptotically robust, they are known to have poor finite sample properties, leading to a downwards bias in the standard error estimates (Roodman 2006, p. 1). This issue is addressed by using the finite sample correction proposed by Windmeijer (2005), which produces standard errors that are asymptotically robust to both heteroskedasticity and serial correlation.

<sup>17</sup> In particular, when the dependent variable follows a path close to a random walk, the differenced-GMM has poor finite sample properties and is downwards biased, especially when the number of periods is small (Presbitero 2006, p. 6).

<sup>18</sup> This implies that the system is stationary and that temporary deviations from the steady state value are uncorrelated with the fixed effects (Djankov et al. 2008, p. 184).

As outlined in Blundel and Bond (1998), the Hansen–Sargan test of overidentifying restrictions is reported in all of the GMM estimations for the null hypothesis of instrument validity. Failure to reject the null hypothesis gives support to the model.<sup>19</sup>

The estimation process also requires the selection of an appropriate lag structure for estimating each of the endogenous explanatory variables. Given the limited sample size that the Pacific islands offers and the need to minimize the number of instruments generated in proportion to the number of country clusters (Roodman 2006), all of the estimations are carried out with a 2-year single lag structure. The use of only a single second-year lag minimizes the number of instruments required, given the small sample size. The second-year lag is chosen as it is the first lag that is not

correlated with the current period error term since  $\Delta e_{i,t} = e_{i,t} - e_{i,t-1}$  and  $\Delta e_{i,t-1} = e_{i,t-1} - e_{i,t-2}$

and, hence, the residuals between the current period and the first lag both contain  $e_{i,t-1}$ . The Arellano–Bond test statistic is used to examine the null hypothesis that the error term is not serially correlated. The values reported are the p-values for first-order autoregressive (AR)(1) and second-order AR(2) autocorrelated disturbances in the first-differenced equations.<sup>20</sup> It is common for the AR(1) test in first differences to reject the null hypothesis of no autocorrelation, but this is to be expected since both residuals contain  $e_{i,t-1}$ . Of most significance are the AR(2) residuals, which detect the presence of autocorrelation in levels.

## 5. Data

### Dependent Variable

The dependant variable for this paper to measure regulatory quality draws on the Governance Matters dataset constructed by Kauffmann et al. (2009). This variable is defined as “perceptions of the ability of the government to formulate and implement sound policies and regulations that permit and promote private sector development.” It is the most comprehensive perceptions-based indicator of regulatory performance available, covering 212 countries from 1996 to 2008. The dataset also includes a large number of SIDS, which are typically excluded from governance indicator datasets, including 14 PICs. This indicator is measured in units ranging from -2.5 to 2.5, with higher values corresponding to better perceptions surrounding the prevailing regulatory environment. Unrecorded values for 1997, 1999, and 2001 were linearly extrapolated from adjoining years.

### Explanatory Variables

The paper uses three indicators of political instability as the core explanatory variable in the model. The first also draws on the Kauffmann et al. (2009) dataset and, as before, measures perceptions of the likelihood that the government will be destabilized either by external forces or from within government, including politically motivated violence and terrorism. This variable has the advantage that it is available for a large number of SIDS including 13 PICs for the period 1996 to 2008. However, it focuses primarily on perceptions of the threat of changes in government through violent or non-political means. To capture the degree to which fractionalized party politics has contributed

<sup>19</sup> For each of the robust system–GMM estimations, Hansen’s J-Statistic is presented instead of the Sargan Statistic. Both tests have the same null hypothesis.

<sup>20</sup> A failure to reject the null hypothesis gives support to the model. Rejecting the null hypothesis indicates a need for higher-order lags of the variables to be used as instruments.

to political instability and regulatory outcomes, other measures were developed using the Beck et al. (2001) and Keefer (2007) political institutions database.

The first indicator measures the extent to which the incumbent government possesses a parliamentary majority by counting the number of seats it holds within Parliament relative to the total number of seats available. The assumption here is that governments with a smaller proportion of seats will be less inclined to undertake reform efforts that disadvantage a party member due to the threat that their defection may have to maintenance of a parliamentary majority. A stronger government coalition may be more inclined to challenge vested interests as their defection would be less likely to threaten the government's hold on power.

The second indicator measures the number of legislative parties required to form a coalition government as the basis for constructing a political Herfindahl index. This variable ( $\Omega_t$ ) is defined as the sum of squared seats of all parties included in the government coalition, such that

$$\Omega_t = \sum_{p=1}^P s_{p,t}^2$$

where  $s_p$  is the share of seats held by party  $p$  in the government at time  $t$ , and  $P$  is the total number of parties in government. This variable measures the concentration of power within government, based on the number of parties required to form the coalition and the proportion of seats held by each party. Higher values of the index indicate less fractionalization (higher concentration of power within a single party).

The final measure of government fractionalization measures the probability that any two deputies picked at random from among the parties that comprise government will be from two different parties. This variable is defined as

$$\Gamma_t = 1 - \sum_{i=1}^P \omega_{i,t}^2$$

where  $\omega_{i,t}$  is the share of group  $i$  in the government coalition at time  $t$ . In contrast to the political Herfindahl index, this index focuses on the amount of political influence that each of the coalition parties has been able to obtain by measuring the probability that two random draws from among government would produce legislators from different parties. When  $\Gamma_t = 0$  there is no fractionalization of parties within government. This is likely to represent a relative cohesion of political opinion. In contrast, as  $\Gamma_t$  approaches 1, there is an increasing probability that each member of government will come from different parties. Such a legislature is assumed to be more likely to be divided, with a lower degree of policy coherence. The variable provides an alternative proxy for the level of political fractionalization.

The downside of using these different measures of government fractionalization is that they are only available for five PICs between 1989 and 2006, giving a relatively small sample size. Therefore, the estimations carried out using these measures were also conducted using all SIDS available in the sample, of which there are 17.

### Other Explanatory Variables

The large and varied literature on the determinants of economic reform offers several other important control variables that should be included in the model. These can be broadly classified into the economic, institutional, and historical determinants of regulatory quality.

The first such variable is a measure of GDP growth to reflect the impact that prevailing economic conditions can have on a government's ability, and desire, to undertake economic reform. On the one hand, higher rates of GDP growth may help promote improvements in regulatory quality, as they provide governments with the resources and the stability to handle any adjustment costs that may arise from reforms. On the other hand, it has been common for Pacific island governments to undertake economic reforms following significant economic turmoil, generally as a means to reestablish some form of macroeconomic stability. Nominal and real GDP growth rates were interchanged in earlier estimations, with the nominal variable recording a higher, more consistent level of significance across each of the estimations—perhaps reflecting the closer relationship nominal GDP growth has with government revenue streams. Therefore, nominal GDP was used in the final estimations. Using this variable also captures the effects of shocks, both to output and to price levels, saving on degrees of freedom.

Data was sourced from the International Monetary Fund's (IMF) International Financial Statistics online database and was measured in terms of percent per annum (IMF 2009). This data was augmented with data from the Asian Development Bank's (ADB) *Key Indicators for Asia and the Pacific* (ADB 2009) for some of the Pacific islands countries, with aggregate GDP converted from local currency units into US dollars using period average exchange rates from the same source.

Another important control variable included in the estimations is the level of foreign aid received by each country. This ODA variable was sourced from the OECD Development Assistance Committee's (DAC) database (OECD DAC 2009). The data was originally measured in nominal US dollars and then taken as a proportion of GDP using the data listed above. Although often targeted at improving institutional outcomes, foreign aid is a heterogeneous good—with different donors targeting different outcomes across a variety of sectors of the economy. For this reason, and to capture those elements of foreign aid most likely to influence levels of regulatory quality, this variable was also disaggregated into two components—technical cooperation ODA and net donor loans. Technical cooperation is defined as “assistance activities designed to improve the level of knowledge, skills, technical know-how, or productive aptitudes of a population in a developing country” (OECD DAC 2007). Net donor loans are defined as the disbursement of new concessional loans to recipient countries less the total amount of repayments made by that recipient to previous creditors (OECD DAC 2007). Both of these aid variables were also measured as a percentage of GDP.

Levels of adult literacy were included in the estimations to capture the influence that a better-educated electorate can have on the demand for economic reform that has public good characteristics. This data was taken from the World Bank's World Development Indicators dataset (2009) and augmented for a number of PICs using the regional Pacific Regional Information System (PRISM) data source as well as the CIA country fact pages for a number of the US-aligned Pacific states.<sup>21</sup>

Population levels were included to capture the disadvantage that smaller countries are likely to face by having fewer institutional and human capital resources. As explained, smaller states also face unique challenges within their bureaucracies that could influence their ability to create well-functioning regulatory institutions. These include the close interpersonal relationships that members of the bureaucracy often have with business interests. This variable was measured as the natural

<sup>21</sup> Another economic variable included in earlier estimations was GDP per capita. However, this variable was not found to be significant—most likely the result of its very high correlation with literacy levels, with an average correlation of 0.91 within the sample. Therefore, to save on degrees of freedom the GDP per capita variable was excluded from the final estimations.

logarithm of thousands of people and taken from the World Development Indicators dataset (2009). This data was augmented with data for several PICs using the ADB *Key Indicators* (2009).

Estimations also controlled for the influence of a country's structural geographic characteristics on institutional quality. These include variables such as distance from the equator and the proportion of the population within 100 kilometers (km) of major waterways. Distance from the equator was measured as the absolute value of latitude in degrees from the equator. This variable measures the structural disadvantages faced by countries due to climatic conditions—with those countries closer to the equator more likely to face a higher burden from tropical diseases and adverse weather events such as cyclones. These factors have been shown in a number of seminal papers to have been a key determinant of more general levels of institutional quality (Sachs 2003; Rodrik et al. 2004). This data was sourced from Rodrik et al. (2004) and updated for several PICs (Appendix 9.2).

Geographic proximity to major waterways measures the proportion of a country's population within 100 km of ice-free coast lines or sea-navigable rivers. This variable captures the impact that easily obtainable access to international markets can have on a country's trade policy and regulations, such as its degree of openness—with those countries with a high proportion of its population in areas that are likely to benefit from international trade more likely to adopt more trade-conducive economic policies. This data was taken from Gallup et al. (1999) and updated for PICs (Appendix 9.2).

A dummy variable measuring whether a country is classified as a "fragile state" was also included in some estimations to control for any differential effects in those countries either in a post-conflict situation or that have very low levels of institutional quality. The fragile states dummy was sourced from Chauvet and Collier (2007) and calculated from the World Bank's definition of fragile states, which includes low-income countries scoring 3.2 and below on the World Bank's Country Policy and Institutional Assessment index. A full list of those SIDS assessed as "fragile" can be found in Appendix 9.2.

The final set of control variables captures the influence of colonial legacy on levels of regulatory quality. In many of the Pacific islands, these historical relationships were strongly influenced by a British colonial legacy. Whether the influence of Britain and the transplantation of its models of governance have helped or hindered the Pacific islands in creating domestic regulatory environments conducive to broad-based employment creation is an open question. To control for this, a dummy variable measuring whether country  $j$  is an ex-British colony or protectorate was included. A full list of the countries is provided in Appendix 9.3.

Other European powers (France, Germany, and Portugal) have also had a significant influence on some PICs as well as on other SIDS. Therefore, a second colonial legacy variable was included to measure the fraction of the population that speaks a European language, including English, to measure the depth of these historical colonial relationships. This linguistic variable was taken from Hall and Jones (1999) and extended to several PICs as described in Appendix 9.2.

Table 9.1 presents the key summary statistics for each of these variables. Within the sample of 30 SIDS, there are 13 PICs, 20 ex-British colonies or protectorates, and 4 countries that have been classified at some stage as a fragile state. The highest-ranking country in terms of regulatory quality was the Bahamas in 2002 with a score of 1.3, while Solomon Islands scored the lowest in 2003. The greatest perception of political stability was in St. Kitts and Nevis in 2004 with an index value of 1.48 and Haiti the worst in 2004 with an index of -1.96. The largest country in the sample is the Dominican Republic with a population of approximately 8.9 million, while the smallest is

Tuvalu with a population of 11,000. Grenada is the only country to have had a 100% parliamentary majority between 1998 and 2000. The lowest proportion of seats held by a single party that was able to form a government was 11% in the Dominican Republic in 1997. The largest amount of donor assistance was received by Solomon Islands in 2006—a total ODA equal to 108% of GDP, of which technical assistance was equivalent to 56% of its GDP. The largest amount of loans received in a single year was by Guyana in 1996, recording new donor lending equal to 12.5% of GDP.

**Table 9.1: Summary Statistics of Variables—Full Sample of Small Island Developing States (1996–2008)**

Variable	Description	Observations	Mean	Standard Deviation	Minimum	Maximum
RQ	Regulatory quality index	287	(0.08)	0.72	(2.50)	1.30
GGI_rq	USP regulatory quality index	59	0.36	0.13	0.07	0.61
PS	Political stability index	287	0.42	0.71	(1.96)	1.48
Maj	Parliamentary majority	175	0.64	0.18	0.11	1.00
Herftot	Herfindhal index of government power	168	0.50	0.22	0.06	1.00
Frac	Government fractionalization	168	0.50	0.22	0.00	0.95
Gdpg	GDP growth	287	2.76	4.32	(27.07)	14.45
Literacy	Adult literacy rate	287	85.57	15.34	40.00	99.00
Fragile	Fragile states dummy	287	0.09	0.28	0.00	1.00
Eurfrac	Fraction population speaking European language	287	0.61	0.45	0.00	1.00
Brcol	British colony dummy	287	0.77	0.41	0.00	1.00
Pop <sup>a</sup>	Population	287	1,387	2,358	11	8,870
Disteq	Distance from the equator	287	13.59	5.31	0.00	25.00
Pop100km	Population within 100 kilometers of waterways	287	0.96	0.11	0.50	1.00
ODAgdp	Total ODA as a proportion of GDP	287	10.79	17.49	0.00	107.80
Loansgdp	Net donor loans as a proportion of GDP	287	0.20	3.58	(34.10)	12.5
Techgdp	Technical assistance ODA as a proportion of GDP	287	3.87	9.05	0.00	56.00

( ) = negative value, GDP = gross domestic product, ODA = overseas development assistance, USP = University of South Pacific.

<sup>a</sup> Natural logarithm used for estimation.

Source: Author.

## 6. Results

Table 9.2 presents the results of the OLS estimation of Equation 1.1 with the dependent variable, regulatory quality, estimated against the political stability index as well as the other control variables discussed. For the purposes of this preliminary estimation, the political stability variable was lagged by one period as an initial attempt to minimize any potential endogeneity between it and the dependent variable. Each of the OLS coefficient estimates shows White's (1980) heteroskedasticity-robust and country-clustered standard errors in parentheses.

Column 1 presents the results of a basic model, including only a limited number of core explanatory variables and estimated for the sample of 13 PICs between 1996 and 2008. The results show that the lagged value of political stability is highly correlated with higher levels of regulatory quality, recording a positive and highly statistically significant coefficient estimate. The results also

show that larger countries tend to be associated with higher levels of regulatory quality, with the natural logarithm of population also recording a positive, highly significant coefficient estimate.

Column 2 presents the results of the estimation of Equation 1.1 with the inclusion of all explanatory variables. The results support those of the previous column, with highly statistically significant positive coefficient estimates for the political stability and population variables. The results also show a strong positive association between European colonial ties and regulatory quality measured via the significant positive coefficient on the European language variable. As expected, the fragile states dummy is negatively signed and significant, suggesting that countries with weak institutional and governance structures tend to have poorer quality regulatory environments, even after controlling for their poorer outcomes on other variables such as literacy and GDP growth.

These results are repeated in Column 3, which disaggregates the ODA as a proportion of GDP variable into its technical assistance and net donor loans components. Whereas in the previous estimation the ODA variable was insignificant, in this case the results suggest that there are divergent correlations between the different types of ODA. In the first instance, the loans variable has a positive correlation with levels of regulatory quality, albeit with its large variance estimate leading to an insignificant coefficient. In contrast, the technical assistance variable has a negatively and moderately significant negative correlation with levels of regulatory quality—suggesting that technical assistance is associated with poorer levels of regulatory quality. However, as discussed below, these results should be treated with caution and do not imply causation. In much the same way that technical assistance could cause deterioration in regulatory performance and loans could entice recipients to undertake economic reform, it is equally likely that donors could allocate more technical assistance to countries with poor regulatory environments and reward reformist governments with additional loans.

Finally, Column 4 presents the results of the estimation of the full model using the entire SIDS sample. This sample includes 30 SIDS, and expands the sample size from 83 observations to 260. In this case, the results suggest that the link between higher levels of political stability and higher levels of regulatory quality is stronger in PICs than it is in SIDS more generally, with the political stability variable recording an insignificant but still positive coefficient estimate. The results also provide support for each of the correlations observed in the previous three columns, in particular with both the disaggregated ODA variables recording similarly signed and significant coefficient estimates.

**Table 9.2: OLS Estimation, in Levels of Variables**

OLS Estimation 1996–2008	(1)	(2)	(3)	(4)
Regulatory Quality	Basic Model PIC Sample	Full Model PIC Sample	Full Model + PIC Sample	Full Model + SIDS Sample
L.PS	0.431 (0.122) <sup>a</sup>	0.502 (0.089) <sup>a</sup>	0.406 (0.127) <sup>a</sup>	0.241 (0.147)
GDPg	0.004 (0.011)	0.001 (0.009)	0.004 (0.009)	0.019 (0.009) <sup>b</sup>
Literacy	0.012 (0.007)	-0.003 (0.006)	-0.002 (0.006)	0.002 (0.006)
LnPop	0.223 (0.084) <sup>b</sup>	0.144 (0.050) <sup>b</sup>	0.157 (0.041) <sup>a</sup>	0.125 (0.080)
Fragile		-0.403 (0.132) <sup>b</sup>	-0.450 (0.176) <sup>b</sup>	-0.436 (0.168) <sup>b</sup>
Brcol		-0.099 (0.119)	0.008 (0.101)	-0.016 (0.130)
Eurfrac		0.593 (0.116) <sup>a</sup>	0.563 (0.115) <sup>a</sup>	0.875 (0.167) <sup>a</sup>
Disteq		0.002 (0.013)	0.002 (0.013)	0.017 (0.020)
Pop100km		-1.042 (0.263) <sup>a</sup>	-0.703 (0.357) <sup>c</sup>	-0.345 (0.572)
ODAgdp		-0.004 (0.002)		
Techgdp			-0.008 (0.004) <sup>b</sup>	-0.019 (0.006) <sup>a</sup>
Loansgdp			0.026 (0.026)	0.014 (0.005) <sup>b</sup>
Constant	-3.220 (0.902) <sup>a</sup>	-0.651 (0.639)	-1.108 (0.577) <sup>c</sup>	-1.499 (0.789) <sup>c</sup>
Observations	83	83	83	260
Countries	13	13	13	30
R-squared	0.308	0.687	0.708	0.700
F-Stat	4.92	115.13	808.10	31.79
Prob > F-Stat	(0.016)	(0.000)	(0.000)	(0.000)

OLS = ordinary least squares, PIC = Pacific island country, SIDS = small island developing states.

<sup>a</sup> Significant at 1%.

<sup>b</sup> Significant at 5%.

<sup>c</sup> Significant at 10%.

Notes: Standard errors in parentheses. Variance estimates country-clustered and adjusted for heteroskedasticity robustness according to the process developed by White (1980). See Table 9.1 for the full descriptions of variables.

Source: Author.

All of these OLS results should be treated with caution. As discussed, political stability is likely to be jointly determined with levels of regulatory quality, similar to other explanatory variables such as GDP growth and ODA flows. Table 9.3 presents the results of the estimation of Equation 1.3, using the system-GMM estimation procedure, which controls for endogeneity and other empirical issues. As discussed, the system-GMM procedure estimates a system of two equations, one in first differences and the other in levels. The variables in levels are then instrumented with their own first differences as a means of improving the efficiency of the estimation procedure. For each of the endogenous variables the second-period lag was chosen for the instruments. For the purposes of estimation, the political stability, GDP growth, and the ODA variables are treated as endogenous.<sup>22</sup> All system-GMM estimations were carried out in STATA, using the xtabond2 command developed by Roodman (2009).

A significant issue when estimating the model with only the Pacific island country sample is that the available degrees of freedom, and countries, are low compared with the number of instrumental variables required in the construction of the levels and first-differenced equations. This can cause a variety of problems including weak test statistics for overall instrument exogeneity. For this reason, as well as to determine whether the Pacific islands experience can be generalized to SIDS more broadly, each of the full model estimations in this and the following tables were repeated with the use of the entire SIDS sample. The consistency of the results across the small and large samples adds a degree of confidence in the core findings.

The results reported in Table 9.3 also use the perceptions-based political stability index as the core explanatory variable. Column 5 presents the results of the basic model, estimated for the sample of 13 PICs between 1996 and 2008. The results support those obtained in the OLS analysis. Political stability has a highly significant, positive impact on levels of regulatory quality, as does population size. The literacy variable is also intuitively signed and significant, suggesting that improvements in educational standards can contribute to a better regulatory environment. This could occur in various ways; for example, a better-informed electorate may result in strengthened accountability mechanisms for political decision making and increased capacity of the public servants who design and implement regulatory standards. Column 6 adds the endogenous aggregate ODA variable into the estimation, which records a negative and highly significant coefficient. This suggests that, in total, higher levels of ODA have contributed to poorer regulatory quality outcomes in the Pacific islands. This result is explored further in Column 7, which includes the two disaggregated measures of ODA as well as the remaining explanatory variables from the full model. Here the results suggest that a key cause of the negative influence of ODA on regulatory quality has been through the technical assistance component, while the loans component has a positive, albeit insignificant, coefficient estimate.<sup>23</sup>

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<sup>22</sup> Estimations were also carried out treating the literacy variable as endogenous and the results were similar, but this estimation required the construction of an additional set of instruments, so the variable was set as exogenous.

<sup>23</sup> This effect is consistent with other studies such as Bowman and Chand (2007) who showed that, while generally positive, the impact of foreign aid on institutional quality turns negative for small states. Batten (2009) provided further evidence that these diminishing marginal returns to foreign aid with respect to population size were particularly large in terms of the impact of technical assistance on institutional quality.

**Table 9.3: Impact of Political Stability on Regulatory Quality**

System-GMM Estimation Regulatory Quality	(5) Basic Model PIC Sample	(6) Basic Model with ODA PIC Sample	(7) Full Model PIC Sample	(8) Full Model SIDS Sample
PS <sup>*</sup>	0.240 (0.052) <sup>a</sup>	0.139 (0.053) <sup>b</sup>	0.252 (0.056) <sup>a</sup>	0.078 (0.038) <sup>b</sup>
GDPg <sup>*</sup>	0.006 (0.005)	0.008 (0.005) <sup>c</sup>	0.005 (0.004)	0.017 (0.003) <sup>a</sup>
Literacy	0.015 (0.002) <sup>a</sup>	0.008 (0.003) <sup>a</sup>	-0.001 (0.003)	0.005 (0.001) <sup>a</sup>
LnPop	0.155 (0.026) <sup>a</sup>	0.027 (0.034)	0.091 (0.031) <sup>a</sup>	0.013 (0.081)
ODAgdp <sup>*</sup>		-0.008 (0.001) <sup>a</sup>		
Techgdp <sup>*</sup>			-0.012 (0.002) <sup>a</sup>	-0.020 (0.001) <sup>a</sup>
Loansgdp <sup>*</sup>			0.020 (0.012)	0.012 (0.003) <sup>a</sup>
Fragile			-0.489 (0.076) <sup>a</sup>	-0.461 (0.046) <sup>a</sup>
Brcol			-0.012 (0.058)	0.001 (0.028)
Eurfrac			0.484 (0.064) <sup>a</sup>	0.780 (0.835)
Disteq			0.001 (0.005)	0.020 (0.002) <sup>a</sup>
Pop100km			-0.593 (0.242) <sup>b</sup>	-0.249 (0.114) <sup>b</sup>
Constant	-2.893 (0.284) <sup>a</sup>	-1.389 (0.387) <sup>a</sup>	-0.719 (0.394) <sup>c</sup>	-1.525 (0.149) <sup>a</sup>
Observations	93	93	93	287
Countries	13	13	13	30
F-Stat	31.60	33.63	38.05	4023.84
Prob > F-Stat	(0.000)	(0.000)	(0.000)	(0.000)
Hansen P > • <sup>2</sup>	1.000	1.000	1.000	1.000
Arellano-Bond Statistics				
AR(1) P-value	0.986	0.496	0.550	0.539
AR(2) P-value	0.153	0.036	0.275	0.020

AR = autoregressive, GMM = generalized method of moments, ODA = overseas development assistance, PIC = Pacific island country, SIDS = small island developing states.

<sup>a</sup> Significant at 1%.

<sup>b</sup> Significant at 5%.

<sup>c</sup> Significant at 10%.

Notes: For the Pacific island country sample system-GMM standard errors have been subject to the small sample adjustment which reports t instead of z statistics and the F-Test instead of the Wald Chi-Squared test. Variables that are treated as endogenous are marked with •. Standard errors are in parentheses. All estimations fail to reject the null hypothesis of instrument exogeneity. All robust system-GMM standard errors are adjusted according to the process developed by Windmeijer (2005). All estimations fail to reject the null hypothesis of no autocorrelation in the AR(1) and AR(2) residuals at the 95% confidence level. See Table 9.1 for the full descriptions of variables.

Source: Author.

Finally, Column 8 estimates the same specification as Column 7 with the inclusion of the full SIDS sample. Importantly, in all of the system-GMM estimations the core political stability variable remains positive and highly statistically significant, showing that the effect it has on regulatory quality is robust to the inclusion of a variety of control variables and to the expansion of the data to the entire SIDS sample. Each of the other core explanatory variables remains largely unchanged, with literacy levels and British and European colonial legacies having a significantly positive impact on levels of regulatory quality. In this case, however, the GDP growth variable is also positive and significant, indicating that higher rates of GDP growth can stimulate improvements in regulatory quality—perhaps by providing the economic and financial room to manoeuvre to undertake regulatory reforms. Both the ODA variables maintain their coefficient signs, although in this case the loans coefficient is highly significant. This suggests that for SIDS in general and in contrast to the negative influence of technical assistance, donor lending has helped to encourage economic reform and improve levels of regulatory quality.

As discussed earlier, there are various ways to measure the impact of political instability on regulatory performance. The previous approach drew on the perceptions-based index of political stability. However, while available for a large number of PICs, this variable is limited by its focus on violent threats to government and people's perceptions of the likelihood that a change in power may take place. In practice, while these factors will obviously influence the ability and desire of incumbent governments to undertake regulatory reform, it is also the behavior of governments while they are in power that will affect these types of policy outcomes. Appendix 9.4 shows the results of a number of estimations using three different measures of political instability. The first measures the parliamentary majority held by government, the second measures the degree of fractionalization present within Parliament, while the third uses the Herfindahl index of the degree to which power is concentrated in terms of political parties.

The drawback to using these different measures of political fractionalization is that they are only available for five PICs (PNG, Samoa, Solomon Islands, Timor-Leste, and Vanuatu). To preserve degrees of freedom, a number of explanatory variables were dropped from the Pacific island estimations. These included the fragile states dummy (only PNG and Solomon Islands had values assigned), British colony and European language variables (since all five PICs come from a European colonial background), and the population within 100 km of a major waterway (since none but PNG have large inland populations). The results are compared against an estimation of the SIDS sample, which increases the number of countries to 17 and significantly increases the sample size. Finally, the results are compared against an estimation of the full model, which includes all explanatory variables, with the SIDS sample of countries.

Columns 9a, 9b, and 9c indicate the impact of the size of the parliamentary majority held by government on regulatory quality. Columns 10a, 10b, and 10c report the same series of estimations with the inclusion of the Herfindahl index of government power. Columns 11a, 11b, and 11c report results using the measure of government fractionalization.

For all three variables the results are consistent—higher levels of political fractionalization are associated with significantly lower levels of regulatory quality. In Columns 9a, 9b, and 9c, the majority variable is positive and significant, indicating that larger parliamentary majorities are associated with improved regulation. Likewise in Columns 10a, 10b, and 10c, the Herfindahl index variable is significant and positive, indicating that governments that are comprised of unified parties vis-à-vis coalitions of smaller parties tend to have better regulatory quality. Columns 11a, 11b, and 11c tell a similar story, with highly fractionalized governments having poorer regulatory outcomes

than their more cohesive counterparts, although this effect loses its significance in the case of the Pacific islands estimation (Column 11a).

Results for the other explanatory variables broadly follow the findings of the previous Table 9.2. Higher rates of literacy have a positive impact on levels of regulatory quality, as do GDP growth and population size; however, these effects are less consistent than the former estimations, with the population size effect becoming insignificant in the SIDS samples and the GDP growth effect becoming insignificant in the Pacific island samples. Donor loans are again shown to have had a positive influence on regulatory quality, although in this case the effect only appears to be significant in the Pacific islands sample, rather than in the larger SIDS sample. Likewise, the results show technical assistance to have a negative impact on regulatory quality, although in this case the effect is only significant for the SIDS sample of countries, while in the Pacific island sample it is shown to have a small, but significant, positive impact.

The final set of results consider Equation 1.2, which estimates the impact of political stability on rates of regulatory reform as opposed to levels of regulatory quality. These results are presented in Table 9.4. The estimation of this specification places a higher burden on the available degrees of freedom within the dataset, given that year-on-year changes must be calculated from each of the countries in the sample. For this reason, these estimations focus on using the political stability index and for the full SIDS sample, which generates a much larger sample size. The first Column 12a reports results for Equation 1.2 with the use of the previously discussed difference-GMM procedure.<sup>24</sup> Column 12b results used the system-GMM procedure, while Column 12c results are from the robust system-GMM procedure. These estimations are replicated in Columns 13a to 13c, with the disaggregation of the foreign aid variable into its technical assistance and loans components. Each of the difference-GMM estimations includes a reduced form set of coefficients, given that a number of these variables are fairly constant through time, and as such must be dropped from the difference-GMM estimation procedure due to collinearity.

The findings again offer broad support to those in the previous estimations. The political stability variable is positive and significant in all but the final estimation, suggesting that higher levels of political stability contribute to faster rates of regulatory reform. The GDP growth variable is also positive and highly significant in each of the system-GMM estimations, suggesting that rates of regulatory reform have been faster during economically prosperous periods. Given the similar results in the previous tables, this finding casts doubt on the claim that Pacific island governments reform best following significant economic crises.

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<sup>24</sup> This estimation process determines whether the results are robust to the differencing procedure or whether the significant coefficient estimates rely on the additional identification obtained from using the additional levels equation during the instrumentation process for the system-GMM results.

**Table 9.4: Impact of Political Stability on Regulatory Reform**

Dependant Variable: • RQ	(12a) Difference-GMM	(12b) System-GMM	(12c) Robust System-GMM	(13a) Difference-GMM	(13b) System-GMM	(13c) Robust System-GMM
L.RQ <sup>•</sup>	-0.516 (0.105) <sup>a</sup>	-0.296 (0.044) <sup>a</sup>	-0.296 (0.062) <sup>a</sup>	-0.713 (0.094) <sup>a</sup>	-0.257 (0.039) <sup>a</sup>	-0.257 (0.081) <sup>a</sup>
PS <sup>•</sup>	0.208 (0.118) <sup>b</sup>	0.118 (0.044) <sup>a</sup>	0.118 (0.057) <sup>c</sup>	0.189 (0.100) <sup>b</sup>	0.069 (0.041) <sup>b</sup>	0.069 (0.050)
GDPg <sup>•</sup>	-0.006 (0.008)	0.011 (0.004) <sup>a</sup>	0.011 (0.004) <sup>a</sup>	0.002 (0.006)	0.014 (0.004) <sup>a</sup>	0.014 (0.004) <sup>a</sup>
Lnpop	-0.662 (0.623)	0.033 (0.017) <sup>b</sup>	0.033 (0.028)	-0.327 (0.565)	0.037 (0.015) <sup>c</sup>	0.037 (0.025)
ODAgdp <sup>•</sup>	0.005 (0.004)	-0.004 (0.001) <sup>a</sup>	-0.004 (0.001) <sup>a</sup>			
Techgdp <sup>•</sup>				-0.007 (0.005)	-0.004 (0.002) <sup>c</sup>	-0.004 (0.002) <sup>c</sup>
Loansgdp <sup>•</sup>				0.012 (0.008)	0.006 (0.003) <sup>b</sup>	0.006 (0.005)
Fragile	0.016 (0.150)	-0.088 (0.061)	-0.088 (0.047) <sup>b</sup>	-0.260 (0.128) <sup>c</sup>	-0.073 (0.061)	-0.073 (0.056)
Literacy		-0.001 (0.002)	-0.001 (0.002)		0.001 (0.002)	0.001 (0.002)
Brcol		-0.095 (0.038) <sup>c</sup>	-0.095 (0.039) <sup>c</sup>		-0.029 (0.035)	-0.029 (0.031)
Eurfrac		0.319 (0.058) <sup>a</sup>	0.319 (0.079) <sup>a</sup>		0.258 (0.052) <sup>a</sup>	0.258 (0.084) <sup>a</sup>
Disteq		0.004 (0.003)	0.004 (0.006)		0.007 (0.003) <sup>c</sup>	0.007 (0.005)
Pop100km		-0.276 (0.137) <sup>c</sup>	-0.276 (0.149) <sup>b</sup>		-0.208 (0.139)	-0.208 (0.145)
Constant		-0.132 (0.219)	-0.132 (0.321)		-0.421 (0.191) <sup>c</sup>	-0.421 (0.270)
Observations	236	264	264	236	264	264
Countries	27	28	28	27	28	28
F-Stat Prob > F-Stat	48.32 (0.000)	54.40 (0.000)	70.07 (0.000)	85.51 (0.000)	55.29 (0.000)	27.78 (0.006)
Hansen P > • <sup>2</sup>	0.981	1.000	1.000	1.000	1.000	1.000
Arellano–Bond Statistics						
AR(1) P-value	0.057	0.000	0.025	0.009	0.000	0.010
AR(2) P-value	0.051	0.226	0.127	0.070	0.367	0.235

AR = autoregressive, GMM = generalized method of moments, PIC = Pacific island country, SIDS = small island developing states.

a Significant at 1%.

b Significant at 10%.

c Significant at 5%.

Notes: Standard errors are in parentheses. Variables that are treated as endogenous are marked with •. All robust system-GMM standard errors are adjusted according to the process developed by Windmeijer (2005). All estimations fail to reject the null hypothesis of instrument exogeneity. All estimations fail to reject the null hypothesis of no autocorrelation in the AR(2) residuals at the 95% confidence level, while they reject the null for the AR(1) process at the 99% confidence level. See Table 9.1 for full descriptions of variables.

Source: Author.

Both the system-GMM and robust system-GMM results in Column 12b and 12c show highly significant, negative coefficient estimates for the total foreign aid variable, although this effect is not robust to the difference-GMM estimation procedure. This effect again appears to exert itself most strongly through the technical assistance component of ODA, with that variable recording moderately significant coefficient estimates in the system-GMM estimations shown in Column 13b and 13c. On the other hand, the loans component of ODA appears to have had a more benign impact on rates of regulatory reform, or in the case of Column 12b, a small and significantly positive impact.

Finally, it is worth noting the highly significant negative coefficient estimates on the lagged regulatory quality variable across each of the six estimations. This suggests that the worse a country's initial regulatory quality, the easier it will be to undertake reforms that lead to significant improvements—indicating diminishing marginal returns in the success of SIDS in managing regulatory reform. The flip side of this finding is that countries that have managed to achieve reasonable levels of regulatory quality tend to find it more difficult to make further improvements in their regulatory environment.

## 7. Conclusion

This research provides new quantitative evidence that political instability and fractionalized party politics have been a key constraint to developing more effective regulatory institutions in the Pacific islands. This effect is highly robust to various measures of political instability, the inclusion of a wide range of control variables, and to the expansion of the sample to a large number of SIDS. This finding helps to explain why the democratic systems established across the region have not brought about needed improvements in these economies' ability to promote private sector enterprise capable of absorbing sufficient numbers of workers into formal sector employment. The *a priori* evidence presented at the beginning of the paper supports these empirical results.

These results do not suggest that Pacific island governments are more predisposed to clientelist politics *per se*—but rather that a number of political attribute have developed from the application of western models of governance and democracy in the region, which have in turn encouraged this behavior. In particular, the weak and fragmented party systems that have evolved from historical circumstance and traditional culture have generated a system of incentives for politicians to favor patronage politics. Furthermore, this system of political incentives has encouraged the delivery of policy with concentrated benefits rather than the provision of widespread public good.

What can be done to strengthen the region's political systems to encourage a greater degree of policy coherence and focus on more effectively providing for the public good?

Strengthening the viability of political parties may be a core component of these efforts. These efforts should focus on reforms that encourage policy makers to better organize and articulate the interests of like-minded voters, and to design policy options that address broader national interests. Stronger party systems would also help to prevent the high levels of political instability created across the region from loose parliamentary coalitions that are easily dislodged by disgruntled members or determined rent seekers.

Numerous attempts at these types of reforms have been attempted across the region. Perhaps the best known example has been PNG's Organic Law on Political Parties and Candidates (OLIPPAC). In place since 2001, among other conditions this legislation penalizes "party hopping"

by members of Parliament<sup>25</sup> in an attempt to instill a greater degree of stability within Parliament—although the jury is still out on whether this has contributed to an improved policy-making environment.

Chand and Duncan (2007) also propose that if political parties are to play a more important role in Pacific politics they need to receive much larger sums of public funding so that they can build and maintain their political coalitions. With respect to PNG, Chand and Duncan give the example of utilizing the current system of district support grants; but instead of the funds being given directly to parliamentarians, Chand and Duncan argue that they should be given as direct payments to parties. The writers propose that this will allow political parties to have an increased ability to “reward politicians with cash... to punish politicians that misbehave and the power to compel voting...” The larger and stronger political parties that may subsequently emerge from this would be more capable of taking into account issues and policies that are in the interest of the broader population rather than of any particular constituency.

However, political party systems are highly country-specific and any efforts to support their development must take into account that the Pacific islands draw on a wide range of electoral systems—with some more favorable to political party systems than others. Likewise, the identities, motivations, and relationships between politicians, members of civil society, and other rent-seeking groups matter. There cannot be a one-size-fits-all solution to improving the impact that political party organization has on a country’s ability to undertake broad welfare-enhancing regulatory reform.

Moreover, attempts by donors to engineer or support particular party systems would be a highly fraught process. The eventual impacts of any reform efforts are likely to be vastly different from those intended. It is for this reason that political change must be a domestically led process, as members of Parliament (if anyone) are likely to be the only ones truly alert to all of the interest groups that have a stake in how reform efforts are manifest.

This situation may condemn donor organizations to remaining on the sidelines of political reform efforts across the region. However, the strong links that this paper has established between political party fractionalization, on the one hand, and the region’s poor regulatory quality, on the other, suggest that donor efforts toward raising levels of economic prosperity are likely to be thwarted by the continuation of the region’s current political systems. Donors thus have a particularly important role to play in highlighting and developing the region’s political capacity to undertake reforms that strengthen domestic political institutions.

Equally, donors must also adopt realistic expectations about what can be achieved by weak coalition governments, given their potential for political instability. This result is particularly important with regards to the application of conditionality loan arrangements and other performance-based aid initiatives. For example, efforts toward regulatory reform may be most effectively made during periods of relative political stability, while, during periods of instability, aid resources may be more effectively applied elsewhere. In this sense, seeking to adapt the uses of aid rather than altering the prevailing political environment is likely to be donors’ most prudent response to the challenges highlighted by this study.

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<sup>25</sup> One of the most significant penalties imposed under the OLIPPAC legislation for crossing the floor is that the member’s seat is declared vacant, so that they must run in a by-election to regain their position.

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## Appendix 9.1: List of Small Island Developing States as Classified by the United Nations

American Samoa <sup>a</sup>	Mauritius
Anguilla	Micronesia, Federated States of <sup>a,b</sup>
Antigua and Barbuda <sup>b</sup>	Montserrat
Aruba	Nauru <sup>a,b</sup>
Bahamas <sup>b</sup>	Netherlands Antilles
Bahrain	New Caledonia <sup>a,b</sup>
Barbados <sup>b</sup>	Niue <sup>a</sup>
Belize <sup>b</sup>	Northern Marianas Islands <sup>a</sup>
British Virgin Islands	Palau <sup>a,b</sup>
Cape Verde	Papua New Guinea <sup>a,b</sup>
Comoros	Puerto Rico <sup>b</sup>
Cook Islands <sup>a</sup>	Samoa <sup>a,b</sup>
Cuba	São Tomé and Príncipe
Dominica <sup>b</sup>	Seychelles
Dominican Republic <sup>b</sup>	Solomon Islands <sup>a,b</sup>
Fiji <sup>a,b</sup>	St. Kitts and Nevis <sup>b</sup>
French Polynesia <sup>a</sup>	St. Lucia <sup>b</sup>
Grenada <sup>b</sup>	St. Vincent and the Grenadines <sup>b</sup>
Guam	Suriname <sup>b</sup>
Guinea-Bissau	Timor-Leste <sup>a,b</sup>
Guyana <sup>b</sup>	Tonga <sup>a,b</sup>
Haiti <sup>b</sup>	Trinidad and Tobago <sup>b</sup>
Jamaica <sup>b</sup>	Tuvalu <sup>a,b</sup>
Kiribati <sup>a,b</sup>	US Virgin Islands
Maldives	Vanuatu <sup>a,b</sup>
Marshall Islands <sup>a,b</sup>	

US = United States.

<sup>a</sup> Pacific island countries.

<sup>b</sup> Countries included in full sample.

Source: United Nations Department of Economic and Social Affairs (2008).

## Appendix 9.2: Additional Data Sources and Information

### *Distance from the Equator*

Originally sourced from Rodrik et al. (2004), this dataset was updated for a number of Pacific island countries on the basis of comparisons with other countries in the region. Nauru, Solomon Islands, and Tuvalu were assumed to be the same distance from the equator as Papua New Guinea (PNG). Samoa was assumed to be equal distance to Vanuatu; Tonga was deemed comparable with the Marshall Islands and Fiji; and Kiribati and Palau were deemed to be the same as the Federated States of Micronesia (FSM).

### *Population within 100 kilometers of Major Waterways*

Originally sourced from Gallup et al. (1999), this dataset excluded a number of small Pacific island countries such as the Marshall Islands, the FSM, Nauru, Palau, Tuvalu, and Solomon Islands. Given their small geographic size, all of these countries were assumed to have 100% of their population within 100 kilometers of the ocean.

### *Linguistic Data*

Linguistic data measures the proportion of the population speaking a Western European language as their mother tongue. This data was originally sourced from Hall and Jones (1999); however, it excluded a number of Pacific island countries. Data was collected primarily from the CIA *World Fact Book* country pages, which report the native languages in each country. The additions made to the existing data include the Marshall Islands (96%), the FSM (96%), Nauru (100%), Samoa (95%), and Tonga (99%).

**Table A9.2: List of Small Island Developing States Included as Fragile States**

Country	Start Date	End Date	Country	Start Date	End Date
Comoros	1978	2006	Papua New Guinea	1999	2004
Guinea	1977	2006	Sao Tome and Principe	1981	2006
Guinea-Bissau	1992	2006	Solomon Islands	1989	2003
Haiti	1977	2006			

Source: Chauvet and Collier (2007).

### Appendix 9.3: List of British Colonies and Protectorates in Regions with Small Island Developing States (Africa, Asia, Caribbean, Central Asia, and the Pacific)

Anguilla	Malta
Antigua <sup>a</sup>	Mauritius
Bahamas <sup>a</sup>	Montserrat
Bahrain	Myanmar
Bangladesh	Namibia
Barbados <sup>a</sup>	Nauru <sup>a,b</sup>
Belize <sup>a</sup>	Nigeria
Bermuda	Niue
Botswana	Pakistan
Brunei Darussalam	Palestinian Administrative Areas
Cameroon	Papua New Guinea <sup>a,b</sup>
Cayman Islands	Qatar
Cook Islands <sup>b</sup>	Samoa <sup>a,b</sup>
Cyprus	Seychelles
Dominica <sup>a</sup>	Sierra Leone
Egypt	Singapore
Falkland Islands	Solomon Islands <sup>a,b</sup>
Fiji <sup>a,b</sup>	Somalia
Gambia	South Africa
Georgia	Sri Lanka
Ghana	St. Helena
Gibraltar	St. Kitts and Nevis <sup>a</sup>
Grenada <sup>a</sup>	St. Lucia <sup>a</sup>
Guyana <sup>a</sup>	St. Vincent and Grenadines <sup>a</sup>
Hong Kong, China	Sudan
India	Swaziland
Iraq	Tanzania
Israel	Tonga <sup>a,b</sup>
Jamaica <sup>a</sup>	Trinidad and Tobago <sup>a</sup>
Jordan	Turks and Caicos Islands
Kenya	Tuvalu <sup>a,b</sup>
Kiribati <sup>a,b</sup>	Uganda
Kuwait	Vanuatu <sup>a,b</sup>
Lesotho	Virgin Islands
Malawi	Yemen
Malaysia	Zambia
Maldives	Zimbabwe

<sup>a</sup> Countries included in estimations.

<sup>b</sup> Countries included as part of the Pacific island region.

Source: Institute of Commonwealth Studies (2007).

## Appendix 9.4: Impact of Various Measures of Government Fractionalization on Regulatory Quality

System-GMM Estimation Regulatory Quality	(9a)	(9b)	(9c)	(10a)	(10b)	(10c)	(11a)	(11b)	(11c)
Maj <sup>c</sup>	1.132	1.036	1.019						
	(0.504) <sup>a</sup>	(0.446) <sup>b</sup>	(0.422) <sup>b</sup>						
Herftot <sup>c</sup>				1.701	0.848	1.151			
				(0.766) <sup>a</sup>	(0.397) <sup>b</sup>	(0.430) <sup>c</sup>			
Frac <sup>c</sup>							-1.560	-0.759	-1.016
							(0.768)	(0.394) <sup>a</sup>	(0.417) <sup>b</sup>
GDPg <sup>c</sup>	0.022	0.022	0.022	0.023	0.022	0.021	0.023	0.023	0.023
	(0.017)	(0.012) <sup>a</sup>	(0.011) <sup>b</sup>	(0.017)	(0.016)	(0.013) <sup>a</sup>	(0.017)	(0.016)	(0.013) <sup>a</sup>
Literacy	0.036	0.028	0.019	0.035	0.025	0.017	0.035	0.025	0.015
	(0.006) <sup>c</sup>	(0.007) <sup>c</sup>	(0.006) <sup>c</sup>	(0.007) <sup>c</sup>	(0.007) <sup>c</sup>	(0.006) <sup>c</sup>	(0.007) <sup>c</sup>	(0.006) <sup>c</sup>	(0.005) <sup>c</sup>
Lnpop	0.675	0.069	0.067	0.837	0.036	0.043	0.812	0.029	0.035
	(0.100) <sup>c</sup>	(0.065)	(0.070)	(0.118) <sup>c</sup>	(0.064)	(0.070)	(0.123) <sup>c</sup>	(0.065)	(0.070)
Disteq	0.207	0.038	0.039	0.284	0.035	0.038	0.277	0.036	0.037
	(0.035) <sup>c</sup>	(0.018) <sup>b</sup>	(0.020) <sup>a</sup>	(0.049) <sup>c</sup>	(0.019) <sup>a</sup>	(0.021) <sup>a</sup>	(0.052) <sup>c</sup>	(0.018) <sup>b</sup>	(0.022) <sup>a</sup>
Techgdp <sup>c</sup>	0.004	-0.013	-0.014	0.007	-0.014	-0.013	0.007	-0.015	-0.014
	(0.002) <sup>a</sup>	(0.007) <sup>a</sup>	(0.005) <sup>c</sup>	(0.001) <sup>c</sup>	(0.007) <sup>a</sup>	(0.004) <sup>c</sup>	(0.001) <sup>c</sup>	(0.008) <sup>a</sup>	(0.004) <sup>c</sup>
Loansgdp <sup>c</sup>	0.084	0.021	0.012	0.097	0.023	0.014	0.098	0.020	0.012
	(0.031) <sup>a</sup>	(0.019)	(0.012)	(0.019) <sup>c</sup>	(0.022)	(0.012)	(0.019) <sup>c</sup>	(0.019)	(0.011)
Fragile			-0.431			-0.574			-0.570
			(0.194) <sup>b</sup>			(0.200) <sup>c</sup>			(0.201) <sup>c</sup>
Brcol			0.139			0.147			0.128
			(0.195)			(0.217)			(0.213)
Engfrac			0.261			0.170			0.219
			(0.206)			(0.230)			(0.225)
Pop100km			-1.066			-1.302			-1.218
			(0.818)			(0.835)			(0.823)
Constant	-10.700	-4.107	-2.510	-12.511	-3.364	-1.775	-10.630	-2.500	-0.620
	(1.438) <sup>c</sup>	(1.166) <sup>c</sup>	(0.956) <sup>c</sup>	(1.449) <sup>c</sup>	(1.035) <sup>c</sup>	(0.907) <sup>a</sup>	(1.286) <sup>c</sup>	(0.952) <sup>c</sup>	(1.010)
Observations	48	175	175	45	168	168	45	168	168
Countries	5	17	17	5	17	17	5	17	17
Wald $\chi^2$ /F-Stat									
Prob > Wald	96.99	67.99	530.77	121.15	52.98	347.87	127.35	49.83	340.89
$\chi^2$ /F-stat	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)
Hansen P > $\chi^2$	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000
Arellano-Bond statistics									
AR(1) P-value	0.141	0.698	0.282	0.129	0.790	0.274	0.012	0.805	0.242
AR(2) P-value	0.100	0.138	0.231	0.347	0.194	0.448	1.000	1.000	0.403

AR = autoregressive, GMM = generalized method of moments.

<sup>a</sup> Significant at 10%.

<sup>b</sup> Significant at 5%.

<sup>c</sup> Significant at 1%.

Notes: All system-GMM standard errors are adjusted according to the process developed by Windmeijer (2005). For the Pacific island countries (9a, 10a, 11a) estimations only, system-GMM standard errors are also subject to the small sample adjustment, which reports t instead of z statistics and the F-test instead of the Wald  $\chi^2$  test. Variables that are treated as endogenous are marked with  $\square$ . All estimations fail to reject the null hypothesis of instrument exogeneity. All estimations fail to reject the null hypothesis of no autocorrelation in the AR(2) residuals at a 99% confidence level, and AR(1) at a 95% confidence level. See Table 9.1 for the full descriptions of variables.

Source: Author.



# 10 Timor-Leste

## Change, Stagnation, and Questions of Political Economy

by Rod Nixon<sup>1</sup>

### ABSTRACT

Timor-Leste is a half-island, post-conflict nation characterized by challenging geographic and climatic conditions. As at colonial contact over 400 years ago, the rural economy is dominated by subsistence agriculture. With high population growth, rural development is critical to avoiding growing poverty and increasing rural–urban movement. Meeting the challenge of rural development will require well-formulated policies targeted for maximum effect. These should ideally be implemented efficiently and without interruption from further crises such as that which occurred in 2006. However, the Government of Timor-Leste has not yet committed to sufficient security sector reform, there is no evidence of effective action against corruption, and there are concerns that the agricultural development focus is too narrow and signs that the extension service is too inefficient. Meanwhile, private sector investment faces multiple bottlenecks. The analysis suggests some “levers of change” that should be used to support improvements in security sector reform, accountability and quality control monitoring, agricultural policy, agricultural extension delivery, and private sector promotion. However, it must be recognized that the potential for exercising leverage is diminishing as oil revenues increase.

### 1. Introduction

Political economy analysis has received renewed attention in recent years with the advent of the Drivers of Change (DOC) approach, first promoted by the Department of International Development (DFID) of the United Kingdom.<sup>2</sup> A key emphasis of the DOC approach as advocated by DFID (2009, p. 5) is on “how to provide support, taking political feasibility into account.”<sup>3</sup> The DOC approach values in-depth historical and contextual knowledge of in-country realities to enable tactical choices to be made about which strategies to advance (DFID 2009, pp. 8–9). Analysis should

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<sup>2</sup> The approach has also been adopted by other development agencies including the Australian Agency for International Development (AusAID). See Cox et al. (2008).

<sup>3</sup> Bold in the original not included in this text.

ideally facilitate the identification of “levers of change” that can be used by the development community to influence realistic change in appropriate areas (DFID 2005, p. 3).

In accordance with the emphasis of the DOC approach on historical factors, this paper begins with analysis of features that characterized the territory in the pre-independence period and that continue, in many cases, to influence the nature and capacity of the state and the rural development challenges facing it today. These include geographic aspects, settlement patterns, demographic trends, and the subsistence rural economy, as well as traditional sociopolitical structures. Other important issues include the impact of the Portuguese and Indonesian periods of rule. The review of structural and historical features is followed in section 3 by an analysis of the new RDTL (República Democrática Timor-Leste) state. This section examines state institutions and governance capacity, focusing on (i) security, stability, and order; (ii) democracy and governance; (iii) public administration and accountability; and (iv) justice. This section finds that the security sector continues to give rise to considerable concern years after the 2006 instability, and that the security sector reform (SSR) process is incomplete. On democracy and governance, the analysis finds that coming to terms with representative democracy in Timor-Leste has proved a challenging process, and that the municipal governance project may face difficulties in the area of capacity, among others. An evaluation of various government institutions promoting accountability and transparency concludes that effectiveness may be compromised by too many institutions with overlapping functions.

Section 4 on rural change examines the two economies of Timor-Leste: the petroleum-funded public sector economy and the almost stagnant rural economy. Discussion on the rural economy includes consideration of the impact of the 2006 political and security crisis on rural development outcomes; quality-control, transparency, and budget expenditure issues associated with rural infrastructure provision; and obstacles to increasing agricultural productivity and private sector investment in the rural economy. The final discussion on opportunities and levers summarizes key obstacles to rural development and suggests strategies for addressing these through development partner incentive or “lever” approaches, focusing where possible on clear areas of government need or possible future need.

## 2. Structural and Historical Features

### Geographical Overview

The state of Timor-Leste comprises the eastern half of the island of Timor and the exclave district of Oecusse, located to the north of the western half of the island. The remainder of the western half of the island is part of the Republic of Indonesia. The topography of the island has been described as the product of “a turbulent geological past... broadly characterized by a core of rugged hill and mountain land consisting of a confused mass of knife-edged, highly dissected ridges trending in various directions and craggy upland blocks” (Metzner 1977, p. 22).

According to the Ministry of Agriculture, Forestry, and Fisheries (MAFF), “the island has relatively unproductive, low fertility, fragile soils” (MAFF 2004, p. 1). The cultivation potential of the island is further limited by the steep slopes that cover close to half the surface area, making the thin layer of soil vulnerable to erosion from the severe monsoonal rains. North of the mountain range, these rains come between November and April and are followed by an extensive dry season that results in widespread water shortages, imposing a further limitation on agricultural potential.

Areas to the south and east of the range experience a later wet season and a less arduous dry season (MAFF 2004, p. 1).

The unpredictability of rainfall is yet another factor that adversely impacts agricultural production capacity: droughts are likely to result in severe food shortages or even famine (Ormeling 1957, pp. 21, 239–240). According to Fox (1988, p. 262), the capricious nature of the natural aquifer system, in which water is “trapped in limestone deposits by irregular sheets of clay,” complicates water supplies even further, since earth tremors may interrupt the flow of spring water from these aquifers, making new springs appear elsewhere. Fox explains that the hydrological features of Timor have implications for human settlement possibilities, necessitating “a scattered form of settlement and cultivation.” As discussed below, these geographical factors have imposed economic constraints on Timor and influenced the nature of the political systems that have developed on the island.

### Human Settlement and Economic Patterns

The diversity of ethnic groups that have migrated to Timor is reflected in a range of “physical types” and 14 or more languages.<sup>4</sup> Yet, as Ormeling (1957, p. 236) noted, despite differences, “the various ethnic groups... [developed]... a striking similarity in their material culture—shifting cultivation being the base of economy for all groups.” Although various changes contributed to a population increase in Timor in the 300 years prior to the 20th century,<sup>5</sup> none of these developments changed the position of shifting cultivation as the dominant mode of production. For example, figures from the early post-independence period (MAFF 2004, p. 4) indicate only a small proportion of arable land being used for irrigated agriculture, and with most used for the production of only one crop per year.<sup>6</sup> As discussed later, the post-subsistence transformation of the rural economy remains a major challenge, particularly in view of present demographic patterns and notwithstanding the states accrual of significant petroleum income.

Population growth on Timor has led to repeated warnings that the island’s carrying capacity is in danger of being exceeded, particularly given prevailing agricultural practices. Current demographic trends in Timor-Leste have led to concerns that the mid-2004 population of 994,500 may increase to 1,780,000 and even higher by 2025, resulting in a crude population density of 120 people per square kilometers (Bulatao 2008, pp. 5, 16–17). Given the combination of geographic constraints and cultivation practices, this level of population density is alarmingly high and highlights the need for rural development advances capable of improving carrying capacity and reducing urban migration. Achieving these advances will clearly require social, organizational, and

<sup>4</sup> In the account of Ormeling (1957, p. 67), “the Timor archipelago” is referred to as “a transition area, where an Indonesian–Malay and a Melanesian population component meet and influence each other.”

<sup>5</sup> Changes included the introduction of maize in the second half of the 17th century, as well as the introduction of muskets and increased trade in sandalwood and beeswax (Fox 1988, pp. 268–275). To these developments might be added the cash crop coffee, which has benefited Timorese smallholders in upland areas in the eastern half of the island since at least the early nineteenth century (Clarence-Smith 1992, p. 1; Davidson 1994, pp. 8, 90).

<sup>6</sup> According to MAFF (2004, p. 4), “there are some 420 irrigation schemes in total, of which only about 10 have modest water storage and thus the potential to produce two crops a year.” The ministry also notes that “even where water is available, farmers appear to lack the incentive to grow a second crop of rice,” preferring to use the land for livestock grazing or vegetable production. MAFF notes in relation to small-scale, community-irrigated, agricultural programs that “[h]istorically, farmers in Timor-Leste have been unable or, in some cases, showed little interest to maintain these schemes, relying on government for maintenance and, eventually, rehabilitation.” Broadly, the MAFF data indicate (2004, pp. 1–2) that 80% of rural East Timorese households source their income wholly from farming, with 39% “engaged in subsistence farming, producing neither saleable surplus nor generating non-farm income.” The two main subsistence crops MAFF (2004, p. 4) identified were maize (estimated area 121,000 hectares [ha]) and cassava (estimated area 91,000 ha).

agricultural changes, and is likely to prove challenging given the risk-averse nature of traditional subsistence societies.

### Sociopolitical and Economic Characteristics at Colonial Contact

Although elsewhere in the archipelago, fertile soils and high rainfall supported the development of technically and administratively complex societies with broad-spanning interdependencies, surplus generation, and administrative capacities, the geographic constraints of Timor were not conducive to such a development trajectory. In contrast to the irrigation-based states of Java, with their webs of inter-reliant communities and bureaucratic service delivery, the political structures that developed in Timor prior to the colonial consolidation of the late 19th and early 20th centuries were characterized by unstable, head-hunting micro-kingdoms continually warring over entitlements to draw tribute from the narrow margin of surplus produced by subsistence farmers. Portuguese colonial accounts from eastern Timor describe a political landscape featuring unstable and opportunistic alliance patterns and core-periphery dynamics into the late 19th century, at least in relation to the interaction between Timorese *reinos* (kingdoms) and the Portuguese colonial administration.

Notwithstanding the subsistence basis of Timorese society and the ongoing warfare, the political structures that characterized the *reinos* of Timor were ritually complex. Even if traditional Timorese social structures lack the administrative and organizational capacities that developed on Java, commentators (Glover 1986, p. 12; Capell 1944, p. 196) have remarked that the Timorese social institutions are highly structured in comparison with the Melanesian “big-man” systems to the east, notwithstanding the mixed ethnic origins of the population, which includes a Melanesian component. In this respect, the “developed class system with hereditary chiefs” (Glover 1986, p. 12) is perhaps of particular note.

In the course of the ensuing colonial consolidation of Timor, the petty kings, or *liurais*, would ultimately be disempowered for the most part and the *sucos* (villages), of which their *reinos* were comprised, integrated into colonial administrative units. Yet the demise of the formal authority of the *liurais* would by no means precipitate the destruction of the ritual and administrative authority that prevailed within the *sucos*, which became integrated into the Portuguese system of colonial administration. Much later still, at the point when the territory of East Timor was emerging from almost a quarter century of Indonesian occupation and preparing for transition to national independence, Berlie (2000, pp. 139–140) would note that the hereditary authority of *soco* leaders remained a fundamental feature of life throughout the territory, with the economy remaining overwhelmingly characterized by subsistence agriculture.<sup>7</sup>

Compared with some Pacific societies, the relatively structured nature of Timorese sociopolitical institutions may ultimately support a greater level of political stability. On the other hand, adherence to traditional and semi-feudal power structures can complicate the advancement of rational–legal administrative processes. In respect to the current governance situation in Timor-Leste, Blunt (2009, p. 94) warns that “where there are strong traditional beliefs in patronage as a central tenet of social exchange and reciprocal obligation, morality will consist in the partial or particularistic distribution of development benefits—towards ruling elites and their supporters.”

<sup>7</sup> See also Davidson (1996, p. 11), according to whom it had long been the authority of *soco* leaders whose “primary authority” was most respected by the Timorese, even prior to the subjugation of the *liurais* in the early 20th century.

## The Portuguese Colonial Period

While the Portuguese reached Timor in the early 16th century, no substantial settlement was constructed in the region until 1566 (for examples, Boxer (1960, pp. 350–354); Vaz (1964); Fox (1996, pp. 5–7); Gunn (1999, pp. 51–67); Schulte Nordholt (1971, pp. 159–181); and Farram (2004, pp. 37–41). There followed a long period during which the Portuguese competed with the Dutch and a Portuguese-native *mestiço* population known as the *Topasses* for control of the sandalwood trade. By the early 1660s, when the Dutch and Portuguese resolved to end their regional conflict, *Topasse* power brokers were endeavoring to influence developments over the entire island (Boxer 1960, p. 352). In 1702, after almost 200 years of engagement, the Portuguese finally established a permanent settlement on Timor at Lifau, in what is now the Timor-Leste exclave of Oecusse. Here the Portuguese faced constant insurgencies and eventually relocated to Dili in 1769 (Fox 1996, p. 8). Thereafter, the Portuguese made few advances toward consolidating control of the eastern half of the island until the late 19th or early 20th century (for example, Boxer 1960, p. 335; and Fox (1996, p. 8). Economic performance was poor, with sandalwood stocks so depleted by the 1850s that Portuguese authorities in Macao, China, cut shipping services for almost 4 decades.<sup>8</sup> As economic malaise and general misery gripped the territory in the mid-19th century, warfare between Timorese kingdoms and insurgencies against the Portuguese were common.

The period of economic stagnation between 1851 and 1916 is important for two reasons. First, during this period the colonial powers sought to reach agreement about the location of their respective domains in the Timor region and assert control over their colonial subjects. Second, the process of colonial consolidation was the catalyst for significant social and political developments (Farram 1999). In response to the decline of the sandalwood trade, the Portuguese initially endeavored to raise revenue through expanding the production of coffee, believed to have been cultivated by Timorese smallholders for sale to Chinese merchants since at least the early 19th century (Davidson 1949, pp. 8, 90; Clarence-Smith 1992, p. 1).<sup>9</sup> To facilitate this outcome, the Portuguese implemented a program that must rank among the more transformative rural development policy initiatives in eastern Timor—the distribution of coffee seedlings. The Timorese communities were expected to cultivate coffee and transfer a proportion of the harvest to the Portuguese administration; however, the new revenue-raising program did not work as planned. While the production of coffee expanded, no proportionate increase in government earnings followed, ultimately resulting in the introduction of a *capitação* (head tax) in 1908 (Davidson 1994, p. 104) by a colonial administration that had long struggled to make the territory pay its way. The introduction of taxes is considered a major factor leading to the “Great Rebellion” of 1911, which was suppressed only after a bloody campaign involving over 12,000 troops and use of a Portuguese gunboat, the *Pátria*, to shell rebel positions (Gunn 1999, pp. 160–169; Davidson 1994, pp. 90–104; Clarence-Smith 1992, pp. 2–6; and Jolliffe 1978, p. 35).

Only following suppression of the rebellion could Portuguese Timor be considered to have been pacified. This development resulted in a dramatic change in the power held by the colonial administration vis-à-vis the power held by the *lurais*, and the system of Portuguese administration finally became a reality with up to 13 districts divided into 50 to 60 subdistricts (or *postos*) and the municipality of Dili (Saldanha 1994, p. 52; Gunn 1999, pp. 244–245). It was within each of the *postos* that the colonial administrative system met the traditional administrative system that continued to operate at the level of the Timorese *soco* (Archer 1941, p. 7). This administrative

<sup>8</sup> See Davidson (1994, pp. 83–87) for an overview of the financial crisis faced by Portuguese Timor during this period.

<sup>9</sup> Note that Clarence-Smith (1992) considers that the introduction of coffee may date back as early as the mid-18th century.

approach suited the under-resourced Portuguese colonial model and, together with the general lack of modernisation, ensured that at the very end of Portuguese colonial rule in the 1960s and 1970s, Portuguese Timor remained a prime destination for Western anthropologists seeking to study traditional social organization.

Despite attempts to expand agricultural production during the late 19th century and the early 20th century, during which time coffee replaced sandalwood as the main export, prosperity for the colony remained elusive; on the brink of World War II the territory was referred to by a visiting British representative, C.H. Archer (1941, p. 37), as having “long been in a precarious economic situation.” Even the governor, wrote Archer, “considered the colony’s best defence [against invasion by the Japanese] to lie in its unattractiveness as a prize,” although this ultimately failed to save the territory from a devastating period of occupation between 1942 and 1945, during which many died due to famine caused by a merciless Japanese food collection policy.

Visiting Portuguese Timor at the end of the colonial era (in 1974) for the purpose of studying decolonization, Helen Hill (2002, p. 40) described the general situation as “one of stagnation and neglect,” characterized by “a traditional society where capitalist penetration had hardly taken place at all, with a people relying overwhelmingly on subsistence agriculture and a colonial power which would not generate any kind of development.”

### **The End of the Colonial Period and the Birth of Politics**

In April 1974, a revolt of the Armed Forces Movement in Lisbon brought a close to the authoritarian regime that had ruled Portugal and its remaining territories for the previous half-century. However, the uninspired and lethargic colonial administration that East Timorese colonial subjects had experienced for generations had provided the small number of educated *assimilados* and the rest of the population with little preparation for creating a democratic, accountable, and development-focused independent state. The vulnerability factors that prevailed at this point, most of which continue to influence developments, include the following:

#### ***The Subsistence Economy***

During the Portuguese colonial period there were no economic or social transformations to tear the majority of the East Timorese away from their traditional beliefs. As a result, the conclusion of the Portuguese colonial period saw little familiarity with the legal and bureaucratic forms of authority central to the functioning of the modern state (Weber 1978, pp. 220–221). Clearly, the subsistence rural economy and the traditional, collectivist-oriented value systems associated with it, presented obstacles at other levels too. As Duncan (2007, pp. 6–7) notes in relation to the Pacific, individual (although not necessarily collective) entrepreneurship can face severe challenges in contexts where distributive kinship systems predominate. Undoubtedly, this factor continues to influence business development in Timor-Leste in the present day.

#### ***Education Levels***

Figures presented by Gunn (1999, p. 214) suggest that fewer than 2,000 people were able to read and write by the late 1920s. Based on his 1941 visit, Archer (1941, p. 8) referred to the lack of a state education system in Portuguese Timor (unlike in Dutch Timor). A Portuguese government decision to allocate the Catholic Church responsibility and resources for the delivery of education in

Portuguese colonies resulted in a significant improvement in the post-war period; however, figures cited by Taylor (1991, p. 17) indicate that a 93% illiteracy rate prevailed as late as 1973.<sup>10</sup>

### *Martial Traditions*

Lee correctly asserts (2000, p. 185) that a “fighting spirit... is the one commodity from which the island of Timor has always suffered an abundance.” The Portuguese are not without some responsibility since, even after pacification, they sought to encourage and harness indigenous martial capacities to consolidate colonial authority and suppress rebellions. As developments would demonstrate, the association between political power and use of martial force remained strong in the minds of the aspiring indigenous political elites as Portuguese power in Timor receded from April 1974 onward, drawing the new East Timorese political organizations into a civil war. This development was followed by a quarter century of resistance against Indonesian occupation, reinforcing the legitimacy of armed force.

### *Political Inexperience*

The small group of indigenous political actors who emerged at the conclusion of the Portuguese period had limited political experience. Portuguese secret police had been stationed in Dili following the 1959 rebellion in Viqueque<sup>11</sup> and there were only minimal opportunities for participating in decision-making forums,<sup>12</sup> even for the few who qualified for participation on the basis of their *assimilado* status. Additionally, although some of those who became involved in the new political organizations had experience either in the colonial administration or the small private sector, many were young, with the average age of members of one of the main organizations, FRETILIN<sup>13</sup> (originally known as ASDT<sup>14</sup>) estimated at 27 (Taylor 1991, p. 27).<sup>15</sup>

As the reference to “revolutionary front” in the FRETILIN name suggests, links with other Portuguese territories meant that some new political actors had been influenced by the ideas, or at least the rhetoric, of radical movements in the Portuguese world (Nicol 1978, p. 102).<sup>16</sup> On the other hand, UDT,<sup>17</sup> another of the main political organizations that emerged in 1974, had a more conservative outlook.

If the lines along which the formation of the ASDT/FRETILIN and UDT organizations had taken place had been to a greater or lesser extent arbitrary in the beginning, then far more serious divisions developed between these parties and the third notable organization to emerge, the pro-

<sup>10</sup> While primary school enrollments are said to have increased from several thousand in 1946 to more than 57,000 by the early 1970s (Saldanha 1994, p. 59, Taylor (1991, p. 17), this level of increase has been questioned (Jones 2000, p. 44). Jones also points out that only in 1952 did the first secondary or middle school (*Lyceum*) open, with enrollments “remaining extremely small, with numbers fluctuating in the range of 200 to 800 students during the course of the 1960s” (see also Gunn 1999, p. 246).

<sup>11</sup> The secret police continued to operate in Portuguese Timor until the overthrow of the Caetano regime on 25 April 1974. See Chamberlain (2005, p. 20); Hill (2002, p. 30); and Taylor (1991, p. 24).

<sup>12</sup> Such as the *Açoa Nacional Popular* (Popular National Accord).

<sup>13</sup> Frente Revolucionária de Timor-Leste Independente (Revolutionary Front for an Independent East Timor).

<sup>14</sup> Associação Social Democrata Timorense (Timorese Social Democrat Association).

<sup>15</sup> See also Hill (2002, p. 69), who remarks that “[i]n general the UDT leaders were older than the ASDT [FRETILIN] founders and were employed at a higher level in the administration or engaged in private business ventures.”

<sup>16</sup> Nicol, who was on the scene at the time, reported that there were “no more than seven” communists involved in the FRETILIN leadership. Still, as indicated by the change of name from ASDT to FRETILIN, which took place on 12 September 1974 (Jolliffe 1978, p. 63; Nicol 1978, p. 79; and Taylor 1991, pp. 48–49), it appears clear that the left-wing radicals involved in ASDT/FRETILIN were successful in initiating a number of changes that increasingly characterized it as a left-wing organization.

<sup>17</sup> União Democrática Timorense (Timorese Democratic Union).

Indonesian APODETI.<sup>18</sup> Xanana Gusmão (2000, pp. 17–18), who later became a resistance leader before becoming inaugural RDTL President and then Prime Minister in 2007, remembers observing a situation vulnerable to getting “completely out of hand,” and recalls that “[f]riends avoided me until I identified myself politically, in writing, and once again I was greeted and could greet others with closed fist, the Fretilin salute! At first, friends and colleagues in the UDT continued to raise their hands and greet me. Then came indifference, until finally it became obvious that we were avoiding each other.”<sup>19</sup>

Despite an attempt at a coalition involving FRETILIN and UDT initiated in early 1975, relations between the parties deteriorated (Nicol 1978, pp. 84–91; Hill 2002, pp. 120–124; Jolliffe 1978, p. 94; and Dunn 1996, p. 76). The antipathy between the major political organizations, their willingness to use martial means to realize political objectives, and their inability to resist the divisive tactics of the Indonesian military, which held geopolitical aspirations involving East Timor, ultimately proved explosive and resulted in a brief civil war that took place during August 1975. In the ensuing chaos, recent political alliances and doctrines sometimes blurred as ancient rivalries emerged and opportunities for retributive killings were created.<sup>20</sup>

After its victory, FRETILIN ruled for about 3 months, during which time the ad hoc government fought Indonesian insurgencies on the western border and issued a unilateral declaration of independence, not long before the launch of a full-scale Indonesian invasion on 7 December 1975. The invasion was followed by almost a quarter century of resistance against Indonesian occupation. At the conclusion of this period, rifts remained in East Timor society stemming from the party formation period of 1974–1975 and developments that transpired during the resistance years.

### Change and Stagnation during the Indonesian Occupation

Although the Indonesians were to put more resources into rural development in East Timor than the Portuguese did, the circumstances of their arrival augured poorly for their chances of success. Commentators have remarked that the severe upheaval<sup>21</sup> of the invasion years was followed by a

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<sup>18</sup> Associação Popular Democrática Timorense (Timorese Popular Democratic Association).

<sup>19</sup> Gusmão writes of this development that “[t]his really was not what I had wanted. UDT parents, Apodeti uncles, Fretilin children. What shit this freedom was!”

<sup>20</sup> The Comissão de Acolhimento, Verdade e Reconciliação (CAVR, or Commission for Reception, Truth and Reconciliation) investigation (CAVR 2005, Part 3, p. 42) found that the highest death rate during the civil war period was “in the rural areas, where tensions based on long-standing clan feuds and personal grudges, intensified by more recent militant party ideological divisions, exploded into violence.” See also Hicks (1983, p. 22), who reflects in relation to this period that “Western notions of right wing and left wing, capitalist and communist, were meaningless to the vast majority of the Timorese population” and suggests that “old rivalries and loyalties” dating back to the 19th century or longer may have played a role in fuelling the 1975 conflict.

<sup>21</sup> The impact of the invasion was devastating, and resulted in widespread famine and disease (CAVR 2005, Part 8, pp. 6–7). Saldanha (1994, p. 136) observed firsthand the unsanitary and overcrowded conditions of the internment camps, which frequently resulted in sickness and death. The dire food shortages can be largely attributed to the destruction of agricultural capacity (resulting from disruption to clearing, planting, and harvesting cycles) caused by internal dislocation and forced internment. According to CAVR (2005, Part 3, pp. 84–85), the number of East Timorese held in “resettlement villages” and “internment camps” at the end of 1979 following the fall of the FRETILIN strongholds was more than 300,000 and possibly more than 370,000. In addition to the agricultural disturbances caused by the confinement of approximately half the population, the invasion resulted in substantial livestock losses, the impact of which was felt for many years. Saldanha (1994, p. 339) has estimated that the destruction of livestock amounted to nearly 80%, and Aditjondro (1994, pp. 12–13, 35) cites figures suggesting that numbers of cattle, buffaloes, horses, and poultry continued to decline steeply into the second half of the 1980s. Another factor related to the early conflict period that may have had an ongoing impact on agricultural productivity, and hence nutrition, concerns the suspected use of defoliants, particularly in eastern parts of East Timor (Aditjondro 1994, p. 10; Beazley 1999, pp. 17–18).

period of high economic growth (up to 10%) from 1983 until the onset of the Asian economic crisis in 1996 (Saldanha 1994, pp. 180–182; da Costa and Soesastro 2002, pp. 2–3). Significantly, this high growth rate was fuelled not by local productivity increases derived from structural changes to the economy but by a steady flow of Indonesian government capital directed at infrastructure development and administration activities, estimated at approximated \$100 million annually in the 1980s (da Costa and Soesastro 2002, pp. 2–3) and referred to by Soesastro (1989, p. 207) as “by far the largest central government financial allocations (on a per capita basis) of any region in Indonesia.” The contribution of private sector capital to the economic growth rate was minimal, since East Timor attracted almost no private investment throughout the entire Indonesian period (Saldanha 1994, pp. 151–152, 176–178; da Costa and Soesastro 2002, pp. 2–3; and Soesastro 1989, pp. 216–217).<sup>22</sup>

The development process itself has been characterized by Saldanha (1994, pp. 131–178) as centrally controlled (from Jakarta) and of a “high technology” nature (focused largely on infrastructure construction)<sup>23</sup> that demanded imported labor, much to the dissatisfaction of East Timorese. Saldanha also argues that the integrity of this nonparticipatory and overly rapid development agenda suffered further compromise because of the tendency for “extravagance and corruption” within the civil service.

The security emphasis that prevailed throughout the Indonesian occupation impacted the nature of development outcomes. Commentators (Aditjondro 1994, pp. 19–20; Beazley 1999, p. 14) have remarked that resettlement and housing construction projects were often motivated less by agricultural objectives than by the desire to resettle local populations in places where they could be easily supervised and controlled by Indonesian security forces, away from areas of guerrilla activity. Highlighting the security-related emphasis of rural and regional development objectives and the neglect of economic outcomes, Saldanha (1994, pp. 149, 161, 166–167) notes that budget allocations for the communications sector typically approximated 30%, whereas allocations for agriculture were usually only around 10%.

In the area of agricultural policy, the Indonesian administration emphasized agricultural self-sufficiency, including in rice production, and it has been estimated (Gunn 2003, p. 190) that “paddy and rain-fed rice” production may have covered 80,000 hectares (ha) by the late Indonesian period.<sup>24</sup> MAFF (2004, p. 4) later reported that motivation and capacity issues appear to have made these projects of questionable sustainability in the absence of an Indonesian presence or other assistance, since local communities often demonstrated little capacity to maintain or rehabilitate them.

While there is undoubtedly a role for irrigated agriculture in Timor-Leste, geographic realities have caused commentators to question the wisdom of agricultural self-sufficiency. During the Indonesian period, Soesastro (1989, pp. 222–228) asserted that the promotion of areas of comparative advantage (including estate crops and livestock) would have been a better approach.

<sup>22</sup> As an indication of the severity of the situation, Soesastro reports that manufacturing comprised less than 1% of GDP in 1986 and showed no signs of improvement.

<sup>23</sup> Perhaps the construction-centered nature of the development program is best illustrated by the roadwork program. According to official Badan Perencanaan Pembangunan Daerah (BAPPEDA, or Indonesian Regional Development Planning Board) figures (1997, p. 325, Table 8.1.2), East Timor had 6,363 km of roads by 1996, of which 3,513 km were sealed.

<sup>24</sup> This may be slightly optimistic. Young et al. (2010, *Technical Note* 1, p. 1) refer to figures suggesting “a total potential irrigation area of 71,258 ha.”

While it is most likely that East Timor offers a suitable environment for timber production,<sup>25</sup> coffee remains East Timor's main estate crop and the sector is in desperate need of modernization. The evidence suggests that the coffee sector either stagnated or deteriorated during the Indonesian period. For much or most of this time, the coffee industry was controlled by the military monopoly PT Salazar/PT Batara, a concern that purchased coffee from farmers at one-quarter of the market value. According to a former Singapore businessman, the military connection to the East Timor coffee trade commenced directly following the Indonesian invasion, in order that money borrowed from Chinese Singaporean financiers to support the invasion could be repaid. Reportedly, millions of dollars worth of stolen coffee, teak, and sandalwood oil was shipped to Singapore in a leased freighter soon after the invasion.

With the fleeing of plantation managers, coffee production became even more smallholder-dominated in the Indonesian period than it was during the Portuguese period, with smallholder operations increasing from 60% (of a total of 48,000 ha of coffee-producing land) during Portuguese times to 80% during Indonesian times (Soesastro 1989, p. 225). While smallholder farming is not negative in and of itself, in this case it was associated with the neglect of the sector due to the poor understanding of coffee crop management among smallholders. It is clear, therefore, that East Timor passed through the Indonesian period with no modernization of its most important cash crop—a development that has contributed to the rehabilitation of the coffee sector being a major rural development priority.

### The United Nations Period

Arriving in Dili following the Indonesian exodus of 1999, one observer (Federer 2005, p. 69) reported “[m]ore than half the buildings in Dili” destroyed and East Timor was “a land without governance, without an economy, no basic services, no food, no law and almost no visible inhabitants.” An initial assessment by the United Nations Office of Coordination of Humanitarian Affairs (UNOCHA) estimated that over 75% of East Timor’s population had been displaced and that over 70% of housing, utilities, and public buildings had been destroyed (UNOCHA 1999). Gunn (2003, pp. 190–192) refers to reports from rural areas of widespread destruction or looting of agricultural and fishing equipment, the theft or destruction of herds and seed stocks, and the burning of crops.

Notwithstanding the apparent absence of governance, order soon returned to the villages and an ad hoc administration system quickly emerged incorporating *suco* and subdistrict representatives of the CNRT,<sup>26</sup> which had been prominent at the international level in advancing the cause for independence. Interestingly, those who assumed positions in the CNRT national network at the grassroots level did not conform to the typology of the CNRT’s elite-level membership. Whereas the former were characteristically leaders in the traditional administrative system with strong connections to local subsistence realities, the latter had in many cases spent the occupation years abroad. Probably influenced more by *assimilado* values than the CNRT representatives in the mountains, many returning political actors bore unresolved tensions that had origins in the civil war and resistance periods, and many were reported (Federer 2005, p. 88) to be possessed of notions of entitlement.

<sup>25</sup> Survey work (Nixon 2005) indicates that the plantation forestry sector was expanded under Indonesian administration and that of the 14,213 hectares of state plantations identified in East Timor in 2005, about 96% dates from the Indonesian period.

<sup>26</sup> Concelho Nacional da Resistência Timorense (National Council of Timorese Resistance).

During the transition period, economic growth was recognized by the Central Fiscal Authority (CFA) as being “centred in Dili... [with]... less spending and less reconstruction in the districts” (CFA 2001, p. 5). Some empirical indication of the Dili-centered nature of activities during the United Nations Transitional Administration in East Timor (UNTAET) period is offered by the UNTAET-era Business Register.<sup>27</sup> In the period following independence, 5,179 of the 6,677 businesses (77%) featured in this register were based in Dili. As a corollary of the Dili-centered growth, there was a population drift to the capital from the districts as individuals seeking alternatives to subsistence agriculture sought work in Dili (CFA 2001).

As elections for a constitutional assembly (which would ultimately transform into the national Parliament) scheduled for 30 August 2001 approached, CNRT was formally disbanded in June 2001 to create space for other political organizations to participate in democratic processes (Dodd 2001; Grant 2001; and Beauvais 2001, p. 1132). By August 2001, sufficient political space had been created for no less than 16 political parties. Notwithstanding the large field, FRETILIN claimed victory with 43 of the 75 national seats and 12 of the 13 district seats.

UNTAET attracted criticism on various fronts—in particular, the time taken to realize meaningful East Timorese participation in the administration. There is no doubt, however, that East Timor in the post-Indonesian period faced a serious skill shortage and that finding suitable recruits for senior administrative positions was difficult. References to an unemployment rate as high as 80% or more, and suggestions that UNTAET may have been able to influence this, fail to recognize both the overwhelmingly subsistence nature of the East Timorese rural economy and the fact that no short-term transitional administration would have been capable of transforming this reality.

As Federer (2005) argued with prescience, given the 2006 instability, there may have been merit in a longer transition to independence under an international trusteeship. This could only have happened had the international community shared a more realistic understanding of the challenges of state development in non-state social contexts (and post-conflict ones at that). In any event, Timor-Leste achieved independence on 20 May 2002, at which point it still faced the challenges associated with creating a functioning administration, maintaining a peaceful engagement with multi-party democracy, advancing the development of the rural economy, and managing the emerging petroleum sector with prudence.

### In a New State

In their study of violence in post-conflict societies, Collier et al. (2006, p. 7) found that of 68 “post-conflict episodes,” war recurred in 31 cases within the first 5 years of independence. Identifying feasibility as a prime factor leading to post-conflict violence, Collier et al. (2006, pp. 5, 15) observed that in post-conflict contexts, “peace appears to depend upon an external military presence sustaining a gradual recovery.” Applying the findings of Collier et al. to the Timor-Leste case study, Shoesmith (2007, pp. 23–25) notes that international troops were withdrawn from Timor-Leste only 3 years after independence and that events leading to the 2006 crisis began to emerge within 6 months.<sup>28</sup>

<sup>27</sup> The Business Register is an unpublished database originally developed during the UNTAET period. The calculations included in the text are based on a post-UNTAET version accessed in mid-2003.

<sup>28</sup> In fact, a warning had sounded much earlier, when serious riots broke out on 4 December 2002 that resulted in the shooting deaths of two people and the destruction and looting of high-profile properties. While political agitation may have played a role in the December 2002 riots, Smith (2004, p. 279) later remarked that “[w]hile it was popular to speak of agitators, the fact that a crowd was so easy to mobilize was worrying and indicative of underlying tensions towards the government, the police and foreign business.”

Factors contributing to the volatility of the political situation in 2006 were numerous and a number have already been discussed. Many were identified in advance of the 2006 political crisis and a summary would include the following:<sup>29</sup>

- the combination of challenging geographical conditions, an overwhelmingly subsistence rural economy, low per capita income, a high fertility rate, and an emerging youth “spike” in the national demographic profile;
- a Dili-centered economy with limited employment opportunities and increasing urban migration to Dili by low-skilled job seekers (including an abundance of young men);
- established clandestine and martial traditions and the existence of numerous martial arts gangs and veterans groups;
- a large number of unresolved land and property disputes involving customary, formal, and irregular claims deriving from the Portuguese, Indonesian, and post-Indonesian periods;
- serious antipathy between veteran (and still active) political leaders, including Prime Minister Marí Alkatiri and President Xanana Gusmão;
- a semi-presidential political system that provided for two centers of power associated with the positions of Prime Minister (with executive power) and the President (supreme commander of the defense force);<sup>30</sup>
- a hazardous police–military dynamic that would exacerbate the antipathy between Alkatiri and Gusmão and the potential for conflict, given their respective positions within the bicentric governance system. One element of this dynamic included recruitment for the new F-FDTL<sup>31</sup> defense force biased toward both “westerners” (or *Firaku*) and supporters of Xanana Gusmão and F-FDTL Chief Taur Matan Ruak (Shoesmith 2003, pp. 236–247). A second element concerned the development of a politicized police force under the Police and the Interior Minister Rogério Lobato, who in 1975 had held the position of FRETILIN defense minister (Rees 2003; 2004, pp. 22, 54–55; and Shoesmith 2003, pp. 248–249).;<sup>32</sup> and
- the establishment of armed groups for political purposes, a development that once again involved Police and the Interior Minister Lobato.<sup>33</sup>

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<sup>29</sup> For discussion on prevailing risk factors in the post-independence period, see Wainwright et al. (2002, pp. 10–14); Whittlesey and Moore (2003, pp. 2–6); Shoesmith (2003, pp. 232–234; 2005, p. 165); Smith (2004, pp. 283–288); Brown et al. (2004, pp. vi–9); and Cutter et al. (2004, pp. 13–25).

<sup>30</sup> Shoesmith (2003, p. 232) warned of a “rivalry... that could frustrate the attempt to establish an effective and... democratic state in East Timor,” given that these positions were occupied at independence by Alkatiri and Gusmão, respectively.

<sup>31</sup> The acronym F-FDTL (meaning Timor-Leste Defence Force) is derived from FALINTIL or Forças Amadas de Libertação Nacional de Timor-Leste.

<sup>32</sup> Note that Rogério Lobato was a known one-man risk factor who had been associated with a host of irregular activities including diamond smuggling in Angola, contact with the Khmer Rouge during the second half of the 1970s, and illegal sandalwood trading (as the suspected “Mr Big” in East Timor/Timor-Leste). See Shoesmith (2003, p. 238); Smith (2004, p. 281); Aarons (2006); ICG (2006, pp. 4–6); and Jolliffe (2007). See also Gusmão (2006), in which reference is made to Lobato’s sandalwood activities, diamond smuggling, and intimidatory tactics toward other FRETILIN officials during the period of exile in Mozambique.

<sup>33</sup> Following the events of 2006, Lobato was sentenced to seven and a half years imprisonment in March 2007 after being found guilty of illegally distributing firearms to militias for the purpose of eliminating government opponents (Jolliffe 2007; BBC 2007). In an example of the Timor-Leste “culture of impunity,” Lobato served only 1 month of his sentence before managing to leave the country on medical grounds (Fitzpatrick 2007b), soon after it became clear that FRETILIN had lost the 2007 parliamentary elections. Note that Nicolau Lobato (Rogério’s brother) is also reported (Nicol 1978, p. 101) to have organized a security force responsible to him alone in 1974–1975 when he held the position of FRETILIN vice president.

Elections held in 2007 saw Gusmão ally José Ramos-Horta win the presidency. Several months after the presidential elections on 30 June, an election for a new Parliament was held. Among the parties contesting this was a new party formed by ex-President Xanana Gusmão called the Congresso Nacional de Reconstrução de Timor (CNRT, or National Congress for Timorese Reconstruction).<sup>34</sup> The results of the election indicated that FRETILIN had experienced a dramatic reduction in support, capturing little more than 29% of the vote. Whereas FRETILIN polled well in the eastern districts of Baucau, Lautem, and Viqueque, they generally received less than 25% of the vote in the remaining 10 districts. Even so, FRETILIN managed to win the highest number of seats of any single party (three more than CNRT), and were seriously aggrieved (with acts of violence and property burnings breaking out almost immediately) when it became clear on 6 August 2007 that the future government would be formed around CNRT in partnership with a number of the smaller parties. Following his swearing in on 8 August 2007, Gusmão swore in the cabinet of the new Aliança para Maioria Parlamentar (AMP, or Alliance of the Parliamentary Majority) government, which FRETILIN has continued to refer to as a “de facto” government.

### 3. Evaluation of State Institutions and Governance Capacity

Although no consensus may exist on how to profile the capacity of states and their ability to foster improved rural development outcomes, key governance themes emerging from the literature<sup>35</sup> can be arranged into the categories of (i) security, stability, and order; (ii) democracy and governance; and (iii) public administration, accountability, and justice. Analysis of these themes forms the basis of the following governance “snapshot” of Timor-Leste, while analysis of a range of equally important economic considerations (including demographic trends, revenue-raising potential, and rural development) is integrated into a later section on the status of rural reform efforts.

#### Security, Stability, and Order

Smith’s view (2004, p. 293) that internal factors would present the real threat to security, stability, and order in Timor-Leste proved correct. Undoubtedly, the future stability of the state will depend in large part on whether sustained economic development occurs, and the findings of Collier et al. (2006, p. 5) suggest the 2007–2012 term of government is an important period for Timor-Leste since, following the 2006 crisis, the international community undertook to provide the “external military presence” necessary to support a “gradual economic recovery.”<sup>36</sup>

<sup>34</sup> Gusmão’s decision to draw on the symbolic value inherent in the CNRT acronym raised the ire of FRETILIN’s Marí Alkatiri, who reportedly (AFP 2007) accused the new CNRT organization of attempting “to confuse and deceive voters.” CNRT, meanwhile, endeavored to capitalize on the heritage of inclusivity associated with the original CNRT and announced (CNRT 2007) that it was “proud to embrace all individuals from all political parties.”

<sup>35</sup> This list of key themes is based on factors commonly referred to in a range of writings considering the determinants of state capacity in weak and vulnerable (including post-conflict) states. These include Migdal (1988); Rotberg (2002a, 2002b, 2003); Collier et al. (2003); Collier et al. (2006); Court et al. (2002); and Kohl et al. (2006).

<sup>36</sup> In the case of Timor-Leste one might more correctly think about the development of a post-subsistence economy.

Since coming into government, and especially since the shooting of President José Ramos-Horta on 11 February 2008, the AMP government has initiated a significant public spending program, which is claimed to have created around 31,000 full-time jobs by the end of 2008.<sup>37</sup> The program has also included “public transfer programs,” including pensions to veterans and vulnerable groups and the distribution of subsidized rice on a large scale.

As organizations central to the 2006 crisis, F-FDTL and the Polícia Nacional de Timor-Leste (PNTL, or Timorese National Police) are of major importance. Concerning the former, it is of note that the CNRT resistance council originally planned no armed force for the new state. However, the militia violence of 1999 and subsequent incursions during the transitional period influenced a change of policy that was probably a serious mistake, as much as it may have seemed valid at the time. Referred to by Hicks (2007, p. 13) as “a minuscule army that serves no purpose,” F-FDTL has already threatened the state it was formed to protect. Before his violent death in 2008 in (unknown) connection with the near-fatal shooting of the RDTL President, the late Major Alfredo Reinado demonstrated the risks of establishing a military in a state in which traditional and resistance power patterns endure. Evocative of past freedom fighters, Reinado developed popularity among pro-western or anti-FRETILIN gangs, demonstrating the continuing niche in Timor-Leste for an armed hero in the mountains who threatens to bring down the government.

Some years after the 2006 crisis, security remains a cause for concern. Despite positive observations concerning the commitment of present F-FDTL Head Taur Matan Ruak to a democratically controlled defense force and the existence of good relations between present government leaders and senior defense personnel, Harris and O’Neil (2010, p. 7) suggest that a future change of government could potentially see “senior F-FDTL personnel questioning or refusing to comply with specific instructions from a post-Gusmão government.” Meanwhile, Peak (2009, pp. 231–232) refers to concerns about the “degree of apparent impunity within the uniformed services,” noting that as the post-2006 international presence begins to diminish, F-FDTL officers found guilty of committing crimes in 2006 “remain in uniform,” despite having been convicted and sentenced to terms of imprisonment. Similarly, the government is reported (Wilson 2010, pp. 4–5) to have merely paid “lip service” to professional development initiatives concerning PNTL, before disregarding “these policies... [and continuing]... to appoint uncertified officers to ranks they have not rightly attained.”

More generally, after being characterized by confusion, failure to address local language needs, coordination oversights, lack of engagement by local actors, unsuitably qualified and skilled foreign advisors, and drifting focus (Peak 2009, pp. 226–230), the security sector review that was so central to the post-2006 crisis United Nations Integrated Mission in East Timor mandate is reported (Wilson and Nélson 2009, p. 4) to have “not occurred, and there is a general consensus that it will not occur.” Unfortunately, these various developments suggest that the security sector retains the potential to contribute to Timor-Leste becoming a “temporarily broken state”<sup>38</sup> on future occasions.

## Democracy and Governance

Excluding public administration and accountability aspects (addressed below), a key consideration concerns the extent to which multi-party democracy is being accepted in Timor-Leste, in an

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<sup>37</sup> See Gusmão (2009a, p. 5), in which elements of this program are outlined. Note that direct public service appointments may not account for all of the 31,000 full-time jobs referred to by Gusmão as, according to Blunt, public service positions in 2008 numbered only 24,000.

<sup>38</sup> As Timor-Leste UN Chief Sukehiro Hasegawa referred to the country following the 2006 instability.

environment where the petroleum income raises stakes for political players. The violence that broke out following the 6 August 2007 announcement that CNRT had been invited to form government indicates that no peaceful acceptance of multi-party democracy prevailed on that occasion.<sup>39</sup> One might reasonably speculate that this violence may have been far worse had no international security presence been in Timor-Leste at the time.

An initiative that could either improve or further complicate what Hicks (2007, p. 13) refers to as the “dysfunctional relationship between the capital, Dili, and the rest of the country” is the municipal governance program based on Section 5 of the Constitution (RDTL 2002) on decentralization. Concerns about how to staff an additional level of administration are valid, given the need to overcome capacity deficiencies that continue to reduce the effectiveness of existing tiers of government. In Shoesmith’s analysis (2010, p. 5), the program has the potential to “close the gap between the government and the people,” yet in a worst-case scenario it may simply “impose another layer of potentially inert bureaucracy and patronage politics over and above local communities.” A further possibility, suggested by the lack of momentum in legislative development, is that the program will be delayed indefinitely.

Concerning the role of the media in strengthening democracy and governance, a 2006 UN study (Cheema et al. 2006, p. 49) found the media to have “limited reach and capacity” and that “press reporting is variable but of generally low quality, reflecting a lack of capacity and experience among journalists.” Cheema et al. (2006, p. 48) also noted that only a limited number of civil society organizations have the capacity to meaningfully contribute to the policy development process. While this assessment may remain generally valid, positive developments include the establishment of a new security-sector monitoring organization, *Fundasaun Mahein*.<sup>40</sup> Probably the most encouraging example of local critical analysis is the *Tempo Semanal* publication (now supplemented by a blog and regular audiovisual footage)<sup>41</sup> produced by José Belo and his team and known for its regular reporting on corruption issues (*Tempo Semanal* 2008 and Kearney 2009).

### Public Administration, Accountability, and Justice

For the reasons discussed earlier, Timor-Leste inherited a skills deficit at independence. While the state now has the resources to send people overseas to study, and while the quality of vocational training programs appears to be improving, it will take many years to overcome the skill shortages. Introducing Portuguese as a language of public administration and education has added a further hurdle to the development of a functional public administration. Additionally, the renewal of the public administration workplace culture is likely to be a slow process and one that may not happen in the absence of determined action, probably involving external actors.

Blunt (2009, pp.90, 94) notes that “traditional beliefs in patronage” threaten administrative outcomes in Timor-Leste, which raises the risk of replicating the mixed “rational–legal”/patronage-based governance model common in other developing countries. A 2004 analysis of the administrative workings of the National Directorate of Land and Property undertaken by the writer

<sup>39</sup> At that time, a FRETILIN spokesperson responded to a series of queries concerning FRETILIN’s possible involvement in the violence by denying that FRETILIN was responsible (Fitzpatrick 2007a), at the same time issuing ominous warnings (Callinan 2007) that the party could no longer control its supporters.

<sup>40</sup> *Fundasaun Mahein* website. <http://fundasaunmahein.wordpress.com/>

<sup>41</sup> *Tempo Semanal* website. <http://temposemanaltimor.blogspot.com>

identified the ad hoc and unsystematic nature in which duties were allocated to staff as a major obstacle to be overcome to enable the directorate to meet its mandated obligations.<sup>42</sup>

Concerning transparency, UN Anticorruption Specialist Shane Cave<sup>43</sup> points out that it is often difficult to measure corruption in weak states due to the absence of auditing institutions. Ironically, one may find more empirical evidence of corruption in highly transparent states simply through the existence of functioning auditing institutions. On this basis, Timor-Leste has provided a suitable habitat for corruption to date as it has lacked “any independent audit agency to keep track of government expenditure” (Cave 2009, p. 4). While the government is now in the process of establishing a High Administrative, Tax, and Audit Court (HATAC), the effectiveness of HATAC has yet to be proven.<sup>44</sup>

Alongside HATAC, other institutions meant to promote accountability in Timor-Leste include<sup>45</sup> (i) the Civil Service Commission, which has already been established and is responsible for standards pertaining to recruitment, discipline, and performance; (ii) the Office of the Inspector General, which is tasked with investigative and auditing responsibilities; (iii) the Prosecutor General; and (iv) the Anti-Corruption Commission, which is designed to have both preventative and investigative functions and, like HATAC, is in the process of being established. Given the small size of Timor-Leste, this is a considerable number of pro-accountability institutions and it could well prove too many. Cave (2009, p. 8) highlights that the institutions are mandated with overlapping functions, and where overlap exists, this “allows agencies to seek to avoid difficult or complex cases and argue that another agency is responsible,” thereby wasting time and delaying outcomes.<sup>46</sup>

While the data collection process on corruption may be unsystematic, Timor-Leste is certainly *not* perceived as being transparent or as improving in transparency. In their 2009 corruption perception index, Transparency International (2009) ranked Timor-Leste 146 (with Sierra Leone and Zimbabwe) out of 180 rankings. This was a slide from the 2007 ranking of 130 out of 180 countries surveyed (Transparency International 2007, p. 6). Moreover, it is difficult to imagine anything will improve in Timor-Leste without a fundamental shift in the government’s approach to transparency and accountability. Without serious commitment, new transparency institutions may achieve little more than provide jobs and new opportunities for corruption and wastage.

Concerning justice, whereas the justice system was the earliest agency to be “Timorized” during the UNTAET period, the sector has been recognized as “the weakest branch of Timor-Leste’s governance architecture” (World Bank 2006, p. 19). Although the level of resources available to the sector was soon identified as a “central problem” (Beauvais 2001, pp. 1155–1156), it is clear that the capacity of the new judiciary has also proved to be a serious obstacle. Recruited by means of an aerial leaflet drop in the early days of UNTAET (Strohmeyer 2001, p. 54), the new judiciary lacked the experience to provide the basis of a courts system. Although the new judiciary were to receive on-the-

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<sup>42</sup> In particular, ministers from other ministries were found to routinely direct staff members to undertake tasks without channeling their requests through the appropriate minister (of justice). Unshielded from a host of ad hoc requests, there was little chance of staff systematically pursuing official activities.

<sup>43</sup> Interviewed in Dili (November 2009).

<sup>44</sup> As outlined in Section 129 of the Constitution (RDTL 2002), HATAC is responsible for monitoring “the lawfulness of public expenditure and to audit state accounts.”

<sup>45</sup> Based on an overview of the sector prepared by Cave (2009, p. 4).

<sup>46</sup> Additionally, Cave (2009, p. 8) points out the inefficiencies associated with multiple agencies requiring resources to undertake the same tasks—an approach likely to prove unrealistic given the limited number of East Timorese with appropriate investigative and auditing skills. Organizations including CPA (Certified Practicing Accountants) Australia have been endeavoring to train Timor-Leste students in accounting skills and these efforts should be encouraged.

job legal training, their task of learning the law and administering justice in an under-resourced environment was made even more difficult by the use of the Portuguese language within the justice sector. The difficulties facing the state justice sector were highlighted when it was announced in January 2005 that all 22 East Timorese judges had failed their evaluations after a 5-year training and probationary period.<sup>47</sup>

There are broader questions about the Timor-Leste justice system that both Timor-Leste citizens and development partners supporting the justice system should be engaging with vigorously. If the government fails to demonstrate a robust commitment to tackling corruption—for example, by investigating and prosecuting ministers suspected of granting contracts to family members and associates, or state officials suspected of benefiting from the rental of state properties—one might legitimately question how serious the government is about accountability. Although the government announced a new campaign of “transparency and accountability” to commence in 2010 (Pereira 2010a; Gusmão 2009b, p. 7), little may change unless Timor-Leste’s leaders are presented with some compelling incentives or “levers” by outside actors.

## 4. Rural Change: Obstacles, Opportunities and Levers

### The Two Economies of Timor-Leste

Several features stand out in relation to the Timor-Leste economy. First, there is the recent high level of economic growth, proudly reported (Gusmão 2009b, p. 7) to be the second highest rate of growth in the world (at over 12%) in 2008.<sup>48</sup> A second feature is the ranking of Timor-Leste in the United Nations Development Programme (UNDP) human development index, with Timor-Leste placed 120 of the 169 countries included in the 2010 index (UNDP 2010, p. 145) and 162 of 182 countries included in the 2009 index (UNDP 2009). These figures reflect the two main economies of Timor-Leste: the public sector, which is dependent on petroleum royalties, and the almost stagnant rural economy.

#### *The Public Sector Petroleum Economy*

The Timor-Leste public sector is presently almost completely dependent on petroleum wealth. Based on treaty arrangements negotiated with Australia, Timor-Leste’s Petroleum Fund accrues payments from one main production field, Bayu Undan.<sup>49</sup> The Petroleum Fund manages petroleum income, and while it is unable to guarantee that the nation’s oil wealth will not be squandered, is a respected model. As Le Lievre (2007, p. 89) has noted, however, East Timor’s dependence on only one field “poses serious risk in the event of disrupted production.” Although reserves from a further large field, Greater Sunrise, are ultimately likely to provide substantial additional revenues, it is uncertain when this field will be developed.

According to the Ministry of Finance (MOF), the estimated sustainable income (ESI) from the Petroleum Fund was calculated at \$502 million for 2010 (MOF 2009, p. 7) with the overall value of the fund estimated at \$6.62 billion at the end of 2010 (MOF 2010, p. 9). For 2010, a budget of \$660 million was originally approved, of which \$502 million would be sourced from the

<sup>47</sup> Following that announcement, all probationary judges were barred from work in the district courts, reducing the number of qualified judges to four internationals and raising questions about the legality of cases that had already been processed.

<sup>48</sup> Gusmão (2009b, p. 7) also announced that “[t]his positive record continued in 2009, with a forecast growth rate of between 7 and 8%.” See also Ministry of Finance (MOF 2009, pp. 6, 19).

<sup>49</sup> Bayu Undan is located within the Joint Petroleum Development Area in the Timor Sea to the southeast of East Timor.

Petroleum Fund (Pereira 2009; MOF 2009, p. 41; and Gusmão 2009b, p. 11. Of the remainder, \$70.6 million was projected to be sourced from reserves and \$87.3 million from non-petroleum or domestic revenue.<sup>50</sup> In May 2010, a “budget rectification” was announced (Pereira 2010b) aimed at supporting “faster national development... to increase the general welfare.” Based on additional withdrawals from the Petroleum Fund, this rectification increased the planned 2010 budget to \$838 million and raised concerns about unsustainable management of the Petroleum Fund (*La’o Hamutuk Bulletin* 2010).

In fact, due to “a change of methodology of the ESI calculation,” government budget predictions increased between 2009 and 2010. Whereas in 2009 the government referred (MOF 2009, p. 35) to future budgets comprised of around \$100 million sourced from domestic revenues plus \$500 million sourced from the Petroleum Fund, the 2011 state budget paper (MOF 2010, pp. 1, 9, 36) refers to a General State Budget (excluding donor contributions) of \$985 million, of which \$734 million (the revised ESI) is to be sourced from the Petroleum Fund, \$110 million from domestic revenue, and \$141 million from government funds held in the Consolidated Fund of Timor-Leste. Although government figures (MOF 2010, p. 14, Table 4.2) indicate that the 2011 budget will not require withdrawals from the Petroleum Fund in excess of the ESI, this is not the case for the years 2012 to 2015, for which years it is planned to withdraw over \$400 million per year in excess of the ESI. Recent budgetary developments, therefore, include not only revision of the means of calculating the ESI but also plans to source budgetary contributions from the Petroleum Fund in excess of revised levels. Government information (MOF 2010, p. 30) indicates that priority areas include infrastructural and human capital development, for which Special Funds will be financed through the budget beginning in 2011. Additionally, the government is reported to be “exploring other options... [for]... funding strategic public investments,” including public–private partnerships and loans (MOF 2009, p. 35). As discussed later, this appears to provide an opening for leverage by development partners, however the growth of the Petroleum Fund and the apparent willingness of the government to make “judicious” withdrawals from it to finance special projects may erode this potential in due course.

The challenge in Timor-Leste is to link its two economies to ensure, through an environment of transparency, accountability, and prudence, that the nation’s petroleum wealth contributes to the development of infrastructure and skill levels that will help take the broader economy beyond subsistence. Ideally, such economic transformation will ultimately present the option of a tax base to support the public sector and reduce dependence on petroleum royalties. For these reasons, much attention has been given to the design and management of Timor-Leste’s Petroleum Fund and to the challenge of avoiding the corruption and violent conflict sometimes experienced by countries with rich natural resources but few other areas of post-subsistence economic endeavor (Whittlesey and Moore 2003, p. 5; Cutter et al. 2004, p. 14; and World Bank 2006, p. 5).

While there are many positive dimensions to the Petroleum Fund, vulnerabilities have been identified. Le Lievre (2007, pp. 95–96) notes that despite the legislation requiring the government to explain appropriations to Parliament, “there is no actual floor establishing an amount below which the fund cannot fall.”<sup>51</sup> Accordingly, as with the broader area of “democracy and governance”

<sup>50</sup> Doubt has been expressed (*La’o Hamutuk Bulletin* 2009, pp. 9–10) about the ability of the Timor-Leste government to raise even 13% of the national budget from domestic revenues, especially given recent tax reforms. Note that the AMP government implemented tax reforms in 2008 (MOF 2009, p. 21), reducing both business and individual taxation.

<sup>51</sup> See also the commentary of the World Bank (2006, p. 4), which notes that “weaknesses in national capacity make the system vulnerable in the face of the [eventual] departure of international advisors.” Realistically, the only means of establishing a “floor” to the Petroleum Fund would have been through an international trusteeship model.

discussed earlier, prudent use of the fund is likely to depend on the judgement exercised by parliamentarians and the extent to which this is scrutinized by the Petroleum Fund Consultative Council,<sup>52</sup> the media, and civil society more generally. As already discussed, the Petroleum Fund is only one (albeit major) area subject to the risks of mismanagement and corruption, since there is also the challenge of ensuring that funds legitimately and transparently withdrawn from the fund are managed so that they speed the development of the country.

### *The Rural Economy*

As outlined earlier, very little post-subsistence economic development has occurred in rural Timor-Leste throughout the various chapters of the territory's history. Notwithstanding the production of coffee and, on a more limited scale, the production of cash crops including candle nuts, peanuts, maize, mungbeans, green beans, and copra, the majority of rural farmers in Timor-Leste rely mainly on subsistence crops for their livelihoods.<sup>53</sup> The traditional nature of the rural economy is highlighted by land tenure field data indicating that only around 47,000 ha of primary industry land in rural areas has been alienated from customary tenure. Much of this land is presently unmanaged.<sup>54</sup>

Whereas comparable countries in the southwest Pacific continue to enjoy "subsistence affluence," this is not the case in Timor-Leste with its relatively high population density, high rate of population growth, non-volcanic soils, and dry climate. The *lapar biasa* (usual hunger period) has long been known on parts of the island of Timor (Ormeling 1957) and food shortages remain common, especially between November and February. According to the Ministry of Economy and Development (MED), survey data from 2007 indicates that 40% of households "are either food insecure, or are living below [the] poverty line" (MED 2008, p. 16; see also, Young et al. 2010, p. 24). Meanwhile, the broader rural economy, as described in a 2009 government discussion paper (RDTL 2009a, pp. 6–9), is characterized by "small markets, high costs, low skill base, poor physical infrastructure and incomplete legal institutions."<sup>55</sup>

The pace of rural development in Timor-Leste has frustrated some. President José Ramos-Horta has lamented provocatively that either the citizens of Timor-Leste must be the most stupid people on earth or they must have the services of the most stupid consultants on earth—or the

<sup>52</sup> The Petroleum Fund Consultative Council (PFCC) was established under Chapter 5 of the Petroleum Fund Law (RDTL 2005, pp. 12–15) as a measure designed to ensure that "appropriations of the Petroleum Fund are being used effectively to the benefit of current and future generations." Comprised of national citizens including former presidents, prime ministers, finance ministers, central bank heads, business, religious and civil society representatives, and others, the council is required (RDTL 2005b, p. 14) to "consult widely in the community... and... hold an annual forum on issues relating to the Petroleum Fund." Notably, however, the council is an advisory body only.

<sup>53</sup> MED documentation states (2008, p. 5) that "more than 50% [of rural households] engage in subsistence farming producing no saleable surplus and generating no off-farm income. Fewer than 50% produce a modest saleable surplus, mainly coffee, rice, vegetables and/or fruit, chicken, pigs, eggs, fish and other grains."

<sup>54</sup> State primary industry land—including around 12,000–13,000 ha of coffee plantations, around 15,000 ha of transmigration/translocation land, and around 14,000 ha of state forest land—represents the great majority of land that has been technically alienated from customary tenure, and the field data suggest that only around 66% of it is managed. Perhaps not surprisingly, the great majority of private (including church-owned) primary industry land (totaling less than 4,000 ha) was found to be managed. For further information, see Nixon (2005). Note that at around 3% of total land area, this proportion is roughly equivalent to the amount of land alienated from other "subsistence states" in the region. Larmour (1998, p. 81) refers to 17% of land in Fiji, 16% in Solomon Islands, 2% in Papua New Guinea, and 1% in Vanuatu. Note that in the case of Vanuatu, it would appear (though data is not easily available) that a significant proportion of customary land is under long-term (up to 75 years) lease.

<sup>55</sup> In addition to the limited skills of farmers, identified rural development bottlenecks (RDTL 2009a, p. 9) include the difficulty of accessing credit, markets, and modern cultivation and processing supplies and technologies (from fertilizers and irrigation systems to processing equipment).

unfortunate combination of both.<sup>56</sup> As outlined by the UN Socio-Economic Affairs Unit (UN 2010), a response to the slow pace of change by government “in 2009 has been to pump cash out to the communities, for boosting business and the private economy.” And yet, as noted in the same report, “many MPs [members of Parliament], politicians, and [c]ivil [s]ociety [g]roups have stated that the 2009 Budget Execution is not realistic as it had no impact on people’s lives.”

Clearly, rapid, uncontrolled spending will not substitute for systematic and targeted expenditure, but the latter has proved challenging. Of course, the lack of progress is less surprising given the disruption to development programs and governance expansion that occurred in connection with the 2006 political crisis, only 4 years into independence. This fact highlights the great importance of meaningful security sector reform, not yet achieved, to ensure that the momentum of rural development is not interrupted. Whereas few substantive advances in addressing rural poverty and economic stagnation may have been made, important areas of rural development include developing rural infrastructure, increasing the productivity of subsistence crops, improving the skill levels of farmers, and advancing post-subsistence agricultural production.

## Infrastructure Development

Infrastructure, with particular emphasis on roads and water supplies, headed the national priorities list for 2010 (MOF 2009, p. 40).<sup>57</sup> The 6,000-kilometer (km) national road network has received little maintenance since Indonesian times;<sup>58</sup> more than half the “core network” is considered to be in “poor or very poor” condition. District and rural roads in particular are in “very poor” condition with poor drainage and other features making them “largely unmaintainable in their present state” (RDTL 2009b, p. 15).<sup>59</sup> Many parts of the country are accessible only with great difficulty in the wet season, including much of the country’s important coffee region. Meanwhile, only 55% of the rural population is estimated to have access to “an improved water source” and only 20% to electricity (RDTL 2009b, pp. 15–16, 34). In rural centers, power is often available only at night, presenting particular difficulties for electricity-dependent, value-adding businesses such as carpentry shops.

The government is well aware of the extent to which poor infrastructure contributes to economic stagnation and the risk of future instability (MOF 2009, p. 35), yet infrastructural development has proved challenging with the Ministry of Infrastructure attracting criticism for budget execution levels of below 50% (*Tempo Semanal* 2010; and UN 2010).<sup>60</sup> Attempts to make up for low budget execution have included the 2009 \$70 million “Referendum Package” of rapid public works projects. This has attracted criticism (*Tempo Seminal* 2009a) for bypassing important accountability processes, including approval from the National Parliament. Noting that the “Government’s technical capacity to deliver good projects that create thousands of jobs and improve public services is not proven until now,” the UN (2010) refers to the Referendum Package as “an example of creating jobs, but unfortunately the money goes to the companies’ pockets with low quality of projects as a result.”

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<sup>56</sup> President Ramos-Horta’s opening speech at the MED conference on Sustainable Rural Development for Poverty Reduction held on 27–28 March 2009 (and attended by the writer).

<sup>57</sup> The remaining development priorities for 2010 (MOF 2009, p. 40) are “Food Security (agricultural productivity),” “Human Resources Training,” “Access to Justice,” “Social Services and Administrative Decentralization,” “Good Governance,” and “Public Security.”

<sup>58</sup> Note that donors (mostly the Asian Development Bank) have allocated \$78 million to roads projects (RDTL 2009b, p. 19).

<sup>59</sup> According to the Strategic Framework for Rural Development (RDTL 2009, p. 14), no “approved design standards” exist in relation to rural roads.

<sup>60</sup> Note that the data supporting this conclusion is derived from financial quarters one to three of 2009.

Earlier government figures (MOF 2009, pp. 35–37) estimated that around \$600 million per annum would be needed to support the administrative apparatus but that sustainable revenues would not allow for spending on other “immediate needs of the nation” including “national priority” infrastructure projects. Noting that “donor funds have been shrinking since 2002,”<sup>61</sup> the government indicated (MOF 2009, p. 37) it had been talking with Portugal and the People’s Republic of China about the possibility of a \$3 billion loan to support infrastructure projects. No loan is understood to have been secured as yet, but the possibility of using future loans to fund “strategic public investments” continues to receive mention in government budget documents (MOF 2010, p. 30). Accordingly, the provision of sizeable loans (probably not \$3 billion given prevailing expenditure bottlenecks) by donors at attractive rates could present development partners with a means of leveraging improvements in government expenditure approaches and quality control processes.

## Food Security and Productivity

Agricultural productivity in Timor-Leste is considered “very low by world and regional standards,” with food crop yields around 20% to 35% of those achieved across a range of Asian countries.<sup>62</sup> Factors contributing to this low productivity include minimal rotation of crops, limited technical knowledge of farmers, and lack of access to high-yield varieties and inputs such as fertilizer (Young et al. 2010, p. 15). The low level of productivity is exacerbated by post-harvest losses stemming from poor food storage practices (MED 2008, p. 17). Initiatives including the Australian Agency for International Development (AusAID)–supported Seeds of Life project<sup>63</sup> are playing an important role in promoting improved-yield staple crops, yet the outlook remains critical. Although some analysis (MED 2008, p. 33) has predicted that levels of productivity will increase, it is also expected that production increases will “be outpaced by the high population growth... expected to occur in the medium term.” Other analysis (Young et al. 2010, p. 2) suggests an even more dire scenario, asserting based on data from 2000 to 2007 that “no significant increases in food production” occurred over that time.<sup>64</sup>

Questions about infrastructure spending have also been raised in connection with the agriculture sector, reflecting the criticism of the rice self-sufficiency policy articulated by Soesastro (1989, pp. 222–228) during the Indonesian period. As demonstrated by Young et al. (2010, *Policy Note 1*, p. 2), government agricultural spending since 2005 has been heavily biased toward the promotion of irrigated production. For 2009, it is asserted that of a total Ministry of Agriculture and Fisheries (MAF)<sup>65</sup> budget of \$34 million, no less than \$26 million was allocated to irrigation rehabilitation, green fields projects, and tractors for irrigated rice-related work.<sup>66</sup> On the basis of their analysis, these authors (Young et al. 2010, p. 4) argue that “large investments in irrigation rehabilitation do not produce adequate economic returns, only benefit small numbers of farmers and

<sup>61</sup> As outlined in the budget paper (MOF 2009, p. 35), “[a]fter ten years of reconstruction and other priorities in other parts of the world, Timor-Leste can no longer rely on development partners to finance its development activities.”

<sup>62</sup> According to Young et al. (2010, p. 15), food crop production in 2007 approximated 70,000 tons of maize, 50,000 tons of cassava, 45,000 tons of rice, and 34,000 tons of sweet potato. See also RDTL (2009b, pp. 12–14).

<sup>63</sup> Seeds of Life official website: [www.seedsoflifetimor.org/](http://www.seedsoflifetimor.org/). Note that the project pays particular attention to maize, rice, sweet potato, cassava, and peanuts.

<sup>64</sup> Young et al. refer to the International Monetary Fund and Food and Agriculture Organization data.

<sup>65</sup> The reference to forestry was removed from the name of this ministry in the period following the 2007 change of government.

<sup>66</sup> This apparently included \$16 million spent on 1,260 hand tractors and 200 larger tractors. Note that Young et al. (2010, p. 3) indicate that the total level of expenditure was associated with the goal of expanding the area of paddy under cultivation from 31,000 ha to 45,000 ha.

may not be sustainable.”<sup>67</sup> Furthermore, as noted by Young et al. (2010, p. 6), the large-scale investment in irrigation infrastructure is inconsistent with the rice subsidy policy that has been implemented by the AMP government “because of its distorting effect on producers’ incentives.”

Whereas Soesastro (1989, pp. 222–228) urged more attention to estate crops, livestock, and other areas of comparative advantage, Young et al. suggest (2010, pp. 6–7) a “more balanced approach” with greater attention to “a broader mix of upland crops and livestock production, and selective investments in and support for the irrigated rice sector.”<sup>68</sup> This approach should focus on generating increased productivity of key staple crops and livestock through the expanded transfer of such improvements as high-yield varieties. The means for delivering this transfer, meanwhile, should build on the existing MAF extension program, including the 400 agricultural extension workers stationed throughout the *sucos*. While Timor-Leste undoubtedly needs a more balanced approach to agricultural development, it is not yet clear that MAF, given present organizational realities, can provide the necessary transfer of technology. Also, while gradual improvements in subsistence crops have played a role in increasing human carrying capacity on Timor throughout history, it remains uncertain whether increasing the yield of subsistence crops alone will prove sufficient to absorb the growing numbers of youth seeking work. These issues receive attention below.

### Agricultural Extension

In considering the possibility of the Timor-Leste civil service achieving outcomes of any kind, the obstacles discussed above under public administration, accountability, and justice must be treated seriously. Obstacles to better public administration are not confined to the areas of resources and capacity; this reality is demonstrated in the recollection of a section meeting of the new Timor-Leste civil service attended by a World Bank staff member who worked for the UN before independence. At this meeting, a widely supported view was expressed to the effect that those who had fought for independence and now worked in the public service were owed a rest, and the task of building the state should be the work of their children. Although recent recruits to programs such as the MAF extension service may be members of a younger generation, it is unlikely they will be motivated to perform well in the absence of committed leadership from more senior-level public servants. According to government documentation (MED 2008, p. 15), “MAF has identified human resources limitations, their capacity and deployment, and the lack of an effective performance monitoring system as major constraints to MAF’s ability to implement its high priority programs in the field and services to farmers in a timely manner.” The Rural Development Framework (RDTL 2009, p. 27) makes reference to the possibility of involving private sector organizations (including nongovernment organizations) in the delivery of extension services, and this should be strongly encouraged by donors. In particular, an independently audited, performance-based extension service could provide a means of overcoming the inertia and lack of adherence to authority structures that

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<sup>67</sup> In relation to the question of sustainability, Young et al. (2010, pp. 6–7) express concern that “the lack of technical capacity in MAF increases the probability of inappropriate scheme design and poor production quality.” This concern is all the more valid given the limited extent to which communities have contributed to the maintenance of irrigation systems in the past (MAFF 2004, p. 4).

<sup>68</sup> Young et al. (2010, p. 4) support improved management of existing irrigation systems but not the construction of new ones. More generally, they suggest that due to factors including the lack of water users associations, smaller irrigation projects are likely to be more sustainable and economically viable than larger ones.

prevails within the civil service, and provide a model for other critical areas of service throughout government.<sup>69</sup>

### Private Sector Involvement in Rural Development

In addition to donor-supported agricultural projects<sup>70</sup> and the weak MAF extension service, private sector involvement could play an important role in advancing primary industry outcomes in rural areas and the development of a value-adding sector, thereby contributing to increased cash incomes and reduced rural–urban drift. The importance of the post-subsistence development of the rural sector is highlighted by the emerging youth “spike” in the national demographic pattern. Specifically, data from 2007 (MOF 2008, p. 16, Table 1.1) indicates that those aged 19 or younger make up more than 50% of the rural population (males: 55.1%; females: 53.2%).

The private sector remains exceptionally weak (for example, RDTL 2009b, pp. 12–13). Estimated to be providing an additional 400 new jobs annually, it is unknown how either the rural economy or the urban economy will be able to absorb the estimated 12,000 to 15,000 new entrants to the job market every year (RDTL 2009b, p. 5).<sup>71</sup> While the challenge is enormous, it also presents another lever to development partners, as the government’s interest in the participation of Timorese citizens in offshore labor programs is well known.

Given the weak regulatory environment and limited use of contracts for agricultural production and leasing of land (discussed below), advancing the rural economy will prove challenging. Irregular decisions by government officials—at times appearing to verge on the criminal—provide further disincentives and have to date provided few assurances to prospective investors.<sup>72</sup> Political risk has also historically been an obstacle to investment, as exemplified by the case of a company interested in investing up to \$30 million in plantation forestry, but which ceased evaluation activities in mid-2006 because of the political and security crisis.<sup>73</sup> Yet another illustration of security sector reform’s (SSR) importance to rural development, this example raises the question of whether development partners could link increased government commitment to SSR to more comprehensive political risk coverage for domestic and international investors.

Research conducted in 2009 into Timor-Leste’s small agribusiness sector highlights the minimal extent to which agricultural intensification and private sector investment characterize the present economy (Nixon 2009). Although a handful of positive examples of engagement between investors and community members can be identified, these initiatives probably amount to no more

<sup>69</sup> Earlier proposals for private sector involvement in agricultural development activities in Timor-Leste (including extension) have attracted criticism (Anderson 2003, pp. 7–13) on the basis that public organizations elsewhere have played valuable roles. Anderson cites the example of the Australian Commonwealth Scientific and Research Organisation. However, for the reasons outlined in section 3 on public administration, accountability, and justice, the writer believes that the differences in capacity and reach between established states such as Australia and new subsistence states such as Timor-Leste must be acknowledged. For additional discussion on this area, see also Gunn (2003).

<sup>70</sup> For a summary of donor-funded rural development projects, see RDTL (2009b, p. 19).

<sup>71</sup> As noted in the report from a major 2009 rural development workshop (Soges S.p.A. 2009, p. 12), the alternative to “skills training and permanent employment... for skilled workers in rural areas” is increasing pressure on land and “a continuous growth of rural poverty, feeding a growing pool of unemployed, and mostly unemployable urban poor.”

<sup>72</sup> A 2009–2010 case involving land leased by the Ministry of Justice (which has responsibility for land and property) to the Dili International School (DIS) provides cause for concern to any prospective foreign investor. A letter of complaint to the RDTL President (DIS 2010) asserts that the school’s lease was not recognized by MAF, which occupied the land in defiance of the lease. According to the school, representatives of the minister of agriculture and fisheries intimidated students and issued death threats against school staff.

<sup>73</sup> This company, New Forests Pty Ltd, intended to operate in accordance with Forest Stewardship Council guidelines ([www.fscus.org](http://www.fscus.org)).

than a few hundred hectares of operations. Notably, some involve organic certification schemes that appear to successfully bond investors and farmers in a mutually beneficial relationship, based upon the premium that investors can pay for produce from areas for which they have arranged organic certification.<sup>74</sup> However, the great majority of private sector actors are engaged largely in competing for shares of the limited—and according to some reports, dwindling—harvest of available cash crops, with very little investment in the expansion of crops or the improvement of crop quality.

The coffee industry is one example of where investors could play a major role, alongside donor-funded projects, in increasing local cash incomes—potentially quadrupling it.<sup>75</sup> As the largest cash crop and non-oil export by far, the coffee industry is estimated to involve around 50,000 families, representing about 30% of the population (World Bank 2009). However, major issues prevail concerning crop quality, the need for rehabilitation, continued use of traditional cultivation methods, and low productivity.<sup>76</sup> Whereas industry actors refer to the possibility of quadrupling production through management improvements, suitable models for engagement between investors and communities still have to be refined. To date, the nature of the free-for-all Timor-Leste coffee market has presented difficulties to investors wishing to invest in rehabilitation activities. In the absence of a contract culture and land tenure formalities, investors have had little confidence they would have priority purchase rights to improved crops following their investment in rehabilitation.<sup>77</sup>

As a possible means of addressing the situation, Chapter V of a draft Land Law prepared for government with donor assistance, has provisions for a negotiation and regulation regime for areas of community land (referred to as “community protection zones”) aimed at supporting engagement between investors and communities from which all parties benefit. Also, the Strategic Framework for Rural Development proposes an initiative aimed at rural land titling to create the conditions for increased investment in land and productivity by smallholders (RDTL 2009b, p. 28; see also World Bank 2009, Annex D). It is unknown, however, if or when either of these initiatives will be implemented.

## Sustainable Regulatory Measures

Senior officials in the current government have signed questionable agreements with international investors for access to large areas of land for primary industry purposes without any consultation

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<sup>74</sup> In such instances, farmers sell to the investors out of self interest, even without contracts, as they would not be able to obtain the same price from another buyer.

<sup>75</sup> In the view of the writer the plantation forestry sector is another example.

<sup>76</sup> Information on coffee quality was sourced from discussions with coffee buyers. For information on present management practices and the need for rehabilitation, see Deutsch (2004). Note that, characteristically, green bean yields per ha are estimated to range between 150 kilograms (kg) and 200 kg, which is low by international standards. The crop usually provides harvests of between 6,000 to 14,000 tons per year (MED 2008, p. 18; World Bank 2009, Annex B).

<sup>77</sup> Commonly at harvest time, the handful of big buyers contract purchasing agents whose role is to purchase as much produce as possible, with priority on areas known for quality. Independent traders (some under contract to the big buyers) also buy and sell produce as opportunities present themselves. The nature of the commercial culture is that farmers will sell to those with whom they have close personal connections (potentially an investor), provided the price paid is the full market rate. Where investors provide inputs for the intensification of production, they expect priority purchase rights, perhaps at an agreed price. However, defaults on contract arrangements remain common, such that contract farming does not feature prominently in the rural economy. The difficulties faced by investors are demonstrated by the experience of Timor Global, Timor-Leste’s largest private sector agribusiness operator and the exception to the rule about industry actors generally not investing. In 2005, the company secured a lease for 3,000 ha of coffee estate land from the state. Although the state was technically able to lease the land, formerly part of the Sociedade Agrícola Pátria e Trabalho in which the Portuguese government had a stake, multiple smallholders also hold claims and the company soon found that it had to undertake detailed negotiations with members of the local population before it could begin work; hence by early 2010 the company had rehabilitated only around 50 ha.

with community members in potentially affected areas.<sup>78</sup> The intense scrutiny from international nongovernment organizations and other agencies in Timor-Leste is likely to present serious obstacles to the implementation of projects with negative social and environmental impacts, such as the mass alienation of subsistence farmers. However, given the state's limited ability to undertake monitoring and enforcement activities related to large-scale primary industry developments, development partners should encourage the state to use the various industry self-regulation schemes that have developed over the past few decades. Requiring investments in excess of a certain land area or employee threshold to be regulated by an appropriate industry scheme could help ensure the realization of minimum social and environmental standards even in the absence of state capacity.<sup>79</sup>

## 4. Opportunities and Levers

A range of obstacles to rural development have been identified in the forgoing analysis. Some of these obstacles are in the process of being addressed, although outcomes are uncertain at this stage. With others, there is reason for concern that the obstacle may persist without donor action. This section summarizes identified obstacles and possible opportunities for action by development partners, and suggests possible "levers" for change. Where possible, the levers relate to the sector in which an obstacle arises. Levers are clearer in some cases than others, and a number of additional levers could be used to encourage reforms in several areas. However, it is important to note that the Timor-Leste receives petroleum royalties and other income supporting a budget, at least in the short to medium term, of \$1 billion or more per year. Accordingly, there are fewer incentives that can be offered than there would be under different circumstances.

### Security Sector Reform

Meaningful security sector reform (SSR) has not yet happened, notwithstanding the expenditure of huge resources. There is a risk that renewed conflict could again disrupt the continuity of government and donor-supported rural development programs, as in 2006,<sup>80</sup> and add to the existing range of deterrents to private sector investors. Although the risk of further conflict may have been reduced through increased public spending, the development setbacks that further conflict would cause mean that SSR remains a leading, albeit challenging, priority. Despite the importance of the sector, however, experience in Timor-Leste warns against excessive SSR expenditure for limited returns.

To date, international support for the security sector appears to have been almost unconditional, despite the slow pace of reforms and the failure of the government to systematically process those recommended for investigation or prosecution in connection with the 2006 instability. As of the time of this writing, the international security presence is downscaling, limiting the potential for levers to be exercised. In the event of future instability, development partners as a united group should insist on commitment to a clear and defined range of SSR deliverables before committing to extended operations. Substantial reforms should be considered including

<sup>78</sup> Examples include a 2008 memorandum of understanding between the government and GT Leste Biotech for a renewable 50-year lease for 100,000 ha "of unproductive land" (*La'o Hamutuk* 2008) and a 2009 agreement between the government and MALTIMOR Lda for a 250,000 ha rubber plantation (*Tempo Semanal* 2009b).

<sup>79</sup> The industry self-regulation movement has developed to the point where certification schemes are themselves certified by organizations such as the International Social and Environmental Accreditation and Labelling Alliance ([www.isealliance.org](http://www.isealliance.org)). See Carey and Guttenstein (2008) for an analysis of 10 examples of the use of industry certification programs to promote government policy.

<sup>80</sup> And also in 1975 and 1999, although the contexts were different in each case.

disbandment of particular security units. The progress of SSR should be subject to external monitoring and reporting and benchmarks should be met in order for international support to continue. Provision of training and equipment may present some opportunities; however, the recent procurement of patrol boats from the People's Republic of China highlights the limits to the bargaining power of established development partners. A more effective strategy may be to provide greater support to SSR-focussed civil society organizations such as *Fundasaun Mahein*.

### **Improving Transparency and Public Sector Management**

The indications are that corruption is entrenched and that the corrupt political economy is damaging rural development outcomes. For this reason, transparency and public sector management is the second priority. Development partners and close neighbors (including Australia, Indonesia, and Singapore) should offer strong support to the current Timor-Leste anticorruption campaign and assist the Anti-Corruption Commission and HATAC in tracing embezzled public funds and freezing offshore bank accounts and assets, where appropriate. Poor public sector management has been particularly evident in the key area of rural infrastructure development. Rural infrastructure is poor and improvement is central to improving trade and investment outcomes, yet there is ample evidence that much of the infrastructure being constructed is of substandard quality due to inadequate accountability and quality control. Present practices waste resources on improvements that are ephemeral and facilitate discretionary payments to contractors.

As discussed in the section on infrastructure development, the government's interest in accessing large funds for major works upgrades presents an opportunity for development partners. Loans at attractive rates could be made available to the government subject to specific conditions. These conditions should require that the government adopts a new auditing model incorporating random external auditing both of financial management and quality control dimensions, which should be applied to *all* infrastructure projects and potentially in other sectors as well. As noted earlier, however, the ability of development partners to exert leverage on the government using loans is likely to be increasingly limited by the growth of the Petroleum Fund and the apparent willingness of the government (MoF 2010, p. 30) to make "judicious" withdrawals from it to finance special projects.

### **Private Sector Investment**

There is very little private sector investment in the rural economy and insufficient jobs in rural areas to accommodate the bulging youth demographic. Private sector development is therefore the third priority. Perhaps as an overreaction to the low level of investment, senior officials have been inclined to sign questionable deals involving large areas of land without going through official processes or consulting potentially affected communities. Broader public sector management and anticorruption reforms would make the investment environment more predictable and transparent, and the investment and land policy work that is underway may also help.

Given that investment decisions often bypass official processes, development partners could work closely with government (subject also to SSR advancement) to design a system where donor-supported political risk insurance is made available to national and international investors willing to operate in accordance with the requirements of appropriate industry certification programs.<sup>81</sup> The

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<sup>81</sup> In the case of Timor-Leste, this could involve a joint donor-government project housed within the Invest Timor-Leste unit.

purpose would be twofold: to stimulate investment in the rural economy and to educate government officials concerning international best practice and adherence to formal processes.

### **Agriculture**

The analysis highlights the need for a more effective extension service and a broader approach to agricultural development that pays greater attention to upland farming, estate crops, and livestock. Experience suggests that much of the investment in irrigation and associated mechanization will be wasted due to the capacities and priorities of farmers. Accordingly, improvements in the breadth of agricultural development projects and the efficiency of extension delivery services are the fourth priority.

It is hoped that rational argument will help broaden current agricultural policy. The government has a strong interest in accessing programs such as Australia's Pacific Island Guest Worker Scheme; participation in such schemes could provide agricultural workers with experience and knowledge of intensified production systems. Participation could be linked to MAF's implementation of a broader agricultural development approach and the use of an externally audited, private sector agricultural extension model.

### **Other Opportunities**

There are a range of additional levers that could be used to reward or stimulate improved governance outcomes, especially at the national level. Access to subsidized or reduced-rate education services is one possibility, given the government's interest in sending, at its own expense, substantial numbers of youth to be educated at overseas tertiary institutions. In the long term, given the ongoing commitments of countries like Australia and New Zealand to peacekeeping and governance in the region, there may be merit in a new regional organization in the southwest Pacific, which, like the European Union, extends benefits to members based on the realization of particular reforms. "Super levers" open to several countries in the region could include offering, in due course, to reopen negotiations concerning territorial boundaries, subject to specific governance outcomes being definitively realized. Undoubtedly, all levers are likely to work better if their use is coordinated among members of the donor community.

## **5. Conclusion**

In over 400 years of Portuguese colonial engagement, there was minimal transformation of the rural economy in eastern Timor; the exception was the role of the Portuguese in the sizeable, yet poorly managed, coffee sector. The Indonesians left the legacy of a 6,000 km road network after a quarter-century's occupation of the territory, yet they failed to bring about profound rural transformation, despite high rates of growth sustained over a period of years. As an independent country, the responsibility for advancing economic development outcomes now lies with the government, which faces nation-building challenges at multiple levels. Advancing the rural economy, one of Timor-Leste's greatest challenges, is important to avoid further increases in poverty and to decrease rural-urban migration. To achieve this, rural development policies must be well formulated and implemented efficiently, and without interruption by crises. The stage must also be set to enable the private sector to play a major role, which means developing regulatory frameworks and controlling predatory behavior by state officials.

Despite the instability of 2006, the government does not yet appear to have committed to the reform of the security sector. In failing to control corruption, it also appears to be repeating one

of the mistakes of the Indonesian administration. Meanwhile, with respect to agricultural policy, it has been seeking to dramatically increase irrigated rice cultivation in a few areas, generating concern among some agriculturalists.

The government claims to have commenced major transparency advances, but as Blunt (2009) warns, this may just be the “rational–legal” rhetoric component of the “rational–legal”/patrimonial hybrid so common in developing countries.<sup>82</sup> Only when the government begins to investigate and prosecute will we know it is serious. Given Timor-Leste’s independent petroleum wealth and the absence of an international trusteeship model such as that proposed by Federer (2005), there is no easy way for development partners to influence policy. However, using the DOC approach some levers have been identified for donors to use in helping to bring about the priority reforms needed to drive change in Timor-Leste.

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<sup>82</sup> The transparency campaign, for instance, follows very closely the high levels of discretionary spending via the “Referendum [infrastructural development] Package” discussed under Infrastructural Development.

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# 11 How Pervasive is Clientelist Politics in the Pacific?

by Ron Duncan and Graham Hassall<sup>1</sup>

## ABSTRACT

This study draws upon the economic theory of contracts to measure the extent of clientelism in Pacific countries and compare their clientelist behavior with that of other countries. The high costs of enforcing contracts between political incumbents and voters suggest various hypotheses to be tested. These include behaviors such as (i) an emphasis on targeted transfers to voter groups rather than the provision of public goods that benefit the wider community; (ii) little interest by politicians in establishing secure property rights and impartial contract enforcement (the two pillars of market economies), as doing so undermines the politicians' ability to create rents and distribute targeted transfers; and (iii) little interest in making the bureaucracy more efficient, as this also undermines the politicians' ability to deliver rents to their voters. Some forms of clientelist behavior are not easy to measure directly and therefore their measurement necessarily involved arbitrary judgments in choosing less direct indicators. The evidence assembled suggests that Kiribati, the Federated States of Micronesia, and Solomon Islands exhibit behavior that is most consistent with that suggested by the clientelist model. These are also countries with some of the lowest per capita incomes and poorest economic growth in the Pacific.

## 1. Introduction

Democracy is not a shield against predation by the powerful or against governments exerting their authority to the benefit of elites. Informed citizens, low social polarization, and political competition are needed. (Zagha et al 2006:9)

It is commonly claimed that in the Pacific, politicians are primarily concerned with their own interests and give little attention to the national welfare. To this end, they are criticized for directing state resources to their clans or villages to ensure their election or reelection. Such criticism of the behavior of incumbents and would-be politicians was essentially the basis for the introduction of the

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limited preferential voting (LPV) system by Papua New Guinea (PNG) in place of its first-past-the-post voting system. The LPV system had its first full trial in the 2007 general elections. The primary aim of adopting the LPV system was to force political candidates to appeal to a wider group of voters (Reilly 2006) and presumably thereby induce them to pay more attention to issues of national welfare. In other Pacific countries, there is interest in the redesign of election and parliamentary systems with the same goal in mind.

Countries in which there is an intense political focus on delivering transfers to targeted constituents to serve narrow interests are identified as clientelist states. The existence of such relationships between politicians and voters is seen to be economically damaging for many reasons; for example, because of the diversion of public investment away from the most broadly welfare-enhancing avenues, or because of the adverse impacts of “policy capture”—that is, legislating policies that favor certain groups within the society.<sup>2</sup>

Does clientelist politics exist in the Pacific? If so, how widespread is it, and what impacts does it have on political behavior and economic performance? We examine these questions within the framework of a model that draws on the economic theory of contracts.<sup>3</sup>

Clientelist or patron-client relationships or politics are believed to exist when the only credible (enforceable) pre-election promises (contracts) that can be made are those between politicians (patrons) and voters (clients). It is argued that these are the only viable forms of political contracts because of the high costs of enforcing contracts between political incumbents and voters. The high costs of enforceability may arise because of the high cost of organizing voters and the need for repeated, face-to-face interaction between the incumbent and voters to ensure that the voters indeed voted for the politician and the voters can see that the politician delivered on the promises made to the voters (that is, establishing “reputation” through repeated exchange overcomes the “time inconsistency” of the contracts). Predominant features of political behavior derived from this model of patron-client politics are the following:

- There is an emphasis on targeted transfers to voter groups rather than the provision of public goods that benefit the wider community. Targeted transfers can be much more easily attributed to the political incumbent by the voters. On the other hand, politicians find it difficult to make credible promises about public goods.
- There is little interest by politicians in developing a reputation for policy making because of the difficulty of making credible promises about broad-ranging policies.
- There is little interest by politicians in establishing secure property rights and impartial contract enforcement (the two pillars of market economies), or law and order more generally, as doing so undermines the incumbents’ ability to create rents and distribute targeted transfers (including nepotism).
- There is little interest in making the bureaucracy more efficient, as this also undermines the politicians’ ability to deliver rents to their voters.
- There is lack of interest in the development of credible political parties, as this would mean having to develop and deliver on policy platforms.

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<sup>2</sup> Hallerberg (2004) and others refer politely to the “common resource pool” problem: “By their very nature all governments and parliaments face a coordination issue. The problem arises because benefits to constituencies, interest groups, and political parties tend to be concentrated, while the costs to be paid for generating benefits are usually spread out more widely than the benefit” (p. 240).

<sup>3</sup> The seminal publication on the economic theory of contracts is Hart (1995). The analytical framework used here is mainly drawn from the work of Keefer (2004). However, antecedents of Keefer’s work are Keefer et al. (1996), Dixit and Londregan (1996), Keefer and Knack (2002), Robinson and Torvik (2002), and Robinson and Verdier (2002).

- There is little interest in establishing good controls over the expenditure of revenues from the exploitation of natural resources (e.g., mining, forestry, and fishing), as again this undermines “rent seizure” and rent distribution.
- There is likely to be a high level of incomplete targeted infrastructure projects for two reasons: incumbents can promise to complete the project if they are reelected, and for newly elected politicians there is no payoff for completing a project begun by the previous incumbent who had a different clientele.

If these are the features of clientelist politics, it is obvious that a high incidence of such behavior would be inimical to economic growth and the enhancement of public welfare. This paper tests the incidence of clientelist politics in the Pacific by measuring political behavior according to selected indicators. The kinds of clientelist political behavior listed above are not easy to measure directly and therefore their measurement necessarily involves arbitrary judgments with respect to the indicators chosen. Such arbitrary judgments are, of course, open to debate.

## 2. Indicators of Clientelist Behavior

A major point that arises from the political behavior suggested to predominate in clientelist countries is that there is an emphasis on targeted transfers rather than on public goods that improve societal welfare generally. Targeted transfers may be in the form of government investment in infrastructure that has a narrow set of beneficiaries (for example, a local road, airport, port, or location of a government business) or a policy (such as a subsidy, a tariff, or a tax concession) that is targeted to a firm or region. Isolating these decisions from aggregated government statistics is impossible. However, it is suggested that because “grand corruption” takes place mostly through public investment, in young democracies where clientelism is more likely, it is reasonable to measure government expenditure associated with rent seeking and the satisfaction of narrow interests through the ratio of public investment to GDP (see Tanzi and Davoodi 1997, and Keefer and Knack 2002). That is, a higher share of public investment in gross domestic product (GDP) is associated with higher targeted transfers.

Normally, we would think of higher public investment leading to better economic growth. However, the quality of investment is important. Therefore, if most of the public investment is of low quality, such as would be expected from investment for targeted transfers (Keefer and Knack 2002), the relationship between public investment and economic growth could well be negative.

Security of property rights may be thought of in two senses. First, there is the sense in which the state effectively defines the rights to property such as land and buildings and protects the rights-holder against predation by others. In another sense, there is the possibility of predation by the state itself. How secure do people feel against the likelihood that the state will take their property without good cause or without appropriate compensation? State appropriation can extend to measures taken against foreign investors to prevent them from recovering their profits or capital investments.

Enforcement of contracts may be poor because of discretionary behavior exercised by the government, the bureaucracy, or the courts. Such behavior can lead to a situation where disputation of contracts becomes pervasive, with the result that there are few contracts entered into or contracting parties settle disputes privately rather than through the courts.

Capturing and distributing rents is another suggested form of political behavior in clientelist states. These rents may be “resource rents,” that is, the revenues accruing to the government from its appropriation of the revenue streams from the exploitation of natural resources such as minerals,

forests, and fisheries. Rents may also be created through policies, such as those that establish monopoly positions within the economy. These “monopoly rents” may be assigned to private sector interests through the use of import tariffs or other restrictions that raise the costs of imports and thereby raise the prices of domestically produced goods and services. The prevalence and form of import restrictions can indicate the creation and distribution of “policy rents” by patron politicians.

The creation of monopolistic government business enterprises (GBEs) can be another means of creating and distributing monopoly rents. Such enterprises are notorious for nepotism in employment. Appointments to senior management positions and boards of directors in GBEs also provide governments with means of rewarding political supporters or of enticing politicians to join the government (see, for example, Tuhaika, Jr. 2007).

Another behavior suggestive of clientelist states is unwillingness to make the public service efficient. Public sector reform has been a very popular activity of development assistance agencies in the Pacific region.<sup>4</sup> Their efforts have met with some success, as in the Cook Islands and Samoa, but there has been very limited, if any, progress in other Pacific countries such as Fiji and PNG. Ensuring the efficient operation of markets and effective and equitable operation of public services through regulation is one of the most important functions of government. However, the dark side to regulations is that they can also serve as a means of limiting entry to an activity, providing preferential entry, or extracting a bribe to provide approval under the regulation.

The clientelist behavior suggested by the model and indicators adopted to measure the extent of clientelist behavior in Pacific states are shown in Table 11.1. Below we discuss possible indicators and evaluate the appropriateness of the indicators selected.

### Targeted Transfers Rather than Investment in Public Goods

As noted above, the share of public investment in GDP is an indirect measure of the extent of targeted transfers suggested by the political economy models on which this study is based. It is suggested that in young democracies, the higher the share of public investment in GDP, the greater the degree of targeted transfers. However, information on public investment (or private investment for that matter) is not available for most Pacific island countries. Nor is there any information that could show the extent of targeted transfers. There are also no data on the extent of incomplete infrastructure projects—although there is much anecdotal evidence of such occurrences in some Pacific countries—and therefore the hypothesis about clientelism being reflected in unfinished infrastructure projects cannot be directly tested.

Thus, we looked to measures of expenditure on public goods—the other side of the equation. The share of health and education expenditure in total government expenditure is taken as a proxy for state expenditure on public goods, as opposed to targeted transfers. In young democracies, the share of health and education expenditure in total public expenditure is expected to be higher the less the extent of targeted transfers.

Public access to essential services can be another proxy for the extent of expenditure on public goods. An indicator for this proxy was constructed by taking the simple arithmetic average of the percentages of the population with access to safe water and sanitation.

<sup>4</sup> See Asian Development Bank (ADB, 2000) and the ADB (2004) report, *Responding to the Priorities of the Poor*, which sets out the ADB strategy for the Pacific member countries for the period 2005–2009, states “... ADB’s studies show that governments fail to supply key public goods, such as secure property rights, an effective legal system, and critical infrastructure, while unproductively participating in some markets and poorly managing and preventing competition in others, such as utilities.”

## Insecurity of Property Rights

Information from the World Bank/International Finance Corporation (IFC) Doing Business database on the extent to which investors are protected was taken as an indicator of the security of property rights. This indicator measures the quality of corporate governance in a country, which partially relies upon the government to enforce transparency and accountability within public companies to try to prevent company managers and directors from acting against shareholder interests. The Doing Business database has three measures of how well investors are protected: the extent of disclosure, the extent of director liability, and the ease of shareholder suits. The extent of disclosure was taken as the indicator to measure the security of property rights, as this appears to be the best measure of attempts to ensure transparency. In the Pacific island countries, there is little private sector activity and much less in the way of incorporated companies, so this indicator is likely not a very good measure of the security of property rights in these countries. Most of the concern about property rights in Pacific island countries arises over the issue of security of tenure over customary land—and even freehold land. However, we do not have a measure of the extent of concern over security of property rights, nor do we have a measure of the level of threat of expropriation of private property by the state.

## Lack of Impartial Contract Enforcement

The indicator used to measure the degree of impartial contract enforcement was taken from the 2006 Doing Business database. Three measures of the costs of enforcing contracts are collected for the database: (i) number of procedures to enforce a contract, (ii) number of days to enforce a contract, and (iii) costs of enforcing a contract as a percentage of the claim. In a sense, these measures reflect on the efficiency of the court system, and no doubt on its impartiality. We chose the costs of enforcing a contract as a percentage of the claim as a better measure of the impartiality of contract enforcement than the other two, although the number of days to enforce a contract is also a good measure. This indicator was scaled within a range of 1–10 by converting the costs of claims for the 175 countries for which indicators were collected to a scale of 1–10 and locating the countries within this range.

## Lack of Interest in Establishing Law and Order

As regards law and order, we would like to have an indicator that measures the degree of government interest in providing a good law and order environment. The costs of enforcing contracts, discussed above, is probably as good a measure of government interest in this area as any available. Government expenditure on the law and justice system is not a suitable measure as it is likely that such expenditure is driven by law and order problems in the country, which are in turn largely a function of a lack of investment and job opportunities and the proportion of young males in the population.

The extent to which political leaders consent to being bound by the same legal obligations that apply to all other citizens may be a potential indicator of respect for the rule of law. At the present time, only Tuvalu has enacted a leadership code following the establishment of a draft leadership code by the Pacific Islands Forum, the declaration of “Principles of Good Leadership” by the Pacific leaders at their 2003 meeting, and the 1997 declaration of “Eight Principles of Accountability” by the Pacific Islands Forum economic ministers.

In countries where leadership codes have existed for some time (PNG, Vanuatu and, more recently, Solomon Islands), they have not been particularly inhibiting for political actors. In the case

of PNG (Sullimann 2006), for instance, a review of 77 cases brought under the Papua New Guinea Leadership Code between 1976 and 1995 indicates that only a single case resulted in criminal conviction; more leaders avoided sanctions such as dismissal (14 instances) or fines (9 cases) through the simple act of resigning from office (18 cases).

### **Lack of Interest in Establishing an Efficient and Effective Public Service**

It is hypothesized that clientelist politicians would not be interested in developing an efficient, effective civil service as this would reduce their ability to create and distribute rents. Two indicators, taken from the World Bank/IFC Doing Business database, have been adopted to measure such behavior: the costs of starting a business and the costs of trading across borders. These indicators basically measure the amount of “red tape” that the private sector has to cope with to do business. The indicator of the costs of starting a business is the number of procedures required. The costs of trading across borders are indicated by the number of days, number of procedures, costs to exporters of getting their cargo onto a ship or plane, and costs to importers of getting cargo from the ship or plane to their store. These two indicators should provide a good measure of the productivity of the civil service. The indicators were scaled in the same manner as for the costs of enforcing a contract.

### **Lack of Interest in the Development of Credible Political Parties**

While there is intense political party activity and competition in clientelist states, most such parties remain fluid, populist, legally unrestrained, policy-poor, and administratively bare. Whereas much scholarship on Pacific politics presumes as much, little of it is empirically based or offers reasons why this is so. Our research indicates that just one Pacific state has enacted legislation regulating the conduct of political parties. PNG’s Organic Law on the Integrity of Political Parties and Candidates 2003 requires political parties to have a minimum of 500 subscribed members and to incorporate under the Associations Incorporation Act 1966 if it seeks to field candidates in general elections (PacLII 2003). Despite this requirement, current records held by the Office of the Registrar of Political Parties are only as complete and correct as the information provided by party officials.<sup>5</sup>

Elsewhere in the region, parties may choose some form of legal registration, but a majority do not. In Solomon Islands, for instance, while 12 of the 17 active parties enjoy legal status under the Charitable Trust Act of 1964, five have chosen not to; and of all these 17 parties, only the Solomon Islands Social Credit Party of former Prime Minister Manasseh Sogavare maintains records of party members and meetings. For the remainder, party memberships are estimated, and no official records of meetings are maintained.

### **Policy Rent Seizure**

Two indicators were chosen as measures of the creation and distribution of rents through policies favoring special interests: (i) the share of international trade taxes in government revenue, and (ii) the number of government business enterprises (GBEs). International trade taxes are made up of customs duties on imports and taxes on exports, usually of primary commodities such as logs. Application of customs duties is a means of creating a situation where a firm or an industry will earn monopoly rents. This action can favor voters in an incumbent’s electorate and earn reelection. The share of international trade taxes in total government revenue indicates the government’s propensity to use this form of taxation over other more neutral taxes such as income and value-added taxes.

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<sup>5</sup> We are grateful to Paul Bengo, registrar of political parties, for providing party registration information.

However, there are a couple of problems with the use of this measure. Taxation of imports and exports is the most easily collected tax in a developing country with poorly developed administrative and infrastructure services. Also, where exemptions (which can also be seen as a form of clientelism) and corruption are more common, less tax will be collected. Hence, an even better measure of clientelist behavior than the share of trade taxes in total taxes could be the extent of exemptions from customs duties. However, such information is not available.

The creation of GBEs increases opportunities for politicians to favor individuals through appointment as managers or members of boards of directors, as well as favoring voters through the geographic location of the GBE or the employment of wantoks (clans). The number of GBEs gives an idea of the opportunities for employment of favored individuals as managers and board directors. This indicator was calculated as the number of GBEs—including agricultural banks, development banks, provident funds, and essential services, as well as other government businesses—operating in areas normally occupied by the private sector. The share of GBE employment in total formal employment and the share of GBE output in total GDP would also give an idea of the relative size of government businesses in the economy and the scope for favoring voters. However, data on these variables are not available.

Table 11.1: Indicators of Clientelist Behavior in Pacific Countries

Clientelist Behaviors	Indicators
Emphasis on targeted transfers rather than public goods	<ul style="list-style-type: none"> <li>Share of health and education expenditure in total government expenditure</li> <li>Public access to essential services</li> </ul>
Insecurity of property rights	<ul style="list-style-type: none"> <li>Protection of investors (extent of disclosure)</li> </ul>
Lack of impartial contract enforcement	<ul style="list-style-type: none"> <li>Costs of enforcing contracts (costs of claim)</li> </ul>
Lack of interest in establishing law and order	<ul style="list-style-type: none"> <li>Share of government expenditure on the law and justice system</li> </ul>
Lack of interest in establishing an efficient and effective civil service	<ul style="list-style-type: none"> <li>Costs of starting a business</li> <li>Costs of trading across borders</li> </ul>
“Policy rent” seizure —use of customs duties —establishment of government business enterprises	<ul style="list-style-type: none"> <li>Share of international trade taxes in government revenue</li> <li>Number of government business enterprises</li> </ul>
Lack of interest in the development of credible political parties	<ul style="list-style-type: none"> <li>Existence of laws requiring formal registration of political parties</li> <li>Proportion of political parties that operate in accordance with required laws</li> <li>Evidence of formal registration, membership, meeting records, financial records, and costed policy platforms</li> </ul>
Lack of interest by politicians in developing a reputation for policy making	<ul style="list-style-type: none"> <li>(i) Clearly established policy statements regarding specific sectors, or “whole of government” policy approaches</li> </ul>

Source: Author.

### 3. Results of Indicators Measuring Clientelist Behavior in the Pacific

Table 11.2 presents the results for the indicators that we have adopted for measuring the various behaviors expected in clientelist countries. As country comparators, we have used Australia and New Zealand, two countries where the expected degree of patron-client political relationships would be low. We have also included as comparators two developing countries that have had extremely good economic performance: Botswana and Mauritius. Mauritius is a country that is often used as a comparator for Fiji because of its similar population size, its reliance on sugar production, and its

large Indian population descended from indentured workers. Botswana is a small African country that was a British colony and has customary land ownerships and traditional chiefs—characteristics similar to many Pacific island countries.

With respect to targeted transfers as a form of clientelist behavior, Fiji, the Federated States of Micronesia (FSM), and Kiribati perform least well in terms of expenditure on public goods (education and health). The low percentage for the Cook Islands should be ignored as Cook Islanders have free entry to New Zealand and all its welfare services. While Fiji and the FSM are not the worst performers as providers of access to essential services (safe water and sanitation), they rank close to the bottom. Kiribati, PNG, Solomon Islands, and Vanuatu score least well on this indicator. However, this may be expected because the bulk of the population of these countries lives in rural areas in topographically difficult environments, including on many small outlying islands.

The Marshall Islands, the FSM, and Palau score poorly as far as protecting property rights (protecting investors) is concerned, with the FSM and Palau among some of the worst performers globally, based on the World Bank/IFC measure. Fiji also does quite poorly on protecting investors, as do Solomon Islands and Tonga. PNG ranks the lowest on enforcing contracts, followed by Solomon Islands, Vanuatu, and the FSM.

As far as gaining secure access to land is concerned, PNG is in the mid of a landmark attempt to establish a secure leasehold system for the use of customary land. Vanuatu already has a system of long-term leasing of customary land; however, it has embarked on a process to strengthen the security of the property right by improving the dispute settlement and land administration procedures. The Cook Islands, Fiji, and Samoa also have in place secure long-term leasehold systems for customary land that have assisted greatly in the development of their tourism industries. However, Fiji needs to renew its leasehold system for agricultural uses, which is different from the system applying to leasehold for nonagricultural uses; it has been in limbo for a decade due to the benefits the major political parties derive from the impasse.

Gaining secure access to customary land for commercial purposes in Kiribati, the Marshall Islands, the FSM, and Solomon Islands is extremely difficult. In these cases, it appears that politicians do not see it to be in their interest to develop a secure leasehold system involving low transaction costs. This is part of the reason why there is very limited private sector activity in these countries.

There is little consistency between the results for registration of property and trading across borders as indicators of the efficiency of the civil service. Solomon Islands is by far the worst performer with regard to the registration of property, followed by Kiribati, Palau, and Samoa. Vanuatu has the highest costs of importing and exporting, followed by Kiribati.

**Table 11.2: Indicators of Clientelist Behavior**

	Share of Expenditure on Health and Education in Total Government	Share of Expenditure on Law and Order in Total Government Expenditure	Share of Taxes on International Trade in Total Revenue Excluding Grants	Access to Improved Water Source, Sanitation Facilities	Trading Across Borders		Registration of Property Number of Procedures	Enforcing Contracts Cost of Claim	Protecting Investors Extent of Disclosure	Number of GBEs
					Cost of Export	Cost of Import				
Cook Islands	22.6	5.6	19.7	100	n.a.	n.a.	n.a.	n.a.	n.a.	6
Fiji	19.8	4.9	20.1	60	9.7	9.7	8.8	7.7	3.3	19
Kiribati	19.7	4.5	18.9	53	7.9	7.9	7.1	8.5	6.6	32
Marshall Islands	32.3	n.a.	21	85	9.3	9.3	n.a.	8.4	2.2	n.a.
FSM	18	n.a.	12.9	61	8.6	8.6	n.a.	6	1	n.a.
Palau	n.a.	n.a.	n.a.	84	8.6	8.7	7.1	7.9	1	n.a.
PNG	26.3	7.6	24.3	42	9.7	9.5	7.9	3.3	5.5	n.a.
Samoa	24.3	5.1	19.2	94	8.9	8.2	7.1	8.9	5.5	19
Solomon Islands	25.3	9.8	57.5	51	8.8	8.5	3.6	5.2	3.3	n.a.
Tonga	32.8	7.1	n.a.	98	9.7	9.6	7.9	8.2	3.3	15
Vanuatu	31.1	8.4	38.1	55	7.4	6.7	9.3	5.5	5.5	n.a.
Australia	23.9	3	2.4	100	9	8.7	7.1	8.8	8.8	n.a.
New Zealand	35.7	4	2.7	97	9.4	9.3	9.3	8.7	10	n.a.
Botswana	31.5	4.9	15	68	6.5	6	7.9	8.3	8.8	n.a.
Mauritius	23.5	8	26.1	97	9.4	9.5	6.4	9	6.6	n.a.

FSM = Federated States of Micronesia, GBE = government business enterprise, n.a. = data not available, PNG = Papua New Guinea.

Source: Author.

The share of taxes on international trade and the number of government business enterprises are the indicators for the extent of “policy seizure” in the economy. Solomon Islands, Vanuatu, and PNG are the countries with the highest shares of such taxes. In Vanuatu’s case, it does not have an income tax and has relied on taxation of imports—which makes sense because of its poorly developed infrastructure. Solomon Islands and PNG are heavily dependent on taxation of exports of primary commodities: logs in the case of Solomon Islands and minerals and logs in the case of PNG. PNG’s taxation of minerals (including petroleum) is in fact higher than represented by this measure as it extracts rents from these exports in other ways besides export taxes.

With regard to the number of GBEs offering opportunities for political favors, Kiribati has by far the largest number among the countries for which this information could be gathered. In fact, most commercial activity in Kiribati is carried on through GBEs. There is very little private sector activity. Although no details are shown in Table 11.2, much the same is true of the Marshall Islands and the FSM. While GBEs do not dominate commercial activity to this extent in PNG, Solomon Islands, and Vanuatu, political appointments to these bodies are important ways of providing favors.

The absence of credible political parties and the absence of political philosophies or political manifestos is the situation in most Pacific island countries. Where political parties have been long-lived, their *raison d'être* is racial identity, as in Fiji, or a rallying point around a language and religious identity, as in Vanuatu. More generally, formation of political parties is only a mechanism for gaining control of government and this is achieved by the offer of participation in government in some form. The ultimate development of this process is in Samoa, where there is virtually only a single party, with opposition parties being obliterated through enticements to join the government.

## 4. Conclusion

On the basis of the rankings in the bottom three for each indicator, Kiribati, the FSM, and Solomon Islands exhibit the strongest clientelist tendencies, with Kiribati in the bottom three for five indicators and the FSM and Solomon Islands in the bottom three for four indicators. Maybe somewhat surprisingly, Tonga is the best performer, not appearing in the bottom three score on any indicator.

Globally, in terms of the World Bank/IFC measures, the Pacific countries do poorly only in terms of the measure of protecting investors. On the other measures, with a few exceptions, they rank in the top half of the country distributions. Australia and New Zealand generally score better than the Pacific island countries, though not always. Botswana scores low on provision of access to clean water and sanitation and on trading across borders. It is surprising that after many years of rapid growth in Botswana that its provision of basic public goods such as clean water and sanitation is so poor. Its poor score on trading across borders is not so unexpected, given that it is a landlocked country in a continent where transport costs are very high.

At this stage, the indicators suggest that Kiribati, the FSM, and Solomon Islands exhibit behavior that is most consistent with that suggested by the clientelist model. They are also countries with some of the lowest per capita incomes and poorest economic growth in the Pacific. Thus, the answer to one of the questions asked may be that clientelist politics leads to slower economic growth. However, one has to ask whether the causality runs in the other direction, or if there is some other factor(s) causing both. It is difficult to think of a convincing reason for poor economic growth to lead to clientelist behavior. It is more convincing to argue that the communal nature of these societies results in both clientelism and poor growth. Some argue that what may be seen by western

eyes as nepotism (in the form of appointments to boards) or serving client interests (such as building roads and bridges in the politician's village) should be considered acceptable forms of customary behavior. But, there are customary economies in the Pacific that have been growing reasonably well and they appear to exhibit less clientelism.

So what else has been learned from this exercise? As with attempts to measure governance, the study confirms the difficulty in finding objective measures of people's behavior (Gani and Duncan 2007a, 2007b). The direct measures we would like to have—such as exemptions from customs duty, how well the judiciary is enforcing contracts, and the number of incomplete projects in politicians' electorates—are impossible to compile. So we are left with trying to find less direct measures of behavior, which can be the result of various factors.

Still, the compilation of indicators of the various forms that clientelist behavior can take does appear to add up to a fairly convincing, though circumstantial, conclusion that clientelism is alive and well in some Pacific island societies. An implication of this finding is that economic reform can be very difficult because of resistance from politicians. If politicians do not wish to see improvements in institutions underpinning the private sector or are resistant to improvements in the public service because it will interfere with their ability to appropriate and distribute rents, then expectations about reform success have to be modified. If reform is to become more successful, ways to change the incentives facing politicians have to be found.

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# 12 The Political Economy of Logging in Solomon Islands

by *Matthew Allen*

## ABSTRACT

This political economy study of the logging industry in Solomon Islands builds upon previous analytical work to propose an explanatory framework for the prevalence of a range of practices that can be broadly described under the rubric of “corruption.” The literature on social embeddedness and political culture is drawn upon to develop a framework that emphasizes the importance of social and cultural influences—as well as economic ones—on the behavior of elected representatives, government officials, and village “big men.” Like all Melanesians, they are enmeshed in networks of obligation and reciprocity. Ultimately, it is the socially and culturally grounded expectations of their kinsmen that compel them to access and distribute resources such as from forestry. This indigenous political culture has been overlain with the distinctive business culture of the Asian loggers and has proven to be highly susceptible to the latter’s venal suasions. This political economy framework goes a long way toward explaining the ongoing lack of political will for legislative reform of the forestry sector, as well as the chronic instability that has characterized politics in Solomon Islands since achieving independence.

## 1. Introduction

Round logs have been the most valuable export commodity for Solomon Islands since the early 1990s. There have been two peaks in the volume and value of annual log exports. The first occurred in 1996, before the Asian financial crisis and the subsequent political and social unrest in Solomon Islands caused a marked decline in timber production and exports. The industry has recovered steadily since 2001 and exports are once again at record levels, with logging revenue currently contributing around 70% of export income (compared with 50% in 1994) and more than 15% of government revenue. High levels of log production and exports have been largely responsible for the high rates of economic growth experienced by Solomon Islands in recent years.

However, timber production has exceeded estimated sustainable production levels in most years since 1981. The most recent technical assessment estimates that Solomon Islands’ forests are being exploited at four times the sustainable limit and that the natural forest resource will be

exhausted by the end of 2015 (URS 2006). The current global economic downturn, and the slowing of demand from the People's Republic of China in particular, caused a slight decline in timber production in Solomon Islands in the fourth quarter of 2008 and a marked decline in the first quarter of 2009. Some observers believe that these declines signal the beginning of the predicted collapse of the logging industry.<sup>1</sup> However, log exports grew by 20.5% in the second quarter and look set to remain stable or increase again in the third quarter. The Central Bank of Solomon Islands (CBSI) attributes the 23% increase in log exports in the month of August 2009 to "increased demand combined with less competition in the log markets" (CBSI 2009).

The first timber boom in Solomon Islands generated an effluence of high-quality social science research on various dimensions of the political economy of the logging industry (Duncan 1995; Price Waterhouse 1995; Frazer 1997a, 1997b; Dauvergne 1998, 1998/9; Bennett 2000; and Kabutaulaka 2000). Collectively, this research documented the growing collusion between foreign logging companies and local politicians, systemic corruption, bureaucratic mismanagement, and poor monitoring and enforcement. These characteristics were attributed to the weakness of the post-colonial state and the emergence of a post-colonial political culture that places value on the distribution of wealth and resources to followers or clients, often along kinship lines. The fluidity of parliamentary politics in the absence of strong political parties—described by Steeves (1996) as "unbounded politics"—is also thought to have contributed to the particular political economy of the logging industry in Solomon Islands.

Researchers further demonstrated that corruption, the distribution of revenues under logging contracts, and the poor enforcement of rules and regulations contributed to large losses in potential government and landowner revenues from the logging industry. It was estimated that in 1993–1994, a period of exceptionally high timber prices, the government and landowners forgave 130 million Solomon Islands dollars (SI\$) in potential logging revenue due to the "unfortunate design" of logging contracts (SI\$36 million) and underreporting of log prices (SI\$94 million) (Duncan 1995, pp. xvi–xvii). This was equivalent to around 35% of gross domestic product (GDP) and 53% of government revenue.

In 1995, it was estimated that SI\$21 million–\$34 million in potential government revenue was forgone due to export tax exemptions granted to local landowning companies (Price Waterhouse 1995, p. I, Bennett 2000, p. 322). Most of this economic rent was captured by foreign logging companies due to the nature of their agreements with landowning companies to which they were contracted to provide logging services (Price Waterhouse 1995, pp. 25–28). This study also found that the Solomon Islands' tax regime encouraged foreign logging companies to find ways to avoid paying tax. Tax avoidance strategies documented in the study included the underreporting, misclassification and mis-scaling of logs, and underinvoicing the value of log exports (Price Waterhouse 1995, p. ii).

In contrast to the situation during the mid to late 1990s, there has been a dearth of research on the political economy of the current logging boom in Solomon Islands. However, sources such as the *2005 Special Audit Report* on the Solomon Islands' Department of Forestry, Environment and Conservation indicates that many of the characteristics described in the earlier research persist (Office of the Auditor-General [OAG] 2005). The report documents ongoing fraud, corruption,

<sup>1</sup> For example, the latest International Monetary Fund (IMF) Article IV Report states, "[t]he current outlook, in line with that of the authorities, is for logging output to decline from 1.5 million cubic meters in 2008 to 1.1 million cubic meters in 2009, and by another 20% a year in 2010 and 2011, with an even more rapid pace of decline thereafter" (IMF 2009, p. 4).

mismanagement, and maladministration throughout the forestry sector. It estimates revenue forgone from export tax exemptions of around SI\$10 million in 2003 and SI\$30 million in 2004.

Moreover, the undervaluing of log prices has become both institutionalized and politicized in the form of the determined value of logs (DVL) schedule. In its March 2008 *Quarterly Review*, CBSI took the unprecedented and extraordinary step of including a section, Log Revenue and the Determined Value of Logs, in which it was highly critical of the government's failure, over many years, to implement a DVL schedule that adequately reflects international prices for round logs. CBSI conservatively estimates that in 2007 the government forgone SI\$80 million in revenue, in the form of export duties, due to the undervaluing of log exports. Foreign logging companies, and their local "clients," are continuing to appropriate most of the economic surplus from the logging industry in Solomon Islands, just as they were during the first logging boom (Duncan 1995; Price Waterhouse 1995; Bennett 2000).

This chapter analyzes the political economy of the logging industry in Solomon Islands, with a particular focus on the past decade or so. It builds upon previous analytical work to propose an explanatory framework for the ongoing prevalence of a range of practices that can be broadly described under the rubric of "corruption." Literature on social embeddedness and political culture is drawn upon to develop a framework that emphasizes the importance of social and cultural influences—as well as economic ones—on the behavior of elected representatives, government officials, and village big men in Solomon Islands. These people, like all Melanesians, are enmeshed in networks of obligation and reciprocity. Ultimately, therefore, it is the socially and culturally grounded expectations of their kinsmen that compel Members of Parliament, government officials, and local big men to access and distribute resources, and the logging industry has afforded significant opportunity for such patronage. This indigenous political culture has been overlain with the distinctive business culture of the Asian loggers and has proven to be highly susceptible to the latter's venal suasions. The political economy framework developed here goes a long way toward explaining the ongoing lack of political will for meaningful legislative reform of the forestry sector, as well as the chronic instability that has characterized politics in Solomon Islands since it gained independence in 1978.

While the primary focus of the chapter is at the national level, on the relationships between foreign logging companies and state actors, some attention is also given to the role of forest resource owners and the nature of their engagements with logging companies and the state. Not all landowners have supported the logging of their forests, as evidenced by various acts of resistance over the years. Many landowning communities have been deeply divided by the issue of logging. However, those who oppose logging frequently lack the resources and capacity to compete effectively in the timber rights process against their fellow community members who have the financial and technical backing of the logging companies. Moreover, the long-standing distinction in the law between the ownership of land and the ownership of timber rights has allowed individuals with tenuous or spurious claims to obtain the rights to timber and become the principal beneficiaries of logging royalties (Corrin 1992). Having said that, we must not lose sight of the fact that many landowners have been active participants in the logging industry.

This chapter begins with a brief introduction to Solomon Islands before moving on to examine the history of its forestry sector from the colonial period up to the present day. The focus is on timber production levels, changes to regulatory arrangements, and the relationship between the two. The political economy of the first logging boom is then examined in more detail with reference to the published literature on this period. The next section focuses on developments over the past

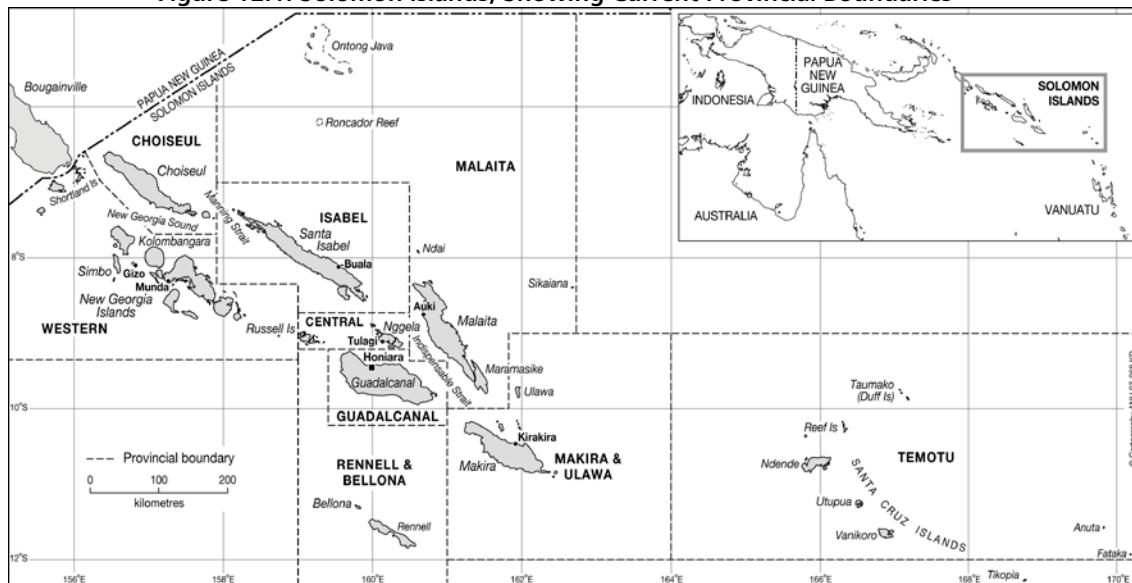
decade or so. It is demonstrated that many of the political economy factors that characterized the logging industry in the 1990s have continued and, in some cases, have intensified. The penultimate part of the chapter proposes a framework for explaining the political economy of the logging industry in Solomon Islands. The approach stresses the need to situate both state actors and formal state institutions within the particular social and cultural context of Solomon Islands. This emphasis, it is argued, requires that a political culture lens is engaged in the analytical framework. The final section draws out the wider implications of the analysis conducted and proposes some options for external donor agencies seeking to operate within, or assist in changing, the underlying political economy of Solomon Islands.

## 2. Solomon Islands: A Brief Social, Political, and Economic History

Solomon Islands is an archipelago of more than 1,000 islands with a population of around 500,000. Its people are distributed over six main islands and speak around 80 languages. While the island of Malaita accounts for one-third of the total population, the national capital, Honiara, is on Guadalcanal, where it was established immediately after the Second World War. Around 85% of Solomon Islanders reside in rural areas on their customary-owned lands. Most Solomon Islanders (around 95%) identify themselves as Melanesians.

The dominant form of indigenous leadership in pre-contact times was the “big man” model, although hereditary chiefly systems existed in some areas. A big man’s success depended in large part on his ability to organize labor and mobilize resources, particularly pigs and root crops, to generate and distribute wealth, thereby creating and maintaining networks of obligation and reciprocity. He was also adept at raising war parties or engaging professional assassins. Sporadic episodes of intergroup warfare were commonplace against a background of constantly shifting alliances. The symbiotic processes of colonization and missionization eventually brought an end to tribal warfare. However, the big man style of politics and leadership continues to exert significant influence on local, provincial, and national politics.

Figure 12.1: Solomon Islands, Showing Current Provincial Boundaries



Source: Cartography Australian National University, 2007.

In 1893, the British formally annexed Solomon Islands, which had been under the “loose jurisdiction” of the British High Commission in Fiji since 1877, establishing the British Solomon Islands Protectorate (Bennett 1987, p. 104). The colony was primarily established for strategic purposes, especially the protection of Australian and New Zealand interests from the perceived threat of French and German expansion in the Pacific. The main economic interest for the colony of Queensland was the Pacific labor trade, which had been supplying cheap labor for the sugarcane plantations of Queensland, Fiji, and Samoa since around 1870. The importance of this trade provided the British with a “plausible excuse for “protecting the Solomons” (Morrell cited in Bennett 1987, p. 105). The establishment of the protectorate was premised on the requirement that the colony would be economically self-sufficient, and this was to be achieved through the establishment of a plantation economy based on copra production (Bennett 1987, p. 103; 2000, p. 39).

Solomon Islands was granted independence in 1978 and inherited the Westminster-style system of government that Britain bequeathed to many of its former colonies. Despite calls from several “federalist” islands and regions (particularly Guadalcanal and Western) for greater political devolution, a unitary system was introduced (Ghai 1983, p. 26). Seven provinces were established under the 1978 Constitution and were later given their own assemblies, executives, and premiers under the Provincial Government Act 1981.<sup>2</sup> However, the central government retained tight regulatory control over the executive and legislative functions of the provinces.

Heralded by the Western Breakaway Movement on the eve of independence, the issues of devolution and provincial autonomy—in the face of what is widely seen as the inequitable concentration of political and economic power in the national capital—have loomed large in the politics of the independent state. Moreover, successive governments have suffered from chronic instability due to the weakness of the political party system and the prevalence of personalized and

<sup>2</sup> There are now nine provinces, following the separation of Choiseul from Western Province in 1992 and Rennell and Bellona from Central Province in 1996.

parochial politics. Governments have changed frequently due to parliamentary votes of no confidence or the threat thereof.<sup>3</sup> There have been 14 governments in the 31 years since independence.

The post-colonial period has seen significant economic diversification, a trend that resulted from the colonial administration's policy of diversifying the export base in preparation for independence. In the 1960s, copra was still the primary export commodity. However by 1977–1978, it accounted for only one-quarter of the value of exports, with timber products and fish (mostly tuna) accounting for about 25% each and palm oil contributing 16% (Bennett 1987, p. 330). Timber exports increased rapidly in the 1980s and 1990s under the governments of Solomon Mamaloni—a product of both the expansion of logging onto customary land from around 1980 and the growing collusion between government ministers and Asian logging companies (Frazer 1997a, 1997b; Dauvergne 1998/9; and Bennett 2000).

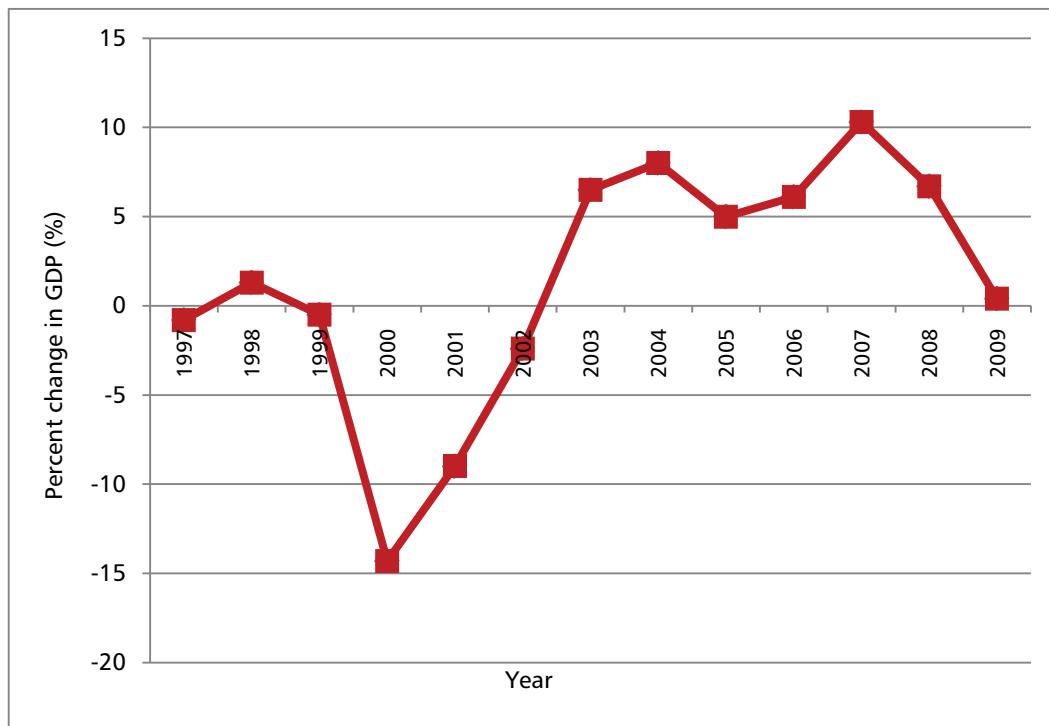
From 1990 to 1998, timber accounted for around 45% of the total value of exports, while fish contributed 27%, palm oil 12%, copra 5%, and cocoa 4% (Fraenkel 2004, p. 33). In 1999, the Solomon Islands Plantation Limited oil palm operation and the Gold Ridge mine (which commenced production in June 1998), both on Guadalcanal, contributed 20% and 25% of export earnings, respectively. However, both of these operations were closed down as a direct consequence of the violent social unrest—the so-called “ethnic tension”—that commenced in late 1998 and continued in various forms until the deployment of the Regional Assistance Mission to Solomon Islands (RAMSI) in July 2003. The conflict, in concert with the earlier collapse of log exports, had a strongly deleterious effect on Solomon Islands economy as measured in terms of real GDP, particularly during 1998–2000 (Figure 12.2).

The regional assistance intervention quickly succeeded in restoring law and order, arresting large numbers of ex-militants, and retrieving most of the guns that had been raided from police armouries during the conflict. Rapid economic recovery ensued on the back of peacekeeping and reconstruction efforts, with the recovery of smallholder cash cropping, the reopening of the palm oil plantation under new ownership and, most importantly, a dramatic increase in logging activity. Economic growth has averaged around 6% a year since 2004. However, most observers agree that this growth rate is fundamentally unsustainable.<sup>4</sup>

<sup>3</sup> The vast majority of post-independence governments have been formed by coalitions of political parties and independents, and most of these coalitions have been “highly unstable, continually in flux and open to persistent challenge through the mechanism of votes of no-confidence” (Steeves 1996, p. 117).

<sup>4</sup> According to the 2007 IMF *Article IV Report* (p. 5), “Nevertheless, with one of the fastest growing populations in the world, per capita income is the lowest in the region. Economic activity continues to rely on the unsustainable exploitation of the country’s forests and large donor assistance.”.

**Figure 12.2: Solomon Islands Gross Domestic Product Growth, 1997–2009  
(1985=100)**



GDP = gross domestic product

Note: The data for 2009 is based on estimated GDP growth of 0.4%.

Source: Central Bank of Solomon Islands.

### The History of Forest Policy and Timber Production Levels

The rapid expansion of logging after around 1980 was related both to legislative changes that enabled logging to expand onto customary land and to a shift in the ownership of the logging companies operating in Solomon Islands away from the United Kingdom and Australia toward Japan, Malaysia, and the Republic of Korea. These developments coincided with expanding international demand for logs, particularly from Japan, and the winding down of export log production in the Southeast Asian countries that had supplied Japan's market (Indonesia, Malaysia, and the Philippines). By 1985, 95% of logging in Solomon Islands was on customary land and most of the companies seeking new licenses were controlled by Asian nationals (Bennett 2000, pp. 235, 238). These two factors, in concert with underlying "Melanesian patterns of reciprocity" (Bennett 2000, p. 209), gave rise to a "new business climate... the main feature of which was a rising level of corruption" (Frazer 1997b, p. 56).

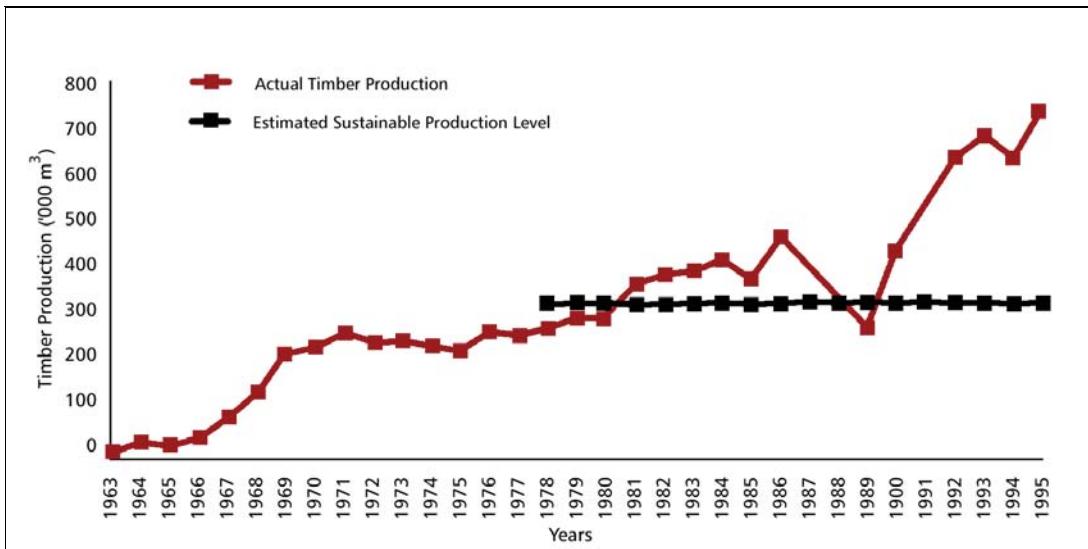
There was no significant logging on customary land in Solomon Islands before the passage of the Forest and Timber Amendment Act 1977, which introduced direct dealings between loggers and landholders in relation to the logging of forests on customary land. Prior to this, almost all logging was on crown or government land. This was a deliberate policy on the part of the colonial administration, which was keen to "protect" Solomon Islanders and their forests from rapacious commercial exploitation, while also ensuring that land perceived to be idle was brought into

productive use (Bennett 2000, p. 182). With these objectives in mind, the colonial government expended much effort in the 1950s and 1960s attempting to create a Forest Estate that would constitute “a sustainable asset for the future Solomons’ state and people” (Bennett 2000, p. 182).

As the relatively small amount of crown land alienated early in the colonial period was insufficient for the purposes of the Forest Estate, the colonial government had to find ways to incorporate more land into the Estate. This was attempted through a variety of legislative vehicles, all of which proved to be deeply unpopular with Solomon Islanders, who inherently distrusted any form of land acquisition by the state in the name of the public good. At the same time, Solomon Islanders became increasingly aware of the possibility that they could sell their logs or timber rights directly to the loggers without having to turn their land over to the government. The desire for direct dealing became “a popular cause” on the eve of independence, one which was seized upon by then Chief Minister Peter Kenilorea, who introduced the necessary amendments to the Forest and Timber Act 1969. According to Bennett,

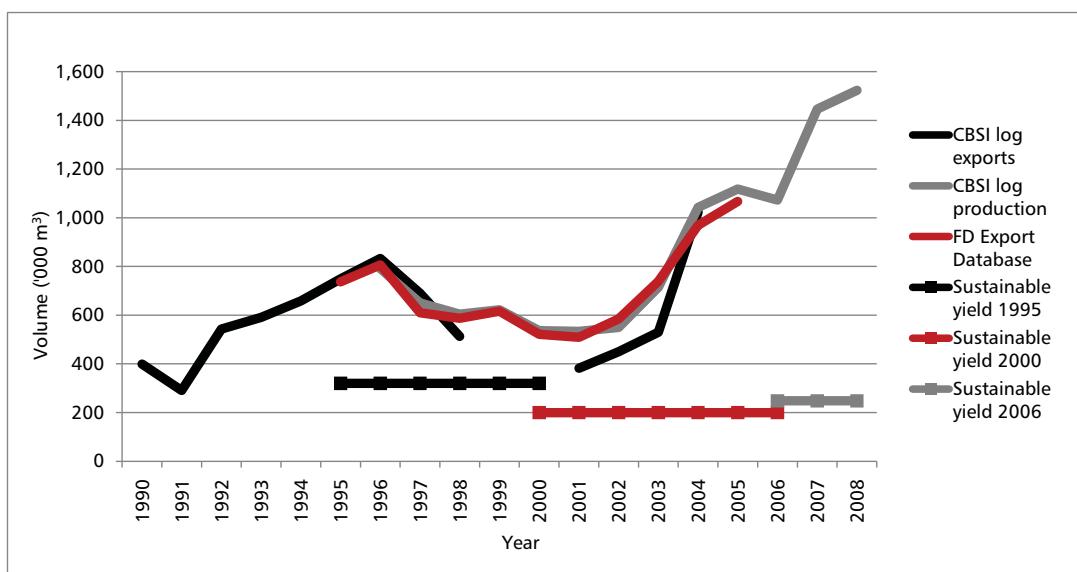
[t]he nascent independent government set the seal on the weakening of state control of forest use for the public good when it introduced this legislation in 1977. Unlike the departing colonial government, Peter Kenilorea and his supporters must have believed that the people of this new nation of villagers were indeed “a fit and proper people to make contracts” (2000, p. 185).

Hence commenced what Ian Frazer describes as the second of two distinct phases in the history of logging in Solomon Islands. The transition into the second phase was marked by (i) the shift of logging activities from government-owned to customary land, (ii) an expansion in both the geographical scope of logging activities and production levels, (iii) an increase in the number of companies licensed to operate (a fourfold increase between 1981 and 1983), (iv) a greatly reduced level of control over logging companies, and (v) the increased use of corrupt practices by the foreign companies entering the country during this period (Frazer 1997b, pp. 45–48). Timber production levels started to increase quite sharply from 1980 and have remained above estimated sustainable production levels in most years since then (Figures 12.3 and 12.4).

**Figure 12.3. Solomon Islands Annual Timber Production, 1963–1995 ('000 m<sup>3</sup>)** $m^3$  = cubic meter.

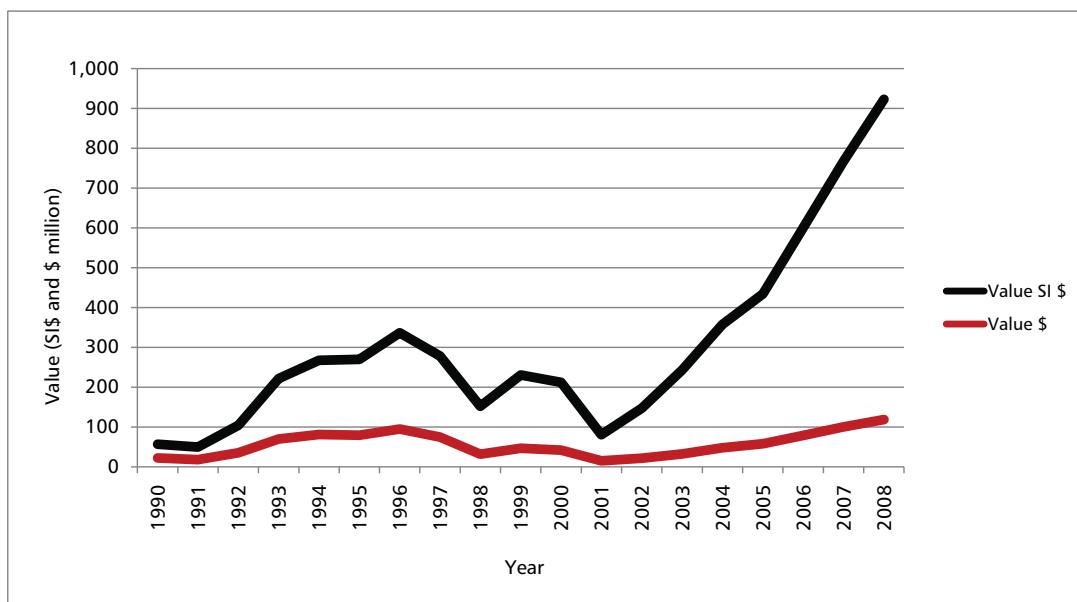
Notes: Frazer's data sources are as follows: Solomon Islands Statistics Office *Statistical Bulletins* 9/85, 15/88, 22/93; Central Bank of Solomon Islands *Annual Reports* 1993–1995; Solomon Islands Ministry of Natural Resources 1994.

Source: Frazer 1997b: 47

**Figure 12.4. Solomon Islands Log Production and Exports, 1990–2008 ('000 m<sup>3</sup>)** $m^3$  = cubic meter.

Notes: CBSI log export data are derived from the Customs Division via the National Statistics Office. According to an officer of the Economic Department of CBSI, the National Statistics Office did not report log export data for 1998 and 1999 and has not reported such since 2004 (D. Kiriau, personal communication, August 2009). CBSI log production data is derived from the Forestry Department and may include a very small volume of logs that are consumed domestically. The Forestry Department export database data was reported in URS (2006, p. 10). Sustainable yield estimates made in 1995, 2000, and 2006 are also reported in URS (2006).

Sources: CBSI *Quarterly Review* 15(1)/2003, 16(4)/2004, 17(1)/2005, 17(2)/2005, 20(1)/2008, 20(3)/2008, 21(1)/2009; Forestry Department Export Database; URS 2006.

**Figure 12.5: Value of Solomon Islands Log Exports, 1990–2008 (SI\$ and \$)**

SI\$ = Solomon Islands dollar, \$ = United States dollar.

Sources: Central Bank of Solomon Islands (CBSI) *Quarterly Review* 15(1)/2003, 16(4)/2004, 17(4)/2005, 20(3)/2008, 21(1)/2009.

### The Regulatory Environment: Law, Monitoring, and Enforcement

Another important development that occurred early in the post-colonial period was the passage of the North New Georgia Timber Corporation Act in 1979. This legislation built upon the direct dealings introduced by the 1977 legislation by enabling landowners to establish logging companies. The number of landowning companies involved in the logging industry has proliferated since the early 1990s when an export tax exemption was introduced for them. Landowning companies have generally contracted the services of foreign logging companies to carry out timber felling, transport, and marketing. By 2005, there were an estimated 24 foreign companies working under contractual agreements with 89 local companies or license holders (Kabutaulaka 2007, p. 252). In her detailed history of the Solomon Islands' forestry sector, Judith Bennett consistently describes the local logging companies as "fronts" for overseas contractors (see, for example, Bennett 2000, p. 333).

Importantly, the North New Georgia Timber Corporation Act further entrenched a distinction between land ownership and the ownership of timber rights that had been introduced with the passage of the 1977 amendment to the Forest and Timber Act. The latter act was amended in 1984 to become known as the Forest Resources and Timber Utilisation Act. However, neither that amendment nor subsequent amendments in 1990 and 1991 succeeded in clarifying "the relationship between landowning groups and persons entitled to grant timber rights" (Corrin 1992, p. 131). The act was amended again in 2000 to assign provincial executives the function of determining the ownership of timber rights. This was previously a function of area councils, which were abolished in 1997.

The 2000 amendment was also necessary because the Forest Act 1999, which had been introduced by the reformist Ulufa'alu government, was passed by Parliament and received royal assent, but was never gazetted and hence never became law. The 2005 OAG report notes that the significant number of licenses issued under the provisions of the Forest Act 1999 are technically illegal (OAG 2005, p. 61). Importantly, both the failed 1999 legislation and the more recently

drafted (but not enacted) Forest Bill 2004 contain provisions that would resolve the long-standing distinction under the forestry law between the ownership of land and the ownership of the timber rights. This distinction has been one the greatest weakness of Solomon Islands' forestry legislation. It has caused an excessive number of disputes within and between landowning groups, and has enabled individuals with "the most tenuous claims to become the principal beneficiaries of logging royalties" (Corrin 1992, p. 136). It is also very difficult for communities to challenge the timber rights process other than through costly court proceedings.

The failure to systematically revise the Forest Resources and Timber Utilisation Act has meant that the forestry sector has been governed by outdated colonial legislation originally designed to regulate logging activities on government land. This legislation has been patently inadequate for regulating the changed nature of logging activities since the early 1980s, particularly the expansion onto customary land and the advent of direct dealing (Bennett 2000; OAG 2005; Wairiu 2007). Observers have also remarked upon the difficulty of reading Solomon Islands' forestry legislation, contained as it is in a "crazy patchwork" of acts, amendments, and regulations (Bennett 2000, p. 240). According to Peter Dauvergne, writing in 1998, "[t]here are serious problems with the structure and content of forest legislation. No consolidated text exists and it is often quite difficult to uncover timber management rules" (Dauvergne 1998, p. 145). A raft of new regulations introduced in 2005 has further added to this legislative complexity.

Adding to these problems with the form and content of forestry law has been the weakness of monitoring and enforcement. This commenced with the chronic under-resourcing of the Forestry Division throughout the 1980s. Although the "bones of a timber control unit" had been in existence since 1980, successive governments failed to fund it adequately, and consequently the Forestry Division was brought to "near immobility as the regulator of forest use" (Bennett 2000, p. 253). This was at time when there was increasing evidence of transfer pricing, undervaluation of species, and the under-declaring of volumes—not to mention destructive and illegal logging practices. Bennett concluded that the failure of successive governments during the 1980s to provide adequate resources for timber control efforts pointed to a lack of "political will to control the forests, the loggers, and the landowners for the long-term interest of the nation" (Bennett 2000, p. 253).

The control of forestry activities became increasingly politicized during the 1990s and revolved around the Timber Control Unit (TCU) within the Forestry Division, supported by the Australian government. The TCU was established in 1993 to monitor log grades, species, volumes, and prices. It immediately began to document abuses by logging companies, raising the ire of the companies, some of which approached politicians about abolishing the unit (Bennett 2000, p. 340). The work of the TCU in 1993–1995 dramatically reduced transfer pricing margins and variations in reported export prices for the same species and grade, thereby increasing foreign exchange receipts and government revenue (Dauvergne 1998/9, p. 535, Bennett 2000, p. 347).

The TCU played an important role in implementing the reforms to the forestry sector that were introduced by former Prime Minister Francis Billy Hilly's National Coalition Partnership (NCP), which formed a government following the national election of mid-1993 (Dauvergne 1998/9, pp. 534–535; Bennett 2000, pp. 341–345). The NCP government increased log export duties and announced plans to introduce a ban on log exports in 1997. It also intensified control activities, including increased measures to verify the grades and species classifications of log exports and improved monitoring of timber export prices. The TCU was central to these new arrangements and also drafted a logging code of practice, which later formed part of broader revisions to forestry legislation also announced by Billy Hilly.

The return to power of Mamaloni following the fall of Billy Hilly's government in November 1994 marked the beginning of the end of the TCU. The new government immediately set about dismantling all of the reforms that had been introduced by NCP and shelved plans to engage a foreign firm to strengthen the surveillance of logging operations (Frazer 1997b, p. 66; Dauvergne 1998/9, p. 534; Bennett 2000, pp. 345–356). There were signs from early 1994 that Mamaloni had the TCU firmly in his sights. In January 1995, the Australian government announced that it would significantly cut aid to the Solomon Islands' forestry sector, as it had long threatened to do, which provided Mamaloni the opportunity he was looking for:

For Mamaloni, it provided the justification for the gutting of the TCU, the bête noir of those who spirited away illegal shipments, protected species, and undersized logs and who paid politicians and others bribes to look the other way (Bennett 2000, p. 354).

Australian government assistance to the forestry sector resumed following the national election of 1997, when Mamaloni lost power to the Solomon Islands Alliance for Change (SIAC) coalition headed by Bartholomew Ulufa'alu. However, the revived TCU has never been restored to its previous level of effectiveness and the long-standing problems of monitoring, surveillance, control, and enforcement persist (Wairiu 2007, p. 243). According to the 2005 OAG report, exporters were regularly failing to detail timber species and grades on export declaration forms, making it impossible for customs officers to check the accuracy of the determined values upon which export duty is paid (OAG 2005, p. 57). The report further noted that this problem was compounded by the lack of resources (fuel and boats) available for forestry officers to carry out inspections at log ponds (where 10% of logs are inspected) and at wharves during loading (where 100% of logs are inspected).

Documents obtained from the Forestry Department in August 2009 indicate that the unsatisfactory state of log export monitoring continues. The summary report of inspections carried out by the Operations Section for the first two quarters of 2009 states that of 262 declared export log shipments, only 79 log pond inspections and 21 wharf loading inspections were carried out, representing 30% and 8% of the total number of shipments, respectively. The report listed "fuel supply and other logistics" and "provision of staff accommodation" as factors constraining the ability of forestry officers to carry out the inspections.

Statements by an "anonymous logger" reported in a local newspaper article in May 2008 suggest that logging companies are continuing to exploit weaknesses in the monitoring and surveillance of log exports to misreport log species and grades, thereby avoiding export tax (*Solomon Times*, 26 May 2008). The logger also claimed that logging companies commonly bribe forestry officers with "money and beer" to accept their log export entries.

### 3. The Political Economy of the First Logging Boom

Solomon Islands' first logging boom, which culminated in 1996, was characterized by an increasingly close association between the executive arm of the state and both foreign- and locally owned logging companies. This was particularly the case with the governments of Solomon Mamaloni, who held power from 1981–1984, 1989–1993, and 1994–1997. Bennett describes how logging in the 1990s became "highly political" and went as far as describing the Mamaloni government of 1994–1997 as "the loggers' government" (Bennett 2000, pp. 339, 346).

The relationship between the logging industry and the state developed two main dimensions. The first was the direct involvement of politicians in the industry, particularly as

directors of landowning companies. The second was the use of bribes and inducements by foreign logging companies as a means of influencing government policy and circumventing or manipulating various aspects of the complex forestry procedures. Not only did this nexus between the state and the logging industry had a strong bearing on forest policy and actual forestry outcomes—steering both to the economic advantage of the loggers—it also directly contributed to the political instability that characterized the 1990s.

Of the three terms that Mamaloni served as Prime Minister, the middle one (1989–1993) was the only occasion when he came to office following a general election. Mamaloni was particularly adroit at manipulating the fluid, “unbounded” parliamentary politics that occur in the absence of strong political parties. Being “the darling of the loggers” (Bennett 2000, pp. 340–341) provided Mamaloni with access to resources with which to grease the wheels of parliamentary fluidity.

A case in point is the collapse of the reformist NCP government in late 1994 due to a spate of defections and resignations of cabinet members who were “lured by lucrative deals” (Dauvergne 1998/9:, p. 534). It was alleged that several Parliament members had defected from NCP after receiving bribes from Honiara businessman Robert Goh, who was acting as the go-between for the “logging lobby” (Bennett 2000, p. 341). These allegations formed the basis of formal charges and court proceedings against at least five former NCP cabinet members, the outcomes of which are unclear (Kabutaulaka 1997, p. 488, and 2000, p. 95; Bennett 2000, pp. 341, 465). There are countless other reports of bribes and inducements being paid or offered to politicians and public officials at all levels of government by logging companies during the 1990s (see, for example, Kabutaulaka 2000, p. 95).

The coming to power of Bartholomew Ulufa’alu’s SIAC government following the 1997 national election exacerbated the pressure on patronage politics caused by the collapse of log exports due to the Asian financial crisis. In response to declining government revenue and increasing public sector debt, the SIAC government, in collaboration with the Asian Development Bank, instituted a reform program described as a mix of “home-grown” and donor-inspired initiatives (Bennett 2000, pp. 360, 379–383).<sup>5</sup> The reforms “would have not only reduced the logging quota to a more sustainable level, but also would have seen much more regulation of the industry” (Bennett 2002, p. 10). They were met with stiff resistance from vested interests throughout the public service and from national Parliament members “who had done well out of the Mamaloni Government” (Gina 2003, p. 271, also see Hughes 2001). Set against this background, allegations that members of the parliamentary opposition, led by Mamaloni until his death in January 2000, were deliberately stirring up trouble on Guadalcanal to destabilize the reformist Ulufa’alu government are not entirely implausible, particularly as several attempts to remove the SIAC government through constitutional means had been unsuccessful.

During his 1990–1993 term, 11 of Mamaloni’s 15 cabinet ministers were directly linked to logging companies (Frazer 1997a, p. 329; Bennett 2000, pp. 340–341). Mamaloni was himself a director of a local logging company known as Somma, which operated in his home province of Makira. Somma was a major beneficiary of various tax exemptions, including export duties, which were introduced when Mamaloni regained power in late 1994 and set about comprehensively dismantling Billy Hilly’s forestry reform program. Somma is estimated to have profited by SI\$4.3 million in 1995 due to these exemptions (Bennett 2000, p. 346).

<sup>5</sup> The reforms included reducing the number of government ministries, downsizing the public service by 10%, and implementing significant reforms in the forestry sector including the drafting of a new forestry act and the establishment of a forestry board and a forestry trust.

## 4. The Political Economy of the Second Logging Boom

Solomon Islands' second logging boom, which has seen log export volumes reach an historic high of 1.5 million cubic meters ( $m^3$ ) in 2008, almost twice the previous peak of around 800,000  $m^3$  in 1996, has attracted much less attention from social scientists. However, a number of published sources, in conjunction with media reports, interviews conducted by the author, and anecdotal evidence, suggest that the basic political economy drivers that were documented during the 1990s continue and, in some cases, have intensified. Key decisions in relation to the forestry sector continue to be made by politicians who have direct interests in the logging industry, and politicians, Forestry Department officials, and landowners continue to be prone to the venal suasions of logging companies. This section focuses on two practices that between them are enabling logging companies to continue to capture much of the economic rent from logging: export tax exemptions and the undervaluing of log exports.

### Export Duty Exemptions

The 2005 OAG report documented fraud, corruption, mismanagement, and maladministration throughout the forestry sector. However, the report gives most attention to the issue of log export duty exemptions. It estimated that the revenue forgone from exemptions was around SI\$10 million in 2003 and SI\$30 million in 2004. The increase in the volume of logs exported under exemption between 2003 and 2004 was 163%.

The report documents a large number of deficiencies with the exemption system including

- the impossibility of verifying if the reforestation and local development projects for which exemptions are being awarded are actually being implemented;
- evidence that contracted logging companies are often failing to pass on the full amount of the exemption to landowning companies;
- evidence of various problems with the legally mandated functioning and composition of the committee responsible for granting exemptions;
- evidence that the former minister of finance was involved in a number of decisions relating to the granting of exemptions which amounted to conflicts of interest including, in one instance, a decision involving "his close relative" (OAG 2005, p. 2); and
- the possible illegality of the minister of finance entertaining appeals of the decisions of the Exemption Committee and subsequently granting exemptions or varying of the terms of exemptions granted (with around SI\$10 million of exemptions granted in this manner in 2004).

The OAG report does not analyze estimated returns on landowner's logging licenses under different types of contractual arrangements with foreign logging companies (such as that carried out by Price Waterhouse in 1995), nor is such an analysis undertaken here. However, in light of the ongoing prevalence of such contractual arrangements, particularly the "60/40 plus costs" arrangement, it is reasonable to assume that logging contractors are continuing to capture a significant proportion of the forgone tax revenue due to tax exemptions. Price Waterhouse concluded that

[t]he diversion of the economic rent to the logging contractors and away from the SI Government and the landowners (who had been the intended

beneficiaries of the tax exemption policy), raises fundamental questions about the efficacy of the present policy (Price Waterhouse 1995, p. 28).

### The Determined Value of Logs

It appears that the determined value of logs (DVL) schedule was introduced to minimize the loss of export tax revenue due to tax avoidance strategies such as transfer pricing and the underreporting of log prices. The DVL schedule determines the price upon which export duty is paid according to species, grade, and log size.<sup>6</sup> The 1995 Price Waterhouse report recommended the introduction of such a system, but with the important caveat that the determined value should be set under advice from an international log monitoring and price advisory service (Price Waterhouse 1995, p. xiii). Under the Customs and Excise Act, the comptroller of customs and excise is responsible for setting the DVL on advice from the Forestry Department, while the finance minister is responsible for determining the level of export duties. In practice, however, the DVL has been set by the finance minister and/or the forestry minister. OAG is of the opinion that these ministerial interventions "appear to be contrary to the intentions of the Customs and Excise Act" (OAG 2005, p. 56).<sup>7</sup>

The DVL system is predicated on the assumption that the determined value will be an accurate reflection of international market prices for logs. If not, the government forgoes export tax revenue and this proportion of the economic rent is directly captured by logging companies. The recent history of the DVL schedule is described in an extraordinary section of the CBSI's March 2008 *Quarterly Review* (CBSI 2008a, pp. 17–18). The DVL schedule was not updated between 2003 and 2006 despite the significant increase in international log prices during this period. In late 2006, the Solomon Islands Government proposed an updated schedule based on international log prices in mid-2006. However, the introduction of the new schedule was delayed until March 2007 and then until October 2007, and an interim schedule that contained lower DVL values was employed in its place. The interim schedule was still being used at the end of 2007. Based on movements in international market prices, CBSI conservatively estimated that lost government revenue in 2007 due to the failure to implement a reasonable DVL schedule was SI\$80 million.

In 2008, there was a concerted campaign by civil society groups, in particular Transparency Solomon Islands (TSI), targeting the government's ongoing failure to update the DVL schedule. In an April 2008 press statement, TSI estimated that the government was forgoing SI\$1 million to SI\$2 million a week in export duty revenue due to the undervaluing of log exports (*Solomon Times*, 11 April 2008). The government responded by announcing a two-step increase in the average DVL, first from 71 US dollars (\$) to \$78 per m<sup>3</sup> on 1 May, and then to \$85 on 1 June. It appears that both of these schedules were implemented, but that the government, under pressure from the logging industry, subsequently dropped the average DVL to \$79 per m<sup>3</sup>, where it remained until it was reduced again to \$76.32 in the latest schedule, dated 30 April 2009.<sup>8</sup>

<sup>6</sup> For most species the duty rate is 25%, rising to 40% for a few of the highest-quality species (CBSI 2008a, p. 17).

<sup>7</sup> The most recent DVL schedule at the time of writing, dated 30 April 2009, which reduced the average DVL for logs from \$79 to \$76.32 per m<sup>3</sup>, was signed by Gordon Darcy Lilo in his capacity as acting finance and treasury minister. Lilo is said to hold direct interests in local logging companies (personal communication from anonymous sources) and it has recently been alleged that his political party, the Grassroot Network Party, receives funding from foreign logging companies (*Solomon Star*, 8 October 2009).

<sup>8</sup> The latest reduction could perhaps be justified by recent downward movements in international log prices. However, although international prices fell significantly in the second (June) quarter of 2009 (by 9.3% according to World Bank price data), they only fell by 0.7% in the first quarter. This is not commensurate with the reduction in the average DVL of around 3.4% that was made in April 2009.

Interestingly, the types of threats being made by the logging industry in response to the 2008 increases in the DVL schedule were very similar to those made, and in some cases carried out, during the 1990s in response to the forestry sector reforms introduced by the Billy Hilly government. For example, in August 1994 logging companies began to stockpile logs in protest over the government's decision to increase the log export duty (Bennett 2000, p. 34). This put immense strain on revenue at a time when the government was under pressure to increase public sector wages. The export duty was reduced as part of Mamaloni's dismantling of Billy Hilly's reforms following the collapse of the latter's government in November 2004 and Mamaloni's subsequent return to power. The reduction of the log export duty "immediately released the 'log jam' imposed by the companies" (Bennett 2000, p. 346).

Logging companies, through their representative body the Solomon Islands Forest Association, threatened to stockpile logs in response to the decision to raise the DVL in 2008 (*Solomon Times*, 21 May 2009). They also threatened "mass redundancies." Given the government's dependence on revenue from log export duties and the importance of the industry in providing employment, it is reasonable to assume that such threats would carry significant weight. More importantly, the recent history of the DVL system demonstrates the extent to which decision making in relation to the forestry sector remains highly politicized and continues to enable logging companies to capture a large proportion of the economic rent from logging. In the words of the auditor-general, writing in relation to the setting of the DVL, "political interference appeared to have occurred where these prices are deemed unacceptable" (OAG 2005, p. 55).

## 5. Explaining the Political Economy of Logging in Solomon Islands

Clearly, there are aspects of the political economy of the forestry sector in Solomon Islands that are best understood in terms of rational actor models of economic behavior. For their part, the logging companies have sought to maximize their profits in the context of the regulatory environment established and enforced by the state and its institutions. Particular policy settings have provided incentives for the companies to behave in particular ways. The most important example of this is how companies have responded to successive governments' policies in relation to the export tax and exemptions. The tax regime itself has encouraged logging companies to engage in tax avoidance strategies.

These practices have been abetted by the ineffectiveness of monitoring and enforcement activities and the susceptibility of forestry officers to bribes and inducements. In more recent years, it has been rational for the forestry industry to use whatever influence it can to ensure that the determined value of logs is kept as low as possible. It has also been rational for foreign logging contractors to enter into contractual arrangements with landowning companies that enable the former to capture a significant proportion of the export tax exemptions that are intended to benefit the latter.

Politicians and government officials have also behaved in economically rational ways. Some politicians have had financial interests in local logging companies and directly benefited from policies that they implemented, such as those involving export tax exemptions for landowning companies. There is also substantial evidence suggesting that politicians, government officials, and landowners have benefited from the proceeds of corruption offered by the foreign logging companies.

However, economic logic alone cannot explain the political economy of the Solomon Islands' logging industry. In line with a growing body of literature on the social embeddedness of economic and political behavior in Melanesia and elsewhere,<sup>9</sup> it is necessary to consider the influence of social and cultural logic, in addition to economic logic, on the behaviors of elected representatives, government officials, and landowners. This approach is consistent with the gradual convergence between proponents of the "new institutional economics" on the one hand and the "new economic sociology" on the other. This convergence is discussed by Bruce Harris in the context of the analytical framework employed in his recent political economy analysis of PNG conducted for the World Bank (Harris 2007). In a footnote to the section in question Harris states,

... the two schools have been gradually converging, and there are few who would resist the argument that economic activity is grounded in a social matrix and is conditioned by social processes and understandings. The role of social networks and cultural understandings is now well recognized as critical in understanding why and how people behave, even in ostensibly economic spheres (Harris 2007, p. 9).

Reviewing literature on the relationships between local political cultures and the formal state in Melanesia, much of which is concerned with PNG, political scientist and historian Michael Morgan concludes that "pre-existing social forms pervade the state at almost every level" (2005, p. 4). For this reason, Morgan eschews political science's conventional preoccupation with the role of formal state institutions in governing political behavior, in favor of an approach that places political culture at the center of the analysis. His approach is summarized as follows:

In this paper, the state, its formal institutions and actors take centre stage, but my intention is to contextualise them within their cultural settings, to move away from the "excessive emphasis" on institutions. Drawing upon select anthropological and political science theory, political culture may be defined loosely as the sets of actions and values that define and guide political behaviour (Morgan 2005, p. 3).

There is a considerable body of literature, mostly from PNG, supporting the proposition that the leadership style and behavior of contemporary Melanesian politicians, particularly Parliament members, strongly resonates with the style and practice of traditional "big man" leadership (Rynkiewich 2000; Standish 2002; Ketan 2004; Morgan 2005; McLeod 2008). Rynkiewich, for example, states that "elected politicians usually develop a big-man like base and are expected to behave like big-men" (2000, pp. 25–26); and McLeod argues that "Melanesian leaders... are renowned for employing *big man* tactics while holding formal office (particularly the dispersing of wealth to immediate followers)" (McLeod 2008, p. 8).<sup>10</sup>

Importantly, it is the expectations of followers and supporters that "motor the political economies of resource distribution" (Morgan 2005, p. 5). According to McLeod,

... the voting public perpetuate big man politics by supporting those who promise immediate material gains and re-electing only those who deliver on such promises, hence mirroring the ways in which traditional big men garner, maintain and lose support [original italicization] (2008, p. 8).

<sup>9</sup> For an overview of the international literature, see Zukin and DiMaggio (1990); and in the particular case of PNG, see Curry (2003).

<sup>10</sup> McLeod, in fact, argues that "indigenous leaders and notions of leadership permeate state institutions" in Melanesia (2008, p. 8).

Once in office, Parliament members tend to use whatever resources they can access to repay their debts, reward their supporters, and shore up support in their voter strongholds to ensure the best possible chance of reelection. While all Parliament members in PNG and Solomon Islands have access to constituency development funds, joining the executive provides further opportunities to access resources for distribution, and becoming a minister affords the best possible opportunities of all. According to Sinclair Dinnen, writing in relation to PNG, “[g]overnment ministers [use] their official powers to appropriate entire national policies or divert public resources to their own personal agendas” (cited in Morgan 2004, p. 4).

Closely related to the evident influence of traditional big-man politics in the modern political sphere is the issue of *wantokism*: “a key cultural practice impacting upon the performance of indigenous leaders in Melanesia” (McLeod 2008, p. 8). Literally meaning “one talk” in Tok Pisin (i.e., someone of the same language group), *wantokism* is often perceived by outsiders as nepotism and cronyism. While not denying the presence of these practices in Melanesia, recent scholarship emphasizes the social and cultural basis of the system, highlighting its role in driving reciprocity and social obligation—and ultimately, social cohesion and corporate identity (Morgan 2005; Morgan and Mcleod 2006; McLeod 2008).

These scholars also emphasize the “very real” sanctions that are enforced if one fails to meet one’s social obligations to *wantoks*, noting that fear of such sanctions “does not disappear upon assuming office in either politics or the public service, rendering many decisions made in institutional settings captive to the system” (McLeod 2008, p. 8; also see Morgan 2005). Morgan argues that while the dynamics of obligation and reciprocity vary in intensity across different parts of Melanesia, they nevertheless “offer a salutary reminder that Melanesian MPs [members of Parliament], like all Melanesians, are enmeshed in networks of social and financial obligation, and that this often influences their actions as elected representatives” (Morgan 2005, p. 5).

Judith Bennett and Tarcisius Tara Kabutaulaka, both of whom have conducted extensive research on the forestry sector in Solomon Islands, argue that the big-man style of politics and leadership and the underlying social norms of reciprocity and obligation have interacted with foreign capital and Asian business practices to shape the political economy of the Solomon Islands’ logging industry (Bennett 2000; Kabutaulaka 2000, 2006). According to Bennett,

[p]oliticians are particularly vulnerable to pressure from constituents who want their way and from interests that can pay to have their way or assist a politician to retain support. Politicians become receivers and distributors in a reciprocity network, like big men of old, but with an overlay of patronage emanating primarily from exogenous opportunities (2000, p. 248).

Similar processes are also at play at the local level, influencing the ways in which communities and individual landowners interact with foreign logging companies. This is demonstrated by Kabutaulaka:

... some of the money from logging is often used for traditional social obligations, or for individuals to establish themselves as big-men... the money has been used to lubricate social relations and fulfil traditional obligations (Kabutaulaka 2006, pp. 253–254; also see Bennett 2000, p. 333, and Wairiu 2007, p. 241).

## 6. Political Economy and Donor Policy

In the forgoing section, it was argued that the particular political economy of the logging industry in Solomon Islands has not been driven only by the greed of the companies, politicians, and landowners who are involved in it. Traditional cultural and social practices compel politicians, public officials, and local big men to access resources for distribution to their *wantoks* and, in the case of politicians, to their political support bases, both in Parliament and in their constituencies. These logics compel politicians to join the Executive at all costs and to make policy decisions that benefit their own commercial interests in the logging industry, as well as those of their *wantoks*. Social and cultural logic also renders politicians, public officials, and landowners particularly prone to corruption. In the absence of strong political parties, bribes and inducements from foreign companies have been used to grease the wheels of parliamentary fluidity by astute politicians, who in turn have rewarded their Asian patrons with favorable policy decisions.

There has been no shortage of expert advice about forestry sector reform offered to the Solomon Islands' policy makers over the past 20 years or so. It has been the lack of political will, as opposed to a lack of knowledge and advice, that has allowed unsustainable harvesting rates, destructive logging practices, the appropriation of timber rights, tax avoidance, and the capturing of much of the economic rent from the forests by foreign logging companies. One aspect of the lack of political will relates to the chronic instability of the Executive, which is inimical to the type of long-term policy goals that are required for good forestry management. Parliamentary fluidity has also enabled commercial interests to influence the formation of the Executive.

In PNG, the desire to strengthen political parties and stabilize the executive arm of government led to the introduction of the so-called Integrity Law, formally known as the Organic Law on the Integrity of Political Parties and Candidates (OLIPPAC) in 2001. The introduction of similar legislation is being considered in Solomon Islands. The literature is divided about the impact of OLIPPAC in PNG. However, notwithstanding the fact that it appears to have contributed to the Somare government of 2002–2007 surviving a full term in office—the first government to have done so since independence—most scholars believe that the law has had little impact, particularly in terms of changing the underlying political culture that drives party weakness and executive instability.<sup>11</sup>

The success of institutional strengthening and electoral engineering initiatives in PNG, such as the OLIPPAC and the introduction of limited preferential voting, will be constrained by their limited potential to change the underlying political culture that drives patronage politics. The same can be said of the likely success of such initiatives in Solomon Islands. There is a growing consensus among academics, policy makers, and donors that institutional strengthening measures must be accompanied by efforts to strengthen civil society and generate grassroots demand for good governance, and that both supply- and demand-side interventions are required in the quest for improved governance outcomes, not only in Melanesia and other parts of the Pacific, but in developing country contexts more broadly (Malena et al. 2004; AusAID 2006a, 2006b; Harris 2007; Haley 2008).

In his political economy analysis of PNG, Harris argues that the behavior of national politicians will change only in response to a change in expectations at the local level. He suggests the

<sup>11</sup> See Morgan (2005), Gelu (2005), Standish (2007), and Fraenkel et al. (2008), all of whom broadly share the opinion that the success of OLIPPAC has been mixed at best. Reilly (2006) is more sanguine about the impacts of the integrity law. In a recent assessment, Standish (2007, p. 148) concludes “[w]hether OLIPPAC will be able to fundamentally shift existing patterns of political behaviour and create a genuinely strong political base for continuity in executive government remains to be seen, but on present indications that seems unlikely.”

“promotion of mechanisms and processes by which legitimacy is gradually transferred from primarily local to broadly based trans-local and, eventually, regional and even national groups” (Harris 2007, p. 47). Harris points to the emergence of a range of civil society groups, including churches, across PNG as demonstrative of “integrative local level processes... deepening links across local groups that, in turn, lead to an extension of legitimacy beyond the clan or village to larger social aggregations” (2007, p. 48).

The emergence of such groups in PNG and Solomon Islands, along with their composition, functioning, and relationships with both formal state institutions and non-state actors, have been the subject of incipient scholarly interest (see Hegarty 2009). However, there is currently a dearth of fine-grained analytical work examining the internal dynamics of these emerging civil society groups, the reasons for their apparent success or failure, and their geographical variation. Such analysis could be supported by donors. Important lines of inquiry revolve around the questions of how and why some civil society groups have been able to forge wider linkages that transcend clan and tribal boundaries and rivalries, and the extent to which these successes could be replicated elsewhere.

It is important to acknowledge the limitations of efforts to generate grassroots demand for good governance. As has been argued above, the behavior of Parliament members and government officials is significantly determined by the social and cultural contexts in which they and their wantoks are embedded. History suggests that cultural change is a slow and nonlinear process that is entangled in broader processes of state and nation building. In a recent article on local governance in Melanesia, David Hegarty poses two salient questions: Are the various civil society groups that are emerging evidence of the types of “political and policy processes” that will lead to “deepening democracy” and a greater sense of nationhood? Or are these processes likely to be thwarted by the “long-known antipathy to the State of Melanesia’s small-scale, acephalous segmentary societies, together with the difficulty they have in combining/coalescing for collective action?” (Hegarty 2009, p. 112). His conclusion is that there is as yet no consensus on these questions among scholars working on the issues of state and nation building in Melanesia.

Importantly, however, efforts to generate demand for good governance would have the potential to positively influence the political economy of extractive resource industries, regardless of the type of resource in question. This is significant in the case of Solomon Islands because the nature of rent-seeking opportunities will change with the predicted shift in the export base from logging to mining. A possible scenario is that Parliament members will seek to maintain their patronage networks by diverting state revenue from mining, particularly windfall revenues if and when they occur, into constituency development funds and programs over which they have significant control.

This has occurred in PNG where the District Services Improvement Program appropriation has increased substantially in recent years, from 400,000 kina (K) per district in 2006 to K4 million in 2007, K6 million in 2008, and K4 million in the 2009 national budget (see Allen 2009, pp. 35–36). The 89 open-seat Parliament members have considerable *de jure* and *de facto* control over these funds and frequently divert them toward patronage and pork barrelling. The increase in allocations has been funded from windfall revenues derived from the minerals and petroleum sectors, a result of high commodity prices in recent years. Interventions aimed at changing voter expectations of politicians can potentially reduce the subversion of state resources into patronage politics regardless of the precise nature of the rent seeking involved.

For the relatively short period of time that remains before the predicted exhaustion of Solomon Islands’ natural forest resource at the end of 2015, donors can continue to advocate for the adoption of the well-documented reforms required to improve the governance of the forestry sector.

Donors can also support the advocacy work of local groups such as Transparency Solomon Islands. Another potential role for donors lies in assisting landowners to realize and enforce their rights in the timber rights determination process. Technical and policy advice will also be required for the establishment of plantation forestry, which holds significant potential, particularly at the village level (URS 2006), and to exploit emerging global carbon market-related opportunities such as Reduced Emissions from Deforestation and Degradation.

## 7. Conclusion

The forests that have provided the bulk of Solomon Islands' export revenue since the early 1990s are rapidly approaching depletion. While "exhaustion estimates" have been inaccurate in the past, it seems certain that the resource will collapse sooner rather than later. The history of the forestry sector since the country's independence in 1978 has been a woeful tale of corruption, greed, profligacy, patronage, tax avoidance, maladministration, incompetence, and environmental destruction. The state has forgone hundreds of millions of Solomon Island dollars in potential revenue due to tax exemptions and the undervaluation and miscategorization of log exports.

While some politicians, public officials, and landowners have benefited from royalties, profits, and bribes and inducements, it is the foreign-owned logging companies that have consistently captured the bulk of the economic rent from forest resources. They have achieved this through a range of tax avoidance practices (including, in recent years, lobbying the government to keep the determined value of logs unreasonably low) and through the nature of their contracts with landowning companies. It has been demonstrated that many of the well-documented political economy factors that characterized the logging industry during the first logging boom of the 1990s have continued and, in some cases, have intensified during the current boom.

It has been argued that the political economy of logging in Solomon Islands is best understood with reference to social and cultural influences—as well as economic influences—on the behavior of elected representatives, government officials, and village big men. These people, like all Melanesians, are enmeshed in networks of obligation and reciprocity that compel them to access and distribute resources, and the logging industry has afforded significant opportunity for such patronage. The indigenous political culture has been overlain with the distinctive business culture of the Asian loggers and has proven to be highly susceptible to the latter's venal suasions. This political economy framework explains the ongoing lack of political will for meaningful legislative reform of the forestry sector, and goes a considerable way toward explaining the chronic instability that has characterized politics in Solomon Islands since its independence in 1978.

In addition to continuing to advocate for forestry sector reform and for institutional strengthening initiatives aimed at improving political stability and representation, donors could focus their efforts on initiatives with the potential to change the underlying expectations that drive patronage politics. This is no easy task, and the first steps lie in conducting rigorous analytical work to better understand the various civil society groups and the "integrative local level processes" that have been emerging in Solomon Islands and other parts of Melanesia. Efforts to generate grassroots demand for better governance can potentially reduce patronage-driven rent seeking, regardless of the resource being exploited. This will be important as the Solomon Islands' export base shifts from logging to mining over the next decade or so.

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# 13 The Atrophied State

## A Supply-Side Perspective on Politician “Slush Funds” in Western Melanesia<sup>1</sup>

by *Jon Fraenkel*

### ABSTRACT

Characteristics of Western Melanesian politics—such as the absence of robust political parties, fluid factional allegiances, frequent changes of government, and high levels of incumbent turnover—cannot be explained by reference to constituency-level “clientelist rent-seeking.” Politician “slush funds” in Papua New Guinea and Solomon Islands have been identified as evidence for such clientelist perspectives. However, this paper demonstrates historically that fluctuations of politician-allocated government expenditures bore little relation to the electoral cycle, but were instead driven by the exigencies of holding together fractious governing coalitions. Schemes depended on the availability of windfall gains from aid or natural resource-intensive industries. Vanuatu resisted pressures to inflate slush funds owing to lack of similar windfall earnings, although it, too, has witnessed frequent changes of government, fluid parliamentary allegiances, and characteristic Melanesian “big-man” styles of politics. Difficulties of building effective states in capital-poor countries with a heavy reliance on subsistence agriculture and a narrow tax base encourage a broader personalization of state finances in the region, including use of slush funds. Yet this drains away funds necessary to strengthen state service delivery and threatens a self-reinforcing atrophy of Western Melanesian states.

### 1. Introduction

Funds allocated to politicians for spending in their constituencies have increased markedly in Western Melanesia over the past decade. Rural Constituency Development Funds in Solomon Islands, the allocation for members of Parliament (MPs) in Vanuatu, and in Papua New Guinea (PNG), the district support grants and funds disbursed under Prime Minister Sir Michael Somare’s District Services Improvement Programme have become major political issues and figure prominently in civil society criticism of alleged parliamentary “corruption.” For some, these slush

<sup>1</sup> I am indebted to Kathy Whimp, Peter Coventry, Anita Jowitt, Ralph Regenvanu, and Derek Brien for their assistance in sourcing data for Papua New Guinea (PNG), Solomon Islands, and Vanuatu. I am also indebted to Hank Nelson, Bill Standish, and Ron Duncan for their comments on an earlier version of this paper. The term “slush funds” is used in the title of this paper following customary use to describe such funds, which commenced in the PNG Finance Department (see Dorney 1990 [2000], p. 270).

funds are indicative of an emerging clientelist order in which politicians plunder state resources for delivery to rent-seeking constituents (Australian Agency for International Development [AusAID] 2006, pp. 95–96; Duncan and Nakagawa 2007, pp. 10–13; Kurer 2007).<sup>2</sup> For others, funds controlled by MPs potentially offer a more effective and accountable mechanism for the delivery of services to rural areas, replacing ossified, post-colonial, state bureaucracies (Brigg 2009; Fukuyama 2008). Both perspectives imply rural, rather than parliamentary or cabinet level, driving forces behind the proliferation of MP-controlled funds—a viewpoint queried in this paper. Despite the topicality of the issue within the region, no study has been undertaken into the emergence, development, and fluctuations of Melanesian MP discretionary spending aimed at testing these various hypotheses.<sup>3</sup> This study aims to fill the gap.

What are called in this paper “politician-allocated expenditures” (PAEs) are funds granted to MPs, whether for local infrastructure projects (roads, schools, clinics, etc.); for cultivating allegiances or ongoing solidarity (e.g., through selective payment of school fees, medical costs, or handouts of farm implements or outboard motors); or, more controversially, for MPs’ personal purposes (e.g., spending in urban bars or casinos). In theory, politicians are required to comply with public finance regulations and often to acquit funds, but in practice the only effective sanction against use for narrowly personal purposes is the general election held every 4 or 5 years, at which over one-half of incumbents usually lose their seats. There have, however, been efforts to hold MPs accountable for such spending, either through the creation of local government controls or through supervision of “corrupt” use of PAEs by national agencies such as the auditor general, ombudsman, or Leadership Code Commission. In other cases, MPs have themselves sought greater scrutiny—for example, through publication of annual PAE allocation reports or setting up constituency-level monitoring or project proposal vetting agencies.<sup>4</sup> However, these responses carry the risk of formalization and systemization of PAEs in ways that may encourage a personalization of the state.

Information on PAE funding is often difficult to establish accurately. Publicly announced figures for amounts per MP may differ from budgetary provisions, and budgeted PAE allocations may be scattered under different headings but aggregated in media reports. Allocated and actual expenditures may differ, particularly in the earlier stages of PAE schemes before local project proposal mechanisms are in place. These forms of spending belong to a gray area of government finance, where incentives exist for concealment, underreporting, or retrospective adjustment. Budgetary records are often incomplete or grossly inaccurate, and central bank or statistical agency records of public spending, where they exist, are often confined to general headings. Strictly speaking, PAEs might be defined as public expenditure at the discretion of the individual legislator; however, the distinction between discretionary and nondiscretionary funds is often a hazy one, and there may be a nominal civil service or ministerial signing-off processes. Putatively nondiscretionary allocations can come under the *de facto* control of MPs, particularly if local organizations entrusted with their administration prove to be incompetent, unable to meet regularly, or amenable to MP pressure. Funds may also not be recorded in government budgets if donors or other benefactors (such as logging companies or casino operators) make them available directly to politicians, without going through normal financing channels. Ad hoc funds used by prime ministers ahead of elections

<sup>2</sup> Such perspectives have been influenced by the arguments raised in Keefer and Vlaicu (2007).

<sup>3</sup> Ketan (2007) gives an account of political problems associated with discretionary funding in PNG, but does not explore the reasons for their introduction or fluctuations across Melanesia.

<sup>4</sup> See, for example, Fred Fono (2007), MP for Central Kwara’e (Malaita) in Solomon Islands. See also the activities of former Vanuatu speaker, George Wells, discussed in section 5.

or threatened “no confidence” motions may, afterwards, be carefully concealed in the retrospective budget “actuals” and/or initially reallocated from underspent parts of the budget.<sup>5</sup>

This paper examines explicit state budgetary provisions or dedicated PAEs identified as such by legislatures, not other projects that may require the MP to sign off before funds are released or state expenditure diverted to MPs through informal channels (although these are occasionally identified in the historical narratives below). That said, a core part of the argument in this paper is that dedicated PAEs are but one high-profile element of a much more pervasive personalization of the management of state finances in Western Melanesia. Section 2 examines the arguments for and against PAE schemes and whether such schemes inevitably undermine the building of effective states. Sections 3 to 5 examine the use of PAEs in PNG, Solomon Islands, and Vanuatu. Section 6 situates PAEs in a broader discussion about the character of post-colonial Melanesian states, looks at their impact on incumbent MP turnover rates, examines the degree of their synchronization with the electoral cycle, and assesses the dangers associated with dispensing windfall gains from aid or natural resource-extractive industries through electoral patronage.

## 2. The Cases for and against Parliament Member Constituency Funding

There exists considerable debate about the pros and cons of the use of state funds for MP constituency spending within PNG, Solomon Islands, and Vanuatu. Participants in local branches of the anticorruption agency Transparency International and in other civil society organizations often unequivocally condemn PAEs as tantamount to legalized corruption, entailing the syphoning of state resources either for individual pecuniary gain or to cement patronage-based relationships (Transparency International 2003; Pelto 2007, p. 61; Ketan 2007, p. 13). In defense of such schemes, Melanesian politicians regularly point to the intensity of demands by constituents for personal favors from their elected representatives, and to the large costs incurred by elected MPs (the complaint is often heard that the MP is considered akin to an automatic teller machine). Although embezzlement and poor use of such funds are widely acknowledged, indigenous commentators tend to highlight numerous examples of sensible use of funds in otherwise impoverished local communities. Whereas government officials are in no way reliant on rural villagers for continued employment, the constituency MP is obliged to act in a more responsive, and generous, fashion for fear of losing his or her seat in Parliament. Allocating funds through the local MP is also claimed to be a more effective vehicle for local service delivery than the centralized bureaucracies of national governments, which tend to exhaust most of their budgets on paying urban wages and salaries and lack capacity to extend services to many rural areas. The rise in PAEs is thus viewed as a response to years of centralized neglect, dilapidated rural infrastructure, and inadequate provision of health and education services. Conversely, within the public sector, PAEs are often blamed for reinforcing the poverty of government service delivery by draining away funds needed to pay teachers and health professionals.<sup>6</sup>

<sup>5</sup> For example, expenditures coming under the vote for the Prime Minister’s office might be listed as “transport,” with actual expenditure exceeding budgetary provisions and funds transferred from other budgetary headings to make up the shortfall.

<sup>6</sup> Speech by Gairo Onagi, vice chancellor, University of Goroka, to The Australian National University (ANU) Crawford School of Economics and Government PNG Update, 4 May 2009. In this respect, there are some differences between the three countries. In Solomon Islands, PAEs are often seen as complementary to public sector service delivery, rather than as an alternative. MPs avoid “wasting” funds by duplicating services believed to be the responsibility of the central government and instead focus on filling gaps not covered in the normal government budget.

Growth of PAEs may be damaging for both nation- and state-building processes: legislative and executive functions become fused, scarce government revenues are diverted, and central planning is undermined. As Axline (1986, p. 37) noted, “[t]he involvement of parliamentarians in the distribution of public funds reflects the lack of separation between the roles of policy formulation and policy implementation in the developing political system of Papua New Guinea.” Of course, there are dangers associated with an insistence on the “separation of powers,” drawing on an idealized perception of the European experience from the 17th and 18th centuries onward (Raadschelders and Rutgers 1996). Even for capital-rich Europe, use of personalized patronage or brokerage at times has generated important links between weak states and remote populations (Namier 1929 [1970], pp. 70, 161; Blockman 1988, p. 126). Yet, these were informal processes, not legalized provisions, and they accompanied a gradual strengthening of state bureaucracies in response to war and peacetime social pressures (Tilly 1990, p. 101–102).

For the capital-poor, post-colonial Western Melanesian states, pressures generating efficient bureaucracy were weaker, and the longer-run dangers were greater. Windfall gains associated with external economic or political engagements (entailing aid or natural resource-related inflows) were instead disbursed in accordance with electoral or parliamentary pressures in contexts where little revenue could be raised from largely rural and subsistence-oriented populations. Personalization of state spending might, for this reason, be seen as generating stagnation or deterioration of government service delivery rather than being a response to weak bureaucracy. While recurrent spending comprises largely running costs of the ministries (mainly wages and salaries) or grants to local governments or state-owned enterprises, sizeable parts of the development budget are diverted to MP funding, diminishing scope for investment in state infrastructure or capital works.<sup>7</sup> The result is an atrophied state, deprived of capacity to facilitate national development.

Apart from concerns about the quality of service delivery or the impact on the central state, debate also centers on the political uses of PAE spending. Proposals to increase PAE allocations are regularly pressed by government backbenchers implicitly or explicitly threatening to club together with opposition MPs to back “no confidence” votes (as a kind of political blackmail), or are used by governments to acquire leverage to have legislation passed (Jowitt 2007, p. 606; Ketan 2007, p. 7). Beleaguered prime ministers feel obliged to respond by granting additional funds or sinecures, whether through budgeted PAEs or informal payments, or by expanding the number of ministerial portfolios to provide lucrative jobs for loyal MPs. In theory, PAEs are available to MPs in general; in practice, politically convenient ministerial logjams or biased acquittal processes have been used to prevent payments to opposition MPs.<sup>8</sup> In this way, PAEs can become primarily a means of holding together fractious governing coalitions, even if the courts find—as has occurred in PNG—that legal payments must also be made to opposition members.<sup>9</sup>

At the constituency level, PAEs are regularly distributed to favored communities rather than through provision of generalized benefits. As Ketan (2004, p. 254) writes of the PNG Highlands, “it is only natural that MPs and MPAs [members of provincial assemblies] concentrate their efforts on base vote areas, for instance, by allocating resources such as the Electoral Development Fund to a

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<sup>7</sup> In 2009, for example, over 40% of the Solomon Islands and around 17% of the PNG development budget was allocated to MP discretionary funding. A significant share of the remainder, in both cases, entailed donor-funded projects routed through government accounts.

<sup>8</sup> In PNG in the early 1980s, for example, no particular bias could be discerned in the distribution of state funds to MPs (see Hegarty 1983). By the late 1990s, however, the distribution had changed dramatically toward favoring pro-government MPs (see Ketan 2007, p. 10; Standish 2000, p. 12).

<sup>9</sup> *The National*. 1999a. Court Orders Govt to Pay Slush Funds. 30 June; and Ketan (2007, pp. 10–11).

single area rather than the whole electorate as intended.” If so, PAEs may become an instrument of factional struggle and thus increase the potential for conflict. Reilly, for example, sees MP-controlled government spending as exacerbating divisions in an already highly heterogeneous setting:

These “slush funds” can be seen as a unique PNG adaptation of the usual budget expenditure of governments which reinforces both exchange links and a strong focus on the needs of the constituency. But as an efficient mechanism of government fiscal policy they are a questionable instrument.... The provision of such direct funding has more often served to reinforce fractionalisation at the electorate level, as funding is widely expected to be “payola” from the winning candidate to reward and reinforce clan support (Reilly 1996, pp. 68–69).

Similarly, Stewart and Strathern warn of inherently divisive repercussions of PNG’s fiscal empowering of the big-man MPs, and likewise assume that rural community expectations are driving the disbursal of slush funds:

The individual MP has become a “super big-man,” creating a level of politics that has eclipsed and/or swallowed other modes of local political activity. But since there are always losers, there is a further built in tendency for factionalism and hostility. This form of democracy does not, then, conduce to local stability. Instead, it increases local tensions. The patronage involved is also intensely local and does not form an easy basis for the development of national-level identities and loyalties (Stewart and Strathern 1998, p. 134).

As with the issue of service delivery, these kinds of statements raise significant “cause and effect” questions. Is it conversely the absence of robust national identities that encourages the focus on local patronage? Is intense local conflict in the PNG Highlands the result of selective MP patronage, or does pervasive conflict ensure that any cash made available to MPs is disbursed along factional lines? After all, the revival of tribal fighting in the PNG Highlands considerably predates the commencement of PAEs. And is the political impact of PAEs everywhere the same, or are the consequences in PNG Highlands different from those in coastal areas or on the PNG islands, or in the Solomon Islands or in Vanuatu?

The claim that Melanesian political patronage is primarily driven by local-level pressures is also embraced by many other scholars, either because methods of disbursal seem to resemble customary big man traditions of accumulation and distribution, or because of adherence to rational choice perspectives regarding Melanesians as “pure material benefit maximisers” (Kurer 2007, p. 41), or simply because of the absence of alternative theories of the dynamics of Melanesian political power (Hameiri 2007, pp. 422–423). Kurer (2007, p. 43) argues that

[t]he political process in Papua New Guinea is pervaded by clientelist rent-seeking where politicians, in exchange for political support, are elected to provide particularist benefits for their supporters. This leads to a highly fluid and inherently unstable political system with weak political parties, personalised and parochial politics, and intense political competition.

Similarly, AusAID’s *Pacific 2020* report found clientelist theories relevant for the Pacific Islands:

Political competition takes place almost exclusively at the micro or local level. Parties are weak; competing policies are absent. Voters are wooed by offers of money, jobs and other help at the individual level. Thus politicians become patrons, their supporters, clients, and democracy as clientelism or “localism” is observed (AusAID 2006, pp. 95–96).

Such interpretations rely primarily on anecdotal literary evidence of intense MP responsiveness to local demands, or in some cases survey data indicating voter perceptions that politicians are expected to deliver individual rewards at the local level. They also assume that local clientelist arrangements can fruitfully be used to explain the fluidity of allegiances in national parliaments, even though the most commonly cited reason for high levels of incumbent turnover in PNG and Solomon Islands is the absence of distribution in, and long absence from, home constituencies. No robust quantitative analyses exist of the extent to which PAEs trickle down to local communities, but much contrary anecdotal evidence exists of diversion of PAEs for other purposes—an interpretation reinforced by numerous court cases dealing with allegations of corruption.<sup>10</sup> In the absence of solid data covering patterns of disbursal, we can at least examine the processes of introduction, and subsequent development, of PAE schemes and assess whether those experiences confirm, or throw into question, the clientelist interpretations.

### 3. Papua New Guinea

Papua New Guinea’s PAEs have been repeatedly reincarnated through a succession of schemes: national development funds in the 1980s, electoral development funds in the 1990s, district support grants from the late-1990s, and district services improvement programs from 2006 onward. Forms of disbursal have changed over time, with cash channeled increasingly through the open MP instead of being routed through the provincial assemblies. The PNG Parliament has 109 seats, 20 of which are provincial or regional seats, usually occupied by the governor of each province. The other 89 are the so-called open seats, 84 covering the country’s rural districts and five for the urban electorates. Voters have two votes: one for an open representative and the other for a provincial representative. Following the creation of provincial governments in the 1970s, a power struggle ensued, culminating in the mid-1990s’ reforms of provincial and local governments through the Organic Law on Provincial Governments and Local-Level Governments. As a result of those reforms, the 89 open MPs significantly enhanced their position as fiscal power-holders, although without raising matching locally generated revenues.

The 1980s proved a watershed in the engineering of PNG government finances to sustain fragile government coalitions. During the 1970s, government funds had been disbursed in rural areas under the Rural Improvement Programme, but these funds were formally at the disposal of local government councils, not MPs (Colebatch 1979). MPs obtained greater control over village economic development funds—entailing Ministry of Commerce assistance for rural business projects in tandem with loans from the Development Bank of Papua New Guinea—which were introduced in the mid-1970s. Prime Minister Michael Somare’s use of such funds to strengthen his 1977–1980

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<sup>10</sup> Over 90% of PNG MPs who faced dismissal after leadership tribunal hearings in 1976–2000 were found guilty of offenses connected to improper usage of electoral development funds (Transparency International 2003, pp. 20–21). In 2008, Prime Minister Somare himself was found by the ombudsman to have failed to file annual returns accounting for district support grants and other discretionary funds, and the case was referred to the public prosecutor (Kantha 2009, pp. 349–373). See also footnotes 32 and 33.

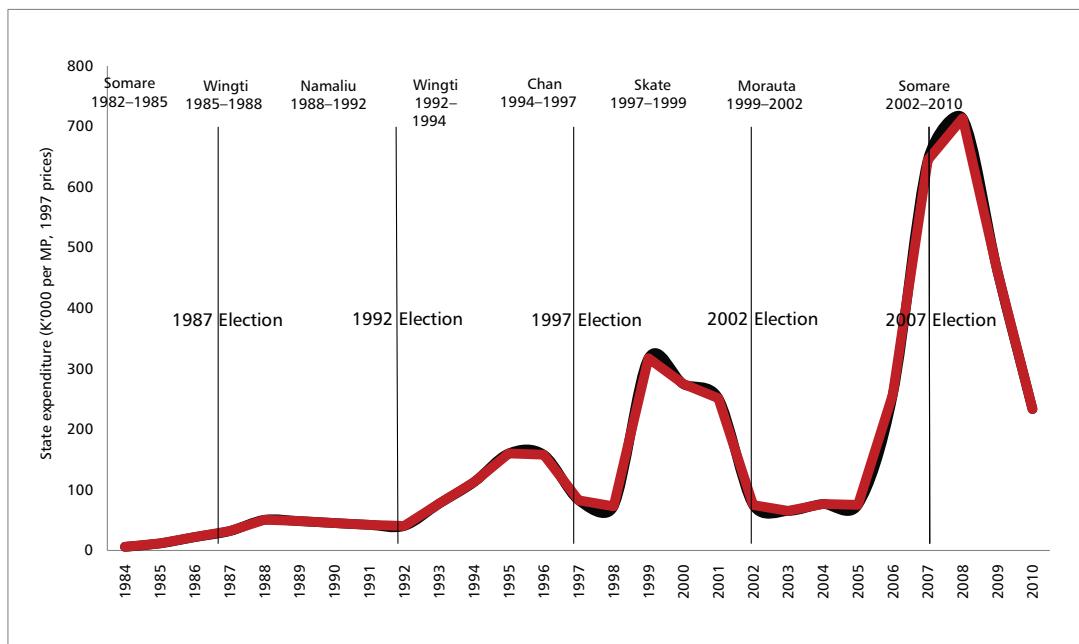
government was criticized for initiating a “personalized form of government” by opposition leader Iambakey Okuk in 1980 (Gordon and Meggitt 1985, p. 183; Hegarty 1998, pp. 339, 345). Under Somare’s successor, Julius Chan, with Okuk as his deputy, cabinet approved use of “sectoral development funds” in MPs’ constituencies, a scheme widely seen as the origin of MP slush funds (Standish 1984, pp. 46–47; Dorney 1990, p. 271). Allocating expenditure to MPs was formally introduced in the 1984 budget through creation of a National Development Fund of 1.18 million kina (K). Paias Wingti, who became Prime Minister in 1985, promised to “kill handouts,” but after a cabinet rebellion he backed down (Dorney 1990, p. 273; Transparency International 2003, pp. 20–21). In his first budget, Wingti increased the National Development Fund from K20,000 to K40,000 for each MP (Saffu 1987). The sum distributed rose to K60,000 per year by 1987 and rose again to K100,000 (around \$121,000) in 1988 (Ghai and Regan 1992, p. 317n).

Figure 13.1 shows the increase in official PAE funds per open MP under the various schemes from 1984 to 2010. These data were drawn from the recorded budgetary appropriations from 1991 onward, and from literary records for earlier years.<sup>11</sup> The figure suggests three booms in PAE spending: the first in the mid-1990s, the second during 1999–2002, and the third during 2006–2009. Wingti’s third government, which commenced after the 1992 elections, initiated the first of the three booms as revenues from oil and the Porgera mine were recycled to MPs. Nevertheless, government remained in deficit and was forced to devalue the kina in 1994. Scope for MP discretionary funds was restricted in 1997–1998 as a result of restraints on spending accompanying a World Bank structural adjustment loan in 1995–1996 (Wesley-Smith 1996, p. 431).<sup>12</sup>

<sup>11</sup> Since annual budgets (as distinct from supplementary or emergency budgets) are released in November of the preceding year, the provision for PAEs is forward-looking.

<sup>12</sup> According to the 1996 budget data, the Rural Action Programme backed by the World Bank initially entailed an increase in funding to K550,000 per MP, but the amount was reduced to K300,000 in the 1997 budget. I am indebted to Colin Filer for assistance in tracking down the mid-1990s’ World Bank reports.

**Figure 13.1: State Expenditure Allocated to Open Members of Parliament, Papua New Guinea, 1984–2010**



Notes: Data for 1991–2010 cover budgetary provisions, except for 1991–1992 when actuals are used. An additional 19 million kina (K) was appropriated for East Sepik in 2005, but only K1.3 million is recorded as expended. This amount is not included since it is impossible to establish which of the members of Parliament (MPs) received the additional funds. Records of 2004 include no provision for the National Capital District (NCD) and Sandaun MPs. 1997 records do not indicate any identifiable provision for the NCD or Bougainville MPs. Some obvious errors have been corrected in the budget data.

Sources: 1991–2010 from Papua New Guinea's budget papers (various years); 1984–1990 from Standish (1984), Saffu (1987), and Ghai and Regan (1992).

Amendments to the 1995 Organic Law on Provincial Governments and Local-Level Governments set the sum to be disbursed to MPs as district support grants at K300,000 for 1998 and K500,000 for subsequent years. District support grants were to be divided into two, with one-half disposed at the unfettered discretion of the MP and a nondiscretionary half to be disbursed under the direction of the new Joint District Planning and Budget Priorities Committees (JDP–BPCs). These committees comprise the heads of local-level governments, with the district administrator as chief executive officer. MPs chair the JDP–BPCs and control selection of three nominated members. Open electoral districts usually have 3–5 local-level governments (Edmiston 2002, p. 224).<sup>13</sup> Thus the open MP in most cases has an inbuilt majority and is also often able to influence the selection of local-level government presidents. A 1996 amendment to the law removed the provincial governor from the JDP–BPCs, in the process further strengthening the position of the open MP. Surveys have found a mixed record as regards the performance of the JDP–BPCs: some meet fairly regularly and obtain considerable authority; others meet only irregularly, or hold meetings in urban Port Moresby and not in the relevant constituency, or act merely as instruments under the personal control of the open representative (May 2005; Haley 2005). As an “organic” law, this legislation is entrenched in the constitution, ensuring that the K500,000 district support grant per MP would be difficult to alter or abolish.

<sup>13</sup> A total of 284 local governments cover 87 districts, excluding Bougainville and the National Capital District, which are governed under alternative arrangements.

The second peak in PAE funding in 1999 again bore little relationship to the electoral cycle, but was connected to the expiry of 1997–1999 Prime Minister Bill Skate’s statutory 18-month grace period (during which no confidence votes are disallowed).<sup>14</sup> Struggling for political support ahead of an impending challenge, Skate raised PAEs by an additional K89 million, or by K1 million per open MP. Despite this action, his parliamentary support dwindled and he resigned ahead of the threatened no confidence challenge in July 1999. The incoming Morauta government (1999–2002) faced pressure from the World Bank, as part of the conditions accompanying a second structural adjustment loan, to rescind Skate’s K89 million hike in PAEs. Fearing the political implications of reversing the increase, the Morauta administration instead settled for tightening up guidelines for fund administration through the Office of Rural Development and in 2002, once a no-confidence challenge had become unlikely,<sup>15</sup> converted the K89 million into funding for fee-free education, hoping that this might prove a vote-winner. That proved not to be the case. Morauta’s People’s Democratic Party fared poorly in a troubled election in 2002, which saw the highest rate of turnover of incumbent MPs (70.6%) ever witnessed in PNG.

The third peak in PAE funding, over 2006–2009, was triggered by buoyant government finances arising from a logging and mineral resources boom. Funds per MP appropriated through the budget ballooned under a new District Services Improvement Programme in 2007–2008, as the government responded to unexpected surpluses by recycling cash to MPs. Allocations per open MP peaked in 2008 at K6.5 million (roughly equivalent to \$2.3 million). Initially, a substantial share of District Services Improvement Programme funds was disbursed into trust accounts, but 2009–2010 saw a rapid drawdown of the trust accounts.<sup>16</sup> There is an increasing trend of decentralization toward the fiscal empowering of open MPs, as well as (in theory) the local-level governments and JDP–BPCs. As then Deputy Prime Minister Puka Temu stated in 2007, the Somare government has a goal to “develop a long-term plan for moving the public service machinery to the districts” (Temu 2007). Anticipated revenues from the large liquefied natural gas project being developed in the Southern Highlands are to be used to fund further increases in the monies distributed through open politicians.<sup>17</sup>

## 4. Solomon Islands

Three-time Prime Minister Solomon Mamaloni (1981–1984, 1989–1993, 1994–1997) was responsible for introducing PAEs in Solomon Islands. Solomon Islands Communities and Provincial Special Assistance funds were introduced in 1989 to support projects initiated by the area councils,<sup>18</sup> but after revelations of abuse they were abolished by the incoming Hilly government in 1993.<sup>19</sup>

<sup>14</sup> In 1991, the 6-month “grace period” after a general election or the election of a Prime Minister, during which there cannot be a vote of “no confidence,” was extended to 18 months.

<sup>15</sup> During the last 12 months of a parliament’s 5-year term, a successful vote of “no confidence” entails a dissolution of parliament and an early general election. There has never been a “no confidence” vote, successful or otherwise, during that final 12 months.

<sup>16</sup> The Asian Development Bank reported in August 2010 that PNG’s trust funds were drawn down in 2009 from K3.5 billion to K1.1 billion (*ABC Pacific Beat* 2010).

<sup>17</sup> At a meeting of the governing National Alliance Party in October 2009, Arthur Somare, state enterprises minister and son of Prime Minister Michael Somare, who was closely involved in negotiations over the huge liquefied natural gas project, told those attending that the project would deliver District Services Improvement Programme payments for the next 20 years (*The National* 2009).

<sup>18</sup> Speech by Finance Minister Christopher Abe, reading of the 1990 Appropriation Bill, 2 May 1989.

<sup>19</sup> Solomon Islands 1994 budget speech by Finance Minister Andrew Nori on 13 December 1993, which announced abolition of a range of grants to provincial governments and local authorities. On abuses, see the comments of Sir Allen Kemakeza in the

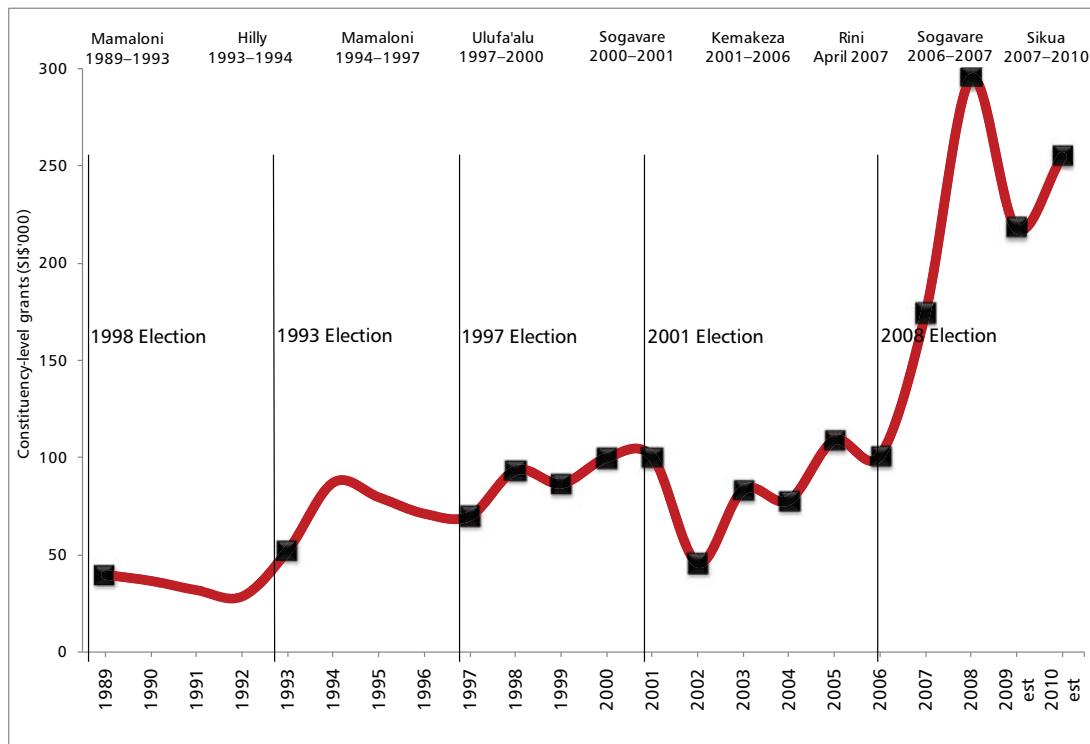
Unlike PNG, Solomon Islands has only constituency MPs—50 of them since 1997. Provincial premiers do not hold seats in Parliament. The political incentives were thus to fund MPs, not area or provincial council representatives. Area councils were abolished in 1996 and 1997.

In the run-up to the 1993 election, Mamaloni introduced a “special discretionary fund” of 100,000 Solomon Islands dollars (SI\$) per MP. In an account of that election, Premdas and Steeves (1994) described the impact:

An issue with a profound impact on the campaign was a decision by the Mamaloni government in the dying days of the last parliament in March 1993 to award each sitting MP a SI\$100,000 “Discretionary Fund” to distribute in his or her constituency for development purposes. This “discretionary fund” became a tool for MPs to cement their local support. Sitting MPs engaged in blatant distribution of development largesse in the form of outboard motors, generators, boats and canoes, iron roofing, etc. among supporters and church groups considered crucial in each constituency. The matter became a heated issue during the campaign. Commentators, private citizens and the media all derided the opportunistic nature of the fund's introduction. It placed challengers to sitting MPs at a severe disadvantage. ... What had begun as a contest between SIGNUR [Solomon Islands Government of National Unity and Reconciliation] and the alternative party formations ended as a contest between the ins and the outs, sitting MPs no matter what their party affiliation and those who sought to displace them. By election day, cynicism seemed widespread (p. 52).

Despite the 1993 handouts, Mamaloni narrowly lost the election to a loose reformist coalition led by Francis Billy Hilly. Hilly's short-lived government converted the special discretionary fund into a community development fund and increased the sums allocated to SI\$200,000 per constituency. However, he was ousted in a no-confidence vote in 1994. One of the MPs associated with Mamaloni's rival SIGNUR faction, Sam Alasia, openly acknowledged that “cheque or cash lobbying by both camps was at its height during this period” (Alasia 1997, p. 13). Joses Tuhanuku, forestry minister in Billy Hilly's government, accused logging companies of masterminding the defeat of the National Coalition Partnership government, and identified ethnic Malaysian Robert Goh as the “bagman” carrying cash to entice defectors (Bennett 2000, p. 345; Dauvergne 2001). Mamaloni returned to office and community development fund payments of around SI\$200,000 per MP were still being distributed ahead of the 1997 elections (Cnossen 2000, p. 163).

**Figure 13.2: Solomon Islands Constituency-Level Grants, 1989–2010  
(Index 2000 = 100)**



est = estimate.

Notes: Asterisks show budget data points. Years 1989–1992 interpolated on the assumption of continuation of Solomon Islands Communities and Provincial Special Assistance grants. Years 1993–1996 based on literary records estimating SIS\$200,000 per members of Parliament. From 1997 onward, all data is from budgetary appropriations.

Source: Adapted from Coventry (2009) and updated using the Solomon Islands government's 2010 development estimates.

Like the short-lived Billy Hilly government, the incoming 1997–2000 Ulufa'alu government—despite its reformist orientation and hostility to “Mamaloni politics”—increased what became known as Rural Community Development Funds (RCDF)<sup>20</sup> to SIS\$300,000 per member in the 1998 budget and to SIS\$370,000 in 2000. Increases in 1998–1999 were funded by aid from PNG and Taipei, China, but PNG aid was halted as a result of the fiscal crisis faced by the incoming Morauta government in PNG in 1999.<sup>21</sup> After 1999, RCDF spending became reliant on a boom in aid from Taipei, China. An uprising on Guadalcanal, commencing in late 1998, severely weakened the Ulufa'alu government and led to the displacement of around 20,000 Malaitan settlers from rural parts of the island, many of whom relocated to the capital, Honiara (also on Guadalcanal). In retaliation, a rival militia group known as the Malaitan Eagle Forces emerged, and on 5 June 2000 it overthrew Ulufa'alu's government in a joint operation with the heavily Malaitan-dominated Police Field Force. By the end of that month, a new government led by Manasseh Sogavare had been elected—nominally in conformity with the 1978 Constitution but in fact in thrall to the Malaitan Eagle Forces militants.

<sup>20</sup> Over time the “C” in the RCDF acronym has morphed from “Community” to “Constituency.”

<sup>21</sup> Solomon Islands government development budget estimates, 1998, 2000; Government of Solomon Islands, 1998 budget speech by Finance Minister Manasseh Sogavare on 16 April 1998; *The National* 1999b.

The consequences for government finances were severe. The 2000–2001 Sogavare government defined its “justice before peace” program by handouts of large sums of money in “compensation” to aggrieved parties, including provincial representatives and militia leaders. A process of systemic extortion continued in 2000–2001 funded by a \$25 million loan from the Export–Import Bank of Taipei, China.<sup>22</sup> Sogavare also increased PAE funding to SI\$400,000 for each of the 50 MPs in 2001, but the collapse of government finances limited scope for PAEs during subsequent years. Elections in December 2001 resulted in Sir Allen Kemakeza replacing Sogavare as Prime Minister, but the militia leaders remained the key behind-the-scenes power brokers and they, rather than the politicians, received most of what little money the government had available to distribute. Judged from the budget records, amounts allocated fell to SI\$10,000 per MP in 2002 and remained at SI\$20,000 per MP in 2003 and 2004 (see Figure 13.2).

The Australian-led Regional Assistance Mission to the Solomon Islands (RAMSI) commenced in July 2003, which entailed deployment of Australian advisors and line personnel into key positions in the Ministry of Finance, the treasury, and other core oversight institutions, as well as the police force and prisons. Contrary to reports that PAE expenditures decreased after RAMSI’s arrival,<sup>23</sup> total politician-controlled spending surged under the Kemakeza (2001–2006), Sogavare (2006–2007), and Sikua (2007–2010) governments. There were several reasons for this. First, although RAMSI tightened controls over the finance ministry, the treasury, and the recurrent budget, the development budget is separately administered under the Ministry of Development, Planning and Aid Coordination with minimal RAMSI input. Second, even if the RAMSI influence at that ministry had been greater, this might have influenced process but not the level of funding since RCDFs are appropriated through Parliament. Third, Taipei, China, which is not a participant in the RAMSI operation, funded three aid programs directed at 50 MPs: the RCDF (SI\$20 million, or SI\$400,000 per MP in 2009); the Constituency Micro-Projects Fund (SI\$10 million, or SI\$200,000 per MP in 2009); and the Millennium Constituency Development Fund (SI\$20 million, or SI\$400,000 per MP in 2009). The leverage exerted by RAMSI is therefore restricted. Nevertheless, there have been efforts to introduce legislation to bring oversight of PAEs more explicitly under the Office of the Auditor General.

As part of the 2006–2007 Sogavare government’s “bottom-up” and “holistic” strategy, additional annual spending of SI\$50 million, or on average SI\$1 million per constituency, was devoted to rural development under the Rural Constituency Livelihoods Fund.<sup>24</sup> The program was continued under the 2007–2010 Sikua government. Expenditures require the endorsement of MPs, but some oversight controls remain within the Ministry of Rural Development, with the Sikua government planning for those ministerial controls also to apply to RCDF disbursals in future.<sup>25</sup> Drawing on the Morauta government experience in PNG, American political scientist Francis Fukuyama, serving as a consultant for the World Bank, urged a simultaneous abolition of the RCDF and school fees (Fukuyama 2008, p. 25). In early 2009, the Sikua government abolished school fees

<sup>22</sup> For details, see Fraenkel (2004b, pp. 95–96, 105–106, 122–126).

<sup>23</sup> Hameiri (2009, p. 79) claims that “RAMSI’s various programmes have made the transfer of such funds increasingly difficult and thus reduced the reliance of politicians on deep-reaching patronage networks.”

<sup>24</sup> Speech by Planning and Aid Coordination Minister Gordon Darcy Lilo in Hansard (Solomon Islands) on 3 October 2006, in which the new rural development funds are to be disbursed via the “government’s constituency development model.” [www.parliament.gov.sb/files/hansard/8th\\_session/2nd\\_meeting/tuesday3october2006.pdf](http://www.parliament.gov.sb/files/hansard/8th_session/2nd_meeting/tuesday3october2006.pdf)

<sup>25</sup> Comments of Deputy Prime Minister Fred Fono in Hansard (Solomon Islands) on 5 March 2009.

for primary school students and for the first 3 years of secondary school, but without any substantial reduction of RCDF spending.

Other funds that are accessed by MPs also exist in Solomon Islands, either under formal oversight provisions or reliant on informal channels.<sup>26</sup> While the RCDF, the Constituency Micro-Projects Fund, the Millennium Development Fund, and the Rural Constituency Livelihoods Fund all entail at least some decision-making role for the 50 MPs, other projects funded through the Ministry of Planning, Development and Aid Coordination often short-cut established project appraisal procedures, and MPs as local power brokers can exert considerable influence over their disbursal. As Coventry (2009, pp. 4–5) shows in his analysis of 2004–2008 development budget project proposals, official deadlines were rarely met because the all-important unofficial deadlines were cabinet meetings where decisions were made according to political imperatives. Development spending also peaked ahead of the defeat of the Sogavare government in late 2007, as the Prime Minister sought to hold together a volatile coalition and avoid breakaways by ministers or backbenchers. Studies of the political diversion of state spending that focus only on formalized MP slush funds run the risk of neglecting other forms of state project funding for which official assessment procedures can be circumvented in the interests of the Prime Minister and Cabinet.

Survey data reporting expectations that MPs assist constituents have been used as evidence of strong politician responsiveness to local pressures or aspirations for “development” (for PNG, see Kurer 2007, p. 41), but these surveys usually provide little indication of patterns of PAE distribution. The annual RAMSI-funded Solomon Islands People’s Survey, for example, entailed interviews with 5,035 people across the country in 2009 and asked respondents (who were allowed multiple answers) what they see as the main job of an MP: 41.7% responded that it was to “assist those who voted for him;” 37.5% to “get better conditions for the constituency;” 16.2% to “govern the country;” and 44.9% to “represent the constituency in Parliament.” That such a large percentage emphasized the provision of local assistance is probably not unique to Melanesia, but it tells us little about the extent of trickle down.

Another question asked respondents whether RCDFs were spent in the respondent’s community, to which only 35.3% responded “yes,” 42.9% “no,” and 21.3% “do not know” (ANU Enterprise 2009). Of those who responded “yes,” 23.8% thought that funds were being misused or given to individuals, while 79.3% thought that they were being spent on community projects. Matching up the two responses implies that only 28% thought that PAEs were being used for community projects in local areas (although it is certainly possible that a gulf exists between perception and reality). Further research is needed on the extent and character of PAE local-level distribution. However, what evidence is available, as well as the historical approach pursued in this paper, suggests that the key driving forces are in Parliament, not out in the rural constituencies.

<sup>26</sup> “Grants paid yearly to MPs are only the tip of the iceberg in Solomon Islands,” according to former MP and journalist Alfred Sasako. “MPs have easy access to other funding sources, mostly known to MPs only. Take for example, a \$10 million grant provided by [Taipei, China] last year to revive the nation’s livestock industry... The funds were administered by the Department of Agriculture and Livestock. As it turned out, funds were disbursed among mostly government ministers and backbenchers in the hope of keeping the coalition together” (Sasako, undated). This claim was confirmed by former Foreign Minister Patterson Oti in Parliament on 5 March 2009 when he mentioned “fisheries projects, forestry related projects or agriculture related projects, which are for constituencies but members of Parliament are also required to endorse all applications.”

## 5. Vanuatu

Like PNG and Solomon Islands, Vanuatu has a political history of factional splintering and frequent floor-crossing and changes of government, at least since 1991. At independence in 1980, a schism between Walter Lini's anglophone Vanua'aku Pati and the francophone Union of Moderate Parties generated a reasonably robust two-party system. The Vanua'aku Pati retained control of government during the 1980s, but by the end of the decade severe schisms emerged in the party. In 1991, Lini was ousted in a no-confidence vote, and there were a succession of 13 short-lived coalition governments from 1991 to 2000. The Vanua'aku Pati and the Union of Moderate Parties both splintered and numbers of candidates and parties soared (Van Trease 2005, pp. 316, 321).

Controversies over the perks of holding office became the main reason for the collapse of governments, which Van Trease identifies with a "reawakening *bigman* style of politics" (Van Trease 2005, p. 325). Despite the obvious incentive to hold together loose coalitions by disbursal of state funds, Vanuatu did not experience a similar inflation of PAEs. Governments have been reluctant to concede substantial increases; and the legal constraints on pro-government backbenchers and opposition members clubbing together to force increases have for the most part proved effective. Budgetary processes are less personalized than in PNG and Solomon Islands, and relevant legislation, such as the Vanuatu Public Financial Management Act, is stronger than that prevailing in PNG.<sup>27</sup>

Vanuatu does have a budgetary provision, called the MP allocation, to "enable the Members of Parliament to participate in the level of their respective constituencies in the development of the community projects."<sup>28</sup> This provision initially appeared in the 1993 budget, and in real terms remained reasonably steady across 1993–2010. It stood at VT117 million or, on average, VT 2.25 million per member in 2009.<sup>29</sup> In addition, MPs have access to significant allowances as supplements to salaries, covering "subsistence," "touring," and "sitting" allowances, as well as gratuities for each year served in Parliament.<sup>30</sup> For 2009, such allowances—including those for the various parliamentary committees—amounted to VT223.7 million or VT4 million per MP. Figure 13.3 shows also the overall cost of Parliament from 1980 to 2010. This cost remained reasonably steady during the 1980s. After the onset of coalition government in 1991, it rose in response to increased expenditure on holding together fractious governing coalitions and keeping pro-government backbenchers in line. Peaks in 2000–2002 and 2008 were connected with substantial salary increases for parliamentarians.<sup>31</sup>

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<sup>27</sup> I am indebted to Nikunj Soni, executive director of the Vanuatu-based Pacific Institute of Public Policy, for this point (personal communication 7 May 2010).

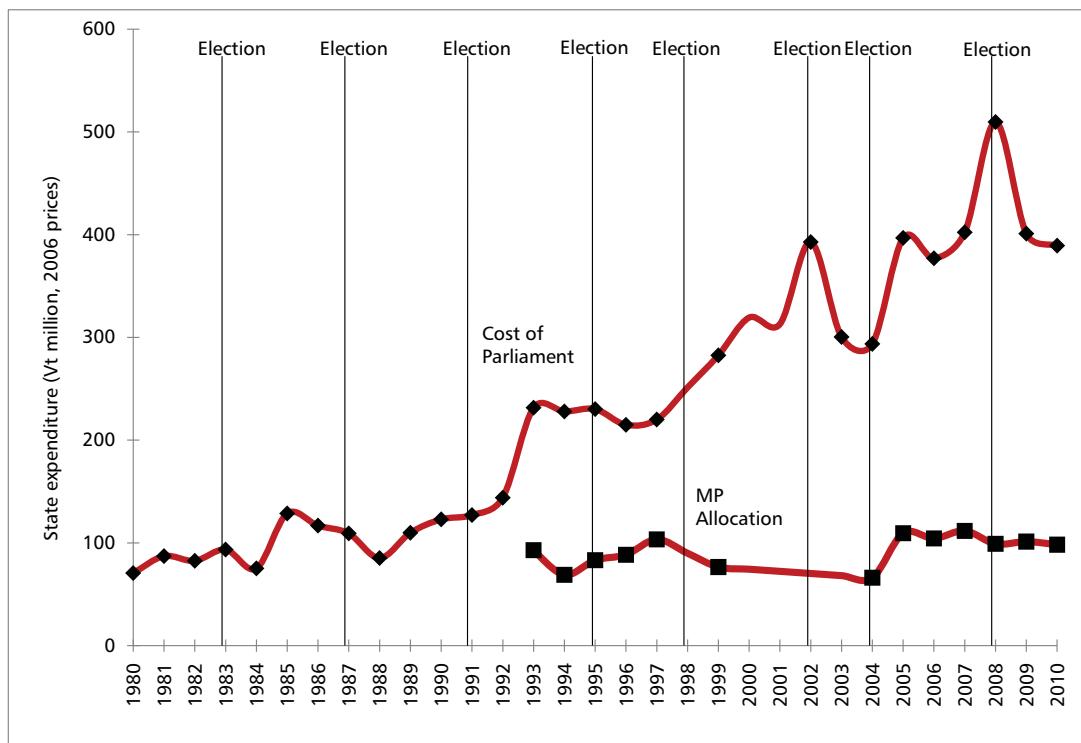
<sup>28</sup> Republic of Vanuatu. 2003 Budget Narratives (English). p. 10.

<sup>29</sup> Government of the Republic of Vanuatu. Budget 2009. Vol. 1, p. 16. The 2009 Members' Expenses and Allowances Act provides for VT2 million per member per year, but limits projects to VT1 million and requires acquittals before disbursal of successive tranches. (I am indebted to Ralph Regenvanu for forwarding a copy of the legislation.)

<sup>30</sup> In the 1990s, the Prime Minister also had access to a community development fund. Under the Casino Control Act of 1993, casinos are required to pay 15% of their gross profits into public funds ([www.paclii.org/vu/legis/consol\\_act/cca166/](http://www.paclii.org/vu/legis/consol_act/cca166/)). However, in the subsequent decade the appointment of a regulator used up most of the resulting funds in administrative costs and so cut off this source of spending by the Prime Minister's office.

<sup>31</sup> Budgetary data is not available for 2001–2002, and figures are interpolated for those years, so the timing of that increase is uncertain. The rise in 2008 is due to a substantial increase in the sums recorded under "procedure and legislative affairs," covering salaries and associated allowances to MPs.

**Figure 13.3: State Expenditure on the MP Allocation and Parliament, Vanuatu, 1980–2010**



GDP = gross domestic product, MP = member of Parliament, Vt = vatu.

Notes: The MP allocation was recorded under the Prime Minister's office in 1993–1995, and then under the parliamentary appropriation. The cost of Parliament adjusted to include the MP allocation for 1993–1995. Data adjusted for inflation using the Vanuatu Ministry of Finance 2006 GDP deflator, extrapolated backward with assistance from Nikunj Sony. Asterisks indicate data points. Data do not include figures for "political gratuities" shown under the appropriation for the Prime Minister's office at VT23 million for 1993, VT24.7 million for 1994, VT16.5 million for 1995, and VT18 million for 1996 (around one-third of the level of the MP allocation), because there were errors in the calculation of these disbursals that were subsequently reversed.

Source: Republic of Vanuatu 1980–2010 budgets.

As in PNG and Solomon Islands, there has been pressure for greater accountability in Vanuatu. Intervention by the ombudsman has uncovered cases of abuse of MP allocation funds.<sup>32</sup> Allegations of corruption have also centered on use of the Prime Minister's Community Development Fund.<sup>33</sup> Speaker George Wells required MPs to deliver annual report on uses of MP allocation funds.<sup>34</sup> In February 2009, an attempt to double the MP allocation to VT4 million, supported both by the opposition and government backbenchers, was passed by the Vanuatu Parliament by 28 votes to 18, but was ruled unconstitutional by Speaker Wells, drawing on the provision that "no motion for the levying or increase of taxation or for the expenditure of public

<sup>32</sup> Office of the Ombudsman, Vanuatu (2002, 2003).

See comments of Justice C.N. Tuohy in *Public Prosecutor v Leo* (2008): "One thing that does come out of these trials is the misuse of MP allocation cheques. They are not the personal property of the MP, they are held in trust for the MP's community, not to be sold, bartered or given as security for the purposes of the MP." (Supreme Court of Vanuatu [2008]).

<sup>33</sup> Office of the Ombudsman, Vanuatu (2003).

<sup>34</sup> *Daily Post* (Vanuatu) (2008a, 2008b).

funds shall be introduced unless it is supported by government.”<sup>35</sup> The revised 2009 legislation for the first time requires MPs to account for MP allocation spending, making disbursements conditional on the supply of receipts and acquittals for previous tranches.<sup>36</sup>

## 6. Comparative Perspectives

The data used in Figures 13.1–13.3 are approximations using available budget data. Politician spending drawn from nominally depersonalized parts of the budget, appropriations shifted retrospectively from one budget header to another, or inaccuracies in the records will not be reflected in the dataset. Additional MP-specific allocations by prime ministers, as regularly used in PNG, are also not included in the dataset. Using the data from Figures 13.1–13.3, Table 13.1 compares the costs of schemes operating in PNG, Solomon Islands, and Vanuatu in 2009. It shows the local currency value of schemes, their share of state expenditure, and their value per MP, converted into United States (US) dollars for comparative purposes.

**Table 13.1: State Expenditure Formally Allocated to Individual Members of Parliament in Western Melanesia, 2009**

	Local Currency (in million)		Share of State Expenditure (%)	Converted per Representative (\$ million)
	Per Representative	Aggregate		
Papua New Guinea	K4.5 <sup>a</sup>	K430.5 <sup>b</sup>	5.5	\$1.80
Solomon Islands	SI\$2.0	SI\$100	6.2	\$0.28
Vanuatu	VT2.25	VT117	0.9	\$0.02

K = kina, SI\$ = Solomon Islands dollar, VT = vatu, \$ = US dollar.

<sup>a</sup> Figure for the 89 Open members of Parliament (MPs). The 20 provincial MPs received K1.5 million per constituency in 2009.

<sup>b</sup> Including both amounts allocated to provincial governors and Open MPs.

Sources: See Figures 13.1–13.3.

The Vanuatu MP allocation scheme costs less than 1% of state expenditure and is only a tiny fraction of the schemes of its western neighbors. While the PNG scheme is over six times larger than that in Solomon Islands in terms of US dollars (owing to its larger size), it accounts for a slightly lower share of government spending. Use of 2009 as a benchmark year is reasonably representative of current levels of PAE spending for Solomon Islands and Vanuatu, but not for PNG where there was a substantial bell curve during 2006–2009. In its peak year, 2008, the PNG scheme was equivalent to 9.3% of state expenditure, or 44.0% of PNG development spending.

In summary, (i) the sums involved in US dollar terms were much larger in PNG than in Solomon Islands, and much larger in Solomon Islands than in Vanuatu; and (ii) the Vanuatu scheme’s share in state expenditure is much smaller than in PNG and Solomon Islands. It is unlikely that these conclusions would be significantly altered if we had used actual, rather than budgeted, PAE data. Now let us turn to a broader analysis of trends in politician discretionary spending and their links with the electoral cycle.

<sup>35</sup> *Daily Post* (Vanuatu) (2007, 2009).

<sup>36</sup> Republic of Vanuatu, Bill for the Parliament (Member’s Expenses and Allowances) (Amendment) Act of 2009. (I am indebted to Ralph Regenvanu for supplying a copy of this legislation.)

## 7. Concluding Discussion

In Western Melanesia, only rudimentary state institutions were in place in the twilight of the colonial era, with the bulk of populations remaining beyond the reach of the state. Electoral democracy and a legal apparatus were left, modeled on institutions in the capital-rich countries, but alongside weak bureaucratic structures—generating incentives for resort to electoral patronage. Unlike much of Africa, formation of governments via regular elections continued in Western Melanesia, but without generating mass-based political parties or even, for the most part, robust party organizational machines. Electoral contests were instead decided based on highly localized factors: kinship, clan, or church linkages, or other networks, or, importantly, animosities, competing big man authority systems, and “money politics.” In the urban capitals, parliaments were sites of factional struggles, which, although often intense, rarely followed clear ideological divisions. Prime ministers could use personalized forms of authority to build and sustain coalitions and consolidate control across the top echelons of the public sector, but constitutions and court rulings everywhere imposed parameters that were difficult, if not impossible, to breach. Even without those legal influences, prime ministers remained vulnerable. Parliamentary sittings regularly centered on avoiding no confidence votes, triggering formal or informal resort to public finances to procure and sustain the loyalty of government-aligned MPs.

Increasing resort to electoral patronage in PNG and Solomon Islands during the 1990s and 2000s was not indicative of the construction of classic patron-client systems, such as those found in Southern Europe or parts of Africa.<sup>37</sup> Voter allegiances remained too fickle, conditional, and transient to be usefully called clientelist, while ministers retained too much authority, autonomy, and independence to be sensibly described as the “clients” of prime ministers. There is little correlation between the fluctuations in PAEs and the electoral cycle—with the exception of the introduction of special discretionary funds ahead of the 1993 Solomon Islands election (although this, too, was primarily an attempt to ensure continuity of Mamaloni’s Solomon Islands Government of National Unity and Reconciliation).

More frequently, substantial increases in MP discretionary funding occurred *after* general elections, as prime ministers sought to hold together loose and fractious governing coalitions, hoping to survive a full term in office.<sup>38</sup> Increasing costs of Parliament in Vanuatu in 2000–2002 and 2008 may appear tuned to the electoral cycle, but these were due to increased salary costs and expenditure on the committees, not an increase in the MP allocation. PAEs were only one part of a broader personalization of the management of state funds to keep coalitions in office. In PNG, the timing of hikes in MP allocations was influenced by that country’s post-1992 18-month grace period during which there cannot be a no-confidence vote. In the Solomon Islands, where no such grace periods existed, development spending more broadly was found to be influenced by cabinet efforts to retain the loyalty of backbenchers ahead of threatened no confidence motions. Thus even reformist coalitions, defined by hostility to “Mamaloni politics,” like those headed by Francis Billy Hilly in 1993–1994 and Bartholomew Ulufa’alu in 1997–2000, were not immune from pressures to resort to patronage to prop up fractious governing coalitions, even though they sought to more closely regulate the log export industry, reduce corruption, and relieve national indebtedness.

<sup>37</sup> On clientelist systems in Africa, see Lemarchand (1988, pp. 153, 155) and Van de Walle (2007, pp. 66–67).

<sup>38</sup> As Ketan (2007, p. 7) found with regard to PNG, “*all* increases were in response to pressures from the government backbenches” (emphasis added).

The key precondition for the substantial expenditure on PAEs in Western Melanesia was not the aspiration of rural peoples for short-run welfare gains but the availability of significant revenue from aid or foreign-controlled natural resource-based industries. In PNG, this was provided by funds acquired from logging companies and mineral resource booms in the early 1990s and 2000s. The exception was 1997–1999, with PNG Prime Minister Bill Skate’s 1999 allocation of K89 million to open MPs, but this was financed through an unsustainable increase in debt finance. In Solomon Islands, it was aid from PNG and then, increasingly, Taipei, China that fueled payouts to MPs. Vanuatu had neither access to large windfall revenues from mineral extraction industries nor significant inflows of fungible aid, since assistance from the People’s Republic of China tended to entail labor and materials sourced from outside the country rather than open-ended budget support.<sup>39</sup>

In the absence of any threat of external war or internal rebellion, PAEs may be subject to a ratchet effect. For cash-starved villagers with little access to government services, delivery of PAEs in the run-up to elections was one of the few mechanisms for gaining access to government funds. Consequently, from the longer-serving politicians’ standpoint, any reduction may seem a sure route to electoral defeat. At the constituency level, returning incumbents regularly rely on distribution of goods or services—such as outboard motors, farming equipment, solar power panels, payments of school fees, or even imported foods—or cash handouts. Big increases in PAEs in response to windfall gains thus appear irreversible, even if the security these offer is only fleeting. In the Solomon Islands’ 1993 election, incumbent turnover fell to 14.9% in the wake of Mamaloni’s introduction of special discretionary grants. Subsequent governments raised the sums disbursed, but incumbent turnover nevertheless rose to 38% in 1997 and to 52% in 2001, suggesting that PAEs may be subject to a law of diminishing returns.

Prime Minister Skate’s K89 million “social and rural development funds” in 1999 were recast as educational expenditures before the 2002 election, in which 71% of incumbents lost their seats, an all-time high. Prime Minister Somare’s hike in disbursals during 2006–2008 might have diminished incumbent turnover slightly at the 2007 polls, but at 60% it was above the historic average.<sup>40</sup> The attraction of PAE spending may be strong for prime ministers wanting to cultivate loyal MPs or secure passage of legislation, but it does not offer a secure passport to sustained employment for the MPs themselves.

Substantial increases in MP funding have neither prevented loose coalition governments from being ousted (e.g., Hilly in 1994 in Solomon Islands or Skate in 1999 in PNG) nor made incumbent MPs more secure. For this reason, MP pressure to increase PAEs may appear odd: why expand political patronage when recipient electorates have such shifting loyalties and when it gives no clear electoral advantage? In theory, that incumbent politicians disburse state funds is no disincentive to switching sides if the voter knows that new MPs will have access to the same level of formal funding. In practice, careful use of PAEs by incumbents can make reelection likely. Those who distribute poorly, or not at all, are unlikely to be reelected. Incumbent MP turnover averaged 47.7% in the six PNG elections from 1977 to 2002, 40.9% in the seven Solomon Islands elections between 1980 and 2006, but only 21.6% in the seven Vanuatu elections between 1983 and 2004.<sup>41</sup>

<sup>39</sup> Assistance from the People’s Republic of China is, at times, provided directly to MPs in Vanuatu, but this money does not go through normal budgetary processes.

<sup>40</sup> Data from the PNG 2007 elections were, at the time of writing, still not officially available. The 60% figure is from Bill Standish (personal communication, 23 February 2010). For earlier data, see Fraenkel (2004a).

<sup>41</sup> Author’s elections database.

In other words, the Melanesian country with the lowest level of PAE had the lowest incumbent turnover rate.

Characteristic features of Western Melanesian political order—such as the absence of robust political parties, fluid factional allegiances, frequent changes of government, and high levels of incumbent turnover—cannot sensibly be explained by reference to intense localism or constituency-level clientelist rent seeking. These characteristics generally predated the introduction of PAEs and themselves generated obvious incentives for expanding MP entitlements through alliances between government backbenchers and opposition members (as well as incentives for the proliferation of ministerial portfolios and other sinecures). Vanuatu proved able to resist pressures to inflate PAEs during the 1990s and 2000s, although party splintering was even more marked, floor crossing was even more frequent, and changes of government more frequent than in PNG or Solomon Islands.

Multilateral donor organizations preparing budgetary support packages have, in the past, included among loan conditions the requirement that local governments cut or abolish politician-allocated spending programs, although without much lasting success. Local politicians, for obvious reasons, tend to be hostile to accepting discontinuation of direct MP funding as a condition of broader aid packages, often claiming, as we have seen, that such funds are a more effective and responsive tool for securing local service delivery. Such relaxed perspectives have, in some cases, been embraced by donors or their advisors, often simply because external insistence on cuts is unlikely to prove effective or because this may jeopardize domestic support for broader reform packages, or as a response to frustration at the inability of Melanesian governments to get money and services out to remote and impoverished rural areas.<sup>42</sup>

As a result, aid conditionality has increasingly been directed toward improved administration and accountability of PAE programs, not abolishing them or restricting spending—but again, without much success. Hostility to PAE schemes is not merely a feature of external pressures. Within PNG and Solomon Islands, criticism of abuses of politician funds is also widespread and increasing in intensity, particularly, but not exclusively, in the urban centers and among organized civil society groups. Even if donors choose, for pragmatic reasons, not to place conditions on loans that require the diminution of the large PAE spending packages in PNG and Solomon Islands, they should at least avoid endorsing the kinds of analyses that depict such schemes as potentially positive instruments for improving the functioning of states.

There is a strong case for refocusing contemporary discussion of MP discretionary funding in Western Melanesia. Schemes that supplement wages or provide small allocations for spending in MPs' constituencies, as in Vanuatu, may broker otherwise-lacking lines of connection to the state, even if abuses are widespread and the extent of disbursal is uncertain. More problematic are the larger schemes through which volatile government surpluses, arising from aid or natural resource industries, are recycled through politicians instead of being deployed to strengthen state capacity. Given the preponderance of rural subsistence agriculturalists in Western Melanesian populations,

<sup>42</sup> Francis Fukuyama, serving as a consultant for the World Bank in PNG, argued that “part of the reason that the District Support Grants (DSGs) exist is that the provincial and local administrations in many parts of the country are ineffective and lack the capacity to provide basic public services. DSGs give legislators a way of bypassing this bureaucracy and delivering resources directly to constituents. While, in theory, it would certainly be preferable to distribute government resources through the regular bureaucracy, abolishing DSGs will not make this happen. It is far more plausible that an MP could be convinced to distribute the DSG more fairly, thereby getting credit from a wider circle of constituents, than to agree to having the money taken away altogether” (Fukuyama 2007:14). However, this perspective neglects the fact that PAEs may reinforce the deterioration of state service provision and offers no approach to dealing with that deterioration. Reliance on appeals to MPs to distribute “more fairly” seems naïve.

domestic taxes (including sales taxes) tend to be raised from only a narrow section of the population, which, for better or worse, lacks much influence over government. If scarce, externally generated resources or enclave-extractive, industry-generated government revenues are used over the longer run to fund politician spending, this leaves few alternative resources to strengthen state service delivery.

Personalized disbursal of state project funding is thus symptomatic of a broader problem of building effective states in capital-poor countries with heavy reliance on subsistence agriculture, rather than being its cause. Unless this is addressed, the result—with or without MP slush funds—is likely to be the continuation and intensification of the atrophy of Western Melanesian states.

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# 14 Aid, Dutch Disease, and the Pacific<sup>1</sup>

by Jonathan Gouy

## ABSTRACT

Does foreign aid have “resource curse” type impacts in developing countries, similar to those associated with windfall revenues earned from nonrenewable resources? Windfalls can have adverse macroeconomic, fiscal, monetary, and governance consequences. This study tests for the presence of one possible “resource curse” effect, that might result from development assistance to Pacific island countries. The supposition is that aid reduces recipient governments’ proclivity to collect tax revenues from citizens. This study finds no reliable evidence for this theory: the regression results suggest that aid contributes to higher, not lower, revenues (excluding aid). Although the effect cannot be proved empirically, the impacts of aid literature concludes that aid needs to be provided with these risks understood. The consensus is that donors should be careful when increasing aid to avoid overwhelming domestic markets, lessening incentives for reform, and contributing to poorer governance. Large increases in purchases of non-traded goods, services, and labor pose the greatest risk of overwhelming or destabilizing the economies of small, aid-dependent countries. The provision of imported capital goods and technical assistance largely removes this risk. The governance impacts are viewed as more substantial. The key lessons for development agencies are (i) slow or reduce proliferation of aid activities by increasing sector and country specialization and rationalizing among individual donors; (ii) use technical assistance that increases the chances of sensible policy reforms, but provide it in response to, rather than in anticipation of, domestic policy processes or reform opportunities; (iii) avoid drawing recipient governments into policy engagements that entail expenditure commitments with uncertain returns or a low probability of payoffs.

## 1. Introduction

There has been much work undertaken to assess the economy-wide impacts of one-off windfalls, which have been experienced by many countries at different times. Much of the earliest work in this area resulted from analysis of the macroeconomic impacts of large resource projects, particularly

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<sup>1</sup> For the purposes of this paper and data permitting, the Pacific includes the Cook Islands, Fiji, French Polynesia, Guam (United States), Kiribati, the Republic of Marshall Islands, the Federated States of Micronesia, Nauru, New Caledonia, Niue, Northern Mariana Islands, Palau, Papua New Guinea, Samoa, Solomon Islands, Timor-Leste, Tokelau, Tonga, Tuvalu and Vanuatu.

minerals and hydrocarbons. This work identified that, for governments, there are dilemmas in choosing the optimal use and distribution of these windfalls, especially how and to whom they should be allocated, and what share should be preserved for future generations. Another issue identified for macroeconomic management is the potential loss of competitiveness that might be experienced by the private, non-resource export sector. This sector might suffer from a higher real exchange rate, making its exports more costly, and higher costs for domestic inputs, because labor and capital become more expensive due to demand from the booming resource sector.

A second key group of potential impacts are those affecting the behavior of governments. A wide range of research has postulated that windfall resources make the job of earning revenues relatively easy for governments; they do not face pressures to provide the services their taxpayers desire, or have an incentive to focus on productive projects, or undertake beneficial reforms. It has also been argued that large revenues from resource projects might contribute to, or encourage poorer governance. The consensus from the literature is that countries rich in natural resources experience slower per capita real income growth than those with fewer natural resources. This mix of potential macroeconomic, political-economic, and governance impacts has been variously described as “Dutch disease” (*The Economist* 1977) or the “resource curse” (Sachs and Warner 1995).

### **Is Aid Also a Curse?**

Foreign aid shares some, but not all, characteristics with resource windfalls. Resource windfalls are received by governments as unconditional tax revenues, whereas aid is primarily provided conditionally, and much of it in-kind. Aid and resource windfalls share the characteristic of increasing rapidly and being of macroeconomic significance such as in the new Timor-Leste. Aid and natural resources have uncertain timing for increases, decreases, or cessation. Annual aid volumes are also volatile from period to period, reflecting both exchange rate movements and the gaps between aid givers' intentions, commitments, and disbursements.

Some have expressed concern that high levels of foreign aid might also cause a resource curse with similar macroeconomic impacts, and could erode the quality of governance that poor countries need for sustained and rapid income growth. These issues of macroeconomic and governance impacts of aid on the Pacific island countries (PICs) are of great relevance at present. Aid flows have exceeded 100% of gross national income (GNI) in some PICs. They are set to rise further in real terms, with greater interest in providing aid to the Pacific by North Asian countries and Australia's plan to expand its overall aid budget to 0.5% of GNI by 2015.

### **About This Paper**

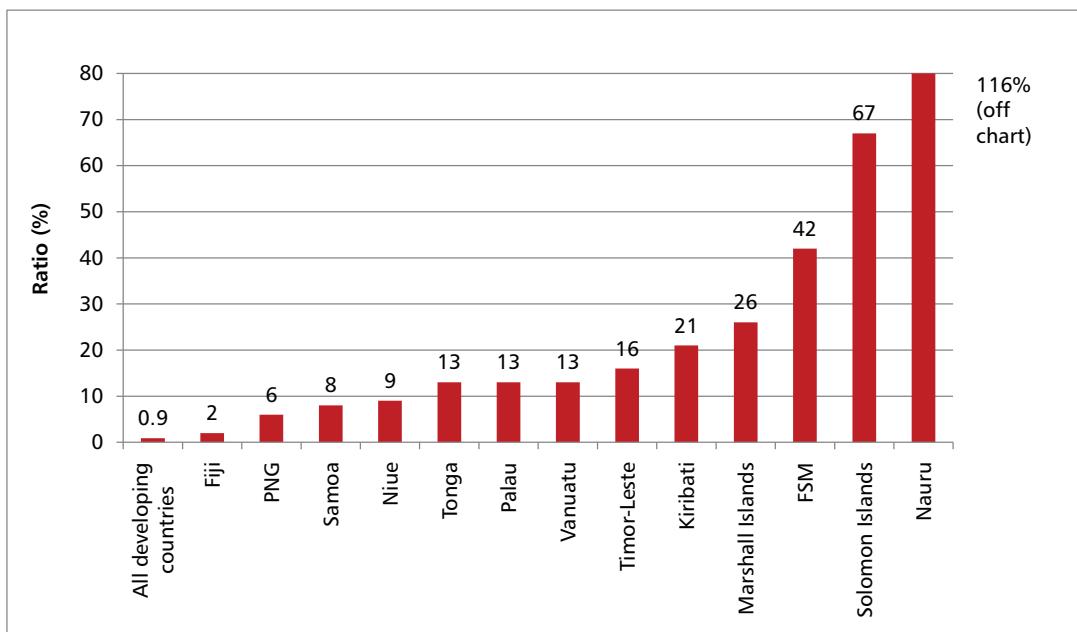
This paper outlines the conceptual issues, analysis, and empirical evidence around aid and possible “Dutch disease” and “resource curse” impacts through the lens of the PICs. It presents data on the nature and trends in donor spending in the region and brings together the wide range of work undertaken on the subject in recent years. This paper complements the literature by assessing one part of the murky aid–governance relationship through multivariate regression analysis by testing the impact of aid (and other control variables) on recipient governments' tax revenues.

## 2. Aid Flows to the Pacific Island Countries

### Size of Aid Flows

All PICs, with the exception of territories governed by France, New Zealand, and the United States (US), receive sizeable overseas development assistance (ODA)<sup>2</sup> from a mix of multilateral, bilateral, and other donors. As is well known, aid flows to several of the PICs are among the highest in the world proportionately. The average level of aid to the PICs far exceeds the average for low-income countries of around 1.0% of GNI. Figures 14.1 and 14.2 summarize PICs' aid receipts in 2007 at the macro level.

**Figure 14.1: Ratio of Aid to Gross National Income for the Pacific Island Countries (%)**

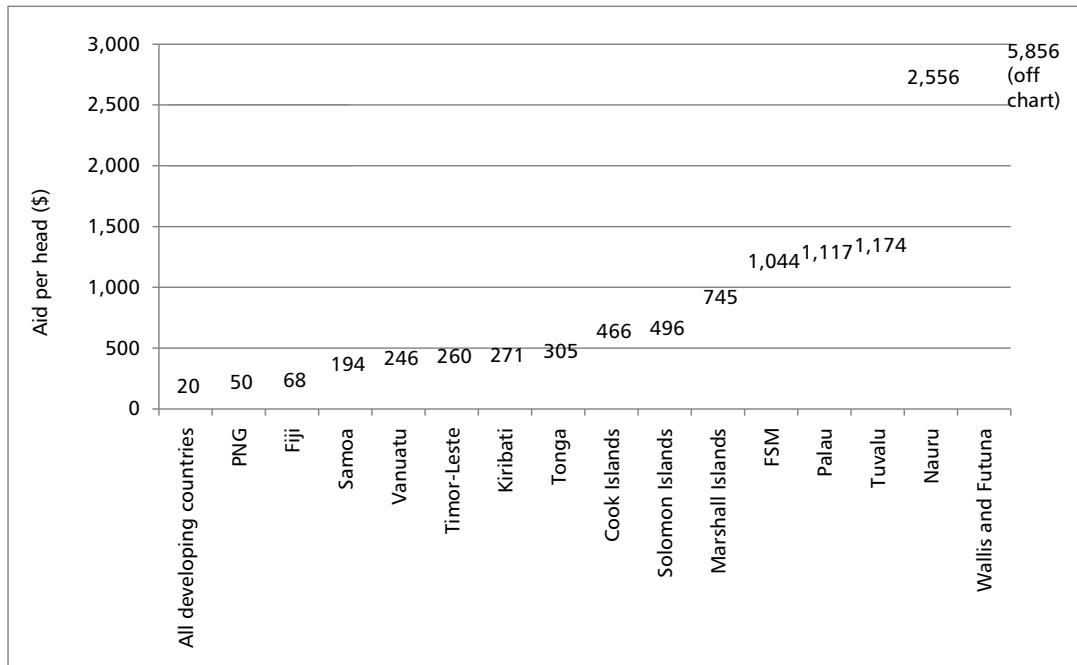


FSM = Federated States of Micronesia, PNG = Papua New Guinea.

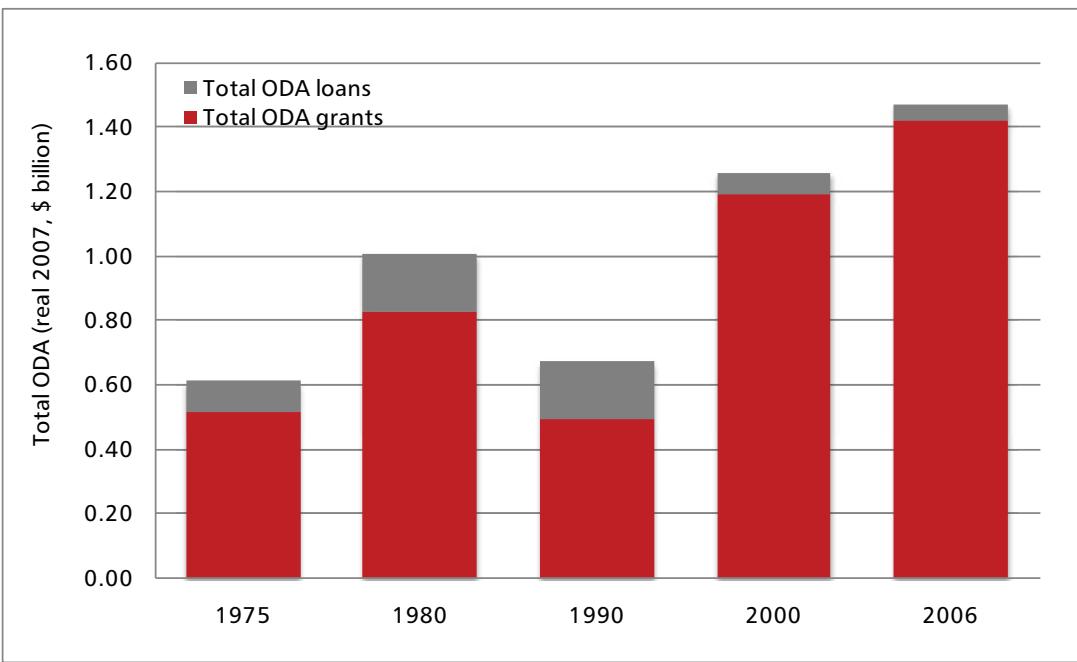
Source: Organisation for Economic Co-operation and Development (OECD, 2009b).

It can be seen that the PICs have received high levels of aid over many decades (Figure 14.3). In real terms, ODA grants grew at an annual average rate of 3.3% between 1975 and 2006 (Organisation for Economic Co-operation and Development [OECD] 2009b), more than outpacing population growth. High and expanding grant aid volumes have underpinned income levels in many parts of the region. Aid is a substantial part of these economies. In contrast, the volume of ODA loans to the region has been in long-term decline.

<sup>2</sup> This paper focuses on ODA grants rather than loans, although it includes the Development Assistance Committee (DAC) data where available on the grant equivalent components of loans provided on concessionary terms.

**Figure 14.2: Per Capita Aid in the Pacific Island Countries (\$)**

FSM = Federated States of Micronesia, PNG = Papua New Guinea, RMI = Republic of the Marshall Islands, \$ = US dollars.  
Source: OECD (2009b).

**Figure 14.3: Overseas Development Assistance Grants and Loans to Pacific Island Countries (real 2007, \$ billion)**

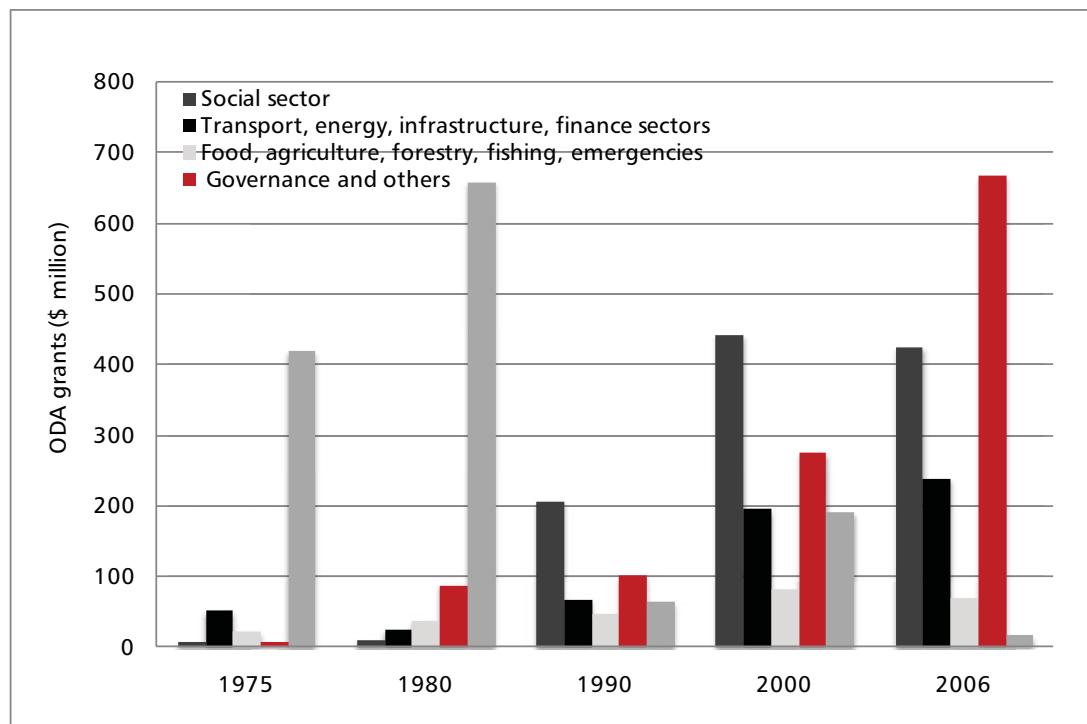
\$ = US dollars.  
Source: OECD (2009b).

## Characteristics of Aid Flows

The ODA grants are provided in several forms across a variety of sectors. They are used to purchase a wide range of domestic and imported goods and services. ODA also includes technical assistance and some expenditures for foreign assistance interventions, such as the Regional Assistance Mission to the Solomon Islands. The primary purpose of ODA grants is to supplement the recipient government's own expenditure programs. In the PICs, donors effectively oversee substantial shares of government expenditure across the various sectors.

Figure 14.4 outlines the changing sector allocation of ODA grants over time. The change in the allocation toward governance and social sector expenditures and away from general budget support is clear. The relatively recent move back *toward* general budget support (with conditions), which has been occurring in some parts of Sub-Saharan Africa, has so far not been replicated in the PICs. Donors in the region have also become involved in more sectors over time.

**Figure 14.4: Allocation of Pacific Island Countries' Overseas Development Assistance Grants, by Sector (\$ million)**



\$ = US dollars.

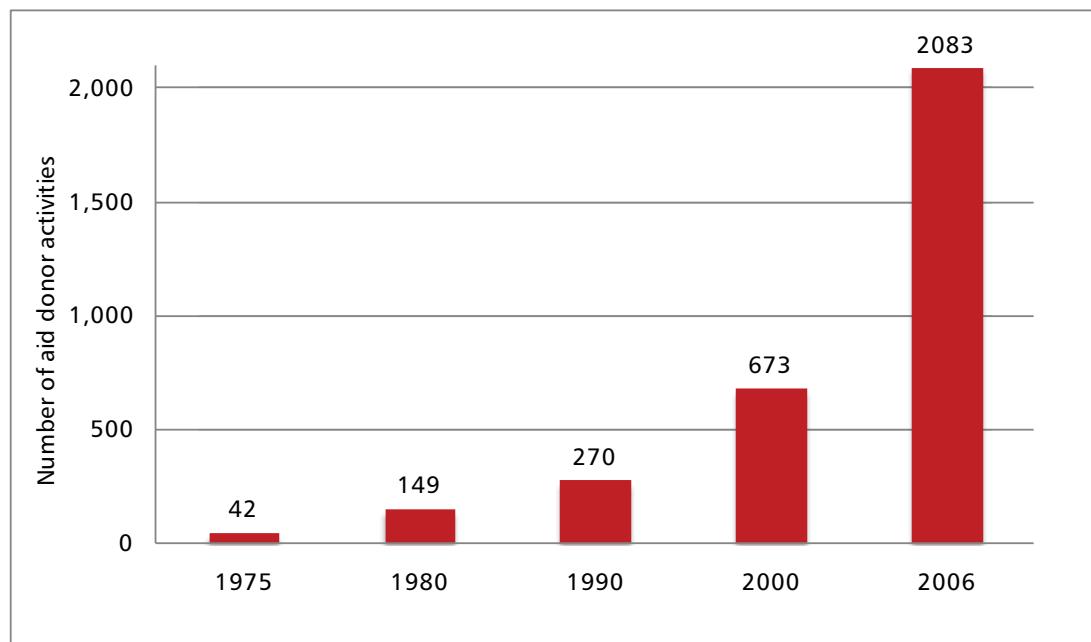
Source: OECD (2009a).

In analyzing the impacts of donor grant expenditures, it would be helpful to know precisely how this money has been spent: on road construction inputs, imported goods, hotels and restaurants, domestic skilled and unskilled workers and the like. However, it is not possible to identify grant expenditure on an economic level; it can only be identified at the sector level from the OECD Creditor Reporting System database (OECD 2009a) and the Development Assistance Committee (DAC) database (OECD 2009b). A thorough economic identification would involve an onerous interrogation of the documentation from individual projects to build up a picture of expenditure

shares on different items. However, the DAC data does provide an estimate of the share of spending on technical assistance, which averaged 31% of total ODA grants received by the PICs during 2000 to 2007 (DAC database).

The OECD data in Figure 14.5 shows that since 1975, there has been an extraordinary proliferation of individual activities in the PICs, as has occurred in other regions. Over that period the number of activities has increased 50-fold, while the number of bilateral and multilateral donors operating in the region rose from 9 to 27. It seems that all donors have overseen an increase in the numbers of aid activities.

**Figure 14.5: Pacific Island Countries—Aid Donor Activities, 1975–2006**



Source: OECD (2009a).

These macro data provide a picture of many donors increasing the number and reach of their aid activities in the PICs. The data however does not allow much more than a superficial impression of the potential macroeconomic and governance impacts of aid activities. Key to determining these aid impacts are the economic channels and transmission mechanisms to markets and institutions. The next section discusses these channels and possible impacts in the context of the PICs.

### 3. Aid Flows: Channels and Impacts

Before considering the various channels and impacts, it is worth outlining what impacts are we really talking about. This paper is not trying to shed light on *net* aid benefits or costs, but rather about some costs that might be experienced by some groups in aid-recipient countries. At question is not whether aid is generally harmful—none of the vigorously disputed evidence about the relationship between aid and economic growth argues that aid reduces growth.<sup>3</sup> At worst, aid is found to fail to

<sup>3</sup> That debate intensified with Burnside and Dollar's (2000 and 2004) findings that aid can contribute to growth in the presence of good policy environments. Although doubt has been cast on the robustness of that finding by Easterly (2003), most studies published since the 1980s conclude that economic growth would be lower in the absence of aid (Feeny 2008).

increase or catalyze economic growth. This paper examines some adverse impacts and the circumstances in which they might occur.

The literature has identified and sometimes measured a variety of channels and potential transmission mechanisms through which aid spending affects the rest of the economy, the political economy, and ultimately governance. Most of the literature draws heavily on Dutch disease, resource curse, and governance analysis frameworks for identifying potentially negative channels and impacts.

Conceptually, these effects of aid inflows can be studied in terms of the following:

- changes in aggregate demand, consumption, and investment;
- changes in aggregate supply, relative prices, and resources;
- monetary and fiscal impacts; and
- impact on governance—corruption and poor policy.

### Aggregate Demand

An unrequited grant from donors expands aggregate demand. In donor programs, grants will either be spent on government consumption items, such as schoolbooks and medicines, or government physical capital investments, such as roads and school buildings. In a sense, the distinction between consumption and investment for a donor is arbitrary, as all of its spending is intended to be an investment, with long-lived benefits. Technical assistance spending is an investment in governance and reform, although the spending is primarily on foreign consultants. The additional aggregate demand is beneficial as it expands the economy and, if overall investment increases in response to the additional public and mixed goods that aid provides, the capital stock will expand as well.

### Aggregate Supply, Relative Prices, and Resources

The increase in aggregate demand might be met in a number of ways. Much of the demand will be spent on imports, since most technical assistance (a services import) and a good part of government consumption is import-intensive. The additional demand from donors for non-tradable domestic goods might be met from spare capacity, which can expand without causing inflationary pressures. However, if the economy is at full capacity, there will be a supply shift toward the non-tradable sector—or at least that part of the non-tradable sector in which donors are expanding demand.

It is this shift in production, and thus of labor and capital, toward part of the non-tradable sector and away from the traded goods sector that is a commonly cited concern regarding windfalls, including those from donors. Labor and capital are attracted to the booming aid sector by higher wages and returns. Labor markets in many developing countries are highly segmented and skilled labor in many professions is often in very short supply. A particular risk is that donors attract the best labor by raising real wages in the non-traded goods sector, luring skilled staff away from governments and the private sector.

The second concern is the potential for appreciation of the real exchange rate, caused by higher non-tradable sector prices. This is a second channel through which the parts of the economy not enjoying the boom might suffer—not only are they paying higher prices for labor and capital, but the exporters among them might be facing a less competitive real exchange rate. The magnitude of the impact will reflect the share of domestic-sourced versus foreign-sourced inputs in donor purchases. This is the route through which aid might contribute to lower exports. The nature of the effects will depend on the size and composition of output in the booming aid sector as compared with the traded (non-aid) goods sector and non-traded (non-aid) goods sectors.

There is a time horizon issue here that is central: the concern about impacts on the real exchange rate and domestic relative prices is relevant only if the aid boom is expected to be temporary. In the PICs, aid inflows are not expected to cease anytime soon. If that is the case, there is no need to worry about these effects, which will be permanent and the policy makers should allow these relative price changes and associated structural changes to permeate the economy.

### **Monetary Impacts**

The inflows of additional donor resources add to the monetary base of the country. There are risks that this will be inflationary, to the extent that aid spending bids up the prices of some non-traded goods where supply cannot respond or respond quickly enough. In this case, monetary sterilization to offset the donor inflows is one possible policy response. The policy concern dissipates if the non-traded goods sector is not operating at full capacity, minimizing the inflationary impact. Donor spending on imports and imported technical assistance will not be inflationary, since these are sourced from world markets.

Policy makers might try to save the donor windfall by using monetary policy or sterilization. The purpose of such a policy would be, assumedly, to benefit from the productivity benefits of donor spending that in a full sterilization would be completely offset, while at the same time saving part of the windfall for a “rainy day.” Implicitly, this policy assumes that one dollar of donor spending will have a bigger payoff and be more productivity-enhancing than that dollar in the hands of the private sector or government. However, sterilization might conflict with other aims of monetary policy, such as inflation targeting and short-term domestic demand management. Running what appear to be heavily contractionary monetary settings to save windfalls might also test the generosity of domestic constituencies and donors.

### **Fiscal Impacts**

There are several possible fiscal impacts of aid inflows. The most obvious is the inherent volatility associated with aid inflows—a characteristic they share with mining and oil revenue flows. The extent of that volatility will be a function of how small and open the economy is, which influences exchange rate volatility. The drivers of aid demand and supply will be important, especially the extent to which aid is driven by donors’ preferences as opposed to the recipient country’s behavior.<sup>4</sup>

Some research have postulated that aid raises government expenditure by drawing governments’ resources into activities that they would not otherwise have undertaken; others have argued that aid does the opposite, by implementing projects that the government would have otherwise have had to do itself. Either way, there are risks. If governments and their taxpayers are drawn into higher expenditures, they will be worse off if those expenditures do not yield the hoped-for payoffs, if only because tax rates will at some stage need to be higher to compensate. If aid is substitutable for other spending—“fungible”—there is a risk that aid will make no difference since governments do not often lower taxes but rather shift their spending to other, assumedly less productive, activities. In both of these scenarios, aid might give rise to a “crowding out” of private sector investment by virtue of higher taxes.

One benefit of aid is the public sector being exposed to new techniques and international standards on a variety of fronts, and accessing more productivity-enhancing imported goods than

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<sup>4</sup> Such as the willingness to undertake reforms and improve the quality of governance and the effectiveness of political institutions.

would otherwise be the case. This is analogous to the potential benefits firms and consumers receive from a trade liberalization policy.

These possible fiscal impacts are closely related to the issues around governance.

### Governance Impacts

The preceding four groups of impacts are primarily economic in nature and affect different groups in society asymmetrically. If there are large, adverse governance impacts of aid in terms of a poor policy environment and corruption, they have the potential to affect many groups. The literature identifies a range of ways in which aid might have adverse impacts on recipient governments, governance, and societies, particularly in countries where governments are weakly accountable and unresponsive to taxpayers, and democratic institutions are weak or still developing.

One possibility is that governments receiving the aid windfall might focus less on growth-enhancing activities, reforms, and providing public services to taxpayers, if donors are happy to provide the public goods and services in their place. This is similar to the dereliction of duty that mining and oil revenue-rich governments are accused of as a manifestation of the “resource curse.”

Another possibility is that governments receiving the donor windfall might reduce their tax enforcement and collection efforts, since donor revenues are much easier to collect and obviate the need to bother domestic taxpayers. If the presence of donors allows governments to avoid or minimize tax collection efforts, this potentially undermines a key incentive that voters have to scrutinize and hold governments to account—the fact that they are the paymasters. The collection of tax and the consequent public spending confers some legitimacy on governments, but also brings additional scrutiny and pressures for transparency on governments.

There are also potential governance impacts from the donors' proliferation of projects. Given the proliferation of activities, which is a feature of the way donors operate (see Figure 14.5), one potentially adverse impact is the time that recipient governments and their bureaucracies need to devote to interacting with aid donors. In this scenario, donors keep governments extremely busy managing and interfacing with donors and the contractors implementing donor projects. Donors take up more than their expenditure-proportionate share of government officials' time and this “crowding out” diminishes their ability to run the government's much larger programs and activities.

A less optimistic depiction of recipient governments is the rent-driven model, which characterizes aid as detached from its paymasters in the donor country, giving rise to political and bureaucratic contests for its capture (Auty 2007). Recipient governments become preoccupied with channeling aid rents to favored constituencies, naturally favoring many projects and their proliferation, since this allows governments to share the aid around.

Lastly, there is the potential for suboptimal use of technical assistance. At present, World Bank research concludes that technical assistance is most effective if it is provided prospectively to assist nascent domestic reformers and to assist countries to get over reform “humps” (World Bank 2008). If technical assistance is used solely to keep governments running, rather than improving policy and assisting with reforms, donors might merely be helping governments muddle along without the pressure for reform. Depending on the country's situation, the opportunity cost of such delayed reforms might be very high. In addition, there might be diminishing marginal returns from technical assistance that is not well targeted or timed. Excessive volumes of technical assistance risk overwhelming and undermining recipient country bureaucrats.

As noted at the beginning, this paper tests for evidence supporting one of these governance hypotheses: that the presence of donors reduces recipient governments' proclivity to collect tax

revenues from its citizens. Before outlining the results of that modeling exercise, it is appropriate to survey the empirical evidence and findings from research into related economic and governance impacts of aid.

## 4. Evidence of the Macroeconomic and Governance Impacts of Aid

Table 14.1 summarizes the key findings from a range of the more recent studies focusing on the Dutch disease and governance impacts of aid in the PICs and elsewhere.

**Table 14.1: Empirical Studies of the Macroeconomic and Governance Impacts of Aid**

Authors	Subject	Findings
Shik, K.J., et al. (2007)	Examine the impact of an aid shock on exports and output in 35 aid recipients.	In half of the countries, an aid shock triggers a fall in exports and output, and a rise in the other half. However, the change in the level of economic output and growth that aid gives rise to is small.
Rao, B.B., et al. (2008)	Identify the effect of aid on growth in three of the largest Pacific island countries (PICs): Fiji, Papua New Guinea, and Solomon Islands.	The effect of aid on the steady state economic growth rate is insignificant in these three PICs.
Gani, A. (2002)	Examines the relationship between indicators of governance and per capita foreign aid in seven PICs.	Voice and accountability, rule of law, and corruption are negatively correlated with foreign aid. Regulatory quality and government effectiveness are positively correlated.
Fielding, D. (2007)	Examines the impact of aid inflows on output and the real exchange rate in 10 PICs.	Inflows produce a variety of effects, consistent with the heterogeneous nature of the PIC economies.
Clarke, M., et al. (2008)	Assess the annual volatility of aid to 44 island states during 1973–2004.	Aid flows to Pacific and the United States' island states have been more volatile than those to island states in Africa.
Knack, S. (2000)	Examines whether aid influences the quality of governance.	Higher levels of aid erode the quality of governance (bureaucratic quality, corruption, and the rule of law).
Burnside, C., and D. Dollar (2000 and 2004)	Assess the relationship between aid and economic growth for a range of periods from the 1970s to 1990s. The main sample of 56 countries (2000) did not include any PIC.	Aid has a positive impact only in countries with good fiscal, monetary, and trade policies, but only a small volume of aid is conditioned on good policy. The key finding is that aid raises growth in a good policy environment. The study has had an important influence on policy and academic debates.
Easterly, W., et al. (2003)	Conduct a data gathering exercise that updates Burnside and Dollar's data and fills in missing data for 1970–1993.	Easterly et al. find that Burnside and Dollar's (2000) results are substantially weakened by the inclusion of the additional data.
Dutta, N., and P. Leeson (2009)	Test whether foreign aid has the power to make dictatorships more democratic or democracies more dictatorial, for 73 countries during 1975–2003.	Aid strengthens democracy in already democratic countries and strengthens dictatorships in dictatorial regimes. Aid does not appear to alter trajectories of political institutions.
Fagernas, S., and J. Roberts (2004)	Assess the fiscal impacts of aid in Uganda, a high-aid recipient, during 1974–1999.	External financing increased public expenditure, as did grant aid. The impact on revenues appears positive, but the finding is not conclusive.
Gupta S., et al. (2003)	Examine the revenue response to inflows of foreign aid (grants and loans) in 107 countries during 1970–2000.	The dampening effect of grants on revenue effort is modest, but larger in more corrupt countries.

Table 14.1 demonstrates that the empirical evidence is supportive of the various conceptual hypotheses of the impact of aid in some cases but not others. Shik et al.'s (2007) is one of a wide range of studies, mostly concentrated in Sub-Saharan African countries, showing that the macroeconomic Dutch disease impacts of aid on the non-aid sector (in this case the export sector) can go either way, reflecting the fact that the real exchange rate and relative price shifts can also go either way. These studies are, inevitably, heavily influenced by the choice of countries, the time period and the quality of data.

The many studies on aid and growth aim to shed some light on the combination of potential Dutch disease macroeconomic and governance effects. Despite the large number of studies done, a dispassionate reading of this evidence leaves one with few clear conclusions. Perhaps one tentative conclusion that can be drawn is that growth is highly unlikely to be *higher* in the absence of aid. If this is true, the main cost of ineffective aid are the foregone development opportunities (opportunity cost) of aid. There is even ambiguity in the few results on the PICs. Rao (2008) finds that aid in the PICs has had no impact on the long-run ("steady state") economic growth rate in three PICs. Fielding (2007) uses data for 10 countries, uses different techniques, and reaches different conclusions, finding mixed impacts of aid on growth and the real exchange rate, which he attributes to the heterogeneous nature of these economies.

The negative relationship between aid and some types of governance appears empirically tighter, such as from Knack's 2000 study. Gani (2002) finds a similar result in the PICs. The aid and governance work also lends support to an emerging idea that aid can erode the quality of governance once it passes a particular ratio of aid to growth domestic product (GDP)—not that there is clear agreement about what that level is for different countries. Feeny and McGillivray (2008) estimated that in the PICs the region-wide average growth-efficient level of aid is around 20% of the recipient's GDP. Beyond that level, aid is characterized as surpassing the absorptive capacity of the recipient.

Work on the fiscal impacts of aid tends to be country-specific, throws up mixed results, and leads to more questions than answers for policymakers. For example, the study of Uganda by Fagernas and Roberts (2004) finds that aid increased government spending, but no relationship could be found with revenues. In contrast, Gupta et al. (2003) find a modest dampening effect of aid grants on revenues. The effect of grants is higher in more corrupt countries. They also find that concessional loans are associated with higher domestic revenue mobilization.

Following on from this fiscal impact and governance impact research, this paper investigates the revenue response to foreign aid (grant) inflows.

## 5. Investigating the Impact of Aid on Revenue Collection

The PICs have high aid levels and a variety of research suggests that aid might be harmful to governance and growth in some circumstances. The consensus from the public finance literature (see, for example, Teera 2004) is as follows:

- Many countries face difficulties in raising tax revenue to the levels required to promote economic growth. Developing countries have lower average tax-to-GDP ratios than higher income countries.
- Low levels of tax revenue mean either weaknesses in tax policy or poor revenue collection effort.

- While developing countries tend to have lower tax-to-GDP ratios, this is not a hard and fast rule. Lower- and higher-income countries with apparently similar economic structures have vastly different tax rates and vice versa.
- Ideally, analysis of tax levels and effort should also encompass consideration of the level of services being provided for those taxes.

## Hypothesis

Taxation is a central part of the governance mix, with tax collections conferring a certain degree of legitimacy on governments and also underpinning accountability. Taxes create the incentive for voters to hold governments accountable for delivering the public goods and services they desire, if only because they are funding them. As noted earlier in the fiscal impacts subsection, one possible hypothesis is that the presence of donor grants allows governments to reduce revenue effort and collect less in taxes than would otherwise be the case. The study tests this hypothesis, which is given some credence by the Gupta et al. (2003) study.

## Estimation Method

Cross-country variations in the tax-to-GDP ratio (excluding donor grants) are modeled as a function of real GDP per capita (to capture the size of the tax base and the level of economic development), the presence of donors (ODA-to-GDP ratio), trade intensity (a proxy for a “tax handle”), the inflation rate (a proxy for macroeconomic policy governance), and the shares of mining and oil in total exports:<sup>5</sup>

$$\text{Tax/GDP} = B_0 + B_1 \text{GDP} + B_2 \text{ODA} + B_3 \text{TRADE} + B_4 \text{INFL} + B_5 \text{OILER} + B_6 \text{MINER}$$

There are other possible control variables that could have been included. For instance, there are several measures of governance other than inflation that might have been used, but the data are poor and cover a shorter time frame. In addition, the relationship between the governance indicators and aid is mixed and the effects probably run both ways.<sup>6</sup> The International Monetary Fund (for example, Gupta et al. 2003) has had mixed results from using inflation as a proxy for economic governance. Additional tax handles, such as the agriculture and manufacturing shares of GDP, might have been included, but these are probably less important than trade exposure in driving PICs' government revenues.

The equation is estimated using panel data for the 1990–2007 period. Multivariate regression analysis with a log transformation was undertaken. Data are sourced from the World Development Indicators (WDI) database (2009). Since data for the Pacific in the WDI are patchy, the *ADB Key Indicators* (2009) was used to fill in some gaps. The data gap-filling was only undertaken for the PICs.

## Results

Table 14.2 provides an overview of the ordinary least squares regressions performed for all countries and for several country income and geographic groupings, including the PICs. The “All Countries” results show that, as expected, real GDP per capita has a large positive correlation with a higher

<sup>5</sup> See Appendix 14.1 for a description of the data.

<sup>6</sup> Burnside and Dollar (2000) note that little aid is provided on an *ex-post* conditionality basis, where recipients are provided aid following demonstrated good governance. The largest exceptions are perhaps World Bank International Development Assistance and the US Millennium Challenge Corporation grants.

revenue-to-GDP ratio. A higher net ODA-to-GDP ratio is found to have only a small positive impact on revenues (excluding ODA). While the effect is small, this result suggests that the presence of donors contributes to higher, not lower, revenues. In the “All Countries” category, higher inflation rates are associated with higher revenues, suggesting that the revenue acceleration effects of inflation are dominating and that the inflation rate is a poor proxy for economic governance.

However, the results from low-income countries do not establish any significant relationship between revenues and ODA levels. There is a positive relationship between revenues and GDP, as expected, and also with mineral ores exports.

Notwithstanding the filling of some gaps in the WDI data, the PICs’ regression from a smaller sample delivered large errors and there was a high degree of multicollinearity in the data. A more efficient specification (4a) included only GDP, ODA, and trade intensity to overcome the multicollinearity, but this specification has poor explanatory power. Counter-intuitively, the coefficient on GDP is negative and significant while the ODA is positive and significant.

**TABLE 14.2 Regression Results for the Relationship between Domestic Revenue and Aid**

Technique	Dependent variable: Revenues to GDP ratio (excluding grant aid)							
	1/OLS	2/OLS	3/OLS	4/OLS	4a/OLS	5/OLS	6/OLS	7/OLS
World Bank country groupings	All Countries (210)	Low-Income Countries (44)	Upper and Lower Middle-Income Countries (99)	PICs (16)	PICs (16)	East Asia and Pacific (23)	Island States (55)	Sub-Saharan Africa (47)
Real GDP per capita (PPP)	0.250 <sup>a</sup> (21.3)	0.538 <sup>a</sup> (4.47)	0.327 <sup>a</sup> (11.37)	-0.167 (-0.406)	-0.269 <sup>a</sup> (-3.20)	0.765 <sup>a</sup> (9.68)	0.147 <sup>a</sup> (4.66)	0.132 <sup>b</sup> (2.37)
Net ODA to GDP	0.062 <sup>a</sup> (7.76)	0.008 (0.19)	0.075 <sup>a</sup> (6.58)	0.104 (0.82)	0.111 <sup>a</sup> (2.89)	0.240 <sup>a</sup> (11.77)	0.051 <sup>b</sup> (2.57)	-0.003 (-0.07)
Trade intensity	0.176 <sup>a</sup> (8.28)	0.078 (1.06)	0.259 <sup>a</sup> (8.57)	0.186 (0.81)	0.154 <sup>c</sup> (1.71)	0.187 <sup>b</sup> (2.52)	-0.032 (-0.52)	0.465 <sup>a</sup> (6.70)
Inflation rate	0.022 <sup>b</sup> (2.54)	0.025 (1.03)	0.027 <sup>b</sup> (2.36)	-0.094 (-1.54)		0.003 (0.09)	-0.034 (-0.97)	0.028 (1.11)
Oil exporter	0.013 <sup>a</sup> (2.72)	0.005 (0.49)	0.008 (1.40)	-0.013 (-0.85)		-0.008 (-0.56)	0.012 (1.54)	0.016 <sup>b</sup> (2.01)
Mineral ores exporter	-0.005 (-.78)	0.030 <sup>a</sup> (2.73)	-0.004 (-0.53)	-0.002 (-0.05)		0.084 <sup>a</sup> (4.55)	-0.004 (-0.39)	0.004 (0.40)
Adjusted R <sup>2</sup>	42.1	39.5	35.7	22.4	12.2	76.2	20.3	51.2
Observations	1,048	96	558	32	175	97	100	123
Missing observations	793	695	1,224	256	113	317	890	723

GDP = gross domestic product, ODA = overseas development assistance, OLS = ordinary least squares, PIC = Pacific island country, PPP = purchasing power parity.

Note: The number of observations for each sample is shown in parentheses.

<sup>a</sup> Significant at 1%.

<sup>b</sup> Significant at 5%.

<sup>c</sup> Significant at 10%.

Sources: World Development Indicators (World Bank 2009) and ADB Key Indicators (2009).

In the regressions for East Asia and the Pacific and for the island states there is also a significant positive relationship between revenue and ODA. The only negative sign on the ODA variable is the insignificant parameter for the Sub-Saharan Africa group.

Based on these results, the hypothesis that the presence of aid is negatively correlated with revenues during 1990–2007 is rejected for the All Countries, Middle Income, East Asia and Pacific, and Island States samples. No reliable relationship is found for the impact of ODA on revenues in the PICs, Low-Income Countries, and Sub-Saharan Africa groups. Compared with other studies, especially from Gupta et al. (2003), the notable result from this research is the positive and significant relationship found between ODA and revenues.

The result that revenue has an unclear relationship with aid in the PICs leaves open several possibilities for investigation. One is that aid and revenue are partially endogenous to each other. Another is that the cause and effect primarily goes in the other direction, such that a change in the circumstance of a country (natural disaster or rapid terms of trade deterioration) impact revenues, which then leads to donors altering aid levels. This outcome is plausible in countries receiving large amounts of aid. Alternatively, the volatile year-to-year macroeconomic shifts that the small, open, and relatively undiversified PIC economies experience could overwhelm any revenue movements that emanate from more or less donor spending.

## 6. Conclusions and Policy Considerations

This paper has studied the Dutch disease and governance impacts of aid in the PICs. It provided an overview of aid received by the PICs. The key demand, supply, fiscal, monetary, and governance impacts of aid were identified, as well as the mixed empirical findings from the literature.

Multivariate regression analysis was not able to establish the expected negative impact of aid receipts on revenues (excluding aid grants) in the PICs. For other regions, the analysis points to aid having a generally positive relationship with revenues (excluding grants).

There is a range of policy implications for PIC governments and donors regarding appropriate management of the Dutch disease and governance impacts of aid covered in this paper. The key issues relate to the demand-side and supply-side management of aid, fiscal policy, and monetary policy. To some extent, the traditional Dutch disease macroeconomic management issues are of second order to those around fiscal policy and governance.

As far as policy is concerned, recipient governments should do the following:

- Manage aid inflows to be sure that donor projects and policies that give rise to higher future government expenditures have sufficient economic, social, or environmental payoffs.
- Manage donors to reduce or limit the extent of aid activity and sector proliferation, to prevent PIC bureaucracies and governments from being swamped.
- Be aware of the composition of aid and identify whether aid spending in the non-tradable domestic sectors would be better spent on imported capital goods, on technical assistance used by governments, or on foreign service delivery providers (this is more important if there are noticeable impacts on factor markets contributing to domestic price increases<sup>7</sup>).
- Consider, in concert with bilateral and multilateral donors, whether short-term sterilization is appropriate to manage large or rapid infusions from increased aid.

<sup>7</sup> For example, in a context of skilled labor scarcity, donors and their contractors poaching the government's and sometimes the private sector's best staff and paying them above-market wages.

- Consider how permanent aid flows are likely to be. If they are likely to be in place for the long run, there is no reason to save aid. However, if there is a short- or medium-run aid boom, there might be consideration of whether an offshore fund or like mechanism is appropriate to save some of the aid.

Donors should take the following steps:

- Undertake aid increases in the PICs carefully to avoid swamping domestic markets and bureaucracies with a mix of Dutch disease and governance impacts. Expenditures on imports, technical assistance, and traded goods pose fewer risks of swamping. Imported capital goods that expand the capital stock have a greater chance of catalyzing private investment, rather than government consumption, which generally crowds out private sector investment. Large increases in purchases of non-traded goods and services pose the greatest risk of swamping markets in small, aid-dependent countries.
- Slow or reduce proliferation of activities by increasing sector and country specialization and rationalizing among individual donors. Donors could consider sharing costs of fixed infrastructure and back offices with other donors to reduce fixed costs in small but expensive-to-operate locations.
- Use technical assistance that increases the chances of sensible policy reforms, but provide it in response to, rather than in anticipation of, domestic policy processes or reform opportunities.
- Avoid drawing recipient governments into policy engagements that entail expenditure commitments with uncertain returns or a low probability of payoffs.

## 7. Appendix 14.1: Description of the Data Elements

### Dependent Variable

- Revenues, excluding overseas development assistance (ODA), as a percentage of gross domestic product (GDP)

### Independent Variables

- Real GDP per capita (in constant \$ purchasing power parity [PPP] terms)
- Nominal net ODA to nominal GDP ratio
- Trade intensity (nominal exports plus imports as a percentage of nominal GDP)
- Inflation rate (annual percentage change)
- Oil exporter (oil exports as a percentage of total exports)
- Mineral ores exporter (minerals and ores exports as a percentage of total exports)

\$ = US dollars.

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# 15 The Political Economy of Sugar Rents in Fiji

by *Satish Chand*

## ABSTRACT

This paper provides a narrative of the political economy of the contest over sugar rents in Fiji. These rents arose from the preferential prices provided to exports of fixed quantities of sugar to the European Union. The key findings of the paper are as follows: (i) sugar rents have fuelled political competition in Fiji; (ii) the competition between the stakeholders has culminated in the dissipation of the rents; and (iii) the externality of competition for these rents has had a deleterious impact on intercommunity relations, national politics, and policy making in general. These findings imply that preference erosion will, under current conditions, improve politics and policy making in Fiji. Some of these lessons may have relevance in other countries.

## 1. Introduction

The Fiji sugar industry has historically been a hotbed for national politics. Prime Minister Commodore Frank Bainimarama announced on 20 August 2009 the dissolution of the Fiji Sugarcane Growers Council—a body claiming to represent some 20,000 smallholder growers—allegedly because it was “trying to influence national politics” (Australian Broadcasting Corporation 2009). This decision followed an earlier decision of the Prime Minister to dissolve the Sugar Commission of Fiji and Fiji Sugar Marketing Ltd., which was supported by the Fiji Sugarcane Growers Council chair who claimed that it would save farmers 1 million Fiji dollars (F\$) annually. The Fiji Labour Party, which has historically drawn its support from the growers, objected to these reforms, arguing that “it will result in the FSC [Fiji Sugar Corporation] playing the dominant role with the consequential marginalization of the cane growers” (Fiji Live 2009b). Furthermore, a former chief executive officer of the Fiji Sugarcane Growers Council claimed that the industry is “confrontational, heavily politicized and too regulated,” with “harvest boycotts and strikes” costing the industry F\$100 million over the past 20 years (Sami 2009).

The above quotes are a sample of the tussles that regularly take place within the Fiji sugar industry. Here I investigate the political ramifications of the contests over sugar rents, defined as the price premium paid relative to the world market price for fixed quantities of sugar exported to the European Union (EU) under the Sugar Protocol of the European Community. This subsidy is being phased out as part of the commitments made to the World Trade Organization. The consequences of the winding down of the subsidy on national politics are also discussed.

Exports of specified quantities of raw sugar from Fiji—an African, Caribbean, and Pacific (ACP) state—into the EU have enjoyed guaranteed prices some two to three times the world market price. These preferences were first offered under the Lomé Convention of 1975 and subsequently extended under the Cotonou Agreement of 2000, which gave 70 sugar-producing countries preferential access into the EU. The Sugar Protocol expired in September 2009 and the preferences are being gradually wound down. The European Community announced reductions in the price paid for sugar imported from Fiji by 5.1% beginning 1 June 2006; by 9.2% in 2008; and by a further 21.7% in 2009. The reduction over the 3 years amounts to 36% of the original preferential price. Further, the preference price is to be phased out fully by 2015.

Assistance for adjustment to the price reduction was promised to Fiji by the European Community via an Economic Partnership Agreement with Fiji and the other Pacific island states. However, the adjustment assistance is being withheld following the military coup of 5 December 2006—the fourth in the nation’s history. On 25 September 2009 the European Community announced a 6-month deferment of its planned adjustment assistance, reportedly due to “violation by the authorities of key commitments Fiji made to the EU, as well as further regressive developments, such as the abrogation of the Constitution, human rights violations and a further substantial delay in holding elections” (Fiji Live 2009c).

The politics surrounding the sugar industry pervades policy making at large. The major stakeholders include the growers, the landowners, the mill workers and their unions, and the government—all significant players within the nation’s political landscape. The politics of sugar extends from the farms to Parliament and from Suva to Brussels. It is a force that was seeded at colonization in 1874 and has persisted for the past 135 years. The erosion of preferences introduces a new dynamic into the politics of sugar rents.<sup>1</sup> Their erosion will diminish the incentives for rent seeking and thus has the potential to improve intercommunal relations, national politics, and policy making in general. This process may already have begun. The reforms announced by the Prime Minister, including the dissolution of several organizations, were triggered by the anticipation of the erosion of sugar rents.

This case study is illustrative of the political ramifications of the competition for rents in a divided polity. The competition has been between the landowners, the majority of whom are indigenous Fijians, and the tenant farmers, who are predominantly Indo-Fijians. A ban on the alienation of land at colonization in 1874 enshrined land rights with the indigenous population. Indian immigrant laborers, first brought to Fiji in 1879 to work for the then Australian-owned Colonial Sugar Refining Company (CSR), later became the majority sugarcane farmers using land leased from indigenous Fijians. The Native Land Trust Board (NLTB) was established in 1940 and given a monopoly over the issue of agricultural leases, institutionalizing a landowner class. The government took an active stake in the sugar industry after acquiring the sugar mills at independence in 1970. Thus, by 1970 the nation was compartmentalized into three groups: the Indo-Fijian growers, the indigenous Fijian landowners (represented by NLTB), and the government as the miller.

At independence, the nation adopted a proportional system of representation in Parliament. With the indigenous and Indo-Fijian populations nearly equal in size at independence, the competition for sugar rents manifested itself within national politics. In sum, Fiji’s colonial history provided the ingredients for fractionalized politics, and the rents from sugar exports the incentives

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<sup>1</sup> Preference erosion refers to a situation where exporters with privileged access to export markets lose their competitive edge as barriers to trade in these export markets are lowered to third country exporters.

for such conflict. The combination of the two has had a deleterious effect on policy making and politics as a whole.

Fiji may be unique in terms of the preconditions for divisive politics, but not in terms of the corrosive effects of rent seeking on politics and policy making. Rent dissipation through political competition is common in several contexts. As shown later, the dissipation of rents through divisive politics, in Fiji or elsewhere, is akin to a prisoners' dilemma where the Nash equilibrium delivers the worst possible outcome for society as a whole.<sup>2</sup>

The main findings of this study are that (i) the sugar rents have fuelled political competition between the two major ethnic groups, (ii) this competition has led to the dissipation of the rents, and (iii) the competition for these rents has inflicted external social costs on national politics and policy making. The remainder of the paper is structured as follows: section 2 presents the context for rent seeking; section 3 discusses the rents provided to the sugar sector; section 4 presents the incentives for land (and ethnic) politics, which in turn has had a corrosive influence on policy making; and section 5 draws the policy implications. Conclusions are presented in section 6.

## 2. The Context and Conditions for Rent Seeking

The term “rent,” as used in economics, is a “gift.” Its use in this paper as an economic concept is distinct from its everyday use. The term “rent seeking” infers competition for the rents. The rent may be innate, such as that of a talented athlete. Alternatively, it can be conferred via fiat. However, rent seeking is possible only for the latter category. The sugar rents allow rent seeking since they arise as a “gift” of a fixed amount, but one “wrapped” in sugar exported from Fiji to the EU. Fijian sugar is produced through the use of land, labor, and capital (mills). The three groups of stakeholders use divisive tactics to maximize their share of the rents. Importantly, the competition (that is, the rent seeking) makes no contribution to productivity; rather, it detracts from the value-adding effort in the sugar industry and deepens the ethnic divide. Debates over the division of the sugar rents are manipulated by the stakeholders so as to tilt the balance of power and distribution of the rents in their favor.

Ethnic divisions within Fiji were seeded at colonization. Sir Arthur Gordon, the first resident governor, experimented with “non-transformative” colonization (Veracini 2007). This involved quarantining ethnic Fijians to their villages and away from agricultural plantation. The alienation of land was banned, sharply reducing the prospects for the establishment of large sugarcane plantations.<sup>3</sup> The governor took these actions supposedly to protect the indigenous population from likely abuse by the resident European planters (Docker 1970).<sup>4</sup> The colony, while rich in land for sugar farming, needed workers. Indian labor was brought in on 5-year renewable contracts under what was then known as the “indenture system” (Gillion 1962). Governor Gordon also established a Council of Chiefs as part of his administration. This was the beginning of a stratified and divided community.

The governor had good reasons for drawing the chiefs into his administration. It was a cost-effective means of extending the reach of his administration—an important consideration given the

<sup>2</sup> A prisoner's dilemma arises when contending parties are unable to reach a binding agreement. In such a situation, both parties end up with the worst possible result. The name of this game originates from the situation of two prisoners asked to confess to a crime in isolation of each other. Each prisoner has the incentive not to confess even if doing so together would land both lesser penalties compared to what would prevail when both deny involvement.

<sup>3</sup> This is a major contrast with the experience of Mauritius.

<sup>4</sup> Docker provides an excellent account of the abuses of labor recruitment by European planters in that era.

meager resources at his disposal and the large archipelago under his authority. The governor outlawed alienation of land given the large land claims by the white settlers, the authenticity of which he doubted. He consolidated the position of chiefs by channeling land-lease payments through them (Ward 1995). This entrenched the position of the chiefs in Fijian society, giving them the imprimatur of the colonial authority. The demarcations between a landowning ethnic group and another comprising the tenant farmers owe their genesis to Governor Gordon's policies at colonization.

Indo-Fijians are far from a homogenous group. The indenture system ended in 1920, but the indentured population was encouraged by the administration to stay after their contracts ended and farm land leased from the indigenous population. Free migrants from India followed the indentured workers.<sup>5</sup> Thus, the current population of Indo-Fijians comprises a heterogeneous mix of descendants of indentured laborers and free migrants who came as agriculturalists and traders, with the latter group continuing to maintain a stronghold on urban business.

Indigenous Fijians, in contrast, were kept apart from the modern economy by the colonial administration. The physical quarantining of the indigenous population and away from enterprise, while thrusting the Indo-Fijians into commerce and agriculture—mostly on land leased from the indigenous population—remains a major factor in the politics of race and income redistribution in contemporary Fiji.

The sugar industry continues to be the source of political patronage for the two major ethnic groups, while access to land is the major source of tension. According to the 1921 population census, there were 84,475 indigenous Fijians and 60,634 Indians in a total population of 157,266. By the 1966 census, there were 240,960 Indo-Fijians and 202,176 indigenous Fijians.<sup>6</sup> The majority of the decedents of Indian indentured laborers continue to work the land, most of which is leased from the indigenous community.

The smallholder sugarcane-producing sector, comprising some 18,691 farmers as of 2007 (see Table 15.1), is the largest single source of livelihood for Indo-Fijians. The average farm was 2.9 hectares in area and produced 165 tons of sugarcane (data for 2007 from FSC, 2008).<sup>7</sup> All farms are rain-fed and, in a good year, total sugarcane production has reached 4 million tons. The technology used in the growing of sugarcane and the milling of the crop remains primitive. Sugarcane is manually harvested, as was the case 135 years ago. There were a total of 11,536 sugarcane cutters in 2007. Today, sugarcane cutters still operate in small cooperatives (called “gangs”) with a *sirdar* (overseer) and a “headman.” These gangs form the bottom rung of the political structure in many rural villages, while being a *sirdar* is good training for village, district, and even national politics.

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<sup>5</sup> See Lal (2004) on the origins of Fiji Indians and an account of the experiences of the indentured laborers in Fiji, and Gillion (1962) for an account of the separatist policies of the colonial administration.

<sup>6</sup> Population statistics are from the Fiji Islands Bureau of Statistics' *Key Statistics* dated June 2007.

<sup>7</sup> Note that as of 2007 there were 14,948 “active growers,” meaning those delivering sugarcane to the mills.

**Table 15.1: Sugar Production Statistics, 1971–2007**

Year	No of Contracts	Area Harvested ('000 ha)	Cane Delivered ('000 t)	Sugar Produced ('000 t)
1971	15,548	47	2,545	323
1972	15,612	44	2,238	303
1973	16,533	46	2,496	301
1974	16,546	45	2,151	272
1975	17,264	45	2,160	264
1976	17,667	47	2,283	286
1977	18,395	52	2,674	362
1978	18,456	54	2,853	347
1979	19,152	62	4,063	473
1980	19,700	66	3,360	396
1981	21,000	66	3,931	470
1982	21,574	69	4,075	487
1983	21,880	59	2,203	276
1984	22,130	69	4,290	480
1985	22,159	70	3,042	341
1986	22,182	69	4,109	502
1987	22,255	66	2,960	401
1988	22,127	64	3,185	363
1989	21,771	71	4,099	461
1990	21,334	70	4,016	408
1991	24,479	73	3,380	389
1992	23,334	73	3,533	426
1993	23,454	74	3,704	442
1994	23,264	74	4,064	517
1995	22,449	74	4,110	454
1996	22,304	74	4,380	454
1997	22,100	73	3,280	347
1998	22,146	57	2,098	266
1999	22,178	65	3,958	377
2000	22,179	63	3,786	341
2001	21,882	66	2,805	293
2002	21,246	65	3,423	330
2003	20,693	61	2,479	237
2004	20,492	61	3,226	310
2005	20,290	58	2,789	289
2006	18,649	56	3,001	314
2007	18,691	54	2,610	294

ha = hectare, t = ton.

Sources: For 1971–2002, Fiji Bureau of Statistics, *Current Economic Statistics Bulletin* (June 2003); for 2003–2007, Fiji Sugar Corporation.

The cane is transported to one of the four sugar mills operated by the Fiji Sugar Corporation Limited (FSC). Approximately equal quantities of cane are transported via the rail system operated by FSC and on privately operated motor trucks; the latter have been increasing as sugarcane cultivation has expanded into areas without rail transport (FSC 2002). The mills are 68% government-owned and employ around 3,000 workers—some only during the 6-month harvesting season. Depending on milling efficiency and the volume of throughput, total sugar production has ranged from 237,000 tons in 2007 to 517,000 tons in 1994 (annual production data is given in Table 15.1).<sup>8</sup> Most of the sugar produced is exported with some 80% of the exports sold to the EU at a preferential price under the Sugar Protocol. The price paid to the grower for the cane is determined by a legislated formula that apportions the average price received for the sugar produced between the FSC and the grower (N. Reddy 2004).

Preferential access for Fiji sugar into the United Kingdom (UK) and subsequently into the EU (after the UK joined the European Economic Community in 1974) has existed since the inception of the industry in 1879. Sugar exports from Fiji to the EU have been governed by two trade agreements: the Sugar Protocol and the Agreement on Special Preferential Sugar (SPS) between the ACP states on the one hand and the EU on the other. Article 1 of the Sugar Protocol states that

... the [European] Community undertakes for an indefinite period to purchase and import, at guaranteed prices, specific quantities of cane sugar, raw or white, which originate in the ACP states and which these States undertake to deliver to it (ACP Sugar Group, 2010).

The price, according to Article 5 of the Sugar Protocol, is to be negotiated annually; Article 3 specifies the country quotas; and Article 7 states that the quota is to be divided among the remaining members should a member fail to meet its allocation. The SPS agreement was enacted in 1995 for an initial term of 6 years to meet the sugar deficit of Portuguese refineries, following the accession of Portugal and Spain to the EU in 1986. Sugar sold under the SPS agreement earned 85% of the price paid under the Sugar Protocol. The United States also gave preferential entry to approximately 10,000 tons of sugar annually from Fiji under the Generalized System of Preferences (GSP).

Over their lifetime, preferential arrangements have transferred a significant quantum of rents to Fiji. The price received—net of transport costs and importer margins—for sugar exports to the preferential markets for the 10-year period to 2001 was 2.6 times the world market price (referred to in Table 15.2 as A-sugar), 2.3 times the world market price under the SPS agreement (referred to in the table as B-sugar), and 1.9 times the world market price under the GSP arrangements (see Table 15.2 and Figure 15.1). The Sugar Protocol accounted for some 90% of the total rent receipts, defined as the price premium multiplied by the preferential quota for the respective markets. SPS accounted for another 6%, with the balance being accounted for by the GSP (see Table 15.3). For the 10 years to 2001, the sugar rents amounted to nearly half the total value of exports of sugar—which equates to approximately 5% of GDP (see Table 15.2).

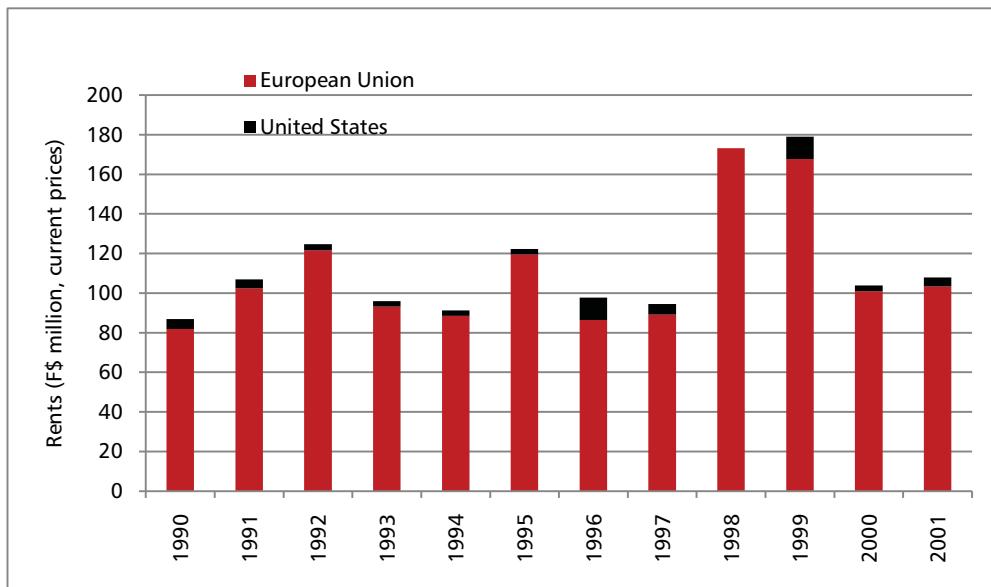
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<sup>8</sup> By international standards, Fiji is a high-cost producer. Its cane productivity of around 50 tons per hectare compares unfavorably with that Mauritius' 80 tons per hectare. The Fiji Prime Minister acknowledged that the country's cane yield is the second lowest and its sugar yield the worst among the 20 African, Caribbean, and Pacific (ACP) sugar-producing states (*Fiji Sun*, 6 October 2004). According to the Prime Minister's statement, the costs of producing a ton of sugar at the four mills were F\$340 in Penang, F\$320 in Lautoka, \$230 in Labasa, and \$160 in Rarawai.

**Table 15.2: Sugar Rents by Source, 1990–2001**

Year	EEC (F\$ million)	US (F\$ million)	Total Rents (F\$ million)	Rent/Sugar Exports (%)	Rent/GDP (%)
1990	81.83	5.14	86.96		5
1991	102.46	4.43	106.88		6
1992	121.66	3.14	124.79	56	6
1993	93.28	2.70	95.97	42	4
1994	88.51	2.81	91.32	36	4
1995	119.56	2.68	122.24	44	5
1996	86.38	11.39	97.77	32	4
1997	89.08	5.36	94.44	44	4
1998	173.25	0	173.25	71	6
1999	167.75	11.21	178.96	68	6
2000	100.97	2.85	103.82	44	3
2001	103.33	4.63	107.96	49	3

EEC = European Economic Community, F\$ = Fiji dollar, GDP = gross domestic product, US = United States.  
Sources: Fiji Sugar Corporation (2002) and Reserve Bank of Fiji *Quarterly Review* (various issues).

**Figure 15.1: Rents from Sugar Exports, 1990–2001**

F\$ = Fiji dollar.

Data source: Fiji Sugar Corporation (2002).

**Table 15.3: Prices and Quantities of Sugar Exports, 1990–2001**

Year	P <sup>EU(A)</sup> (F\$)	P <sup>EU(B)</sup> (F\$)	P <sup>US</sup> (F\$)	P <sup>WLD</sup> (F\$)	Q <sup>EU(A)</sup> (ton)	Q <sup>EU(B)</sup> (ton)	Q <sup>US</sup> (ton)	Total Exports (ton)
1990	869.31	–	621.95	351.08	157,891	–	18,979	367,762
1991	896.53	–	635.33	336.05	182,799	–	14,800	355,146
1992	948.42	–	532.92	333.19	197,740	–	15,702	391,203
1993	856.04	–	664.42	343.61	182,033	–	8,403	400,919
1994	886.43	–	615.97	362.85	169,055	–	11,106	471,172
1995	875.21	778.89	631.84	368.73	191,420	55,112	10,197	412,011
1996	902.66	771.87	935.79	364.10	137,554	30,151	19,930	409,872
1997	911.32	697.99	656.83	374.37	145,566	33,733	18,980	303,118
1998	1,110.20	881.57		293.66	189,180	31,932	0	253,058
1999	973.02	890.38	865.38	259.81	201,206	38,448	18,513	336,437
2000	941.48	768.44	724.11	410.56	176,471	20,331	9,083	308,283
2001	978.20	910.68	934.91	423.51	172,493	15,700	9,065	243,873

– = not available

Notes: P denotes price per ton in current Fiji dollars and Q for quantity of sugar exports under preferential quotas A, B, and to the United States (US). The superscripts EU, US, and WLD stand for the European Union, the United States, and the World, respectively.

Source: Fiji Sugar Corporation (2002).

Contest for the rents takes place via national politics of race. Fiji has at least three distinct features that underscore its fractionalized politics: sharp divisions along ethnic lines between the two major communities, each of nearly equal size; a parallel landowner–laborer divide; and large rents from an agricultural crop. A proportional electoral system introduced at independence in 1970 provided the incentive for the politicization of ethnicity. The National Alliance Party, led by Ratu Mara, a high chief and the first Prime Minister of Fiji, drew its majority support from the indigenous (landowning) community. The National Federation Party drew its support from the Indo–Fijian (tenant) community.<sup>9</sup> The former championed the rights and aspirations of the indigenous population, while the latter did the same for Indo–Fijians. A proportional system of voting provided the incentives for the nurturing of these divisions, particularly by aspirants for political office. Such divisions were hyped in the lead-up to national elections. Despite the rewriting of the Constitution in 1990 and again in 1997, ethnically segregated electoral competition continues to bedevil reforms to land tenure and to the sugar industry.

The two major ethnic groups have competed over government and over public handouts with deleterious effects on policy making. Politicians have canvassed redistribution on the basis of ethnicity, often under the guise of poverty alleviation.<sup>10</sup> While ethnic segregation and redistribution owe their origins to the first colonial governor, the two coups of 1987 provided considerable thrust to “affirmative action” policies, which have widened the gulf between the two communities. The interim government installed following the first coup in 1987 introduced its “Nine-Point Plan,” which included injections of funds into Fijian Holdings Limited—a company created solely for the benefit of the indigenous population. The policies included (i) subsidized access to finance for the

<sup>9</sup> The “Others,” meaning people of all other races, composed less than 10% of the total population at independence, with their share falling to approximately 7% by 2007. They include the more affluent Chinese and Europeans, as well as the relatively poorer non-indigenous Pacific islander communities.

<sup>10</sup> Fiji is a “bipolar” polity; a context difficult for policy making for poverty reduction (Fearon 2003) and highly conducive to conflict (Cederman and Girardin 2007).

indigenous population from state-owned banks, (ii) government-funded business training for indigenous Fijians, (iii) the establishment of compulsory savings schemes for the indigenous population, and (iv) the reservation of half of all government contracts and investments in resource-based activities for the indigenous population. Indigenization of the public service was also aggressively pursued, while similar expectations were made of the private sector.

The third coup in 2000 saw the overthrow of the first Indo-Fijian Prime Minister. He was replaced by an interim Prime Minister, Laisenia Qarase, who introduced a second, and more ambitious, round of taxpayer-funded handouts. Mr. Qarase launched an ambitious policy agenda called “the Blue Print for the Advancement of Fijians and Rotumans” (the Blue Print) “to improve the economic and social positions of the indigenous population in Fiji society” (Government of Fiji [GoF] 2002, p. i). He rationalized the discriminatory policies on the basis of an “expressed recognition of the paramountcy of Fijian interests and also the principle that the interests of the Fijian community are not to be subordinated to the interests of the other communities.” He quoted, but partially only, from Chapter 2 of the 1997 Fiji Constitution. Clause (k), section 6 of this chapter allows for “affirmative action and social justice programs to secure effective equality of access to opportunities, amenities or services for the Fijian and Rotuman people, *as well as for other communities, for women as well as men, and for all disadvantaged citizens or groups, are based on an allocation of resources broadly acceptable to all communities*” (emphasis added to the words that Qarase omitted).

The redistributive (distortionary) policies were used to provide handouts to the indigenous population, the majority of whom belonged to the political party of the Prime Minister.<sup>11</sup> Mr. Qarase referred to *The Fiji Poverty Report* of the United Nations Development Programme (UNDP), jointly produced with the government, to justify affirmative action programs of his government, claiming that

[t]he 1997 United Nations Poverty Report revealed that households with the lowest level of income were those in rural areas and outer islands. Again, the majority of these were Fijians (GoF 2002, p. i).

The Prime Minister was once again economical with the truth. The 1997 UNDP *Fiji Poverty Report* had stated categorically that “[p]overty is not concentrated in any particular sector of Fiji society but is an under-current across all communities” (UNDP 1996, p. 2; emphasis added). The incidence of poverty among ethnic Fijians was no greater than among Indo-Fijians; if anything, the converse was probably true (Chand 1997).

Prime Minister Qarase argued in the Blue Print that the proposed policies would prevent future coups, acknowledging that past coups had done “irreparable damage” to race relations and the economy. The Blue Print not only failed to prevent another coup but also was an espoused reason for the next coup that led to the ousting of Mr. Qarase from office. The “clean up” campaign that Commodore Bainimarama began as part of his 2006 coup is reportedly designed to bring an end to race-based politics in Fiji (GoF 2008).

<sup>11</sup> Laisenia Qarase was Prime Minister from July 2000 to December 2006. He was first installed as the interim Prime Minister by the military following the coup of 2000 and deposed by the same military in December 2006. He won two national elections; one in September 2001 and the other in May 2006.

### 3. Sugar Rents and Adjustment Assistance

Sugar is a large part of the Fiji economy. It contributes about 6% of gross domestic product (GDP) and 26% of total merchandise exports, and provides livelihoods for nearly one-quarter of the population.<sup>12</sup> Thus, the impact of the phasing out of the EU preference will reverberate throughout the economy. By one estimate, a 40% reduction in the preference margin will result in deterioration in the terms of trade of 8 percentage points (Page 2004). The preferential price is due to be eliminated by 2015 and its impact is already being factored into domestic politics. The “de-politicization” of the industry, as announced by the Prime Minister in September 2009, is part of this adjustment process.

The Asian Development Bank (ADB) and the EU have promised assistance for adjustment to the new subsidy-free price regime. However, assistance to reform the sugar industry has itself been subject to contestation. ADB provided technical assistance with grant funding of \$660,000; this was supplemented by \$280,000 from the Fiji government. The program was launched in 2002 to

...provide a neutral forum for stakeholder discussions and consultations on the restructuring of the sugar industry, along with the expertise to provide sound technical advice to the restructuring process (ADB 2002, p. 3).

This technical assistance had the goal of “prevent[ing] serious economic and social disruption as a result of a catastrophic and uncontrolled collapse of the sugar industry (ADB 2002, p. 6). ADB (2006) assessed this technical assistance as being successful.

The EU promised support via its Economic Partnership Agreement (EPA). An objective of the EPA is to

...avoid trade disruption between Pacific States and the European Community in view of the expiry of the trade preferences granted under the Cotonou Agreement on 31 December 2007 (European Commission 2009; Article 1, paragraph a).

According to media reports, the EU had promised F\$350 million to the Qarase government as adjustment assistance.<sup>13</sup> The 2006 military coup has led to the withholding of this assistance; the promised assistance is being used as an instrument to further political objectives. The EU has placed conditions for release of these funds on the military government linked to the fulfilment of its timetabled transition to democracy and the treatment of all human right infringements in accordance with the laws of Fiji.

In sum, the Fiji sugar industry has enjoyed large rents via preferential access to markets in the EU and the United States. Moreover, assistance provided by donors for adjustment to a rent-free environment has itself entailed large rents and increased the risks of rent seeking. While the value of the latter assistance remains in question, at least one provider of assistance has judged the support provided as being successful.

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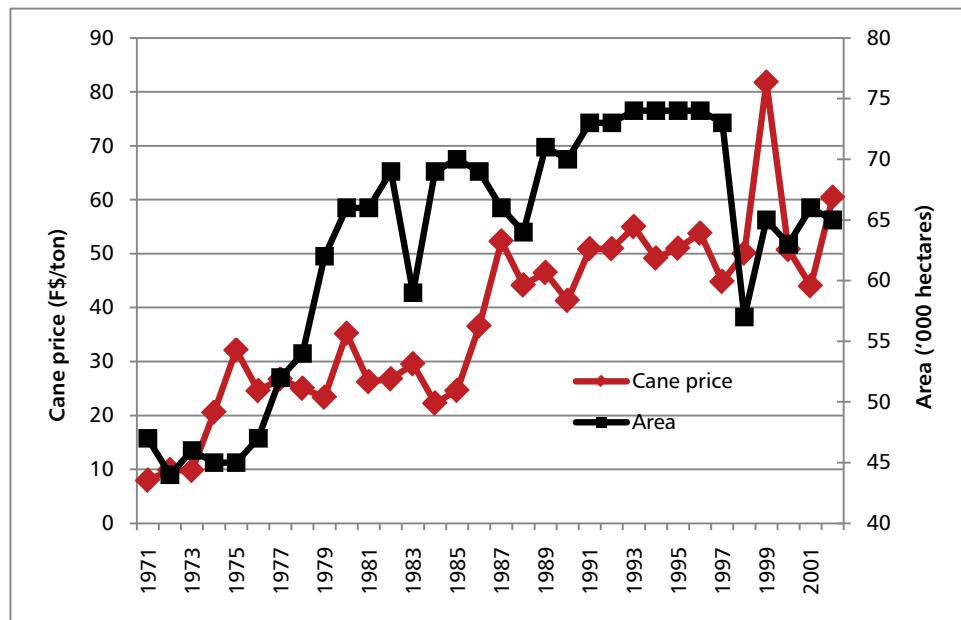
<sup>12</sup> Data is for 2006, the most recent available, from the March 2008 issue of *Key Statistics*, Tables 3.1 (GDP by Activity) and 8.5 (Merchandise Exports), published by the Fiji Islands Bureau of Statistics, Suva, Fiji.

<sup>13</sup> Reported on Fiji Live (2007, 2009a). The Fiji Times of 1 June 2009 reported loss of EU support in an article titled “Fiji sugar reform should proceed without EU funds” after the EU’s decision to withhold a F\$60 million grant, while Radio New Zealand reported on 18 May 2009 that Fiji had lost \$32 million earmarked for assistance to sugar industry reforms.

## 4. The Forms of Rent Dissipation

Sugar rents have been dissipated through inefficient farming practices and milling inefficiencies, and through wage premiums paid to organized labor. Rents to the growers are dissipated through three channels. First, the rent component of income from profitable farms such as those on alluvial plains close to the mills has been capitalized in their prices. Thus, farms purchased recently have incorporated the stream of income, inclusive of the preferential price, into the indefinite future. Second, the artificially increased prices for sugarcane have led to an expansion of the area under cultivation (Figure 15.2). This expansion has mainly been onto marginal land and/or to land further away from the mills, such that rents have been lost to rising costs of production and/or transportation. Third, the subsidy has induced inefficiencies in both farming and milling. Productivity within the Fiji sugar industry compares unfavorably with other sugar-producing nations. As an example, average sugarcane output in Fiji at 48 tons per hectare compares unfavorably with 79 tons for Mauritius, 87 tons for Queensland, and 108 tons for Hawaii (M. Reddy 2004). Several surveys have confirmed that the majority of the farms make poor returns, with many being continually in debt (Rao 2003). Despite the premium prices received for sugar exports, of which the millers receive a fixed share, the Fiji Sugar Corporation (FSC) has had losses in 7 of the 10 years to 2008. As shown in Table 15.4, the rate of return on assets of the FSC has ranged from a maximum of 2.76% (in 2007) to a low of -7.62% in 2001; the average return for the decade to 2008 was -2.74%.

**Figure 15.2: Expansion in Area of Sugarcane Cultivation and Price of Cane (1971–2002)**



F\$ = Fiji dollar.

Source: Fiji Bureau of Statistics, *Current Economic Statistics Bulletin* (January 1990 and June 2003).

**Table 15.4: Financial Statistics for Fiji Sugar Corporation<sup>a</sup>**

	2008	2007	2006	2005	2004	2003	2002	2001	2000	1999
Turnover (F\$ million)	236.7	274.3	235.2	242.7	227.5	265.7	243.8	251.2	287.2	257.1
Profit/Loss before taxation (F\$ million)	(19.7)	6.9	(6.9)	(2.7)	0.7	(13.4)	(13.6)	(20.9)	(5.3)	3.0
Income tax expense/benefit (F\$ million)	0.4	(0.3)	3.3	0.7	1.6	1.2	(2.8)	–	2.0	1.0
Profit/Loss after taxation and extraordinary items (F\$ million)	(19.3)	6.6	(3.6)	51.9	2.3	(15.8)	(16.4)	(20.9)	(3.3)	2.0
Total assets (F\$ million)	273.5	249.9	211.4	222.8	220.1	252.3	252.6	274.1	304.1	237.2
Net assets (F\$ million)	125.7	167.1	168.4	168.6	116.	114.3	130.1	153.7	174.6	114.4
Proceeds of sugar and molasses (F\$ million)	206.1	272.1	231.6	237.8	223.6	261.1	239.4	236.6	282.0	245.1
FSC's share of proceeds (F\$ million)	61.8	81.6	69.5	71.4	67.1	78.2	71.8	70.7	83.1	73.5
Price per ton cane (F\$)	58.21	59.05	58.13	55.48	60.12	53.80	60.80	44.01	50.76	81.79

– = not available; F\$ = Fiji dollars.

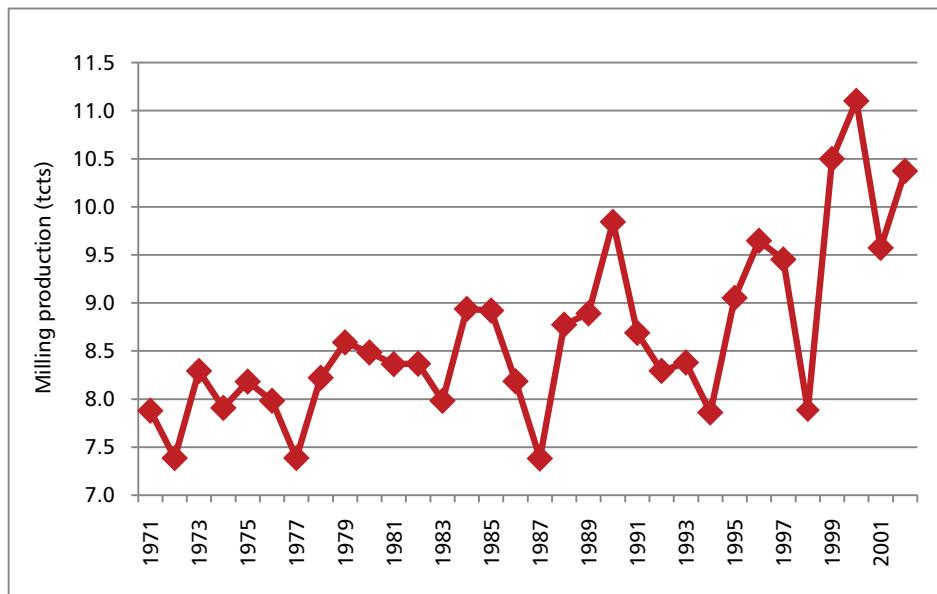
<sup>a</sup> From 1999 to 2003, the year ended on 31 March, while from 2004 to 2008, the year ended on 31 May.

Source: Fiji Sugar Corporation (FSC). 2008. *Annual Report*. p. 76.

Milling inefficiency has risen with time (Figure 15.3).<sup>14</sup> Milling (technical) efficiency, in terms of tons of sugarcane crushed to produce a ton of sugar, has deteriorated by 30% from 1973 to 2002. Milling efficiency has deteriorated most during periods of increased sugarcane production. Frequency of mill breakdowns, for example, has increased whenever throughput has been abnormally high. This may be the consequence of a lack of excess milling capacity—say above that required to serve the preferential quota. But constraining milling capacity to the fixed preferential quota may also be a strategic response by FSC to maximizing profits, particularly if the marginal costs of milling sugarcane exceed the world market price of sugar. The latter is a reasonable assumption given the poor record on the rate of return to equity in FSC. In other words, FSC being the monopoly miller may have an incentive to limit production to the level of the preferential quota. Anecdotal evidence supports this conclusion.<sup>15</sup>

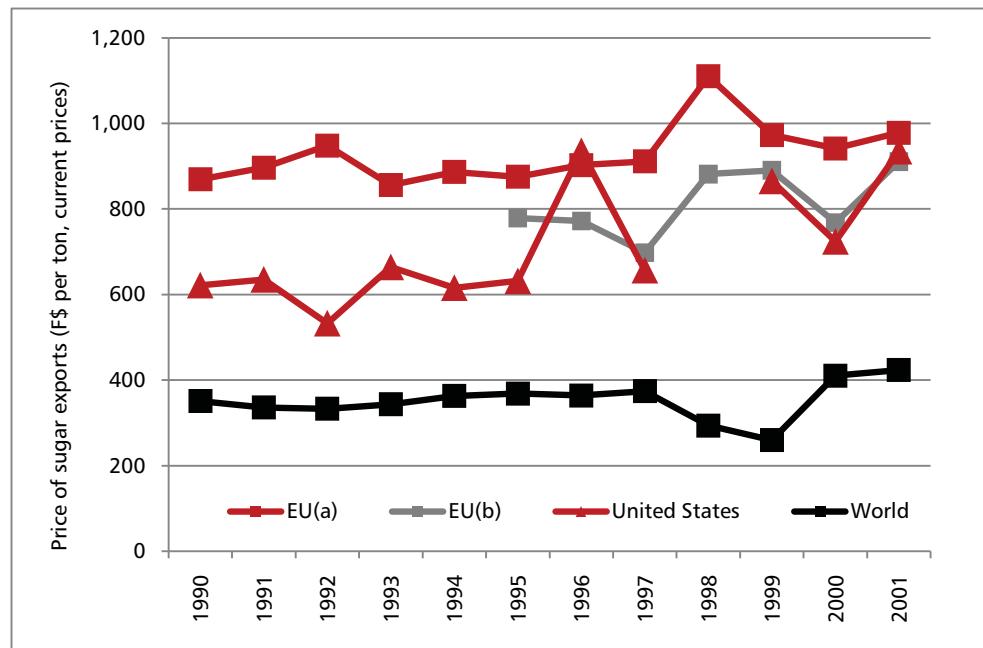
<sup>14</sup> Part of the rise in tons of crushed sugarcane required to produce a ton of sugar is attributed to planting of varieties such as *Mano* that have low pure obtainable cane sugar and increased burning of cane during harvest; these in turn are due to cane being grown on marginal land. Burning of cane increases at the end of the season when farmers rush to clear the standing crop from the fields.

<sup>15</sup> The growers, while having a similar incentive, face collective action problems. Furthermore, sugarcane output is largely determined by weather conditions and an even distribution of rain during the growing season particularly.

**Figure 15.3: Milling Efficiency (1971–2002)**

tcts = tons of crushed cane to produce one ton of sugar.

Data source: Current Economic Statistics Bulletin, Fiji Bureau of Statistics, (June 2003 and January 1990).

**Figure 15.4: Price of Sugar Exports to the European Union, the United States, and World Markets, 1990–2001**

EU(a) and EU(b) denote exports to the European Union under preferential quotas (a) and (b).  
Source: Fiji Sugar Corporation (2002).

Finally, landowners and unionized labor have claimed some of the rents. Land values within the sugarcane growing districts have risen with the expansion of area under sugarcane cultivation. With land rentals set at 6% of the unimproved capital value, the landowners have shared in the rents from sugarcane farming. With regard to labor's share, Prasad and Akram-Lodhi (1998, p. 49) report that "high union densities and a well established industrial relations framework have ensured that factory and field employees of the FSC have benefited from both preferential prices and the sales security guaranteed by the Protocol."<sup>16</sup> FSC is mandated to pay the minimum legislated wages, which was \$97 per week for manufacturing sector workers in 1999. By contrast, the non-unionized sugarcane cutters earned an average income of \$62 per week during the 6-month harvesting season (wage data from Fiji Bureau of Statistics 2004 and N. Reddy 2004). The skill levels are comparable between the two since many sugarcane cutters work for FSC as unskilled employees clearing the tracks and loading fallen sugarcane, tasks that they do as sugarcane cutters on privately run farms. As further evidence of rent dissipation through wages, payroll costs for the FSC in 1999 amounted to 55% of total operating costs—a figure considered to be "too high" by White (2004, p. 292).

## 5. Incentives for Land (and Ethnic) Politics

The tenants and the landowners use the political process to gain access to the sugar rents. The land tenure system provides incentives, and serves as the instrument, for the politicization of race—particularly with respect to access to land for sugarcane farming. Indigenous Fijians own some 87% of the total land area; the state holds another 6%, with the remainder held under freehold title (Prasad 2004). The Native Land Trust Board (NLTB) has the sole legislative mandate to administer all land held in native title "for the benefit of Fijian Owners" (NLTB n.d.) The Board of Trustees of NLTB comprise the President, the minister for Fijian affairs, and another 10 members, of whom at least eight must be indigenous Fijians. NLTB makes general policies regarding administration of native land, approval of leases, collection and distribution of proceeds from rental of land,<sup>17</sup> and landlord-tenant relations.

NLTB has a monopoly, granted via legislation, over the issuance and administration of leases. As an institution, it has been active in national politics. It serves as a focal point for discussion of issues of interest to landowners and the indigenous population. The close links NLTB has with the Great Council of Chiefs gives them political clout parallel to that of Parliament. As such, it is an effective institution for extraction of rents from the sugar industry, using its political clout whenever necessary. However, contestation for these rents takes place at multiple levels: (i) between NLTB and the growers, (ii) between NLTB and the landowners, and (iii) among the landowners themselves. Ward (1995, p. 247) suggested that NLTB effectively dispossesses the owners of their land, while Vesikula (2002) noted that the distribution of rental income is a cause of considerable conflict within landowning clans. The multi-tiered contests for the rents from sugar sold at preferential prices induce formation of groups at the level of growers who are predominantly Indo-Fijians and

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<sup>16</sup> Establishing that mill workers appropriate some of the preference rents requires the estimation of wage equations as in Krueger and Summers (1988) and Katz and Summers (1989); however, data for such analysis is not available. Workers on farms run by FSC earn wages well in excess of their counterparts on adjoining farms run by private operators. This has led to queuing for such work opportunities.

<sup>17</sup> Land rents are set at a maximum of 6% of unimproved capital value. NLTB retains 25% of the rental proceeds to cover administrative costs. The holders of the top three chiefly titles within the traditional hierarchy take another 22.5%, leaving the remaining 52.5% to be shared by the rest of the *mataqali* (the land owning unit according to custom) (Ward 1995, p. 221).

landowners who are in the main indigenous Fijians. These contests regularly take the form of race rivalries that seep into national politics.

The institutions created within the sugar industry have been conducive to adversarial politics. Several organizations were set up to formalize groupings within the industry. The Sugar Commission of Fiji was created by the Sugar Industry Act of 1984 and given responsibility for coordinating activities of the various sections of the industry. The Sugar Industry Tribunal was established to settle industrial disputes. The Sugar Cane Growers Council was set up to represent the growers. Mill area committees were established to organize harvesting (FSC 2002). FSC, the trade unions, the Fiji Sugar Marketing Company, and the Sugar Cane Research Station add to these formal (institutionalized) groupings. Finally, the apportionment of the proceeds from the sale of sugar between the miller and the growers is governed by legislation in the form of a "Master Award" (N. Reddy 2004).

National politics provides incentives for political aspirants to use ethnically divisive strategies to garner support. The two major political parties draw the majority of their support on the basis of ethnicity. The Fiji Labour Party has a strong following among the Indo-Fijian growers, while the *Soqosoqo ni Duavata ni Lewenivanua* party<sup>18</sup> that was led by Mr. Qarase had its majority support within the indigenous Fijian community. Past constitutions have allocated the majority of the seats in the Parliament (that is, the House of Representatives) on the basis of ethnicity. The now abrogated 1997 Constitution, for example, had 23 communal seats reserved for indigenous Fijians and 19 communal seats reserved for Indo-Fijians; the remaining 29 (of a total of 71) seats were "open" seats.<sup>19</sup> Its predecessor, the 1990 Constitution, allowed for only communal seats, 37 of which were allocated to indigenous Fijians and 27 to Indo-Fijians. The 1970 Constitution had a total of 52 seats, of which 23 were reserved for indigenous Fijians and 23 for Indo-Fijians.

Debates over the division of sugar rents have resurfaced in the lead-up to each parliamentary election. Landowners are led to believe that the returns they receive are an unfairly low share of the rents from sugarcane farming. For instance, Kurer (2001, p. 1) notes that "[t]here is hardly a more universal complaint among Fijian landowners that they receive unfairly low rents from their land." This view was given legitimacy by Davies and Gallimore (1999) when this study was publicized widely in the popular press. Of particular note was the conclusion that if "just and fair" rents had been paid over the previous 30 years, each Fijian household would have received an additional accumulated total of approximately F\$15,000. The "exploitation" of landowners gained currency in the lead-up to the coup of 2000. However, Kurer (2001) showed that the average sugarcane farmer earns an annual cash income, inclusive of the costs of family labor, of F\$862. This figure is in sharp contrast to the estimate of F\$8,000 by Davies and Gallimore (1999).<sup>20</sup>

Several studies have pointed to the low productivity of the sector, the prevalence of inefficient farming practices, and the unrealistic expectations landowners have of rewards from sugarcane farming (see Forsyth 1995; Kurer 2001; Rao 2004). The incentives for spreading misinformation about the returns from cane farming, particularly during election campaigns, remain strong, however. Land serves as a convenient instrument for mobilizing the electorate on ethnic lines. It forms the basis for ethnic politics, a process reinforced by the electoral system, where the majority of the parliamentary seats are allocated on ethnic lines.

<sup>18</sup> This translates to "Union of the Children of the Land" in reference to the indigenous population.

<sup>19</sup> The 1997 Constitution had 25 open seats to be contested by universal suffrage.

<sup>20</sup> Davies and Gallimore reach this figure by multiplying the average price of cane of F\$50 by the average farm production of 160 tons, ignoring the costs of all inputs (land rent, harvest and transport costs, etc).

Incentives also explain the polarization of the community along ethnic lines. NLTB presents the landowners as a united front. This, in turn, provides an incentive for tenants to unite in an adversarial environment. The land-lease system was the outcome of a political bargain between parties representing the two major ethnic groups in Parliament. The Agricultural Landlord and Tenants Act of 1976, for example, defined the term of agricultural leases (30 years), the rights of tenants and landowners, a rental formula, and a dispute settlement mechanism.<sup>21</sup> Thus, the Growers' Union earned its legitimacy as a defender of the interests of the tenants. This confrontation can be thought of as a landowner-tenant tussle, but a tussle reinforced by an electoral system that allocates seats in the national parliament on the basis of ethnicity. In this context, aspiring leaders have an incentive to play up the landlord-tenant divide to maximize their support in national elections. Not surprisingly, land issues resurface regularly during political strife. The system of incentives explains the prevalence of ethnically divisive politics, which is in essence a landowner-tenant struggle. Rents have been dissipated in "wars of attrition" between the two ethnic groups, leading to an outcome akin to that of a prisoner's dilemma game.

The history of the contestation of rents within the sugar industry, and its dynamics since colonization, may be characterized as follows. Sugar is produced, largely for export, by a miller using land and labor. The sugar industry at colonization constituted the Colonial Sugar Refining Company (CSR), which grew the bulk of the crop and milled it. Labor was provided by indentured workers. Land was acquired from the indigenous community, at first directly from them and later intermediated by the state. The existence of many laborers and landowners would imply that all of the excess profits accruing to the industry would have been shared between the state and CSR. The ban on land alienation induced the establishment of the smallholder growers. This also led to the establishment of NLTB. By the mid-20th century, the industry was characterized by a monopoly miller who was supplied the crop by a competitive smallholder sector, which, in turn, leased land from NLTB. Market power in the purchase of the crop remained with CSR, while market power to lease land now rested with NLTB. Thus, rents accrued to CSR and NLTB. Independence led to the purchase of CSR by the government and the establishment of FSC, while NLTB retained its role. Market power now resided with FSC and NLTB. However, the substantial change at independence was that the seat of government could now be contested via the electoral process.

The market structure sketched out above provides several useful insights into the prevailing political economy of sugar rents in Fiji. A rent-seeking monopoly such as NLTB has the incentive to retain all rents, given the competitive nature of its franchisees. Therefore, one would expect NLTB to be highly politicized, legitimizing its existence in a competitive framework as an agency for extracting rents from the competing party—the tenants. This description presupposes the existence of rents to begin with, and NLTB has an incentive to exaggerate the profits earned by the Indo-Fijian farmers. This explains why a study such as Davies and Gallimore (1999), which supported the existence of high profits for tenant farmers, would be popular among the indigenous (landowner) leadership, while studies challenging such a view, as did Kurer (2001), would largely be ignored.

The Growers' Union, as the representative of the tenants, has a symmetric incentive to convince tenants that security of access to land, and conditions for lease renewals particularly, can be achieved via the political process. That is, the union loses its legitimacy should lease-renewals become independent of the political process. The Growers' Union is funded via levies (in contrast to NLTB), and thus its existence depends on continuing political support. Moreover, such support is critical for

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<sup>21</sup> The Agricultural Landlord and Tenants Act of 1976 superseded the Agricultural Landlord and Tenant Ordinance of 1966 that legislated 10-year leases.

winning communal Indo-Fijian seats at national elections within the sugarcane growing districts. The politicization of the industry on the part of the Indo-Fijians is thus to be expected.

While highly stylized, this representation of the contest for rents within the sugar industry in Fiji generates a number of predictions regarding the nature of politics that are consistent with reality. For instance, the analysis shows the basis for the ethnically based and highly divisive politics. Furthermore, the political leadership that draws support from an ethnically divided electorate has an incentive to preserve the status quo. Consequently, land reforms attract considerable rhetoric but little action from the leaders of the two major ethnic groups. Furthermore, ethnic polarization increases during the electoral campaigns, when grievances regarding the division of proceeds from sugar exports are debated by aspirants to the national Parliament. The nurturing of this divide has adverse ramifications for race relations and policy making as a whole. This problem was recognized by the architects of the 1997 Constitution. They reduced the proportion of communal seats in Parliament from 100% in the 1990 Constitution to 65% in the 1997 Constitution. Of the 71 seats in the House of Representatives, 25 were designated “open seats” that had no restrictions on the ethnicity of the candidate or the electorate.<sup>22</sup> These rules were designed explicitly to induce candidates to seek support from all ethnic groups. With the benefit of hindsight from two further military coups (in 2000 and 2006) and three national elections (1999, 2002, and 2006), it is clear that these modifications were unsuccessful in eradicating the incentives for ethnically divisive politics.<sup>23</sup> This evidence supports the proposition that electoral engineering via the 1997 Constitution failed to address the deep roots of ethnically based competition.

In many respects, the competition between the landlords and the tenants in Fiji is not too dissimilar to that seen elsewhere. However, the parallel ethnic and electoral demarcation between the two is unique. The ramifications of this competition on national politics and policy making are hugely damaging. Therefore, the erosion of trade preferences will reduce this socially harmful competition.

## 6. Conclusions

Fijian society has a fractionalized and deeply polarized polity, which is largely a product of its colonial past, but the divisions have been nurtured since independence 4 decades ago. The deep divide within the population between descendants of Indian laborers brought to the colony more than a century ago and the indigenous population—together with the differences with respect to language, culture, and land ownership—is itself a recipe for racial strife. Moreover, political independence in 1970 resulted in a Constitution that allocated the majority of the seats in the national Parliament on the basis of ethnicity. This allocation provided the incentive for aspirants to political office to mobilize voters along ethnic lines. The divisive politics is evident in the various income redistribution schemes that political parties have pursued when in power. Many of these schemes have been the source of corruption and poor governance.

Post-independence, Fiji had all the ingredients for conflict. In a comparative international context, Fiji, with an ethnic fractionalization index of 0.55 (figure for 1996 from Alesina et al 2003), has done a lot better in terms of economic development and the quality of governance than Guinea, which had an ethnic fractionalization index of 0.74 (figure for 1990), but considerably worse than

<sup>22</sup> The original proposal was for 45 open seats, but this figure was reduced to 25 by the Fiji Parliament. Commodore Bainimarama has proposed the abolishing of all communal seats from the next Constitution.

<sup>23</sup> See Ghai and Cottrell (2007) and Reilly (2006) on electoral engineering in Fiji.

Mauritius with an index of 0.46 (figure for 1992).<sup>24</sup> Mauritius is a better comparison since it had the same preferential access for its sugar exports to the EU as did Fiji, but different in that it had no indigenous community and thus a very different land tenure system.<sup>25</sup>

This paper shows that rents implicit in the sugar exports from Fiji to the EU under the Sugar Protocol have fuelled ethnically divisive politics. Given the ethnic composition of the population, the divisive politics may still have taken place in the absence of the sugar rents, but with less ferocity. The many institutions and organizations in Fiji—including the Constitution, the unions of farmers and mill workers, and NLTB representing the landowners—have provided the means for organized rent seeking, which has had a deleterious impact on governance and policy making. Specifically, an ethnically fractured population and a divisive land tenure system provided the environment for fractionalized politics. Mauritius has the first feature, but not the second. Thus, this is a story of the damage caused to policy making from divisive politics fuelled by rent-seeking activity.

Given its structural features, Fijian society could not have escaped divisive politics altogether. However, the argument of this paper is that the sugar rents provided large resources for rent seeking. Fortunately, the announcement of the phasing out of the preferential price paid for sugar exports to the EU is creating pressures for the de-politicization of the industry. The dismantling of several of the organizations that have fought over the rents is evidence of this. Further, the loss of rents embodied in sugar exports could reduce (but not eliminate) incentives for ethnically divisive politics in Fiji.

The rents provided through the preferential access have been dissipated through inefficiencies in the cultivation and milling of sugarcane and through transfer payments to landowners and unionized labor. Such dissipation is not peculiar to the Fiji sugar industry; rather, it is a common phenomenon across industries and countries. Horstman and Markusen (1986), for example, have shown that subsidies and tariffs that lead to inefficient entry have negative welfare consequences. Snape (1963) and Johnson (1966) had foreseen these effects when preferential access to sugar exports from ACP countries to the EU was first proposed. Therefore, the erosion of the preferences will enhance efficiency, as it will remove the rents that fund the inefficiencies in the first place. However, these gains will only accrue following adjustment to a subsidy-free environment. The dislocation of capital, labor, and land from sugar production in the interim will incur costs.

The rents implicit in preferential pricing for sugar exports from Fiji have been used in this paper to provide a narrative of its effects on politics and policy making. The key lessons from this paper for policy making are that (i) rents fuel rent-seeking activity, and (ii) such rent-seeking activity can have a deleterious impact on national politics and policy making. The situation created in Fiji by colonization and subsequent events provided fertile ground for divisive politics. The creation of two large ethnic groups, mirrored by a landowner-tenant divide, has promoted divisive politics within an industry that draws on land and labor to produce the subsidized export. While the damaging effects of rent seeking on politics and policy making discussed here are grossly obvious and specific to Fiji, the principles have broader applicability.

<sup>24</sup> Ethnic fractionalization ( $F$ ) is a measure of ethnic diversity. It is defined as the probability that two randomly selected individuals in a country will belong to different groups and calculated as  $F \equiv 1 - \sum_{i=1}^N p_i^2$  where  $i$  indexes ethnic groups (Fearon 2003).

<sup>25</sup> Note that ethnic fractionalization and economic growth feed off each other, so establishing causation is tricky (see Fearon 2003, Cederman and Girardin 2007, and the references therein).

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