The Future of Asia-Pacific Economies

Pacific Islands at the Crossroads?

Eds Rodney V. Cole & Somsak Tambunlertchai
THE FUTURE OF ASIA-PACIFIC ECONOMIES

PACIFIC ISLANDS AT THE CROSSROADS?
THE FUTURE OF ASIA-PACIFIC ECONOMIES

PACIFIC ISLANDS AT THE CROSSROADS?

EDS RODNEY V. COLE & SOMSAK TAMBUNLERTCHAI

Published by the Asian and Pacific Development Centre and the National Centre for Development Studies
While attaining a reasonably high standard of living compared with other developing economies, most island economies in the South Pacific are still experiencing slow economic growth. They are also highly dependent on external financial resources from aid, trade and tourism. The rapid changes in the external economic environment in recent years and the years to come will undoubtedly have profound repercussions on the Pacific island economies.

Most economies in the Asia-Pacific region have achieved respectable rates of economic growth over the last two decades. The growth rates of the newly-industrializing economies in East Asia have particularly been impressive. More recently, countries in Southeast Asia, including Indonesia, Malaysia and Thailand, have also experienced high economic growth rates and rapid industrialization. Being a part of the Asia-Pacific region, the island economies could gain much from a closer trade and investment relationship with other economies in the region. Despite the marked difference in size, some of the policy measures conducive to growth and industrialization in East and Southeast Asia could provide useful lessons for the Pacific island economies. The world is getting smaller and countries are getting closer in their economic and socio-cultural activities, thanks to rapid development of transportation and communications technology. But with the outside world moving at a rapid pace, the Pacific island economies cannot afford to remain idle and isolated. How the island economies can join the race of rapid economic growth while preserving their much treasured traditional values and ways of life is a question that needs to be addressed. More importantly, how the Pacific island economies could adjust to achieve a better performance and higher living standard amidst rapid changes in the world economy is a problem demanding serious attention. It may be necessary for the Pacific island economies to remain open in order to ensure efficiency and to capture the many opportunities available to them. But at the same time, they also have to find ways and means to cushion the adverse effects of outside shocks, which come in many forms and may even pose a threat to their socio-cultural foundations.

This volume contains the papers presented at the Brisbane Conference on 'The Future of Asia-Pacific Economies: South Pacific Islands at the Crossroads?' held in Brisbane, Australia on 10–12 November 1992. This Conference is the fifth in the conference series on the Future of Asian-Pacific Economies organized by APDC. Since 1986, with the support of UNDP, ADB and the host governments, APDC has successfully organized this series of development fora on the future of Asia-Pacific economies in the context of global economic adjustments. The Brisbane Conference is part of this continuing emphasis on future development directions. This time the focus is on the South Pacific islands. This Conference has been made possible with core funding from the Australian International Development Assistance Bureau (AIDAB) and with supplementary funding from UNDP. I would like to express our sincere gratitude.
to the Australian Government for its generous financial support, and to UNDP for its continued support to this conference series.

It is a great pleasure for us to organize this international conference at Griffith University. Our thanks to the University and to its staff, particularly Vice-Chancellor Professor Webb, Deputy Vice-Chancellor Professor Kearny, Dean Edmund Fung and Professor David Lim of the Faculty of Asian and International Studies. Our thanks also go to the staff members of the Faculty, especially Ms Julene Commerford, and to the other staff of the University who have worked hard in preparing the venue and necessary facilities for this Conference.

The National Centre for Development Studies of the Australian National University has helped us in many ways, including identification of relevant topics, paper writers and discussants, and printing of papers for this Conference. We are particularly grateful to Professor Helen Hughes and Mr Alexander Agafonoff, who were instrumental in convincing AIDAB to financially support this project, and to Mr Rodney Cole, who has been the key person helping us organize this Conference from the very beginning. Without their kind assistance it would not have been possible for APDC to have single-handedly gathered this distinguished group of policy-makers and scholars from the South Pacific. I also would like to thank the resource persons and the participants who, despite the pressing demands on their time, have kindly agreed to prepare the papers and participate in this Conference.

Finally, APDC is grateful to Ms Maree Tait, Ms Kate Gainer and other staff at the National Centre for Development Studies for their help in editing and publication of this volume. It is our hope that this volume will reach a wider audience, particularly those who are interested in development policy issues in the South Pacific.

Suk Bum Yoon
## Contents

Foreword, *Suk Bum Yoon* 
List of symbols and abbreviations used in tables  
Contributors  
Signposts at the crossroads of development in the Pacific, *Rodney V. Cole and Somsak Tambunlertchai*  
Statistical summary  
Key issues of the Pacific island economies, *Gary Wiseman*  
Relevance of East Asian development experiences to the South Pacific, *David Lim*  
The South Pacific economies in a changing international environment, *Andrew Elek*  
External economic relations of Pacific island states, *Rodney V. Cole*  
Economic cooperation: Asia Pacific and the Pacific islands, *James Mak and Seiji Naya*  
Impact of external resources inflow on the South Pacific island economies, *Sione Kioa*  
Macroeconomic management in the small open economies of the Pacific, *Savenaca Siwatibau*  
Human resource development in the South Pacific, *Ken Gannicott*  
Some issues in the development and management of human and natural resources in the South Pacific, *John Rofeta*  
Issues for the service sector in Pacific island development, *Rod Falvey and Norman Gemmell*  
Strategies to stimulate private sector development in the Pacific island economies, *James MacMaster*  
Socio-cultural aspects of development in the South Pacific, *Antony Hooper*  
Program of the conference ‘The future of Asia-Pacific economies: Pacific islands at the crossroads?’
Symbols and abbreviations used in tables

n.a. Not applicable
.. Not available
— Zero
. Insignificant
f.o.b. Free on board
c.i.f. Cost, insurance, freight
Suk Bum Yoon is now with the Department of Economics at Yonsei University in Korea. He was Director of the Asian Pacific Development Centre at the time of the writing of this book.

Rodney V. Cole is the Research Director of the Islands/Australia program at the National Centre for Development Studies. He was formerly the Secretary for Finance, Fiji and Managing Director of the Papua New Guinea Development Bank.

Somsak Tambunlertchai is the Coordinator, International Trade and Regional Cooperation, at the Asian Pacific Development Centre. He was responsible for arranging the conference.

Gary Wiseman is Director of the Economic Development Division of the Forum Secretariat in Suva.

David Lim is Professor of Economics in the Faculty of Asian and International Studies at Griffith University in Queensland.

Andrew Elek is a Senior Research Fellow in the Department of Economics, Research School of Pacific Studies at the Australian National University. Formerly he held positions with the World Bank and the Government of Papua New Guinea.

James Mak is Professor of Economics at the University of Hawaii at Manoa in Honolulu.

Seiji Naya is Professor and Chairman in the Department of Economics at the University of Hawaii at Manoa in Honolulu.

Sione Kioa has just completed his PhD dissertation on sources of economic growth in South Pacific small-island economies and has now returned to Tonga where he is Deputy Director of the Central Planning Department.

Savenaca Siwatibau is Head of the Pacific Operations Centre, ESCAP, in Port Vila. He was formerly Governor of the Reserve Bank of Fiji and Secretary for Finance, Fiji.

Ken Gannicott is Professor of Education at Wollongong University. His main interest is the economics of education, and he has worked in this area for the OECD, UNESCO and the World Bank as well as in universities in Australia and overseas.

John Rofeta is Regional Senior Economist, United Nations Development Programme, in Suva.
Contributors

Rodney Falvey is a Reader in the Department of Economics, Faculty of Economics and Commerce of the Australian National University.

Norman Gemmell is a Reader in the Department of Economics at the University of Nottingham.

James MacMaster is Dean of the Faculty of Management and Associate Professor of Economics at the University of Canberra.

Antony Hooper is an anthropologist working with the Pacific Islands Development Program at the East–West Center, Hawaii.
Signposts at the crossroads of development in the Pacific

Rodney V. Cole and Somsak Tambunlertchai

For most Pacific island states the act of attaining political independence is now a matter for an annual celebration but little more. They have enjoyed those early, heady, days of independence for a sufficiently long period so that the legacies of the colonial days are now seldom raised to explain shortcomings in economic and social progress. During the post-colonial period considerable efforts have been made by individual governments, aided and advised by a host of multilateral and bilateral agencies, particularly those associated with the former colonial powers, to promote and enhance domestic economic performance. Despite much effort in planning and in the implementation of plans, most countries in the region have not arrived at a crossroads where new and exciting ventures might begin: rather most appear to be still where they were at the time of gaining independence, about to begin the journey of economic and social progress.

In spite of substantial aid inflows the Pacific island economies have generally suffered economic stagnation as revealed by per capita GNP growth figures for the period 1980–1990 (Table 3, Statistical Summary). By contrast is the rapid economic growth of most market economies in the Asia-Pacific region, especially the newly industrializing economies and some ASEAN countries. The growth centre of the world in the next decade and into the twenty-first century is predicted to be the Asia-Pacific region but as things stand now the Pacific island economies do not seem destined to share in this growth.

A region of contrasts: Asia and the Pacific

In ‘Key issues of the Pacific island economies’, Wiseman identifies the key issues which affect the Pacific islands in their efforts to promote growth and development (page 17). There are obviously many factors that can impede or support economic and social progress and that are directly related to the small size of most of the island states. These are reviewed and an assessment made of the resource base and economic potential of individual states. Changing attitudes towards development are considered including the important matter of sustainability in countries where factors such as climate are beyond the control of even the most dedicated political and bureaucratic leaders.

The writer’s association with the regional institution, the South Pacific Forum, is reflected in a section which argues for closer relations between the Pacific island economies and larger countries and international groupings as a way in which the islands might overcome some of those fundamental problems associated with small size, isolation and limited resources.

1. Pacific Islands at the crossroads?
A basic problem facing the development process in a number of Pacific island economies (noted in discussion of Wiseman’s paper) is a lack of commitment to change by the governments. Motivation to change or to make improvements in economic policies is often weakened by the cushioning effect of substantial flows of overseas development assistance. Aid donors should play a more active role in the identification and implementation of effective policies.

By way of contrast, Lim’s paper (page 33) considers the factors which have contributed to the high growth performance in East Asia. Lim points out that market-friendly policies, which enable governments and markets to work together, and an international orientation are major factors influencing the superior growth performance of those countries. High rates of investment made possible by effective domestic savings and foreign capital inflows were also crucial. Sound macroeconomic policies in terms of positive interest rates, controlled inflation, and effective management of public expenditure helped provide a climate conducive to investment.

In the case of the Pacific island economies, Lim suggests that the adoption of policies which made the East Asian economies successful could do much to improve their development performance. While small size and remoteness do pose some problems the experience of small island economies in other parts of the world prove that difficulties are not insurmountable.

Mak and Naya (page 100) address the importance of rising economic interdependence and cooperation in the Asia–Pacific region and urge that Pacific island economies be included in a broader sphere of Asia–Pacific economic cooperation. They note that increasing interdependence in Asia is characterized by economic complementarity and subregional divisions of labour without formal trading arrangements. As a result of the increasing concern for the uncertainty of the outcome of the Uruguay Round, as well as the economic integration in Europe and America, a closer cooperation among economies in the Asia–Pacific region is needed. Participation in ‘open regionalism’ through a consultative forum among the member governments such as the Asia Pacific Economic Cooperation (APEC) could serve useful purposes. Despite their small size, the Pacific island economies could contribute to the process of economic cooperation in the Asia–Pacific region. The Pacific island economies should consolidate themselves and agree on critical issues of mutual concern. They can gain much from joining a broader Asia–Pacific cooperation scheme, which could result in an expansion of trade and investment, and greater inflows of financial as well as technological inputs.

The changing face of the Pacific

The impact of the second world war on the Pacific island economies quickly faded once the warring factions passed on. Not until the 1960s did the great post-war technical and political changes begin to impact on the islands: these changes coincided broadly with the first moves by the region’s foreign powers to begin the de-colonisation process.
The paper by Elek (page 56) reviews the prospects of the island economies in a rapidly changing international environment. The prospects of growth 'being driven by increasing flows of aid' are declining and accordingly the need to focus on domestic policies becomes critical. In an increasingly competitive environment local constraints to growth must be tackled: these include high domestic labour costs, poor economic management and the adoption of ineffective protectionist policies.

After reviewing the options which are available to some of the islands, Elek concludes that these economies are capable of expansion through the export of a fairly wide range of goods and services but that this can only be achieved by acting in concert with international investors or firms. In addition, it will be important for the islands to foster trade through regional and global cooperation so that their options and opportunities are maximized.

In his paper 'External economic relations of Pacific island states' (page 82), Cole suggests that the wide range of favourable international trading agreements now available to the islands will allow them to readily 'break free' from their traditional (colonial) partners. While their range of exports is narrow and the volumes small, opportunities exist for the development of lucrative niche export industries. Like Elek, he believes that the islands must seek to strengthen their global trading position by regional cooperation and by paying more attention to their opportunities in world markets and less to constraints, real or imagined, so they can enjoy the benefits of expanding market opportunities.

Kioa in his paper on external resource flows (page 108), clearly demonstrates that the islands are now, whether they like it or not, involved in world affairs. He reviews issues involved with private transfers and urges encouragement of domestic saving as a means of strengthening the internal development capacity of the Pacific island economies. A careful watch needs to be kept on official development assistance and funds borrowed overseas in order to avoid the crowding out of private sector savings and the possible booming sector effects that such flows could induce. The productivity analysis in this paper shows that increases in capital stock in the islands contribute to some 30 per cent of growth, of which 18 per cent is derived from national savings and 12 per cent from external flows.

Various issues relating to macroeconomic management and stabilization policies in the Pacific island economies are discussed by Siwatabau (page 135). The Pacific island economies are exposed to external shocks which are transmitted through goods and capital markets which make for difficult macroeconomic adjustments. Such external shocks have to be managed in a sound fashion to ensure that domestic economic stability prevails: a pre-condition for stable long-term growth. While consideration is usually given to negative shocks or shocks that create damage to the domestic economy, positive shocks such as financial resource inflows also have to be well managed, and there are instruments available, including fiscal, monetary, exchange rate and income policies. Temporary shocks causing balance of payments deficits can be
managed by running down foreign exchange reserves or incurring external debt, but those which last must be addressed through expenditure-switching policies such as exchange rate adjustments. These policies should in general be accompanied by a mix of expenditure-reducing policies in order to avoid excessive demand and inflationary pressures within the economy.

In discussion, it was suggested that while the evidence points to a relatively good record of macroeconomic stability, by and large, this has not led to effective growth. The lack of attention to issues at the microeconomic level might well be the cause of this. The adoption of policies which are known to be appropriate is often avoided by a rent-seeking environment at various levels. The importance of micro-level policies should not be overlooked. Some countries are weakening their own prospects for development through excessive patronage. This involves the failure to apply user-pays principles and the provision of services through increasing budget deficits. As another example, policy makers are aware that wage increases can lead to inflation, but implementing wage restraint is difficult, particularly when political pressures are involved.

Building blocks for development

The references accompanying the papers in this book reveal only too clearly the enormous amount of work that has been done in the past to identify, document and review constraints to development in the island states. Despite a good record of macroeconomic stability in most states, growth has not been achieved. Earlier chapters have recorded the international resources available: this section looks at the real ‘building blocks’ for future progress; that is, the domestic resources and the role they must play.

Human resource development in the region is reviewed by Gannicott (page 187). The difference between Tonga, Western Samoa and Fiji and Kiribati, Vanuatu and Solomon Islands, as revealed by basic education indicators (Statistical Summary, Table 1), is highlighted and the historical reasons identified. Despite the achievements of the eastern islands, Gannicott notes that skill shortages remain a feature of the region. This is in part due to the shortage of trained teachers. But a lack of teachers is not the only problem: quality of education, although difficult to measure, is identified as a major issue that needs to be addressed. Gannicott considers the problems of improving quality in the face of growing school age populations and the complex question of meeting the rising costs of education and its relationship with economic growth. He concludes that a ‘case for substantial investments in human resource development in the South Pacific ... has been made’, but in itself this will not ensure enduring economic growth unless accompanied by policy reforms which will ‘install a dynamic culture of growth’.

Rofeta highlights issues involved in the development and management of human and natural resources in the region (page 218). He describes UNDP’s sustainable human development initiative for the South Pacific and its objective
of assisting island governments in planning future development strategies through access to information that a Human Development Index will provide.

Discussion on the human resource development papers focused on the issues of entrepreneurship, work ethics and a broader policy environment which is conducive to utilization of private sector initiatives and entrepreneurial talents. It is important to recognize that a money economy is replacing the subsistence lifestyle and that in order to achieve success new work ethics must be adopted. Another issue of concern is migration. If highly educated islanders continue to emigrate to high-income countries, improving the quality of education could be of greater benefit to the developed countries to which islanders may migrate rather than the islands themselves.

The availability and utilization of natural resources, including mineral resources, agriculture (including fishery) and forestry resources, in the Pacific island economies are also briefly dealt with by Rofeta. Proper natural resource management remains a critical problem for the Pacific island economies. High rates of population growth and unwise utilization of resources to meet immediate demands will put increasing pressure on the already fragile resource base.

Various issues of natural resource management were raised at the conference by a panel discussion. The panel members were unanimous in their agreement that natural resource management in the Pacific is extremely complex, not only because of fragility of the islands' ecosystems but also because not a great deal is known about the likely effects of those policies which aim for change. It is suggested that great damage could be done by too hasty a shift from one management system to another. It is difficult to generalize on natural resource issues in the region because they differ widely from country to country, ranging from Papua New Guinea with its vast marine, mineral and agricultural resources to Niue with its poor soils and limited land area. However, it is not possible to be complacent because population growth is placing great pressure on agricultural land and more frequent rotations, a direct consequence of this pressure, are affecting the value of the soil to future generations. It would be difficult to assess the impact of any policy changes in the short term; this implies slow and complex change mechanisms which could be costly. Care should be taken to avoid exploitation by foreigners while recognizing that in some fields, particularly minerals and petroleum, foreign expertise and capital are essential in the development process.

The paper by Falvey and Gemmell (page 236) reviews the prospects for developing the services sector in the South Pacific. They analyse the general role of the services sector, then focus on tourism as the component most likely to provide a vehicle for growth in individual countries. The range of activities involved in tourism is wide and there is an opportunity for participation by a large number of people who could provide a variety of tourist-related services. There are probably two major constraints to the development of the industry. The first involves cultural issues and the second problem is access to tourist
Signposts at the crossroads of development in the Pacific

destinations, a direct consequence of inadequate or insufficient transport systems. There is scope for regional cooperation to promote the industry as well as other services common in the region, but so far proposals for the adoption of regional policies have met with only lukewarm responses.

In the discussion of the services sector it was suggested that while the development of the tourist industry could provide large external transfers to support those islands with particularly fragile economies, governments should avoid subsidizing the industry. Concessions and other benefits sought by operators, such as duty and taxation concessions, could only detract from the earning power of the industry for the national economy; but subsidies in the form of infrastructural facilities may be needed. The example of Singapore was cited: the absence of a natural environment in Singapore was overcome by the creation of an artificial environment which includes beaches, bird parks, zoos and artificial mountains.

The development of strategies to stimulate the private sector is dealt with by McMaster (page 275). He presents a comprehensive review of constraints to private sector development and spells out the various strategies developed to stimulate this sector. It is now a matter for positive responses to a wide range of policy advice and government incentives, but moving along newly determined paths appears to be a matter for individual choice, and this is not always being exercised in a manner which some technocrats see as desirable.

Hooper, commenting on the socio-cultural aspects of development (page 314), draws attention to the fact that for most Pacific island economies 80 per cent or more of their population is located in the rural sector. He suggests that the structure of Pacific societies involves three main parts: government (political), business/professional and ‘traditional’. The complex interaction of these has a strong effect on the development process in the island states, each state having its own set of peculiarities. Concern for development must not be confined to the economy but include consideration for the structure of island society and the influence this has on the development process.

The concluding session of the conference dealt with the topic ‘Future Asian-Pacific Relations’. Six speakers focused on a number of issues which are summarized as follows.

- Powerful forces are at work reshaping alliances and trading patterns in the world. The Asia-Pacific region is very much part of those changes, and the small island states must be fully aware of what is transpiring and seek to avoid being excluded from the ‘new Asia’. While it is recognized that they are disadvantaged on account of size and low levels of GDP, nonetheless they will benefit from being a real part of this dynamic region.

- Movements of foreign direct investment, as well as people, between countries, has resulted in the demonstration and realization of the benefits of development and growth, and created incentives for progress in developing countries. Economies in the Asia-Pacific region have
undergone a process of catching up with the more advanced economies and intra-regional trade and investment are facilitators of this catching up process. Intra-industry trade has also been on the rise. It may not be impossible for the Pacific island economies to join this catching up race if appropriate policies can be adopted. It is important for the Pacific island economies to improve their performance. This will involve the adoption of policies appropriate to the capabilities of the island as well as those which encourage investment, external trade linkages, and transfer of technology.

- The Pacific island economies must take advantage of the opportunities offered by such regional fora as APEC (Asia Pacific Economic Cooperation) and PECC (Pacific Economic Cooperation Conference). They could participate jointly through a regional body such as the South Pacific Forum.

- The performance of Maldives which has achieved a rate of growth averaging 10 per cent over the last decade is held up as an example of the ability of small island states to overcome a wide range of constraints faced by such countries in the development process.

Signposts to the future

If, as was suggested at the start of this chapter, the island states have failed to make significant progress in terms of economic and social development over the last decade, what might be done to bring some of the initiatives identified in this book to the attention of the leaders? The road to development is not easy: despite the best efforts of outsiders in terms of aid and advice, the adoption of initiatives is the prerogative of the islands alone. Here we suggest a number of 'signposts' to the future—the response to these will be for the leaders to decide.

'Smallness' is not a major constraint to development

Being small offers no threat to the large players on the world stage and can offer opportunities for specialization and well-focused efforts to develop appropriate social and economic activity. Positive thinking and a determination to turn 'smallness' to advantage can lead to success and progress. Cooperation between 'small' countries can enhance their options and opportunities in the global market place. Banding together to exploit niche activities in tourism and available material resources can serve the interests of small states.

Regional cooperation is important

There is considerable scope for increasing the level of cooperation among the Pacific island economies in fields as diverse as diplomatic and trade representation and communications. Regional cooperation could incorporate activities such as sharing information, learning from others' experience, reducing barriers to trade and investment, and pooling human and other resources. A regional approach to the management and exploitation of sea-bed resources might well pave the way to a new level of cooperation in fields such as shipping, health
services and tourism. Political will is probably more critical in this area than in domestic issues.

Regional cooperation should be sought in areas where economies of scale could be achieved. For example, freeing-up of aviation policy could lead to rationalization, service improvements and efficiencies that would have lasting effects on export capacity and tourism potential.

**Commitment to change is necessary**

Implementation of effective policies is often hindered by a lack of determination or motivation, and this results in poor economic performance. The Pacific island economies must display a willingness to learn from the achievements as well as mistakes of others. Models for the future can be obtained from successful countries in Asia and small island economies elsewhere. Some adjustments could be made to suit individual countries' socio-political reality. But there must be willingness and even a strong desire for change. Positive change can be the consequence of adjustment to external shocks; it is important that the likely benefits be identified in reacting to what might at first sight be negative events.

**Links to Asia are important and should be actively pursued**

Such links could be in trade, investment, tourism, utilization of resources and technology transfer. The Pacific island economies must take initiatives to establish the links. Attempts should be made to improve the investment climate through, for example, reducing regulatory impediments and provision of information on trade and investment opportunities.

**Aid should not be allowed to hinder reforms**

Aid could have the effect of diverting the attention of island governments away from the hard decisions necessary to ensure economic and social progress, encouraging them to indulge in activities which, often in hard currency terms, they can ill afford. More serious efforts must be made towards the effective utilization of aid for the purpose of long-term sustainable growth and development.

**The role of governments must be reviewed**

The private sector has been recognized as having the best potential for supporting growth; macroeconomic and especially microeconomic reforms must be identified and implemented to underline a commitment to private sector development. Priority areas for privatization should be identified and plans for privatization should be earnestly implemented.

**Population planning is an important priority**

Measures must also be made in the area of human resource development such as improvement in the quality of education and training, and effective utilization of highly-educated workers to discourage migration to high-income countries.
An environment conducive to informal sector growth is critical
The informal sector has the potential to support an increasing number of part-time workers. The Asian experience in the informal sector could be studied.
Table 1  Geographic and demographic indicators

<table>
<thead>
<tr>
<th>Country</th>
<th>Land area (km²)</th>
<th>Sea area ('000 km²)</th>
<th>Population 1990 ('000)</th>
<th>Density (per km²)</th>
<th>Growth 1973-90 (per cent)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cook Islands</td>
<td>237</td>
<td>1830</td>
<td>16.9</td>
<td>71</td>
<td>-0.2</td>
</tr>
<tr>
<td>Federated States of Micronesia</td>
<td>701</td>
<td>2978</td>
<td>101.2</td>
<td>144</td>
<td>4.0</td>
</tr>
<tr>
<td>Fiji</td>
<td>18272</td>
<td>1290</td>
<td>725.0</td>
<td>40</td>
<td>1.9</td>
</tr>
<tr>
<td>French Polynesia</td>
<td>3521</td>
<td>5030</td>
<td>196.3</td>
<td>56</td>
<td>2.5</td>
</tr>
<tr>
<td>Kiribati</td>
<td>690</td>
<td>3550</td>
<td>71.8</td>
<td>104</td>
<td>2.3</td>
</tr>
<tr>
<td>Marshall Islands</td>
<td>181</td>
<td>2131</td>
<td>46.2</td>
<td>255</td>
<td>4.2</td>
</tr>
<tr>
<td>Nauru</td>
<td>21</td>
<td>320</td>
<td>9.3</td>
<td>443</td>
<td>2.3</td>
</tr>
<tr>
<td>New Caledonia</td>
<td>19103</td>
<td>1740</td>
<td>167.6</td>
<td>9</td>
<td>2.0</td>
</tr>
<tr>
<td>Niue</td>
<td>259</td>
<td>390</td>
<td>2.5</td>
<td>10</td>
<td>-5.3</td>
</tr>
<tr>
<td>Papua New Guinea</td>
<td>462243</td>
<td>3120</td>
<td>3528.0</td>
<td>8</td>
<td>1.6</td>
</tr>
<tr>
<td>Solomon Islands</td>
<td>27556</td>
<td>1340</td>
<td>324.0</td>
<td>12</td>
<td>3.7</td>
</tr>
<tr>
<td>Tokelau</td>
<td>10</td>
<td>290</td>
<td>1.8</td>
<td>180</td>
<td>1.5</td>
</tr>
<tr>
<td>Tonga</td>
<td>747</td>
<td>700</td>
<td>96.3</td>
<td>129</td>
<td>0.5</td>
</tr>
<tr>
<td>Tuvalu</td>
<td>26</td>
<td>900</td>
<td>10.2</td>
<td>392</td>
<td>4.1</td>
</tr>
<tr>
<td>Vanuatu</td>
<td>12190</td>
<td>680</td>
<td>146.4</td>
<td>12</td>
<td>2.4</td>
</tr>
<tr>
<td>Western Samoa</td>
<td>2935</td>
<td>120</td>
<td>157.7</td>
<td>54</td>
<td>0.1</td>
</tr>
</tbody>
</table>

Source: South Pacific Economic and Social Database, National Centre for Development Studies, the Australian National University.
## Table 2  Social indicators

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Cook Islands</td>
<td>75</td>
<td>..</td>
<td>98</td>
<td>65</td>
<td>65</td>
<td>36</td>
<td>37</td>
<td></td>
</tr>
<tr>
<td>Fiji</td>
<td>86</td>
<td>101</td>
<td>129</td>
<td>64</td>
<td>68</td>
<td>50</td>
<td>20</td>
<td></td>
</tr>
<tr>
<td>French Polynesia</td>
<td>94</td>
<td>..</td>
<td>..</td>
<td>..</td>
<td>73</td>
<td>..</td>
<td>..</td>
<td></td>
</tr>
<tr>
<td>Kiribati</td>
<td>96</td>
<td>112</td>
<td>100</td>
<td>54</td>
<td>55</td>
<td>59</td>
<td>59</td>
<td></td>
</tr>
<tr>
<td>Nauru</td>
<td>..</td>
<td>..</td>
<td>..</td>
<td>..</td>
<td>..</td>
<td>..</td>
<td>..</td>
<td></td>
</tr>
<tr>
<td>New Caledonia</td>
<td>91</td>
<td>..</td>
<td>..</td>
<td>61</td>
<td>69</td>
<td>..</td>
<td>..</td>
<td></td>
</tr>
<tr>
<td>Niue</td>
<td>100</td>
<td>..</td>
<td>..</td>
<td>..</td>
<td>..</td>
<td>..</td>
<td>..</td>
<td></td>
</tr>
<tr>
<td>Papua New Guinea</td>
<td>46</td>
<td>52</td>
<td>70</td>
<td>47</td>
<td>55</td>
<td>125</td>
<td>60</td>
<td></td>
</tr>
<tr>
<td>Solomon Islands</td>
<td>51</td>
<td>61</td>
<td>60</td>
<td>40</td>
<td>65</td>
<td>52</td>
<td>50</td>
<td></td>
</tr>
<tr>
<td>Tokelau</td>
<td>97</td>
<td>..</td>
<td>..</td>
<td>..</td>
<td>..</td>
<td>..</td>
<td>..</td>
<td></td>
</tr>
<tr>
<td>Tonga</td>
<td>93</td>
<td>140</td>
<td>77</td>
<td>56</td>
<td>67</td>
<td>16</td>
<td>23</td>
<td></td>
</tr>
<tr>
<td>Tuvalu</td>
<td>98</td>
<td>..</td>
<td>..</td>
<td>..</td>
<td>68</td>
<td>..</td>
<td>38</td>
<td></td>
</tr>
<tr>
<td>Vanuatu</td>
<td>53</td>
<td>..</td>
<td>..</td>
<td>..</td>
<td>65</td>
<td>..</td>
<td>71</td>
<td></td>
</tr>
<tr>
<td>Western Samoa</td>
<td>98</td>
<td>75</td>
<td>80</td>
<td>61</td>
<td>66</td>
<td>48</td>
<td>47</td>
<td></td>
</tr>
</tbody>
</table>

a Figures may be greater than 100 because they are calculated on the basis of primary school-age population.

**Source:** South Pacific Economic and Social Database, National Centre for Development Studies, the Australian National University.
### Table 3 Economic indicators

<table>
<thead>
<tr>
<th>Country</th>
<th>Real GNP growth 1980-90 (per cent)</th>
<th>GNP per capita 1990 (US$)</th>
<th>Real GNP per capita growth 1980-90 (per cent)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cook Islands</td>
<td>.</td>
<td>.</td>
<td>.</td>
</tr>
<tr>
<td>Fiji</td>
<td>1.3</td>
<td>1770</td>
<td>-0.4</td>
</tr>
<tr>
<td>French Polynesia</td>
<td>.</td>
<td>.</td>
<td>.</td>
</tr>
<tr>
<td>Kiribati</td>
<td>3.6</td>
<td>760</td>
<td>1.7</td>
</tr>
<tr>
<td>Nauru</td>
<td>.</td>
<td>.</td>
<td>.</td>
</tr>
<tr>
<td>New Caledonia</td>
<td>.</td>
<td>.</td>
<td>.</td>
</tr>
<tr>
<td>Niue</td>
<td>.</td>
<td>.</td>
<td>.</td>
</tr>
<tr>
<td>Papua New Guinea</td>
<td>1.9</td>
<td>860</td>
<td>-0.5</td>
</tr>
<tr>
<td>Solomon Islands</td>
<td>7.0</td>
<td>580</td>
<td>3.4</td>
</tr>
<tr>
<td>Tokelau</td>
<td>.</td>
<td>.</td>
<td>.</td>
</tr>
<tr>
<td>Tonga</td>
<td>2.1</td>
<td>1010</td>
<td>1.5</td>
</tr>
<tr>
<td>Tuvalu</td>
<td>.</td>
<td>.</td>
<td>.</td>
</tr>
<tr>
<td>Vanuatu</td>
<td>2.4</td>
<td>1060</td>
<td>-0.5</td>
</tr>
<tr>
<td>Western Samoa</td>
<td>2.0</td>
<td>730</td>
<td>1.2</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Country</th>
<th>Aid per capita 1990 (US$)</th>
<th>Inflation rate 1990 (per cent)</th>
<th>Merchandise trade balance (US$ million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cook Islands</td>
<td>710</td>
<td>6.0</td>
<td>-41.07 (1989)</td>
</tr>
<tr>
<td>French Polynesia</td>
<td>1330</td>
<td>0.2</td>
<td>-693.27 (1989)</td>
</tr>
<tr>
<td>Kiribati</td>
<td>279</td>
<td>5.1</td>
<td>-17.56 (1989)</td>
</tr>
<tr>
<td>Nauru</td>
<td>.</td>
<td>.</td>
<td>66.16 (1989)</td>
</tr>
<tr>
<td>New Caledonia</td>
<td>1796</td>
<td>1.1</td>
<td>-91.25 (1989)</td>
</tr>
<tr>
<td>Niue</td>
<td>2800</td>
<td>5.7</td>
<td>.</td>
</tr>
<tr>
<td>Papua New Guinea</td>
<td>107</td>
<td>8.9</td>
<td>-33.61 (1991)</td>
</tr>
<tr>
<td>Solomon Islands</td>
<td>136</td>
<td>10.3</td>
<td>-26.78 (1991)</td>
</tr>
<tr>
<td>Tokelau</td>
<td>2778</td>
<td>.</td>
<td>.</td>
</tr>
<tr>
<td>Tonga</td>
<td>301</td>
<td>14.4</td>
<td>-44.90 (1991)</td>
</tr>
<tr>
<td>Tuvalu</td>
<td>588</td>
<td>5.9</td>
<td>-4.10 (1989)</td>
</tr>
<tr>
<td>Vanuatu</td>
<td>335</td>
<td>4.6</td>
<td>-59.09 (1991)</td>
</tr>
<tr>
<td>Western Samoa</td>
<td>311</td>
<td>9.1</td>
<td>-74.99 (1991)</td>
</tr>
</tbody>
</table>

**Source:** South Pacific Economic and Social Database, National Centre for Development Studies, the Australian National University; World Bank, *World Bank Atlas*, 1992.
### Table 4 National income by sector of origin (percentage shares)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture</td>
<td>21.8</td>
<td>32.7</td>
<td>31.5</td>
<td>44.3</td>
<td>29.1</td>
<td>23.0</td>
<td>35.7</td>
</tr>
<tr>
<td>Agriculture</td>
<td>12.6</td>
<td>14.3</td>
<td>.</td>
<td>12.9</td>
<td>.</td>
<td>12.5</td>
<td>31.2</td>
</tr>
<tr>
<td>Forestry</td>
<td>1.6</td>
<td>—</td>
<td>.</td>
<td>4.4</td>
<td>.</td>
<td>0.6</td>
<td>.</td>
</tr>
<tr>
<td>Fishing</td>
<td>1.5</td>
<td>7.4</td>
<td>.</td>
<td>9.0</td>
<td>.</td>
<td>.</td>
<td>.</td>
</tr>
<tr>
<td>Non-monetary</td>
<td>6.1</td>
<td>11.0</td>
<td>16.4</td>
<td>18.0</td>
<td>.</td>
<td>9.9</td>
<td>.</td>
</tr>
<tr>
<td>Industry</td>
<td>16.3</td>
<td>9.2</td>
<td>30.7</td>
<td>8.0</td>
<td>14.1</td>
<td>14.7</td>
<td>18.1</td>
</tr>
<tr>
<td>Mining</td>
<td>0.2</td>
<td>—</td>
<td>15.0</td>
<td>—</td>
<td>.</td>
<td>.</td>
<td>.</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>11.8</td>
<td>1.9</td>
<td>8.0</td>
<td>3.2</td>
<td>13.5</td>
<td>7.3</td>
<td>14.8</td>
</tr>
<tr>
<td>Electricity, gas and water</td>
<td>1.3</td>
<td>1.9</td>
<td>1.9</td>
<td>1.2</td>
<td>.</td>
<td>2.0</td>
<td>1.4</td>
</tr>
<tr>
<td>Construction</td>
<td>3.0</td>
<td>5.4</td>
<td>5.9</td>
<td>4.5</td>
<td>.</td>
<td>5.5</td>
<td>1.9</td>
</tr>
<tr>
<td>Services</td>
<td>61.9</td>
<td>58.1</td>
<td>37.8</td>
<td>47.7</td>
<td>56.9</td>
<td>62.3</td>
<td>46.3</td>
</tr>
<tr>
<td>Government</td>
<td>.</td>
<td>24.2</td>
<td>.</td>
<td>22.1</td>
<td>.</td>
<td>10.8</td>
<td>8.9</td>
</tr>
<tr>
<td>Other</td>
<td>.</td>
<td>38.6</td>
<td>.</td>
<td>27.2</td>
<td>.</td>
<td>51.5</td>
<td>37.4</td>
</tr>
<tr>
<td>Less imputed bank service charges</td>
<td>3.4</td>
<td>4.7</td>
<td>4.0</td>
<td>1.6</td>
<td>.</td>
<td>2.1</td>
<td>.</td>
</tr>
</tbody>
</table>

**Source:** South Pacific Economic and Social Database, National Centre for Development Studies, the Australian National University.
### Table 5 Destination of exports (per cent)

<table>
<thead>
<tr>
<th>Papua New Guinea</th>
<th>Solomon Islands</th>
<th>Vanuatu</th>
<th>Tonga</th>
<th>Samoa</th>
<th>Kiribati</th>
<th>Tuvalu</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>1970</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Australia</td>
<td>42.1</td>
<td>8.8</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Japan</td>
<td>11.2</td>
<td>4.2</td>
<td>12.8</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Netherlands</td>
<td>3.0</td>
<td>34.3</td>
<td>16.9</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>United Kingdom</td>
<td>18.4</td>
<td>31.4</td>
<td></td>
<td>4.2</td>
<td></td>
<td></td>
</tr>
<tr>
<td>United States</td>
<td>11.3</td>
<td>15.7</td>
<td>37.0</td>
<td>6.3</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Germany^</td>
<td>6.0</td>
<td>0.7</td>
<td></td>
<td>12.7</td>
<td></td>
<td></td>
</tr>
<tr>
<td>New Zealand</td>
<td>0.6</td>
<td>7.1</td>
<td>33.3</td>
<td>0.2</td>
<td>64.0</td>
<td>46.4</td>
</tr>
<tr>
<td>Hong Kong</td>
<td>0.1</td>
<td>0.3</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Korea, Republic of</td>
<td>7.4</td>
<td>31.9</td>
<td>66.7</td>
<td>50.0</td>
<td>1.7</td>
<td>13.5</td>
</tr>
<tr>
<td>Other</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>100.0</td>
</tr>
<tr>
<td><strong>1980</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Australia</td>
<td>48.7</td>
<td>32.0</td>
<td>36.1</td>
<td>32.7</td>
<td>19.4</td>
<td>17.0</td>
</tr>
<tr>
<td>Japan</td>
<td>17.3</td>
<td>11.8</td>
<td>16.4</td>
<td>9.0</td>
<td>2.7</td>
<td>7.3</td>
</tr>
<tr>
<td>Singapore</td>
<td>13.9</td>
<td>11.3</td>
<td>15.5</td>
<td>12.1</td>
<td>3.5</td>
<td>1.2</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>2.6</td>
<td>5.7</td>
<td>5.1</td>
<td>2.2</td>
<td>5.1</td>
<td>3.0</td>
</tr>
<tr>
<td>United States</td>
<td>3.9</td>
<td>7.2</td>
<td>3.4</td>
<td>1.7</td>
<td>5.8</td>
<td>7.0</td>
</tr>
<tr>
<td>Germany^</td>
<td>1.2</td>
<td>0.8</td>
<td>1.3</td>
<td>0.8</td>
<td>1.9</td>
<td>1.1</td>
</tr>
<tr>
<td>New Zealand</td>
<td>4.5</td>
<td>14.7</td>
<td>7.3</td>
<td>8.6</td>
<td>31.7</td>
<td>35.5</td>
</tr>
<tr>
<td>Hong Kong</td>
<td>2.5</td>
<td>1.8</td>
<td>3.3</td>
<td>3.1</td>
<td>0.3</td>
<td>1.2</td>
</tr>
<tr>
<td>Korea, Republic of</td>
<td>0.2</td>
<td>0.9</td>
<td>0.0</td>
<td>0.0</td>
<td>0.1</td>
<td>5.9</td>
</tr>
<tr>
<td>Other</td>
<td>5.2</td>
<td>13.9</td>
<td>11.7</td>
<td>29.8</td>
<td>29.5</td>
<td>20.8</td>
</tr>
<tr>
<td><strong>1991</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Australia</td>
<td>40.9</td>
<td>14.5</td>
<td>1.7</td>
<td>6.0</td>
<td>8.7</td>
<td>15.9</td>
</tr>
<tr>
<td>Japan</td>
<td>24.1</td>
<td>5.2</td>
<td>46.2</td>
<td>20.1</td>
<td>59.0</td>
<td>33.9</td>
</tr>
<tr>
<td>Netherlands</td>
<td>1.0</td>
<td>0.2</td>
<td>5.3</td>
<td>0.5</td>
<td>2.3</td>
<td></td>
</tr>
<tr>
<td>United Kingdom</td>
<td>3.6</td>
<td>23.9</td>
<td>13.9</td>
<td>1.3</td>
<td>0.5</td>
<td></td>
</tr>
<tr>
<td>United States</td>
<td>2.4</td>
<td>10.4</td>
<td>0.2</td>
<td>6.9</td>
<td>16.2</td>
<td>4.4</td>
</tr>
<tr>
<td>Germany^</td>
<td>10.4</td>
<td>0.2</td>
<td>4.0</td>
<td>31.0</td>
<td>16.5</td>
<td></td>
</tr>
<tr>
<td>New Zealand</td>
<td>0.3</td>
<td>8.2</td>
<td>0.8</td>
<td>0.2</td>
<td>7.5</td>
<td>25.8</td>
</tr>
<tr>
<td>Hong Kong</td>
<td>0.3</td>
<td>1.0</td>
<td>3.7</td>
<td></td>
<td>5.3</td>
<td>1.4</td>
</tr>
<tr>
<td>Korea, Republic of</td>
<td>6.9</td>
<td>0.1</td>
<td>8.0</td>
<td>2.3</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other</td>
<td>10.3</td>
<td>36.3</td>
<td>16.3</td>
<td>31.7</td>
<td>8.6</td>
<td>12.5</td>
</tr>
</tbody>
</table>

^ West Germany.

**Source:** International Monetary Fund, *Direction of Trade Statistics*, August 1992.
### Table 6  Origin of imports (per cent)

<table>
<thead>
<tr>
<th>Origin</th>
<th>Papua New Guinea</th>
<th>New Zealand</th>
<th>Solomon Islands</th>
<th>Vanuatu</th>
<th>Tonga</th>
<th>Western Samoa</th>
<th>Kiribati</th>
<th>Tuvalu</th>
</tr>
</thead>
<tbody>
<tr>
<td>1970</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Australia</td>
<td>60.8</td>
<td>24.6</td>
<td>40.9</td>
<td>26.3</td>
<td>14.4</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>New Zealand</td>
<td>1.2</td>
<td>13.7</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Japan</td>
<td>12.7</td>
<td>14.6</td>
<td>12.7</td>
<td>2.5</td>
<td>10.0</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Singapore</td>
<td>2.3</td>
<td>2.5</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Taiwan</td>
<td>0.6</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Hong Kong</td>
<td>2.0</td>
<td>3.6</td>
<td>39.2</td>
<td>4.6</td>
<td>3.1</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>United States</td>
<td>6.1</td>
<td>4.7</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>United Kingdom</td>
<td>2.4</td>
<td>15.0</td>
<td>6.4</td>
<td></td>
<td>6.1</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Germany</td>
<td>1.6</td>
<td>1.3</td>
<td>1.3</td>
<td></td>
<td>1.5</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other</td>
<td>11.1</td>
<td>19.4</td>
<td>60.8</td>
<td>34.1</td>
<td>71.3</td>
<td>18.3</td>
<td>100.0</td>
<td>100.0</td>
</tr>
<tr>
<td>1991</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Australia</td>
<td>49.4</td>
<td>25.5</td>
<td>28.7</td>
<td>23.3</td>
<td>13.4</td>
<td>18.8</td>
<td>20.9</td>
<td>46.8</td>
</tr>
<tr>
<td>New Zealand</td>
<td>4.2</td>
<td>19.6</td>
<td>7.4</td>
<td>6.0</td>
<td>35.7</td>
<td>39.8</td>
<td>5.0</td>
<td></td>
</tr>
<tr>
<td>Japan</td>
<td>12.5</td>
<td>9.7</td>
<td>22.0</td>
<td>23.6</td>
<td>7.9</td>
<td>9.2</td>
<td>10.1</td>
<td>1.3</td>
</tr>
<tr>
<td>Singapore</td>
<td>11.1</td>
<td>9.0</td>
<td>15.4</td>
<td></td>
<td>1.7</td>
<td>1.7</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Taiwan</td>
<td>0.9</td>
<td>6.8</td>
<td>2.1</td>
<td>0.2</td>
<td>1.4</td>
<td>0.9</td>
<td>0.2</td>
<td>1.7</td>
</tr>
<tr>
<td>Hong Kong</td>
<td>2.3</td>
<td>4.4</td>
<td>3.5</td>
<td>3.4</td>
<td>1.6</td>
<td>2.2</td>
<td>1.7</td>
<td>4.3</td>
</tr>
<tr>
<td>United States</td>
<td>7.3</td>
<td>3.3</td>
<td>4.3</td>
<td>1.0</td>
<td>9.7</td>
<td>7.0</td>
<td>57.8</td>
<td></td>
</tr>
<tr>
<td>United Kingdom</td>
<td>2.1</td>
<td>2.7</td>
<td>2.0</td>
<td>0.6</td>
<td>3.3</td>
<td>1.3</td>
<td>1.1</td>
<td>8.5</td>
</tr>
<tr>
<td>Germany</td>
<td>0.7</td>
<td>0.9</td>
<td>0.8</td>
<td>0.2</td>
<td>0.4</td>
<td>2.3</td>
<td>0.4</td>
<td>0.4</td>
</tr>
<tr>
<td>Other</td>
<td>9.5</td>
<td>18.2</td>
<td>13.9</td>
<td>41.8</td>
<td>25.0</td>
<td>16.8</td>
<td>2.9</td>
<td>37.0</td>
</tr>
</tbody>
</table>

a West Germany.

**Source:** International Monetary Fund, August 1992.

### Table 7  Tourist arrivals in South Pacific countries, 1990

<table>
<thead>
<tr>
<th>Country</th>
<th>Australia</th>
<th>New Zealand</th>
<th>North America</th>
<th>Japan</th>
<th>Europe</th>
<th>Other</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fiji</td>
<td>103535</td>
<td>29432</td>
<td>55366</td>
<td>21619</td>
<td>41984</td>
<td>27060</td>
<td>278996</td>
</tr>
<tr>
<td>Solomon Islands</td>
<td>3403</td>
<td>1269</td>
<td>828</td>
<td>537</td>
<td>791</td>
<td>2367</td>
<td>9195</td>
</tr>
<tr>
<td>Tonga</td>
<td>3519</td>
<td>4840</td>
<td>4881</td>
<td>542</td>
<td>3175</td>
<td>3962</td>
<td>20919</td>
</tr>
<tr>
<td>Vanuatu</td>
<td>17667</td>
<td>6291</td>
<td>1094</td>
<td>751</td>
<td>2039</td>
<td>7200</td>
<td>35042</td>
</tr>
<tr>
<td>Western Samoa</td>
<td>5029</td>
<td>8224</td>
<td>4686</td>
<td>481</td>
<td>7533</td>
<td>21689</td>
<td>47642</td>
</tr>
<tr>
<td>Kiribati</td>
<td>381</td>
<td>158</td>
<td>642</td>
<td>252</td>
<td>10</td>
<td>1889</td>
<td>3332</td>
</tr>
</tbody>
</table>

Key issues of the Pacific island economies

Gary Wiseman

The Pacific island economies face unique problems and specific challenges which are usually overlooked by glossy tourist brochures with their images of paradise and islands in the sun. Differences in the region also need to be taken into account. While all of the Pacific islands face constraints to development, some face significantly greater problems than others. Poor soil fertility, lack of resources, natural disasters, diseconomies of scale, wide geographic dispersion and distance from markets combine to create an environment which severely limits economic development.

Despite this rather gloomy picture, considerable effort is being made throughout the region to bring about economic development and to overcome these problems. This is a review of the economic performance of the Pacific island countries which identifies some of the key issues which will impact on future development options in the region.

The Pacific island economies covered in this paper are the thirteen independent self-governing island states which are members of the South Pacific Forum (Forum island countries): Cook Islands, Federated States of Micronesia, Fiji, Kiribati, Marshall Islands, Nauru, Niue, Papua New Guinea, Solomon Islands, Tonga, Tuvalu, Vanuatu and Western Samoa. While specific details relate to only these countries, many of the issues are relevant to all island groups in the region. Selected physical and economic indicators of the thirteen Forum island countries are provided (Table 1, Statistical Summary).

Economic indicators

The region is extremely fragmented, consisting of many islands and coral atolls dispersed over a vast area of the Pacific Ocean. Port Moresby, the most western capital of the Pacific islands lies 5,000 kilometres from Alofi, the most eastern. Kiribati, one of the smallest countries in the region (and indeed the world) consists of 33 islands scattered throughout a sea area of 3.5 million square kilometres.

The total population of the Forum island countries is about 5.3 million people. Seventy per cent live in Papua New Guinea. Fiji has the second biggest population accounting for 13 per cent of the total regional population. This is in sharp contrast to Niue with fewer than 2,500 people or only 0.04 per cent of the region’s population.
Changes in the size and structure of the population are a concern in many of the island countries. In the Solomon Islands, Vanuatu, Papua New Guinea and the Marshall Islands, the rate of population growth is very high at more than 3 per cent per annum. In Niue, Cook Islands, Western Samoa, Tonga and Fiji, emigration reduces potential growth rates but results in skilled human resource depletion. Because of the high population growth rates, children comprise a high proportion of the total population, producing relatively high dependency ratios.

There are high population densities in some countries which again cause difficulties. They are particularly high in the small island states such as Nauru and Tuvalu with 400 and 348 people per square kilometre respectively. The highest population density in the entire Pacific region is found in the tiny islet of Ebeye, on Kwajalein atoll in the Marshall Islands, where over 7,000 people live on 0.3 square kilometres of land. Next is South Tarawa in Kiribati with an estimated 1,350 per square kilometre.

The economies of the countries are also relatively small. Traditional unprocessed commodity exports are the prime feature of most Forum island country economies, for example copper and timber in Papua New Guinea, phosphate in Nauru, copra in Kiribati, sugar in Fiji and coconut oil in Western Samoa. All of these countries are currently experiencing declining terms of trade and their exports are extremely vulnerable to world market fluctuations.

Semi-subsistence agriculture and fisheries, the backbone of many of the economies, have not experienced sustained growth in the 1980s, basically for two reasons: the sharp decline of prices for traditional primary export commodities and costly import substitution policies. With the exception of Nauru, all Forum island countries exhibited a negative trade balance in 1989. Earnings from major crops have been seriously affected by recurring drought and cyclone damage. In recent years negative development was also associated with high dependency on the Australian and New Zealand markets and the downturn of both these economies. In 1989, the trade deficit ranged from US$2 million in Niue to US$250 million in Fiji. Leaving aside Nauru, the excess of imports over exports as a percentage of GDP ranged from 89 per cent in the Cook Islands to 1 per cent in Papua New Guinea (Table 1).

The prominence of Papua New Guinea and Fiji within the thirteen countries is clearly demonstrated by a few figures. Together, these nations account for 85 per cent of the region’s GDP, 92 per cent of all exports and 80 per cent of the imports. The smaller island nations (Niue, Tuvalu, Cook Islands, Kiribati, Marshall Islands and Tonga) have few natural resources and contribute a mere 4 per cent to the region’s GDP.
### Table 1  Forum island countries: GDP, exports, imports, trade balance, 1989 (US$million)

<table>
<thead>
<tr>
<th>Country</th>
<th>GDP</th>
<th>Exports</th>
<th>Imports</th>
<th>Trade balance</th>
<th>Trade balance as proportion of GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cook Islands</td>
<td>46</td>
<td>3</td>
<td>44</td>
<td>-41</td>
<td>89</td>
</tr>
<tr>
<td>Federated States of Micronesia</td>
<td>145</td>
<td>5</td>
<td>68</td>
<td>-63</td>
<td>43</td>
</tr>
<tr>
<td>Fiji</td>
<td>1097</td>
<td>394</td>
<td>644</td>
<td>-250</td>
<td>23</td>
</tr>
<tr>
<td>Kiribati</td>
<td>32</td>
<td>5</td>
<td>22</td>
<td>-17</td>
<td>53</td>
</tr>
<tr>
<td>Marshall Islands</td>
<td>69</td>
<td>2</td>
<td>44</td>
<td>-42</td>
<td>61</td>
</tr>
<tr>
<td>Nauru</td>
<td>182</td>
<td>26</td>
<td>10</td>
<td>+16</td>
<td>9</td>
</tr>
<tr>
<td>Niue</td>
<td>4</td>
<td></td>
<td>2</td>
<td>-2</td>
<td>50</td>
</tr>
<tr>
<td>Papua New Guinea</td>
<td>3902</td>
<td>1304</td>
<td>1346</td>
<td>-42</td>
<td>1</td>
</tr>
<tr>
<td>Solomon Islands</td>
<td>109</td>
<td>71</td>
<td>106</td>
<td>-35</td>
<td>32</td>
</tr>
<tr>
<td>Tonga</td>
<td>66</td>
<td>10</td>
<td>54</td>
<td>-44</td>
<td>67</td>
</tr>
<tr>
<td>Tuvalu</td>
<td>4</td>
<td></td>
<td>3</td>
<td>-3</td>
<td>75</td>
</tr>
<tr>
<td>Vanuatu</td>
<td>120</td>
<td>22</td>
<td>71</td>
<td>-49</td>
<td>41</td>
</tr>
<tr>
<td>Western Samoa</td>
<td>105</td>
<td>13</td>
<td>75</td>
<td>-62</td>
<td>59</td>
</tr>
<tr>
<td><strong>Forum island countries</strong></td>
<td>5881</td>
<td>1855</td>
<td>2489</td>
<td>-634</td>
<td>11</td>
</tr>
</tbody>
</table>

**Source:** Forum Secretariat/GTZ, Promotion of Small and Medium-sized Industries in Forum Island Countries of the South Pacific, 1991.

### Table 2  Forum island countries: GDP by economic sector, 1989 (per cent)

<table>
<thead>
<tr>
<th>Country</th>
<th>Agriculture and forestry</th>
<th>Mining</th>
<th>Manufacturing</th>
<th>Utilities and construction</th>
<th>Trade</th>
<th>Other services</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cook Islands</td>
<td>13</td>
<td>-</td>
<td>5</td>
<td>17</td>
<td>23</td>
<td>42</td>
</tr>
<tr>
<td>Federated States of Micronesia</td>
<td>42</td>
<td>-</td>
<td>1</td>
<td>8</td>
<td>15</td>
<td>34</td>
</tr>
<tr>
<td>Fiji</td>
<td>23</td>
<td>2</td>
<td>11</td>
<td>17</td>
<td>16</td>
<td>31</td>
</tr>
<tr>
<td>Kiribati</td>
<td>18</td>
<td>-</td>
<td>2</td>
<td>23</td>
<td>14</td>
<td>43</td>
</tr>
<tr>
<td>Marshall Islands</td>
<td>..</td>
<td>..</td>
<td>1</td>
<td>..</td>
<td>..</td>
<td>..</td>
</tr>
<tr>
<td>Nauru</td>
<td>..</td>
<td>..</td>
<td>..</td>
<td>..</td>
<td>..</td>
<td>..</td>
</tr>
<tr>
<td>Niue</td>
<td>..</td>
<td>..</td>
<td>..</td>
<td>..</td>
<td>..</td>
<td>..</td>
</tr>
<tr>
<td>Papua New Guinea</td>
<td>33</td>
<td>10</td>
<td>11</td>
<td>12</td>
<td>8</td>
<td>26</td>
</tr>
<tr>
<td>Solomon Islands</td>
<td>45</td>
<td>-1</td>
<td>5</td>
<td>10</td>
<td>10</td>
<td>31</td>
</tr>
<tr>
<td>Tonga</td>
<td>22</td>
<td>1</td>
<td>10</td>
<td>15</td>
<td>13</td>
<td>39</td>
</tr>
<tr>
<td>Tuvalu</td>
<td>12</td>
<td>-</td>
<td>1</td>
<td>12</td>
<td>64</td>
<td>11</td>
</tr>
<tr>
<td>Vanuatu</td>
<td>23</td>
<td>-</td>
<td>5</td>
<td>14</td>
<td>34</td>
<td>24</td>
</tr>
<tr>
<td>Western Samoa</td>
<td>34</td>
<td>-</td>
<td>13</td>
<td>7</td>
<td>8</td>
<td>38</td>
</tr>
</tbody>
</table>

**Source:** Forum Secretariat/GTZ, Promotion of Small and Medium-sized Industries in Forum Island Countries of the South Pacific, 1991.

19  Pacific Islands at the crossroads?
Key issues of the Pacific island economies

A closer look at the GDP figures reveals that most Forum island countries are heavily dependent on primary production. Despite a significant upswing during the past decade, the manufacturing sector remains modest and relatively undeveloped in most Forum island countries. Especially in the smaller island nations, the service sector (particularly trade and government services) plays a dominant role.

Due to transportation and communication problems, improving economic performance will not be easy. These difficulties exist within the islands, among islands of the same nation and among the Forum island countries as a group. Nevertheless, there is prospect for improvement with structural adjustments and strengthening of the private sector now underway almost everywhere. These changes are increasing the potential for new investment, notably in the labour intensive, export-oriented, resource-based industries processing agricultural, marine and forestry products. However, such development will only become a reality if the existing market distortions (e.g. import restrictions, high tariffs, price controls and agricultural subsidies) are further reduced.

It is important that Forum island countries expand their foreign markets, identify and use market niches, diversify their product range and attract foreign investment. Linked with these considerations is the need to improve management and to create favourable conditions for private sector development. Failure to do so will lead to economic stagnation, if not decline, and the continuation of dependency on large amounts of foreign aid and remittances from citizens living overseas.

Resources and economic potential

From the viewpoint of resource endowment and development potential, the Pacific islands can be divided into four major categories. The first comprises the relatively large island groups, Papua New Guinea, Fiji, Solomon Islands and Vanuatu. These islands have the best resource potential and together account for an estimated 90 per cent of the region’s total population. Each possesses extensive land areas suitable for agriculture and has control over a large exclusive economic zone. These resources provide the basis for major development in agriculture, forestry, fisheries, tourism and, in one or two cases, minerals. Much progress has already been made in developing this resource potential, and this has contributed to a relatively high degree of diversification and economic growth.

These countries are capable of achieving financial and economic independence. For them, steady economic growth without continuing large injections of grant aid is feasible provided appropriate domestic policies are put in place. These policies include

- exposure of the domestic economy to outside competition with the aim of increasing domestic efficiency
- allowing market mechanisms to determine resource allocations
- removal of barriers to exports
- containment of the public sector's role in the production of goods and services
- encouraging the private sector to play a greater role in economic activities
- deregulating the financial sector to encourage domestic savings, thereby increasing investments which yield the highest returns to the economy
- adoption of macroeconomic policies which will assure financial stability at all times.

The second group are the middle-sized islands, represented by Western Samoa and Tonga. These islands have modest resource bases. Agricultural potential is present but constrained by limited land areas. Exclusive economic zones are small (Western Samoa has the smallest in the region), commercially exploitable minerals are absent, and tourism has only limited scope. Paucity of raw materials and small domestic markets restrict industrialization and also limit economic diversification.

Exports from Tonga and Western Samoa consist largely of agricultural products. They run trade deficits which are financed through aid and remittances. In Tonga, remittances are as high as three times the value of exports or half that of imports. Similar orders of magnitude for remittances are current in Western Samoa. The bulk of development expenditures are financed through aid. Tonga and Western Samoa are capable of achieving economic viability in the long term without continuing, large aid inflows. However, this calls for domestic policies similar to those mentioned earlier and lower standards of living will perhaps need to be accepted temporarily.

The third group comprises the small, remote and resource-poor islands of Kiribati, Tuvalu, Niue and Cook Islands. Except for Niue and Cook Islands, whose people have free access to New Zealand, all have relatively high population growth rates, limited land-based resources, and lack the capacity to exploit their exclusive economic zones although they are among the largest in the region. Agricultural output is small and restricted almost entirely to subsistence production. Opportunities for industrial development are negligible and only Cook Islands has tourist potential. Economic diversification is rudimentary with exports dominated by a single traditional crop, copra.

Substantial trade deficits which cannot be sustained without continuing large inflows of aid are experienced every year. Remittances are very important, but the high levels of consumption and welfare are underwritten by aid.

The other sources of foreign exchange for these countries include rent on fishing rights granted to the vessels of other nations and sales of artifacts. Earnings from commemorative stamps were once important in Tuvalu and Cook Islands. The public sector, the activities of which are to a large extent supported by aid, dominates the economies. Gross domestic product, government revenue, the
national import bill and the movements in the external accounts are all highly sensitive to public sector expenditures. The small private sectors depend heavily upon the goods and services which they supply to the governments.

Long term financial and economic independence is a difficult target for this group of countries. Sharpened skills in rent seeking, emigration arrangements with metropolitan countries or closer association with other countries are some of the strategies available.

The fourth group comprises those island economies that enjoy some singular advantage that compensates for otherwise poor economic prospects. These special-case economies include Nauru, which is dependent on lucrative (though soon to be exhausted) phosphate deposits and the Federated States of Micronesia and the Marshall Islands whose strategic value to the United States has enabled them to benefit from large financial subsidies. Through the exploitation of these special assets, these countries have been able to raise their living standards to levels that are among the highest in the region.

For all three countries, there is considerable uncertainty about their long-term future. In the case of the Federated States of Micronesia and the Marshall Islands, reduced support from the United States is already beginning to have an impact. In many respects, the situation of the Federated States of Micronesia and the Marshall Islands is very similar to that of the countries included under the third group.

**Economic growth**

The *Asian Development Bank Outlook* (1992) revealed that island countries of the South Pacific registered an average growth rate of 6.1 per cent in 1991. However, this was mainly due to a dramatic economic turnaround in Papua New Guinea. The remaining countries included in the review, showed decelerating growth for reasons including the slowdown in the world economy, internal policies and adverse weather conditions.

As noted, economic prospects for a number of the island economies were dependent to a large extent upon weather conditions, primary commodity prices and, in the case of Papua New Guinea, on activities in mineral related projects. Even if normal weather conditions prevail over the next two years, economic growth in the region is expected to decelerate in 1992 and recover in 1993.

Such fluctuations in growth are mainly attributable to Papua New Guinea where mineral projects initiated in 1992 will not start full production until the end of the year. Following a full year of petroleum exports, economic growth in Papua New Guinea is expected to accelerate sharply in 1993. Fiji will also show improvement in its economic growth during the next two years. Recovery will come from the resumption in growth of tourist arrivals and related services. In the Solomon Islands, the forestry and fishing sector should continue to grow but a serious fiscal imbalance will limit growth in the industrial and service
sectors. In Tonga, growth is projected to decelerate as agricultural exports, particularly squash and vanilla, will slow down. Cyclone damage will require large public expenditures for rebuilding and rehabilitation in Vanuatu and Western Samoa over the next two years and, as a result, prospects there are uncertain.

The international economic situation continues to affect the development prospects of Forum island countries. While it is difficult to quantify the practical impact of global macroeconomic trends on the relatively small economies of the South Pacific, it is clear that the open nature of the economies means they are very susceptible to external changes. Development assistance flows remain linked to political, strategic and other considerations, while foreign investment, tourism and trade flows are based directly on financial and economic considerations.

The current prospects for development and economic growth vary considerably throughout the region (World Bank 1991). Some economies have grown in recent years while others have stagnated. There remains, nevertheless, an underlying optimism that prospects are bright in the longer term, not least through the harnessing of the region’s marine resources.

Comparison with other regions

The World Bank noted that as a group, Fiji, Kiribati, Solomon Islands, Tonga, Vanuatu and Western Samoa recorded an average growth of real GNP of 0.6 per cent per annum over the period 1980–88. This is in sharp contrast to over 5 per cent growth in the Caribbean and 6 per cent in the Maldives and Mauritius over the same period (World Bank 1991).

Priorities for the region

In reviewing the region’s priorities it is recognized that for some of the larger countries in the region, there is already significant mining, maritime, forestry, agriculture and associated processing activity, together with other manufacturing activity, to have confidence in their achieving longer-term self-sustaining growth. The prospects for such growth among the smaller economies is far less certain.

The region remains extremely susceptible to natural disasters. These have, in recent years, had a tremendous impact on economic development. While the international community remains responsive to the hardship caused, rebuilding programs in most situations merely restore the status quo rather than contribute to economic growth and improved living standards.

In the South Pacific, regional cooperation is sometimes considered an appropriate vehicle for pursuing development strategies as a means for attaining national economic, political and social objectives. Such cooperation need not necessarily be pursued through formal regional bodies, though it often is, and
in all cases regional strategies are designed to complement national goals. Benefits which accrue from regional cooperation include economies of scale, increased weight in securing concessions in trade and aid negotiations and for ensuring that the region's views are at least listened to in the various international economic and political fora. Regional cooperation implies that individual members may occasionally have to divest themselves of a component of their sovereignty in the interest of the region as a whole; this requires a lot of political will and, not surprisingly, is sometimes very difficult to accept politically.

Accordingly, the areas where a regional approach is taken in pursuit of national and group objectives must be chosen carefully. That said, in the South Pacific these have included a wide range of areas, for example, transportation, civil aviation, telecommunications, higher education, tourism, agriculture, trade, energy, exploration within the exclusive economic zones, the environment, economic issues, nuclear testing, security and political developments in the Pacific region.

High population growth rates affect the level of resources required to maintain adequate health and education standards and limit employment prospects. The importance of enhancing opportunities for all people to contribute to the maximum extent possible to the development process is being increasingly recognized and human resource development programs are being developed towards this end.

As part of establishing an appropriate policy regime and stable macroeconomic environment, governments in the region are now recognizing the need to encourage the development of policies that promote private sector development, trade and joint ventures. Efforts are also being directed to promoting linkages at the private sector level between the region and Asia and other parts of the world, recognizing that to be effective contact cannot only be government-to-government. Emphasis is also being placed on investment and trade missions.

In terms of Pacific island country-donor relations, the importance of policy dialogue between countries and their development partners is receiving greater acceptance. Such policy dialogue encompasses policies relating to trade, tourism, foreign investment and private sector participation.

An effective and efficient civil service is also recognized as a prerequisite to the formulation of appropriate development policies and for ensuring effective linkages with the private sector. As many countries in the region seek to encourage the development of the private sector and/or reduce the role of the public sector, public sector reform is assuming greater importance.

Telecommunications, air services and shipping are also important in developing the region's links with the rest of the world and in promoting inter-regional communications. The region continues to face a wide range of problems in
ensuring effective communications. The development of new technologies is also placing pressure on the region due to the need for more training to maintain and operate the new technology. In addition, as the region imports all its fuel requirements, the efficient use of energy resources remains a priority as this impacts on all major economic activity.

The region's marine resources offer considerable scope for further development and, for a number of the smaller Forum island countries, offer the greatest potential for resource-based economic development. Experience shows that, in general, issues relating to the activities of Distant Water Fishing Nations operating in the region are most effectively addressed at the regional level. This is also true of activities designed to identify the economic potential of non-living marine resources of the region.

**Priority themes in development**

**Sustainable development**

The region increasingly recognizes the importance of sustainable development and the need to halt environmental degradation. Major global threats include the depletion of the ozone layer and the greenhouse effect. The small atoll states, with heavy pressure on available land and high dependence on fragile marine ecosystems, are particularly vulnerable. Climate change and sea level rise are particular threats. The region is also vulnerable to an increase in the number and severity of tropical storms and changes in their patterns. Environmental degradation caused by local factors also requires urgent attention.

It is increasingly recognized that the environment is crucial to development. For example, the sustainable rate of development is determined by the ability of the physical and social environment to continue to renew itself. These interlinkages were a key theme of the 1992 United Nations Conference on Environment and Development, or Earth Summit, where developing countries, including the South Pacific, were concerned to secure additional financial and technical assistance to promote ecologically sustainable development.

**Population**

Family planning strategies require greater attention by many of the Forum island countries, not just the smaller ones. The aim of family planning is to reduce population growth to levels that the island economies can sustain and support. This is a controversial and emotionally charged issue. However, it touches and is touched by so many other facets of development that it cannot be ignored.

The macroeconomic frameworks of Forum island countries are also undergoing change. In most, economic growth has not kept pace with population growth. Most governments are attempting to make their public services more efficient by cutting back both staff and expenditure. International assistance has also been directed away from social services to private sector development. This
Key issues of the Pacific island economies

has led to structural adjustment policies in many countries. Children, particularly amongst lower income families, are often the first victims of such adjustments through the reduction of health, education and social services.

As stated by Madame Courte, Director of Programs of the South Pacific Commission:

The problems of population are not limited to a lack of food and shelter to accommodate our people. The issues reach into many areas—the under-employed of our young which can lead to their disenchantment and crime, the limited supply of nutritious food for our young children, the over-fishing of our waters, urban drift, health problems over-crowded educational institutions and even environmental concerns.

Private sector development

Private sector development leading to greater trade and investment is increasingly regarded as the key to bringing about sustained economic development. At the Forum Secretariat Pacific Island Countries/Development Partners Meeting held in March 1992, it was recommended that the basic strategy for promoting private sector development should centre on

- economic policy dialogue between public and private sectors regarding the business and investment environment, privatization, corporatization, management contracts, restructuring, private supply of public services, regional dialogue and harmonization of foreign investment promotion, incentives schemes, duty-free zones, taxation, etc.
- training in the public and private sectors in policy dialogue, development banking, trade and investment promotion, entrepreneurship and basic business skills
- micro-enterprises and small business development including the provision of wide-ranging small business services to cooperatives and the encouragement of new indigenous entrepreneurs at the community and village level
- finance and credit such as equity lines for development banks, small credit schemes integrated with business support services, venture capital enterprises, funds for development equipment leasing firms, better credit coordination between commercial and development financial institutions, trade and investment agencies, export financing and insurance schemes
- improved regional clearing and distribution of information in a detailed, timely and practical manner, of private sector support through training and financing schemes and the diffusion of one-stop business-service agencies.

New technologies

In a paper presented at the 48th Session of ESCAP, particular attention was paid to the implications of new technologies on economies. New technologies
Gary Wiseman

are revolutionizing production techniques and creating new opportunities. ESCAP predicts that in the 1990s, most countries' productive sectors will continue to use conventional technology with new technologies making gradual inroads. Therefore no sudden shifts in international trade patterns or in the location of industry are likely to take place during this period, although on the domestic front significant shifts will take place with increasing frequency as the decade proceeds. Pressures will also build up on producers in a wide range of industries to adopt new technologies to remain competitive.

The advent of new technologies does not herald a breakthrough for Forum island countries into a situation in which almost any product can be made cheaply and economically on a very small scale. If anything, it reinforces the advantage of large-scale producers in the developed countries in most industries. Nevertheless, with new technologies there are greater opportunities for cutting costs. In the Pacific, this has been demonstrated by the introduction of microcomputer equipment in the service sector particularly in the areas of managerial activities and data processing.

Another area of opportunity is the commercial application of services based on new technology which can be provided at low marginal cost in such areas as satellite telecommunication and remote sensing services. Remote sensing services are useful in both the production and management of primary products, including those in the forestry and fisheries sectors, as well as for weather forecasting, which is very important in a region subject to frequent severe cyclones. The extension of telecommunications networks to isolated rural areas or outlying islands is seen as a high priority in reducing urban drift and improving the quality of life for all people in the region.

Lastly, new technologies are used not as complete systems in themselves but are blended with traditional technologies. Unlike the large-scale use of new technologies in manufacturing where new technologies constitute the whole process, blended technology takes what is good in existing technology and increases its efficiency by grafting on new technological elements.

In order for Forum island countries to take full advantage of these new technologies, there is a need for continued training and specialization. While a large proportion of development assistance is already directed towards education and training, this is not expected to reduce significantly in the immediate future given the need to keep pace with technological change. There is, however, a need to ensure that the training is effective and compatible with the introduction of new techniques and procedures. At the regional level, a useful service can be provided to countries in monitoring new developments, researching their applicability to the region and advising on the scope for utilization.

Macroeconomic policy settings

Policy and planning remained at the top of the agenda of regional bodies and the major multilateral institutions active in the region. Recently, the strategic
Key issues of the Pacific island economies

approach to policy formulation and planning has gained significant momentum and the Forum Secretariat, together with other institutions in the region, is providing technical support. Work currently being carried out by multilateral agencies in analysing economic performance and prospects in the region will be a key agenda item at the 1993 Pacific Island Countries/Development Partners Meeting.

Provision of development assistance

It is clear that greater attention is being paid to how effective aid has been to the region in the past. The World Bank Regional Economic Report (1991) expressed concern that despite the high levels of aid provided to the region the majority of island countries registered little or no growth in gross national product per capita over the last decade.

A number of suggestions have been made for improving aid utilization through improved planning, greater levels of policy dialogue and improved implementation and reporting procedures. The 1991 South Pacific Forum said it was pleased to note the firm resolve shown by all those interested in South Pacific development to foster greater levels of cooperation, coordination and policy dialogue.

At the regional level efforts are being made to more clearly identify the region's priorities as directed by the Forum. This requires the development of a framework for establishing a regional strategy. The aim of the strategy is to allow Pacific island countries to determine which programs should be pursued at the regional level and what priority they should be accorded. It will establish how, when and by whom, proposals for activities should be developed and implemented and it will provide donors with a basis for supporting regional activities based on the region's own areas of emphasis.

The output of this exercise is threefold.

- Formulation of a statement of strategy.
- Development of a supporting regional database.
- Establishment of an on-going process for monitoring regional priorities, determining how they can most effectively be met and modifying the strategy.

Human resources development

Human resources development is of paramount importance for improving economic and social conditions. Population growth, basic education and health care, as well as employment prospects for the high numbers of young people in many Forum island countries, are a major preoccupation of governments in the region. In the United Nations Children's Fund submission on the state of the Pacific's children, particular attention was given to the need for the region
to respond to health, education and population issues if the living standards of children were to improve (United Nations Children's Fund 1992).

Recent studies have shown that there remains a continuing imbalance between the demand for and supply of skills in the Forum island countries. Despite heavy investment in human resource development, there are few signs of improvement. Serious shortfalls in domestic skills availability persist, partly due to weaknesses in training programs and partly due to substantial emigration. At the same time, demand for these skills continues to exceed the capacity of national and development-partner financed training programs.

Institutional deficiencies including uncompetitive wage/salary structures, overextension of activities undertaken by the public sector, inappropriate staffing structures and constraints on training institutions remain. As well, operational weaknesses impair the skill-creating potential of technical assistance and training programs. Excessive reliance on certain approaches to training, lack of attention to private sector training and deficient project management are further concerns.

At the Pacific Island Countries/Development Partners Meeting in March 1992, it was generally agreed that appropriate guidelines for the design and appraisal of technical assistance and training projects needed to be developed and the Forum Secretariat was requested to coordinate this work in collaboration with relevant bodies, such as the University of the South Pacific.

The World Bank has recently completed a Pacific Region Post Secondary Education Study. The regional report, which is based on detailed reviews in six Forum island countries, highlights the need for a stocktake to be taken of the education opportunities being offered by 35 education institutions in the region. The report identifies three key areas as needing attention.

First, rationalization of management of post secondary programs and institutions at the national level. This should include attention to planning, budgeting and operational procedures conducive to national sectoral strategies fitting the economic scale of the Forum island countries. Similarly, donors in partnership with Forum island countries should assess which training programs, scholarships and technical assistance would alleviate skill shortages at the national, regional and rim countries levels to improve the responsiveness, cost effectiveness, efficiency and sustainability of programs.

Second, attention to the quality of programs through the upgrading of staff, particularly in mathematics and the sciences. And third, the Forum island countries and donors rationalizing financial allocations and directing support to priority needs and only to viable and sustainable programs.

Some member governments are placing particular emphasis on human resources development in general and higher education in particular. Some have recently adopted National Higher Education Plans. These address issues
such as reduction of the number of higher education institutions. The remaining institutions will be more economically viable in size, leading to improved cost-effectiveness. Reform of the system of student financing is also being addressed.

By 1993 the United Nations Development Programme intends to produce a Pacific Human Development Report which will address human development in fifteen Pacific island countries. Attention will be given to the current state of human development in the region with the identification of strategies and priorities for the future. A special focus will be on the inter-relationship between population and human development.

**Closer relationships with larger countries and international groupings**

The forging of closer relationships with larger countries and international groupings is also of major importance for the region, both to smaller and larger Forum island countries.

This process requires the fostering of closer integration with countries such as Australia, France, the United States and New Zealand. Closer integration can be attained by developing special economic relationships, such as preferential trading arrangements and common currency systems, or through constitutional and political change. For island countries, such integration can mean a more predictable basis for securing aid, trade and emigration concessions. However, close integration with metropolitan countries can lead to the erosion of national identity and cultural integrity and ultimately the loss of political sovereignty. Therefore, Pacific island countries are unlikely to view this as a feasible option.

In addition, the islands must participate more actively in Asia-Pacific regional cooperation, working with regional organizations such as the Association of South East Asian Nations (ASEAN) and the Asia Pacific Economic Cooperation (APEC) initiative. So far, the Pacific island countries have had minimal involvement in these wider regional initiatives. The countries of ASEAN are part of the dynamic East Asian regional economy that is experiencing unequalled economic growth and socio-economic structural change. Closer cooperation with these countries and associated regional groupings could offer trade, aid and training opportunities for the Pacific islands. Similarly, active participation in the APEC process would, among other things, gain a wider regional audience for island interests and development opportunities.

**Smaller island states**

The development predicament of the smaller islands in the region has resulted in heavy dependence on foreign aid, high overseas migration, a heavy reliance on remittances from overseas and heavy dependence on imported foodstuffs and other raw materials. There is also concern that the economic and social costs associated with such dependence may exceed the apparent benefits. Aid dependency can seriously undermine national initiative and has serious
distorting effects on the economy, preventing the efficient allocation of resources.

A study completed for the Forum Secretariat in 1992 suggests that for those countries which are highly dependent upon remittances, it was unlikely that this situation was sustainable in the longer term. It was concluded that remittances were unlikely to grow at a sufficiently rapid pace to enable even a modest growth in living standards in the highly remittance dependent Forum island countries. The study also showed that remittances did not contribute substantially to the development of the productive sectors in Forum island countries. Overseas migration has led to the loss of talented people with technical skills and experience. Some Forum island countries have special employment schemes with international shipping and fishing companies. However, the problem with these is that they can always be withdrawn at relatively short notice.

It is essential that the Forum island countries, particularly the smaller ones, explore other possible strategies that are more likely to achieve sustainable growth in the longer term. In the case of Tuvalu, a trust fund has been established with the assistance of a number of aid donors. Under this fund, investments are made and managed overseas and the return, after allowing for annual administrative expenses and maintenance of fund value in real terms, is available to the Government of Tuvalu to support its recurrent budget. It is a pioneer scheme aimed at ensuring the economic viability of a small country with limited production base. The Kiribati Income Equalization Scheme, started with returns on phosphate exports, offers similar support to that country’s annual budget.

The smaller Forum island countries should also consider giving greater recognition to subsistence activities as a complement to the monetary economy. Subsistence activity is still substantial in many Forum island countries. According to the study completed for the Forum Secretariat in 1992, 80 per cent of the population of Kiribati and Tuvalu still receive a major part of their basic needs from non-monetary subsistence produce. The subsistence sector, in its mixed subsistence/cash mode, is the source of the majority of the Forum island countries greatest comparative advantage. It is argued that it is largely this mode which enables them to remain economically and politically independent. It is also the basis of their culture and identity.

Conclusion

These are just some of the key issues facing Forum island countries as they seek to realize their long term development aspirations. They are issues which have received specific attention at recent South Pacific Forum meetings and other major conferences in the region.
Key Issues of the Pacific island economies

References


Relevance of East Asian development experiences to the South Pacific

David Lim

The newly industrializing economies have not only grown much faster than other Asian economies, especially the South Asian ones, but have also achieved more equitable income distribution and better quality of life (Tables 1 and 2).

### Table 1  Average annual growth rates of GNP per capita of Asian countries, 1950–89 (per cent)

<table>
<thead>
<tr>
<th></th>
<th>Exchange rate conversion</th>
<th>Purchasing power parity conversion</th>
</tr>
</thead>
<tbody>
<tr>
<td>Newly industrializing economies</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Hong Kong</td>
<td>5.0</td>
<td>6.3</td>
</tr>
<tr>
<td>Singapore</td>
<td>6.4</td>
<td>7.0</td>
</tr>
<tr>
<td>Republic of Korea</td>
<td>5.1</td>
<td>7.0</td>
</tr>
<tr>
<td>Taiwan</td>
<td>5.3</td>
<td>9.1</td>
</tr>
<tr>
<td>Southeast Asia</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Indonesia</td>
<td>2.0</td>
<td>4.4</td>
</tr>
<tr>
<td>Malaysia</td>
<td>2.6</td>
<td>4.0</td>
</tr>
<tr>
<td>Philippines</td>
<td>2.8</td>
<td>1.6</td>
</tr>
<tr>
<td>Thailand</td>
<td>3.6</td>
<td>4.2</td>
</tr>
<tr>
<td>South Asia</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bangladesh</td>
<td>..</td>
<td>0.4</td>
</tr>
<tr>
<td>India</td>
<td>1.5</td>
<td>1.8</td>
</tr>
<tr>
<td>Myanmar</td>
<td>2.3</td>
<td>..</td>
</tr>
<tr>
<td>Nepal</td>
<td>0.7</td>
<td>0.6</td>
</tr>
<tr>
<td>Pakistan</td>
<td>..</td>
<td>2.5</td>
</tr>
<tr>
<td>Sri Lanka</td>
<td>1.6</td>
<td>3.0</td>
</tr>
<tr>
<td>China</td>
<td>4.2</td>
<td>5.7</td>
</tr>
<tr>
<td>Developing countries</td>
<td>3.4</td>
<td>2.5</td>
</tr>
</tbody>
</table>

Relevance of East Asian development experiences

Table 2  Quality of life indicators for Asian countries, 1989

<table>
<thead>
<tr>
<th>Percentage of age-group enrolled in secondary education</th>
<th>Life expectancy at birth (years)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Newly industrializing economies</td>
<td></td>
</tr>
<tr>
<td>Hong Kong</td>
<td>74</td>
</tr>
<tr>
<td>Singapore</td>
<td>69</td>
</tr>
<tr>
<td>Republic of Korea</td>
<td>87</td>
</tr>
<tr>
<td>Taiwan</td>
<td>..</td>
</tr>
<tr>
<td>Southeast Asia</td>
<td></td>
</tr>
<tr>
<td>Indonesia</td>
<td>48</td>
</tr>
<tr>
<td>Malaysia</td>
<td>57</td>
</tr>
<tr>
<td>Philippines</td>
<td>71</td>
</tr>
<tr>
<td>Thailand</td>
<td>28</td>
</tr>
<tr>
<td>South Asia</td>
<td></td>
</tr>
<tr>
<td>Bangladesh</td>
<td>18</td>
</tr>
<tr>
<td>India</td>
<td>41</td>
</tr>
<tr>
<td>Myanmar</td>
<td>..</td>
</tr>
<tr>
<td>Nepal</td>
<td>30</td>
</tr>
<tr>
<td>Pakistan</td>
<td>19</td>
</tr>
<tr>
<td>Sri Lanka</td>
<td>71</td>
</tr>
<tr>
<td>China</td>
<td>44</td>
</tr>
</tbody>
</table>


Other measures of economic performance (for example, employment and wages growth), equity performance (for example, reduction in the level of poverty) and quality of life performance (for example, the number of doctors per capita) could have been used but they would have shown the same thing.

This success of the newly industrializing economies has, not surprisingly, encouraged many countries to attempt to follow their development strategy. Witness the attempt by Malaysia to 'look East' in its development efforts in the early 1980s.

Various explanations of the newly industrializing economies' superior development performances are assessed here. There is little point in discussing the relevance of this experience unless there is some agreement about its nature. The hypothesis which seems to warrant the most support, that the newly industrializing economies have done well because they have tended to follow a market-friendly and internationally competitive approach to development, is presented in a way that identifies the economic policies that have to be pursued to produce economic growth with equity. The development performances of the South Pacific economies are then examined and the relevance of the newly industrializing economies' experience to these economies is assessed.
Why development performances differ

Many explanations have been given for the development success of the newly industrializing economies. A very recent and rather ingenious one argues that the newly industrializing economies do not possess abundant natural resources and therefore do not have to contend with the debilitating Dutch disease, the phenomenon where the existence of a buoyant primary export sector draws resources away from traditional exports and detracts from their international competitiveness (Corden 1984). An abundance of resources may also cause the government to spend and tax inefficiently (Lim 1988). According to this theory the newly industrializing economies, with no abundance of natural resources, have been spared this affliction.

There is not much to this argument. The East Asian countries do have booming manufacturing export sectors and, as noted, do not suffer from the Dutch disease as did Ghana, Nigeria, Venezuela, Mexico and other countries rich in natural resources. The theoretical and empirical literature on this, however, is quite clear that it is not the size and the type of the booming sector that matters, but the macroeconomic policies pursued.

If nature cannot be blamed, then surely politics can, so runs another hypothesis. The Republic of Korea and Taiwan were lucky enough to receive massive foreign aid from the United States and other friendly, rich anti-communist countries. This must have helped to increase investment and economic growth. Detailed case-studies of Korea (Krueger 1979; Mason et al. 1980) and Taiwan (Scott 1979; Kuo 1983) show that foreign aid was used mainly to control inflation helping significantly to produce economic and political stability. According to this hypothesis, as political and economic stability is essential to economic growth it is hard to ignore the argument that Korea and Taiwan were just plain lucky to be situated where they are geographically and historically, otherwise, they would not have received the aid which made such political and economic stability possible.

This argument raises more questions than it answers. There is no guarantee that foreign aid will be used to fight inflation. There is also no shortage of theoretical and empirical literature to show that foreign aid can reduce domestic savings and economic growth. What is to be made of countries which receive significant foreign aid but grow slowly, if at all (for example, Cuba and Papua New Guinea) and of countries which receive little aid but grow rapidly (Malaysia and Singapore)? The conclusion that should be drawn is that while foreign aid is indeed determined exogenously, its use is determined very much by the governments of the recipient countries themselves.

A third hypothesis holds that the newly industrializing economies have done well because of their common Confucian heritage which gives them a labour force that is hard working, loyal, thrifty and places great value on education, giving them a huge advantage over other countries. This cultural hypothesis
Relevance of East Asian development experiences

has also been used to explain the economic success of Malaysia, Thailand and Indonesia where the Chinese influence is significant.

This hypothesis ignores the fact that in the 1950s Confucian values were blamed for the lack of economic progress in Taiwan and Korea (Han 1984; Baum 1982) and for the economic decline of China in the past (Needham 1954). It cannot explain the economic success of those developing countries without the Confucian heritage. It either does not concede, or ignores, the fact that people respond rationally to changes in the economic environment. Maybe the workers in the newly industrializing economies work hard because they get paid well, remain loyal because they are treated fairly, place high value on education because of the mobility it gives them, and save substantially because of high real interest rates. Surely the argument cannot be that Confucian values require high wages in order to encourage hard work. That would be carrying it too far. In any case, it is not necessary to resort to the teachings of Confucius to arrive at this. The first chapter of any first-year textbook in economics will do. The cultural explanation is disheartening for other economies as it will take a very long time for the necessary values to be inculcated and it is not possible to import large enough numbers of people with a Confucian background to make a difference. Are countries to believe that they are doomed to poverty because they cannot introduce the necessary cultural values in time?

Evidence from around the world shows that attitudes to work can be changed by the provision of incentives and by giving people room to move. Farmers in developing countries, for example, increase their output once agricultural pricing policies reward rather than punish their efforts (Schiff and Valdés, forthcoming). Hypotheses which parade cultural determinism explain everything and nothing at the same time. The values attributed to the possession of a Confucian heritage are values which are in fact determined endogenously.

The fourth hypothesis is that countries which allow their governments and markets to work together to produce international competitiveness will grow much faster than those which persist without such cooperation and with the belief that they can operate outside the international economic system. In other words, countries which pursue a market-friendly and internationally competitive approach to development will grow faster.

If markets can work well and are allowed to, there can be a substantial economic gain. If markets fail, and governments intervene cautiously and judiciously in response, there is a further gain. But if the two are brought together, the evidence suggests that the whole is greater than the sum. When markets and governments have worked in harness, the results have been spectacular, but when they have worked in opposition, the results have been disastrous (World Bank 1991a:2).

'Market friendly' refers to market-government cooperation where each makes use of the advantages of the other. 'Internationally competitive' refers to the need for market-government cooperation to produce goods and services at internationally competitive prices. For example, it is often argued that countries
cannot produce manufactured goods successfully without some initial form of protection. Governments usually provide this protection. The trick, of course, is to make the protection transparent and to reduce the level of protection as industries move from infancy to adolescence, picking up skills and experience as they grow older. By the time the import-substituting market has been saturated, adulthood will have been reached and the industries should be able to compete in the big wide world without any more help. Macroeconomic, industry and trade policies must be introduced to ensure such a transition takes place.

This hypothesis identifies that the reason behind better development performance is the implementation of policies by the countries themselves. The other hypotheses emphasize the role of exogenous factors such as nature, history, chance or friendly powers.

There is strong empirical support for the hypothesis that emphasizes endogenous factors (World Bank 1991a). Evidence shows that the newly industrializing economies have adopted a more market-friendly and internationally competitive approach to development than other developing countries in Asia. First, they have less government intervention. For example, their effective rates of protection on manufacturing are significantly lower. Second, they are more concerned that government intervention does not unduly distort prices down the line. For example, the anti-export bias created by protecting domestic producers was neutralized more quickly in the newly industrializing economies than elsewhere. Third, they subject their government intervention to the discipline of international and domestic competition. For example, in the 1970s Korea increased the level of protection to encourage the development of the heavy chemicals industry. It also supplied the industry with subsidized credit and tax rebates. When the industry performed badly the government withdrew its support and liberalized imports. In many other countries the response would have been the opposite. The first two examples illustrate the concern for being market-friendly, the third the concern for international competitiveness.

What appears to be important amongst the arguments of the various hypotheses is not the abundant supply of natural resources, foreign aid, or other exogenous factors, but what use is made of the available resources. This suggests that more credence should be placed on those hypotheses which seek explanations for economic growth in the policies pursued by the developing countries themselves.

A step-wise and back-tracking approach

While the market-friendly and internationally competitive hypothesis appears to be more acceptable than the other hypotheses in explaining differences in development performances between Asian countries, it does suffer from an important weakness. It is often presented at a highly aggregated level and with little attempt to identify the sources of output growth, the factors necessary for the sources of output growth to operate and the economic policies needed to provide those factors.
A step-wise and back-tracking approach to explaining differences in growth performances has been suggested by Lim (1991c). This consists of three steps. The first is to estimate the production functions of developing countries in order to identify the sources of output growth and the contribution of each of these to the measured growth rate of output. The second is to identify the factors responsible for these sources of output growth. The third is to identify the economic policies needed to bring about these factors.

Production function analysis can be used to identify three sources of growth in aggregate output. They are increases in the supply of the factors of production, increasing returns to scale and technological progress.

Different forms of the production function have been estimated for developed and developing countries in a large number of studies. The results of the latest large-scale study by the World Bank are presented in Table 3. They show that the major source of growth in developing countries is increases in factor inputs, especially capital. The contribution of technological progress is relatively small. These findings contrast sharply with those obtained for developed countries where technological progress is much more important. Within the developing world, the results for East Asia conform more to the pattern in the developed world, with the contribution of technological progress being more significant. Increasing returns to scale are not an important source of output growth in either category of economies.

Table 3  Contributions of capital, labour and technological progress to output growth (per cent)

<table>
<thead>
<tr>
<th></th>
<th>Capital</th>
<th>Labour</th>
<th>Technological progress</th>
</tr>
</thead>
<tbody>
<tr>
<td>Developing countries 1960–87 (average)</td>
<td>64</td>
<td>22</td>
<td>14</td>
</tr>
<tr>
<td>Africa</td>
<td>73</td>
<td>28</td>
<td>—</td>
</tr>
<tr>
<td>East Asia</td>
<td>57</td>
<td>16</td>
<td>28</td>
</tr>
<tr>
<td>Europe, Middle East and</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>North Africa</td>
<td>58</td>
<td>14</td>
<td>28</td>
</tr>
<tr>
<td>Latin America</td>
<td>67</td>
<td>30</td>
<td>—</td>
</tr>
<tr>
<td>South Asia</td>
<td>67</td>
<td>20</td>
<td>14</td>
</tr>
<tr>
<td>Selected developed countries 1960–85 (average)</td>
<td>27</td>
<td>2</td>
<td>70</td>
</tr>
<tr>
<td>France</td>
<td>27</td>
<td>-5</td>
<td>78</td>
</tr>
<tr>
<td>West Germany</td>
<td>23</td>
<td>-10</td>
<td>87</td>
</tr>
<tr>
<td>Japan</td>
<td>36</td>
<td>5</td>
<td>59</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>27</td>
<td>-5</td>
<td>78</td>
</tr>
<tr>
<td>United States</td>
<td>23</td>
<td>27</td>
<td>50</td>
</tr>
</tbody>
</table>

The results of production function analysis are sensitive to definitional problems but the findings do fit in with what is known about the pattern of development. Developing countries lack capital but not labour and their growth naturally depends on massive injections of capital. A low level of development limits the scope for using advanced technology, but as development proceeds, increases in factors \textit{per se} become less important and growth depends more on technological progress.

The next step is to identify the factors which will increase the supply of factor inputs and bring about technological progress.

\textbf{Supply of capital}

The size of the capital stock is determined by the investment level over a long period of time. The gross domestic investment to gross domestic product ratios of the newly industrializing and of the Southeast Asian economies, with the exception of the Philippines, have been significantly higher than those of the South Asian ones since 1950 (Table 4).

\begin{table}[h]
\centering
\caption{Gross domestic investment and saving as shares of GDP, 1960–90 (per cent)}
\begin{tabular}{lccccccc}
\hline
 & \multicolumn{3}{c}{Gross domestic investment/} & \multicolumn{3}{c}{Gross domestic savings/} \\
 & \multicolumn{3}{c}{GDP} & \multicolumn{3}{c}{GDP} \\
\hline
Newly industrializing economies & & & & & & \\
Hong Kong & 21.7 & 26.5 & 27.5 & 20.6 & 27.5 & 30.5 \\
Singapore & 24.0 & 41.1 & 42.0 & 14.9 & 30.0 & 42.3 \\
Republic of Korea & 17.6 & 28.9 & 30.5 & 13.7 & 22.3 & 31.8 \\
Taiwan & 30.6 & 22.6 & 19.8 & 32.2 & 32.9 & \\

Southeast Asia & & & & & & \\
Indonesia & 9.4 & 24.8 & 30.2 & 4.9 & 22.6 & 31.8 \\
Malaysia & 17.7 & 20.5 & 30.8 & 20.6 & 30.4 & 33.2 \\
Philippines & 19.3 & 26.7 & 20.0 & 18.2 & 23.4 & 19.0 \\
Thailand & 20.7 & 25.9 & 26.6 & 19.9 & 21.5 & 24.5 \\

South Asia & & & & & & \\
Bangladesh & 9.9 & 7.3 & 11.4 & 7.8 & 2.2 & 2.6 \\
India & 17.6 & 20.8 & 23.9 & 15.3 & 20.5 & 20.3 \\
Myanmar & 15.0 & 13.4 & 15.6 & 11.4 & 12.3 & 12.4 \\
Nepal & 6.0 & 16.2 & 19.9 & 2.9 & 5.7 & 10.4 \\
Pakistan & 16.3 & 16.4 & 18.7 & 8.9 & 10.1 & 10.3 \\
Sri Lanka & 14.9 & 19.4 & 24.8 & 11.8 & 13.8 & 13.3 \\

China & 34.2 & 34.6 & & 32.5 & 33.7 & \\
\hline
\end{tabular}
\end{table}

Relevance of East Asian development experiences

This difference has been due to two factors. First, the East Asian economies save significantly more than the South Asian ones (Table 4). Second, East Asian economies have been more successful in attracting direct foreign investment. Japan has traditionally been the main source of direct foreign investment in the developing economies of Asia. The largest share of this investment has gone to the newly industrializing economies, followed closely by the Southeast Asian group where the performance of Indonesia is particularly striking (Table 5). The South Asian economies have been able to attract only one per cent of this investment between them.

Table 5 Japanese foreign direct investment in Asia, 1951–88

<table>
<thead>
<tr>
<th>Amount (US$million)</th>
<th>Percentage distribution</th>
</tr>
</thead>
<tbody>
<tr>
<td>Newly industrializing economies</td>
<td>15018</td>
</tr>
<tr>
<td>Hong Kong</td>
<td>6167</td>
</tr>
<tr>
<td>Singapore</td>
<td>3812</td>
</tr>
<tr>
<td>Republic of Korea</td>
<td>3248</td>
</tr>
<tr>
<td>Taiwan</td>
<td>1791</td>
</tr>
<tr>
<td>Southeast Asia</td>
<td>14750</td>
</tr>
<tr>
<td>Indonesia</td>
<td>9804</td>
</tr>
<tr>
<td>Malaysia</td>
<td>1834</td>
</tr>
<tr>
<td>Philippines</td>
<td>1120</td>
</tr>
<tr>
<td>Thailand</td>
<td>1992</td>
</tr>
<tr>
<td>South Asia</td>
<td>270</td>
</tr>
<tr>
<td>Bangladesh</td>
<td>11</td>
</tr>
<tr>
<td>India</td>
<td>148</td>
</tr>
<tr>
<td>Pakistan</td>
<td>18</td>
</tr>
<tr>
<td>Sri Lanka</td>
<td>93</td>
</tr>
<tr>
<td>China</td>
<td>2036</td>
</tr>
</tbody>
</table>


The East Asian economies have been more successful in introducing policies which encourage domestic savings and direct foreign investment. The empirical literature shows that the national saving ratios of developing Asian economies are increased by improvements in the overall government budget balance and by increases in the real interest rate but are reduced by higher population dependency ratios, inflation rates and foreign debt (Fry 1991). East Asian economies, especially the newly industrializing economies, possess significantly more of the characteristics which encourage domestic savings (Table 6). They pursue more responsible fiscal policies by keeping a tighter reign over the government budget. Their monetary policies keep the inflation rate low and the real interest rate high. They resort to foreign borrowing, but do so judiciously.
Their effective family planning programs lower their population growth rate and dependency ratio, and the process of economic growth itself decreases the population growth rate.

### Table 6  Government budget, real interest rate, inflation rate, external debt and dependency ratio of Asian developing countries (per cent)

<table>
<thead>
<tr>
<th></th>
<th>Government surplus or deficit/ GDP 1985-89</th>
<th>Average real deposit rate of interest 1982-88</th>
<th>Average annual changes in consumer prices 1981-90</th>
<th>Total debt service/ exports of goods and services 1990</th>
<th>Population aged 0–14 years/ total population 1989</th>
</tr>
</thead>
<tbody>
<tr>
<td>Newly industrializing economies</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Hong Kong</td>
<td>2.5</td>
<td>..</td>
<td>8.2</td>
<td>..</td>
<td>21.6</td>
</tr>
<tr>
<td>Singapore</td>
<td>1.3</td>
<td>..</td>
<td>2.3</td>
<td>1.4</td>
<td>23.7</td>
</tr>
<tr>
<td>Republic of Korea</td>
<td>-0.3</td>
<td>5.1</td>
<td>6.5</td>
<td>11.0</td>
<td>18.0</td>
</tr>
<tr>
<td>Taiwan</td>
<td>0.1</td>
<td>5.5</td>
<td>3.1</td>
<td>0.9</td>
<td>..</td>
</tr>
<tr>
<td>Southeast Asia</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Indonesia</td>
<td>-5.7</td>
<td>7.6</td>
<td>8.8</td>
<td>30.7</td>
<td>36.8</td>
</tr>
<tr>
<td>Malaysia</td>
<td>-7.8</td>
<td>5.4</td>
<td>3.3</td>
<td>11.4</td>
<td>37.8</td>
</tr>
<tr>
<td>Philippines</td>
<td>-2.7</td>
<td>-0.3</td>
<td>14.6</td>
<td>30.3</td>
<td>40.1</td>
</tr>
<tr>
<td>Thailand</td>
<td>-1.1</td>
<td>7.7</td>
<td>4.4</td>
<td>15.4</td>
<td>33.4</td>
</tr>
<tr>
<td>South Asia</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bangladesh</td>
<td>-6.2</td>
<td>2.3</td>
<td>10.7</td>
<td>19.0</td>
<td>44.6</td>
</tr>
<tr>
<td>India</td>
<td>-5.3</td>
<td>1.1</td>
<td>9.1</td>
<td>26.4</td>
<td>37.1</td>
</tr>
<tr>
<td>Myanmar</td>
<td>..</td>
<td>..</td>
<td>11.7</td>
<td>26.0</td>
<td>37.5</td>
</tr>
<tr>
<td>Nepal</td>
<td>-9.5</td>
<td>..</td>
<td>10.5</td>
<td>19.1</td>
<td>43.0</td>
</tr>
<tr>
<td>Pakistan</td>
<td>-7.0</td>
<td>3.0</td>
<td>7.5</td>
<td>21.8</td>
<td>45.3</td>
</tr>
<tr>
<td>Sri Lanka</td>
<td>-11.4</td>
<td>4.1</td>
<td>12.3</td>
<td>19.6</td>
<td>32.5</td>
</tr>
<tr>
<td>China</td>
<td>-1.8</td>
<td>..</td>
<td>7.7</td>
<td>9.2</td>
<td>27.2</td>
</tr>
</tbody>
</table>


Policies which succeed in attracting direct foreign investment are not those which offer fiscal incentives only. Empirical studies show that there is no support for the belief held by governments of most developing countries that the provision of fiscal incentives is necessary to attract direct foreign investment (Lim 1983). Nor is there support for the belief that the greater the generosity of the incentive programs the greater will be the level of such investment. What
Relevance of East Asian development experiences

matters is the pursuit of sound economic policies. This includes the type of fiscal, monetary and budgetary policies which lead to high savings. Countries which cannot boast of such policies tend to compensate for this weakness by offering more and more generous incentives. This strategy can be self-defeating for extreme generosity in giving incentives can be read as a danger signal.

Supply of labour

On the surface there is no difference in the ability of various Asian developing economies to supply labour. All of them, especially the South Asian ones, have experienced rapid population growth, often in excess of 2.5 per cent per annum, ensuring that there is no shortage of workers. However, rapid population growth has its negative side. It diverts scarce resources from programs on education, health and nutrition. In the extreme case, poor medical and nutritional facilities result in a reduction in the number of able-bodied workers, the adverse effect is seen in a drop in the size of the labour force. In the more likely case, rapid population growth reduces the quality of labour, the adverse effect is then reflected in a smaller value for the contribution of technological progress to output growth. In either case, the rapid population growth rates of the South Asian countries reduce the impact of labour’s contribution to economic growth.

Promotion of technological progress

The first requirement for technological progress as a source of output growth is a high level of education which includes an appropriate mixture of skills. The educational attainment of the newly industrializing economies is much higher than that of other economies, with the exception of the Philippines and Sri Lanka (Asian Development Bank 1989; Psacharopoulos and Arriagada 1986). Moreover, there is a much greater emphasis on vocational and technical, as opposed to general, education (Lim 1991b). This is particularly important because of the widespread introduction of the computer in the workplace, even in jobs usually regarded as requiring less skill.

This level of education has been achieved by expanding and improving the quality of primary and secondary education and by providing incentives to increase the supply of, and demand for, vocational and technical training. In providing for universal primary education the newly industrializing economies pursued innovative and cost-effective measures. One important measure was to run two school shifts rather than use scarce resources to build more schools. This then released funds for the construction of other important infrastructure facilities such as roads and irrigation schemes.

The way in which specialized technical training is provided is also instructive. It is widely accepted that most skills are best obtained by on-the-job training in private enterprise. However, experience also shows that it may be difficult to persuade firms to invest in on-the-job training. Employees who have benefited from such training may leave before the training costs have been recovered through productivity gains. This was the situation faced by the newly
industrializing economies in the late 1960s and their response to it is exemplified by the action taken by Singapore. A number of vocational training programs were established under the Vocational Training and Industrial Training Board. When such programs failed to provide enough skilled workers the Board encouraged enterprises to set up their own programs. Workers were required to contribute 4 per cent of their monthly pay to a fund against which employers could draw for reimbursement of training costs. The next stage was the establishment of public training centres when it was found that on-the-job training by the private sector could not keep pace with the demand for new skills. Such centres were funded by a levy on business organizations equivalent to 1 per cent of their wages bill.

The newly industrializing economies have also been more successful in introducing more efficient techniques of production. Data to substantiate this is difficult to obtain but the value added per worker in manufacturing can be used as a proxy and figures on this show that the newly industrializing economies are considerably ahead of the other developing nations of Asia (World Bank 1991a:216–7). Another proxy is the presence of foreign firms as they tend to adopt the technologies they use in their own countries and they constantly seek to increase productivity to offset wage increases.

Not only have the newly industrializing economies increased their labour quality and the number of more productive technologies, they have tended to use them more efficiently as well. An important measure of this efficiency is the level of capital utilization. The empirical evidence available shows that countries in East Asia tend to utilize capital in manufacturing longer and more intensively than countries in South Asia (Winston 1971; Kim and Kwon 1971; Bautista et al. 1981; Phan-Thuy et al. 1981). Having a large capital stock is not enough. It has to be used efficiently. Some South Asian countries such as India and Sri Lanka have high rates of investment but relatively little to show for it.

An important determinant of capital utilization is a pricing system which does not distort relative factor prices. Price distortions arise when the prices of goods and services and of capital and labour do not correctly reflect their scarcity. They are caused by government intervention in the economy in the pursuit of social or economic objectives or by the presence of monopoly in the market. Agawala (1983) presents distortion indices (low, medium or high) for foreign exchange pricing, factor pricing and product pricing for 31 developing countries in the 1970s. The results for Asian developing countries show that on balance the East Asian countries are less distorted than South Asian ones, especially in factor prices (Table 7). Capital costs are therefore relatively higher in East Asia, reflecting more accurately its relative scarcity, and this encourages a higher level of capital utilization.

The ability to combine the factors of production in a more economically efficient way and thereby to increase total factor productivity is also helped by having less price distortion. Labour-abundant and capital-scarce developing countries would thus have a comparative advantage, or the least comparative
disadvantage, in producing labour-intensive and low-technology manufactured goods. Artificial reduction of capital costs by the provision of fiscal incentives, and increase in labour costs from the imposition of minimum wage and other legislation, would discourage these countries from using their natural comparative advantage. Capital and labour costs are least distorted in East Asian countries and this has helped to give their producers a competitive edge in world markets (Table 7). Having a distorted exchange rate can also prevent the most efficient combination of factors of production from being used. An overvalued exchange rate creates a bias against exports, and for imports. Production can therefore depend too much on imports and be too foreign exchange intensive.

Table 7 Distortion indices for selected Asian developing economies in the 1970s (1 = low, 2 = medium, 3 = high)

<table>
<thead>
<tr>
<th></th>
<th>Foreign exchange pricing</th>
<th>Factor pricing</th>
<th>Product pricing</th>
<th>Composite distortion index</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>EX PM DA</td>
<td>RI RW IN PT</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Newly industrializing economies</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Republic of Korea</td>
<td>1 1 3</td>
<td>2 1</td>
<td>2 1</td>
<td>1.57</td>
</tr>
<tr>
<td>Southeast Asia</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Indonesia</td>
<td>2 2 1</td>
<td>2 1</td>
<td>2 3</td>
<td>1.86</td>
</tr>
<tr>
<td>Malaysia</td>
<td>1 1 2</td>
<td>2 2</td>
<td>1 2</td>
<td>1.57</td>
</tr>
<tr>
<td>Philippines</td>
<td>1 2 2</td>
<td>2 1</td>
<td>1 2</td>
<td>1.57</td>
</tr>
<tr>
<td>Thailand</td>
<td>1 2 1</td>
<td>1 1</td>
<td>1 3</td>
<td>1.43</td>
</tr>
<tr>
<td>South Asia</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bangladesh</td>
<td>1 3 2</td>
<td>3 3</td>
<td>3 3</td>
<td>2.57</td>
</tr>
<tr>
<td>India</td>
<td>1 3 2</td>
<td>2 2</td>
<td>1 2</td>
<td>1.86</td>
</tr>
<tr>
<td>Pakistan</td>
<td>2 3 2</td>
<td>2 3</td>
<td>2 2</td>
<td>2.29</td>
</tr>
<tr>
<td>Sri Lanka</td>
<td>1 2 1</td>
<td>2 3</td>
<td>2 2</td>
<td>1.86</td>
</tr>
</tbody>
</table>

Notes: EX = distortion level in exchange rate  
PM = protection level for manufacturing  
DA = distortion level in agricultural pricing  
RI = distortion level for interest rates  
RW = distortion level for wages  
IN = distortion level for overall price level  
PT = distortion level for infrastructure pricing indicated by pricing of power utilities

The economically efficient combination of factors of production is also encouraged by the adoption of export-oriented policies by the newly industrializing economies. These are reflected in the ratio of merchandise exports to GDP (Table 8). Countries have to be competitive to succeed in the export market and this forces them to combine and use their resources efficiently. It is therefore not surprising that countries which are export-oriented tend to grow faster than those which are inward-looking (Ram 1987).

### Table 8 Merchandise exports/GDP and share of world exports, 1981 and 1990 (per cent)

<table>
<thead>
<tr>
<th>Merchandise exports/GDP</th>
<th>Share of world exports</th>
</tr>
</thead>
<tbody>
<tr>
<td>Newly industrializing economies</td>
<td></td>
</tr>
<tr>
<td>Hong Kong</td>
<td>73.9</td>
</tr>
<tr>
<td>Singapore</td>
<td>141.6</td>
</tr>
<tr>
<td>Republic of Korea</td>
<td>29.6</td>
</tr>
<tr>
<td>Taiwan</td>
<td>46.5</td>
</tr>
<tr>
<td>Southeast Asia</td>
<td></td>
</tr>
<tr>
<td>Indonesia</td>
<td>27.3</td>
</tr>
<tr>
<td>Malaysia</td>
<td>46.7</td>
</tr>
<tr>
<td>Philippines</td>
<td>14.8</td>
</tr>
<tr>
<td>Thailand</td>
<td>19.8</td>
</tr>
<tr>
<td>South Asia</td>
<td></td>
</tr>
<tr>
<td>Bangladesh</td>
<td>6.1</td>
</tr>
<tr>
<td>India</td>
<td>4.6</td>
</tr>
<tr>
<td>Myanmar</td>
<td>9.1</td>
</tr>
<tr>
<td>Nepal</td>
<td>6.5</td>
</tr>
<tr>
<td>Pakistan</td>
<td>9.7</td>
</tr>
<tr>
<td>Sri Lanka</td>
<td>24.2</td>
</tr>
<tr>
<td>China</td>
<td>8.1</td>
</tr>
</tbody>
</table>


### Development performances of South Pacific economies

The analysis so far suggests that the newly industrializing economies have done well because they have tended to adopt the market-friendly and internationally competitive approach to development. Before the relevance of policies pursued in such an approach for the South Pacific economies can be examined, their development experiences must be analysed.
In the South Pacific region there are 15 independent states and a number of islands still linked politically to New Zealand, France and the United States. They can be divided into three regional sub-groups: Micronesia, Melanesia and Polynesia. Only those South Pacific economies which are members of the Asian Development Bank and the World Bank are included here. These are Fiji, Kiribati, Papua New Guinea, Solomon Islands, Tonga, Vanuatu and Western Samoa.

Some of the major development indicators for these seven economies are shown for the period 1980–88 (Table 9). GDP grew very slowly and in some cases below the rate of population growth to produce decreases in per capita GDP (Fiji, Kiribati and Solomon Islands). The same fate would have befallen Tonga and Western Samoa if large-scale emigration had not taken place. The domestic savings rates were low and in the cases of Kiribati, Solomon Islands and Western Samoa consumption actually exceeded GDP. The domestic investment rates were high and sustained and this was made possible by remittances and foreign aid, the exception being Fiji where it was financed largely by domestic savings. The high investment level, however, did not produce rapid economic growth because it was carried out inefficiently. Exports also grew much more slowly in the 1980s than in the 1970s. Employment growth outside traditional activities has also been disappointing.

On the other hand, welfare indicators, as exemplified by life expectancy at birth, show the South Pacific economies to enjoy a standard of living which is at odds with their per capita income levels (Table 9). They suggest that the populations of these countries enjoy what has been called subsistence or primitive affluence. The important point to note though is that such affluence is the result of the education and health systems established under the colonial era. The economic growth in the post-colonial period has not been rapid or broad enough to generate such benefits.

<table>
<thead>
<tr>
<th>Table 9 Selected development indicators for South Pacific economies</th>
</tr>
</thead>
<tbody>
<tr>
<td>----------------------------------</td>
</tr>
<tr>
<td>Fiji 1540</td>
</tr>
<tr>
<td>Kiribati 590</td>
</tr>
<tr>
<td>Papua New Guinea 890</td>
</tr>
<tr>
<td>Solomon Islands 430</td>
</tr>
<tr>
<td>Tonga 800</td>
</tr>
<tr>
<td>Vanuatu 820</td>
</tr>
<tr>
<td>Western Samoa 600</td>
</tr>
</tbody>
</table>
Table 9  Selected development indicators for South Pacific economies—continued

<table>
<thead>
<tr>
<th></th>
<th>Average annual growth rate of real exports</th>
<th>Life expectancy 1988 (years)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1970-79</td>
<td>1980-89</td>
</tr>
<tr>
<td>Fiji</td>
<td>17.3</td>
<td>3.6</td>
</tr>
<tr>
<td>Kiribati</td>
<td>..</td>
<td>12.7</td>
</tr>
<tr>
<td>Papua New Guinea</td>
<td>14.1</td>
<td>6.4</td>
</tr>
<tr>
<td>Solomon Islands</td>
<td>33.0</td>
<td>1.6</td>
</tr>
<tr>
<td>Tonga</td>
<td>21.8</td>
<td>4.9</td>
</tr>
<tr>
<td>Vanuatu</td>
<td>26.8</td>
<td>-6.2</td>
</tr>
<tr>
<td>Western Samoa</td>
<td>26.0</td>
<td>6.0</td>
</tr>
</tbody>
</table>


On an a priori basis it could be argued that the disappointing economic performances of the South Pacific economies can be explained by the fact that they are small, remote and open. That size can be a constraint on efficiency and economic growth is well recognized, especially if it is accompanied by a small natural resource base. Unless production is for export, and this is not easy at the start of any program, the unit cost of production will be high because of the limited size of the domestic market.

The remoteness of the South Pacific economies is self-evident. This is compounded by the fact that their land mass is very fragmented. All this makes for high transport costs and difficult access to the major metropolitan markets. The high costs of imported inputs make exports more expensive to produce. When this handicap is added to the high cost of transporting the exports to metropolitan markets, the disadvantage can be severe.

The openness of the South Pacific economies is demonstrated by exports and imports of goods and services as a percentage of GDP for 1980–88. The lowest figure recorded was for Tonga at 65 per cent, the highest for Solomon Islands at 137 percent. This high degree of openness makes the economies vulnerable to external forces outside their control. If, for example, the terms of trade were to turn against them, this could reduce their rate of economic growth.

The smallness, remoteness and openness of the South Pacific economies make development beyond the stage of subsistence affluence inherently difficult. The outflow of skilled workers from some countries exacerbates the situation.

The evidence for the hypothesis that it is only the characteristics of smallness, remoteness and openness which have combined to produce the very low rates of economic growth in the South Pacific economies is not very strong. The small
Relevance of East Asian development experiences

island economies of the Caribbean and the Indian Ocean, which are more or less similarly handicapped, have performed much better. The Caribbean group, excluding Trinidad and Tobago and Barbados, increased its per capita GNP by over 4 per cent over the 1980–88 period, while Maldives and Mauritius increased theirs by over 5 per cent. In fact, according to the World Bank (1991b:3), this better economic performance was achieved in spite of these economies being less well endowed in land area, sea area, arable land per person and forest area than the South Pacific economies (Table 10). Moreover, the terms of trade of the Caribbean island economies deteriorated significantly in the 1980s whereas those of the South Pacific economies remained more or less the same.

Table 10 Geographical attributes and resource endowments of small island economies

<table>
<thead>
<tr>
<th></th>
<th>Land area (km²)</th>
<th>Sea area ('000 km²)</th>
<th>Arable land per person (ha)</th>
<th>Forest area (km²)</th>
<th>Major minerals</th>
<th>Nominal freight factor</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Pacific</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fiji</td>
<td>18272</td>
<td>1290</td>
<td>2.1</td>
<td>11850</td>
<td>gold</td>
<td>13.8</td>
</tr>
<tr>
<td>Kiribati</td>
<td>690</td>
<td>3550</td>
<td>...</td>
<td>20</td>
<td>none</td>
<td>...</td>
</tr>
<tr>
<td>Solomon Islands</td>
<td>27556</td>
<td>1340</td>
<td>1.4</td>
<td>25600</td>
<td>none</td>
<td>19.9</td>
</tr>
<tr>
<td>Tonga</td>
<td>749</td>
<td>700</td>
<td>1.8</td>
<td>80</td>
<td>none</td>
<td>15.3</td>
</tr>
<tr>
<td>Vanuatu</td>
<td>12190</td>
<td>680</td>
<td>1.4</td>
<td>160</td>
<td>none</td>
<td>19.9</td>
</tr>
<tr>
<td>Western Samoa</td>
<td>2935</td>
<td>120</td>
<td>3.5</td>
<td>1340</td>
<td>none</td>
<td>...</td>
</tr>
<tr>
<td><strong>Caribbean</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Antigua, Barbuda</td>
<td>440</td>
<td>110</td>
<td>1.0</td>
<td>50</td>
<td>none</td>
<td>10.0</td>
</tr>
<tr>
<td>Barbados</td>
<td>430</td>
<td>167</td>
<td>1.3</td>
<td>...</td>
<td>none</td>
<td>12.4</td>
</tr>
<tr>
<td>Belize</td>
<td>22800</td>
<td>...</td>
<td>2.5</td>
<td>10120</td>
<td>none</td>
<td>11.2</td>
</tr>
<tr>
<td>Dominica</td>
<td>750</td>
<td>15</td>
<td>0.9</td>
<td>310</td>
<td>none</td>
<td>10.1</td>
</tr>
<tr>
<td>Grenada</td>
<td>340</td>
<td>27</td>
<td>0.5</td>
<td>30</td>
<td>none</td>
<td>11.7</td>
</tr>
<tr>
<td>St Kitts, Nevis</td>
<td>360</td>
<td>11</td>
<td>1.9</td>
<td>60</td>
<td>none</td>
<td>10.1</td>
</tr>
<tr>
<td>St Lucia</td>
<td>610</td>
<td>16</td>
<td>0.4</td>
<td>80</td>
<td>none</td>
<td>10.0</td>
</tr>
<tr>
<td>St Vincent and the</td>
<td>340</td>
<td>33</td>
<td>1.2</td>
<td>140</td>
<td>none</td>
<td>11.1</td>
</tr>
<tr>
<td>Grenadines</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Trinidad and Tobago</td>
<td>5130</td>
<td>77</td>
<td>0.6</td>
<td>2250</td>
<td>oil</td>
<td>...</td>
</tr>
<tr>
<td><strong>Africa and Indian Ocean</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cape Verde</td>
<td>4030</td>
<td>790</td>
<td>1.1</td>
<td>10</td>
<td>...</td>
<td>...</td>
</tr>
<tr>
<td>Comoro Islands</td>
<td>2230</td>
<td>249</td>
<td>1.8</td>
<td>350</td>
<td>none</td>
<td>...</td>
</tr>
<tr>
<td>Maldives</td>
<td>300</td>
<td>959</td>
<td>0.2</td>
<td>10</td>
<td>none</td>
<td>23.0</td>
</tr>
<tr>
<td>Mauritius</td>
<td>1850</td>
<td>1171</td>
<td>1.0</td>
<td>580</td>
<td>none</td>
<td>12.3</td>
</tr>
<tr>
<td>Sao Tome, Principe</td>
<td>960</td>
<td>128</td>
<td>0.2</td>
<td>...</td>
<td>none</td>
<td>22.4</td>
</tr>
<tr>
<td>Seychelles</td>
<td>270</td>
<td>1349</td>
<td>0.1</td>
<td>50</td>
<td>none</td>
<td>17.8</td>
</tr>
</tbody>
</table>

Two other explanations based on exogenous factors have been given for the poor and uneven economic performances of the South Pacific economies. First, they are subject to periodic natural disasters, especially cyclones. In Western Samoa in 1990 a quarter of the homes and half of the food supply were destroyed. In Fiji in 1986, nearly a third of the population was affected. The effects on the economy must have been severe. Even the generous and prompt emergency aid in response to the natural disasters cannot completely neutralize the adverse effect on growth.

The second argument is that natural disasters and the price elasticities of supply and demand of the export products of the South Pacific economies combine to produce instability in their export earnings. As export instability is seen to be detrimental to economic growth, this would explain the poor economic performances. This argument can be faulted at two levels. First, the negative relationship between export instability and economic growth is by no means proven (Lim 1991a). Second, the instability of export earnings and imports for the South Pacific economies is not significantly higher than that for the small island economies in the Caribbean and the Indian Ocean (World Bank 1991b:22).

Of all the explanations which emphasize the role of exogenous factors in slowing economic growth in the South Pacific economies, the only one which has strong empirical support is the impact of natural disasters. It would appear that the reasons for slow economic growth lie elsewhere, most probably with the policies pursued by the governments of the countries.

Of particular importance are the policies which have increased the size of the public sector, inhibited the development of the private sector and produced a poor human resource development program. If the share of central government expenditure in GDP is used as the measure of the size of the public sector, it can be seen that the South Pacific economies have large public sectors by the standards of developing countries. For the 1985–89 period the highest share was recorded by Kiribati at 85 per cent. In Tonga, Vanuatu and Western Samoa the share was around 50 per cent and in Fiji and Papua New Guinea around 30 per cent. For developing economies with low and middle income levels, the average share was only 21 per cent (Lim 1992).

The presence of a large public sector in the South Pacific has traditionally been explained by the need for the governments to spend more per head on physical infrastructure and administrative and social overheads in order to provide facilities to populations spread over remote islands. Another explanation is the growth of public enterprises in directly productive activities. Generally these have been operating at a loss and have to rely more and more on public funding from their governments and from foreign governments in the form of foreign aid. High wage costs, overstaffing and political interference are among the reasons for the poor economic performances of these public enterprises.
Relevance of East Asian development experiences

The effect of growth of public enterprises is not limited to a drain on the fiscal budget. It has encouraged rent-seeking and has crowded out private investment. The harm that has been done has been recognized by a number of countries, especially Western Samoa and Fiji. Programs to privatize or liquidate unprofitable enterprises have been carried out and there is now acceptance that certain economic activities are best left to the private sector. For those enterprises which provide basic services and remain in the public sector, there is a move to set tariffs which produce a profit and generally to subject them to stringent market conditions.

The operation of marketing and commodity boards has also increased the size of the public sector. These have been established to stabilize producer prices and incomes for certain export crops and have been successful in doing so. However, the cost has been high. In general the boards have been overstaffed and have paid high wages, which have resulted in large markups between the price paid to producers and the export price, and reduced the competitiveness of the export sector. At the same time the smaller South Pacific economies do not possess the skills to run the boards efficiently and have often set producer prices too high, incurring losses which have to be borne by the government. These weaknesses have been recognized and steps taken to reform the operation of the boards, especially in Tonga and Western Samoa. The reforms might have to include the use of trade taxes and levies to stabilize prices and the use of private traders to market the products.

The development of the private sector has been further retarded by policies which have directly reduced its level of competitiveness. Exchange rate policies have been used primarily to restore price stability, not to increase competitiveness. As a result, the real effective exchange rates of some of the countries (for example Tonga, Kiribati and Papua New Guinea) have remained too high, maintained by the generous inflow of foreign aid. Labour market policies have not helped. There is a high degree of unionization, wages are set centrally and minimum wage legislations apply. Wages in the private sector have been increased further by the flow-on effect of generous wage awards to employees in the public sector. The result is an average level of real wages which is well above that in countries with similar or higher per capita incomes (Goodman et al. 1985:61–2; World Bank 1991b:44).

Inward-looking trade policies have also hindered the development of the private sector. The use of quantitative controls and punitive tariffs has created a bias toward the small home-market. The unit cost of production, already inflated by high wage costs, will become even higher because of the short production run and the more expensive imported inputs. The situation is not helped by excessive regulation of new investment. The licensing systems, regulations and procedures are complex and appear to have been designed to control rather than promote new investment. The cost of doing business is high in more ways than one and might have been responsible for the slow growth in direct foreign investment in the 1980s.
Policies to develop the financial system have also been inadequate. The use of interest rate ceilings and credit targets for different sectors in the past, the use of blunt direct instruments for managing liquidity and foreign exchange reserves, the weak supervision of banks (especially local ones) and the failure to promote the development of a capital market have produced a financial sector that is not able to facilitate investment in the private sector in a significant way.

The human resource development program has been successful in producing a high level of literacy but much less so in the supply of skilled workers. Expatriates continue to fill key positions and the shortage of skilled and experienced personnel has been a major constraint on economic development. The reasons for the shortage are well known in developing countries: education programs have not been tailored to the skill requirements of the country and greater emphasis has been placed on general, as opposed to technical and vocational, education. The high rate of emigration, especially from Western Samoa and Tonga, does not help.

It would thus appear that the policies pursued by the governments of the South Pacific economies have played an important role in slowing their rate of economic growth. It may be argued that most of these policies have been encouraged by the availability of abundant foreign aid.

There is little doubt that the South Pacific economies receive very high levels of foreign aid. On a per capita basis the amounts received in 1988 were US$74 for Fiji, US$88 for Papua New Guinea, US$243 for Kiribati, US$192 for Solomon Islands, US$186 for Tonga, US$260 for Vanuatu and US$182 for Western Samoa. These are very high figures by international standards. So are the figures when presented as a percentage of central government revenue, with the exception of that for Fiji where it was only 4 per cent. For the others they ranged from 84 per cent for Vanuatu to 32 per cent for Solomon Islands (World Bank 1991b).

With the exception of aid to Papua New Guinea, most foreign aid is in the form of grants. The availability of such large and generous amounts of foreign aid has helped to increase the size of the public sector by underwriting its high wages and keeping unprofitable public enterprises in business. It may have been responsible for the overvaluation of real exchange rates by raising wages and prices in the nontradable sector and, indirectly, for the stunted growth of the private sector. Easy access to aid has also retarded the development of the financial system and local training facilities.

In other words, easy availability of large amounts of foreign aid has produced most of the problems associated with the Dutch disease found in countries which are rich in natural resources. In this case, it is foreign aid and not natural resources which has triggered the process. It is not, however, correct to go on and argue that the policies which have increased the size of the public sector, hindered the development of the private sector and produced acute shortages
of skilled personnel are exogenously determined by the level of foreign aid. The South Pacific economies do have a say in determining their economic policies. If foreign aid is used sensibly and appropriate macroeconomic policies pursued, many of the ills that it may bring can be avoided.

Relevance of newly industrializing economies' development experience

Examination of the development performances of the South Pacific economies suggests that endogenous factors are more important than exogenous ones in explaining their unsatisfactory progress. The smallness and remoteness of their economies does pose problems but the experiences of small island economies in other parts of the world show that the problems are not insurmountable. The periodic occurrences of natural disasters do not help but they cannot be blamed for everything.

Much of the fault lies with the policies pursued by the governments of the South Pacific economies. One is the move to extend the role of the government beyond the provision of law and order and of public and merit goods. This has led the public sector into economic activities best left to the private sector. Another is the introduction of distortions into the pricing of products, factors of production and the foreign exchange rate. This hampers the development of the private sector which is already being crowded out by the public sector. Other policies which are equally detrimental include trade policies which create a home-market bias, and investment regulations which are more intent on control than promotion. Policies for developing the financial sector and human resources have also been unsatisfactory. The position taken by the World Bank (1991b) may be a bit extreme in that it appears to place all of the blame for the poor economic performances of the South Pacific economies on endogenous factors. Nevertheless, the point remains that if the exogenous factors of smallness, remoteness and vulnerability to the elements are a constraint on economic growth, then it is all the more important to pursue policies which will put the countries in a better position to deal with them. The analysis has shown that most of the South Pacific economies have not pursued such policies.

The analysis has also shown that the adoption of the policies which have made the newly industrializing economies successful can do much to improve the development performances of the South Pacific economies. The newly industrializing economies have allowed their governments and markets to work together, each specializing in areas where it has a comparative advantage, to produce international competitiveness. The South Pacific economies have tended to let them compete, very often with the private sector being severely handicapped, and to operate without regard for the international market.

The newly industrializing economies have used monetary and fiscal policies to produce budget surpluses, low inflation and foreign debt, and positive real interest rates which have resulted in a high rate of domestic savings. The South Pacific economies ran budget deficits, ranging from 4 per cent of GDP in Fiji to
38 per cent of GDP in Kiribati over the 1985–89 period. Their annual inflation rates were generally higher, ranging from 5.1 per cent in Kiribati to 12.9 per cent in Solomon Islands over the 1980–89 period. Deposit rates have remained highly negative in real terms. Their debt service to exports ratios are low, but this is because of the high level of foreign aid, most of which is in grant form. The net result is a very low rate of domestic savings.

The newly industrializing economies have reduced the level of price distortion and thereby increased the efficiency with which they have made use of their resources. The South Pacific economies have not moved very far in this direction and the home-market bias created by their trade policies has further hindered the efficient use of their resources.

The human resource development program of the newly industrializing economies has reduced their population growth rates significantly and produced a labour force whose skills are in line with what is required. Lower population growth rates have reduced the dependency ratio and therefore increased domestic savings. Improved skill levels have removed a major constraint to economic growth, especially in the industrial sector. The South Pacific economies cannot claim similar successes. Their natural population growth rates remain high, ranging from 2.2 per cent per annum in Fiji to 3.5 per cent per annum in Solomon Islands over the 1980–88 period. Acute shortages in skilled personnel are common, with expatriates filling many of the key positions.

It should be clear by now that the development experiences of the newly industrializing economies are relevant to the South Pacific economies. It should also be clear that the newly industrializing economies have done well on the development front, not because they have discovered something that is unique to them, but because they have managed to get most of the key economic policies correct. This has been done with the clear understanding that what ultimately determines the economic performance of a country is the economic policies it formulates and implements. International and exogenous factors matter but they are less important than internal ones in determining the pace of economic development.
Relevance of East Asian development experiences

References


---, 1991c. 'Why development performances differ between Asian countries', Research Lecture 1991, Griffith University, Queensland.


54 The future of Asia-Pacific economies


The author acknowledges the excellent research assistance provided by Rebecca Lim.
The South Pacific economies in a changing international environment

Andrew Elek

There has been a remarkable transformation of the global and regional environment of the Pacific islands, reflecting the economic, political, security-related and technological changes of the past two decades. The likely impact of these changes on specific aspects of the Pacific islands' international economic relations, including aid, trade and investment links are reviewed here. Particular attention is given to the emergence of regionalism in the world economy and the scope for regional cooperation among the island states and their regional neighbours.

The Pacific in a global setting

There are many differences among Pacific island economies, but there are some important common characteristics. These include the very small scale of these economies in a global context, the importance of aid, the rather narrow base of their exports and their vulnerability to world price fluctuations and to natural disasters. In most cases, they face serious shortages of skills, weakly developed physical infrastructure, fragmented domestic markets due to geographic problems, combined with long distances from many major trading partners.

In 1990 Papua New Guinea, the largest of these economies, had a population of 3.5 million and GDP of about US$3.2 billion, only 0.1 per cent of Japan’s GDP. The combined population of Papua New Guinea, Fiji, Solomon Islands, Vanuatu, Tonga and Western Samoa was around 4.9 million, while their combined GDP represented only 0.2 per cent of that of Japan.1 In such small economies, sustained development leading to corresponding improvements in living standards can come about only through effective economic engagement with the rest of the world. While the small Pacific island economies need to expand their trade and investment links with others, the rest of the world does not have a corresponding need for such links.

The Pacific island economies have a fairly good range of natural resources, including minerals, timber and fisheries, as well as the climatic and soil conditions for efficient production of tropical agricultural products. Not surprisingly, these are the base of most of their current exports. The islands also have

1 Data and examples from Papua New Guinea, Fiji, Vanuatu, Solomon Islands, Western Samoa, Tonga and Kiribati and Tuvalu are dealt with here although the issues discussed are also relevant to other island states. For reasons of space, no attempt is made to present extensive data on the structure of each of these economies, other than aid flows and their trading patterns. Recent reports on the region by the World Bank (1991a) and Fairbaim (1992) provide considerable social and economic data on these economies.
attractive tourism potential and the consistently declining costs of transport and communications are improving prospects for involvement in a broadening range of manufactures and services trade. At the same time, none of the natural resource based commodities are expected to be in short supply, in a global context, during the next few decades. There are many other physically attractive tropical islands. The Pacific islands are competing with scores of other economies seeking to expand their exports of services and manufactured products, often from a considerably better base of skills, with much lower costs of unskilled labour and frequently geographically closer to other large economies.

The end of the superpower rivalry which dominated recent decades means that the geopolitical or strategic significance of the islands has declined further. This part of the world now has to work harder in all respects to attract aid or investment or to expand marketing links with the rest of the world.

This is certainly not a cause for pessimism. The Pacific islands are not desperately poor and their relatively strong base of subsistence production, combined with other physical and human resources, can provide the basis for sustainable economic development. What it does mean is that the leaders of these nations need to have a realistic assessment of what can be expected from the rest of the world. There is less prospect than ever of growth being driven by increasing flows of aid. There is little reason to expect any more preferential treatment in trade relations than they already receive. On the other hand, there is more reason to focus on their domestic economic policies in order to improve the efficiency of the development and use of their own resources as the key to development and viable external relations. Importantly, and fortunately, there is also considerable scope to learn from the experience of other small economies, some of whom have developed significant exports of manufactures and services.

**Development assistance**

All of the Pacific island economies receive aid which, in per capita terms, is high by world standards (Table 1). Dependence is particularly high in the smaller island economies of the Pacific, although Fiji is considerably less dependent on aid. Papua New Guinea has been able to reduce its aid dependence substantially since it became politically independent in 1975. Figure 1 indicates the main sources of assistance.
Table 1 Comparative aid indicators, 1990

<table>
<thead>
<tr>
<th>Country</th>
<th>Population ('000)</th>
<th>Total (US$ million)</th>
<th>Per capita (US$)</th>
<th>Per cent of GDP</th>
<th>Per cent of government expenditure</th>
</tr>
</thead>
<tbody>
<tr>
<td>Papua New Guinea</td>
<td>3528.0</td>
<td>376</td>
<td>107</td>
<td>11.7</td>
<td>33.2</td>
</tr>
<tr>
<td>Fiji</td>
<td>725.0</td>
<td>45</td>
<td>62</td>
<td>3.3</td>
<td>12.4</td>
</tr>
<tr>
<td>Kiribati</td>
<td>71.8</td>
<td>20</td>
<td>279</td>
<td>46.5</td>
<td>125.1</td>
</tr>
<tr>
<td>Solomon Islands</td>
<td>324.0</td>
<td>44</td>
<td>136</td>
<td>26.2</td>
<td>69.6</td>
</tr>
<tr>
<td>Tonga</td>
<td>96.3</td>
<td>29</td>
<td>301</td>
<td>30.2</td>
<td>67.9</td>
</tr>
<tr>
<td>Vanuatu</td>
<td>146.4</td>
<td>49</td>
<td>335</td>
<td>31.9</td>
<td>52.7</td>
</tr>
<tr>
<td>Western Samoa</td>
<td>157.7</td>
<td>49</td>
<td>311</td>
<td>25.4</td>
<td>124.0</td>
</tr>
</tbody>
</table>

a 1988 figures. b 1989 figures.


Figure 1 Net disbursements of official development assistance by source, 1988 (per cent)

Note: Net disbursements made to Fiji, Kiribati, Solomon Islands, Tonga, Vanuatu and Western Samoa.

The experience of the past two decades suggests that there is little prospect of increases in donors' aid-to-GDP ratios. Moreover, competition for aid has intensified dramatically due to the serious difficulties being faced by the formerly centrally-planned economies. While those economies may have considerably higher GDP per head than most developing economies, the sudden fall in their living standards and their considerably greater effect on the security concerns of most donors, means that there will be an inevitable diversion of priorities for international aid, whether or not they are classified as official development assistance.

Within the pool of aid resources remaining available for the developing economies, increasing priority is likely to be given to the poorest economies in Asia and Africa. Among the middle income economies (and the Pacific islands are regarded as being at the lower bounds of that category) priority is likely to be given to those which are serious about good economic management and have shown potential to absorb aid efficiently.

Australia and New Zealand can be expected to maintain their strong interest in the Pacific island economies. In the case of Papua New Guinea, however, there is a bilateral agreement to eliminate budget aid by the year 2000. Budget aid currently accounts for 85 per cent of Australia's aid to Papua New Guinea and it will not be easy to transform much of that into considerably more administration-intensive and potentially more intrusive forms of project or program aid. Aid from former European colonial powers could well decline as historical ties continue to weaken and their attention is diverted by the problems of the nearby formerly centrally-planned economies. On the other hand, any such declines could be offset by increased aid from less distant Japan.

Assistance from multilateral aid agencies is likely to be influenced by their assessments of the quality of economic management and of the absorptive capacity for aid. Although they account for only a small share of total aid, the views of these agencies will be quite influential on other donors, especially where they chair consultative groups of aid donors. The Pacific islands are facing problems of absorbing additional project aid due to limits on administrative and implementation capacity. In some cases, budget constraints are already making it difficult to operate and maintain investments financed by past project aid. These limits on absorptive capacity for project aid also warn against recourse to borrowing on commercial terms for general government expenditure.

The combination of these factors suggests that the Pacific island economies should not expect to base their development strategies on substantial increases in development assistance. Aid is likely to provide a reasonably reliable flow of financial resources and technical assistance, probably close to current levels in real terms for quite some time and it will be very helpful in progressive strengthening of the base of skills and of physical infrastructure. As they have done recently, aid flows are also likely to respond promptly to reconstruction needs following natural disasters, such as tropical cyclones, which frequently afflict the region. Both routine and emergency aid will provide important support,
but substantial and sustained increases in income levels will depend increasingly on commercial links with the rest of the world.

**An increasingly competitive environment**

There are some serious problems in the international trading environment. These are reflected in increasing tensions in trans-Pacific trade, for example between the United States and Japan, and by widespread resort to non-tariff measures to protect rich economies against an increasingly broad range of exports from developing economies. It is proving extremely difficult to bring the Uruguay Round of multilateral trade negotiations to a successful conclusion. Moreover, important aspects of international economic transactions are not covered by GATT rules and there is increasing interest in regional solutions to international economic problems.

Such trends pose important risks, especially for large developing economies such as China and Indonesia, who have the potential, based on their comparative advantage, to capture significant shares of global markets in labour-intensive light manufactures, provided their access to markets is not impeded by extensive protectionism. Protectionism also threatens to slow global economic growth, placing additional downward pressure on the demand and price prospects of the Pacific islands' natural resource-based exports. For these reasons, the islands have a large stake in the long-run stability of an open and non-discriminatory trading system.

Fortunately, the size of the Pacific island economies is an advantage in avoiding protectionist barriers to their exports. Their commodity exports are small in relation to total demand and, in any case, commodity trade (except in temperate agricultural products) is not greatly affected by problems of market access. Even in manufactures, such as garments, the growth in such exports from these island economies is unlikely to be seriously constrained by protectionism.\(^2\)

For a considerable time, even very rapid growth of Pacific island exports would not threaten the interests of inefficient sectors in developed economies and serious threats of retaliation are likely to be directed elsewhere. There is certainly no case for pessimism about export prospects on grounds of limited market access. The effective constraints on the volume and range of exports from these islands are limits on their ability to deliver products which are competitive in terms of price, quality and timeliness.

---

\(^2\) Some exceptions to this may occur for garment exports where international trade is seriously distorted by the multi-fibre arrangement. The Pacific islands may face quota limits on specific items of garment exports if exports to particular markets grow quickly. As noted later in the paper, a quota has been imposed on exports of men's sleepwear from Fiji. However, given the capacity to switch production among a wide range of garments and markets, such quotas will only be minor irritations rather than serious impediments to growth of garment exports from the islands for the foreseeable future.
The Pacific island economies do not have an abundance of cheap labour. In some cases, such as Papua New Guinea and to a lesser extent Fiji, minimum wages have been held artificially high by legislation, although in Papua New Guinea the system of wage-setting may become essentially deregulated in the near future, following the decision of the 1992 Minimum Wages Board. The fundamental cause of relatively high labour costs is the ready access to land for subsistence and small-scale commercial rural activities. This access offers a reasonable alternative to wage employment for most of the population. In some island economies, the option of working abroad also raises the opportunity cost of labour. Even in the absence of any regulatory intervention, unskilled wages would settle at rates considerably above those in China, Indonesia or South Asia. For example, the legal minimum wage in Solomon Islands equates to US$2.22 per day, well above the prevailing rate in China or Indonesia, and most waged employees in Solomon Islands earn well above the prescribed minimum (Solomon Islands, Central Bank of 1991:19). Accordingly, the Pacific islands' export prospects need to be based on sectors where unskilled labour accounts for a relatively lower share of costs and is combined with correspondingly higher inputs of natural resources, skilled labour and capital.

The practical challenge is to generate or import skills and capital in adequate amounts. The issues to be faced in doing so differ from sector to sector, but a number of general considerations apply if the island states are to compete successfully with all others also seeking to improve their trading prospects.

The Pacific islands suffer from a shortage of domestic savings and are in the early stages of developing a strong domestic skill base. Accordingly, regulatory restrictions on foreign investment and on medium-term employment of expatriate skills need to be kept to a minimum in order to minimise unnecessary costs. In most developing economies, including the Pacific islands, the policies towards foreign investment have swung toward promotion and away from regulation. On the other hand, some governments still place considerable bureaucratic obstacles in the way of hiring necessary skills overseas, raising the cost of production and deterring investment.

Competitiveness does not depend only on the cost of capital and types of labour employed directly in the production of various goods and services. Indirect costs imposed by physical constraints, such as transport costs or by domestic government policies, such as import restrictions, have an important bearing on competitiveness.

The Pacific islands face some inevitably high transport costs due to distance from many of their markets. There may, however, be scope for reducing domestic infrastructure-related costs through enhancement of local road networks, wharves for inter-island or coastal shipping and telecommunications. The coverage of services can be enhanced by additional investment and there are good prospects for obtaining grants or highly concessional finance for economically viable infrastructure projects. A different set of problems relate to ensuring efficient and low-cost operation of services and the maintenance of...
South Pacific economies in a changing environment

infrastructure assets. Many developing economies are reducing costs by better monitoring of public utilities and by insisting on more commercially oriented approaches to their operations. Privatization does not always make sense as some public utilities do not operate in a competitive environment, but costs can be lowered in some cases by exposing more aspects of their operations to competition. The Pacific islands could consider adopting some of these measures as they cannot afford the additional burden of unnecessarily high infrastructure costs.

Weaknesses in economic management can also add to the costs of production. For example, trade policies involving tariffs or extensive import licensing, raise costs for domestic consumers and for downstream users of the products protected from international competition. They place existing or potential exporters at a considerable disadvantage directly, by increasing the cost of imported inputs, as well as indirectly, by placing additional upward pressure on the domestic wage structure. High indirect costs can also be caused by the administrative burden of restrictive import systems.

There is considerable and convincing evidence to be drawn from the comparative track record of developing economies in recent decades. Those which have adopted open trade policies have outperformed those which relied on heavy protection (World Bank 1991b). A protectionist, import-substitution strategy would be particularly inefficient for the Pacific islands due to the very small scale of its markets. This was illustrated by Fiji’s experience up to the mid-1980s. Fiji has indicated its willingness to learn from its own, as well as international experience. Import protection has been lowered considerably since 1987 and export-oriented producers have been exempted from duties on imports. These policies have already succeeded in broadening Fiji’s export base, indicating how reducing protection against imports can help attract export-oriented investors (Elek, Hill and Tabor 1991). With more and more economies moving away from a highly protected and regulated environment, internationally oriented investors are not likely to be interested in operating in a more difficult protectionist environment.

The Pacific island economies will also need to sustain sound macroeconomic management to ensure domestic price stability and convertible exchange rates. Most of the island economies and the surrounding East Asian and Australasian economies have established a good record of prudent macroeconomic management. Accordingly, any island economy which allowed inflation to accelerate or was forced to impose exchange restrictions due to weaknesses in fiscal or monetary management would find it hard to attract investment. Law and order is also important. Problems in that area are making it very difficult for Papua New Guinea to attract investment except in mineral or petroleum projects, in view of the better security environment available elsewhere.
Sectoral trade and investment issues

It may be seen that tropical agricultural products and minerals dominate the pattern of exports to the Pacific islands’ main trading partners (Tables 2 and 3, Figure 2, Statistical Annex Tables 5 and 6). The outlook for particular commodities or products from individual island economies is not assessed here due to space limitations. Instead, some general comments are made on broad groups of current and potential exports, together with issues related to each of these in the light of emerging trends in global demand and competition.

Table 2 Principal commodity exports, Pacific island economies (US$million)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Fiji Sugar</td>
<td>36.5</td>
<td>213.0</td>
<td>149.4</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Coconut oil</td>
<td>5.9</td>
<td>7.9</td>
<td>1.6</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Gold</td>
<td>3.8</td>
<td>15.2</td>
<td>31.6</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fish, prepared or preserved</td>
<td>-</td>
<td>10.5</td>
<td>24.2</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other fish</td>
<td>-</td>
<td>0.6</td>
<td>7.4</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Lumber</td>
<td>0.3</td>
<td>5.0</td>
<td>5.2</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Clothing</td>
<td>-</td>
<td></td>
<td>88.8</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Re-exports</td>
<td>15.0</td>
<td>92.8</td>
<td>74.4</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total exports f.o.b.</td>
<td>71.5</td>
<td>373.6</td>
<td>450.4</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Papua New Guinea

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Cocoa</td>
<td>17.4</td>
<td>69.3</td>
<td>35.7</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Coffee</td>
<td>22.6</td>
<td>176.8</td>
<td>74.4</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Copra</td>
<td>14.9</td>
<td>36.5</td>
<td>5.1</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Copra oil</td>
<td>7.2</td>
<td>24.7</td>
<td>11.8</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Palm oil</td>
<td>-</td>
<td>17.9</td>
<td>42.0</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Logs</td>
<td>2.9</td>
<td>44.7</td>
<td>85.3</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Marine products</td>
<td>1.0</td>
<td>47.2</td>
<td>7.8</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Gold</td>
<td>0.9</td>
<td>257.7</td>
<td>700.7</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Copper</td>
<td>-</td>
<td>207.6</td>
<td>345.5</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Re-exports</td>
<td>24.8</td>
<td>80.5</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total exports f.o.b.</td>
<td>104.8</td>
<td>1031.2</td>
<td>1349.0</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Solomon Islands

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Fish</td>
<td>-</td>
<td>28.0</td>
<td>38.9</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Timber</td>
<td>3.1</td>
<td>19.3</td>
<td>19.7</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Copra</td>
<td>4.0</td>
<td>12.7</td>
<td>3.8</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Palm oil and kernels</td>
<td>-</td>
<td>8.4</td>
<td>6.5</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cocoa</td>
<td>-</td>
<td>0.7</td>
<td>5.0</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Re-exports</td>
<td>0.2</td>
<td>0.7</td>
<td>1.7</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total exports f.o.b.</td>
<td>8.0</td>
<td>73.3</td>
<td>83.3</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Vanuatu

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Timber</td>
<td>-</td>
<td></td>
<td>88.8</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Copra</td>
<td>-</td>
<td>8.7</td>
<td>4.7</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cocoa</td>
<td>1.1</td>
<td>1.4</td>
<td>3.2</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Meat</td>
<td>-</td>
<td>1.1</td>
<td>3.2</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Re-exports</td>
<td>-</td>
<td>23.0</td>
<td>1.3</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total exports f.o.b.</td>
<td>-</td>
<td>35.9</td>
<td>16.2</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Western Samoa

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Coconut products</td>
<td>1.9</td>
<td>9.7</td>
<td>2.2</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cocoa</td>
<td>1.4</td>
<td>3.3</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Meat</td>
<td>-</td>
<td>1.4</td>
<td>2.9</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Timber</td>
<td>-</td>
<td>0.4</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Re-exports</td>
<td>-</td>
<td>0.2</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total exports f.o.b.</td>
<td>4.6</td>
<td>17.0</td>
<td>7.6</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Kilibati

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Copra</td>
<td>-</td>
<td>2.5</td>
<td>1.6</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fish</td>
<td>-</td>
<td>0.2</td>
<td>0.2</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Re-exports</td>
<td>-</td>
<td>0.2</td>
<td>0.5</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total exports f.o.b.</td>
<td>-</td>
<td>3.0</td>
<td>3.3</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Table 3  Principal commodity imports, Pacific island economies (US$million)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Fiji</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Food</td>
<td>19.4</td>
<td>79.3</td>
<td>95.8</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Beverages and tobacco</td>
<td>2.0</td>
<td>4.8</td>
<td>5.4</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Crude materials</td>
<td>1.5</td>
<td>4.0</td>
<td>5.4</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mineral fuels</td>
<td>11.5</td>
<td>129.2</td>
<td>99.1</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Oils and fats</td>
<td>1.6</td>
<td>6.2</td>
<td>6.8</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Chemicals</td>
<td>6.8</td>
<td>37.3</td>
<td>49.1</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Manufactured goods</td>
<td>20.2</td>
<td>104.6</td>
<td>166.2</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Machinery and transport equipment</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total imports c.i.f.</td>
<td>21.6</td>
<td>126.8</td>
<td>146.6</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tonga</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Food and beverages</td>
<td></td>
<td></td>
<td></td>
<td>10.4</td>
<td>15.1</td>
<td></td>
</tr>
<tr>
<td>Crude materials</td>
<td></td>
<td></td>
<td></td>
<td>1.8</td>
<td>2.8</td>
<td></td>
</tr>
<tr>
<td>Oils and fats</td>
<td></td>
<td></td>
<td></td>
<td>4.9</td>
<td>9.3</td>
<td></td>
</tr>
<tr>
<td>Chemicals</td>
<td></td>
<td></td>
<td></td>
<td>1.9</td>
<td>4.8</td>
<td></td>
</tr>
<tr>
<td>Manufactured goods</td>
<td></td>
<td></td>
<td></td>
<td>6.8</td>
<td>9.2</td>
<td></td>
</tr>
<tr>
<td>Machinery and transport equipment</td>
<td></td>
<td></td>
<td></td>
<td>5.8</td>
<td>11.3</td>
<td></td>
</tr>
<tr>
<td>Total imports c.i.f.</td>
<td></td>
<td></td>
<td></td>
<td>34.3</td>
<td>59.3</td>
<td></td>
</tr>
<tr>
<td>Vanuatu</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Food</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Beverages and tobacco</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Crude materials</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mineral fuels</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Oils and fats</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Chemicals</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Basic manufactures</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Machinery and transport equipment</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total imports c.i.f.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Kiribati</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Food</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Beverages and tobacco</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Crude materials</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mineral fuels</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Oils and fats</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Basic manufactures</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Machinery and transport equipment</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total imports c.i.f.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Western Samoa</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Food</td>
<td>3.3</td>
<td>13.4</td>
<td>11.9</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Beverages and tobacco</td>
<td>0.6</td>
<td>2.0</td>
<td>1.1</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Crude materials</td>
<td>0.1</td>
<td>2.0</td>
<td>0.4</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mineral fuels</td>
<td>0.6</td>
<td>10.8</td>
<td>8.6</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Oils and fats</td>
<td>—</td>
<td>0.7</td>
<td>0.4</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Chemicals</td>
<td>0.8</td>
<td>3.2</td>
<td>2.5</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Basic manufactures</td>
<td>3.2</td>
<td>14.6</td>
<td>9.5</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Machinery and transport equipment</td>
<td>3.5</td>
<td>12.7</td>
<td>12.1</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total imports c.i.f.</td>
<td>13.6</td>
<td>62.2</td>
<td>51.3</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

a 1990 figures.  
b 1985 figures.  
Agricultural export commodities

Tropical cash crops such as sugar, copra, cocoa and coffee have been the mainstay of past exports from this region. The Pacific islands' total production of any of these commodities is not sufficient to influence world market prices. Regional producers can therefore be confident of selling all they can produce at an externally determined market price, although some special considerations apply to sugar: distortion of international trade due to protection and extensive domestic subsidization means that a world market price for sugar is hard to define. Most of the islands could increase their production of tropical cash crops, either by increasing areas under cultivation or by improving yields, but the outlook for prices is reducing the attraction for doing so.

Recent movements and expected trends in the prices of the region's major commodity exports, measured in constant dollars, are given (Table 4). It may be seen that most of these prices are at low levels in historical terms and only a modest recovery is expected in the purchasing power of these exports. Continued downward pressures on prices are likely to persist, due to the existence of substitutes for products such as palm oil and coconut products, as well as potentially increased production from economies such as Indonesia where labour costs are far below those in the Pacific island economies. Combined with the inelastic demand for most of these tropical agricultural commodities, there is some risk that even the modest projected recovery in prices may not be realized.
### Table 4  Commodity prices and price projections (constant 1985 US$)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Coffee (c/kg)</td>
<td>328</td>
<td>321</td>
<td>218</td>
<td>172</td>
<td>135</td>
<td>126</td>
<td>94</td>
<td>103</td>
<td>120</td>
<td>128</td>
<td>155</td>
<td>147</td>
</tr>
<tr>
<td>Cocoa (c/kg)</td>
<td>248</td>
<td>225</td>
<td>114</td>
<td>90</td>
<td>87</td>
<td>80</td>
<td>75</td>
<td>76</td>
<td>76</td>
<td>77</td>
<td>82</td>
<td>88</td>
</tr>
<tr>
<td>Sugar ($/mt)</td>
<td>602</td>
<td>90</td>
<td>162</td>
<td>204</td>
<td>190</td>
<td>133</td>
<td>137</td>
<td>135</td>
<td>145</td>
<td>163</td>
<td>197</td>
<td>197</td>
</tr>
<tr>
<td>Coffee (c/kg)</td>
<td>556</td>
<td>501</td>
<td>315</td>
<td>254</td>
<td>199</td>
<td>228</td>
<td>255</td>
<td>264</td>
<td>230</td>
<td>235</td>
<td>208</td>
<td>183</td>
</tr>
<tr>
<td>Cocoa (c/kg)</td>
<td>642</td>
<td>590</td>
<td>407</td>
<td>375</td>
<td>231</td>
<td>421</td>
<td>378</td>
<td>349</td>
<td>367</td>
<td>387</td>
<td>314</td>
<td></td>
</tr>
<tr>
<td>Sugar ($/mt)</td>
<td>556</td>
<td>501</td>
<td>315</td>
<td>254</td>
<td>199</td>
<td>228</td>
<td>255</td>
<td>264</td>
<td>230</td>
<td>235</td>
<td>208</td>
<td>183</td>
</tr>
<tr>
<td>Coffee (c/kg)</td>
<td>432</td>
<td>386</td>
<td>286</td>
<td>252</td>
<td>158</td>
<td>193</td>
<td>294</td>
<td>271</td>
<td>213</td>
<td>223</td>
<td>272</td>
<td>221</td>
</tr>
<tr>
<td>Sugar ($/mt)</td>
<td>186</td>
<td>136</td>
<td>168</td>
<td>163</td>
<td>144</td>
<td>149</td>
<td>161</td>
<td>162</td>
<td>164</td>
<td>166</td>
<td>175</td>
<td>186</td>
</tr>
<tr>
<td>Coffee (c/kg)</td>
<td>240</td>
<td>174</td>
<td>195</td>
<td>198</td>
<td>236</td>
<td>212</td>
<td>212</td>
<td>212</td>
<td>213</td>
<td>232</td>
<td>234</td>
<td></td>
</tr>
<tr>
<td>Sugar ($/mt)</td>
<td>2080</td>
<td>1417</td>
<td>1873</td>
<td>2064</td>
<td>1826</td>
<td>1572</td>
<td>1550</td>
<td>1498</td>
<td>1272</td>
<td>1167</td>
<td>1356</td>
<td>1249</td>
</tr>
<tr>
<td>Coffee (c/kg)</td>
<td>579</td>
<td>318</td>
<td>315</td>
<td>276</td>
<td>263</td>
<td>244</td>
<td>229</td>
<td>227</td>
<td>229</td>
<td>233</td>
<td>232</td>
<td>238</td>
</tr>
<tr>
<td>Sugar ($/mt)</td>
<td>29.1</td>
<td>26.7</td>
<td>9.8</td>
<td>11.8</td>
<td>14.5</td>
<td>11.7</td>
<td>11.4</td>
<td>11.2</td>
<td>11.3</td>
<td>11.7</td>
<td>13.6</td>
<td>13.7</td>
</tr>
</tbody>
</table>

**Source:** World Bank, International Economics Department, International Trade Division, 'Revision of primary commodity price forecasts', 3 August 1992: Table 1.
This does not imply that island governments should discourage production and export of these products. Rather, the limited price prospects and competition point to the need for constant efforts at research and extension to improve yields and quality, together with policies which can reduce the costs of production. These export crops have provided an important means of transition beyond subsistence into the cash economy and will continue to play an important economic role in the rural areas of the region. It is less likely, however, that reliance on export cash crops alone can lead to rapid and sustained increases in living standards. Opportunities for diversification need to be explored. Some new income earning opportunities can be generated gradually in manufacturing and service activities and these will, in turn, generate further growth in demand for domestic food supplies to urban areas. There is some evidence from Papua New Guinea that returns from such activities are competing for land and labour in several areas, since returns to labour are comparable to those in smallholder cash crop production or employment on plantations.

Sugar production in Fiji may provide an exception to these general considerations since it receives favourable prices from the European Community for an agreed volume of sugar exports under the Lomé Convention. In contrast to this artificial price, the open market price is highly volatile and low in most years, due to trade distorting import barriers and production subsidies by major temperate-zone producers. Incremental production in the absence of price agreements comparable to those available to Fiji would be highly risky. For example, the experience of the Ramu sugar project in Papua New Guinea indicates that considerably higher costs to domestic consumers have resulted from the project’s inability to compete at prevailing international prices. The scope for and benefits conferred by the preferential price arrangements for exports to the European Community under Lomé arrangements will need to be reviewed to the extent that agricultural trade is brought gradually under normal GATT disciplines, as expected during the 1990s.

Whatever the medium-term trend in agricultural commodity prices, considerable short-term fluctuations can be expected around such trends due to weather related disruptions to production as well as to delayed responses to past price fluctuations. International agreements to stabilize prices for individual commodities have not proved effective in recent decades and provisions for price stabilization and/or export quotas are tending to be dropped from such agreements.

Although the United Nations’ Common Fund for Commodities became active recently, there is very little likelihood of substantive or sustained international efforts to stabilize prices; nor would these necessarily be in the interests of relatively small producers. On the other hand, there is scope for domestic action to reduce price instability. The Papua New Guinea experience has shown that commodity price stabilization funds can reduce fluctuations in prices paid to growers by paying bounties in low-price years from levies collected in years of above average prices (Overfield 1991). This policy helped reduce uncertainties
faced by growers until the stabilization funds were exhausted following very sharp commodity price declines in 1989 and 1990.

The international environment suggests that there is further scope and need for such domestic price stabilization policies in the Pacific in the 1990s. At the same time, care should be taken that stabilization schemes do not become long-term price subsidy schemes. The latter would provide artificial production incentives and would reduce the scope for public spending on alternative means to assist producers (for example through research, extension or improved transport facilities).

**Timber and fisheries**

All of the Pacific island economies have exclusive economic rights to extensive marine resources. The larger of them also possess valuable timber resources. The South Pacific Forum Fisheries Agency has proved to be a valuable cooperative initiative. It has helped provide a better assessment of available resources. It has also helped to reduce potentially damaging competition for investment in fisheries around Forum states. Since commercial species such as tuna are migratory, a lack of coordination could considerably reduce the bargaining power of the Pacific island economies in obtaining fair returns from their marine resources. A joint stance has also proved effective in securing acknowledgment by the United States of their rights over fishing zones. A substantial growth in demand for marine products can be expected with the rapid growth in East Asian incomes per head and there appears to be scope for increasing supply without permanent depletion of marine resources.

Demand for tropical hardwood from the South Pacific has also increased, due to growing Asian incomes and the gradual tightening of management of tropical timber resources in Southeast Asia as those governments have become increasingly concerned about the rapid depletion of resources. The experience of recent years suggests it will not be easy to avoid similar problems in the Pacific islands. The recent inquiry into the Papua New Guinea forestry industry revealed that some of the unscrupulous practices, which have depleted tropical forest resources seriously elsewhere, have also emerged in this region. There has been extensive damage to resources in some areas, with negligible benefits to the local population and the nation except for a few corrupt intermediaries. The legislation and rules for access to and the rates of exploitation have been strengthened since then, but considerable political commitment will be required in Papua New Guinea and in other island states to ensure that a potentially valuable and sustainable resource is not destroyed by over-exploitation during the next one or two decades.

For both marine and forest resources, international experience suggests that it is difficult to ensure a fair return to exporting nations. Since the products are not homogeneous, either in terms of species or in quality, international market prices are not well defined. The scope for transfer pricing can reduce returns to resource owners, especially where there is vertical integration, with the same
companies involved in fishing and forestry also involved in processing and marketing. High rates of \textit{ad valorem} export taxes increase the incentive for transfer pricing while high volume-based royalties can deter genuine investors. One option, which may be considered by island states in order to reduce the problem, is to negotiate the right to purchase and market some share of forestry and marine products on a right of first refusal basis. This could allow them to form a better estimate of the market value of their products. The island states could cooperate in contracting reputable, large international fishing or timber companies to market a sufficient share of their product to establish their true market value, which other companies would then need to match.

**Minerals and petroleum**

Several of the Pacific islands, including Papua New Guinea, Fiji and New Caledonia, have proven mineral resources that already contribute significantly to their exports. Geological prospects are fairly good for additional discoveries in these and some other island economies, subject to adequate exploration efforts. The first oil exports from Papua New Guinea commenced in 1992 and there are good prospects for further commercial fields. Papua New Guinea also has natural gas reserves which could prove sufficient for exports of liquefied natural gas by the end of the 1990s. Natural gas could also provide the basis for energy-intensive manufacturing such as aluminium processing.

Mineral or petroleum based projects, such as the recent developments in Papua New Guinea, will not have a significant direct effect on employment. They can, however, make a significant indirect contribution to economic development of the island economies by increasing significantly the resources available to improve physical infrastructure and for human resource development.

A thorough discussion of the policy conditions required to ensure that the revenue from such projects makes a positive contribution is beyond the scope of this paper, but the following issues are worth considering.

- While it would be reasonable to use some of the mineral or petroleum revenues to reduce aid dependence, it would be counter-productive for aid to be reduced too sharply. A significant share of the benefits from exploiting non-renewable resources should remain available to develop the social and physical infrastructure of the exporting economies.

- The island governments will need to improve their capacity for planning the allocation of public expenditure in order to ensure that any incremental resources available to governments are allocated to investments with high rates of return.

- Sound macroeconomic policies will be needed to avoid the risks of upward pressure on domestic costs leading to a loss of competitiveness of other existing or potential export sectors (Parsons and Vincent 1991). To minimize these risks, restrictions on the import of goods and services should be avoided. Provision should also be made for avoiding sudden fluctuations of domestic demand: Papua New Guinea's Mineral Resources
Stabilisation Fund (MRSF) provides a mechanism for this. All mineral revenues are initially deposited into this fund which is invested abroad as part of the nation's foreign exchange reserves. Resources from the MRSF are then drawn on to ensure a smooth and sustainable addition to budgetary resources, allowing effective medium-term expenditure planning and avoiding sharp fluctuations in public sector demand.

If the above conditions are met, the economic base of island economies can be boosted considerably by mineral or petroleum projects. The challenge is to attract adequate investment in exploration and development of these resources. There is no reason for concern about potential demand. The high transport costs involved mean that Pacific islands' proximity to rapidly growing East Asia, combined with those economies' desire to diversify their sources of supply, provide assurance of markets for several decades.

Very large financial resources and long lead-times are required for developing mineral or petroleum projects. There are inevitable risks in exploration and the recent Bougainville experience in Papua New Guinea points to potential risks during the production phase of such projects. In order to attract investment, it is important to develop a policy framework to ensure that potential explorers will retain rights to develop any discoveries and that the tax policies for sharing of profits from development are known in advance and provide adequate returns for risks undertaken.

Papua New Guinea has developed a legislative framework which defines the rights of explorers over resources and the taxation of profits. In particular, the legislation provides for high marginal rates of tax to apply if a rate of return specified in the legislation is exceeded, possibly due to unexpectedly high commodity prices or ore grades. The built-in flexibility for sharing profits in the light of changing circumstances avoids the risk of renegotiations during the life of resource projects (Garnaut and Clunies Ross 1983).

The existence of such legislation has sustained strong interest in mineral and petroleum development in Papua New Guinea, despite the closure of the Bougainville mine (although the recent calls for the review of already-signed agreements by Papua New Guinea's leaders will reduce confidence in future investment). The taxation provisions of the legislation have been adopted by several other developed as well as developing economies. It may be useful for other Pacific islands to consider developing similar legislation to encourage mineral development, a pooling of scarce administrative resources for doing so may be useful. A well-defined legislative framework for taxation of resource-based revenues provides assurances for governments as well as investors. There is a smaller risk of obtaining a less than adequate share of returns from a project due to the considerable bargaining strength of the companies involved in such projects.

Although the demand for any mineral and petroleum exports is assured, exporting economies face the problem of price fluctuations for these products,
just as for agricultural commodities. In these sectors, however, there is no need for governments to seek to stabilize returns to investors since such large companies can cover themselves against risk. Governments themselves face the problem of fluctuations in taxation revenue due to changes in company profitability as export prices fluctuate. The extent of fluctuation in government revenue is amplified if (as in the case of Papua New Guinea) tax legislation provides for higher marginal rates of tax on profits in any years of above expected profitability. In these circumstances, stabilization of the flows of funds to the budget becomes essential. The problem of fluctuations can be overcome by using a mechanism such as Papua New Guinea’s Mineral Resources Stabilisation Fund.

**Manufacturing**

The current scope of manufacturing industries in most of the island economies is essentially limited to simple processing of agricultural products and light industry, producing products such as bottled or canned drinks. Transport costs provide natural protection allowing profitable production, even on a small scale by international standards. Most islands do offer some protection to selected manufacturing activities however, with the exception of Fiji, they did not adopt a post-independence strategy of heavy protection for a wide range of import-replacing manufacturing activities.

Fiji’s import replacement strategy did lead to a relatively broadly-based manufacturing sector. By the early 1980s, only a decade after independence, it became clear that the strategy had reached its limits and could not provide sustained growth in employment in manufacturing. The job creation which had taken place was imposing a considerable and increasing burden on the rest of the economy (World Bank 1987). This experience, combined with extensive similar evidence from many developing economies, suggests that other Pacific island economies should continue to avoid widespread import restrictions in order to nurture uncompetitive import replacement. The costs of such a strategy would fall heavily on their rural-based majorities.

As the size of these economies expands and their skill-base is strengthened, the scope for efficient import-replacement will also widen gradually. However, significant sustained growth in manufacturing activity and employment can be achieved only by developing export-oriented manufacturing. Several other small island economies have succeeded in doing so; the experience of Mauritius indicates that a substantial manufacturing base can be built up in a location whose distance from markets is comparable to that of the South Pacific (World Bank 1991a).

As noted earlier, Fiji has begun to dismantle its heavy protection of import replacement activities and is providing significant incentives to export-oriented activities. Tax holidays of 13 years have been offered to firms which export over 95 per cent of their output. Such firms also have access to duty-free inputs for all of their exports. The latter is important, since the high costs of protected
local inputs or the duties paid on imported inputs would undercut the com-
petitiveness of any export-oriented activities.

This change in strategy has led to a strong investment response. One hundred
and twenty factories had been set up by the end of 1991 under the tax-incentive
scheme, providing employment to more than 11,000 people (Fiji Trade and
Investment Board 1992). Most of the initial investments were aimed at the
Australian and New Zealand markets, where Pacific island economies enjoy
preferential duty-free access under the South Pacific Regional Trade and
Economic Cooperation Agreement (SPARTECA) or the Papua New Guinea–
Australia Cooperation and Trade Relations Agreement (PACTRA). (There are
quantitative limits on access to Australian textiles, clothing and footwear
markets, but these limits will expire by 1994.) By 1990, a substantial diversifi-
cation commenced into exports of garments to the United States and other
markets, since Fiji, as a new exporter, did not face quota limits under the
multi-fibre arrangements. The first quota restriction was imposed in 1990 on
men’s sleepwear exports to the United States. The extremely wide range of
alternative garment exports and markets provides considerable scope for
expansion. Many of the firms targeting garment markets in the United States
and elsewhere have already established marketing linkages originally develop-
ed in Asian economies which now face severe import restrictions.

The Fiji example should encourage other island economies to adopt export-
oriented, rather than protectionist import-oriented, strategies for the long-term
promotion of manufacturing. The interest by investors may, however, be less
than in Fiji, since Fiji has better transport links and a relatively stronger base
of education and skills than several other island economies. Prospects for
export-oriented manufacturing in Papua New Guinea will be improved con-
siderably by implementing the recommendation of the 1992 Minimum Wages
Board to abolish the artificially high urban minimum wage. This is to be replaced
by a single national minimum equal to the former rural minimum wage which is
much more closely aligned with productivity and returns to labour elsewhere in
the economy. On the other hand, continued weakness in the law and order
situation would decrease investor interest despite the improvement in com-
petitiveness. On balance, there should be at least modest scope for expanding
export-oriented manufacturing in Papua New Guinea and other island
economies, as has happened in Fiji. A recent investment in exports of garments
from the Solomon Islands is encouraging in this context.

While the examples of Fiji and island economies show that some manufacturing
exports can be a viable option, expectations of a rapid transition towards
manufacturing should not be exaggerated. As emphasized early in this paper,
the Pacific island economies are among scores of others seeking to enter the
same markets. It is also important to recognize that a considerable part of
investment interest in these economies has been due to distortions in the
regional and global trading environment.
The advantages offered by preferential, duty-free access to Australian and New Zealand markets will decline substantially during the next decade as those economies continue to dismantle protectionist barriers which have damaged them substantially in recent decades. The Pacific islands' access to these important markets will be improved, but they will need to compete on gradually more even terms with all other economies. Correspondingly, the interest sparked in investment in exports of garments has been prompted in considerable part by quota-free access to importers who are members of the trade-distorting multi-fibre arrangements. The Pacific islands have substantial scope for expanding employment in the textile and clothing industries before their own quotas became a serious constraint. There is now a reasonable prospect that trade in textiles and clothing will be brought under normal GATT rules. The draft outcome of the Uruguay Round of multilateral trade negotiations provides for all quotas to be phased out over a period of ten years. This proposal may be subject to revision and delays, but indicates that the special opportunity offered to the Pacific island economies by constraints on others cannot be expected to be permanent.

This does not mean that investment to take advantage of these opportunities should be discouraged. The experience, reputation and marketing linkages which are being developed in Fiji, for example, will be of considerable benefit even after any special advantages are eroded by trade liberalization elsewhere. It does mean, however, that skill development programs will need to be pursued so that the island economies can face up to world-wide competition in future by achieving levels of productivity and quality which can allow them to be competitive, despite their relatively high labour costs compared to much of Asia.

At the same time, the competition which the Pacific will need to face warns against relying exclusively on export-oriented manufacturing as the key to development and employment growth. Manufacturing should be seen as one of several sectors where efficient internationally competitive investments should be encouraged. Such encouragement should focus on enhancing productivity by investment in skills as well as by ensuring adequate and efficient transport and communications services. Developments in international marketing patterns in manufacturing place a high premium on excellent telecommunications which allow producers to respond flexibly to changing patterns and sources of demand.

Care should be taken about the nature and extent of any sector-specific incentives provided. It makes sense, as Fiji has done, to exempt export-oriented manufacturers from import restrictions and tariffs on their inputs. It also makes sense to remove unnecessary regulations, for example on the use of imported skilled labour, and to help finance local skill development for these sectors. On the other hand, generous tax incentives carry long-term risks. In view of the high and hopefully rising share of exports to GDP in these small economies, the domestic revenue base would be greatly diminished if all export-oriented industries were given extremely generous tax exemptions. Nor would it be appropriate to have widely different tax treatment of alternative export options.
There is, moreover, a general trend away from heavy reliance on taxation incentives, including in Asia. This follows a growing realization that the general economic environment, including stable macroeconomic management and the availability of skills and infrastructure, is much more important in terms of attracting investment. Against that background, it would be unfortunate if the Pacific islands were to compete against each other in terms of the generosity of tax exemptions, weakening their ability to improve the skill and infrastructure base for sustained investment. Consultations leading to a coordinated policy on investment incentives by the Pacific island economies could be useful in order to avoid potentially damaging competition.

Services

All of the Pacific islands have excellent tourism potential based on scenery, beach and underwater activities. Fiji and Vanuatu have already built up a sizeable industry relative to their population size (Statistical Annex Table 7). While Western Europe is the largest source of international tourists worldwide, the most rapidly growing sources are in East Asia, reflecting rapidly rising incomes in Japan, Korea, Taiwan, Hong Kong and Singapore. All of these are reasonably close to the Pacific islands and the islands are also well placed to attract tourists from Australia and New Zealand. The Maldives has shown that a very rapid development of tourism can be achieved by a small island economy at comparable distances from major tourism markets.

Substantial growth of tourism will depend on the coordinated growth of accommodation and air transport capacity. To be competitive with other destinations, the Pacific islands will need to ensure that appropriate sites for development can be acquired for long-term periods. Traditional ownership of land can make it difficult to acquire long-term leases to suitable sites in the Pacific islands. Joint ventures which assure traditional landowners a share in profits and provide training to allow direct participation in operations can help to promote tourism.

Air fares will need to be reduced in order to be competitive with destinations such as Bali. Lowering air transport costs would require a change in the approach to aviation policy, particularly for economies other than Fiji which are not on major trans-Pacific routes. Present tourism volumes are too low to warrant frequent scheduled flights and make it difficult to utilize the capacity of separate international carriers based in each island state. The reservation of a significant share of capacity for these small carriers leads to very high air fares and makes it difficult to raise tourist volumes.

One policy option would be to focus locally based airlines on domestic and intra-regional operations, allowing other airlines unlimited landing rights for long-haul operations, thus reducing the overhead costs per passenger. The Maldives do not impose any restrictions on landing rights. A liberal approach to landing rights, however, will not automatically generate traffic. Since the market has to be built from a small base in most cases, regular scheduled
flights would not be economic at the outset. As in the case of the Maldives, early development could benefit considerably from promoting charter flights, with the growth in the number of flights coordinated with expansion of accommodation. It is likely that charter flights would be organized largely by touriste enterprises involved in the ownership or operation of expanded accommodation. With a liberal approach to landing rights, a subsequent and smooth transition to regular low-cost scheduled flights by large aircraft could be achieved.

There are further options for expanding exports of services. Some island economies, such as Tonga and Western Samoa, export a significant proportion of their labour force to other economies, sometimes on a permanent basis. Another option which does not involve long-term emigration is the provision of crews for maritime shipping. Following the establishment of training facilities, this has become an important source of export income for Kiribati, setting a potential example for others.

Several Caribbean islands have become involved in substantial provision of data entry and data processing services. With rapid changes in technology, telecommunication costs are declining rapidly, making geographic distance only marginally relevant to competitiveness in such activities. For simple tasks such as large-scale data entry, the skill requirements are modest. As the skill base strengthens and familiarity with data processing technology increases, involvement in more sophisticated aspects of computing would not be ruled out in years to come. Investment by, or joint ventures with, large international data processing operators would be essential to becoming involved in exporting such services.

Overview of trade and investment issues

This brief review of sectoral options suggests that the island economies could expand exports of a reasonably wide range of goods and services. In each case, for the foreseeable future, international investment by and/or joint ventures with international firms will be needed in order to establish marketing channels as well as to gain access to the capital and technology required. In all cases, the Pacific island economies will face competition from many other developing economies. The general economic policy environment and the efficiency of infrastructure will be of comparable importance to direct labour costs, and generous investment incentives cannot be relied upon to offset weaknesses in other aspects of the economic policy environment. The competition facing potential exporters in all sectors suggests that there is no single sector which can be expected to guarantee an adequate growth of income earning opportunities. In such an environment, government policies to encourage development are more appropriately provided in ways which can promote all sectors, for example by investment in education, training and infrastructure. Incentives to particular activities are less appropriate since their cost will fall, indirectly, on all other sectors.
Regional economic cooperation and the Pacific islands

An important feature of the global economic environment, especially in the past five years, has been the strong renewal of interest in regional economic cooperation. The effect of this trend on global trade and growth prospects, and its influence on the economic prospects of the Pacific islands, will depend on the motivation and mode of regional economic cooperation.

One motive for regional cooperation stems from frustration with the slow pace of the GATT in reducing barriers to trade, such as tariffs and quotas, on a global non-discriminatory basis. This has led some pairs or groups of countries to set up bilateral or regional free trade agreements, within which barriers to trade in goods or services are reduced only among participants. Although such free trade agreements are contrary to the basic non-discrimination principle of the GATT, they are sanctioned by an escape clause: Article XXIV of the GATT allows preferential trading arrangements among groups of economies so long as most internal barriers to trade in goods are eliminated and no new external trade barriers are raised against outsiders.

Such preferential arrangements carry risks for the multilateral trading system. Due to preferential rules for market access, trade and investment are diverted from the most efficient directions. Some new trade opportunities can be created for outsiders by increased competition and growth among members of free trade agreements, but there is no assurance that the benefits from such trade creation outweigh the costs of trade diversion. Preferential arrangements among some economies could also prompt corresponding deals among others. The emergence of the North American Free Trade Agreement (NAFTA) in addition to the European Community (EC) has raised fears that the world trading system might be split into large discriminatory trading blocs, especially if another such group was set up in East Asia.

Such risks can be reduced if those involved in free trade agreements also lower barriers to trade against outsiders, although not necessarily as rapidly as the reduction of internal barriers.

In that case, there is a much greater probability that trade creation can outweigh diversion. There would also be less risk of retaliatory free trade agreements being set up by others. The Australia–New Zealand Closer Economic Arrangements have eliminated all trade restrictions between the two, but both have also lowered trade barriers facing all of their trading partners. The ASEAN economies are also likely to lower external trade barriers at the same time as moving to eliminate internal trade barriers. In contrast, while the parties to the NAFTA have undertaken not to raise new barriers against outsiders, they have made no commitment to lower them. There is no assurance that new trade opportunities for others, including the Pacific islands, will compensate for the trade diversion caused by the new preferential North American arrangements.
Other forms of regional economic cooperation do not carry such potential costs and risks. A different, more positive motive for regional economic cooperation is the need to deal with the increasing scope and complexity of international economic transactions which extend well beyond trade in goods to exchanges of services, information, movement of people and of capital. Impediments to international transactions include far more than tariffs and quotas imposed on trade in goods. The rapid growth of trade, especially around and across the Pacific, has highlighted the importance of dealing with physical bottlenecks to trade such as the limited capacity of harbours and airports, divergent rules influencing foreign investment, differences in customs procedures and in physical, safety and environmental standards.

The GATT was originally designed to set multilateral rules for trade in goods and a successful Uruguay Round would start to bring trade in services under similar rules. It will be quite some time, however, before the GATT comes to grips with many of the new emerging issues which influence international transactions. Therefore, groups of economies which trade intensively with each other have felt the need to address these issues in smaller groups. The harmonization of a wide range of regulations, legislation and standards has been the basic content of the European Community’s Single Market Program.

There is scope for a corresponding process of cooperation in the Asia-Pacific region where trade flows have been growing faster than anywhere else and where around two-thirds of trade flows take place within the region. Such a process of progressive regional harmonization of policies will facilitate trade and other transactions among those involved. So long as any agreed new rules or procedures are explicit and published, then access to those regional markets by outsiders will also be eased. In practice, bilateral or regional economic agreements tend to reflect both motives for cooperation. Agreements such as the Australia–New Zealand Closer Economic Relations and the imminent NAFTA contain some preferential trade arrangements as well as understandings on issues such as commercial standards and legislation which do not involve discrimination against outsiders.

The Pacific islands benefit from some existing preferential trade arrangements. They receive preferential access to Australia and New Zealand markets under SPARTECA or PACTRA. They also benefit from general systems of tariff preferences for developing economies extended by most developed economies. However, they are not likely to receive any new preferential treatment under further free trade agreements among their trading partners. They are more likely to be disadvantaged by preferential arrangements which give certain developing economies with greater political weight better access to neighbouring developed economy markets. In addition to the direct costs of potential further discriminatory free trade agreements, the islands’ prospects could also suffer quite serious indirect damage. A potential division of the world economy into antagonistic discriminatory trading blocs would reduce global prospects for growth, dampening the demand for all potential exports from the Pacific islands.

77 Pacific Islands at the crossroads?
Moreover, the competition for relatively smaller markets would be exacerbated by the preferential access which may be granted to others.

Against this background, it is in the Pacific islands' interest to discourage the further proliferation of preferential trading arrangements, while encouraging regional as well as global cooperative efforts to reduce impediments to international transactions in ways which do not discriminate among different trading partners.

The relatively small size of the Pacific island economies suggests that they cannot expect to have significant individual influence on the approach taken towards regional economic cooperation by their trading partners. They do, however, have the option of joining with others to build coalitions of economies which recognize their overriding long-term interest in an open global trading system. For example, Fiji's participation in the Cairns Group of agricultural exporters has helped to enhance the credibility and influence of the group. It has also allowed Fiji to inject its views on agricultural trade reform into that group much more effectively than by acting alone in GATT-wide negotiations.

**Asia Pacific Economic Cooperation**

There is a corresponding option to influence the nature of regional economic cooperation in the Asia-Pacific region. The Asia Pacific Economic Cooperation (APEC) forum was established in 1989 with the precise objective of fostering increased trade and investment in the region in ways which avoid discrimination, helping to strengthen a global trading system and reducing the risk of fragmentation into rival trading blocs. APEC includes the six members of ASEAN, the United States, Canada, Japan, Korea, Australia, New Zealand, China, Hong Kong and Chinese Taipei (Taiwan). These 15 participants include most of the Pacific islands' major trading partners. The South Pacific Forum is an observer at ministerial-level meetings of APEC.

APEC has already developed a pragmatic work program which is identifying options for cooperation in several areas which do not involve preferential arrangements. Some of these areas, such as fisheries, marine environment and telecommunications, are of direct interest to the island states of the region (Elek 1991). The sharing of information about trading prospects and the opportunity to inject the views of the Pacific islands on options and priorities for cooperation can improve their prospects for trade and investment. APEC's working groups of officials have established close cooperation with the task forces of the Pacific Economic Cooperation Council, which draws in private sector and academic representatives in a less formal setting. Both APEC and Pacific Economic Cooperation Council working groups are open to participation by non-members, so there is no need to wait for admission as full members before taking advantage of the opportunities they provide.

The location and trade patterns of the islands qualify them as potential members of both the Pacific Economic Cooperation Council and APEC. Full
membership of the Pacific Economic Cooperation Council depends only on making a substantive contribution to a number of task forces and can be achieved quickly. APEC participation is likely to take longer, since the new organization will seek to consolidate for some time before expanding its participation significantly. Constructive use of the observer role of the South Pacific Forum and constructive participation in APEC working groups by the Forum (or by individual Pacific island economies) can, however, allow them to gain from the process and influence its work at the same time as strengthening their claims for subsequent full membership.

Economic cooperation among the Pacific islands

There is scope for enhancing the already active cooperation among the islands themselves. The South Pacific Forum has proved to be a useful means for internal consultation as well as for projecting the islands’ common political and economic interests into broader forums and to their major trading partners. The work of the Forum Fisheries Agency is an example of pragmatic cooperation.

Pursuing preferential free trade agreements among the island economies would not be productive. The very similar structure of these economies would offer very limited new opportunities for trade. Moreover, the pursuit of discriminatory arrangements among them would reduce their credibility in arguing against potentially damaging discriminatory trade arrangements elsewhere. Significant benefits could be gained from further reduction of tariff or quotas by the island states, but any such reductions in protection would be most effective in terms of reducing their cost structures and enhancing their competitiveness if they reduced trade barriers against all trading partners.

These considerations also apply to any future reforms of SPARTECA or PACTRA. These arrangements provide preferential duty-free access to the islands without requiring corresponding preferences for exports to the islands by Australia or New Zealand. There is no case for the islands lowering trade barriers only against Australia or New Zealand, even though such moves might seem to create greater balance within SPARTECA or PACTRA. As noted earlier, the preferences provided to the Pacific islands by SPARTECA or PACTRA will decrease in significance during the 1990s as both Australia and New Zealand are committed to further reductions in tariffs and to eliminate the few remaining quantitative restrictions on their imports.

From the islands’ point of view, the benefits from lower trade barriers would be maximized if they can purchase from the most competitive trading partners. Australia and New Zealand could achieve some short-term gains, at the islands’ expense, by seeking to divert trade from others. This would, however, run counter to their positive efforts to assist the islands’ development through aid. It would also be inconsistent with Australia’s and New Zealand’s much greater interest in discouraging discriminatory trade arrangements elsewhere.
While there is little merit in the Pacific islands pursuing discriminatory free trade agreement options among themselves, or with selected trading partners, the preceding sections have noted a number of fields in which pragmatic cooperation could advance their common economic interests. These include cooperation in fisheries and forestry management and marketing, cooperative agricultural and other research programs, joint efforts to develop a legislative framework for mineral sector development or further efforts at joint promotion of tourism to the region. Effective consultations among the island economies can prevent destructive competition, for example by avoiding competition for investment by ever more generous tax incentives. Many of these areas are also being addressed by the working groups of the Pacific Economic Cooperation Council and APEC. Some of the options being considered could be of interest to the island states.

**Conclusion**

The external environment for the Pacific islands has become more difficult in several ways. The end of the Cold War has led to very large new demands for aid to the formerly centrally-planned economies which have greater strategic significance for major donors. The relatively generous aid to the Pacific islands is not likely to increase, so their development prospects will depend on forming increasingly effective trade and investment linkages with the rest of the world.

The international trading environment is fraught with tensions. The small island economies face little risk from protectionism targeted directly at them, so there is no reason for concern about adopting an outward-looking, export-oriented development strategy. A fragmentation of the world economy into rival trading blocs could, however, slow global economic growth, dampening demand for commodity exports from the region and increasing competition in markets for manufactures and services. The Pacific islands cannot expect to have a major direct influence on global trading policies. However, constructive participation in regional cooperative efforts such as the Pacific Economic Cooperation Council and APEC is a useful opportunity to work towards preserving an open multilateral trading system.

The extent of competition from other developing economies has also intensified. An ever increasing number of them in Asia and Latin America are adopting better macroeconomic management policies and moving away from protectionist trade policies which had proved to be damaging to their competitiveness in export markets. The widespread trend towards strong macroeconomic management, less protectionism and less distorted pricing systems in developing economies around the world is an important feature of the changing international environment. This makes it vital for the Pacific island economies to sustain their own standards of economic management as part of their effort to be competitive in international markets.

A positive development is the decreasing cost of remoteness, thanks to lower costs of transport and telecommunications. There are several island
Andrew Elek

economies, such as Maldives and Mauritius which have set positive examples in terms of developing a successful and diversified export base despite their distance from most major markets. The recent experience of Fiji shows that such success could begin to be replicated in the Pacific island region. By learning from the examples of others, the islands can broaden their economic bases gradually towards manufacturing and services, while developing their natural resources of timber, fisheries and minerals. Sustained improvements in living standards can be achieved despite the emerging stresses in the international economic environment.

References


Despite any real pressure from within for change in their colonial status, external forces, in particular the United Nations Committee 24 on Decolonization, meant that ready or not, many Pacific island states were granted political sovereignty, beginning in the 1960s with Western Samoa.

While independence brought the inevitable trappings of a new nation—flag, national anthem, a written constitution, membership of a range of international bodies and above all indigenous leadership at the political level—it meant little, initially, within the commercial sector of national economies. Relationships established over generations persisted. Buyers for trading houses in the islands continued to purchase from those sources with which they were familiar. While the new leadership spoke of the need to 'localize' and seek out both new markets and sources of supply, merchants and the plantation community continued to relate to those off-shore colleagues with whom they had carried on business, often for decades past. On the other hand, outside the commercial sector, new economic vistas opened for the emerging political élite.

Aid, which during the colonial period was very much a matter to be negotiated between the governed and the governing, now provided an opportunity for the new leadership to move in novel and heady environments. Annual meetings of the World Bank and the International Monetary Fund allowed for the establishment of new contacts as well as the chance to lobby for soft loans or technical assistance. In the period of the cold war, donors of aid could be played off one against the other for a better deal. Aid, through whatever pipeline it was available, suddenly became an important tool in the management kit of both donor and recipient, and capable of exerting important influences on economic decision making.

While trade and aid are perhaps the principal features of the external relations of the island states at the government level, service industries, education, and finance are fields where government intervention is not wholly appropriate but where international contact can have important policy and profit implications.

Over the last decade or so island economies have performed in a sluggish fashion. Growth rates in GNP per capita indicate poor performance by Pacific island member countries between 1980 and 1990 (Table 3, Statistical Summary). Before seeking to identify new avenues for improving national income or creating more efficient economies it is important to review the present state of the islands' external economic relations.
The essential relationships

Trade

During the colonial period strong linkages were maintained with the dominant power and the partners who had established trading relationships both before and after the raising of the flag of the imperial nation. These were essentially twentieth century relationships that persisted on the basis of both convenience and the legal framework which encouraged, through fairly primitive tariff preferences, the islands to look to the colonial power and associated countries for their import needs and export destinations. Reinforcing this pattern of external trade were the shipping facilities which were closely linked with either the colonial power or the major trading houses. Thus, those often maligned (perhaps with justification in some instances) trading houses such as Burns Philip, Steamships Trading and W.R. Carpenter performed all the functions of a true multi-national at a time when the term had not been invented. The ‘home boats’ of the pre- and immediate post-war period served Fiji well, bringing regular cargoes from the United Kingdom which were discharged at Suva and then distributed throughout the Pacific by carriers of the trading houses.

With the advent of the aeroplane in the 1950s trading patterns began to change. New sources of supply, particularly for motor vehicles and goods to serve the demands of an expanding tourist industry, were identified within the Asia-Pacific region itself (Table 6, Statistical Summary). Independence tended to provide a spur for merchants, both old and newly emerging, to seek out new sources of supply to meet the needs of a steadily expanding indigenous middle class, and a burgeoning public service fuelled by an increasing flow of development assistance.

The range of exports originating from most of the island states has varied little in the period since independence, with the exception of Papua New Guinea where minerals now dominate. While the range of exports remains dominated by primary products in most other countries there have been some interesting developments over the last twenty years in terms of destination (Table 5, Statistical Summary).

For Papua New Guinea the dominant destination remains Australia, largely on account of gold exported for refining, with Japan emerging as an important destination for other minerals. Sugar exports from Fiji to the United Kingdom under the favourable terms offered by the Lomé Convention continue to be the major income source of that country although garment exports, encouraged by the South Pacific Regional Trade and Economic Cooperation Agreement (SPARTECA) have increased significantly as the result of government action to foster exports.

The remaining countries reveal a distinct move away from partners of 1970 (Table 5, Statistical Summary). Newly emerging industries, such as squash and timber from Tonga and Solomon Islands respectively, export to Japanese
External economic relations of Pacific island states

markets. Germany is important for Solomon Islands, Vanuatu and Kiribati as a market for coconut products.

In the period since attaining political independence the islands’ attempts to break with tradition in their trade relations have met with a reasonable degree of success. This has been partly due to an expansion in the range of domestic products of some countries as well as an active policy on the part of others to seek out new and more appropriate partners. Just what options exist for improving upon the status quo will be considered.

Aid

For most Pacific countries aid, or overseas development assistance (ODA), is a post-independence phenomena. Although development assistance was available in the colonial period it was limited in its application, small in amount and controlled by the colonial bureaucrats. Aid now flows in great quantity, takes many shapes and forms and emerges from numerous conduits. There has been much argument and debate over the merits of aid, the manner in which it should or should not be disbursed, and the policies and philosophies of both donor and recipient. The fact remains that it is an essential component in the external relations of Pacific island states.

While the debates continue, the number of donor agencies is increasing and the total volume of assistance remains high (Table 1).

ODA comes in numerous guises, such as cash grants, technical assistance, defence support and interest free loans. Such is the complexity of describing aid and determining where it has gone, that precision in the measurement of total aid to specific countries is virtually impossible. The figures in Table 1 are probably the best available and give a reasonable indication of magnitude in dollar terms.
Table 1  ODA by donor and amount to selected Pacific Island states, 1985–89 (US$mlllion)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Vanuatu</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Australia</td>
<td>4.4</td>
<td>5.3</td>
<td>9.1</td>
<td>9.0</td>
<td>13.8</td>
</tr>
<tr>
<td>New Zealand</td>
<td>1.0</td>
<td>1.0</td>
<td>1.6</td>
<td>2.2</td>
<td>1.3</td>
</tr>
<tr>
<td>Japan</td>
<td>0.8</td>
<td>1.1</td>
<td>5.6</td>
<td>3.7</td>
<td>2.9</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>6.6</td>
<td>6.3</td>
<td>7.7</td>
<td>8.8</td>
<td>8.7</td>
</tr>
<tr>
<td>EC and members&lt;sup&gt;a&lt;/sup&gt;</td>
<td>7.0</td>
<td>8.5</td>
<td>22.9</td>
<td>11.7</td>
<td>6.4</td>
</tr>
<tr>
<td>Multilateral agencies</td>
<td>0.7</td>
<td>1.0</td>
<td>2.2</td>
<td>1.2</td>
<td>4.5</td>
</tr>
<tr>
<td>UN agencies/other</td>
<td>1.3</td>
<td>1.2</td>
<td>1.9</td>
<td>2.7</td>
<td>2.2</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>21.8</td>
<td>24.4</td>
<td>51.0</td>
<td>39.3</td>
<td>39.8</td>
</tr>
</tbody>
</table>

| **Western Samoa** |      |      |      |      |      |
| Australia       | 5.3  | 3.4  | 6.0  | 7.3  | 7.6  |
| New Zealand     | 3.8  | 3.4  | 3.9  | 4.0  | 3.5  |
| Japan           | 1.8  | 9.2  | 6.9  | 7.7  | 6.0  |
| United Kingdom  | 0.1  | ..   | ..   | 0.1  | 0.1  |
| EC and members<sup>a</sup> | 2.8  | 3.6  | 10.5 | 6.5  | 5.2  |
| Multilateral agencies | 2.3  | 1.6  | 3.1  | 2.7  | 4.7  |
| UN agencies/other | 3.3  | 2.1  | 4.8  | 2.4  | 4.4  |
| **Total**       | 19.4 | ..   | ..   | 30.7 | 31.5 |

| **Tonga** |      |      |      |      |      |
| Australia  | 4.9  | 4.4  | 5.9  | 6.9  | 9.3  |
| New Zealand| 2.7  | 2.1  | 3.1  | 2.8  | 2.7  |
| Japan      | 1.3  | 3.6  | 5.1  | 3.5  | 5.4  |
| United Kingdom | 0.2  | 0.1  | 0.1  | 0.3  | 0.4  |
| EC and members<sup>a</sup> | 2.2  | 2.6  | 4.9  | 2.0  | 3.4  |
| Multilateral agencies | 1.0  | 1.3  | 1.1  | 2.4  | 2.6  |
| UN agencies/other | 2.3  | 1.0  | 1.1  | 0.9  | 0.9  |
| **Total**  | 14.6 | 15.1 | 21.3 | 18.8 | 24.7 |

| **Fiji** |      |      |      |      |      |
| Australia  | 10.0 | 13.8 | 11.3 | 19.8 | 18.7 |
| New Zealand| 3.4  | 2.3  | 3.8  | 1.8  | 2.7  |
| Japan      | 8.2  | 11.0 | 10.3 | 9.1  | 7.5  |
| United Kingdom | 1.8  | 1.6  | 0.9  | 0.5  | 1.8  |
| EC and members<sup>a</sup> | 5.1  | 9.2  | 5.8  | 15.5 | 6.1  |
| Multilateral agencies | 0.2  | 0.4  | ..   | 1.5  | 2.2  |
| UN agencies/other | 3.2  | 4.2  | 3.8  | 6.1  | 4.1  |
| **Total**  | 31.9 | 42.5 | ..   | 54.3 | 43.1 |

<sup>a</sup> Excluding the United Kingdom.

### Table 1 ODA by donor and amount to selected Pacific island states, 1985-1989 (US$ million)—continued

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Papua New Guinea</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Australia</td>
<td>227.0</td>
<td>222.3</td>
<td>217.2</td>
<td>240.9</td>
</tr>
<tr>
<td></td>
<td>New Zealand</td>
<td>2.9</td>
<td>1.7</td>
<td>2.1</td>
<td>2.6</td>
</tr>
<tr>
<td></td>
<td>Japan</td>
<td>4.0</td>
<td>10.4</td>
<td>17.7</td>
<td>41.2</td>
</tr>
<tr>
<td></td>
<td>United Kingdom</td>
<td>0.1</td>
<td>0.1</td>
<td>6.6</td>
<td>13.1</td>
</tr>
<tr>
<td></td>
<td>EC and members&lt;sup&gt;a&lt;/sup&gt;</td>
<td>9.2</td>
<td>18.1</td>
<td>67.6</td>
<td>63.3</td>
</tr>
<tr>
<td></td>
<td>Multilateral agencies</td>
<td>8.4</td>
<td>3.2</td>
<td>5.8</td>
<td>8.8</td>
</tr>
<tr>
<td></td>
<td>UN agencies/other</td>
<td>7.4</td>
<td>7.6</td>
<td>5.7</td>
<td>9.7</td>
</tr>
<tr>
<td></td>
<td>Total</td>
<td>258.9</td>
<td>263.4</td>
<td>322.7</td>
<td>379.6</td>
</tr>
<tr>
<td></td>
<td>Solomon Islands</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Australia</td>
<td>5.6</td>
<td>10.0</td>
<td>7.4</td>
<td>8.5</td>
</tr>
<tr>
<td></td>
<td>New Zealand</td>
<td>0.6</td>
<td>1.4</td>
<td>1.5</td>
<td>1.5</td>
</tr>
<tr>
<td></td>
<td>Japan</td>
<td>0.8</td>
<td>1.0</td>
<td>4.7</td>
<td>13.8</td>
</tr>
<tr>
<td></td>
<td>United Kingdom</td>
<td>5.3</td>
<td>5.5</td>
<td>8.1</td>
<td>9.3</td>
</tr>
<tr>
<td></td>
<td>EC and members&lt;sup&gt;a&lt;/sup&gt;</td>
<td>1.6</td>
<td>2.4</td>
<td>25.8</td>
<td>14.1</td>
</tr>
<tr>
<td></td>
<td>Multilateral agencies</td>
<td>3.4</td>
<td>4.3</td>
<td>6.3</td>
<td>7.6</td>
</tr>
<tr>
<td></td>
<td>UN agencies/other</td>
<td>3.5</td>
<td>5.5</td>
<td>3.3</td>
<td>3.4</td>
</tr>
<tr>
<td></td>
<td>Total</td>
<td>20.8</td>
<td>30.1</td>
<td>57.1</td>
<td>58.2</td>
</tr>
<tr>
<td></td>
<td>Kiribati</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Australia</td>
<td>2.6</td>
<td>2.4</td>
<td>2.5</td>
<td>1.8</td>
</tr>
<tr>
<td></td>
<td>New Zealand</td>
<td>0.9</td>
<td>0.9</td>
<td>1.8</td>
<td>1.7</td>
</tr>
<tr>
<td></td>
<td>Japan</td>
<td>2.8</td>
<td>4.3</td>
<td>6.5</td>
<td>5.3</td>
</tr>
<tr>
<td></td>
<td>United Kingdom</td>
<td>4.6</td>
<td>4.2</td>
<td>3.8</td>
<td>3.4</td>
</tr>
<tr>
<td></td>
<td>EC and members&lt;sup&gt;a&lt;/sup&gt;</td>
<td>0.5</td>
<td>1.1</td>
<td>2.1</td>
<td>2.8</td>
</tr>
<tr>
<td></td>
<td>Multilateral agencies</td>
<td>0.2</td>
<td>0.2</td>
<td>0.9</td>
<td>0.3</td>
</tr>
<tr>
<td></td>
<td>UN agencies/other</td>
<td>0.5</td>
<td>0.3</td>
<td>0.9</td>
<td>1.0</td>
</tr>
<tr>
<td></td>
<td>Total</td>
<td>12.1</td>
<td>13.4</td>
<td>18.5</td>
<td>16.3</td>
</tr>
<tr>
<td></td>
<td>Cook Islands</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Australia</td>
<td>..</td>
<td>0.6</td>
<td>0.8</td>
<td>1.7</td>
</tr>
<tr>
<td></td>
<td>New Zealand</td>
<td>..</td>
<td>22.5</td>
<td>8.3</td>
<td>8.8</td>
</tr>
<tr>
<td></td>
<td>Japan</td>
<td>..</td>
<td>2.1</td>
<td>0.3</td>
<td>0.2</td>
</tr>
<tr>
<td></td>
<td>United Kingdom</td>
<td>..</td>
<td>..</td>
<td>0.1</td>
<td>0.2</td>
</tr>
<tr>
<td></td>
<td>EC and members&lt;sup&gt;a&lt;/sup&gt;</td>
<td>..</td>
<td>0.3</td>
<td>0.2</td>
<td>..</td>
</tr>
<tr>
<td></td>
<td>Multilateral agencies</td>
<td>..</td>
<td>0.2</td>
<td>0.5</td>
<td>0.2</td>
</tr>
<tr>
<td></td>
<td>UN agencies/other</td>
<td>..</td>
<td>0.7</td>
<td>1.0</td>
<td>0.9</td>
</tr>
<tr>
<td></td>
<td>Total</td>
<td>..</td>
<td>26.4</td>
<td>11.2</td>
<td>12.0</td>
</tr>
</tbody>
</table>

<sup>a</sup> Excluding the United Kingdom.

Services

One area of their external economic relations in which the island states of the Pacific are able to exercise a high level of independence and initiative is services (Table 2). This is a comparatively new facet of economic endeavour on the part of island entrepreneurs and public sector innovators. Accordingly many of the constraints to external linkages, real or imagined, that exist in other sectors of national economies do not appear to inhibit the activities and policies of island governments, and participation by foreigners is welcome on terms laid down by the host nation.

Table 2 Contribution of service exports to total Forum island country exports, 1990

<table>
<thead>
<tr>
<th>Country</th>
<th>Total exports of goods and services (US$ million)</th>
<th>Total service exports (US$ million)</th>
<th>Service export share of Total exports (per cent)</th>
<th>GDP (per cent)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fiji</td>
<td>868.4</td>
<td>379.9</td>
<td>43.7</td>
<td>31.1</td>
</tr>
<tr>
<td>Kiribati</td>
<td>9.1</td>
<td>3.7</td>
<td>40.7</td>
<td>11.5</td>
</tr>
<tr>
<td>Papua New Guinea</td>
<td>1333.3</td>
<td>90.9</td>
<td>6.8</td>
<td>2.8</td>
</tr>
<tr>
<td>Solomon Islands</td>
<td>84.8</td>
<td>16.9</td>
<td>19.9</td>
<td>17.9</td>
</tr>
<tr>
<td>Tonga</td>
<td>19.9</td>
<td>10.9</td>
<td>54.8</td>
<td>22.1</td>
</tr>
<tr>
<td>Vanuatu</td>
<td>72.4</td>
<td>57.8</td>
<td>79.9</td>
<td>37.8</td>
</tr>
<tr>
<td>Western Samoa</td>
<td>37.6</td>
<td>28.9</td>
<td>76.6</td>
<td>63.0</td>
</tr>
<tr>
<td>Total</td>
<td>2425.5</td>
<td>589.0</td>
<td>24.3</td>
<td>11.8</td>
</tr>
</tbody>
</table>


While the services in which the islands participate on an international level are relatively small they are capable of expansion and development.

Tourism. The visitor industry can be both rewarding and fickle, subject to rapid movements in response to domestic and external shocks against which the island economies have little redress or protection. The military coups of 1987 impacted swiftly and dramatically on the industry in Fiji while cyclones in Vanuatu (Uma in 1987) and Western Samoa (Ofa in 1990) caused a dramatic fall in visitor numbers (Table 3).
External economic relations of Pacific island states

Table 3 Visitors to selected South Pacific island nations, 1985–92

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Fiji</td>
<td>221875</td>
<td>257824</td>
<td>189866</td>
<td>208155</td>
<td>250565</td>
<td>278996</td>
<td>259350</td>
<td>21608³</td>
</tr>
<tr>
<td>Papua New Guinea</td>
<td>30391</td>
<td>31900</td>
<td>34970</td>
<td>40529</td>
<td>48918</td>
<td>40742</td>
<td>17512</td>
<td>..</td>
</tr>
<tr>
<td>Solomon Islands</td>
<td>11974</td>
<td>11630</td>
<td>12555</td>
<td>10679</td>
<td>9860</td>
<td>9195</td>
<td>11105</td>
<td>..</td>
</tr>
<tr>
<td>Tonga</td>
<td>81199</td>
<td>44677</td>
<td>39570</td>
<td>40377</td>
<td>39230</td>
<td>38823</td>
<td>..</td>
<td>..</td>
</tr>
<tr>
<td>Vanuatu</td>
<td>18889</td>
<td>13197</td>
<td>9201</td>
<td>12420</td>
<td>17457</td>
<td>24283</td>
<td>28578</td>
<td>1298³</td>
</tr>
<tr>
<td>Western Samoa</td>
<td>43919</td>
<td>49710</td>
<td>48663</td>
<td>49088</td>
<td>54964</td>
<td>48211</td>
<td>..</td>
<td>..</td>
</tr>
</tbody>
</table>

a To March. b To June.

Source: South Pacific Economic and Social Database, National Centre for Development Studies, The Australian National University, Canberra.

Aggressive marketing in source countries following any form of shock in the host country can restore industry confidence and numbers, particularly if accompanied by concessionary fare and accommodation deals as the above data indicate. Despite efforts to widen the range of countries from which visitors are sourced, near neighbours continue to dominate the number of arrivals. Habit and tradition play an important role in the decision making process of the travelling community.

The definition of visitor may at some time require clarification to avoid over counting of visitors who in reality contribute to the national economy: it is likely that Australians shown as visitors to Papua New Guinea may hold fairly long-term work permits while the category Other probably represents a large number of islanders on home visits (Statistical Summary, Table 7).

Transport and communications. All islands are dependent on efficient transport and communications for the effective conduct of their external relations. This is particularly so in the Pacific where there are enormous distances not only between countries but between islands or atolls within countries. The classic dilemma is represented by Kiribati: 33 atolls spread over some 5 million square kilometres. The advent of the aeroplane has made both inter and intra-regional travel more reliable and easier, although costs are high and schedules often erratic. The fact that most of the states have opted for their own flag carrier has not made air travel either cheaper or easier. The prospects for a single regional carrier seem as far off now as they did some 30 years ago when air travel became a feature of the region. Cargo rates are high, but because of the advantages offered to some exports, such as garments, fresh leaf and root vegetables and other perishables, air is becoming more important in the trading position of some islands. Tourism remains the principle support of the airline industry and any action by any party that influences tourist destination preferences can have repercussions on airline viability.

Sea communications are still an important feature of the domestic and international trading patterns of the region, transporting both passenger traffic
and bulk cargoes, mainly of outbound agricultural products, and inbound machinery, vehicles, fuel and building materials. The regionally owned Forum Line, in direct competition with commercial carriers, plays an important role in serving the smaller states. As a result of new technologies, telecommunications in the region have improved dramatically in recent years. Lines are, however, heavily loaded in business hours, stressing but not seriously jeopardizing, commercial and government business. The introduction of facsimile facilities in all main centres has expedited business transactions considerably.

**Finance and banking.** Commercial and private business transactions are well served in the region by banking facilities, most of which have links with banks in the industrial economies of Australasia or the Indian sub-continent. The banking system, through international connections, plays an important role in the funding of both public and private sector development in a number of countries, particularly mining and petroleum in Papua New Guinea.

With the exception of Kiribati, Cook Islands, Niue, and Nauru, the South Pacific islands operate their currencies through the traditional central bank system. These institutions have adequate financial instruments to control international financial transactions and for the most part play an influential role in the development and implementation of macroeconomic policy.

**Foreign investment.** Each of the states has introduced legislation aimed at encouraging direct foreign investment, but a welcoming legal environment is not enough, and the effect of other factors such as lack of raw materials and skilled labour, distance from markets and costly service industries have inhibited large-scale investment in most states.

**Table 4  Net direct foreign investment, selected Pacific island states, 1980–91 (US$million)**

<table>
<thead>
<tr>
<th></th>
<th>Fiji</th>
<th>Solomon Islands</th>
<th>Tonga</th>
<th>Vanuatu</th>
<th>Western Samoa</th>
<th>Papua New Guinea</th>
</tr>
</thead>
<tbody>
<tr>
<td>1980</td>
<td>34.2</td>
<td>2.4</td>
<td>..</td>
<td>..</td>
<td>—</td>
<td>59.8</td>
</tr>
<tr>
<td>1981</td>
<td>37.6</td>
<td>0.2</td>
<td>..</td>
<td>..</td>
<td>—</td>
<td>85.6</td>
</tr>
<tr>
<td>1982</td>
<td>35.9</td>
<td>1.0</td>
<td>..</td>
<td>6.9</td>
<td>—</td>
<td>84.1</td>
</tr>
<tr>
<td>1983</td>
<td>32.0</td>
<td>0.3</td>
<td>..</td>
<td>5.9</td>
<td>—</td>
<td>137.7</td>
</tr>
<tr>
<td>1984</td>
<td>23.1</td>
<td>1.9</td>
<td>..</td>
<td>7.4</td>
<td>—</td>
<td>113.4</td>
</tr>
<tr>
<td>1985</td>
<td>42.8</td>
<td>0.9</td>
<td>..</td>
<td>4.6</td>
<td>—</td>
<td>82.4</td>
</tr>
<tr>
<td>1986</td>
<td>30.0</td>
<td>-1.0</td>
<td>0.1</td>
<td>2.0</td>
<td>—</td>
<td>99.5</td>
</tr>
<tr>
<td>1987</td>
<td>6.3</td>
<td>8.4</td>
<td>0.2</td>
<td>12.9</td>
<td>—</td>
<td>115.4</td>
</tr>
<tr>
<td>1988</td>
<td>48.6</td>
<td>3.4</td>
<td>0.1</td>
<td>10.8</td>
<td>—</td>
<td>119.7</td>
</tr>
<tr>
<td>1989</td>
<td>41.2</td>
<td>5.7</td>
<td>0.1</td>
<td>9.2</td>
<td>—</td>
<td>221.3</td>
</tr>
<tr>
<td>1990</td>
<td>100.9</td>
<td>12.9</td>
<td>0.1</td>
<td>13.2</td>
<td>—</td>
<td>..</td>
</tr>
<tr>
<td>1991</td>
<td>33.8</td>
<td>18.7</td>
<td>0.2</td>
<td>18.5</td>
<td>—</td>
<td>..</td>
</tr>
</tbody>
</table>

**Source:** International Monetary Fund, *International Financial Statistics*, Washington, DC, various issues.

---

89  Pacific Islands at the crossroads?
External economic relations of Pacific island states

Labour services. An important feature of the economies of Tonga and Western Samoa are remittances of cash and kind from those, mostly young, people who have emigrated to the industrial countries of the region (Table 5). The likelihood of these remittances continuing over the long term has been subject to much debate. Experience to date seems to indicate that a continuing flow of emigrants will ensure a continuing flow of remittances, but much depends on the long-term immigration policies of the receiving countries.

Table 5 Remittances to Tonga and Western Samoa compared with exports and imports, 1970–91 (national currency, million)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Western Samoa</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Remittances a</td>
<td>1.4</td>
<td>5.2</td>
<td>17.2</td>
<td>53.1</td>
<td>73.8</td>
<td>86.6</td>
<td>92.0</td>
<td>74.4</td>
</tr>
<tr>
<td>Exports</td>
<td>3.3</td>
<td>4.5</td>
<td>15.6</td>
<td>36.2</td>
<td>31.4</td>
<td>29.2</td>
<td>20.5</td>
<td>18.3</td>
</tr>
<tr>
<td>Imports</td>
<td>9.8</td>
<td>23.2</td>
<td>57.2</td>
<td>115.1</td>
<td>159.1</td>
<td>174.6</td>
<td>193.4</td>
<td>237.2</td>
</tr>
<tr>
<td><strong>Tonga</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Remittances b</td>
<td>11.1</td>
<td>29.1</td>
<td>36.6</td>
<td>38.4</td>
<td>36.8</td>
<td>35.6</td>
<td>46.5</td>
<td>45.3</td>
</tr>
<tr>
<td>Exports</td>
<td>8.4</td>
<td>10.7</td>
<td>8.2</td>
<td>10.4</td>
<td>8.8</td>
<td>12.1</td>
<td>11.6</td>
<td>14.6</td>
</tr>
<tr>
<td>Imports</td>
<td>30.1</td>
<td>51.6</td>
<td>60.3</td>
<td>65.6</td>
<td>68.7</td>
<td>68.9</td>
<td>72.7</td>
<td>79.8</td>
</tr>
</tbody>
</table>

a Total private transfers (net).
b Private transfers – receipts.


The vulnerability of the economies of these two countries is clearly demonstrated by reviewing the relationship between exports and imports. There are other countries in the region that count temporary worker migration as important in the management of their economies; these are Kiribati and Tuvalu which provide workers for the phosphate industry on Nauru and trained crews on merchant ships engaged in international trade. Opportunities for employment in Nauru and the earning of foreign exchange for the home nation are now strictly limited as phosphate deposits on Nauru expect to be worked out in some four years.

Education. The relationship between education as a service industry and the external economic relations of Pacific island states is critical to the future of the countries concerned. Despite a strongly expressed desire on the part of
national leaders at the time of independence for a wholly national public service and a substantial run-down in foreign workers in the private sector, such a position has not been achieved. It has not been for want of investment in the education of indigenous people that the objectives of the early leadership have not been reached. Indeed the investment in education by both the individual countries, through their domestic budgets, and a range of aid donors has been substantial. Despite these investments the number of expatriates in public services and the private sector is greater than during the colonial period. This situation is in part explained by a rapid growth in most public services fuelled by aid funds, by the needs of industry in some nations, by emigration of skilled workers, and by numbers of trained people opting for the village environment rather than the life of a city dweller. It is difficult to gather data on the number of full or part-time students from the islands enrolled in national or overseas tertiary or tertiary equivalent institutions. Numbers, however, do not reflect the critical position that some countries face in meeting the need for national staff to fill important technical and administrative posts. To meet these shortcomings, overseas resources will be needed for the foreseeable future and access to these are a fundamental part of the overall relationship between the islands and the industrial nations of the region and beyond.

Breaking free

Quite rightly and reasonably the island states of the Pacific are still concerned at the nexus (real or imagined) between themselves and the former colonial powers. It may well be that this colonial hang-over is only associated with the leadership that brought the individual countries to independence and that with passing of such leaders, as is now happening, the new, younger breed of leader will be content to enter into economic and other relationships that provide the greatest benefit for the country regardless of what the historical links may have been. Such a scenario is not too difficult to imagine: new opportunities and options are emerging with a regularity and on a scale that the already hard pressed bureaucracies of the islands must find difficult to manage. Many issues lie ahead for those island nations with the courage, determination, and capacity to explore the options which they now face in their external economic relations.

The new traders

In the Pacific, no less than elsewhere, it is issues in the field of international trade that have a major influence on the external economic relations of the states. The days of the island traders which played such a dominant role in the development of the region from first contact until the end of the second world war have now passed into history. In their place, as marketeers of primary produce, came the statutory marketing boards and authorities. Now even their role, on the grounds of efficiency in an increasingly competitive world, is being challenged. As the more developed states corporatize and privatize their marketing activities, so others have begun to follow suit. As price takers, efficiency at all levels of the production and marketing chain must be a prime consideration. To promote the rural sector and discourage the rural-urban drift,
Sir Julius Chan, when Minister for Trade in an earlier Papua New Guinea government, canvassed the idea of abandoning Australian budgetary aid in favour of using the equivalent funding to provide a floor price for all the country’s exports of primary produce to Australia, a novel concept which did not eventuate.

In recent years island governments have moved away, for the most part, from protectionism as a basis for building up domestic production and lifting the level of self sufficiency of their nation. Instead, led by Fiji in the aftermath of the 1987 coup, most countries have adopted policies that are export oriented and seek to build on the basis of their limited resources, relatively low wage rates and willing workforces. At the same time some governments have sought to bypass the private sector, still seen in certain quarters to be unduly unmindful of national needs, in developing new sources of supply for basic materials required in the development process. The classic case of how such policies can go astray was the FINAPECO debacle in Fiji where the Interim Government sought to become, against sound economic advice, the sole importer of petroleum in order to break an alleged cartel among existing suppliers and to move away from Australia as the traditional source of supply. The move, which involved external relations with Malaysia as the new supplier from its state-owned Petronas corporation, and the use of refining facilities at the Esso plant in Singapore, has now been abandoned on purely economic grounds and at a cost to Fiji’s taxpayers estimated to be in the region of F$2 million (The Review, Sept. 1992). The lesson to be learned from this not inexpensive exercise is that changing the existing order of economic relations needs to be carefully thought through before action is initiated.

It is right and proper that the independent states of the Pacific should examine existing trade relations carefully, with a view to making changes which will be to their advantage. However, in this day and age, with major changes likely to occur in the mechanisms that affect trading relations between nations such as the GATT, it is important that even countries as small as most in the Pacific be fully aware of the possible implications of these international negotiations before embarking on changes in their own existing arrangements. To alert Forum island countries to recent and impending changes in the global scene, the Trade Division of the Forum Secretariat recently organized a seminar at which experts briefed representatives of member nations on current developments in world trade negotiations. While the volume of trade generated by the region is minute in global terms (with perhaps the exception of gold and copper from Papua New Guinea), none the less the effects of decisions taken outside their region, perhaps with little or no concern for the region, could have disastrous consequences. Trading arrangements which most affect the Forum island countries are summarized below.

**Single European Market (SEM).** A number of Forum island countries are highly dependent for their export trade on the concessional entry of their products, mostly primary, into European countries under the provisions of the Lomé Convention. Reforms contemplated in the European Common Agricultural Policy (CAP) and moves towards the integration of European economies can be
expected to lead to an erosion of the advantages offered by Lomé. At the same time an integrated and economically growing Europe can offer opportunities for expanded world trade especially in agricultural products. Given the distance of Forum island countries from European markets there will need to be a marked increase in production efficiency if the islands are to continue to compete in, and benefit from, the SEM. While the changes in Europe needed to create a SEM may seem a long way off, now is the time to plan for the future.

**North American Free Trade Agreement (NAFTA).** Integration of the economies of the United States, Canada and Mexico has the potential to create an enormous market on the doorstep of the Forum island countries. However, the Agreement, if signed, will bring the islands into competition with Mexico as suppliers to the northern markets. To overcome the advantages which will accrue to Mexico under NAFTA, especially those relating to rules of origin, Forum island countries now exporting to the United States and/or Canada will need to lift their level of competitiveness, particularly in the fields of garment manufacture and agricultural produce. Hopes that the USAID project, Market Access and Regional Competitiveness, and the setting up of a Joint Consultative Committee for the Pacific might soften the possible effects of NAFTA on the Forum island countries, should not raise too high a level of expectations.

**Generalized System of Preferences (GSP).** This scheme seeks to provide preferred access to the markets of specified countries for the exports of developing countries. Those offering GSP privileges of value to Forum island countries include the United States and Canada (privileges that will be eroded if NAFTA comes into force), Japan and the Scandinavian countries. The GSP provides encouragement for the Forum island countries but only Fiji’s garment trade has taken significant advantage of the rights into north America.

**Association of South East Asian Nations (ASEAN).** While only Papua New Guinea, with observer status to ASEAN, has strong physical links with the region, there has been a desire by some Forum island countries to strengthen economic ties with the Association member countries in order to counter the perceived dominance of Australia and New Zealand in the region. Apart from the FINAPECO affair their have been a number of trade missions to the region and diplomatic posts established. There are, however, many constraints to be overcome if the Forum island countries are to make any headway in the ASEAN market. These include

- higher relative costs
- lower level of skills affecting their competitive edge
- their narrow range of exports.

On the other hand, a deal of interest has been expressed by ASEAN members in investing in the Pacific, possibly as a gateway to Europe through Lomé. An important recent development has been the establishment in Fiji of a new credit corporation, National MBF Finance Company, a joint venture between the National Bank of Fiji and Malaysia’s MBF group.
External economic relations of Pacific island states

South Pacific Regional Trade and Economic Cooperation Agreement (SPARTECA), Papua New Guinea Australia Trade and Commercial Relations Agreement (PATCRA). These are agreements between the Forum island countries and Australia and New Zealand in the case of SPARTECA and between the two parties nominated in the case of PATCRA. They are non-reciprocal treaties and are designed to admit all Forum island country exports (with nominated exceptions) to the two developed partners at zero duty. Rules of origin apply and herein lies much that has detracted from the benefits that the agreements were expected to provide. The agreements are considered to have been trade diversionary and have clouded broader issues concerning the direction and overall prospects of Forum island country trade relations with Australasia and other prospective partners. There have recently been moves to meet the objections levied against the rules of origin provisions but they may have come too late. As the two developed partners gradually reduce their tariffs against other trading partners so the advantages provided by the agreements are eroded.

Taking advantage of the world market

From this brief review of the arrangements which govern global trading it is obvious that the Pacific island states have a major task in negotiating their way around the complex provisions which regulate dealings between countries, if only on the grounds of the availability of technical staff. What lessons are there here for those bureaucrats and the emerging mercantilists of the private sector? The role of the bureaucrat is to be aware of those issues in international trade protocols which benefit or hinder the ability of the private sector to export, making a realistic return on investment.

As economic conditions generally improve so the demand for traded goods should pick up. The islands should expect to participate in this expansionary process but they will have to do so in competition with the rest of the world. They do receive some valuable concessions as regards the entry of their exports into the markets of specific countries, but these concessions must not be allowed to detract from the need to be competitive.

The islands will have to overcome the normal constraints which face them in doing business outside the region. Apart from lifting the quality of exports and ensuring price competitiveness on the basis of labour efficiency, the islands should look to countering problems of low volume production and distance from markets, for example by developing niche markets. While there is evidence of past success in niche markets, such as in the case of Tongan squash exports to Japan, and while prospects for similar agricultural niche markets are good, careful attention will have to be paid to the development of appropriate strategies so as to ensure prolonged benefits for the nation and the exporters (Fleming and Hardaker 1992). The role of governments must also be carefully defined so as to ensure that the national reputation for quality, consistency, reliability and compliance with international protocols is maintained.
While it is realistic to expect that the larger Pacific states should be capable of guiding and controlling their private sector entrepreneurs in export promotion, what about the smaller countries? Trade promotion through international missions and fairs is expensive and time consuming. Just keeping abreast with legislative changes is difficult; the main NAFTA document is alleged to comprise some 2000 pages. Trade commissions in Australia and New Zealand funded as part of SPARTECA are invaluable but these are essentially promotion agencies. Perhaps it is time for a more active regional approach through the existing facility, the Forum.

**Aid and overseas development assistance**

As much as most countries may wish it to be otherwise, it seems inevitable that aid, in some form or other, will be their lot for the foreseeable future. An exception could be Papua New Guinea, where a former Minister of Finance foreshadowed the prospect of the country becoming an aid donor on the basis of mineral and petroleum revenues. Breaking free from the aid crutch may not be practical for most, but there may be options for less obvious modes of support which might serve to strengthen regional and bilateral economic relations without evoking the rather crude sentiments which appeared in a recent lead article in a Fiji daily: 'it is in the sphere of aid-giving where neo colonial forces are strongest'. A little earlier in the same article: 'but what of neo colonialism? What of the forces of imperialism that continue to suck resources from the home lands of our Pacific people...' (The Daily Post 22 October 1992).

Perhaps in their efforts to be supportive and understanding of the problems of the islands, the donor countries have tried too hard. A recent joint announcement from the responsible ministers in Australia and New Zealand indicated that they are now prepared to provide recurrent cost finance for South Pacific aid projects. A generous gesture and certainly well intentioned but of questionable long-term help unless used as a means to ensure a more careful evaluation of the recurrent cost implications of capital projects. An over abundance of ODA has led to the rapid growth of island public services, to a diversion of human talent away from the private sector to the more obvious rewards of a government post, and to an avoidance of the hard decisions necessary in resource allocation when resources are in short supply.

**Services**

As already noted, the services sector of island economies provides them with the greatest opportunity to break free from the traditional regional linkages and demonstrate to the world a real spirit of enterprise and initiative. Opportunities exist in a wide range of services: tourism, aviation, communications, education, migrant workers, financial services, information technology, accounting and consulting services. For the services sector to fulfil its potential in individual states it would seem that a high degree of regional cooperation is an essential prerequisite in skills development, the avoidance of counterproductive
competition, and the development of policies which give the Pacific islands a strong capability to take on the rest of the world in the various fields chosen for exploitation. While it is important that the services sector take an outward looking position for some activities (e.g. the finance sector, and labour services such as demonstrated by Fiji’s peace keeping role in the Middle East), the domestic and intra-regional opportunities must not be overlooked. Tourism obviously provides the best opportunity for local service development and this can be done on a variety of levels. Where international capital is involved there must be recognition of its extreme volatility and that the Pacific has no lien on the ultimate resting place that it may choose. Tax breaks have little attraction for the international financier who looks for stability in macroeconomic policy, a realistic law and order situation, and a fair return on capital as a pre-requisite to the commitment of investment capital. Those Pacific states that look, as indeed they should, to foreign investment as a major factor in their future development, must not rely solely on attractive legal provisions as the come-on for international entrepreneurs, but rather an internal environment which reflects a stable and welcoming country.

Regional solutions

It is important that the islands of the Pacific have access to an efficient and broadly based regional organization which can, especially in the case of the smaller states, represent their interests in international fora and bring to their attention matters of importance which an over-committed bureaucracy may overlook. Shortly after the second world war, the colonial powers with interests in the region established the South Pacific Commission (SPC) with a mandate to address regional issues of common interest. The Commission was to be apolitical and membership restricted to independent states. From its inception the SPC has tended to concentrate on social issues, health and education as well as natural resource development (agriculture and fisheries). As the number of independent island states grew the emerging leadership began to fret over the no politics protocol and in 1974 under the leadership of Fiji’s Prime Minister Mara the Pacific Island Producers Association (a lobby group of island leaders set up to press for better access for their island produce into New Zealand) formed itself into the South Pacific Forum (the Forum). The Forum, whose members could only include independent states in the region, including perhaps unfortunately Australia and New Zealand, set itself a quite different agenda from that followed by the SPC. In addition to political issues, which attracted a high profile, the Forum addressed itself to economic, communications, trade, investment and development assistance issues.

A 1976 review of aid to the South Pacific included, among some twenty-four recommendations, one which proposed a ‘Move towards a comprehensive regional organisation’ (South Pacific Bureau for Economic Cooperation 1976:3). In doing so the review group noted the considerable number of regional bodies and came to the conclusion that the countries of the Pacific would be best served by the amalgamation of the Forum and SPC, such integration taking place over a three year period. The idea of a single regional organization (SRO)
was taken up with enthusiasm by some. Paulius Matane, New Guinea's Secretary for Foreign Affairs, was a most enthusiastic advocate. There was opposition to the idea, particularly by those such as the French territories, who would not qualify to join an enlarged Forum on the grounds of not being an independent Pacific state. The battle for and against a single regional organization waxed strongly for some years with neither side willing to yield until the 'Pacific way' led to a compromise with the setting-up of a South Pacific Organisations Co-ordinating Committee (SPOCC) comprising a range of regional executive bodies such as the Forum Fisheries Agency, the University of the South Pacific and the two major bodies, Forum and SPC. The SPOCC was to meet annually with the view to coordinating the various activities.

For the time being at least, the concept of a single regional organization appears to be off the agenda of island governments, more's the pity. At a recent regional meeting a senior diplomat was asked about the prospects of reviving the idea as a sensible way of strengthening the islands' position in international economic negotiations generally. His response was forthright. 'SRO is off the agenda, it's dead, it's divisive, forget it!' From the purely pragmatic point of view this seems tragic as surely there are many benefits to be gained from one strong regional body which represents the interests of all. Is there no room for compromise? Would not some of the external relations of the Pacific island states, particularly the smaller ones, be served more effectively by some form of regional body?

One suggestion by Kasper is that the 'Pacific nations could become (politically and culturally different) "cantsons" within a Pacific Economic and Currency Union' (Bauer, Siwatibau and Kasper 1991:77). Given the recent technical developments in communications, Kasper sees this idea as feasible for the smaller countries initially with others joining as the benefits of such a union become apparent. As attractive as the idea of a more integrated form of regional body might be to some there are vested interests which would be reluctant to see the prerequisites of political and bureaucratic office move elsewhere. However, it is worth recording some of the advantages of such a move, including those perceived by Kasper.

- A currency union which adopted an internationally recognized currency would be less costly, provide for macroeconomic stability and be attractive to foreign investors. Presently six island states have their own currency; the others use either Australian, New Zealand, or US dollars. The French Territories use the Pacific franc linked to the French franc. The central bankers of the independent currency states meet annually with their Australian and New Zealand colleagues to discuss a range of operational issues, not it is suspected, a currency union! A first step towards a degree of integration (of sorts) might be agreement by the Reserve Bank of Australia to act as the clearing house for the other banks' foreign exchange dealings.

- Common trade policies and possibly some form of customs union could facilitate inter and intra-regional trade. The matter has been examined
External economic relations of Pacific island states

(Drake and Hall 1987), but thus far only Fiji has taken a positive step by offering duty free access to all Forum member product operations (presumably conditions will apply). The political grouping, the Melanesian Spearhead, comprising Papua New Guinea, Solomon Islands and Vanuatu is proposing a trade agreement which is expected to allow the duty free entry of certain domestic products into each others market; tea from Papua New Guinea, tinned fish from Solomon Islands and beef from Vanuatu.

- Transport and communications provide a great opportunity for cost savings and increases in efficiency through a major program of rationalization.

- Diplomatic and trade representation organized on the basis of a Pacific union of states could offer opportunities for cost sharing and more efficient operations.

- The management of regional and national aid programs through the operation of a World Bank type consultative group for the smaller states could offer increased efficiency and possibly the more effective allocation of resources.

- Amalgamating the existing functions of the specifically regional bodies, and they are numerous (both the bodies and the functions), would offer real opportunities for increasing administrative efficiency, cost savings and hopefully a better service with a greater proportion of funds going to the purpose for which they were allocated and not overheads.

**Conclusion**

It is important that the opportunities that exist in the Pacific are optimized and this can only be done through the skilful management of external economic relations by the Pacific island states, either alone or collectively. These relations, for the most part involve trade, aid and service activities. Not all the states of the Pacific can participate equally in the beneficial exploitation of the regions resources for the simple reason that they are not divided equally between states. Political unity and a sharing of economic benefits is still a vision in the minds of the dreamers so it is left to those responsible at the time to ensure the adoption of policies which maximize current opportunities while preserving the natural and social environment for future generations.

While aid has an important place in the development of the Pacific states it should not be overvalued but used to underpin those activities which the island leaders, in all sectors of the community, can control and direct. Policies which affect the efficient promotion and the beneficial effects of trade and services must be accorded high priority and appropriate steps taken to ensure their proper implementation. Monitoring and ongoing evaluation of policy initiatives, particularly their effect on the local population is important. It must be recognized that policies alone are not enough to ensure harmonious and rewarding economic relations. The national infrastructure must also be responsive to the objectives and goals of the leaders and the reasonable needs of investors. Education and skills development, efficient service industries, a
quality law and order situation and a committed public service are essential ingredients for success in today's competitive environment. In this day and age the unique characteristics of the Pacific count for little in the eyes of the outside world as countries struggle for economic and social survival. If the islands aspire to progress in modern terms the decisions are theirs and theirs alone.

References


The Daily Post (Suva), 1992.


In the mid to late 1980s, much was written of the coming 'Pacific Century', a phenomenon referring in great part to the rapid growth and dynamism not just of Japan, but also of the newly industrializing economies, ASEAN, and China, and of their increasing role in the region and the world trading system. Some of the highest economic growth rates in the world have occurred in several East and Southeast Asian nations. Asian developing economies as a whole averaged more than 6 per cent real economic growth in the 1980s compared to 3 per cent for other developing economies. With this strong economic performance, trade among economies in the Pacific region grew faster than trade with other regions. By 1988, at least half of the exports of all economies in the region went to Asia Pacific markets. The United States has been a key factor in this trend: it served as a consumption centre with Asia being the production centre.

One unique aspect of the region has been the graduation of economies from the ranks of developing to industrialized. Trade in the region was based on changing comparative advantage which allowed economies to specialize in different products and gain from the technology of those ahead of them on the ladder of industrialization. As Japan moved up the ladder of industrialization, it provided the necessary capital and technology to support the industrialization of the other economies in the region. Following on the heels of Japan, Hong Kong, Korea, Singapore and Taiwan have moved from labour-intensive to capital-intensive manufactures. These newly industrializing economies have done the same with the larger resource-rich economies of the Association of Southeast Asian Nations (ASEAN) following close behind them (with the exception of the Philippines). Malaysia and Thailand are now considered to be the next newly industrializing economies.

Japan, in particular, has been serving as a growth pole for developing Asia, both as a source of direct foreign investment and official development assistance, and also as a growing market for manufactures exports. Likewise, the newly industrializing economies are increasing their direct foreign investment in ASEAN at a rapid rate, even exceeding that of Japan in several key markets in ASEAN and China. These new investments will be followed by higher levels of trade flows. The Asia Pacific region has become truly interdependent. Increasing reliance on the international marketplace occurred naturally as an outcome of outward-oriented policies and increasing regionalization of production.

Factors contributing to regionalism in the Asia Pacific region

The most interesting characteristic of this increasing interdependence in Asia is that it is purely market driven; no formal trading arrangement has promoted it.
Since national economic processes have become linked and because it was not jointly planned, some relationships have become strained due to negotiation and adjustment failures. By necessity, Asia Pacific economies are supporters of freer trade, since they are dependent for growth on outward-oriented policies. Regional economic cooperation can, therefore, be a step towards freer trade and can diffuse tensions arising from a high level of interdependence.

In contrast, there are trading blocs which have emerged through institutional arrangements and which are causing great uncertainties in the contemporary world order. The main protagonist has been Europe. Its integration into a single market has led to fears of it becoming inwardly focused (Robertson 1992). It is not to suggest that it will become a 'fortress Europe' creating new trade barriers to the outside world, rather, it is a new Europe preoccupied with its own problems. Another concern is the formation of the North American Free Trade Agreement (NAFTA) by the United States, Canada and Mexico and the probable inclusion of other Latin American countries. This would culminate in a hemisphere-wide free trade agreement as espoused by the 'Enterprise for the Americas Initiative'. From the perspective of Asian economies which are outside these schemes, the interesting question to ask is, should they pursue similar schemes of their own?

This difficult issue is further complicated, in that GATT, the multilateral trading system which adheres to the principle of free trade and progressive tariff reductions, is at a crossroad. The Uruguay Round of GATT negotiations has stalled. In the meantime, the United States, which used to champion free trade, is now less willing to push for free trade at any cost. This is likely to be particularly true under the Clinton Administration. Unfortunately, Japan and the new economic superpowers in Europe have not adopted the expected leadership that could nurture the principle of non-discrimination in the world trading regime. What could be the likely consequences of these developments to Asia?

In the past few years, instead of a 'Pacific century', there have been apprehensions that Asia will be left to fight an increasingly hostile and polarized world. For example, MIT economist Lester Thurow contends that the time is over when all countries could prosper by finding niches in the world economy; instead, the future will bring 'head to head' competition which means that for every winner there is a corresponding loser. He also made the famous (or infamous) announcement that the 'GATT is dead' and that a tripolar world will emerge consisting of the United States, Europe and Japan. He argues that each will vie for dominance in key strategic industries, a new kind of economic race to replace that of the Cold War, and a race in which the winner, aptly, will stay ahead. Interestingly, Thurow predicts that Europe will most likely prevail.

As Bhagwati (1991:7) would say, 'Thurow is dead wrong' about GATT being dead. GATT's vitality and importance can be gleaned from the increase in the number of GATT members, from 86 in 1982 to over 100 in 1992, and also from the significant rise in the number of dispute settlement cases coming to GATT. The GATT certainly needs change to accommodate a changed world where
reduction of tariffs is diminished in importance, and non-tariff issues (such as trade in services, trade-related investment measures, trade related intellectual property rights, among others) are at the centre of trade conflicts. Although the success of the current Uruguay Round is not guaranteed, by most judgements, GATT lives.

Our decisive response to Thurow's prognosis is to remind him that there will be no real winner in a global economic war. All participants will suffer, initially consumers, and ultimately producers of all nations will be losers. The world economy can be compared to a sporting arena, the best prepared will win. In this race, the winner gets the gold, while all participants gain from the experience of the race. By being cooperative with one another, economies can increase their gains. The driving force should, therefore, be to achieve freer trade by encouraging cooperation both within and across regions.

Initiatives for Asia Pacific economic cooperation

The emergence of a tri-polar world practising inward-looking policies and exclusivity would work to the detriment of Asia. In response to the trend towards bilateralism in the rest of the world, Asian countries have proposed various schemes to form regional groupings. The East Asian Economic Caucus (EAEC), a Malaysian proposal which includes all East Asian and Southeast Asian countries, was initially proposed as a sort of trade bloc to counter the blocs in North America and Europe. The group has since been watered down to be a consultative body. We believe that two main reasons account for the lack of consensus support for EAEC: one relates to the exclusion of the United States from the group; the other, is the leadership vacuum associated with a purely Asian bloc. The United States continues to be the most important market for Asia, especially for manufactures, it is also an important investor, and it continues to play a key diplomatic and security role in the Asia Pacific region. It is uncertain whether Japan is willing to play the kind of leadership role established by the United States in the region and how much resistance exists against Japan taking such a role.

Meanwhile, in view of rising economic interdependence in trade, investment, and services, there is a need for an Asia Pacific organization that can foster economic cooperation, reduce bilateral disputes and facilitate exchange of information. Present efforts to establish a formal agreement for Asia Pacific cooperation can be seen as an acknowledgement of the increasing interdependence that has already occurred. There has been no formal organization coordinating trade and development issues, but there are two private sector initiated regional organizations: business people, including bankers meet at the Pacific Basin Economic Council (PBEC) and scholars meet at the Pacific Trade and Development Conference (PAFTAD). The Pacific Economic Cooperation Conference (PECC) is more widely based with a tripartite participation on a private capacity by government officials, businessmen, and academics. These meetings concentrate on consensus-building through
consultation on economic cooperation but do not attempt to build an institutional framework to resolve regional issues.

A major organization and currently the best candidate to fulfill the role of regional coordinator is the Asia Pacific Economic Cooperation (APEC), a mechanism consisting of inter-governmental meetings. In particular, Australia has demonstrated leadership in institutional development in the region as shown by its critical role in hosting the inaugural meetings of both the Pacific Economic Cooperation Conference (PECC) in 1980 and APEC in 1989. APEC was organized under the initiative of the then Australian Prime Minister Hawke in 1989, and now encompasses fifteen economies: the United States, Japan, South Korea, Taiwan, Hong Kong, China, ASEAN countries, Canada, Australia and New Zealand. The importance of the United States being part of APEC is underscored.

While it is only in its early stages of formation, having just set up a small secretariat in Singapore, APEC has considerable potential for linking Asia with the rest of the world in a cooperative mode. First, since Canada and the United States are members both of APEC and NAFTA, APEC has the capacity to influence the United States not to make NAFTA an inward-looking trade bloc. This development is likely to be of great concern to the Pacific islands; their economies are very open and the bulk of their exports are concentrated on a few primary products (sugar, coffee, copra, coconut products, timber, fish). Recently, Fiji has stated particular concern over the potential consequences of NAFTA on its sugar and textile exports. So far, it is the only Pacific island country that has expressed fears of market closure stemming from NAFTA. If APEC can be an alliance relationship with the United States and other industrialized economies in the Pacific as well as Asian countries, there will be greater incentive for Pacific islands to gain membership in APEC. APEC can serve as a forum for the United States to discuss bilateral disputes with Asian and Pacific countries. Since most of the US disputes are with Asian countries, APEC as a regional complement to GATT could be used to work out these disputes in a regional context. The use of unilateralism and ‘crowbarism’ may not be needed, they only serve to exacerbate bilateral disputes. This will ensure that NAFTA will not alienate Asia and the Pacific but rather should be brought into the Asia Pacific context.

Second, APEC’s goal should be to work as an Asian version of a consultative organization similar to the Organization for Economic Cooperation and Development (OECD), before moving on to greater things. APEC should not be seen as a challenge to GATT but as an organization that complements it. The concept of ‘open regionalism’ which was recently endorsed by Arthur Dunkel, Secretary General of GATT, in the PECC IX meeting, is a promising model for the Asia Pacific region. The recently announced ASEAN Free Trade Area (AFTA), which is to be created over 15 years, is a concrete example of a regional grouping which is consistent with the goals and the promotion of APEC. APEC should advocate membership of the Pacific islands as they, too, are members of PECC and participate in several of the sub-committees. At present, the Pacific Islands at the crossroads?
island nations (through the South Pacific Forum) have observer status and participate in the various working groups. Similarly, APEC should also encourage membership by some Latin American countries, with Mexico logically being the first to join, since it already is part of NAFTA.

Third, APEC can provide Japan the opportunity to learn what it means to be a global leader by starting at the regional level. Japan, being an economic powerhouse, needs to assume the responsibilities that go with it. Japan can play a leadership role, with the United States by its side, in APEC. Therefore, Japan can assume greater leadership without creating any security fears.

In sum, APEC can prompt countries of the Asia Pacific region to forge closer economic cooperation, and widen and deepen regional integration.

Pacific islands and Asia Pacific economic cooperation

As mentioned earlier, the Pacific islands are part of the Pacific but they are omitted in the discussions of Asia Pacific cooperation. It is important to consider why the Pacific islands are left out of the concept.

There are two basic reasons for this exclusion. First, the size of the Pacific islands group is small in terms of population and economic strength. There are less than 6 million people in the Pacific islands, representing less than 0.5 percent of the total GDP and population in the Asia Pacific region. Second, the island nations are spread over a wide area and are not recognized as a cohesive entity. They are remarkably diverse culturally, politically and economically. Given their small size, diverse background, and the large distances between them, it is not too surprising that the Pacific islands have been overlooked. It is also interesting to know that multilateral financial organizations, like the World Bank, find per country cost of project appraisals in the Pacific islands very high because of the difficulty and cost of dealing with so many island countries spanning a vast area of the Pacific and wide range of concerns. Most often, Pacific islands’ concerns are left to the Asian Development Bank. This contributes to the apparent lack of interest in this part of the Pacific.

This neglect cannot and should not continue. The Pacific islands should participate actively in Asia Pacific cooperation efforts. By participating, the Pacific islands can enhance their overall development through the expansion of trade and investment. The financial resources and technology needed to push the Pacific islands beyond their level of development would be more readily available. At the same time, the islands have a lot to offer a regional cooperation scheme. The group offers a strategic location in the middle of the Pacific. The island nations have valuable fishing access agreements with other countries both inside and outside the region. There is significant flow of tourists from the APEC nations to the Pacific islands, as well as impressive and growing volumes of foreign investments in tourism and other economic activities. In the future, there is also potential for regional cooperation in seabed mining in these island
nations. Regional cooperation would also reduce the transaction costs of donor nations in administering aid programs in the Pacific island countries.

**Involving the Pacific islands**

We propose two steps that will help to improve the visibility of the Pacific islands. First, the Pacific island economies must improve their economic performance. This will provide a more conducive environment for trade and investment. This, of course, is a very large undertaking. Not only must they continue to liberalize their economies and to ease restrictions on foreign direct investment, but, fundamentally, they need to upgrade their infrastructure and to re-examine their legal and social institutions. Infrastructure, such as roads, transportation and communication systems, is a requirement of development but especially important is improved education. The shortage of skilled labour and low labour productivity are two major constraints to economic growth of Pacific island nations. The land tenure system is a serious impediment to investment in virtually all the island countries, as is labour policy, such as minimum wage regulations, in a number of countries. Island governments must also practise greater fiscal integrity. They must also wean themselves from their present levels of dependence on external aid. Significant progress in accomplishing these goals will improve both their economic performance and their image and acceptance among governments in regional groups.

Second, they must take a much more regional approach to economic development. This means that they must consolidate themselves and agree on critical issues of mutual concern, as well as look at broader Asia Pacific cooperation. Already some organizations, such as the South Pacific Forum (SPF), are in existence and can be built.

Admittedly, it is not a simple task to overcome differences and present a united front on important issues. But it is important to look toward other economies in the region. As in the case of ASEAN, a Pacific island community may have a stronger voice than the sum of the individual members. This will not only help to ensure that their concerns are heard in an Asia Pacific forum, but will also allow them to deal more effectively with bilateral donors, such as the United States, Japan and Australia, and international organizations such as the ADB, World Bank and UNDP.

There are a few possible ways that the Pacific island economies can cooperate for mutual benefit. Bilateral and multilateral donors often find it difficult to come up with regional projects and loans. For example, ADB gives loans to the individual ASEAN countries but has not extended loans for ASEAN regional projects. One reason is that there is no clear institutional medium to develop and appraise regional projects and which can be responsible for the financial viability of such undertaking. If a country can come up with good proposals, perhaps by developing a 'soft' cooperation network through international symposia, and in conjunction with academic and technical institutions like the Asian and Pacific Development Centre (APDC), the Pacific islands may be able
to find support for important projects that can help the entire group. Clearly, Japan has the funds to support development in the region, but Japanese aid has been dispensed basically on a request basis. The United States, in addition, has the technical expertise and experience. Both the United States and Japan are in agreement that cooperation will increase the effectiveness of their aid programs.

A good first step towards closer economic cooperation may be an industrial cooperation scheme established along lines similar to the ASEAN Industrial Joint Venture. Under this program, private firms from two member countries can form a joint venture and sell their products virtually tariff-free in the participating countries. A key element of the agreement is that foreign firms are also allowed to participate in the joint venture and can contribute up to 60 per cent of the necessary capital. Cooperation in other areas such as tourism can also be mutually beneficial to all.

In terms of cooperation on a broader regional basis, the Pacific islands would not be expected to participate on the same basis as the larger countries in the region. Even as a cohesive group, the Pacific islands are small relative to their neighbours and they have not achieved the same level of development. Thus, they should push for special consideration and treatment. Although APEC treats member countries equally, differential treatment is not ruled out if it is based on justifiable grounds. It is not out of the question for even the ASEAN countries to receive special and differential treatment. Some precedent for special and differential treatment is already present in the South Pacific Regional Trade and Economic Cooperation (SPARTECA), which provides for the removal of import controls in New Zealand and Australia for the South Pacific countries.

The issue of whether the Pacific island nations should join APEC as separate individual members, or be represented through the South Pacific Forum has not been considered. The Forum member nations have not thoroughly discussed this issue themselves. At present, it appears that Fiji and Papua New Guinea aspire to become fully-fledged members. It is, however, unlikely that the current fifteen members of APEC will permit all the Forum member nations to have individual membership. Thus, the issue of membership status still needs to be resolved. This should not detract from the fundamental argument that membership of Pacific island nations in a larger regional organization, such as APEC, will yield benefits to both its current members and the island nations.

The Pacific islands must actively participate in discussions regarding the concept of Pacific economic cooperation to ensure that they are not left out. At the same time, the individual island nations must make a serious commitment among themselves to greater cooperation. This will not only give them a stronger voice in regional cooperation groupings but will improve their accessibility to outside sources of funding for research and development projects. Remaining passive would definitely be inimical to taking control of one's own destiny. The prosperity of the Pacific Century should also include the prosperity of the Pacific islands.
References


The impact of the net inflow of external resources on the recipient economy is a subject of continuing research. Although external resources augment the total availability of investible resources in the recipient economy, their actual impact on domestic saving, domestic investment and economic growth varies from economy to economy and from time to time. If these foreign funds are used judiciously, they favour economic growth by raising investment capacity and encouraging technological transfers. It is equally possible, however, that these inflows substitute for domestic saving.

Net inflow of external resources is defined, for the purpose of this paper, as the sum of net exports of factor services, net official transfers, net private transfers and net capital inflows in the form of foreign direct investment, overseas borrowing, other capital inflows and the movements in foreign reserves. Exports of merchandise goods and non-factor services are part of domestic production sold to the rest of the world and although returns from such sales are foreign exchange, these receipts are treated as domestic resources.

Due to data constraints, modelling the direct and indirect effects of the inflow of external resources on domestic saving and economic growth and the contribution of net capital inflow to economic growth is confined to Papua New Guinea, Fiji and Tonga, where sufficient time series are available. The modelling results may apply specifically to these three island economies, however, they enable some generalizations about the effect of external inflows on other small island economies.

Characteristics of small island economies

The islands of the South Pacific are characterized by being small in terms of population and land area, fragmentation, remoteness from metropolitan economies, and subsistence affluence. Although Cole and Hughes (1988) and Elek et al. (1991) emphasize that being small is not in itself a handicap to economic development. Kioa (1992) maintains that small size, as well as other characteristics of the islands, not only influences their respective level of development, standard of living and rate of economic growth, but limits possible development strategies.

Small land area limits the capability of the islands to support and accommodate human population and this magnifies the problems associated with population growth. It also narrows, with few exceptions, the range of natural resources available.
With the exception of Papua New Guinea, small land area in the South Pacific islands, especially the Kiribati and Cook Islands, is associated with fragmentation and remoteness from large economies. Fragmentation and remoteness create high transportation, communication and information costs that not only impede international factor mobility and flows of commercial and technical information, but also contribute to low participation of local entrepreneurs and reduction of business confidence on the islands (Helleiner 1982; Treadgold 1988).

Remoteness and fragmentation also make the allocation and distribution of public goods and services, especially health and education, costly, and contribute to the concentration of island population in the main urban centres as citizens find it difficult to obtain quality education and health facilities in remote island villages.

Subsistence affluence has given the island population an aura of well-being and despite the level of development being categorized together with those in low income economies, the islands are not considered to be poor by international standards (Australia 1989:8). Starvation and malnutrition, characteristically present in most developing economies, are virtually non-existent in the islands.

A small population means a small labour force with limited labour skills and hence limited labour productivity. High population growth, especially in the Solomon Islands and Vanuatu, which are among the five countries in the world with highest population growth (World Bank 1989), has led to a very youthful composition of the population with correspondingly high demands for health and educational facilities, putting pressure on both the level and direction of public expenditures.

There is a compensatory advantage for having a small population in that small nations may find it relatively easy to make social adjustments and implement economic reforms (Kuznets 1960:28; Blazic-Metzner and Hughes 1982:56; Elek et al. 1991:2).

Domestic production in the islands concentrates on a limited number of industries and a handful of products. Export earnings therefore rely on a few primary commodities and domestic demand falls heavily on imported goods and services. Treadgold (1988:270) and Lloyd and Sundrum (1982:28) argue that limited production possibilities in small economies reduce their capacity to adjust to shocks and thus lower the profitability of leading sectors.

The islands' own economic policies, small resource base, institutional structures and cultural attitudes are fundamental to their task of economic development (Kioa 1992). The islands are, however, open economies, integrated into the global markets through capital flows, technological transfers, migration and policy actions such as re-alignments of exchange rates of major trading partners. The characteristics of the islands and their economies necessitate the import of goods and services (requiring export earnings), official transfers (especially foreign aid) and private transfers (especially workers' remittances)
Impact of external resources inflow on island economies

from abroad. These inflows of external resources are very important in the economic development of the South Pacific islands.

Inflow of external resources to the South Pacific islands

The inflow of external resources to the small islands is channelled in various ways. Exports of factor services, private and official current transfers received from abroad, overseas borrowing, direct foreign investment and other capital transfers are examples of ways foreign resources flow into the economies.

Some statistics on domestic saving, which include net receipts from exports of goods and non-factor services and inflows of external resources to the islands are shown (Table 1). Over the period 1985–89, Papua New Guinea experienced a positive visible trade balance (a contribution of its mineral exports) while other small island economies suffered from the common problem of deficit merchandise trade balance. With the net inflow of receipts from exports of factor and non-factor services, all economies remained net debtors, including Papua New Guinea, despite the impact of boosted tourism on Fiji and mineral exports from Papua New Guinea. The effect of the inflow of current transfers on net exports of goods and services registered more comfortable balances in the current accounts of island economies except for Papua New Guinea and the Solomon Islands. They registered current account deficits of US$226.8 million and US$15.2 million respectively.

Kioa (1992) argues that exports earnings in Tonga are artificially low as some export earnings are being recorded as remittances. Some Tongan farmers ship their agricultural produce to be marketed by relatives and friends in Australia and New Zealand. The returns are remitted back to Tonga and instead of being reported as part of export earnings, they are reported as remittances.

Net current transfers received from abroad

The importance of foreign expatriates and workers to Papua New Guinea is reflected by the significant net outflow of private transfers from the economy. In Fiji, the presence of foreign expatriates, combined with emigration of ethnic Indians, especially after 1987, also shows a significant net outflow of private transfers. All island economies seem to receive significant official transfers. Judging from the percentages of their respective gross domestic products, net receipts from current transfers is a significant source of income to the islands.

Many Tongans and Western Samoans work overseas and send remittances home (Tables 1 and 2). Ahlburg (1991) showed that in 1989, 43 per cent of private remittances to Western Samoa came from New Zealand, 32 per cent from the United States, 11 per cent from American Samoa and 9 per cent from Australia. In the same year, Tonga received 49 per cent of its private remittances from the United States, 24 per cent from Australia and 22 per cent from New Zealand. As indicated by the ratio of net official transfers to gross domestic product, Solomon Islands, Vanuatu, Western Samoa and most of the island states, receive significant
amounts of official assistance. The dependent territories such as French Polynesia, New Caledonia, American Samoa, Niue, Tokelau, etc., receive more aid per capita than the full independent economies. Carew-Reid (1989:113) showed that in 1985, the population of all developing countries and territories was 3,672 million, of which only 0.14 per cent lived in the South Pacific islands. Nevertheless, the South Pacific islands receive 3.5 per cent of the US$37 billion of official development assistance flows to developing economies.

### Table 1  Saving and inflows of external resources (average for 1985–89, current prices, US$million)

<table>
<thead>
<tr>
<th></th>
<th>Papua New Guinea</th>
<th>Fiji</th>
<th>Solomon Islands</th>
<th>Western Samoa</th>
<th>Vanuatu</th>
<th>Tonga</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net exports of merchandise goods</td>
<td>68.8</td>
<td>-106.5</td>
<td>-9.8</td>
<td>-42.9</td>
<td>-40.3</td>
<td>-30.6</td>
</tr>
<tr>
<td>Net exports of NFS&lt;sup&gt;a&lt;/sup&gt;</td>
<td>-349.7</td>
<td>119.8</td>
<td>-30.3</td>
<td>2.8</td>
<td>9.5</td>
<td>-2.8</td>
</tr>
<tr>
<td>Net exports of goods and NFS&lt;sup&gt;b&lt;/sup&gt;</td>
<td>-280.9</td>
<td>13.3</td>
<td>-40.1</td>
<td>-40.1</td>
<td>-30.8</td>
<td>-33.4</td>
</tr>
<tr>
<td>Net factor income received</td>
<td>-54.5</td>
<td>-31.1</td>
<td>-7.0</td>
<td>-0.2</td>
<td>-3.2</td>
<td>3.6</td>
</tr>
<tr>
<td>Net exports of goods and services</td>
<td>-335.4</td>
<td>-17.3</td>
<td>-47.4</td>
<td>-40.6</td>
<td>-34.0</td>
<td>-29.8</td>
</tr>
<tr>
<td>Gross domestic saving&lt;sup&gt;b&lt;/sup&gt;</td>
<td>411.4</td>
<td>211.9</td>
<td>11.0</td>
<td>-7.9</td>
<td>11.8</td>
<td>-9.9</td>
</tr>
<tr>
<td>Net current transfers received</td>
<td>108.7</td>
<td>14.5</td>
<td>31.9</td>
<td>48.8</td>
<td>38.8</td>
<td>28.1</td>
</tr>
<tr>
<td>Net private transfers</td>
<td>-105.4</td>
<td>-10.7</td>
<td>-0.6</td>
<td>33.5</td>
<td>7.0</td>
<td>21.6</td>
</tr>
<tr>
<td>Net official transfers</td>
<td>214.1</td>
<td>25.2</td>
<td>32.4</td>
<td>15.3</td>
<td>31.8</td>
<td>6.5</td>
</tr>
<tr>
<td>Gross national saving</td>
<td>465.6</td>
<td>195.4</td>
<td>35.9</td>
<td>40.7</td>
<td>47.3</td>
<td>21.8</td>
</tr>
<tr>
<td>Gross domestic investment</td>
<td>692.4</td>
<td>198.6</td>
<td>51.1</td>
<td>32.5</td>
<td>42.5</td>
<td>23.5</td>
</tr>
<tr>
<td>Net capital inflow&lt;sup&gt;c&lt;/sup&gt;</td>
<td>226.7</td>
<td>3.3</td>
<td>15.2</td>
<td>-8.2</td>
<td>-4.8</td>
<td>1.7</td>
</tr>
<tr>
<td>Net inflow of external resources</td>
<td>280.9</td>
<td>-13.3</td>
<td>40.1</td>
<td>40.4</td>
<td>30.8</td>
<td>33.4</td>
</tr>
<tr>
<td>Gross domestic product</td>
<td>3075.2</td>
<td>1197.6</td>
<td>161.0</td>
<td>101.8</td>
<td>130.2</td>
<td>88.5</td>
</tr>
<tr>
<td>Average exchange rate&lt;sup&gt;d&lt;/sup&gt;</td>
<td>0.9</td>
<td>1.3</td>
<td>1.9</td>
<td>2.2</td>
<td>108.5</td>
<td>1.4</td>
</tr>
</tbody>
</table>

<sup>a</sup> Non-factor services.

<sup>b</sup> Gross domestic saving equals gross domestic product less total consumption. Alternatively, it is the sum of gross domestic investment and net exports of goods and non-factor services.

<sup>c</sup> The negative of the balance in the current accounts is represented by net capital inflow entry.

<sup>d</sup> Local unit per US dollar.

**Note:** Net exports of merchandise goods comprised the difference between the market value of exports and imports of movable goods, including non-monetary gold. Net exports of non-factor services comprised shipment, passenger and other transport services, travel, as well as current account transactions not separately reported. Net factor services receipts comprised services of labour and capital, thus covering income from direct investment abroad, interest, dividends, property and labour income. Private current transfers comprised net private transfers payments from the rest of the world carrying no provision for repayments. Included are workers remittances, transfers by migrants, gifts, dowries, inheritances and alimony. Net official current transfers comprised net official transfers between governments of the reporting country and the rest of the world.

The gross flow of overseas development aid to the South Pacific does not actually arrive at the islands. Overseas development aid statistics are provided by donors and these statistics do not reflect the actual transfers of financial resources provided for the islands. The flow of financial resources is significantly less than overseas development aid chiefly because a considerable part of official development assistance expenditure is incurred outside the recipient economy (for example one-fifth of Australia’s assistance to each island economy is allocated for overseas study awards). While technical assistance represents a transfer of skills, financial transfers are far less as expatriates tend to remit savings back home (World Bank 1990:81).

Traditional aid donors to the South Pacific have been the United Kingdom, New Zealand and Australia which emerged as the largest donor in the early 1980s. Since 1986, level of aid flows have risen rapidly owing primarily to the European Community and Japan becoming substantial aid donors to the South Pacific as well as a rise in Australian aid. Today, 75 per cent of all aid to the South Pacific islands is provided by these five aid donors (World Bank 1990:78).

Table 2 Saving and inflow of external resources as a percentage of GDP at market prices (average for 1985–89, per cent)

<table>
<thead>
<tr>
<th></th>
<th>Papua New Guinea</th>
<th>Fiji</th>
<th>Solomon Islands</th>
<th>Western Samoa</th>
<th>Vanuatu</th>
<th>Tonga</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net exports of merchandise goods</td>
<td>2.2</td>
<td>-8.9</td>
<td>-6.3</td>
<td>-42.4</td>
<td>-30.9</td>
<td>-34.6</td>
</tr>
<tr>
<td>Net exports of NFSa</td>
<td>-11.4</td>
<td>10.0</td>
<td>-18.8</td>
<td>2.8</td>
<td>7.3</td>
<td>-3.2</td>
</tr>
<tr>
<td>Net exports of goods and NFSa</td>
<td>-9.2</td>
<td>1.1</td>
<td>-25.1</td>
<td>-39.6</td>
<td>-23.6</td>
<td>-37.8</td>
</tr>
<tr>
<td>Net factor income received</td>
<td>-1.8</td>
<td>-2.6</td>
<td>-4.3</td>
<td>-0.2</td>
<td>-2.5</td>
<td>4.1</td>
</tr>
<tr>
<td>Net exports of goods and services</td>
<td>-11.0</td>
<td>-1.5</td>
<td>-29.4</td>
<td>-39.8</td>
<td>-26.1</td>
<td>-33.7</td>
</tr>
<tr>
<td>Gross domestic saving</td>
<td>13.4</td>
<td>17.7</td>
<td>6.8</td>
<td>-7.8</td>
<td>9.1</td>
<td>-11.2</td>
</tr>
<tr>
<td>Net current transfers received</td>
<td>3.5</td>
<td>1.2</td>
<td>19.8</td>
<td>47.9</td>
<td>29.8</td>
<td>31.8</td>
</tr>
<tr>
<td>Net private transfers</td>
<td>-3.4</td>
<td>-0.9</td>
<td>-0.4</td>
<td>32.9</td>
<td>5.4</td>
<td>24.4</td>
</tr>
<tr>
<td>Net official transfers</td>
<td>7.0</td>
<td>2.1</td>
<td>20.0</td>
<td>15.0</td>
<td>24.4</td>
<td>7.3</td>
</tr>
<tr>
<td>Gross national saving</td>
<td>15.1</td>
<td>16.3</td>
<td>22.3</td>
<td>40.0</td>
<td>36.3</td>
<td>24.6</td>
</tr>
<tr>
<td>Gross domestic investment</td>
<td>22.5</td>
<td>16.6</td>
<td>31.7</td>
<td>31.9</td>
<td>32.6</td>
<td>26.6</td>
</tr>
<tr>
<td>Net capital inflow</td>
<td>7.4</td>
<td>0.3</td>
<td>9.4</td>
<td>-8.1</td>
<td>-3.7</td>
<td>2.0</td>
</tr>
<tr>
<td>Net inflow of external resources</td>
<td>9.2</td>
<td>-1.1</td>
<td>25.1</td>
<td>39.6</td>
<td>23.6</td>
<td>37.8</td>
</tr>
</tbody>
</table>

a Non-factor services.


Tonga and Western Samoa experienced negative domestic saving as domestic consumption exceeded their respective gross domestic product. High domestic consumption in Tonga is due to use of some of the remittances received from abroad to finance family and religious obligations such as school fees, weddings, funerals and church donations (Lafitani 1992), all of which are classified under
current consumption by national accounts definition. Although there is little
documented evidence that remittances sent to Tonga and Western Samoa have
been saved and invested, local knowledge witnesses that part of the remit-
tances are also used for upgrading and construction of residential buildings,
purchasing of vehicles, fishing boats and fishing gear, both for personal and
business use, and also for establishing small-scale businesses. These expend-
itures are recorded as part of gross domestic investment by national accounts
definition. Although purchasing a vehicle or boat is primarily for personal use,
the access or the distance to agricultural lands or fishing targets becomes
artificially closer. Thus there is a tendency for improved subsistence and
commercial fishing and agricultural production.

The distortionary effects of high inflow of net current transfers to the islands is
highlighted by Ahlburg (1991) and is known as the booming sector effect or
Dutch disease. These effects result in the reallocation of productive factors
away from the traded goods sector to the non-traded goods sector in response
to high inflow of, for example, private remittances and foreign aid. Private and
official transfers are partially spent on non-traded goods and the increase in
demand for non-traded goods raises their prices, increasing the relative price
of non-traded to traded goods. This draws resources away from other productive
activities to non-traded outputs (such as services). High inflow of private and
official transfers not only causes misallocation of resources, their contribution
to high domestic consumption also causes excess demand and thus triggers
inflation.

Net capital inflow

Net capital inflow is represented by the balance in the capital account (or the
current account deficit) and is composed of net direct investment, foreign
borrowing, other capital transfers and movements in international reserves
(Table 3). Foreign direct investment is strongly encouraged in the islands as a
mode for supplementary resources. Foreign investments offer job opportunities
to the local population, introduce new skills and technological know-how, and
reduce the concentration phenomena by broadening and diversifying the type
of economic activity and sources of income in the islands.

Official statistics show that net foreign direct investment, during 1985-89,
ranged from an outflow in Fiji equivalent to US$14 million per annum to an
inflow of US$106 million in Papua New Guinea. The political situation in Fiji
after 1987 triggered outflow of direct investments and low net direct invest-
ments in the islands, apart from Papua New Guinea, reflect the relative
unattractiveness of investing in the islands. Apart from being distant from
metropolitan markets, inward looking policies, high wages, domination of key
commercial sectors by public enterprises and excessive regulatory environment
in the islands serve as disincentives to new domestic and foreign private
investment. Regulations like complex licensing systems and controls on price
and new investment acted to restrain competition, constrain flexibility in
resource use, limit productivity improvements, raise production costs and

113 Pacific islands at the crossroads?
Impact of external resources inflow on island economies

damage international competitiveness. This explains the stagnating trend of foreign direct investment during the 1980s. Foreign direct investment was strong in Fiji until 1987 due to expansion of existing foreign enterprises (World Bank 1990). Vanuatu, with its off-shore financial centre and range of tax free privileges has managed to attract growing amounts of foreign investment.

Table 3 Composition of net capital inflow (average for period 1985–89, US$million)

<table>
<thead>
<tr>
<th></th>
<th>Papua New Guinea</th>
<th>Fiji</th>
<th>Solomon Islands</th>
<th>Western Samoa</th>
<th>Vanuatu</th>
<th>Tonga</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net long-term capital inflow$^a$</td>
<td>111.6</td>
<td>-25.5</td>
<td>16.0</td>
<td>0.9</td>
<td>-50.5</td>
<td>1.4</td>
</tr>
<tr>
<td>Net direct investment$^b$</td>
<td>108.0</td>
<td>-14.0</td>
<td>3.3</td>
<td></td>
<td>6.1</td>
<td>0.1</td>
</tr>
<tr>
<td>Net long-term loans$^c$</td>
<td>189.2</td>
<td>-11.9</td>
<td>10.6</td>
<td>0.8</td>
<td>2.9</td>
<td>2.8</td>
</tr>
<tr>
<td>Other long-term capital received$^d$</td>
<td>-185.7</td>
<td>0.4</td>
<td>2.1</td>
<td>0.1</td>
<td>-59.5</td>
<td>-1.6</td>
</tr>
<tr>
<td>Other net capital inflow$^e$</td>
<td>85.5</td>
<td>41.0</td>
<td>-4.6</td>
<td>1.1</td>
<td>48.2</td>
<td>-1.4</td>
</tr>
<tr>
<td>Changes in foreign reserves$^f$</td>
<td>29.7</td>
<td>-12.2</td>
<td>3.8</td>
<td>-10.2</td>
<td>-2.5</td>
<td>1.5</td>
</tr>
<tr>
<td>Balance in the capital account</td>
<td>226.9</td>
<td>3.3</td>
<td>15.2</td>
<td>-8.3</td>
<td>-4.8</td>
<td>1.4</td>
</tr>
</tbody>
</table>

a Net long-term capital inflows comprise changes, apart from valuation adjustments, in residents' long-term foreign liabilities less their long-term assets, excluding any long-term items classified as reserves.

b Net direct investment comprise all capital transactions that are made to acquire a lasting interest in an enterprise operating in an economy other than that of the investor, where the investors' purpose is to have an effective voice in the management of the enterprise. Direct investment includes items such as equity capital, re-investment of earnings, and other long and short term capital.

c Long-term loans comprise all public, publicly guaranteed and private non-guaranteed loans that have an original or extended maturity of more than a year and that are repayable in foreign currencies, goods or services.

d Other long-term net capital inflows comprise the differences between long-term capital, as defined above and the similar item reported in the IMF balance of payments statistics.

e Other net capital inflows comprise the sum of short-term capital, net errors and omissions, and capital transactions not included elsewhere.

f Changes in reserves comprise the net change in a economy's holding of international reserves resulting from transactions on the current and capital accounts.


Although long-term borrowing was quite significant in some of the islands during 1985–89 (Table 4), the islands remain credit-worthy as their external debt is small and they are expected to be able to meet the debt services without major difficulties. Papua New Guinea, Western Samoa, Solomon Islands and Tonga
have large outstanding debts in relation to GDP, but their debt service payments remain modest (Table 5).

### Table 4  Net capital inflow as percentages of domestic investment (average for period 1985–89, per cent)

<table>
<thead>
<tr>
<th></th>
<th>Papua New Guinea</th>
<th>Fiji</th>
<th>Solomon Islands</th>
<th>Western Samoa</th>
<th>Vanuatu</th>
<th>Tonga</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net long-term capital inflow</td>
<td>16.1</td>
<td>-12.8</td>
<td>31.3</td>
<td>2.8</td>
<td>-118.7</td>
<td>6.0</td>
</tr>
<tr>
<td>Net direct investment</td>
<td>15.6</td>
<td>-7.0</td>
<td>6.5</td>
<td>..</td>
<td>14.4</td>
<td>0.4</td>
</tr>
<tr>
<td>Net long-term loans</td>
<td>27.3</td>
<td>-6.0</td>
<td>20.7</td>
<td>2.5</td>
<td>6.8</td>
<td>11.9</td>
</tr>
<tr>
<td>Other long-term capital</td>
<td>-26.8</td>
<td>0.2</td>
<td>4.1</td>
<td>0.3</td>
<td>-140.0</td>
<td>-6.8</td>
</tr>
<tr>
<td>Other net capital inflow</td>
<td>12.3</td>
<td>20.6</td>
<td>-9.0</td>
<td>3.4</td>
<td>113.4</td>
<td>-6.0</td>
</tr>
<tr>
<td>Changes in foreign reserves</td>
<td>4.3</td>
<td>-6.1</td>
<td>7.4</td>
<td>-31.4</td>
<td>-5.9</td>
<td>7.2</td>
</tr>
<tr>
<td>Balance in the capital account</td>
<td>32.8</td>
<td>1.7</td>
<td>29.7</td>
<td>-25.5</td>
<td>-11.3</td>
<td>7.2</td>
</tr>
</tbody>
</table>


### Table 5  Indicators of debt and credit-worthiness, 1989

<table>
<thead>
<tr>
<th></th>
<th>Papua New Guinea</th>
<th>Fiji</th>
<th>Solomon Islands</th>
<th>Western Samoa</th>
<th>Vanuatu</th>
<th>Tonga</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total external debt (US$ million)</td>
<td>2496.0</td>
<td>398.2</td>
<td>103.2</td>
<td>74.8</td>
<td>31.8</td>
<td>45.2</td>
</tr>
<tr>
<td>Debt outstanding as percentage of GDP</td>
<td>71.2</td>
<td>32.0</td>
<td>58.5</td>
<td>68.4</td>
<td>23.5</td>
<td>45.8</td>
</tr>
<tr>
<td>Debt outstanding per capita</td>
<td>654.8</td>
<td>535.9</td>
<td>328.7</td>
<td>470.4</td>
<td>209.2</td>
<td>461.2</td>
</tr>
<tr>
<td>Debt services (US$ million)</td>
<td>..</td>
<td>64.5</td>
<td>5.6</td>
<td>4.5</td>
<td>1.6</td>
<td>2.3</td>
</tr>
<tr>
<td>Debt service as percentage of exports</td>
<td>..</td>
<td>18.4</td>
<td>6.5</td>
<td>12.5</td>
<td>2.9</td>
<td>3.8</td>
</tr>
</tbody>
</table>


The World Bank expects that the flow of external resources to the islands will remain substantial during the 1990s, owing to expected increases in aid flows and remittances. As most of the island economies now offer attractive industrial incentives to foreign investors, foreign investment is also expected to rise.
Impact of external resources inflow on island economies

Saving and domestic investment

Expenditure on domestic investment in a economy can be financed by local and/or foreign savings. Fry (1991) noted that since 1970, world saving as a proportion of world income has fallen. Between the periods 1975–81 and 1982–88, saving in the industrial market economies has fallen from 25 per cent to 20 per cent; in developing economies, it has fallen from 25 per cent to 22 per cent; and in Asian developing economies, it has fallen marginally from 27.9 per cent to 27.5 per cent. Similar trends were also observed in Papua New Guinea and Fiji. During the same period, domestic saving as proportion of GDP declined in Papua New Guinea, Fiji and Tonga but national saving was mixed (Tables 6 and 7).

Table 6  Saving rate in the major South Pacific island economies
(percentage of GDP)

<table>
<thead>
<tr>
<th>Gross domestic saving</th>
<th>Papua New Guinea</th>
<th>Fiji</th>
<th>Solomon Islands</th>
<th>Western Samoa</th>
<th>Vanuatu</th>
<th>Tonga</th>
</tr>
</thead>
<tbody>
<tr>
<td>1975–81</td>
<td>17.5</td>
<td>21.8</td>
<td>..</td>
<td>..</td>
<td>..</td>
<td>-2.6</td>
</tr>
<tr>
<td>1982–88</td>
<td>12.6</td>
<td>18.3</td>
<td>14.3</td>
<td>-8.1</td>
<td>6.8</td>
<td>-11.1</td>
</tr>
<tr>
<td>Gross national saving</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1975–81</td>
<td>19.7</td>
<td>20.9</td>
<td>..</td>
<td>..</td>
<td>..</td>
<td>24.0</td>
</tr>
<tr>
<td>1982–88</td>
<td>15.1</td>
<td>17.0</td>
<td>23.6</td>
<td>34.5</td>
<td>35.5</td>
<td>27.9</td>
</tr>
<tr>
<td>Gross domestic investment</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1975–81</td>
<td>23.3</td>
<td>27.1</td>
<td>..</td>
<td>..</td>
<td>..</td>
<td>29.0</td>
</tr>
<tr>
<td>1982–88</td>
<td>25.2</td>
<td>19.1</td>
<td>29.8</td>
<td>30.1</td>
<td>29.3</td>
<td>28.0</td>
</tr>
</tbody>
</table>


Over the period 1982–88, the national saving rates of the islands were quite comparable to those of other developing economies, but it should be noted that a significant proportion of the national saving, especially for Western Samoa, Vanuatu and Tonga, comes from net current transfers received from abroad, mainly private remittances and foreign aid (Tables 1 and 2).
Table 7 Saving and external resources as percentages of domestic investment (average for 1985–89)

<table>
<thead>
<tr>
<th></th>
<th>Papua New Guinea</th>
<th>Fiji</th>
<th>Solomon Islands</th>
<th>Western Samoa</th>
<th>Vanuatu</th>
<th>Tonga</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net exports of merchandise goods</td>
<td>9.9</td>
<td>-53.6</td>
<td>-19.2</td>
<td>-132.9</td>
<td>-94.6</td>
<td>-130.2</td>
</tr>
<tr>
<td>Net exports of NFS(^a)</td>
<td>-50.5</td>
<td>60.3</td>
<td>-59.3</td>
<td>8.6</td>
<td>22.4</td>
<td>-11.9</td>
</tr>
<tr>
<td>Net exports of goods and NFS(^a)</td>
<td>40.6</td>
<td>6.7</td>
<td>-78.5</td>
<td>-124.3</td>
<td>-72.2</td>
<td>-142.1</td>
</tr>
<tr>
<td>Gross domestic saving</td>
<td>59.4</td>
<td>106.7</td>
<td>21.5</td>
<td>-24.3</td>
<td>27.8</td>
<td>-42.1</td>
</tr>
<tr>
<td>Net factor income received</td>
<td>-7.9</td>
<td>-15.7</td>
<td>-13.7</td>
<td>-0.6</td>
<td>-7.5</td>
<td>15.3</td>
</tr>
<tr>
<td>Net current transfers received</td>
<td>15.7</td>
<td>7.3</td>
<td>62.4</td>
<td>150.2</td>
<td>91.3</td>
<td>119.6</td>
</tr>
<tr>
<td>Net private transfers</td>
<td>-15.2</td>
<td>-5.4</td>
<td>-1.2</td>
<td>103.1</td>
<td>16.5</td>
<td>91.9</td>
</tr>
<tr>
<td>Net official transfers</td>
<td>30.9</td>
<td>12.7</td>
<td>63.4</td>
<td>47.1</td>
<td>74.8</td>
<td>27.7</td>
</tr>
<tr>
<td>Gross national saving</td>
<td>67.2</td>
<td>98.4</td>
<td>70.3</td>
<td>125.2</td>
<td>111.3</td>
<td>92.8</td>
</tr>
<tr>
<td>Net capital inflow</td>
<td>32.8</td>
<td>1.7</td>
<td>29.7</td>
<td>-25.2</td>
<td>-11.3</td>
<td>7.2</td>
</tr>
<tr>
<td>Net inflow of external resources</td>
<td>40.6</td>
<td>-6.7</td>
<td>78.5</td>
<td>124.3</td>
<td>72.2</td>
<td>142.1</td>
</tr>
</tbody>
</table>

\(^a\) Non-factor services.


Although the island economies need to encourage more investment in the private sector, their fragmentation and remoteness justifies the high inflow of official assistance and investment in infrastructure projects and administrative services. A high proportion of wage employees are engaged in the public sector inducing a booming sector effect as resources are drawn into the public sector.

Impact of the net inflow of external resources on domestic savings and economic growth

One of the problems with previous studies on the impact of external resource inflows (Rahman 1968; Areskoug 1973; Griffin and Enos 1970) is that they only captured the direct effect on domestic saving. The inflow of external resources has both direct and indirect effects on domestic saving and economic growth, and the direction and magnitude of the total effect depend on the direction and strength of these two effects. External resource inflow may affect domestic saving directly by increasing domestic consumption and, thus, reducing domestic saving. However, it also has some positive indirect effects on domestic saving by relieving pressure on private saving caused by government deficits.

Even though a negative direct effect was revealed in earlier studies, indirect effects were not estimated, so that the total effect of capital inflow was left undetermined. To analyse the impact of external resource inflow on domestic saving and economic growth, a simultaneous equation system is an appropriate tool to capture both direct and indirect effects (Lee et al. 1986).
The model

Because simultaneity prevails between domestic saving and economic growth, a single equation model is inappropriate because it does not capture the indirect effects and the estimated parameters will be biased and inconsistent (Lee et al. 1986). To eliminate this specification bias, a simultaneous equation model is used. Full details of the derived simultaneous equation model, consisting of a growth equation and a saving equation, are given (Appendix II). Accordingly, the two structural equations are

\begin{align*}
\frac{dY}{Y} &= a_{10} + a_{11}ER + a_{12}NDS + a_{13}dL/L + u_t \quad (1) \\
NDS &= a_{20} + a_{21}ER + a_{22}YN + a_{23}dY/Y + v_t \quad (2)
\end{align*}

where
- \( \frac{dY}{Y} \): rate of growth of net domestic output
- \( ER \): net inflow of external resources (the sum of net capital inflow, net current transfers and net factor income received from abroad)
- \( NDS \): net domestic saving as a percentage of net domestic product
- \( dL/L \): rate of growth in employment
- \( YN \): per capita income
- \( v_t, u_t \): disturbance terms.

The reduced form equations are

\begin{align*}
\frac{dY}{Ya} &= \alpha_{10} + \alpha_{11}ER + \alpha_{12}YN + \alpha_{13}dL/L + U_t \\
NDS &= \alpha_{20} + \alpha_{21}ER + \alpha_{22}YN + \alpha_{23}dL/L + V_t \quad (4)
\end{align*}

where
\begin{align*}
\alpha_{10} &= a_{10} + a_{12}a_{20} \\
\alpha_{11} &= a_{11} + a_{12}a_{21} \\
\alpha_{12} &= a_{12}a_{22} \\
\alpha_{13} &= a_{13} + a_{12}a_{23} \\
U_t &= u_t + a_{12}V_t \\
\alpha_{20} &= a_{20} + a_{23}a_{10} \\
\alpha_{21} &= a_{21} + a_{23}a_{11} \\
\alpha_{22} &= a_{22} + a_{23}a_{12} \\
\alpha_{23} &= a_{23}a_{13} \\
V_t &= v_t + a_{23}U_t
\end{align*}

The coefficients of the structural equations give the direct effects of net inflows of external resources and the reduced form parameters represent the total effects. The two equations are exactly identified (and all variables in the right hand side of both equations are exogenous). Thus indirect least squares can be used to obtain consistent and unbiased estimates of the reduced form and the structural parameters. The structural parameters are computed from the reduced form estimates, such that

\begin{align*}
a_{10} &= \alpha_{10} - a_{12}a_{20} \\
a_{11} &= \alpha_{11} - a_{12}a_{21} \\
a_{12} &= \alpha_{12}a_{22} \\
a_{13} &= \alpha_{13} - a_{12}a_{23} \\
a_{20} &= \alpha_{20} - a_{23}a_{10} \\
a_{21} &= \alpha_{21} - a_{23}a_{11} \\
a_{22} &= \alpha_{22} - a_{23}a_{12} \\
a_{23} &= \alpha_{23}a_{13}.
\end{align*}
Estimation procedure

The major problem associated with estimation, affecting the reliability of the estimates, is the inadequacy of relevant time-series data. The available data for the relevant variables are 20 annual observations for Papua New Guinea and Fiji, 15 for Tonga, 10 for the Solomon Islands, 8 for Western Samoa, 7 for Vanuatu and less for other small islands. Since there are only very few economies with available time-series data on the relevant variables, it would be unwise to conduct a pooled estimation (cross-sectional-time-series estimation) as the very few cross-sectional observations are not enough to conduct a regression exercise. Similarly, it would also be irresponsible to run the model on the very few data available for the Solomon Islands, Vanuatu and Western Samoa. Even though only 15 observations are available for Tonga, an econometric estimation can be forced, but any interpretation of the results should bear in mind the problems associated with small sample size.

This section is thus confined to estimating the simultaneous equation model separately for Papua New Guinea, Fiji and Tonga. The ordinary least squares method is used to estimate the coefficients of the reduced form model and the indirect least squares method is used to obtain the structural parameters.

Data sources

The main sources of data are the South Pacific Economic and Social Database of the National Centre for Development Studies, The Australian National University and the World Bank’s World Tables 1991 Edition. Estimates of net capital stock are made for Fiji and Tonga (Kioa 1992). Individual data series are defined in the text where necessary.

Empirical results

The results, for all three island economies, suggest that the total effect of external resources inflow on economic growth has been favourable and that net inflow of external resources has had an unfavourable impact on domestic saving (Table 8). This is in line with the results given by Lee et al. (1986) on some Asian developing economies. The signs of the statistically significant coefficients are theoretically sound. The coefficients of external resources are negative and less than unity, suggesting that external resources partially substitute for domestic saving. Part goes into current consumption and since domestic saving is obtained as a residual (gross domestic product less total consumption), it declines as total consumption increases. The coefficient of per capita GDP for Tonga has the wrong sign but since it is not statistically significant, its validity can be ignored (Table 8).
Impact of external resources inflow on island economies

Table 8 Reduced form estimates of the two equation model

<table>
<thead>
<tr>
<th>Exogenous variables</th>
<th>Papua New Guinea</th>
<th>Fiji</th>
<th>Tonga</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Growth equation (Eq. 3) dY/Y</td>
<td>Saving equation (Eq. 4) NDS</td>
<td>Growth equation (Eq. 3) dY/Y</td>
</tr>
<tr>
<td>Intercept term</td>
<td>-0.86 (0.40)**</td>
<td>0.62 (0.37)</td>
<td>-0.24 (0.18)</td>
</tr>
<tr>
<td>KI</td>
<td>0.71 (0.31)**</td>
<td>-0.80 (0.28)**</td>
<td>0.41 (0.20)**</td>
</tr>
<tr>
<td>YN</td>
<td>0.62 (0.27)**</td>
<td>-0.41 (0.25)*</td>
<td>0.22 (0.17)</td>
</tr>
<tr>
<td>dL/L</td>
<td>19.22 (12.19)*</td>
<td>-11.03 (11.25)</td>
<td>0.94 (0.39)**</td>
</tr>
<tr>
<td>R²</td>
<td>0.30 0.38</td>
<td>0.40 0.56</td>
<td>0.46 0.56</td>
</tr>
<tr>
<td>R²</td>
<td>0.16 0.26</td>
<td>0.22 0.26</td>
<td>0.19 0.43</td>
</tr>
<tr>
<td>RSS</td>
<td>0.10 0.09</td>
<td>0.04 0.01</td>
<td>0.03 0.04</td>
</tr>
<tr>
<td>DW</td>
<td>2.31 1.80</td>
<td>1.96 1.92</td>
<td>2.03 1.71</td>
</tr>
<tr>
<td>F statistic</td>
<td>2.18 3.11</td>
<td>2.18 1.89</td>
<td>1.72 4.22</td>
</tr>
<tr>
<td>SER</td>
<td>0.08 0.08</td>
<td>0.06 0.03</td>
<td>0.06 0.07</td>
</tr>
<tr>
<td>Maximum of log-likelihood</td>
<td>22.47</td>
<td>23.99</td>
<td>29.58</td>
</tr>
</tbody>
</table>

Note: The standard errors of the estimates are shown in the parentheses.

** imply that the estimate is significant at 5 per cent level.
* implies that the estimate is marginally significant.
R² is the correlation coefficient.
R² is the coefficient of determination.
RSS is the residual sum of squares.
DW is the is Durbin Watson statistic.
SER is the standard error of regression.
Source: DFIT econometric estimation.

The direct and total effects of the inflow of external resources on economic growth and domestic saving rates are also computed (Table 9). Inflows of external resources result in higher levels of investment capacity than might otherwise have been achieved and has also enabled funding of imports relevant for development. Technical assistance supplements management and technical skills that are lacking in the islands. The indirect effects of net external inflows on economic growth are unfavourable in Papua New Guinea and Fiji.
External resources, especially official transfers, can sometimes introduce inappropriate technology to the islands or finance capital-intensive projects (Kioa 1992). Most of the official transfers and foreign borrowing are directed towards the relatively large public sectors of the islands. They tend to foster growth in the government sector at the expense of the private sector and as governments tend to rely on continuing aid, it encourages high wages in the government sector and induces a booming sector effect in the economy. High levels of aid-financed investment projects can also contribute to budgetary problems as the domestic government has to finance the maintenance of foreign-financed projects. Public sector investment crowds out private investment and offsets economic growth.

The positive and significant indirect effects are, however, due to the fact that large public sectors mean that the remote island groups receive public goods and services, which indirectly favour human resources development and enhance economic growth. Investment in public infrastructure also indirectly facilitates the development of other sectors of the economy.

Table 9  
Direct and total effects of net inflow of external resources on economic growth and domestic saving

<table>
<thead>
<tr>
<th></th>
<th>Papua New Guinea</th>
<th>Fiji</th>
<th>Tonga</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Direct effect</td>
<td>Total effect</td>
<td>Direct effect</td>
</tr>
<tr>
<td>Economic growth (dY/Y)</td>
<td>-0.50</td>
<td>0.71</td>
<td>-2.04</td>
</tr>
<tr>
<td>Net domestic saving (NDS)</td>
<td>-0.40</td>
<td>-0.80</td>
<td>-0.70</td>
</tr>
</tbody>
</table>

Contribution of net capital inflow to domestic investment and economic growth

The neoclassical growth-accounting framework can be extended to provide empirical evidence on the contribution of net capital inflows to the economic growth of the island economies (Kioa 1992).

Using the constant returns to scale assumption to quantify non-parametrically the contribution of increases in factor inputs to production as well as the share of net capital inflow in economic growth, the basic growth-accounting equation is

\[ \frac{dY}{Y} = \alpha \frac{dK}{K} + \beta \frac{dL}{L} + \mu_t \]  

(5)

where

- \( \frac{dY}{Y} \) annual growth rate of domestic output (rate of economic growth)
- \( \frac{dK}{K} \) growth rate of capital stock
Impact of external resources inflow on island economies

\[ \frac{dN}{N} = \alpha \cdot \frac{N}{K} + \alpha \cdot \frac{K}{L} + \beta \cdot \frac{dL}{L} + \gamma \cdot d\beta \]

where

- \( dY/Y \) annual growth rate of net domestic product
- \( dL/L \) annual growth rate of labour
- \( NDS \) net domestic saving
- \( NNS \) net national saving
- \( Ki \) net capital inflow
- \( ER \) net inflow of external resources
- \( dB/B \) changes in total factor productivity.

Tables 10–12 summarize the growth-accounting results for Papua New Guinea, Fiji and Tonga. The rate of growth of aggregate output for the three island economies during their respective period of account were 4.6 per cent, 3.0 per cent and 4.4 per cent respectively.

### Table 10 Papua New Guinea: sources of economic growth, 1970–89

<table>
<thead>
<tr>
<th>Source of Total Factor Productivity</th>
<th>Factor Income Share</th>
<th>Share of Net Domestic Investment (per cent)</th>
<th>Rate of Growth (per cent)</th>
<th>Economic Growth Contribution (percentage points)</th>
<th>Economic Growth Contribution (percent)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net domestic product</td>
<td>1.00</td>
<td>..</td>
<td>4.60</td>
<td>..</td>
<td>..</td>
</tr>
<tr>
<td>Capital stock</td>
<td>0.30</td>
<td>..</td>
<td>4.47</td>
<td>1.34</td>
<td>29.13</td>
</tr>
<tr>
<td>Net national saving</td>
<td>..</td>
<td>59.49</td>
<td>..</td>
<td>0.80</td>
<td>17.39</td>
</tr>
<tr>
<td>Net domestic saving</td>
<td>..</td>
<td>25.15</td>
<td>..</td>
<td>0.34</td>
<td>7.39</td>
</tr>
<tr>
<td>Net current transfers</td>
<td>..</td>
<td>67.35</td>
<td>..</td>
<td>0.90</td>
<td>19.56</td>
</tr>
<tr>
<td>Net factor income received</td>
<td>..</td>
<td>-33.01</td>
<td>..</td>
<td>-0.44</td>
<td>-9.57</td>
</tr>
<tr>
<td>Net capital inflow</td>
<td>..</td>
<td>40.51</td>
<td>..</td>
<td>0.54</td>
<td>11.74</td>
</tr>
<tr>
<td>Net external resources inflow</td>
<td>..</td>
<td>74.85</td>
<td>..</td>
<td>1.00</td>
<td>21.74</td>
</tr>
<tr>
<td>Labour</td>
<td>0.70</td>
<td>..</td>
<td>2.85</td>
<td>2.00</td>
<td>43.48</td>
</tr>
<tr>
<td>Total factor productivity</td>
<td>..</td>
<td>..</td>
<td>..</td>
<td>1.26</td>
<td>27.39</td>
</tr>
</tbody>
</table>
In Papua New Guinea during 1970–89, the inflow of external resources was equivalent to 75 per cent of annual domestic investment but due to the net outflow of factor services, net capital inflow contributed only 40 per cent of domestic capital accumulation. This means that national savings contributed 60 per cent of domestic investment. Net capital inflow contributed 0.54 percentage points to annual growth in Papua New Guinea's domestic output, equivalent to 12 per cent of its economic growth during 1970–89. In Fiji net capital inflow contributed 0.47 percentage points, equivalent to 16 per cent of annual growth of domestic output during 1970–89.

<table>
<thead>
<tr>
<th>Table 11 Fiji: sources of economic growth, 1970–89</th>
</tr>
</thead>
<tbody>
<tr>
<td>Factor income share</td>
</tr>
<tr>
<td>---------------------</td>
</tr>
<tr>
<td>Net domestic product</td>
</tr>
<tr>
<td>Capital stock</td>
</tr>
<tr>
<td>Net national saving</td>
</tr>
<tr>
<td>Net domestic saving</td>
</tr>
<tr>
<td>Net current transfers</td>
</tr>
<tr>
<td>Net factor income received</td>
</tr>
<tr>
<td>Net capital inflow</td>
</tr>
<tr>
<td>Net external resources inflow</td>
</tr>
<tr>
<td>Labour</td>
</tr>
<tr>
<td>Total factor productivity</td>
</tr>
</tbody>
</table>

Net national saving financed 80 per cent of domestic capital accumulation in Tonga during the period 1974/75–88/89 leaving 20 per cent to net capital stock. The main source of national saving is net current transfers, mainly official transfers and private remittances. Unlike Papua New Guinea and Fiji, there is no net outflow of factor services as foreign investment is relatively low in Tonga and local salaries do not attract private foreign expatriates. Foreign expatriates working in Tonga are mainly part of the technical assistance component of official development assistance. The bulk of their total salaries are paid in their home countries as part of bilateral and multilateral arrangements. Tonga, like Fiji, is quite careful in committing itself to overseas borrowing and thus the contribution of net capital inflow to its annual output growth is only 0.33 percentage points or 7.5 per cent of annual growth in domestic output.
Table 12 Tonga: sources of economic growth, 1974/75-88/89

<table>
<thead>
<tr>
<th>Factor</th>
<th>Share of net domestic investment (per cent)</th>
<th>Rate of growth (per cent)</th>
<th>Economic growth contribution (percentage points) (per cent)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net domestic product</td>
<td>1.00</td>
<td>4.37</td>
<td>1.68</td>
</tr>
<tr>
<td>Capital stock</td>
<td>0.30</td>
<td>80.29</td>
<td>5.60</td>
</tr>
<tr>
<td>Net national saving</td>
<td>..</td>
<td>-109.91</td>
<td>..</td>
</tr>
<tr>
<td>Net domestic saving</td>
<td>..</td>
<td>171.72</td>
<td>..</td>
</tr>
<tr>
<td>Net current transfers</td>
<td>..</td>
<td>18.48</td>
<td>..</td>
</tr>
<tr>
<td>Net factor income received</td>
<td>..</td>
<td>19.71</td>
<td>..</td>
</tr>
<tr>
<td>Net capital inflow</td>
<td>..</td>
<td>209.91</td>
<td>..</td>
</tr>
<tr>
<td>Net external resources inflow</td>
<td>..</td>
<td>209.91</td>
<td>..</td>
</tr>
<tr>
<td>Labour</td>
<td>0.70</td>
<td>1.48</td>
<td>1.65</td>
</tr>
<tr>
<td>Total factor productivity</td>
<td>..</td>
<td>..</td>
<td>..</td>
</tr>
</tbody>
</table>

Measured growth in total factor productivity or the residual component of the growth-accounting equation can be explained by technical progress, improvement in the quality of capital and labour, improvements in allocative efficiency, economies or dis-economies of scale in production, changes in capital and labour utilization, and specification and measurement errors. Appropriateness in domestic policies and effectiveness of local institutional arrangements in allocating resources to productive uses affects allocative efficiency (Kioa 1992:171). Low total factor productivity growth in the islands, especially Fiji, stems from inappropriate policies such as inward looking policies, high wages and excessive protection and regulations that restrain competition, constrain flexibility in resource allocation and use, limit productivity improvements, raise production costs and damage international competitiveness. High aid flows create booming sector effects which result in resource misallocation.

Summary and policy implications

Although the inflow of external resources, especially capital inflow, contributes to economic growth, some inflows crowd out domestic saving. Though the total effect of the inflow of external resources on the rate of growth of the domestic economy may be positive, its direct effects may be negative. This was the case for Papua New Guinea and Fiji where the direct effect of the inflow of external resources was unfavourable to economic growth but the indirect effects were large enough to generate a positive total effect on economic growth. The changes in total factor productivity as percentages of the rate of economic growth reflect the growth contribution of efficiency in the use of available resources, changes in the utilization of capital stock and labour force, improvements in the quality of capital and labour, appropriateness in economic policy in allocating resources to productive uses, and other factors. For Papua New Guinea and Tonga, during their respective period of analysis, these changes
were quite impressive. The rates of growth of capital and labour in Papua New Guinea were 4.5 and 2.9 per cent respectively and the increase in output due to these increases in factor inputs was 3.3 percentage points, 1.3 percentage points of which were attributable to appropriate policies and efficiency in the use of resources. The situation is similar in Tonga with total factor productivity growth of 1.7 percentage points.

Total factor productivity in Fiji was relatively low at only 1.4 per cent per annum. If Fiji had allocated and utilized its resources more efficiently its annual rate of economic growth could have reached 4.5 per cent. Papua New Guinea and Tonga accumulated their capital stock at a faster pace than Fiji and their total factor productivity growth also exceeded Fiji's total factor productivity growth. Fiji's slower economic growth, relative to Papua New Guinea and Tonga during 1970-89 was therefore not entirely due to its slower rate of capital accumulation but also resulted from the way its resources were allocated and utilized. Excessive protection and regulation in Fiji, contributed to the limited growth of total factor productivity. This is probably also true for Tonga.

The lessons to be learnt

- Tonga and Western Samoa need to encourage their domestic saving as they are too dependent on private transfers from the rest of the world.

- Papua New Guinea, Fiji, Solomon Islands and Vanuatu have to watch the deterioration in their foreign reserves due to outflows of factor income. Although foreign investments supplement the domestic resource base and help to diversify the types of economic activity available, the outflow of factor income should not outweigh the benefits generated.

- The use of external resources, especially official development assistance and overseas borrowed funds, should be monitored so that they do not crowd out private sector saving and the booming sector effects of such flow is minimized.

- Appropriate policy mixes should be used, especially for Fiji, to ensure that available resources are allocated to more productive sectors and utilized more efficiently.

---

**Appendix I**

**Defining the net inflow of external resources**

According to the national accounting definition, gross domestic investment equals the net increment to existing capital stock plus allowances for consumption of fixed capital.
Impact of external resources inflow on island economies

\[ GDI = NI + CC \]  
(A1.1)

where

- **GDI**: gross domestic investment
- **NI**: net domestic investment
- **CC**: fixed capital consumption.

In terms of finance, gross domestic investment can be financed from gross national saving and net capital inflows. By the nature of the balance of payments framework, the balance in the capital account (which is the sum of net direct investment, long-term loans, other net capital inflows, statistical discrepancies and changes in international reserves) equals the current account balance. In developing island economies, current account balances are normally in deficit, so the balance in the current account is a current account deficit. For the purpose of this study it is statistically easier to use current account deficit in place of capital account balance to represent net capital inflow. Net capital inflow represents the balance of all international capital transactions of an economy that are recorded in the capital account of the balance of payments schedule, including movements in international reserves.

\[ GDI = GNS + KL = NN S + CC + KL \]  
(A1.2)

where

- **GNS**: gross national saving
- **KL**: net capital inflow, represented by the current account deficit
- **NNS**: net national saving.

Gross national saving is defined as the sum of gross domestic saving, the difference between gross domestic product at market prices and expenditure on consumption goods and services, net factor income and net current transfers received from abroad.\(^1\)

\[ GNS = GDS + NCT + NFY \]  
(A1.3)

where

- **GDS**: gross domestic saving
- **NCT**: net current transfers received from abroad
- **NFY**: net factor income received from abroad.

It follows that

\[ GDI = NI + CC = NNS + CC + KL \]
\[ = NDS + CC + NCT + NFY + KL \]  
(A1.4)

\(^1\) Gross domestic saving can also be obtained as the sum of gross domestic investment and the net exports of goods and non-factor services.
Levy (1976) raised the question of net official current transfers being treated as a current transaction both in the national accounts and the balance of payments. Conventionally, net official transfers are classified as part of national saving instead of net capital inflow. The United Nations recommendations for systems of national accounts, however, indicates that

transfers on current account should be utilized to finance production or consumption, but not investment in tangible or financial assets, during the period of account and should be made out of current income. In order to be classed as a current transfer, a transaction should be on the current account from the point of view of both the recipient and donor [economies] (United Nations 1968:120).

In some economies, some of the official transfers are directed principally towards financing investment, that is, development projects. The transactions are recorded in the donor economies as current expenditure (i.e. gifts and donations), thus they are considered under current transfers, however, the end use of most of these transactions is investment and they should therefore be classified in the recipient economies as net capital transfers. The treatment of current transfers in national accounts is adapted for expenditure behaviour analysis of the industrial economies (Levy 1976:189). This convention may not, however, be appropriate to the treatment of official transfers when analysing the economic performance of aid recipient economies (Levy 1976:187–98).

This study accepts that if official transfers are primarily used for investment, then gross national saving should exclude official transfers, thus

\[ \text{GNS}^* = \text{GDS} + \text{NPT} + \text{NFY} \] (A1.5)

where

- \( \text{GNS}^* \) modified gross national saving
- \( \text{NPT} \) net private current transfers.

The actual use of official transfers, however, ranges from expenditures on investment goods to technical assistance and training programs. In practice, it is difficult to separate the portion of official transfers that goes into technical assistance and purchases of other non-investment goods. In this paper, net capital transfers or inflows are represented only by the current account deficit. The net inflow of external resources (ER) is defined to include net capital inflow (which is the current account deficit), net current transfers (which include private remittances and foreign aid) and net factor income received from abroad.

\[ \text{ER} = \text{KI} + \text{NCT} + \text{NFY} \] (A1.6)
Appendix II

Derivation of the simultaneous equation model to estimate the impact of the inflow of external resources on domestic saving and economic growth

This paper slightly modifies the simultaneous model used by Lee et al. (1986) consisting of a growth equation and a saving equation.

The growth equation

The growth equation is derived from the traditional aggregate production function of the form

\[ Y_t = F \left[ Z_t, N_t; t \right] \]  \hspace{1cm} (A2.1)

where

- \( Y_t \): total real output produced at time \( t \)
- \( N_t \): labour services employed in the production of \( Y \)
- \( Z_t \): capital services utilized in the production of \( Y \)
- \( t \): shift parameter introduced to allow for changes in total factor productivity.

Solow (1957:312) referred to \( t \) as technical change representing any kind of shift in the aggregate production function. He assumed Hicks neutral technical change, that is, technical changes that leave the marginal rates of technical substitution untouched but increase or decrease output attainable from a given input combination. Accordingly, the production function with the Hicks neutral efficiency parameter can be represented as

\[ Y_t = A_t F \left[ Z_t, N_t \right] \]  \hspace{1cm} (A2.2)

The multiplicative factor \( A_t \) measures the effect of shifts over time in technical know-how. The growth equation derived from Equation A2.2 is

\[ \frac{dY}{Y} = Y_Z(Z/Y).dZ/Z + Y_N(N/Y).dN/N + dA/A \]  \hspace{1cm} (A2.3)

\[ \frac{dY}{Y} = \alpha.dZ/Z + \beta.dN/N + dA/A \]  \hspace{1cm} (A2.4)

where

- \( dY/Y \): growth rate of total real output (the rate of economic growth)
- \( dZ/Z \): growth rate of capital services used in production
- \( dN/N \): growth rate of labour services used in production
- \( dA/A \): rate of change in total factor productivity
- \( \alpha \): elasticity of output with respect to capital
- \( \beta \): elasticity of output with respect to labour.
For growth-accounting purposes, constant returns to scale are assumed such that $\alpha + \beta = 1$.

Data on $Z$ and $N$ are not available but the use of capital stock ($K$) and labour force ($L$) as proxies (as is quite common in growth accounting and productivity analysis), is only valid if

- capital stock ($K$) and labour force ($L$) are always fully employed so that the total services used in production equal the total services available from the capital stock and labour force in the economy; or
- the amount of labour and capital services that are used in production ($Z$ and $N$) are constant proportions of the capital stock and the labour force respectively (Hulten 1986:38).

The full employment assumption is unrealistic since unemployment and under-employment are characteristically high in developing economies. It is useful to assume that the proportion of labour and capital services used in production ($Z$ and $N$) remains constant in respect to capital stock and labour force. Kioa (1992) showed how this proportionality assumption is justified by relating the capital services used in production to the maximum services available from the capital stock and labour force. From the relationships

$$
\frac{dZ}{Z} = \frac{dU^K}{U^K} + \frac{dZ^f}{Z^f} \quad \text{(A2.5a)}
$$

$$
\frac{dN}{N} = \frac{dU^L}{U^L} + \frac{dN^f}{N^f} \quad \text{(A2.5b)}
$$

where

- $Z^f_t$, $N^f_t$ maximum services available from the existing capital stock ($K$) and the labour force ($L$) respectively in a given period of time. This represents the total machine-hours and man-hours available in the economy at period $t$.
- $Z_t$, $N_t$ machine-hours and labour-hours in period $t$ that were actually used in production.
- $U^K_t$, $U^L_t$ capital and labour utilization rates respectively such that $0 < U^K_t < 1$ and $0 < U^L_t < 1$.
- $dU^K_t/U^K_t$, proportionate changes in the rates of capital utilization and $dU^L_t/U^L_t$ labour employment respectively.
- $dZ/Z$, $dN/N$ proportionate changes in the capital and labour services used in production.
- $dZ^f/Z^f$, $dN^f/N^f$ proportionate changes in the maximum services available from the existing capital stock ($K$) and the labour force ($L$) respectively in a given period of time.
Kioa (1992) showed that
\[ \frac{dZ}{Z} = \frac{dK}{K} \]  

(A2.6)

The same procedure can be applied to labour input
\[ \begin{align*}
\frac{dZ}{Z} &= \frac{dU^K}{U^K} + \frac{dK}{K} \\
\frac{dN}{N} &= \frac{dU^L}{U^L} + \frac{dl}{L}
\end{align*} \]  

(A2.7a)  

(A2.7b)

Intuitively, the growth rate of capital (or labour) services used in production equals the proportionate change in the capital utilization rate (or labour employment rate) plus the growth rate of capital stock (or labour force). Data on variables \( L \) and \( K \) are available or easy to estimate, but the rates of capital utilization \( (U^K) \) and labour employment \( (U^L) \) are difficult to obtain.

Substituting Equations A2.7a and A2.7b into A2.4 produces a modified and empirically usable version of the growth-accounting equation.
\[ \frac{dY}{Y} = \alpha \cdot \frac{dK}{K} + \beta \cdot \frac{dl}{L} + u_t \]  

(A2.8)

where

\( u_t \) the error term representing, among other things, changes in utilization rates; quality improvements in the labour force, and changes in total factor productivity.

Assuming that the output elasticity with respect to capital services used in production \( (\alpha = Y_Z Z/Y) \) equals the output elasticity with respect to capital stock \( (\alpha^* = Y_K K/Y) \), we can rearrange Equation A2.8 so that
\[ \begin{align*}
\frac{dY}{Y} &= \alpha^* \cdot \frac{dK}{K} + \beta \cdot \frac{dl}{L} + u_t \\
&= Y_K \cdot NI / Y + \beta \cdot \frac{dl}{L} + u_t
\end{align*} \]  

(A2.9)

where

\( NI \) net domestic investment \( (dK/dt = NI) \).

From Equation A1.4
\[ GDI = NI + CC = NNS + CC + Kl \]

thus
\[ \frac{dY}{Y} = Y_K \cdot [NNS + Kl] / Y + \beta \cdot \frac{dl}{L} / Y + u_t \]  

(A2.10)

From equation A1.6
\[ ER = Kl + NCT + NFY \]

thus
\[ \frac{dY}{Y} = Y_K \cdot [NDS + ER] / Y + \beta \cdot \frac{dl}{L} / Y + u_t \]  

(A2.11)

where, in equations A2.10 and A2.11
Slone N. Kioa

NDS  net domestic saving as a percentage of GDP
NNS  net national saving as a percentage of GDP
KI   net capital inflow as a percentage of GDP
ER   net inflow of external resources as a percentage of GDP. It
      includes current account deficit plus net current transfers and
      net factor income received
dL/L  growth rate of employed population.

Implicit in Equations A2.10 and A2.11 is an assumption that the marginal
product of both foreign capital inflow and domestic capital are equal. Relaxing
that assumption, enables construction of a growth equation similar to the
growth equation of Lee et al. (1986).

\[
\frac{dY}{Y} = a_{10} + a_{11}ER + a_{12}NDS + a_{13}\frac{dL}{L} + u_t
\]

(A2.12)

where

\[a_{ij}\] parametric coefficients.

We can obtain a detailed version of Equation A2.12 by incorporating the
information given in Equation A1.6 and the definition of net capital inflow such
that

\[KI = DI + EB + OK + CIR\]

(A2.13)

where

DI    direct investment
EB    long-term borrowing
OK    other capital inflow
CIR   changes in international reserves.

Due to data constraints (the small number of time-series observations available
for each island), further disaggregation of the external resources variable
reduces the statistical degrees of freedom of the model. It is thus advisable to
treat all net inflows of external resources together as one variable. If data allow
a proper econometric exercise, a disaggregation of external resources is
important.

The saving equation

The saving equation of Lee et al. (1986) is adopted with slight modification
such that

\[NDS = a_{20} + a_{21}ER + a_{22}YN + a_{23}\frac{dY}{Y} + v_t\]

(A2.14)

The inclusion of the growth rate of output in the saving function is fairly common
(Mikesell and Zinser 1973; Lee et al. 1986). Rapid economic growth leads to
increased relative income and a new life-time consumption pattern, together
with increased transitory income which increases the saving rate. Per capita
income reflects the level of development of the economy. Exports of goods and non-factor services are excluded from the model, unlike in Lee et al. (1986), because they are part of domestic savings and treating them as a separate independent variable reduces the degrees of freedom of the model and would also increase any autocorrelation already associated with the model.

The two structural equations are

\[
dY/Y = a_{10} + a_{11}ER + a_{12}NDS + a_{13}dL/L + u_t \quad (A2.12)
\]

\[
NDS = a_{20} + a_{21}ER + a_{22}YN + a_{23}dY/Y + v_t \quad (A2.14)
\]

and the reduced form equations are

\[
dY/Y = \alpha_{10} + \alpha_{11}ER + \alpha_{12}YN + \alpha_{13}dL/L + u_t \quad (A2.15)
\]

\[
NDS = \alpha_{20} + \alpha_{21}ER + \alpha_{22}YN + \alpha_{23}dL/L + v_t \quad (A2.16)
\]

where

\[
\alpha_{10} = a_{10} + a_{12}\alpha_{20} \quad \alpha_{20} = a_{20} + a_{23}\alpha_{10}
\]

\[
\alpha_{11} = a_{11} + a_{12}\alpha_{21} \quad \alpha_{21} = a_{21} + a_{23}\alpha_{11}
\]

\[
\alpha_{12} = a_{12}\alpha_{22} \quad \alpha_{22} = a_{22} + a_{23}\alpha_{12}
\]

\[
\alpha_{13} = a_{13} + a_{12}\alpha_{23} \quad \alpha_{23} = a_{23}\alpha_{13}
\]

\[
u_t = u_t + a_{12}v_t \quad v_t = v_t + a_{23}u_t
\]

The coefficients of the structural equations give the direct effects of capital inflows and the reduced form parameters represent the total effects. The two equations are exactly identified and all variables in the right hand side of both equations are exogenous. Indirect least squares can therefore be used to obtain consistent and unbiased estimates of the reduced form and the structural parameters. The structural parameters are computed from the reduced form estimates, such that

\[
a_{10} = \alpha_{10} - a_{12}\alpha_{20} \quad a_{20} = \alpha_{20} - a_{23}\alpha_{10}
\]

\[
a_{11} = \alpha_{11} - a_{12}\alpha_{21} \quad a_{21} = \alpha_{21} - a_{23}\alpha_{11}
\]

\[
a_{12} = \alpha_{12}\alpha_{22} \quad a_{22} = \alpha_{22} - a_{23}\alpha_{12}
\]

\[
a_{13} = \alpha_{13} - a_{12}\alpha_{23} \quad a_{23} = a_{23}\alpha_{13}
\]
References


Impact of external resources inflow on island economies


The author gratefully acknowledges the assistance of Helen Hughes and Malcolm Treadgold for their advice on some theoretical and empirical aspects of the paper. I also thank Rodney Cole for allowing access to the South Pacific Economic and Social Database. Finally, I would like to thank Maree Tait for her general editorial support.
Macroeconomic management in the small open economies of the Pacific

Savenaca Siwatibau

The Pacific island economies are dispersed and isolated. Their physical and economic characteristics vary widely as do their resource endowments. The Melanesian group of islands, which includes Papua New Guinea, Fiji, New Caledonia, Solomon Islands and Vanuatu, is comprised in the main of large, rugged volcanic islands. These economies are relatively well endowed with fertile land and natural resources both onshore and offshore. All economies in Melanesia have abundant non-living and living marine resources within their exclusive economic zones.

Papua New Guinea has substantial mineral resources which dominate its economy. A number of large new mines were opened recently and the prospects for further development are good. Oil and gas deposits have also been discovered. The share of gold and copper in total exports increased from zero in the early seventies to around 70 per cent by 1990. Mineral exports also account for the trade surpluses registered in the country’s external accounts in recent years. Other export items from Papua New Guinea include coffee, logs, palm oil, cocoa and copra.

The economic importance of copper and gold imposes challenges upon policy makers in the country. The substantial revenue these minerals generate, which accrue to residents, including the government, will need to be directed into investments which enhance the productive capacity of the economy in the non-mineral sectors. Substantial receipts from minerals could sustain an over-valued kina over a long period with consequent erosion in the competitiveness of other sectors of the economy. Fluctuations in mineral export receipts in the wake of external or domestic economic shocks now have major impacts upon GDP, employment, government revenue, import demand, the external accounts and foreign reserves. The attenuation of the negative impacts of such shocks within the domestic economy and the re-establishment of macro-economic balances pose difficult problems for decision makers from time to time.

Gold is important in Fiji, as is nickel in New Caledonia. Gold deposits have been discovered in the Solomon Islands and in Vanuatu, but as yet these have not been mined commercially.

Fish, timber, copra, palm oil and kernels and cocoa, are the main exports of the Solomon Islands while copra, beef, cocoa and timber are the most important export earners for Vanuatu. The export base for Fiji is also narrow. Sugar, garments, gold, fish and fish products, timber and copra products are the country’s most important export items. Tourism is important in Fiji, New
Macroeconomic management of small island economies

Caledonia and Vanuatu and is also being encouraged in Solomon Islands and Papua New Guinea.

Except for Papua New Guinea all the economies of Melanesia run substantial trade deficits. All, including Papua New Guinea, register substantial current account deficits each year.

The economies of Micronesia and Polynesia are made up of groups of relatively small islands. A small number of these economies, including Tonga, Western Samoa and the Federated States of Micronesia, have rich soil. On the whole, however, the islands in these parts of the Pacific are very small isolated atolls with poor soil. Forestry is important only in Western Samoa. The seas surrounding the economies of Polynesia and Micronesia are well endowed with living resources and the prospects for discovering non-living resources within their exclusive economic zones are reportedly good.

Tonga and Western Samoa export a narrow range of agricultural products. Like all economies in Polynesia and Micronesia they register substantial trade and current account deficits annually. The annual value of remittances to Tonga hovers at around three times the value of its exports, half the value of its imports and 30 per cent of its GDP. Remittances are equally important to the Western Samoan economy.

Tourism has potential for further development in these two economies and they have invested heavily in infrastructure for the sector. The bulk of development expenditures in Tonga and Western Samoa, as indeed in other economies of Polynesia and Micronesia, are financed through aid.

Population growth rates in Tonga and Western Samoa have been low due to high levels of emigration particularly to New Zealand, Australia, Hawaii and the west coast of North America. Following the ongoing difficult economic conditions in these economies however, and the consequent tightening of their immigration policies, future emigration is expected to decelerate significantly. The likely impacts of such a trend upon national income, domestic consumption, revenue and the external accounts of these two economies could pose difficult problems for their governments.

The other island economies of Micronesia and Polynesia, which include Niue, Tuvalu, Kiribati, Tokelau, Palau, Nauru, Cook Islands, Marshall Islands and Federated States of Micronesia, are smaller than Tonga and Western Samoa. Except for Niue, Tokelau and Cook Islands, whose people have free access to New Zealand, these economies have relatively high population growth rates. Their land areas are severely limited. Except for the living resources of the sea and, possibly, the non-living resources within their exclusive economic zones, natural resources are scarce. Their economies and physical environments are extremely fragile. They experience substantial annual trade deficits. These cannot be sustained, except with on-going large in-flows of aid and, in some
economies, remittances. Their high levels of consumption, welfare and investment expenditures are substantially underwritten by aid.

Sources of foreign exchange earnings for these economies include copra, minor agricultural produce, rent on fishing rights granted to overseas shipping entities and handicrafts. They have worked hard at generating small export activities such as commemorative stamps in Tuvalu and Cook Islands and black pearls in Cook Islands. The geographic dispersion, immense distances and high transport costs, lack of marketing knowhow and keen competition faced by these economies present them with difficult hurdles.

The public sectors of these small island economies, supported by aid, dominate their economies. Private businesses depend heavily upon government purchases for their sales and survival. To a large extent, aid and government expenditures are thus significant determinants of GDP, revenue, imports and movements in the external accounts of these economies.

Some of these smaller Pacific island economies have achieved political independence while a number are at various stages of transition towards the same status. Complete economic and financial independence will not be achieved as easily. Long-term economic survival will require a range of bold initiatives including enlightened population policies, adjustment policies which may entail acceptance of a lower standard of living, ongoing aid inflows, sharpened skills in rent seeking, fiscal discipline, active search for viable projects which contribute to the expansion of productive capacities, human resource development, emigration and the targeting of opportunities for temporary employment overseas.

The Pacific island economies do have common characteristics and face similar problems. They are dispersed over wide areas of ocean and are distant from their main markets. Markets are fragmented, and internal and external transport services are poor and expensive. Their economies are very open. They rely upon a limited range of commodities for export and are exposed to external factors over which they have no control. Economic shocks transmitted through the goods (imports and exports) and capital markets (interest rates, exchange rates and capital flows) are experienced frequently. Domestic economic shocks emanating from natural disasters (hurricanes, drought) or destabilizing political events have also occurred in recent years with what appears to be increasing frequency.

Substantial trade and current account deficits are registered each year. These have to be financed through aid, remittances, external borrowing and other capital inflows. For quite a number of Pacific island economies high levels of consumption widen trade and current account imbalances and cannot be sustained without ongoing aid and remittances.

Aid per capita is high and to date has underwritten external financial stability and financed the bulk of development expenditures for most Pacific island
Macroeconomic management of small island economies

Macroeconomic management of small island economies. While aid will continue to be needed by some Pacific island economies for some time it has made it somewhat easier for important adjustment policies to be postponed or avoided.

The mobilization of domestic resources is constrained by low per capita income, narrow tax bases, negative interest rate structures, under-developed capital markets, high public sector consumption levels and the weakness of supportive domestic policies. The dependence upon external savings is high, as reflected in the large current account deficits, excluding unrequited transfers, of most of the Pacific island economies.

Because of ample aid receipts, recourse to external loan finance has been modest and has concentrated on access to concessionary multilateral sources. Borrowings from the euro-credit markets have, in the main, been avoided. External debt burdens and service ratios are consequently still relatively low.

All Pacific island economies have adopted fixed exchange rate systems. Six peg their currencies to selected currency baskets which include the currencies of their major trading partners. The others peg to the currency of a selected industrialized economy (US$, A$, NZ$). Except for Vanuatu, economies which issue their own currencies have exchange control legislation in place. These are, however, enforced with varying degrees of rigour. This situation, and the difficulty of controlling financial flows in very open economies, imply that capital moves with relative ease into and out of the Pacific island economies. Economic openness, fixed exchange rate systems and free capital flows impose strict limitations upon the flexibility with which fiscal and monetary policies may be employed for expanding economic activity.

Public sectors occupy a dominant position in the Pacific island economies. They employ large sections of the labour force and generally set the pace and trend in wage settlements. Annual real wage increases are relatively common implying that the burden of adjustments fall disproportionately upon other sections of the community. They also severely restrict the use of policies such as exchange rate adjustments which are necessary to maintain or enhance the external competitiveness of these economies.

Unskilled labour is generally in abundant supply while skilled labour demand far exceeds availability. Training facilities are severely limited. In a number of Pacific island economies a centralized wage system and strong unions have contributed to the existence of wage levels which are far in excess of what might be justified by consideration of productivity. In economies where remittances per head are high, reserve wage levels are also high in relation to productivity. High wage levels, together with the apparent difficulty of implementing measures which enhance competitiveness, such as real effective exchange rate depreciation, have contributed to the slow pace of private sector investment and high unemployment levels particularly among the young in urban areas. This issue is of particular importance because high population growth rates have led to relatively young population structures.
Human resource development is seen as a priority area for investment by all governments in the Pacific island economies and loss of skilled workers through emigration is a serious problem in Polynesia although its impact should perhaps be traded off against substantial remittances into the relevant economies.

Remittances are directly related to the number of emigrants and inversely to their average length of stay in the host economies. With the tightening of immigration rules in the traditional host economies, a reflection of their current difficult economic circumstances, past growth rates in remittances may be difficult to recapture.

The important role of the private sector in economic development has increasingly been recognized. In this connection, deregulation of the financial, commercial and labour markets has increasingly been viewed as necessary economic adjustment and reforms in a number of Pacific island economies.

Annual economic growth rates have fluctuated widely in recent years. Over the last decade the average growth rates of the Pacific island economies were lower than those of similar island economies in the Indian Ocean and the Caribbean despite higher aid per capita and similar terms of trade developments. The International Bank for Reconstruction and Development attributes these poor growth performances to inappropriate domestic policies including too strong an inward looking focus, over-regulation of the labour, commercial and financial sectors, the public sector's dominant role in trade and production, over-valued exchange rates and an environment not conducive to private sector growth.

Access to development finance has been relatively easy but projects which satisfy minimum appraisal standards have been scarce. Financing, including aid, has not always been confined to projects which enhance productive capacity. Quite a number of public sector projects have placed a heavy burden upon the current budgets of governments without producing compensating streams of social and economic benefits for the relevant economies.

The changing global scene could present the Pacific island economies with a less friendly external economic environment. The supply of world capital, due to the fiscal positions of the large industrialized economies, has been static while demand for capital is keen, particularly in Eastern Europe, the Republics of the former USSR, other transition economies and the Middle East: economies which are strategically and economically important to the industrialized economies. Bilateral aid and multilateral assistance are increasingly responding to that demand. This trend, coupled with the apparent diminution in power rivalry in the Pacific and the ongoing economic difficulties of the main traditional donors could well imply more modest growth in future aid flows to the Pacific island economies.

The Pacific island economies enjoy advantages over competitors under a number of trading arrangements such as the South Pacific Regional Trade and Economic Cooperation Agreement (SPARTECA), the Australia Trade and
Commercial Relationship Agreement (PATCRA) (for Papua New Guinea), the Generalized System of Preference (GSP) and the Lomé Convention. Exports under these arrangements, save in the case of Fiji and perhaps Western Samoa and Tonga, have not responded well because of a range of factors including shortage of skills, heavy transport costs, high wages, low productivity, over-valued exchange rates and the consequent inability to compete effectively. This situation will be compounded by the steady erosion in the level of advantages under the arrangements consequent upon the increasing trend towards economic liberalization in the industrialized economies. The Pacific island economies have to export in order to achieve economic expansion and long-term growth. Therefore, since aid, and in some cases remittances, may become less reliable guarantors of external sector stability, the formulation and implementation of appropriate domestic policies for ensuring macroeconomic balance and for promoting growth will increasingly demand the attention of decision makers in the Pacific island economies.

Managing domestic and external shocks

The situations in Papua New Guinea, Western Samoa and Fiji can be taken as examples of the impact of economic policies aimed at managing domestic and external shocks. Their example serves as an introduction to a more general analysis of macroeconomic management in the economies of the Pacific islands.

**Papua New Guinea**

Papua New Guinea was exposed to a domestic shock to its economy in 1989 when the Bougainville mine was closed. The mine at the time contributed about 35 per cent of export earnings, 16 per cent of government revenue and 8 per cent of GDP. To compound national difficulties, the economy was also subjected to an external shock; commodity prices weakened in 1989, 1990 and 1991. Economic activity in the North Solomons, which produced about 40 per cent of the country's cocoa output, had also fallen sharply in the wake of disturbances in that part of the country; a further domestic shock.

The Papua New Guinea authorities have an excellent track record in macroeconomic management for ensuring financial stability. They acted quickly to re-establish stability in the fiscal and external accounts. At the same time, it was decided that structural adjustment and reform measures aimed at fostering domestic savings and redirecting resources into priority areas in the interest of securing growth with stability should accompany the stabilization measures.

The broad objectives were

- to re-establish macroeconomic balances
- to encourage investments and entrench long-term growth in the non-mineral sectors of the economy
- to redirect the country's development strategy so as to enhance participation in the development process by all sections of the community and to improve the distribution of income and wealth over time. Population policy and training were to be accorded high priority and increased resources.

The stabilization and structural program was supported by the International Monetary Fund, the International Bank for Reconstruction and Development, the Asian Development Bank, and other donors under the International Bank for Reconstruction and Development consultative group process. Over US$700 million were committed to support a mix of financing and adjustment policies.

The stabilization measures included the usual mix of expenditure reducing and shifting policies prescribed under International Monetary Fund programs. New revenue measures were introduced and recurrent expenditures, save for priority ones such as operating and maintenance costs, were compressed. To ensure that the fiscal deficit did not deteriorate, external public sector borrowing was fixed within defined limits. Tight monetary policy which contained credit from the banking system and raised interest rates, was put in place. Wage increases were constrained to be lower than the domestic inflation rate. The expenditure shifting policy took the form of a 10 per cent devaluation of the kina.

The restructuring program incorporated a host of far reaching measures. The tax base was broadened and the overall burden shifted towards indirect taxes. The reduction in the range of imports covered under licensing was accompanied by progressive tariff reductions which exposed domestic industries to external competition. The adverse revenue impact of the latter was offset by the broadening of the tax base, and the short-term harmful impact of both measures upon import substituting industries was softened through the devaluation. The tax restructuring and the devaluation were aimed at reducing previous bias against outward looking commercial activities. The tax administration was strengthened, cost recovery measures for public services were adopted and plans were implemented to contain the government salary bill through reduction in the size of the civil service and appropriate incomes policy. Public expenditure control was to be improved and strengthened. Projects were to be carefully screened against established criteria of return before being accepted for financing from whatever source. The planning machinery was reviewed and strengthened and measures for increasing the efficiency of the public service were planned.

The authorities were concerned about the harmful impacts, such as sustained over-valuation of the exchange rate, which the enclave mineral sector could impose upon the non-mineral sectors of the economy. As the bulk of the population depend upon these sectors for their livelihood it was imperative that they be made more competitive. The constrained wage settlement formula which was adopted and the 10 per cent devaluation were aimed at improving the competitiveness of the Papua New Guinea economy.
It was accepted that the private sector should play a more dominant role in the economy. This goal complemented the perhaps ambitious program aimed at reducing the size of the public sector. Selected activities of the central government were to be corporatized. These new entities and existing public sector enterprises were targeted for progressive privatization. The financial system was to be reviewed to allow for more efficient credit delivery, particularly in the rural sector. The gradual lowering of the tariff wall and the effective rates of protection were designed to expose economic operatives to increased competition and thereby promote improved efficiency.

The policies which the authorities put in place, assisted by the increased production of the Porgera and Misima mines in 1991, have helped re-establish macroeconomic stability (Figures 1-4 and Tables 1a and 1b). The long-term growth and development of the country will, however, depend critically upon whether or not the authorities succeed in channelling a large part of the country's share of mineral riches into enhancing productive capacity and also upon the resolve and political will with which the government can sustain its declared direction and policies under its adjustment program.

Figure 1  Papua New Guinea: external account balances, 1985-1990

<table>
<thead>
<tr>
<th>Year</th>
<th>Merchandise trade balance</th>
<th>Overall balance</th>
<th>Current account balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>1985</td>
<td>-200</td>
<td>-300</td>
<td>-400</td>
</tr>
<tr>
<td>1986</td>
<td>0</td>
<td>-100</td>
<td>-200</td>
</tr>
<tr>
<td>1987</td>
<td>100</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>1988</td>
<td>-100</td>
<td>-200</td>
<td>-300</td>
</tr>
<tr>
<td>1989</td>
<td>0</td>
<td>-100</td>
<td>-200</td>
</tr>
<tr>
<td>1990</td>
<td>200</td>
<td>0</td>
<td>0</td>
</tr>
</tbody>
</table>
Figure 2  Papua New Guinea: government finances, 1985-1991

Figure 3  Papua New Guinea: monetary aggregates, 1986-1991

Figure 4  Papua New Guinea: monetary aggregates, 1986-1991
### Table 1a  Papua New Guinea: economic indicators, 1985–91

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Monetary survey (Kina, millions)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Foreign assets (net)</td>
<td>390.2</td>
<td>407.9</td>
<td>396.7</td>
<td>325.3</td>
<td>234.2</td>
<td>228.6</td>
<td>145.1</td>
</tr>
<tr>
<td>Domestic credit</td>
<td>594.7</td>
<td>718.6</td>
<td>740.5</td>
<td>884.8</td>
<td>1012.7</td>
<td>1101.7</td>
<td>1357.2</td>
</tr>
<tr>
<td>of which:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Claims on central government (net)</td>
<td>25.2</td>
<td>44.4</td>
<td>-6.6</td>
<td>55.6</td>
<td>69.7</td>
<td>144.5</td>
<td>272.4</td>
</tr>
<tr>
<td>Claims on private sector</td>
<td>563.8</td>
<td>668.2</td>
<td>738.6</td>
<td>823.5</td>
<td>937.7</td>
<td>951.2</td>
<td>1081.3</td>
</tr>
<tr>
<td>Claims on other financial institutions</td>
<td>2.0</td>
<td>2.0</td>
<td>4.6</td>
<td>3.2</td>
<td>4.2</td>
<td>2.3</td>
<td>2.4</td>
</tr>
<tr>
<td>Money supply</td>
<td>820.1</td>
<td>929.0</td>
<td>943.3</td>
<td>984.9</td>
<td>1037.5</td>
<td>1081.6</td>
<td>1272.5</td>
</tr>
<tr>
<td>Interest rates (per cent)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Discount rate (end period)</td>
<td>9.8</td>
<td>11.4</td>
<td>8.8</td>
<td>10.8</td>
<td>9.6</td>
<td>9.3</td>
<td>9.3</td>
</tr>
<tr>
<td>Treasury bill (ave)</td>
<td>10.4</td>
<td>12.3</td>
<td>10.4</td>
<td>10.1</td>
<td>10.5</td>
<td>11.4</td>
<td>10.3</td>
</tr>
<tr>
<td>Deposit rate (ave)</td>
<td>9.5</td>
<td>11.5</td>
<td>9.6</td>
<td>9.3</td>
<td>8.2</td>
<td>8.7</td>
<td>9.1</td>
</tr>
<tr>
<td>Lending rate (ave)</td>
<td>11.5</td>
<td>12.3</td>
<td>11.9</td>
<td>12.7</td>
<td>14.6</td>
<td>15.5</td>
<td>14.1</td>
</tr>
<tr>
<td>Inflation (per cent)</td>
<td>3.7</td>
<td>5.0</td>
<td>3.0</td>
<td>5.4</td>
<td>4.5</td>
<td>7.0</td>
<td>8.0</td>
</tr>
<tr>
<td>Exchange rates</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Nominal effective</td>
<td>100.0</td>
<td>95.1</td>
<td>96.9</td>
<td>99.2</td>
<td>109.1</td>
<td>105.5</td>
<td>110.2</td>
</tr>
<tr>
<td>Real effective</td>
<td>100.0</td>
<td>94.6</td>
<td>93.4</td>
<td>92.4</td>
<td>95.5</td>
<td>86.2</td>
<td>88.4</td>
</tr>
<tr>
<td>Government finance (Kina, millions)</td>
<td>-56.2</td>
<td>-76.9</td>
<td>-52.0</td>
<td>-28.2</td>
<td>-35.2</td>
<td>-100.3</td>
<td>-85.4</td>
</tr>
<tr>
<td>Deficit (-) or surplus</td>
<td>489.0</td>
<td>548.1</td>
<td>627.8</td>
<td>700.4</td>
<td>807.2</td>
<td>766.7</td>
<td>834.2</td>
</tr>
<tr>
<td>Revenue</td>
<td>215.5</td>
<td>204.7</td>
<td>184.3</td>
<td>189.9</td>
<td>189.7</td>
<td>222.1</td>
<td>220.4</td>
</tr>
<tr>
<td>Grants received</td>
<td>759.3</td>
<td>802.7</td>
<td>834.5</td>
<td>874.5</td>
<td>986.8</td>
<td>1058.7</td>
<td>1128.6</td>
</tr>
<tr>
<td>Expenditure</td>
<td>1.4</td>
<td>27.0</td>
<td>29.6</td>
<td>43.0</td>
<td>45.3</td>
<td>30.4</td>
<td>11.0</td>
</tr>
<tr>
<td>Net lending</td>
<td>30.9</td>
<td>3.3</td>
<td>—</td>
<td>38.5</td>
<td>33.9</td>
<td>88.3</td>
<td>55.0</td>
</tr>
<tr>
<td>Financing</td>
<td>25.3</td>
<td>73.6</td>
<td>—</td>
<td>-10.3</td>
<td>1.3</td>
<td>0.1</td>
<td>30.4</td>
</tr>
<tr>
<td>Population (millions)</td>
<td>3.3</td>
<td>3.4</td>
<td>3.5</td>
<td>3.6</td>
<td>3.6</td>
<td>3.7</td>
<td></td>
</tr>
<tr>
<td>GDP growth (per cent)</td>
<td>4.0</td>
<td>6.0</td>
<td>3.0</td>
<td>3.0</td>
<td>-1.0</td>
<td>-4.0</td>
<td></td>
</tr>
<tr>
<td>Balance of payments (Kina, millions)</td>
<td>47.0</td>
<td>121.0</td>
<td>193.0</td>
<td>77.0</td>
<td>-20.0</td>
<td>61.0</td>
<td></td>
</tr>
<tr>
<td>Merchandise trade balance</td>
<td>920.0</td>
<td>1023.0</td>
<td>1155.0</td>
<td>1276.0</td>
<td>1132.0</td>
<td>1111.0</td>
<td></td>
</tr>
<tr>
<td>Exports</td>
<td>873.0</td>
<td>902.0</td>
<td>962.0</td>
<td>1199.0</td>
<td>1152.0</td>
<td>1050.0</td>
<td></td>
</tr>
<tr>
<td>Imports</td>
<td>-370.0</td>
<td>-354.0</td>
<td>-407.0</td>
<td>-438.0</td>
<td>-366.0</td>
<td>-287.0</td>
<td></td>
</tr>
<tr>
<td>Services (net)</td>
<td>-323.0</td>
<td>-233.0</td>
<td>-214.0</td>
<td>-361.0</td>
<td>-386.0</td>
<td>-226.0</td>
<td></td>
</tr>
<tr>
<td>Goods and services balance</td>
<td>-89.0</td>
<td>-77.0</td>
<td>-95.0</td>
<td>-108.0</td>
<td>-112.0</td>
<td>-102.0</td>
<td></td>
</tr>
<tr>
<td>Private unrequited transfers (net)</td>
<td>-218.0</td>
<td>207.0</td>
<td>185.0</td>
<td>188.0</td>
<td>186.0</td>
<td>215.0</td>
<td></td>
</tr>
<tr>
<td>Official unrequited transfers (net)</td>
<td>-194.0</td>
<td>-103.0</td>
<td>-124.0</td>
<td>-261.0</td>
<td>-312.0</td>
<td>-113.0</td>
<td></td>
</tr>
<tr>
<td>Current account balance</td>
<td>173.0</td>
<td>127.0</td>
<td>152.0</td>
<td>203.0</td>
<td>210.0</td>
<td>183.0</td>
<td></td>
</tr>
<tr>
<td>Capital account balance</td>
<td>19.2</td>
<td>-24.3</td>
<td>-35.9</td>
<td>23.6</td>
<td>49.6</td>
<td>-61.0</td>
<td></td>
</tr>
<tr>
<td>Errors and omissions (net)</td>
<td>-1.8</td>
<td>-0.3</td>
<td>-7.9</td>
<td>54.4</td>
<td>-52.4</td>
<td>9.0</td>
<td></td>
</tr>
</tbody>
</table>


144 The future of Asia-Pacific economies
Table 1b Papua New Guinea: percentage change in monetary aggregates, 1986–91

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Foreign assets (net)</td>
<td>5</td>
<td>-3</td>
<td>-18</td>
<td>-28</td>
<td>-2</td>
<td>-37</td>
</tr>
<tr>
<td>Domestic credit</td>
<td>21</td>
<td>3</td>
<td>19</td>
<td>14</td>
<td>9</td>
<td>23</td>
</tr>
<tr>
<td>Claims on central government (net)</td>
<td>76</td>
<td>-115</td>
<td>849</td>
<td>25</td>
<td>107</td>
<td>88</td>
</tr>
<tr>
<td>Claims on the private sector</td>
<td>19</td>
<td>11</td>
<td>12</td>
<td>14</td>
<td>1</td>
<td>14</td>
</tr>
<tr>
<td>Money supply</td>
<td>13</td>
<td>2</td>
<td>4</td>
<td>5</td>
<td>4</td>
<td>18</td>
</tr>
</tbody>
</table>


Western Samoa

The experience of Western Samoa in the early eighties illustrates the case of macroeconomic instability generated by unrestrained fiscal policy and compounded by external shocks. In the late seventies the Western Samoan authorities wanted to invigorate economic activity through fiscal policy. The development expenditures of the public sector, including public sector enterprises, were increased sharply. The overall annual budget deficits of the government deteriorated quickly. The deficits were financed through domestic inflationary financing and external borrowings. Because of the openness of the Western Samoa economy, external imbalances emerged quickly and deteriorated progressively.

During 1980–82 Western Samoa, like other Pacific island economies, was exposed to both import and export shocks. The terms of trade deteriorated sharply as oil prices rose steeply while commodity prices fell. These developments caused further deterioration in the budget and balance of payments deficits. Inflation also gathered momentum and rose steeply to more than 20 per cent. The widening balance of payments deficits resulted in rapidly falling external reserves, increasing indebtedness and the emergence of external payments arrears.

The government had to change direction to re-establish financial stability. It sought an International Monetary Fund program to support its adjustment efforts. Growth and the ambitious development expenditure program had to be abandoned temporarily. In 1983 a set of reducing and expenditure shifting policies were put in place. The budget deficit was drastically reduced through new revenue measures and reduction in development and recurrent expenditures. The level of credit to the public and private sectors was reduced and contained within prescribed limits. Interest rates were raised and the tala was devalued by 17 per cent.

By the end of 1983 the external and internal imbalances had improved significantly. The inflation rate had decelerated with the impact of the expenditure...
Macroeconomic management of small island economies

reducing policies. The current account deficit had declined, external reserves had risen and external payments arrears were diminishing.

In 1984, the authorities decided to strengthen their stabilization efforts and undertake other restructuring measures necessary for stable long-term economic growth. To this end, cautious fiscal and monetary policies were maintained and the tala was devalued by a further 12 per cent. Adjustments were also made to the structure of import duties and excise taxes to minimize the degree of bias against the export sector.

The adjustment policies of 1983 and 1984, assisted by improvements in the terms of trade beginning in 1983, and substantial aid and concessional loan receipts, were effective in re-establishing macroeconomic stability in the country. Western Samoa was able to redirect its efforts towards economic growth but was keenly aware that growth cannot be sustained for long at the expense of macroeconomic stability. Since 1985, Western Samoa has gone through a period of macroeconomic stability assisted by substantial remittance and aid inflows, despite the ravages of two hurricanes. The government is currently a substantial net lender to the banking system and net foreign assets hover at around 12 months of visible imports (Figures 5–8; Tables 2a, 2b and 2c).

Figure 5 Western Samoa: external account balances, 1986–90
Figure 6  Western Samoa: government finances, 1985–90

Figure 7  Western Samoa: monetary aggregates, 1986–91

Figure 8  Western Samoa: monetary aggregates, 1986–91
### Table 2a Western Samoa: economic indicators, 1985–91

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Monetary survey (Tala, millions)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Foreign assets (net)</td>
<td>6.5</td>
<td>30.1</td>
<td>57.0</td>
<td>88.0</td>
<td>124.0</td>
<td>157.8</td>
<td>162.5</td>
</tr>
<tr>
<td>Domestic credit</td>
<td>57.7</td>
<td>48.3</td>
<td>33.3</td>
<td>14.9</td>
<td>-2.3</td>
<td>—</td>
<td>-10.8</td>
</tr>
<tr>
<td>Claims on central government (net)</td>
<td>23.2</td>
<td>9.5</td>
<td>-9.8</td>
<td>-31.3</td>
<td>-48.7</td>
<td>-61.4</td>
<td>-76.4</td>
</tr>
<tr>
<td>Claims on non-financial public enterprises</td>
<td>12.1</td>
<td>12.3</td>
<td>10.5</td>
<td>6.2</td>
<td>4.1</td>
<td>2.6</td>
<td>2.4</td>
</tr>
<tr>
<td>Claims on the private sector</td>
<td>22.4</td>
<td>26.6</td>
<td>32.6</td>
<td>40.0</td>
<td>42.3</td>
<td>58.8</td>
<td>63.2</td>
</tr>
<tr>
<td>Money supply</td>
<td>52.4</td>
<td>63.2</td>
<td>80.7</td>
<td>86.9</td>
<td>101.5</td>
<td>121.0</td>
<td>118.7</td>
</tr>
<tr>
<td>Interest rates (per cent)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Lending rate (average)</td>
<td>19.0</td>
<td>18.8</td>
<td>17.5</td>
<td>17.5</td>
<td>17.0</td>
<td>13.3</td>
<td>14.8</td>
</tr>
<tr>
<td>Deposit rate (average)</td>
<td>12.0</td>
<td>13.5</td>
<td>12.0</td>
<td>12.0</td>
<td>12.0</td>
<td>8.3</td>
<td>7.2</td>
</tr>
<tr>
<td>Inflation (per cent)</td>
<td></td>
<td>5.7</td>
<td>5.0</td>
<td>8.0</td>
<td>6.0</td>
<td>15.0</td>
<td>..</td>
</tr>
<tr>
<td>Population (millions)</td>
<td>0.2</td>
<td>0.2</td>
<td>0.2</td>
<td>0.2</td>
<td>0.2</td>
<td>..</td>
<td>..</td>
</tr>
<tr>
<td>Exchange rates</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Nominal effective</td>
<td>100.0</td>
<td>92.0</td>
<td>89.3</td>
<td>85.8</td>
<td>81.9</td>
<td>78.6</td>
<td>76.0</td>
</tr>
<tr>
<td>Real effective</td>
<td>100.0</td>
<td>92.9</td>
<td>89.0</td>
<td>89.0</td>
<td>86.0</td>
<td>90.4</td>
<td>82.9</td>
</tr>
<tr>
<td>External debt service ratio (per cent)</td>
<td>11.9</td>
<td>11.9</td>
<td>7.5</td>
<td>6.4</td>
<td>6.8</td>
<td>..</td>
<td>..</td>
</tr>
<tr>
<td>Government finance (Tala, millions)</td>
<td>-4.7</td>
<td>5.5</td>
<td>0.8</td>
<td>18.3</td>
<td>5.7</td>
<td>-6.7</td>
<td>..</td>
</tr>
<tr>
<td>Deficit (-) or surplus</td>
<td>71.2</td>
<td>77.5</td>
<td>91.5</td>
<td>105.8</td>
<td>109.5</td>
<td>121.1</td>
<td>..</td>
</tr>
<tr>
<td>Revenue</td>
<td>26.5</td>
<td>36.0</td>
<td>37.4</td>
<td>42.5</td>
<td>39.9</td>
<td>38.7</td>
<td>..</td>
</tr>
<tr>
<td>Grants</td>
<td>102.5</td>
<td>108.1</td>
<td>128.1</td>
<td>130.1</td>
<td>143.7</td>
<td>166.5</td>
<td>..</td>
</tr>
<tr>
<td>Expenditures (current, capital, net lending) of which recurrent</td>
<td>41.9</td>
<td>48.0</td>
<td>49.8</td>
<td>54.4</td>
<td>58.2</td>
<td>64.8</td>
<td>..</td>
</tr>
<tr>
<td>Financing</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>External</td>
<td>2.5</td>
<td>2.1</td>
<td>8.0</td>
<td>3.2</td>
<td>4.2</td>
<td>20.5</td>
<td>..</td>
</tr>
<tr>
<td>Domestic</td>
<td>2.3</td>
<td>-7.6</td>
<td>-8.0</td>
<td>-21.6</td>
<td>-9.8</td>
<td>-13.8</td>
<td>..</td>
</tr>
</tbody>
</table>

**Source:** International Monetary Fund, *International Financial Statistics*, Washington, DC, various issues; Central Bank of Western Samoa, *Quarterly Bulletin.*

### Table 2b Western Samoa: percentage change in monetary aggregates, 1986–91

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Foreign assets (net)</td>
<td>366.0</td>
<td>-10.0</td>
<td>55.0</td>
<td>41.0</td>
<td>27.0</td>
<td>3.0</td>
</tr>
<tr>
<td>Domestic credit</td>
<td>-16.0</td>
<td>-31.0</td>
<td>-55.0</td>
<td>-115.0</td>
<td>110.0</td>
<td>-542.0</td>
</tr>
<tr>
<td>Claims on central government (net)</td>
<td>-59.0</td>
<td>-103.0</td>
<td>-220.0</td>
<td>-56.0</td>
<td>-26.0</td>
<td>-24.0</td>
</tr>
<tr>
<td>Claims on non-financial public enterprises</td>
<td>1.0</td>
<td>-14.0</td>
<td>-40.0</td>
<td>-35.0</td>
<td>-37.0</td>
<td>-9.0</td>
</tr>
<tr>
<td>Claims on private sector</td>
<td>19.0</td>
<td>23.0</td>
<td>22.0</td>
<td>6.0</td>
<td>39.0</td>
<td>7.0</td>
</tr>
<tr>
<td>Money supply</td>
<td>21.0</td>
<td>28.0</td>
<td>8.0</td>
<td>17.0</td>
<td>19.0</td>
<td>-2.0</td>
</tr>
</tbody>
</table>

**Sources:** International Monetary Fund, *International Financial Statistics*, Washington, DC, various issues; Central Bank of Western Samoa, *Quarterly Bulletin.*

148 The future of Asia–Pacific economies
Table 2c Western Samoa: Balance of payments, 1986–91 (tala, millions)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Current account (net)</td>
<td>-12.4</td>
<td>-12.1</td>
<td>-13.0</td>
<td>-3.6</td>
<td>-12.5</td>
<td>-7.5</td>
<td>-72.1</td>
</tr>
<tr>
<td>Goods, services and income</td>
<td>-75.9</td>
<td>-89.3</td>
<td>-86.8</td>
<td>-90.2</td>
<td>-104.5</td>
<td>-78.1</td>
<td>-126.9</td>
</tr>
<tr>
<td>Merchandise trade (net)</td>
<td>-81.8</td>
<td>-105.1</td>
<td>-123.7</td>
<td>-142.0</td>
<td>-165.6</td>
<td>-127.3</td>
<td>-159.6</td>
</tr>
<tr>
<td>Exports (f.o.b.)</td>
<td>23.5</td>
<td>25.0</td>
<td>31.4</td>
<td>29.2</td>
<td>20.5</td>
<td>15.7</td>
<td>13.5</td>
</tr>
<tr>
<td>Imports (c.i.f.)</td>
<td>-105.3</td>
<td>-130.1</td>
<td>-155.1</td>
<td>-171.2</td>
<td>-186.1</td>
<td>-143.0</td>
<td>-173.1</td>
</tr>
<tr>
<td>Services and income (net)</td>
<td>5.9</td>
<td>15.8</td>
<td>36.9</td>
<td>51.9</td>
<td>61.1</td>
<td>49.2</td>
<td>32.8</td>
</tr>
<tr>
<td>Travel (net)</td>
<td>15.5</td>
<td>16.7</td>
<td>32.8</td>
<td>42.0</td>
<td>43.0</td>
<td>34.2</td>
<td>26.6</td>
</tr>
<tr>
<td>Credit</td>
<td>19.1</td>
<td>20.1</td>
<td>35.8</td>
<td>45.7</td>
<td>47.6</td>
<td>37.5</td>
<td>29.5</td>
</tr>
<tr>
<td>Debit</td>
<td>-5.2</td>
<td>-4.9</td>
<td>-4.7</td>
<td>-5.5</td>
<td>-3.5</td>
<td>-2.6</td>
<td>-3.4</td>
</tr>
<tr>
<td>Investment income (net)</td>
<td>-2.5</td>
<td>2.3</td>
<td>1.3</td>
<td>4.7</td>
<td>11.9</td>
<td>9.0</td>
<td>8.5</td>
</tr>
<tr>
<td>Credit</td>
<td>2.7</td>
<td>7.2</td>
<td>6.0</td>
<td>10.2</td>
<td>15.5</td>
<td>11.6</td>
<td>11.9</td>
</tr>
<tr>
<td>Debit</td>
<td>-5.2</td>
<td>-4.9</td>
<td>-4.7</td>
<td>-5.5</td>
<td>-3.5</td>
<td>-2.6</td>
<td>-3.4</td>
</tr>
<tr>
<td>Other services (net)</td>
<td>-7.1</td>
<td>-3.2</td>
<td>2.8</td>
<td>5.2</td>
<td>6.2</td>
<td>6.0</td>
<td>-2.3</td>
</tr>
<tr>
<td>Credit</td>
<td>10.7</td>
<td>14.8</td>
<td>20.2</td>
<td>26.2</td>
<td>34.8</td>
<td>25.1</td>
<td>29.1</td>
</tr>
<tr>
<td>Debit</td>
<td>-17.8</td>
<td>-18.0</td>
<td>-17.4</td>
<td>-21.2</td>
<td>-28.6</td>
<td>-19.1</td>
<td>-31.4</td>
</tr>
<tr>
<td>Private transfers (net)</td>
<td>63.5</td>
<td>77.2</td>
<td>73.8</td>
<td>86.6</td>
<td>92.0</td>
<td>70.5</td>
<td>54.7</td>
</tr>
<tr>
<td>Bank notes</td>
<td>13.6</td>
<td>18.0</td>
<td>14.2</td>
<td>21.6</td>
<td>20.3</td>
<td>16.5</td>
<td>11.2</td>
</tr>
<tr>
<td>Others (net)</td>
<td>49.9</td>
<td>59.2</td>
<td>59.6</td>
<td>65.0</td>
<td>71.7</td>
<td>54.0</td>
<td>43.5</td>
</tr>
<tr>
<td>Capital account (net)</td>
<td>37.0</td>
<td>37.8</td>
<td>44.7</td>
<td>36.1</td>
<td>50.1</td>
<td>39.2</td>
<td>81.0</td>
</tr>
<tr>
<td>Government (net)</td>
<td>35.3</td>
<td>42.7</td>
<td>43.4</td>
<td>41.3</td>
<td>58.5</td>
<td>49.5</td>
<td>..</td>
</tr>
<tr>
<td>Transfers (net)</td>
<td>34.1</td>
<td>35.7</td>
<td>41.1</td>
<td>37.8</td>
<td>36.1</td>
<td>27.9</td>
<td>..</td>
</tr>
<tr>
<td>Project grants</td>
<td>27.1</td>
<td>29.1</td>
<td>31.7</td>
<td>35.0</td>
<td>31.9</td>
<td>26.3</td>
<td>..</td>
</tr>
<tr>
<td>Cash and commodity grants</td>
<td>8.9</td>
<td>8.3</td>
<td>10.8</td>
<td>4.7</td>
<td>6.7</td>
<td>3.7</td>
<td>..</td>
</tr>
<tr>
<td>Other</td>
<td>-1.9</td>
<td>-1.7</td>
<td>-1.5</td>
<td>-1.9</td>
<td>-2.6</td>
<td>-2.1</td>
<td>..</td>
</tr>
<tr>
<td>Loans (net)</td>
<td>1.1</td>
<td>7.0</td>
<td>2.3</td>
<td>3.5</td>
<td>22.5</td>
<td>21.6</td>
<td>..</td>
</tr>
<tr>
<td>Disbursements</td>
<td>5.8</td>
<td>12.5</td>
<td>8.3</td>
<td>10.5</td>
<td>29.1</td>
<td>26.4</td>
<td>..</td>
</tr>
<tr>
<td>Repayments</td>
<td>-4.7</td>
<td>-5.5</td>
<td>-6.0</td>
<td>-7.0</td>
<td>-6.6</td>
<td>-4.8</td>
<td>..</td>
</tr>
<tr>
<td>Government guaranteed loans (net)</td>
<td>-2.6</td>
<td>-1.2</td>
<td>-1.1</td>
<td>-1.4</td>
<td>-1.0</td>
<td>-0.3</td>
<td>..</td>
</tr>
<tr>
<td>Disbursements</td>
<td>..</td>
<td>..</td>
<td>..</td>
<td>..</td>
<td>..</td>
<td>..</td>
<td>..</td>
</tr>
<tr>
<td>Repayments</td>
<td>-2.6</td>
<td>-1.2</td>
<td>-1.1</td>
<td>-1.4</td>
<td>-1.0</td>
<td>-0.3</td>
<td>..</td>
</tr>
<tr>
<td>Other</td>
<td>4.3</td>
<td>-3.7</td>
<td>2.4</td>
<td>-3.8</td>
<td>-7.5</td>
<td>-10.0</td>
<td>..</td>
</tr>
<tr>
<td>Overall balance</td>
<td>24.6</td>
<td>25.7</td>
<td>31.7</td>
<td>32.6</td>
<td>37.5</td>
<td>31.7</td>
<td>8.8</td>
</tr>
</tbody>
</table>

\(a\) First 9 months.

**Sources:** International Monetary Fund, *International Financial Statistics*, Washington, DC, various issues; Central Bank of Western Samoa, *Quarterly Bulletin*.

**Fiji**

The Fiji economy was subjected to a series of domestic and external shocks in 1987. The domestic shocks came in the wake of the two coups of that year. The economic and psychological climate changed dramatically following these events. Investment and consumer confidence evaporated quickly. Capital flight became the preoccupation of many. Most attempted capital flight through the banks but others sought avenues outside the banking system. Exporters deferred the repatriation of foreign exchange receipts but importers, because of expected falling consumer spending, delayed import orders and attempted
to run down stocks. Residents who held short-term external debts sought accommodation from their banks to settle them early.

External loan facilities and the supply of credit virtually dried up in the two weeks following the first coup. Businesses and members of the public rearranged their portfolios opting for liquid financial assets. Most individuals opted for cash, thereby compounding the rapidly tightening liquidity position of the banks. The demand for bank credit rose sharply (Figure 9). The Reserve Bank initially misread the signs and accommodated this increased demand. It very quickly changed its stance when it noted that it was financing capital outflows and the leads and lags in external transactions.

**Figure 9** Fiji: commercial bank credit to the private sector (percentage change)

![Percentage change graph](image)

Source: Reserve Bank of Fiji.

The number of tourists declined sharply as their home governments advised them to avoid visiting Fiji until further notice. Sugar harvests were delayed through a strike and export products were black-banned in a number of economies of destination. Foreign exchange receipts fell dramatically accompanied by falling imports. The economy was contracting quickly and with it government revenue. The import substituting businesses soon realized that it would be difficult to survive within a contracting market and that long-term survival required a change in attitude and reorientation towards exporting. Many business firms were forced to lay off workers and/or reduce salaries and wages.

The overall deficit in the balance of payments widened sharply. External financing sources were effectively closed. The government, which used to have long queues of international bankers wishing to lend to it, found its overtures...
Savenaca Siwatibau

for external accommodation politely ignored. Only two banks, both with branches in Fiji, responded positively and concluded stand-by arrangements, each for A$10 million, with the Reserve Bank.

The widening overall deficit had to be financed by running down external reserves and the liquidity in the banking system deteriorated sharply as foreign reserve levels fell (Figures 10 and 11). The authorities immediately focussed upon protecting the dwindling level of foreign exchange reserves. The Fiji dollar was devalued by 17.75 per cent on 29 June and by a further 15.25 per cent on 7 October, 1987. Interest rates were completely deregulated and allowed to find their own levels (Figure 12).

**Figure 10**  
Fiji: Liquidity of commercial banks, borrowing from the Reserve Bank (A), cash held at banks and deposits with the Reserve Bank (B), net position (B) – (A) = (C) (as a percentage of total deposits with banks)

<table>
<thead>
<tr>
<th>Month</th>
<th>January</th>
<th>February</th>
<th>March</th>
<th>April</th>
<th>May</th>
<th>June</th>
<th>July</th>
<th>August</th>
<th>September</th>
<th>October</th>
<th>November</th>
<th>December</th>
<th>January</th>
<th>February</th>
</tr>
</thead>
<tbody>
<tr>
<td>1986 (C)</td>
<td>-3.0</td>
<td>-2.5</td>
<td>-2.0</td>
<td>-1.5</td>
<td>-1.0</td>
<td>-0.5</td>
<td>0.0</td>
<td>1.0</td>
<td>2.0</td>
<td>3.0</td>
<td>3.5</td>
<td>4.0</td>
<td>5.0</td>
<td>6.0</td>
</tr>
<tr>
<td>1987 (C)</td>
<td>-4.0</td>
<td>-3.5</td>
<td>-3.0</td>
<td>-2.5</td>
<td>-2.0</td>
<td>-1.5</td>
<td>-1.0</td>
<td>-0.5</td>
<td>0.0</td>
<td>0.5</td>
<td>1.0</td>
<td>1.5</td>
<td>2.0</td>
<td>2.5</td>
</tr>
</tbody>
</table>

**Source:** Reserve Bank of Fiji.
Credit was quickly tightened. The Reserve Bank raised the statutory reserve deposit ratio and advised the banks that it would not, until further notice, re-discount securities held by them. Short-term accommodation for banks was cut back and the interest penalty upon outstanding overdue advances was substantially increased. To supplement these measures the Reserve Bank introduced absolute credit limits which banks were required to observe. Commercial bank credit, which had risen in the second and third quarters, fell sharply during the fourth quarter of 1987 (Figure 9).
Interest rates rose quickly. The discount rate on promissory notes, short-term instruments issued by a number of public sector enterprises, rose from 2 per cent in March to 24 per cent by October. Interest rates in the Treasury bill and interbank market also followed similar trends (Figure 12).

The devaluations made capital flight fairly expensive and it was optimistically assumed that higher interest rates would, with a lag, counter capital outflows and encourage inflows. As these measures were not adequate to stem outflows, exchange controls were tightened. The value of funds which departing residents were allowed to remit was sharply reduced. Overseas portfolio investments by residents were stopped and travel allowances were also sharply reduced. It was announced that exchange control measures would be relaxed as soon as circumstances allowed, as the Reserve Bank held reservations about the long-term efficacy and effectiveness of this instrument. While the banks do cooperate in administering exchange control measures it is always possible to transfer substantial amounts of funds across borders without using bank services.

The government and public sector enterprises whose financial positions had deteriorated rapidly sought accommodation from the Reserve Bank. The Bank's claims upon the public sector increased from zero in April to over $50 million in October 1987 (Figure 13). That trend needed to be reversed quickly through drastic expenditure policies. The government announced a 15 per cent reduction in public service salaries and the public sector enterprises had their budgetary allocations reduced by 50 per cent. They were required to reduce operating expenditures including salaries and were informed that further requests for government assistance would not be accommodated.

**Figure 13  Claims by the Reserve Bank**

![Graph showing claims by the Reserve Bank](image)

Source: Reserve Bank of Fiji.
Financial stability, albeit at a low level of economic activity, began to emerge in November, 1987. External reserves, measured in special drawing rights to eliminate the distorting effect of the devaluations, started rising by the end of November (Figure 10). Commercial bank liquidity started increasing in October and total liquidity, broad money, had turned around by December (Figures 11 and 14). Claims upon the public sector by the Reserve Bank fell quickly from December onwards and money market interest rates were down to their late 1986 and early 1987 levels by February of 1988 (Figures 12 and 13).

Macroeconomic balance was sustained through 1988 (Figures 15–18 and Tables 3a and 3b). External reserves levels have steadily increased and the government deficit has improved from its 1987 position (Figures 15 and 16) and (Table 3a). Domestic credit, reflecting the uncertainty of the time, fell throughout 1988 but has grown strongly from 1989 (Figure 17).
**Figure 15 Fiji: external account balances, 1987–91**

![Graph showing Fiji's external account balances, 1987–91](image)


**Figure 16 Fiji: government finances, 1985–1991**

![Graph showing Fiji's government finances, 1985–1991](image)


155 Pacific islands at the crossroads?
Macroeconomic management of small island economies

Figure 17 Fiji: monetary aggregates, 1986–91

SOURCES: International Monetary Fund, International Financial Statistics, Washington, DC, various issues; Reserve Bank of Fiji, Quarterly.

Figure 18 Fiji: monetary aggregates, 1986–91

SOURCES: International Monetary Fund, International Financial Statistics, Washington, DC, various issues; Reserve Bank of Fiji, Quarterly.

156 The future of Asia–Pacific economies
### Table 3a Fiji: economic indicators, 1985–91

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Monetary survey (F$millions)</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Foreign assets (net)</td>
<td>117.7</td>
<td>177.6</td>
<td>182.3</td>
<td>316.7</td>
<td>311.3</td>
<td>373.0</td>
<td>410.3</td>
</tr>
<tr>
<td>Domestic credit</td>
<td>442.0</td>
<td>472.0</td>
<td>541.3</td>
<td>501.0</td>
<td>661.9</td>
<td>780.8</td>
<td>961.6</td>
</tr>
<tr>
<td>Claims on central government (net)</td>
<td>31.9</td>
<td>48.0</td>
<td>81.5</td>
<td>19.1</td>
<td>53.1</td>
<td>29.2</td>
<td>60.9</td>
</tr>
<tr>
<td>Claims on official entities</td>
<td>59.6</td>
<td>56.4</td>
<td>66.2</td>
<td>70.4</td>
<td>68.0</td>
<td>75.2</td>
<td>92.8</td>
</tr>
<tr>
<td>Claims on the private sector</td>
<td>350.4</td>
<td>367.6</td>
<td>393.6</td>
<td>411.5</td>
<td>540.8</td>
<td>676.4</td>
<td>802.9</td>
</tr>
<tr>
<td><strong>Money supply</strong></td>
<td>489.4</td>
<td>575.0</td>
<td>598.2</td>
<td>721.3</td>
<td>825.8</td>
<td>1023.7</td>
<td>1163.6</td>
</tr>
<tr>
<td><strong>Interest rates (per cent)</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Treasury bill</td>
<td>7.0</td>
<td>6.4</td>
<td>9.8</td>
<td>1.8</td>
<td>2.8</td>
<td>4.4</td>
<td>5.5</td>
</tr>
<tr>
<td>Deposit rate (average)</td>
<td>6.0</td>
<td>6.0</td>
<td>6.0</td>
<td>4.9</td>
<td>4.0</td>
<td>4.0</td>
<td>4.0</td>
</tr>
<tr>
<td>Lending rate (average)</td>
<td>13.5</td>
<td>13.5</td>
<td>13.5</td>
<td>20.5</td>
<td>11.6</td>
<td>11.9</td>
<td>12.3</td>
</tr>
<tr>
<td>Inflation (per cent)</td>
<td>4.4</td>
<td>1.8</td>
<td>5.7</td>
<td>11.9</td>
<td>6.1</td>
<td>8.1</td>
<td>6.5</td>
</tr>
<tr>
<td><strong>Government finance (F$millions)</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Deficit (–) or surplus</td>
<td>35.4</td>
<td>–70.6</td>
<td>–73.9</td>
<td>–11.9</td>
<td>–54.7</td>
<td>–46.5</td>
<td>–1.6</td>
</tr>
<tr>
<td>Revenue</td>
<td>392.2</td>
<td>330.6</td>
<td>324.8</td>
<td>367.6</td>
<td>448.1</td>
<td>530.4</td>
<td>499.3</td>
</tr>
<tr>
<td>Grants received</td>
<td>10.5</td>
<td>9.5</td>
<td>11.4</td>
<td>22.2</td>
<td>11.9</td>
<td>8.7</td>
<td>18.4</td>
</tr>
<tr>
<td>Expenditure</td>
<td>371.7</td>
<td>383.3</td>
<td>398.2</td>
<td>397.2</td>
<td>477.9</td>
<td>522.1</td>
<td>494.8</td>
</tr>
<tr>
<td>Net lending</td>
<td>3.4</td>
<td>27.3</td>
<td>11.9</td>
<td>4.5</td>
<td>36.7</td>
<td>63.5</td>
<td>24.5</td>
</tr>
<tr>
<td><strong>Financing</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Domestic</td>
<td>33.4</td>
<td>73.7</td>
<td>88.8</td>
<td>29.4</td>
<td>83.6</td>
<td>66.9</td>
<td>14.7</td>
</tr>
<tr>
<td><strong>Balance of payments (F$millions)</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Trade balance</td>
<td>..</td>
<td>..</td>
<td>–10.3</td>
<td>–55.1</td>
<td>–109.9</td>
<td>–266.8</td>
<td>–201.5</td>
</tr>
<tr>
<td>Goods, services, income (net)</td>
<td>..</td>
<td>..</td>
<td>–0.2</td>
<td>–14.2</td>
<td>–38.9</td>
<td>–78.7</td>
<td>–12.2</td>
</tr>
<tr>
<td>Transfers (net)</td>
<td>..</td>
<td>..</td>
<td>–10.7</td>
<td>43.0</td>
<td>20.6</td>
<td>2.6</td>
<td>5.1</td>
</tr>
<tr>
<td>Current account balance</td>
<td>..</td>
<td>..</td>
<td>–10.9</td>
<td>57.2</td>
<td>59.5</td>
<td>–76.1</td>
<td>–7.1</td>
</tr>
<tr>
<td>Capital account balance</td>
<td>..</td>
<td>..</td>
<td>–28.9</td>
<td>99.6</td>
<td>–29.3</td>
<td>102.0</td>
<td>41.9</td>
</tr>
<tr>
<td>Overall balance</td>
<td>..</td>
<td>..</td>
<td>–49.1</td>
<td>154.9</td>
<td>–17.5</td>
<td>55.5</td>
<td>23.5</td>
</tr>
<tr>
<td>External debt service ratio (per cent)</td>
<td>..</td>
<td>17.3</td>
<td>13.7</td>
<td>11.1</td>
<td>12.0</td>
<td>9.2</td>
<td></td>
</tr>
</tbody>
</table>

**Sources:** International Monetary Fund, *International Financial Statistics*, Washington, DC, various issues; Reserve Bank of Fiji, *Quarterlies*.

### Table 3b Fiji: percentage change in monetary aggregates, 1986–91

<table>
<thead>
<tr>
<th></th>
<th>1986%</th>
<th>1987%</th>
<th>1988%</th>
<th>1989%</th>
<th>1990%</th>
<th>1991%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Foreign assets (net)</td>
<td>51.0</td>
<td>3.0</td>
<td>74.0</td>
<td>–2.0</td>
<td>20.0</td>
<td>10.0</td>
</tr>
<tr>
<td>Domestic credit</td>
<td>7.0</td>
<td>15.0</td>
<td>–7.0</td>
<td>32.0</td>
<td>18.0</td>
<td>23.0</td>
</tr>
<tr>
<td>Claims on central government (net)</td>
<td>50.0</td>
<td>70.0</td>
<td>–77.0</td>
<td>178.0</td>
<td>–45.0</td>
<td>109.0</td>
</tr>
<tr>
<td>Claims on official entities</td>
<td>–5.0</td>
<td>17.0</td>
<td>6.0</td>
<td>–3.0</td>
<td>11.0</td>
<td>23.0</td>
</tr>
<tr>
<td>Claims on private sector</td>
<td>5.0</td>
<td>7.0</td>
<td>5.0</td>
<td>31.0</td>
<td>25.0</td>
<td>19.0</td>
</tr>
<tr>
<td>Money supply</td>
<td>17.0</td>
<td>4.0</td>
<td>21.0</td>
<td>14.0</td>
<td>24.0</td>
<td>14.0</td>
</tr>
</tbody>
</table>

**Sources:** International Monetary Fund, *International Financial Statistics*, Washington, DC, various issues; Reserve Bank of Fiji, *Quarterlies*.

157 Pacific islands at the crossroads?
Beginning in 1988 the authorities, having re-established financial stability, were able to experiment with further policies for restructuring with the aim of stimulating growth. The nominal devaluations of 1987, despite the temporary surge in domestic prices in 1987 and 1988, resulted in a substantial devaluation of the real effective exchange rate of the Fiji dollar (Figure 19). This, together with wage settlements below the variation in the consumer price index, has significantly improved the competitiveness of the Fiji economy. To supplement these gains and further strengthen the country's outward looking strategy, significant adjustments and reforms were made to the tax system. Import licences, were progressively replaced by tariffs and it was planned that the level and dispersion of tariffs should be reduced steadily over time. The initial shock to import-substituting industries was largely cushioned by the devaluations of 1987. The negative revenue impact of the tariff reductions and the proposed reductions in direct taxes were to be offset by a broad-based value-added tax. The new tax structure, together with a strengthened inland revenue service and tighter control over the depth and breadth of concessions is expected to establish a tax system which is weakly elastic with respect to GDP. Better control over discretionary recurrent expenditures and stricter guidelines for clearing capital projects are also part of an overall long-term program for ensuring fiscal stability and economic growth in the country.

Figure 19 Pacific islands: real effective exchange rates (index 1985 = 100)

Public sector investments are to concentrate upon human resource development and economic and social infrastructure. It is increasingly recognized that investments in the production of goods and services for sale in the market place are, in the case of Fiji, better left to the private sector. Policies for promoting efficiency and private sector development have therefore become central to the country's development strategy. Trade liberalization measures will be followed by further measures, such as freer entry into business activities. Deregulation in the labour market is on the reform agenda. Legislation effecting part of this
program is now on the statute book but it remains to be seen whether past momentum in this important area of domestic policy will be sustained.

Deregulation in the finance sector has evolved over a longer period. Interest rate controls were eliminated in 1987. Securities issued by the government, Reserve Bank and public sector enterprises have been put out to tender since the early eighties. The Reserve Bank supports a secondary market for these securities, but it will shed this role when the stock exchange is sufficiently strong to absorb it. Current international transactions are, under the provisions of a 1971 Statute, freely entered into and exempt from exchange controls. Such transactions include payments for imports and services, and remittances of dividends and interest payments. The repatriation of capital invested in Fiji is, by policy, not controlled. Domestic borrowings by non-resident persons or overseas controlled entities, while still controlled, are readily approved. No public issue of debentures, commercial papers or similar instruments by the larger private entities has so far been undertaken, but the authorities see this process gradually evolving with the development of the financial sector.

The corporatization of identified areas of government activities followed by progressive privatization is also an important component of the country’s development strategy. Public sector enterprises are increasingly expected to operate on commercial lines with increased autonomy and reduced financial support from the central government.

**External economic shocks**

The Pacific island economies are exposed to external shocks over which they have no control. Such shocks may be transmitted through the goods or capital markets and pose extremely difficult macroeconomic management challenges for small open economies. Such shocks are accompanied by escalating import bills, falling export receipts, widening trade and current account deficits, falling income, external reserves and investments and increased unemployment and pressures upon the domestic currency.

Recession in the industrialized economies may, as has occurred in the past, result in falling demand and prices for Pacific island commodities such as sugar, minerals and copra products causing an export shock. Similar export shocks may be triggered by the development and marketing of substitutes such as artificial sweeteners, in the case of sugar, or increased supply from other parts of the world. The latter could happen, for instance, if the EC had a particularly good sugar beet crop. During an export shock an island country experiences rapid falls in export receipts, GDP and government revenue. Budget and current account deficits widen since government and private expenditures and imports adjust to the adverse changes only after a considerable time lag. Positive export shocks do happen and generate unexpected foreign exchange windfalls. They may be triggered by accelerating economic growth in the industrialized economies or natural disasters in a major competing producer country.
The oil price escalations of 1973–74 and 1979–80 were examples of severe import shocks. Their impact upon the Pacific island economies, as indeed upon all oil importing economies, were particularly troublesome. They triggered substantial macroeconomic imbalances due to rapid domestic price increases and mounting fiscal and external deficits. The oil price increases of 1990 resulting from the Gulf War also created an import shock but it was less severe. The sharp fall in oil prices in 1986 was, of course, a welcome positive import shock.

The US dollar appreciated sharply against the special drawing right (SDR) by more than 20 per cent from January 1978 to January 1985 and depreciated steeply by more than 40 per cent from January 1985 to April 1992. A Pacific island country whose exports were denominated in non-US dollar currencies of the SDR basket, namely Deutschmark, French franc, Sterling and Yen, but with imports denominated in the US dollar would have experienced both export and import shocks when the US dollar appreciated. Its export receipts would have fallen sharply while its import bill would have increased equally sharply. Another country whose export prices were denominated in US dollars and imports in non-US dollars would have experienced negative export and import shocks when the US dollar fell steeply but positive import and export shocks when it rose sharply. A country which had accumulated external debt in US dollars would of course be exposed to an escalating external debt service burden during the period when the US dollar appreciated.

The combined impact of import and export shocks appears in a country’s terms of trade movements. Adverse terms of trade changes which are temporary are easier to manage. Those that show a persistent downward trend call for more difficult macroeconomic adjustments which are sometimes politically difficult to put in place.

External shocks which are transmitted through the world capital markets have not to date been as troublesome to the Pacific island economies. This reflects the limited Pacific island country forays into the external loan markets particularly the floating-rate euro-credit markets. In recent years, however, a small number of economies have accessed external floating-rate loans because of persistent fiscal deficits. Difficulties arise when high external nominal interest rates occur simultaneously with falling external inflation rates to confront borrowing economies with high real interest rates. An interest payments shock is particularly burdensome when the size of external floating rate loans is large and real interest rates are rapidly rising.

The events which led to the suspension of external debt servicing by Mexico and other heavily indebted developing economies, beginning in 1982, are illustrative. These economies were already heavily indebted overseas and the bulk of their external debts were in floating-rate euro-credits. Oil prices escalated in 1979–80: a difficult import shock for most of them. For Mexico, an oil exporter, this was a positive import shock, but instead of financing the shock by accumulating external reserves or refinancing external debts, it squandered
its wealth through public expenditures and used its improved credit rating to raise more external loans.

Non-oil commodity prices fell through the late seventies and early eighties resulting in a series of export shocks. The sharp increase in real interest rates and the steep appreciation of the US dollar during the early eighties, shocks transmitted through the capital markets, compounded these economies' already difficult external debt service positions.

Current account deficits that accompany external shocks have to be adjusted or financed through increasing exports, cutting back on imports, running down foreign exchange reserves, external borrowing or capital inflows in the form of direct or portfolio investments, but these policy options are not always easy to implement. Export volumes are difficult to increase when domestic supply constraints and protective measures in the export markets exist. In any case, time is required before the benefits of export promotion measures emerge. Cutting back imports is politically difficult as it involves the containment or reduction of domestic consumption and, possibly, investments. External borrowings add to future debt servicing commitments while direct and portfolio investments are relatively modest in the Pacific island economies and are certainly not responsive to short-term needs.

The appropriate policy measures required for addressing external imbalances generated by external shocks depend upon whether such shocks are likely to be temporary and whether the widening balance of payments deficit will reverse itself in a relatively short period. An accurate judgement about what will happen is normally very difficult to make.

If a shock is temporary, it is safe to finance the resulting external deficits, thereby allowing levels of consumption and investments to be maintained. Financing could be secured through running down external reserves, international commercial loans or the softer windows of the International Monetary Fund such as the Compensatory and Contingent Financing Facility the reserve tranche and the use of special drawing rights.

Financing, however, involves risks. If the country's assessment of the likely duration of the shock and associated unfavourable trend in the terms of trade are unduly optimistic, external reserves could evaporate rapidly, the external debt position could deteriorate sharply and the willingness of external creditors to continue to provide loan accommodation will end. At that point economic adjustment policies, with or without International Monetary Fund support, will become unavoidable.

If the shock is expected to last for a longer period and the external imbalances are not readily reversible, economic adjustment policies need to be put in place quickly. These would include policies geared towards containing or reducing the import bill, increasing foreign exchange earnings and containing domestic price levels. Expenditure reducing policies need to be implemented, to reduce
resident expenditures on imported and locally produced goods. Such policies include increased taxes, reduced government expenditures and restrictions on credit to the public and private sectors. Because of the resulting reduced domestic demand, resources are encouraged to flow into investments which can cater to export demand. Expenditure reducing policies could, however, have harmful effects which need to be taken into account. In the short run, while the process of reallocation of productive resources is taking place, reduced domestic demand may cause slower economic growth and perhaps increased unemployment. Worse, decision-makers may embrace the politically softer option of cutting back on capital expenditures so as to avoid raising additional revenue or cutting back unproductive but politically sensitive current expenditures such as wages and salaries, overseas travel for officials and ministers, subsidies to public sector enterprises and welfare expenditures. This easy option may result in long-term problems as reduced levels of national investment adversely affect the future growth of productive capacity and the economy.

Expenditure switching policies are aimed at redirecting expenditures by residents and non-residents to locally produced goods and services. Imports will become more expensive and local items more competitive overseas when devaluation is employed to switch expenditures. Commercial policies such as tariffs, export subsidies and import quotas are popular alternatives. These policies, unlike devaluation, have associated disadvantages which are often conveniently ignored. They are expensive to administer and the numerous officials and decision makers who administer them are continually exposed to pressures and temptations which they may find difficult to resist. They also create distortions and encourage interest groups, such as trade unions and businesses to exert their energies on protection and accumulation of rent rather than on efficient production and selling.

The increased domestic demand for local production which accompanies expenditure switching policies generates upward pressure on domestic prices. This development is compounded by the fact that domestic supply is generally inelastic in the Pacific island economies. If devaluation is used to switch expenditures with the aim of re-establishing external stability and improving competitiveness to enhance growth prospects, the domestic inflationary pressures which accompany it may well result in an appreciation of the real effective exchange rate of the home currency. This would of course frustrate the achievement of the desired objectives while contributing to a worsening domestic inflation. To avoid such developments, expenditure switching policies must be accompanied by a mix of expenditure reducing fiscal, monetary and incomes policies.

External shocks which persist without effective adjustment measures being taken to address them, result in unsustainable balance of payments deficits, depleted external reserves, falling government revenue, rising external debts and ultimately unavoidable devaluation. More often than not the initial reaction is to assume that shocks will be temporary and that fiscal and current account deficits should be financed. External reserves are used, followed by external
commercial borrowing. Such borrowing will end as soon as the market concludes that the country’s annual current account deficits are no longer sustainable. It is at such a point that a country will have no option but to seek a program from the International Monetary Fund and accept stabilization and adjustment measures composed of a range of expenditure reducing and expenditure shifting policies. Until agreements on such policies are concluded, access to financing from commercial sources, and even from multilateral financial institutions and bilateral donors, may effectively be closed.

The management of positive shocks is also important. Decisions have to be made on whether to finance or adjust to such shocks. If the associated terms of trade improvements are expected to be temporary, financing through increasing the level of foreign reserves and/or refinancing external loans held by residents including the government should be effected. If a positive shock is likely to persist for a long period adjustment through a mix of revaluation, increased domestic investment and consumption could be considered. Authorities tend to assume that positive shocks are likely to persist and are tempted to over adjust and dissipate the foreign exchange windfalls through consumption or public investments, which may not be appraised carefully. They opt for adjustment rather than financing. Expenditures are allowed to catch up, with a short lag, to the short-term trend in revenue. Later, as the shock ends, revenue plunges while expenditures, which are politically difficult to cut back, are maintained at the increased levels. A substantial budget deficit will quickly emerge.

**Fiscal policy**

The fiscal deficit may be taken to be the difference between the sum of revenue and grants and the sum of expenditures on goods and services, transfer payments and net lending. It is also equal to the sum of borrowings and the net decrease in cash holdings minus amortization.

Fiscal deficits may emerge and increase in response to a number of factors. The tax system may be inelastic because of numerous factors including a narrow tax base, the adoption of specific and not *ad valorem* taxes over a range of important tax bases and the existence of widespread and generous tax concessions for businesses and other entities. At the same time expenditures may be rising quickly due to popular public demand and lack of fiscal discipline by the authorities. The government may have adopted over-ambitious public sector investment programs. Pressures for substantial increases in the wages of public officials and parliamentarians succeed. Subsidies and other forms of transfers are regularly increased and state-owned enterprises run substantial losses which are financed through the annual budgets. Over time, the ratios of revenue and expenditures to GDP diverge and fiscal deficits widen.

The terms of trade may, in the wake of negative export and import shocks, decline with attendant deterioration in the national income and the standard of living. The authorities, adopting the easier political option of financing, may
pursue policies which increase subsidies and other transfers, reduce taxes on fuels and other consumer goods or increase public capital expenditures in an effort to invigorate economic activity. As total public expenditures rise and revenue receipts decline the fiscal deficit will deteriorate.

Fiscal deficits frequently cause external instability in open economies with fixed exchange rate systems and where capital is internationally mobile. The current account deficit equals the excess, within an economy, of expenditures over income. This identity may be expressed as

\[ CA = (S_p - I_p) + (T - G) \]

The current account balance is the sum of the differences between private savings and investments, \((S_p - I_p)\), and the fiscal deficit, \((T - G)\) where \(T\) represents tax revenue and \(G\), government outlays. A current account deficit can therefore be addressed by reducing the fiscal deficit, increasing private savings or reducing private investments. Alternatively, a deteriorating fiscal position, unless offset by rising private savings or falling private investments, will result in external imbalances which may not be sustainable and will ultimately demand difficult adjustment measures. It should, however, be noted that current account deficits can be sustainable if the financing items in the capital accounts are used for investments which enhance the productive capacity of a country. Under such circumstances the country cannot be considered to be living beyond its means, but if capital inflows finance consumption, including projects which are not carefully appraised, current account deficits will not be sustainable over time.

The extent of instability generated by unsustainable fiscal deficits is a function of the size of the deficit itself, the composition of government expenditures and the mode of financing adopted. The deficit itself releases additional demand and expenditures which result in larger national import bills, worsening current account balances, evaporating external reserves, rising external debts and, ultimately, pressures upon the domestic currency. Price increases will also emerge well before a devaluation is effected as part of an adjustment program that may become unavoidable.

**Financing fiscal deficits**

Fiscal deficits have to be financed and financing may be secured from domestic and/or external sources. The two avenues available for domestic financing are non-inflationary and inflationary financing. The former involves the use of domestic private sector savings through direct borrowings or the issue of securities such as bonds and treasury bills to the provident fund, insurance companies, businesses and members of the public. In contrast, inflationary financing relies upon credit from the banking system, including the central bank. Unlike non-inflationary financing, which calls upon resources generated at the expense of demand within the economy, this mode of financing triggers off macroeconomic imbalances. When inflationary financing is used in a fixed exchange rate environment, as applies in the Pacific island economies, the
Savenaca Siwatibau

external sector deficits will rapidly widen and the country’s external reserves will decline sharply. Prices are likely to deteriorate relatively slowly during the period when imports are able to supplement domestic supply and before external financing sources dry up and external reserves are completely depleted. Ultimately, when devaluation becomes inevitable, domestic prices will rise quickly accompanied by a possible appreciation of the real effective exchange rate.

External financing for fiscal deficits has, to date, been accessible to the Pacific island economies. External grants, the most preferred source, finance the bulk of development expenditures in these economies. A number of economies are classified as less developed economies and have access to International Development Association resources and the soft window of the Asian Development Bank. About ten Pacific island economies are members of the multilateral development financial institutions, the International Bank for Reconstruction and the Asian Development Bank, and enjoy concessionary loan resources from these organizations. Private commercial credit from international banks has so far been avoided although some Pacific island economies have made forays into this market in recent years. Pacific island country authorities will need to continue to avoid this market which should not be used as a first resort to put off necessary adjustments and difficult political decisions.

Tonga and the Solomon Islands

The cases of Tonga and the Solomon Islands are illustrative of recent trends in fiscal management in a number of Pacific island economies.

Tonga embraced cautious fiscal policies during the 1980s. The country’s tax system was restructured and in 1987 a broad-based system was adopted. The progressive tax schedule, which peaked at a 40 per cent marginal rate for taxable income over 7,600 pa’anga, was replaced by a 10 per cent flat tax rate. Company tax rates were also reduced. The loss in revenue from direct taxes was offset by a 5 per cent sales tax collected at retail points. The restructuring was aimed at encouraging savings, private sector investments, simplifying the tax system and lightening the burden of tax administration.

The tax to GDP ratio hovered around 30 per cent. Small surpluses in recurrent budgets were realized in a number of years enabling transfers to the development budgets. The government was also a consistent and substantial net lender to the banking system. The prudent fiscal policy which Tonga had in place throughout most of the eighties contributed to the relatively stable macro-economic environment and the average positive, albeit modest, growth rate which the country enjoyed during that period.

After 1989 Tonga’s fiscal position began to change following a 50 per cent increase in public service wages. This wage adjustment also coincided with substantial increases in development expenditures. As in other Pacific island economies, the bulk of development budget expenditures were financed by aid
Macroeconomic management of small island economies

and concessionary loan funds. Euro-credit markets were generally avoided. The 28 per cent growth in total recurrent expenditures which emerged resulted in a 4 million pa‘anga deficit in the recurrent budget in the fiscal year 1989–90. The overall budget deficit has also deteriorated resulting in increasing recourse to inflationary financing from the banking system (Table 4b and Figures 21 and 23).

Table 4a  Tonga: economic indicators, 1985–92a

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Monetary survey (Pa‘anga, millions)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Foreign assets (net)</td>
<td>25.0</td>
<td>25.1</td>
<td>37.0</td>
<td>34.8</td>
<td>33.3</td>
<td>33.1</td>
<td>32.9</td>
<td>36.6</td>
</tr>
<tr>
<td>Domestic credit</td>
<td>8.7</td>
<td>12.8</td>
<td>11.9</td>
<td>18.9</td>
<td>22.5</td>
<td>30.9</td>
<td>35.4</td>
<td>40.9</td>
</tr>
<tr>
<td>Claims on central government (net)</td>
<td>-5.0</td>
<td>-4.1</td>
<td>-7.1</td>
<td>-6.4</td>
<td>-11.8</td>
<td>-6.5</td>
<td>-0.5</td>
<td>5.9</td>
</tr>
<tr>
<td>Claims on non-financial public enterprises</td>
<td>2.2</td>
<td>2.4</td>
<td>1.8</td>
<td>2.5</td>
<td>1.8</td>
<td>1.7</td>
<td>1.4</td>
<td>0.9</td>
</tr>
<tr>
<td>Claims on the private sector</td>
<td>11.3</td>
<td>14.3</td>
<td>17.0</td>
<td>22.5</td>
<td>32.2</td>
<td>35.3</td>
<td>33.3</td>
<td>35.5</td>
</tr>
<tr>
<td>Money supply</td>
<td>24.1</td>
<td>27.0</td>
<td>36.0</td>
<td>36.7</td>
<td>37.6</td>
<td>40.3</td>
<td>43.9</td>
<td>50.1</td>
</tr>
<tr>
<td>Interest rates (per cent)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Deposit rate (average)</td>
<td>6.25</td>
<td>6.25</td>
<td>6.25</td>
<td>6.25</td>
<td>7.25</td>
<td>7.25</td>
<td>7.25</td>
<td>7.25</td>
</tr>
<tr>
<td>Lending rate (average)</td>
<td>10.00</td>
<td>10.00</td>
<td>10.00</td>
<td>10.00</td>
<td>13.50</td>
<td>13.50</td>
<td>13.50</td>
<td>13.50</td>
</tr>
<tr>
<td>Exchange rates</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>A$/Pa‘anga</td>
<td>1.00</td>
<td>1.00</td>
<td>1.00</td>
<td>1.00</td>
<td>1.00</td>
<td>1.00</td>
<td>1.00</td>
<td>1.00</td>
</tr>
<tr>
<td>NZ$/Pa‘anga</td>
<td>1.47</td>
<td>1.28</td>
<td>1.23</td>
<td>1.20</td>
<td>1.30</td>
<td>1.32</td>
<td>1.31</td>
<td>1.38</td>
</tr>
<tr>
<td>US$/Pa‘anga</td>
<td>0.67</td>
<td>0.71</td>
<td>0.71</td>
<td>0.78</td>
<td>0.78</td>
<td>0.77</td>
<td>0.78</td>
<td>0.76</td>
</tr>
<tr>
<td>Real effective (index) (March 1985=100.0)</td>
<td>100.0</td>
<td>114.0</td>
<td>97.0</td>
<td>101.0</td>
<td>112.0</td>
<td>109.0</td>
<td>116.0</td>
<td>127.0</td>
</tr>
<tr>
<td>Inflation (per cent)</td>
<td>1.4</td>
<td>29.1</td>
<td>7.5</td>
<td>11.3</td>
<td>4.0</td>
<td>5.6</td>
<td>13.3</td>
<td>..</td>
</tr>
<tr>
<td>Real GDP growth (per cent)</td>
<td>3.4</td>
<td>1.3</td>
<td>0.4</td>
<td>-1.6</td>
<td>1.8</td>
<td>..</td>
<td>..</td>
<td>..</td>
</tr>
<tr>
<td>Population (millions)</td>
<td>0.1</td>
<td>0.1</td>
<td>0.1</td>
<td>0.1</td>
<td>0.1</td>
<td>0.1</td>
<td>..</td>
<td>..</td>
</tr>
</tbody>
</table>

a  Financial year ends 30 June; 1992 figures to March.

Table 4b  Tonga: balance of payments and finance, 1985–1991\(^a\)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Balance of payments</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Merchandise Trade</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Exports (f.o.b.)</td>
<td>10.7</td>
<td>8.4</td>
<td>10.7</td>
<td>8.8</td>
<td>12.1</td>
<td>11.7</td>
<td>13.5</td>
</tr>
<tr>
<td>Imports (f.o.b.)</td>
<td>47.7</td>
<td>49.3</td>
<td>54.7</td>
<td>60.4</td>
<td>59.1</td>
<td>64.2</td>
<td>65.5</td>
</tr>
<tr>
<td>Trade balance</td>
<td>-37.0</td>
<td>-40.0</td>
<td>-44.0</td>
<td>-51.6</td>
<td>-47.0</td>
<td>-52.5</td>
<td>-52.0</td>
</tr>
<tr>
<td>Services (net)</td>
<td>0.8</td>
<td>-2.3</td>
<td>3.8</td>
<td>-0.9</td>
<td>-0.2</td>
<td>11.5</td>
<td>-3.9</td>
</tr>
<tr>
<td>Investment income (net)</td>
<td>3.8</td>
<td>3.7</td>
<td>5.8</td>
<td>6.2</td>
<td>2.1</td>
<td>4.3</td>
<td>3.8</td>
</tr>
<tr>
<td>Transfers</td>
<td>30.5</td>
<td>37.5</td>
<td>43.4</td>
<td>37.1</td>
<td>42.8</td>
<td>53.1</td>
<td>46.9</td>
</tr>
<tr>
<td>Private (net)</td>
<td>26.3</td>
<td>33.2</td>
<td>33.8</td>
<td>29.3</td>
<td>30.5</td>
<td>39.7</td>
<td>38.9</td>
</tr>
<tr>
<td>Official (net)</td>
<td>4.1</td>
<td>4.4</td>
<td>9.6</td>
<td>7.8</td>
<td>12.3</td>
<td>13.5</td>
<td>8.1</td>
</tr>
<tr>
<td>Current account balance</td>
<td>-1.9</td>
<td>-1.9</td>
<td>8.9</td>
<td>-9.3</td>
<td>-2.3</td>
<td>16.4</td>
<td>-5.1</td>
</tr>
<tr>
<td>Capital account balance</td>
<td>2.4</td>
<td>0.2</td>
<td>—</td>
<td>6.6</td>
<td>1.5</td>
<td>-17.6</td>
<td>-0.6</td>
</tr>
<tr>
<td>Net errors and omissions</td>
<td>3.2</td>
<td>2.7</td>
<td>2.5</td>
<td>0.2</td>
<td>-0.6</td>
<td>3.6</td>
<td>2.1</td>
</tr>
<tr>
<td>Overall balance</td>
<td>3.8</td>
<td>1.0</td>
<td>11.5</td>
<td>-2.5</td>
<td>-1.4</td>
<td>2.4</td>
<td>-3.6</td>
</tr>
<tr>
<td>Government finance (pa'anga, millions)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Deficit(−) or surplus</td>
<td>-2.1</td>
<td>-4.8</td>
<td>-6.7</td>
<td>-0.6</td>
<td>0.1</td>
<td>-1.9</td>
<td>-10.1</td>
</tr>
<tr>
<td>Revenue</td>
<td>22.2</td>
<td>26.2</td>
<td>29.2</td>
<td>33.8</td>
<td>32.7</td>
<td>39.8</td>
<td>51.9</td>
</tr>
<tr>
<td>Grants received</td>
<td>18.7</td>
<td>8.4</td>
<td>15.6</td>
<td>16.3</td>
<td>23.8</td>
<td>29.3</td>
<td>51.5</td>
</tr>
<tr>
<td>Expenditure</td>
<td>38.0</td>
<td>37.9</td>
<td>42.4</td>
<td>44.0</td>
<td>54.2</td>
<td>68.9</td>
<td>99.2</td>
</tr>
<tr>
<td>of which recurrent</td>
<td>21.3</td>
<td>26.9</td>
<td>32.0</td>
<td>33.9</td>
<td>34.8</td>
<td>44.5</td>
<td>48.4</td>
</tr>
<tr>
<td>Net lending</td>
<td>5.0</td>
<td>1.5</td>
<td>9.1</td>
<td>5.4</td>
<td>2.4</td>
<td>2.2</td>
<td>14.1</td>
</tr>
<tr>
<td>Financing</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Domestic</td>
<td>1.0</td>
<td>3.3</td>
<td>-0.8</td>
<td>-0.6</td>
<td>0.1</td>
<td>0.3</td>
<td>2.7</td>
</tr>
<tr>
<td>Foreign</td>
<td>1.1</td>
<td>1.5</td>
<td>7.5</td>
<td></td>
<td></td>
<td>1.6</td>
<td>7.3</td>
</tr>
</tbody>
</table>

Table 4c  Tonga: percentage change in monetary aggregates, 1986–1992

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Foreign assets (net)</td>
<td>—</td>
<td>47.0</td>
<td>-6.0</td>
<td>-4.0</td>
<td>—</td>
<td>-1.0</td>
<td>11.0</td>
</tr>
<tr>
<td>Domestic credit</td>
<td>47.0</td>
<td>-7.0</td>
<td>59.0</td>
<td>19.0</td>
<td>37.0</td>
<td>15.0</td>
<td>15.0</td>
</tr>
<tr>
<td>Claims on central government (net)</td>
<td>18.0</td>
<td>-73.0</td>
<td>9.0</td>
<td>-84.0</td>
<td>45.0</td>
<td>92.0</td>
<td>1208.0</td>
</tr>
<tr>
<td>Claims on private sector</td>
<td>26.0</td>
<td>19.0</td>
<td>32.0</td>
<td>43.0</td>
<td>10.0</td>
<td>-6.0</td>
<td>—</td>
</tr>
<tr>
<td>Money supply</td>
<td>12.0</td>
<td>34.0</td>
<td>2.0</td>
<td>2.0</td>
<td>7.0</td>
<td>9.0</td>
<td>14.0</td>
</tr>
</tbody>
</table>

167  Pacific islands at the crossroads?
Macroeconomic management of small island economies

Figure 20  Tonga: external account balances, 1985–1991

Figure 21  Tonga: government finances, 1985–1991

Figure 22  Tonga: monetary aggregates, 1986–1992
At the end of fiscal year 1988–89 the government was a net lender of about 12 million pa‘anga to the banking system. Due to increasing budget deficits the government had become a net borrower from the banking system by the end of March, 1992 and owed some 6 million pa‘anga, the bulk to the Reserve Bank. By contrast, claims upon the private sector by the banks declined annually in absolute terms post-1989 reflecting the steady crowding-out of the private sector from the domestic credit market (Table 4c). The effects of the flow-on of the public sector wage settlement to the rest of the economy and the widening fiscal deficits since 1989–90 have contributed to the accelerating pace of inflation (Table 4a) and to the external imbalances which have emerged since 1990 (Table 4b; Figures 20–23). Net foreign assets, currently at a comfortable level of five months of imports, are expected to come under increased pressure in the months ahead. The marked appreciation of the real effective exchange rate of the pa‘anga (Figure 19) has contributed to the steady erosion of the country’s competitiveness and reflects the increase in domestic prices.

In its efforts to address the widening budget deficits the authorities introduced a range of revenue raising measures and cut back upon non-wage recurrent expenditures including items such as essential operation and maintenance costs and materials required for education and medical services.

The authorities, aware of the potential macroeconomic instability which accompanies widening and persistent budget deficits are examining more fundamental and longer-term solutions. As the tax to GDP ratio is considered appropriate at around 30 per cent, tax measures, except for changes which help maintain or enhance the elasticity of the tax system (such as conversion to an *ad valorem* basis where possible, incorporation of new bases and cutting back on the range and depth of tax concessions) will not play an important role. Emphasis will be placed upon expenditure policies. The level of wages and the need for containing or reducing the size of the public service are being examined.
Macroeconomic management of small island economies

Projects are to be carefully appraised in an attempt to ensure that only those which meet minimum standards of returns are accepted for financing. This will help lighten the burden an increasing number of low priority, aid-supported projects have imposed upon recurrent budgets in recent years.

State-owned enterprises have increasingly been expected to operate commercially. Transfers from annual budgets to these entities are to be better controlled and steadily reduced. The Tonga Commodities Board, whose mounting losses contributed to the government’s deteriorating fiscal position was broken up into a number of government-owned companies. Legislation facilitating the hiving-off of selected government activities into commercially-run government companies is under consideration. Over time government intends, when appropriate, to progressively sell its interests in selected state-owned enterprises.

Recent developments in the Solomon Islands offer useful lessons for macroeconomic managers in the Pacific island economies. The country enjoys generous support for its capital programs from bilateral and multilateral donors (particularly the European Community under STABEX transfers). Government expenditures have risen rapidly in the wake of accommodated demands from the public service for substantial wage increases, rising costs of provincial governments and increased capital expenditures (Table 5a and Figure 24). The overall deficit has widened rapidly since 1989. The authorities have increasingly resorted to domestic inflationary financing sources to cover these deficits. The net claims upon the central government by the banking system, including the central bank, rose from SI$8 million in 1987 to SI$118 million by the end of 1991 (Table 5a). The extent of the monetization of the budget deficits by the central bank within this financing program has been significant during this period. At the end of 1987 government was a net lender of SI$15.44 million to the central bank. By the end of 1991 it had become a net borrower of SI$56.06 million from the central bank; a swing of SI$71.50 million over the four year period.

Domestic credit grew at rates varying between 21 per cent and 41 per cent over the last four years but the private sector has been crowded out of the domestic credit market since 1989 and its share of credit has declined in absolute terms since that year. The growth in domestic liquidity within the economy was, however, modest during the four years because of the offsetting influence of rapidly falling net foreign assets and credit restraints by the central bank upon the private sector (Figures 27 and 28).

Reflecting the deteriorating fiscal position of the government and the mode of financing adopted and, to some extent, weak export commodity prices, the external position of the Solomon Islands has weakened steadily over the last four years (Table 5 and Figure 25). Widening overall balance of payments deficits have steadily eroded external reserves. Net foreign assets declined from an equivalent of 5.5 months of visible imports in December 1987 to three weeks of imports by the end of 1991. Inflation rates, except for 1990, were well in excess of 10 per cent.
# Table 5a Solomon Islands: economic indicators, 1985–91

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Monetary survey (SI$m millions)</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Foreign assets (net)</td>
<td>24.7</td>
<td>40.8</td>
<td>63.3</td>
<td>79.7</td>
<td>50.2</td>
<td>34.5</td>
<td>21.0</td>
</tr>
<tr>
<td>Domestic credit</td>
<td>60.9</td>
<td>63.0</td>
<td>71.2</td>
<td>91.1</td>
<td>128.3</td>
<td>154.7</td>
<td>203.8</td>
</tr>
<tr>
<td>Claims on central</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>government (net)</td>
<td>12.7</td>
<td>9.6</td>
<td>8.1</td>
<td>9.7</td>
<td>23.7</td>
<td>60.3</td>
<td>118.1</td>
</tr>
<tr>
<td>Claims on private sector</td>
<td>47.1</td>
<td>51.6</td>
<td>55.0</td>
<td>69.5</td>
<td>92.2</td>
<td>82.3</td>
<td>75.6</td>
</tr>
<tr>
<td>Claims on other</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>financial institutions</td>
<td>1.1</td>
<td>1.8</td>
<td>8.1</td>
<td>12.0</td>
<td>12.4</td>
<td>12.2</td>
<td>10.1</td>
</tr>
<tr>
<td>Money supply</td>
<td>66.4</td>
<td>72.7</td>
<td>97.6</td>
<td>128.6</td>
<td>128.1</td>
<td>140.4</td>
<td>173.7</td>
</tr>
<tr>
<td>Growth rate (per cent)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interest rates (per cent)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Treasury bill rate</td>
<td>9.6</td>
<td>12.0</td>
<td>11.3</td>
<td>11.0</td>
<td>11.0</td>
<td>11.0</td>
<td>14.8</td>
</tr>
<tr>
<td>Deposit rate (average)</td>
<td>8.7</td>
<td>10.5</td>
<td>10.7</td>
<td>10.2</td>
<td>10.5</td>
<td>10.5</td>
<td>10.5</td>
</tr>
<tr>
<td>Lending rate (average)</td>
<td>12.8</td>
<td>15.1</td>
<td>17.3</td>
<td>18.0</td>
<td>18.0</td>
<td>18.0</td>
<td>19.5</td>
</tr>
<tr>
<td>Inflation (per cent)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Exchange rates</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Nominal effective</td>
<td>100.0</td>
<td>76.8</td>
<td>61.7</td>
<td>56.3</td>
<td>52.7</td>
<td>46.8</td>
<td>43.4</td>
</tr>
<tr>
<td>Real effective</td>
<td>100.0</td>
<td>84.6</td>
<td>73.2</td>
<td>75.2</td>
<td>77.5</td>
<td>71.2</td>
<td>73.3</td>
</tr>
<tr>
<td><strong>Government finance (SI$m millions)</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total government revenue</td>
<td>54.4</td>
<td>82.5</td>
<td>103.4</td>
<td>119.4</td>
<td>139.9</td>
<td>142.8</td>
<td>154.0</td>
</tr>
<tr>
<td>Grants</td>
<td>2.0</td>
<td>25.4</td>
<td>30.2</td>
<td>28.2</td>
<td>25.7</td>
<td>21.6</td>
<td>15.0</td>
</tr>
<tr>
<td>Internal revenue</td>
<td>52.4</td>
<td>57.1</td>
<td>73.2</td>
<td>91.7</td>
<td>114.2</td>
<td>121.2</td>
<td>139.0</td>
</tr>
<tr>
<td>Total government</td>
<td>73.8</td>
<td>97.5</td>
<td>143.1</td>
<td>144.2</td>
<td>154.2</td>
<td>170.9</td>
<td>214.0</td>
</tr>
<tr>
<td>expenditure</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Current</td>
<td>59.6</td>
<td>66.4</td>
<td>80.4</td>
<td>101.1</td>
<td>125.2</td>
<td>146.6</td>
<td>191.0</td>
</tr>
<tr>
<td>Capital</td>
<td>13.0</td>
<td>29.8</td>
<td>54.7</td>
<td>38.7</td>
<td>19.6</td>
<td>19.4</td>
<td>20.0</td>
</tr>
<tr>
<td>Net lending</td>
<td>1.3</td>
<td>1.3</td>
<td>8.0</td>
<td>4.4</td>
<td>9.4</td>
<td>4.9</td>
<td>3.0</td>
</tr>
<tr>
<td>Deficit</td>
<td>-19.4</td>
<td>-15.0</td>
<td>-39.7</td>
<td>-24.8</td>
<td>-14.3</td>
<td>-28.1</td>
<td>-60.0</td>
</tr>
<tr>
<td>Deficit (excluding grants)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Financing</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Domestic (net)</td>
<td>12.5</td>
<td>-3.0</td>
<td>34.7</td>
<td>17.3</td>
<td>8.9</td>
<td>19.9</td>
<td>71.0</td>
</tr>
<tr>
<td>Foreign (net)</td>
<td>7.0</td>
<td>18.0</td>
<td>5.0</td>
<td>7.5</td>
<td>5.4</td>
<td>8.2</td>
<td>-11.0</td>
</tr>
<tr>
<td>Balance of payments</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Trade balance</td>
<td>-1.0</td>
<td>- 6.4</td>
<td>- 12.4</td>
<td>- 48.3</td>
<td>- 91.1</td>
<td>- 55.1</td>
<td>-72.3</td>
</tr>
<tr>
<td>Exports</td>
<td>105.1</td>
<td>112.2</td>
<td>126.6</td>
<td>170.6</td>
<td>171.3</td>
<td>178.1</td>
<td>226.5</td>
</tr>
<tr>
<td>Imports</td>
<td>106.1</td>
<td>117.6</td>
<td>139.0</td>
<td>218.9</td>
<td>262.4</td>
<td>233.2</td>
<td>298.8</td>
</tr>
<tr>
<td>Services</td>
<td>-50.9</td>
<td>-71.4</td>
<td>-82.1</td>
<td>-103.5</td>
<td>-73.1</td>
<td>-93.9</td>
<td>-119.6</td>
</tr>
<tr>
<td>Unrequited transfers</td>
<td>13.5</td>
<td>67.9</td>
<td>63.6</td>
<td>93.0</td>
<td>88.3</td>
<td>88.2</td>
<td>90.4</td>
</tr>
<tr>
<td>Current account balance</td>
<td>-38.4</td>
<td>-9.9</td>
<td>-30.9</td>
<td>-58.8</td>
<td>-75.9</td>
<td>-60.8</td>
<td>-101.5</td>
</tr>
<tr>
<td>Capital account</td>
<td>12.8</td>
<td>14.2</td>
<td>29.2</td>
<td>83.2</td>
<td>48.5</td>
<td>57.4</td>
<td>77.7</td>
</tr>
<tr>
<td>Net errors and omissions</td>
<td>8.1</td>
<td>5.6</td>
<td>-9.4</td>
<td>-30.9</td>
<td>3.9</td>
<td>-14.5</td>
<td>3.9</td>
</tr>
<tr>
<td>Overall balance</td>
<td>-17.5</td>
<td>9.9</td>
<td>-11.1</td>
<td>-6.5</td>
<td>-24.0</td>
<td>-17.9</td>
<td>-19.9</td>
</tr>
<tr>
<td>External debt service ratio (per cent)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Population (millions)</td>
<td>0.27</td>
<td>0.28</td>
<td>0.29</td>
<td>0.30</td>
<td>0.31</td>
<td>0.32</td>
<td></td>
</tr>
<tr>
<td>GDP growth (per cent)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Table 5b  Solomon Islands: percentage change in monetary aggregates, 1986–91

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Foreign assets (net)</td>
<td>66.0</td>
<td>55.0</td>
<td>13.0</td>
<td>-37.0</td>
<td>-31.0</td>
<td>-39.0</td>
</tr>
<tr>
<td>Domestic credit</td>
<td>3.0</td>
<td>13.0</td>
<td>28.0</td>
<td>41.0</td>
<td>21.0</td>
<td>32.0</td>
</tr>
<tr>
<td>Claims on central government (net)</td>
<td>-24.0</td>
<td>-16.0</td>
<td>20.0</td>
<td>145.0</td>
<td>154.0</td>
<td>96.0</td>
</tr>
<tr>
<td>Claims private sector</td>
<td>10.0</td>
<td>7.0</td>
<td>26.0</td>
<td>33.0</td>
<td>-11.0</td>
<td>-8.0</td>
</tr>
<tr>
<td>Money supply</td>
<td>10.0</td>
<td>34.0</td>
<td>32.0</td>
<td>—</td>
<td>10.0</td>
<td>24.0</td>
</tr>
</tbody>
</table>

Figure 25  Solomon Islands: external account balances, 1985–91

Figure 26  Solomon Islands: government finances, 1985–91
In attempts to address macroeconomic imbalances, the Central Bank has made adjustments to the nominal exchange rates of the Solomon Islands dollar. The enhanced competitiveness which should have accrued from this policy has, to a large extent, been frustrated by the positive real wage increases that have been allowed and the widening fiscal deficits. This is reflected in the relatively stable movements in the real effective exchange rate of the Solomon Islands dollar since 1987 following its steep depreciation from 1985 to 1987 (Figure 19). The Solomon Islands will need to address its fiscal position urgently. It has relied almost entirely upon the Central Bank to counter the destabilizing impact of its fiscal imbalances. Without a change in the government's fiscal stance, however, external balances and external reserves will continue to deteriorate. Ultimately, stabilization and adjustment measures involving both
expenditure reducing and expenditure shifting policies will become unavoidable. Growth will then be disrupted as financial stability, an important pre-condition to stable long-term growth, is re-established.

**Monetary policy**

Monetary policy in the Pacific island economies plays an effective supporting role to fiscal policy in demand management aimed at short-term internal and external financial stability. However, active monetary policy which provides easy credit with the aim of stimulating economic activity is likely to fail as increased demand, which such a policy generates, will result in deterioration in balance of payments deficits and fuel domestic inflation in the open economies of the Pacific island economies.

The volume of liquidity within an economy is not always easy for the central bank in a Pacific island country to effectively influence (Appendices 1 and 2). Of the variables which determine money supply (M₃), the central bank is able to influence only the required reserve ratio of banks and claims upon banks through its policy instruments (Appendix 2).

Net foreign assets are largely determined by external and domestic factors including external and domestic shocks over which the central bank has little influence. When faced with a temporary positive external shock and the increased net foreign assets and domestic liquidity that it generates the central bank can however adopt an effective support role for the overall financing programs implemented to cope with such a shock. It may absorb part of the excess liquidity by selling government securities, issuing its own securities or offering attractive deposit interest terms to banks. It may also encourage and allow limited amounts of external debt refinancing for the public and private sectors.

The currency ratio is determined by members of the public, while the excess reserve ratio is set by the management of commercial banks. In the Pacific island economies where capital and money markets are still relatively underdeveloped, the range of financial instruments in which banks can invest is narrow so that the excess reserve ratio tends to be large.

Unless the central bank is able to exercise a strong influence upon fiscal policy and the government shows willingness to exercise fiscal discipline, central bank claims upon the government and upon state-owned enterprises can easily become a major and difficult source of macroeconomic instability.

The six Pacific island economies which have central banks recognize the macroeconomic dangers that may be generated by inflationary financing, particularly the monetization of the deficit through central banking credit. The central banking legislation of these economies limits the extent of government borrowing from the central bank. Such limits are generally set at a fixed percentage of average annual revenue over a number of years immediately
preceding the budget year. In three of these economies the government and state-owned enterprises are required by law to consult with the central bank in the course of preparation of their annual budgets. This arrangement mandates comprehensive discussions about the optimal size of the public sector deficit in the interest of minimizing recourse to inflationary financing. It also allows the central bank to assume more than a passive role in the determination of the financing programs of the public sector. Much is therefore put upon the central bank to counter the natural tendency of governments towards fiscal laxity and the macroeconomic difficulties which it generates.

The central bank and Treasury officials need to work together closely. They have to cultivate political savvy and must be able to brief decision-makers simply, clearly and convincingly. Their technical capacity and integrity should be beyond doubt and their ability to communicate well and to persuade are essential if effective control of CG and CPSE is to be achievable. Used in combination with fiscal policy, monetary policy can play an effective supporting role in the maintenance or re-establishment of short-term financial stability in Pacific island economies.

The onset of a positive external shock and upswing in the terms of trade increases net foreign assets, money supply and bank reserves. Domestic demand, spending and imports however, generally follow the terms of trade cycle with a lag. The authorities may be tempted to adjust, when financing would have been appropriate, at the peak and commencement of the downswing in the terms of trade cycle. Such a strategy would result in rapid deterioration in the external account. The challenge therefore lies in ‘guessimating’ the wavelength of the terms of trade cycle and in addressing the liquidity overhang through tight credit policies before and at the peak of the cycle. Monetary policy is therefore a powerful component of necessary counter-cyclical expenditure reducing measures prior to the onset of the downswing in the terms of trade cycle.

Some Pacific island economies have commodity stabilization funds which, when managed well, become effective supportive instruments of counter-cyclical policy. Papua New Guinea, Fiji and Western Samoa have such funds. Tonga had a similar arrangement which was, however, terminated following mounting losses. These funds levy exporters when commodity prices exceed specified levels and prices are supplemented from the funds when they fall below specified levels. Disposable incomes are stabilized to some extent. The reduced amplitude of fluctuations in disposable income is reflected in the relative stability of the external account cycles. The Mineral Resources Stabilization Fund, of Papua New Guinea is a similar arrangement. It attempts to stabilize the fluctuations in central government revenue consequent upon its fluctuating share of the export proceeds from mining activity.

Stabilization funds, however, are politically difficult to administer according to the letter of the legislation that establish them. Farmers, aided and abetted by politicians, are constantly agitating for reductions in the floor price below which
supplements are paid and for increases in the ceiling prices beyond which levies are made. They invariably succeed in giving rise to regular financial difficulties for such funds.

A number of central banks in Pacific island economies target monetary aggregates as part of their monetary strategy. A monetary budget (or monetary survey) forms the basis of this exercise (Appendix 2). The expected claims on the government by the banking system are computed from estimates of the likely revenue, expenditures and deficits of the central government and the relevant state-owned enterprises. Net foreign assets are difficult to estimate and are targeted based upon realistic estimates of the external accounts. The expected claims upon the private sector form the background around which monetary policy for the budget year is formulated.

The proposed values of claims upon the public sector will determine the size and financing strategy of the budget as well as the expenditure and revenue policies of the government. It will also be influenced by the need to avoid crowding out of the private sector from the domestic credit market. The authorities would closely monitor domestic credit growth, particularly during the upswing in the terms of trade cycle when $M_3$ could deviate substantially from target.

Monetary budgeting presents a workable framework for closer coordination between macroeconomic policy formulation and implementation in the Pacific island economies. Economic expertise is severely limited in these economies and should be pooled to ensure that sound coordinated advice is available quickly to the decision makers. A workable arrangement which Fiji has in place and which a number of Pacific island country central banks are thinking of adopting centres upon a macroeconomic committee of which the Governor of the Central Bank, the Permanent Secretary for Finance, the Director of Economic Planning and the Government Statistician are members. Assisted by their technical staff, the members formulate the monetary budget, the frame of the government budget and the accompanying fiscal, monetary, exchange rate and incomes policies. During the budget year, quarterly reviews of the economy are undertaken. Macroeconomic policies are also reviewed in the light of changing external and internal circumstances. Such reviews form the basis for regular briefings for, and decisions by, the authorities.

The central banks of the larger economies in the Pacific island economies hope to increasingly effect monetary policy through intervention in the financial markets. To this end they are encouraging the issue of a wider range of financial assets such as treasury bills, government bonds and securities from the state-owned enterprises. In a number of Pacific island economies, where competition among financial institutions exists, interest rates have been deregulated and new security issues are regularly put out to tender.

Invariably though, the central bank finds itself in a position of conflict. It wants to promote the development of money and capital markets thereby assuming
the role of underwriting a secondary market in securities to enhance their liquidity. This it does by offering rediscout facility to holders while an independent secondary market slowly evolves. Initially, automatic rediscouting is offered and is taken for granted in the market place.

The central bank could therefore be frustrated when it wishes to close its rediscouniting window or unload its own holdings of securities to tighten credit. Open market operations are therefore somewhat restricted in scope in the bigger Pacific island economies at present due to the current phase of monetary development. It should however be noted that central banks have, as in the case of Fiji, closed their rediscount windows when difficult macroeconomic imbalances calling for tight monetary policies have emerged.

The variable statutory reserve deposit (SRD) ratio is commonly used in the Pacific island economies, but this is a cumbersome instrument which could impose difficult adjustments on commercial bank balance sheets if varied by large increments. The maximum SRD ratio is set by statute, generally below 25 per cent. This instrument is sometimes ineffective if the banks hold substantial excess reserves, including public sector securities, in their portfolios. To enhance SRD effectiveness, central banks in the Pacific island economies are also empowered to set a separate liquid assets ratio. As acceptable liquid assets are generally those issued by the public sector, the application of these two instruments has a secondary impact of entrenching and increasing public sector shares in the domestic credit market at the expense of the private sector.

Short-term advances from the central bank have the same effect as rediscounting securities held by the banks. A central bank generally holds approved short-term securities owned by the banks. Advances are then allowed to banks against such securities, but such facilities are for very short periods and lose importance as the inter-bank market develops. As the rediscout facility at the central bank also presents an alternative avenue for banks to adjust their liquidity position, the minimum lending rate which central banks announce, is therefore not a very effective instrument of monetary policy. Nevertheless, the minimum lending rate is certainly useful as an indicator of the monetary policy which the authorities wish to follow.

A number of central banks now issue their own debt instrument which is regularly put out to tender. It is a more flexible instrument than the normal deposit facility for excess bank reserves as it allows interest to be determined in the market place. It has proved, in the case of Fiji, to be popular among banks. It is a useful instrument when the central bank focuses upon absorbing excess liquidity in the banking system.

Moral suasion can be a useful and effective tool in the Pacific island economies. The number of banks is typically small. The monthly meetings which bank managers have with the central bank and at which developments in the economy and its prospects are discussed, together with changes in policies that are being considered, are useful. They help bankers understand the background
Macroeconomic management of small island economies

to, and the objectives of, the instruments which the central bank has, or proposes to, put in place. The banks are also able to appreciate that financial stability is a necessary condition to stable growth and therefore complementary to their long-term interests.

Personalities are important in a small community. The rapport which the monthly meetings and briefings fosters and their contribution to bankers confidence in the technical capacity and perceived independence of view of the central bank are helpful and improve the effectiveness of moral suasion as an instrument of monetary policy in the Pacific island economies.

Interest rate policy influences domestic savings, the allocation of domestic resources, the demand for credit and external capital flows. A resident, given the ease with which assets can be exported from a Pacific island country, has the option of investing in domestic or overseas assets. The yield on domestic assets will be compared to the relevant interest rate abroad adjusted for expected exchange rate variation and possibly a risk premium. Domestic interest rates therefore cannot deviate from levels in economies with which a Pacific island country has transactions without risking undesirable capital outflows. When macroeconomic imbalances emerge and confidence in the determination of the authorities to address them effectively is lacking, the expectation of dwindling external reserves and consequent devaluation could generate outflow from the capital accounts of the balance of payments if positive interest rate differentials in favour of the Pacific island country are not sufficiently wide.

Positive real interest rates encourage nationals to forego consumption and save. Because financial institutions must maintain sufficient margins between the average cost of funds and lending rates, the high nominal lending rates which such a policy supports, given the existence of a financial sector which works effectively, promotes a more efficient allocation of limited resources within a country. Investments with potential for higher returns are in a better position to attract funds at the expense of those that don't.

When influencing or determining the level of domestic interest rates, macroeconomic managers should be guided by the level of domestic inflation, the possible range of rates of return on domestic investments, the real interest rates in other economies and expectations of movements in the exchange rate of the domestic currency.

External reserve management

External reserves are looked upon by central banks as 'shock absorbers'. When a country experiences a temporary economic shock and reversible current account deficit, financing can be effected through running down the level of external reserves. Similarly a temporary positive export shock should be financed and the stock of external reserves allowed to increase.
The burden of adjustments in the wake of lasting economic shocks could, to some extent, be lightened through judicious use of external reserves. Such shocks call for expenditure reducing and shifting policies. The availability of external reserves enables the authorities to introduce and implement the necessary adjustments over a relatively longer period. In other words, it allows them the option of a possible mix of financing and adjustments, while avoiding rapid accumulation of external debt, as the economy moves towards a new equilibrium level.

In the Pacific island economies where exposure to, and the frequency of, external and domestic shocks are high, and the economies have a narrow base and are fragile, reserve management is a challenging exercise for the authorities. The external investment portfolios of the central banks take into account the weightings of their currency baskets. Securities and deposits are generally short-term to minimize capital losses and central banks are generally very particular about the credit ratings of issuers of securities and financial institutions with which they invest. They place a premium on liquidity, return and minimization of exchange and capital loss, characteristics which sometimes conflict.

The establishment of an optimum target reserve level for a country is difficult. It is a topic on which consensus is impossible but central banks take account of a number of factors when considering the issue. If, as is the case in the Pacific island economies, a country's external sector is highly vulnerable to shocks, then a high level of reserves is appropriate. The opportunity cost of holding external reserves is another consideration. If domestic investment opportunities yield high returns compared with external earnings, external reserve levels probably do not need to be too high. The speed with which the economy can adjust to shocks can be viewed as inversely related to the acceptable level of external reserves. There is yet another variable which should be taken into account. A country is likely to be able to access external resources more easily if its need is not desperate and credit rating good. If macroeconomic management is perceived by external lenders as sound and reserves are seen as comfortable, then a country's access, at favourable terms, to the world's credit markets is likely to be assured. As a rule, central banks of Pacific island economies target relatively high reserve levels of about 4-6 months of visible imports.

**Exchange rate policy**

Pacific island economies which peg their currencies to a basket of selected currencies, adopt the US dollar as their intervention currency. On the day a Pacific island country switches from an old peg (usually a single convertible currency or, as in the case of Vanuatu, the SDR), the exchange rates against the US dollar of the currencies in the basket of selected currencies are weighted by previously determined currency weights. In order not to break the exchange rate against the intervention currency from that of the previous day, the weighted basket, in US dollars, is multiplied by a constant which equates to the exchange
rate, against the dollar, of the previous day. The domestic currency then floats with the basket of currencies which constitute its peg. When the authorities wish to devalue or revalue against the basket of currencies, the value of the constant is adjusted by the required percentage devaluation or revaluation.

Every working day the central bank calculates the central rate of the domestic currency against the US dollar, adds its buying and selling margins and advises the commercial banks. The banks in turn add their own margins thereby setting the buying and selling rates for members of the public. Cross rates between the US dollar and other foreign currencies determine the value of the domestic currency against those currencies.

Real exchange rate changes combine the effects of both nominal exchange rate changes and relative inflation rates between the home country and other economies. If domestic inflation is accelerating at a faster rate than inflation in trading-partner economies, domestic costs will rise faster resulting in an effective appreciation and loss of competitiveness for the home country. The real exchange rate appreciates even though no adjustment to the nominal exchange rate has been made.

An appreciation of the real exchange rate of the domestic currency leads to increased demand for imports and reduced sales of exports. Real exchange rate appreciation beyond the equilibrium real exchange rate, or over-valuation, results in deteriorating current account deficits. If over-valuation persists the competitiveness of businesses which produce tradable goods and services falls and they may cut back on production giving rise to increased unemployment, a reduced pace of economic activity and loss of government revenue. Export and import substitution activities are discriminated against. Investment in the export sector becomes less attractive and resources are directed into activities which produce for the home market and which do not compete against imports.

Over-valuation has to be financed. Such financing may be sustained, for a time, through aid, remittances or, as in Papua New Guinea, the export proceeds from rich mineral deposits. These financing sources have allowed strict monetary policies aimed at containing domestic prices in a number of Pacific island economies to be maintained over a period of time. The harmful effects of over-valuation on tradable goods sectors such as agriculture, fisheries, manufacturing, processing and tourism are, however, likely to be very serious.

Ultimately, over-valuation results in falling reserves and rising external debts. Expectation of expenditure shifting policies, particularly exchange rate adjustments soon increases and residents will look for imaginative ways of exporting capital. Potential overseas investors defer investment plans. Exporters hold proceeds offshore or defer sales, and importers build up stock quickly. All these activities result in rapidly rising bank credit, high interest rates and crowding out of priority activities from the domestic credit market.
Over-valuation is a soft option for decision-makers. It has a powerful effect on income distribution, favouring the urban population against rural dwellers. Powerful pressure groups such as the urban-based trade unions and large importing houses therefore have an interest in maintaining it. Such groups, unlike the dispersed rural-based farmers who produce for export, are well organized and vocal. Faced with difficult decisions, the authorities may opt to defer the inevitable and experiment with temporary commercial policies. Quotas and high tariffs may be imposed in an effort to stabilize the current account but such temporary measures are likely to compound the difficulties associated with over-valuation. They add to inflationary pressures and increase the degree of over-valuation, thereby creating further difficulties for the export sector. Management in the import substitute sector will be encouraged to devote energy and resources to seeking and capturing rents that emerge with restrictive commercial policies, at the expense, perhaps, of production and marketing. Such policies have a tendency to perpetuate themselves because the public officers and decision makers who administer them, and businesses which benefit from them, have a strong interest in ensuring their retention.

In Pacific island economies, the impact of a nominal currency depreciation upon domestic prices is immediate. Import prices rise. If wages are indexed to the consumer price index, increased input costs permeate quickly throughout the tradable and nontradable goods sectors. The enhanced competitiveness targeted by a nominal devaluation is therefore eroded by domestic price increases and the real effective exchange rate may remain stable or actually appreciate. Under such circumstances, competitiveness does not improve and inflation worsens.

Incomes policy is therefore an important component of the expenditure reducing policies which should accompany exchange rate policy. This has proved to be a difficult policy area for governments in the Pacific island economies. Highly regulated labour markets manifest in centralized wage settlement mechanisms, minimum wage legislation and powerful trade unions. These factors, coupled with the high wage structures in the public sector which are supported to some extent by aid, have enabled consistent and sometimes substantial real wage increases which are unjustified on grounds of productivity changes or demand and supply conditions in the labour markets. Unless labour market reforms are implemented where appropriate and governments confront the issue of public sector wage demands directly and effectively, the effectiveness of exchange rate policy may remain seriously impaired in a number of Pacific island economies.

The real effective exchange rate index is the weighted real exchange rate index of currencies in the currency basket used. The weights are the same as those applied in the currency basket. The movements in the real effective exchange rate indices for five selected Pacific island economies are shown (Figure 19). The real effective exchange rate for the Tongan pa'anga has appreciated by more than 20 per cent since 1987. The pa'anga was pegged to the Australian dollar until February 1991 when a basket of selected currencies was adopted
as the new peg. As Tonga has not engaged in nominal exchange rate adjustments against its currency pegs since 1987, the substantial appreciation of the pa'anga's real effective exchange rate reflects the relatively higher domestic inflation rates within the country compared to those of its trading partners.

Fiji, Western Samoa, the Solomon Islands and Papua New Guinea have witnessed significant depreciation in the real effective exchange rates of their currencies since 1985 (Figure 19). Most central banks in the Pacific island economies, now target either stability or gradual depreciation over time in the real effective exchange rate of their currency. This strategy requires adjustments in the nominal exchange rate which at least offsets the differentials in inflation rates between the home country and the average of its trading partners. Adjustments should be implemented over selected intervals to iron out fluctuations that could be introduced by irregular swings in inflation rates.

**Conclusion**

The Pacific island economies have received substantial aid and concessionary assistance to date. Such assistance, along with the contribution made by remittances, has helped them maintain internal and external financial stability. Should the future level of these inflows be adversely affected, difficult adjustment problems will emerge. Quite a number of Pacific island economies were able to defer or avoid needed adjustments through the availability of aid and other concessional external resources.

Nonetheless, circumstances may be changing and initiatives may need to be taken. Sound macroeconomic management, in which a number of Pacific island economies have established good track records, and firm structural adjustment policies and reforms which entrench an improved environment for growth are necessary.

The authorities will probably need to focus their energies on

- ensuring, in the face of external and domestic shocks, internal and external financial stability employing the instruments of fiscal, monetary, incomes and exchange rate policies imaginatively
- investments in human resource development and social and economic infrastructure
- creating a macroeconomic and microeconomic environment which fosters savings, investments, private sector activities and growth.

Adjustments and reform policies need to be sequenced carefully and made to suit the individual circumstances of each of the Pacific island economies. Trade liberalization, for instance, should not be implemented during periods of macroeconomic instability. The loss in revenue stemming from tariff reductions could worsen the fiscal deficit, particularly where, as in the Pacific island economies, reliance upon such revenue sources is heavy. The short-term
impact upon employment and economic activity when inward looking policies prevail can lead to social and political difficulties while the immediate burden upon the external accounts could be serious if macroeconomic imbalances already exist.

If and when trade liberalization is considered appropriate it should be accompanied by a devaluation to cushion its impact upon the fiscal and external balances and upon the pace of economic activity. It should also be accompanied by restructuring which widens the tax base and maintains elasticity in the tax system so as to ameliorate its negative revenue impact, particularly in the trade-tax dependent Pacific island economies.

The need for policy coordination is also evident. In small open economies, fiscal policy is the dominant instrument. Monetary policy used for stabilization is neutralized by lax fiscal policy. Exchange rate policy, a potential powerful instrument for stabilization and enhancing the competitiveness of an economy, must be accompanied by appropriate incomes and other expenditure reducing fiscal and monetary policies if it is to work successfully.

Appendix I

Money multiplier

From the balance sheet of the central bank we have

\[
\text{Assets} = \text{Liabilities}
\]

\[
\therefore \quad [\text{NFA} + \text{C_B} + \text{C_G} + \text{C_PSE} + \text{OIN}] = [\text{C} + R_1 + R_2] = \text{Reserve money} \tag{a}
\]

where

- NFA = net foreign assets of the central bank
- \text{C_B} = \text{claims upon the commercial banks}
- \text{C_G} = \text{claims upon the government}
- \text{C_PSE} = \text{claims upon public sector enterprises (if any)}
- \text{OIN} = \text{other items (net)}
- \text{C} = \text{currency in the hands of the public}
- \text{R_1} = \text{required reserves of banks in cash and in deposits with the central bank}
- \text{R_2} = \text{excess reserves of banks in cash and deposits with the central banks.}
Now

\[ M_3 = \beta [C + R_1 + R_2] \]  \hspace{1cm} (b)

where

\[ M_3 = \text{money supply} \]
\[ \beta = \text{money multiplier}. \]

Assuming that

\[ C = \alpha D, \quad R_1 = \theta D, \quad R_2 = \varepsilon D \]

where \( \alpha, \theta \) and \( \varepsilon \) are constants (cash ratio and required and excess reserve ratios respectively) and \( D \) is the total deposits with commercial banks, we have, substituting into (b) yields

\[ M_3 = \beta [\alpha D + \theta D + \varepsilon D] \]  \hspace{1cm} (c)

but

\[ M_3 = C + D, \]

and substituting in (c)

\[ D (\alpha + 1) = \beta [\alpha D + \theta D + \varepsilon D] \]  \hspace{1cm} (d)

\[ \therefore \beta = \frac{\alpha + 1}{\alpha + \theta + \varepsilon} \]  \hspace{1cm} (e)

From equations (a), (b) and (e)

\[ M_3 = \frac{\alpha + 1}{\alpha + \theta + \varepsilon} [\text{NFA} + C_B + C_G + C_{PSE} + \text{OIN}] \]  \hspace{1cm} (f)

Note

- The central bank has influence only over \( \theta \) and \( C_B \).
- \( \alpha \) is determined by members of the public.
- \( \varepsilon \) is determined by management of commercial banks. In developing economies of the Pacific \( \varepsilon \) tends to be large as the capital and money markets, where banks excess liquidity could be invested, are relatively underdeveloped.
- The central bank has little control over NFA.
- \( C_G \) and \( C_{PSE} \) can be difficult to control in the Pacific island economies. The central bank should establish close working relationship with the Ministry of Finance and government and public sector enterprises to enable proper monitoring and influence upon \( C_G \) and \( C_{PSE} \).
Appendix II

Monetary survey

Framework for macroeconomic policy formulation

For the banking system as a whole, central bank and commercial banks,

Total liabilities = Total assets

that is

$M_3 = C_g + C_{pse} + C_p + NFA = OIN$

where

- $M_3$ = money supply
- $NFA$ = net foreign assets of the central bank
- $C_g$ = claims upon the government by the banking system
- $C_{pse}$ = claims upon public sector enterprises by the banking system
- $C_p$ = claims upon the private sector by the banks
- $OIN$ = other items (net).

Equation (1) is derived by:

(a) Taking the balance sheets of the Central Bank and the commercial banks, and
    (i) Netting off their overseas assets and liabilities,
    (ii) Netting off what the Central Bank on the one hand and the commercial banks on the other owe to each other,
    (iii) Netting off the central government’s and the public enterprises assets and liabilities in the Central Bank and in the commercial banks, then

(b) After the adjustments, (i), (ii), (iii), summing the liabilities of the Central Bank and commercial banks, and summing their assets. The two totals equal each other.
Further reading

Aghevli, Khan, Narvekar and Short, 1979. 'Monetary policy in selected Asian economies', *IMF Staff Papers*, December.

Beveridge and Kelly, 1980. 'Fiscal content of financial programs supported by stand-by arrangements in the Upper Credit tranche, 1969-78', *IMF Staff Papers*, June.


Smith, B.J. 'Some aspects of economic adjustment in small island countries', in Sir Frank Holmes (ed.), *Economic Adjustment: policies and problems*, International Monetary Fund.

Human resource development in the South Pacific

Ken Gannicott

From the earliest days of exploration, the Pacific islands have had a powerful impact on the European imagination. Rousseau published his concepts of the Noble Savage in 1749, and reports from late 18th century explorers, embellished and romanticized through the artists and engravers of the day, fostered European perceptions of simple and unsophisticated people living in earthly paradise in the South Seas (Moorehead 1966).

Despite the lost Eden, enough of paradise remained to captivate later travellers. In an evocative passage that managed to contrast the idealized image of the South Seas with the ennui of Edwardian England, Rupert Brooke observed:

It’s all true about the South Seas. I get a little tired of it at moments, because I am just too old for romance. But there it is; there it wonderfully is; heaven on earth, the ideal life, little work, dancing and singing and eating; naked people of incredible loveliness, perfect manners and immense kindliness, a divine tropical climate, and intoxicating beauty of scenery... If ever you miss me, suddenly, one day, from lecture room B in King’s, or from the Moulin d’Or at lunch, you’ll know that I’ve got sick for the full moon on these little thatched roofs, and the palms against the morning, and the Samoan boys and girls diving thirty feet into a green sea or a deep mountain pool under a waterfall ... and that I’ve gone back (Rupert Brooke, quoted in Winchester 1992).

It remains important today, however, as in earlier years, to separate myth from reality. There is virtually no absolute poverty in the South Pacific island economies, and the cliché of ‘subsistence affluence’ is often appropriate. In many of the islands the maintenance of comfortable traditional lifestyles has been possible in an environment where climate and soils are benign. The intruding reality, however, in the years since independence, is that rates of economic growth have been low and population growth has been fast.

Fiji, Kiribati, Solomon Islands and Vanuatu registered negative growth in per capita incomes during the 1980s, and without large-scale migration Tonga and Western Samoa would have shown a similar decline (World Bank 1991:6). In the Polynesian countries, lifestyles are subsidized by the remittances of those who go to work overseas. In the region as a whole, per capita aid levels are among the world’s highest (Throsby and Maglen 1990; World Bank 1991).

The reasons for the low rates of economic growth are complex, but it is clear that deficiencies in human resource development are at least part of the story. In its recent extensive survey of the prospects for higher growth in the region, the World Bank remarked that ‘the acute shortage of qualified and experienced personnel represents a fundamental constraint to development in the South Pacific’ (1991:51).
Schooling in the past and present: colonial rule and its aftermath

In most island economies of the South Pacific, the foundations of a formal school system were laid by European missionaries, with the early pastoral schools providing the basis for an extensive system of primary education. The London Missionary Society arrived in Western Samoa in 1830, having been converting people in Tonga for some years. Catholic and Wesleyan missionaries followed not long after. Mission activity quickly led to the establishment of pastoral schools in the villages, with the main purpose of teaching students to read, write and reckon in their own language, so that they would learn the Scriptures and become Christian. Basic literacy and numeracy diffused rapidly among the population, and by the end of the nineteenth century both countries had achieved very high rates of literacy in their own language.

Tonga and Western Samoa take pride in these early achievements in basic education. Tongan policy documents typically point out that primary education became compulsory at the remarkably early date of 1876 (Tonga, Central Planning Department 1987), and the Department of Education in Western Samoa has shared the anecdote about 'a group of dignitaries from London [who] recorded in 1900 their amazement at finding a population who were almost 100 per cent literate in their own language' (Western Samoa, Department of Education 1980:1).

Similarly, in Kiribati basic schooling was essentially a church responsibility. It was only during the 1980s that the mission primary schools were unified under government control, and still today there are seven secondary schools managed by various church groups, compared with two public schools. An adult literacy rate of 90 per cent is indicative of the fact that basic schooling is widely accessible and is of relatively long standing.

In the 1830s, Methodist missionaries in Fiji established a system of village schools in which children were taught to read and write in their own language. Catholic missions also established village schools after their arrival in 1844. In 1877 the Governor of Fiji reported

I have visited a great number of schools and have been impressed by their efficiency. A very large proportion of the natives can read and write and the amount of native correspondence would greatly surprise those who are inclined to sneer at native progress (Fiji, Ministry of Education, Youth and Sport 1977:1).

Indian Fijians, who started life in Fiji as indentured labourers on the sugar plantations, did not share in the Christian teaching that underpinned the spread of literacy among the ethnic Fijian population. The Indian Fijians lacked the settled village structure that facilitated the spread of Fijian schools, and officials did not consider the provision of education to be a high priority for a group initially viewed as being only transient. The result was that literacy was lower among Indian Fijians than among ethnic Fijians, and, in addition, Indian social
customs meant that literacy was much lower among women than among men. By the time of the 1976 census, the first to be held after independence, the Fijian/Indian disparity had virtually disappeared, the overall adult literacy rate had reached 79 per cent and 94 per cent of the 6–11 age group were enrolled in school (Gannicott 1990:8–9).

Some basic education indicators for the South Pacific bring out clearly the generally high enrolment ratios in the Polynesian countries and Fiji (Table 1). The high rates of adult literacy are indicative of long-standing and widely available basic education.

Table 1    Education indicators for the South Pacific (per cent)

<table>
<thead>
<tr>
<th></th>
<th>Fiji</th>
<th>Kiribati</th>
<th>Solomon Islands</th>
<th>Tonga</th>
<th>Vanuatu</th>
<th>Western Samoa</th>
<th>Asia</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Primary</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Gross enrolment</td>
<td>129</td>
<td>63</td>
<td>48</td>
<td>99</td>
<td>87</td>
<td>99</td>
<td>105</td>
</tr>
<tr>
<td>Teacher/pupil ratio</td>
<td>30:1</td>
<td>28:1</td>
<td>26:1</td>
<td>22:1</td>
<td>24:1</td>
<td>27:1</td>
<td>36:1</td>
</tr>
<tr>
<td>Transition to secondary</td>
<td>85</td>
<td>30</td>
<td>74</td>
<td>97</td>
<td>71</td>
<td>82</td>
<td>64</td>
</tr>
<tr>
<td><strong>Secondary</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Gross enrolment</td>
<td>55</td>
<td>16</td>
<td>11</td>
<td>87</td>
<td>12</td>
<td>82</td>
<td>30</td>
</tr>
<tr>
<td>Teacher/pupil ratio</td>
<td>17:1</td>
<td>20:1</td>
<td>18:1</td>
<td>17:1</td>
<td>16:1</td>
<td>18:1</td>
<td>24:1</td>
</tr>
<tr>
<td><strong>Teachers trained</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Primary</td>
<td>100</td>
<td>..</td>
<td>64</td>
<td>87</td>
<td>60</td>
<td>..</td>
<td>97</td>
</tr>
<tr>
<td>Secondary</td>
<td>82</td>
<td>..</td>
<td>72</td>
<td>80</td>
<td>82</td>
<td>99</td>
<td>67</td>
</tr>
<tr>
<td><strong>Tertiary</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Gross enrolment</td>
<td>4</td>
<td>&lt;1</td>
<td>2</td>
<td>..</td>
<td>&lt;1</td>
<td>..</td>
<td>7</td>
</tr>
<tr>
<td>Adult literacy rate</td>
<td>86</td>
<td>90</td>
<td>20</td>
<td>..</td>
<td>30</td>
<td>98</td>
<td>61</td>
</tr>
<tr>
<td><strong>Public expenditure on education (per cent of total)</strong></td>
<td>16</td>
<td>..</td>
<td>24</td>
<td>..</td>
<td>24</td>
<td>..</td>
<td>11</td>
</tr>
</tbody>
</table>

\[a\] For Solomon Islands 28 per cent expatriates, Tonga 10 per cent and Vanuatu 70 per cent.

\[b\] World Bank estimates.

The picture is quite different for the Melanesian countries of Solomon Islands and Vanuatu (Table 1). As elsewhere in the South Pacific, missionaries established a network of missions and church schools and laid the foundations of formal schooling in these Melanesian countries, but in contrast to the relatively homogeneous Polynesian societies, Vanuatu and Solomon Islands are culturally very diverse, with wide regional variations in customs, social structure, culture, religious affiliations, and, not least, language and dialect. In Vanuatu, for example, well over a hundred Melanesian dialects are spoken amongst a population of 143,000 (McMaster 1990:51). Nor should the basic facts of geography be overlooked. Both Solomon Islands and Vanuatu are classic South Pacific archipelagoes, with many small islands scattered across vast areas of ocean. This cultural and geographical fragmentation placed fundamental constraints on what could have been achieved in human resource development.

While Fiji and the Polynesian countries embarked on independence in much better shape, educationally speaking, than many other developing countries in Africa or Asia, adult literacy in both Vanuatu and the Solomon Islands was no more than 15 per cent at independence. In 1960, there were only 45 secondary pupils in the Solomon Islands (Gannicott and McGavin 1990:76). At the time of Vanuatu’s independence in 1980 there were only ten university graduates (World Bank 1991:279). In 1985 more than 50 per cent of the Solomon Islands’ population aged 25 and over had not received any schooling (Solomon Islands Government 1988:60). The 1979 census in Vanuatu showed that nearly 20 per cent of ni-Vanuatu between the ages of 6 and 19 had never been to school (UNICEF/Vanuatu Government 1991:44).

In recent years both countries have made genuine progress in expanding access to schooling. By 1986, the enrolment ratio for the 7–14 age group in the Solomon Islands had reached 63 per cent, and 27 per cent of primary school leavers attained a place in secondary school (Solomon Islands Government 1988:61–2). Even though actual attendance rates, at 48 per cent for primary and 11 per cent for secondary schools, are much lower than this, there has been much progress in raising the country’s very low average level of schooling.

Similarly, Vanuatu is now within sight of achieving universal primary education. Few countries inherited such a daunting colonial legacy as Vanuatu. The New Hebrides, as it was known in colonial times, had been administered jointly by Britain and France, and the result was that a country with fewer than 150,000 people had two separate English-speaking and French-speaking school systems. The waste, duplication, and high cost of two parallel systems of education can be readily imagined, and much government effort since independence in 1980 has been directed towards the massive task of integrating the two systems (McMaster 1990:52). If there is a positive side to this colonial legacy, it is that in the approach to independence, competition between Britain and France to establish a dominant system meant that many extra primary school places were established. The gross primary enrolment ratio is now approaching 90 per cent (Table 1). In quantitative terms, the prevailing
bottleneck in Vanuatu’s school system is at secondary level. Despite an expansion of places under a World Bank program, gross enrolment of the 12–18 age group remains among the region’s lowest at 12 per cent (World Bank 1991:52).

**Shortage of skills in the South Pacific**

As both Vanuatu and Solomon Islands embarked on independence with such low levels of labour skills, it is hardly surprising that skill shortages should continue to be a key feature of their human resource development. What is of particular interest is that the same theme emerges in Kiribati, Western Samoa and Tonga, despite the fact that all three have well-developed education systems and an overall level of human resources which is high by the standards of other developing countries (Gannicott 1990:xiii). These shortages are not simply transient features of normal labour market adjustments, but constitute a long-standing structural problem. Emigration of highly skilled Indian Fijians after the coups of 1987 left Fiji desperately short of high level labour, but the problem of skill shortage pre-dates this political turmoil.

One of the most obvious features of skill shortage, right across the region, is that even in the second or third decade after independence many countries are still short of trained teachers.

- In the Solomon Islands, 50 per cent of primary teachers in 1986 were either untrained or partly trained. In 1987, 36 per cent of primary teachers in government schools were untrained.
- In Vanuatu in 1986, 32 per cent of primary teachers and 30 per cent of ni-Vanuatu secondary teachers lacked teaching qualifications.
- In Tonga, much progress has been made over the last decade in improving the training of teachers but, in 1987, 20 per cent of secondary teachers were untrained, and a further 15 per cent were trained only as primary teachers.
- In Western Samoa, many teachers who have been trained for primary teaching are being used in junior secondary schools.
- In Fiji, 17 per cent of secondary school teachers have no teaching qualifications.
- In Kiribati, primary teachers have been upgraded in recent years, but 25 per cent of secondary school teachers have no post-secondary qualification at all (Throsby and Gannicott 1990:32; World Bank 1991:156).

The result is a continued heavy reliance on expatriate teachers. In the mid-1980s, expatriate staff constituted 45 per cent of teachers at national secondary schools in the Solomon Islands and two-thirds of secondary teachers in Vanuatu (World Bank 1986:25; World Bank 1988a:7). These percentages were substantially unchanged by the late 1980s (Table 1). Expatriate teachers
are employed in substantial numbers in secondary schools in Tonga and Western Samoa.

It is not only qualified teachers who are in short supply. The crucial shortage of technical and managerial skills is seen dramatically in the Solomon Islands. Despite considerable recent achievements in raising the primary enrolment ratio, skill levels remain low, with critical shortages of people with technical, administrative and managerial skills. The point was made in a World Bank appraisal of education in the Solomon Islands that as a consequence of the critical skill shortage, ‘a large number of tasks affecting the country’s development are not being accomplished’ (World Bank 1986:1). The evidence for this is no less persuasive for being anecdotal, and any visit to the Solomon Islands quickly reveals the shortage of skill. Capital equipment, whether provided from local or aid funds, becomes useless once repairs or maintenance are required. Refrigeration and air-conditioning units cannot be fixed once they need attention. Outboard motors, a crucial aid to productivity in an archipelago stretching over 1,450 km of ocean, receive amateur rather than trained servicing and at the higher levels, there is a severe deficiency of people trained in managerial skills (Gannicott and McGavin 1990:77).

The shortage of local skills and reliance on expatriate labour is striking in Vanuatu. In 1983, ni-Vanuatu filled only 3 per cent of high level professional and technical private sector jobs, 50 per cent of low and middle level professional and technical jobs, and 15 per cent of professional managerial jobs (McMaster 1990:Table 12). In the public sector in 1986, expatriates filled 245 out of 403 high level professional and technical jobs (McMaster 1990: Table 14). It is not surprising, therefore, that the number of work permits for senior occupations issued in Vanuatu continued to increase during the first half of the 1980s. The improvements in Vanuatu’s education system over the last decade have meant that young ni-Vanuatu are increasingly finding their way into senior occupations, but ‘even so, only 1,152 citizens ... or 1 per cent of the Vanuatu total, have obtained an academic qualification at senior secondary or higher level. This compares with 802 persons attaining a qualification of at least senior secondary level among the far smaller group of citizens of other countries. Indeed, at degree level, non ni-Vanuatu citizens accounted for approximately 70 per cent of qualified residents’ (Vanuatu Statistics Office 1991:47). Expatriates continue to be employed in large numbers in the more highly skilled occupations (Table 2).
Table 2  Broad occupational categories of the employed urban labour force in Vanuatu, 1986

<table>
<thead>
<tr>
<th></th>
<th>Ni-Vanuatu</th>
<th>Non-ni-Vanuatu</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Professional, technical and related workers</td>
<td>805</td>
<td>297</td>
<td>1102</td>
</tr>
<tr>
<td>Administrative and managerial workers</td>
<td>123</td>
<td>104</td>
<td>227</td>
</tr>
<tr>
<td>Clerical and related workers</td>
<td>1041</td>
<td>103</td>
<td>1144</td>
</tr>
<tr>
<td>Sales workers</td>
<td>672</td>
<td>195</td>
<td>867</td>
</tr>
<tr>
<td>Service workers</td>
<td>1896</td>
<td>93</td>
<td>1989</td>
</tr>
<tr>
<td>Agriculture, forestry and fishing workers</td>
<td>490</td>
<td>41</td>
<td>531</td>
</tr>
<tr>
<td>Production related and transport labourers</td>
<td>2102</td>
<td>..</td>
<td>..</td>
</tr>
<tr>
<td>Armed forces and others</td>
<td>160</td>
<td>2</td>
<td>162</td>
</tr>
</tbody>
</table>


In Tonga there is much fragmentary evidence of low skill levels. The Potter Report, commissioned for the Third Development Plan 1975–80, recommended post-secondary training in priority areas of vocational and technical skills, agricultural training, marine and teacher training (Potter 1975). An International Labour Office survey indicated there were at least one thousand workers in different trade occupations who lacked any formal training (International Labour Office 1984). During the mid-1980s, large numbers of foreign workers were working in professional, administrative and managerial roles because of the shortage of Tongan skills in these occupations (Tonga, Ministry of Education 1985). In Tonga, as was noted in Development Plan Six (1991:72), the most significant impact on the labour market has been the heavy emigration trend. With its highly selective character, emigration has attracted more than 25 per cent of the labour force, generally younger people in the prime working age groups with relatively high education, qualifications and skills.

The story is similar for Western Samoa. Every development plan since the first (1966–70) has highlighted a general lack of labour and entrepreneurial skills. Some comments from the fourth plan (1980–85), paraphrased from a lengthy exposition, will convey the flavour of what has been written in virtually every development plan.

Areas where shortages occur include senior and middle-level management, technical positions of all levels and accountants. The shortage of well-trained management staff is the most crucial. In addition there are very few Western Samoan engineers at present and at the subprofessional level there are key shortages too. Key areas here include agriculture, food technology, and surveying and perhaps even more important is the shortage of sufficiently skilled tradesmen: mechanics, electricians, carpenters and
Human resource development in the South Pacific

plumbers. There is also a need for higher levels of skills for secretarial and clerical staff (Western Samoa Government 1981:16).

More recently, it has been noted that the 'lack of skilled people ... is a problem in Samoa not only in manufacturing, trade and services but also in government [and that] many routine tasks of an operational nature are performed by expatriates' (Western Samoa Government 1988:7,11).

In its recent survey, the World Bank has noted that 'despite high levels of literacy, shortages of skilled labour represent a major development constraint in Kiribati' (1991:156). There are too few doctors (only one doctor per 1,967 persons), too few trained teachers, and too few people with vocational/technical skills. The consequence, as elsewhere in the South Pacific, is that senior professional posts are filled by expatriates (World Bank 1991:156-7, 174). Though expatriates represent only three per cent of total government employment, they hold one third of all senior positions (World Bank 1988c:5).

Up to 1985 the number of expatriates in the public service declined steadily, from 71 in 1983 to 47 in 1985. By 1987 the total was back up to 96. The Sixth Development Plan (Kiribati 1988:12) gave high priority to the localization program and a British review of the potential for localization suggested that, apart from a few highly specialized functions, the number of students completing training by 1991 would be sufficient to replace not only the 48 British posts but virtually all donor-funded expatriates in 1987 (Kiribati 1988:107-13). This has not happened. In December 1991 there were still 94 expatriates working in the public service and statutory authorities. The forthcoming Seventh Development Plan forecasts (again, using projections of students completing training) that about 65 of these positions will be localized by 1995 (Kiribati 1992).

Granted that new demands for specialist skills can reduce the planned pace of localization, it nonetheless seems fair to conclude that Kiribati has made very little progress with the localization of senior positions. There is no reason to suppose that the Seventh Development Plan targets will be achieved, and there is indeed recognition within Kiribati that 'past experience shows that localization forecasts have been too optimistic' (Kiribati 1990).

With its much larger stock of trained labour, Fiji relied on expatriate skills to a much lesser extent than the smaller economies, but, even before the coups, Fiji's planners were aware of persistent shortages of appropriate skills. It was argued that the main fault lay with a school curriculum insufficiently oriented to the production of vocational/technical skills (Fiji Government 1980, 1985). This question of appropriate skills was linked to the differential educational attainment of the two main ethnic groups. Ethnic Fijians had already attained high levels of literacy by the turn of the century, whereas the Indians who were imported to work on the sugar plantations were mostly illiterate. By the early 1980s, it was the Indian Fijians who had, on average, the superior educational attainment. In Fiji a large part of this turnaround was ascribed to a school system
which, it was alleged, was not well suited to the production of vocational skills in which ethnic Fijians would perform well. The supply of technical skills would be increased and the educational performance of ethnic Fijians would be much better, so this argument runs, if the school curriculum became more orientated to the production of technical and vocational skills (Gannicott 1990:xiii).

The emigration of skilled Indian Fijians after the coups of 1987 drastically worsened the picture of skill shortage. Net departures were 18,359 in 1987 and 10,674 in 1988, much higher numbers than pre-1987, and were 'mainly persons with higher education qualifications and job skills' (Fiji Government 1990:31). Of those employed at the time of the 1986 Census, 4.8 per cent of professional and technical, 12.5 per cent of administrative and managerial, and 6 per cent of clerical staff had left Fiji by June 1988, whereas the rate for lower level personnel was less than 1 per cent (World Bank 1990:102). Post-coup shortages are dramatically illustrated in the fact that 50 per cent of lawyers, 33 per cent of doctors, 14 per cent of accountants, 10 per cent of architects, engineers and engineering technicians, close to 10 per cent of teachers, and 6 per cent of public servants, mostly from senior positions, had left the country by mid-1988 (World Bank 1990:103).

Quality of education in the South Pacific

There is a broad-based problem that affects the quality of schooling in the South Pacific and cuts across specific differences between countries. While shortages of skilled labour lend themselves readily to quantitative measurement, data on quality are very limited, and it is necessary to fall back on the compilation of a variety of indicators, sometimes of an anecdotal type.

The counterpart of Solomon Islands' genuine achievement in expanding access to education during the 1980s is what the World Bank has termed the country's 'pervasive problem of educational quality', and the Ministry of Education and Training has itself observed 'that even casual examination ... reveals many qualitative shortcomings' (World Bank 1986:5). Academic performance in primary school, as measured by the Grade 6 achievement test of mathematics, English and general reasoning, is very low. In 1983 students were required to have a minimum score of 12 out of 15 to gain admission to national secondary school and only 17 per cent scored 12 and above.

1 This section draws extensively on work carried out jointly by the present author and Professor C.D. Throsby of Macquarie University. That joint work was undertaken for the Islands/Australia Project, National Centre for Development Studies, Australian National University, and it is reported in C.D. Throsby and K. Gannicott, The Quality of Education in the South Pacific, NCDS Working Paper No. 90/9, 1990. An edited version of that work has been published as 'Educational quality in economic development: ten propositions and an application to the South Pacific', International Review of Education, 38(3):223-39, 1992.
This poor standard of preparation at primary school has an inevitable impact at secondary level. Solomon Islands is very short of post-secondary labour, but the problem is not one of shortage of tertiary places. In fact, the Solomon Islands College of Higher Education has excess capacity, and donors fund a large number of tertiary fellowships at overseas institutions. The real problem is that the low standard of secondary education means that there are insufficient students of adequate quality coming through the secondary system, and those selected for overseas training often require remedial preparation.

Vanuatu raises in acute form the trade-off between quantity and quality in educational development. It was noted earlier that the education pyramid in Vanuatu narrows dramatically after primary school, with only 17 per cent of the relevant age group progressing to lower secondary school, and only 2 per cent of the 16–18 age group progressing to upper secondary. Quantitative expansion of upper secondary would help remedy persistent shortages of technical and professional labour, but the current National Plan argues that the problem of low overall quality is so severe that investment priorities should favour improved quality, with only very modest quantitative expansion (Vanuatu National Planning and Statistics Office 1988:18).

From her observations of both English and French-speaking schools in Vanuatu, Dutcher bluntly remarked that the only issue is that 'children do not learn enough in school' (1986:8). The World Bank concurred that 'direct observation tends to confirm the low quality of learning throughout the education system' (World Bank 1988b:5). As in Solomon Islands, examination results add weight to the anecdotal evidence, with results at both primary and secondary levels indicating that students are particularly weak in science and mathematics. In the 1985 primary leaving examination only 40 per cent of students achieved the 50 per cent pass score for language and mathematics, and less than a third of candidates from English-speaking schools were able to pass the Junior Secondary Leaving Exam.

In Tonga the issue of educational quality is not so stark. Tonga has a long-established primary system, and a high level of literacy and numeracy. In a small and homogeneous society, where basic education was not seen primarily as a tool of private or social economic advance, but as a corollary to the deeply religious basis of Tongan society, there was little of the pressure seen in other developing countries for a pell-mell expansion of secondary and tertiary facilities. Expansion was contained within the steady growth of secondary schools, still overwhelmingly a church responsibility, and by a scholarship system for overseas universities.

It therefore comes as a shock in Tonga to find that a recent survey of primary schools discovered that pupils had major learning problems. Using a variation of standardized tests which have been found to be good indicators of cognitive development, the survey found 'the majority of schools having 20–40 per cent of children being unable to cope with the content and speed of the present curriculum' (Platt 1988). The survey describes pupils in this category as having
learning difficulties, but there was no evidence that these high percentages could be explained by the incidence of children with acute learning difficulties such as physical or mental handicap. This suggests that the learning difficulties do not originate with the children, but with the schools failing to teach 20–40 per cent of pupils to the required standard. This conclusion is supported in Development Plan Six, which noted ‘a relatively high proportion of students repeating the final year of primary school because of literacy or numeracy problems [indicating] certain deficiencies in the primary education system’ (Tonga, Central Planning Department 1991:295).

It needs to be stressed that the quality problem in Tonga is of a different order of magnitude from that found in Solomon Islands or Vanuatu. Nonetheless, the Platt survey provides strong evidence that there is much room for improvement in the quality of primary schooling in Tonga.

Western Samoa, like Tonga, long ago achieved a high rate of literacy and numeracy. Some schools in Samoa have distinguished performance records; Samoa College attracts the cream of students who go on to gain most of the tertiary scholarships, and subsequently return from abroad to hold the most prestigious jobs. The examination record of most other secondary schools is, however, very poor. In 1983 Samoa College accounted for 70 per cent of successful candidates in the university entrance examination, but some schools had none. A dramatic perspective on these examination results can be gained by looking at the cohort experience over time. Of those children who sat the Form II (Grade 8) test in 1979, only 2 per cent passed the School Certificate in 1982; and only 1.5 per cent of the same cohort subsequently passed the university entrance examination (Galumalemana 1985:100).

Examination results need to be interpreted judiciously. Nonetheless, results cited above are consistent with other indicators of low average quality in Western Samoa, such as the poor performance of Western Samoan tertiary students in New Zealand. Samoan students studying in New Zealand are the cream of a highly selective educational system. If the products of that elite system are not receiving a basic education up to international standards, there cannot fail to be concern about the quality of schooling received by the vast majority who don’t go through the senior secondary stream.

In Kiribati, the role of untrained teachers has dominated the discussion of quality, and little attention seems to have been paid to the much more serious problem of the low standard of other inputs into the teaching process. Just as there is now a worldwide literature on the role of teachers, there is also a wide understanding of the crucial role of instructional materials in educational quality. The returns to lavish expenditures on buildings or equipment are, in general, small but the returns to investments in basic pedagogical resources such as text and exercise books, simple teaching aids, and the provision of clean, safe work space are very high. A recent survey has shown that Kiribati scores poorly on these investments (Kiribati 1992). Good quality schooling is not possible when 10 per cent of schools do not have a writing surface or a
chalkboard. Teachers cannot teach and children cannot learn when almost one-third of schools do not have a seating surface. Teachers cannot prepare decent instructional materials in the absence of lockable cupboards, cabinets or shelves. Children cannot stay healthy enough to be active learners when 70 per cent of schools do not have a proper toilet. Many schools experience a combination of these deficiencies.

Quality issues in Fiji have a dimension not found elsewhere in the South Pacific. The central quality issue in Fiji is not the overall standard but the quality of education received by the ethnic Fijian population. By independence it was already becoming clear that the superior educational attainment of the ethnic population was starting to reverse itself, a process which has continued. Indian children are now less likely to repeat or drop out within levels, have higher rates of survival within each school level, have a better success rate, and have higher rates of progression from one level of education to another. A single comparison that summarizes these differences is that for every 100 Indian Fijian children who enrolled in grade 1 in 1975, 31 completed the full 12 years of school in 1986. For every 100 ethnic Fijian children in the same entering group, only 19 finished year 12 in 1986 (Gannicott 1990:12).

This difference in educational attainment between the ethnic and Indian Fijians is a very complex issue, with part of the explanation lying in economic incentives and social and cultural factors outside the education system. A major part of the disparity, however, can be found in the fact that ethnic Fijians on average receive a lower quality of schooling than Indian Fijians. This comes about because there are effectively two separate school systems in Fiji, each catering to its own ethnic group. There is certainly no formal segregation of schools, and, particularly among urban secondary schools, there are schools with substantial enrolments from both ethnic groups. In general, however, schools for ethnic Fijians are in more isolated rural areas, are smaller and thereby require more multi-grade classes, have poorer quality teachers, less experienced principals, suffer a lack of textbooks, and are poorly equipped with laboratories, libraries and furniture (Bennett 1974; Stewart 1984). The Fijian schools are deficient in the very resources which are known to have an important and direct impact on educational achievement (Fuller 1987; Heyneman and White 1986).
Population growth and resources for education

Remedying shortages of qualified labour as well as raising the average quality of schooling in the region have obvious implications for resource allocation. The quality of education in the region cannot be improved without a substantial increase in funding. For example, one of the most important findings to emerge from studies of education in developing countries is that 'the safest investment in educational quality ... is to secure adequate books and supplies' (World Bank 1988b:45). Such materials are in chronically short supply almost everywhere in the South Pacific. In Tonga there continues to be a critical shortage of textbooks, reading materials, science equipment and even such basic materials as exercise books, pens and rulers. In the Solomon Islands, many pupils at both primary and secondary levels are deprived of access to essential books and equipment (Gannicott and McGavin 1990). In Fiji, the shortage of books and essential equipment bears heavily on the issue of the quality of ethnic Fijian students. Rural Fijian schools are substantially less well equipped with textbooks, libraries and school laboratories and equipment than the mainly urban Indian schools.

As well as being desperately short of books of all kinds, many schools in the region have a standard of building and equipment which is inimical to effective learning. In Western Samoa, junior high schools are almost totally devoid of materials for the teaching of agriculture, home economics and science. In the Solomon Islands, facilities in lower secondary schools, or provincial high schools, are sometimes primitive in the extreme, and in Fiji, the lack of books and teaching resources has been described as a major factor contributing to the high rate of failure amongst Fijian children at upper secondary and tertiary levels (Gatu 1988:14–6; Luker, Bailey and Bishop 1983).

In the South Pacific teacher training, especially at primary level, is particularly crucial given the distance and terrain. With their many scattered islands and isolated villages, most South Pacific countries have little option but to operate small schools, often with multi-grade classes. Many teachers have received little or no teacher training and completely untrained teachers are often required to cope with the difficult task of teaching classes of multiple ages and grades. In Fiji, for example, there are some 100 primary schools which are so small that teachers have to teach 2–3 grades in the same class. The teachers in these predominantly Fijian schools have received no specific training in the special skills required for such teaching. In Vanuatu, one out of every five

2 This section draws on work currently under way for the Pacific 2010 project of the National Centre for Development Studies (1992) at the Australian National University. The underlying population projections were prepared by a team under the direction of David Lucas and Christine McMurray, and the cost and enrolment estimates based on those projections were presented by the present author at a seminar 'Pacific 2010: population projections and employment and training needs', held at the Australian National University in March 1992. I should like to acknowledge the very substantial help of Suzanne Stanley with the material for that seminar paper.
Human resource development in the South Pacific

teachers has more than one grade in the same class, in some cases teaching three grades in the same class. In 1985, none of these multi-grade teachers had the special training to cope with this difficult task (Fiji, Parliament of 1988:81; Vanuatu National Planning and Statistics Office 1988:13–18).

Many teachers, whether trained or untrained, have an inadequate level of basic schooling. Substantial proportions of secondary school teachers have no more education than the pupils they teach. Of the approximately 200 Solomon Islander secondary teachers in 1987, half had no more than Grade 9 schooling. In Tonga, 47 per cent of secondary teachers have no more than secondary education, and in Vanuatu 25 per cent of non-expatriate secondary teachers have nothing higher than Grade 10 education (World Bank 1986:25; Tonga, Ministry of Education 1988:43; Vanuatu National Planning and Statistics Office 1988:18).

It goes without saying that deficiencies in the quality of teachers or in the provision of textbooks and materials cannot be remedied without substantial funding. In several countries rapid rates of population growth are adding an extra layer to human resource problems. Resources have to be found not only to cope with past and present problems of skill shortage and low average quality, but with the extra numbers in the school-age population. In countries such as Vanuatu and Solomon Islands, population growth is so rapid that funding for the extra numbers is likely to dominate the problem of providing adequate school resources and will severely constrain the scope for those countries to overcome their existing problems of quality and quantity of available education.

Notwithstanding the small absolute scale of population issues in the South Pacific (the total population of Fiji, Kiribati, Solomon Islands, Tonga, Vanuatu, and Western Samoa is just over 1.5 million), the rate of population growth is relatively high, averaging 2.2 per cent across the region. Growth rates are particularly high in the Melanesian countries, reflecting declining mortality but very high fertility rates. Between 1980 and 1988, the net population growth rate was 3.5 per cent in the Solomon Islands and 2.9 per cent in Vanuatu (World Bank 1991:3). In the other countries, fertility rates are lower but still high by international standards (World Bank 1991:2). While high rates of emigration mean that the net population growth rate is very low in Kiribati, Western Samoa and Tonga, a change of policy in the recipient countries would shift attention to the fact that the natural growth rates in those countries are relatively high at 2.3, 2.2 and 2.9 per cent respectively (World Bank 1991:3). By way of comparison, it should be noted that virtually all the industrial countries are projected to have essentially constant populations until the end of this century and that the average for all developing countries 1990–2000 is forecast to be 2.0 per cent (United Nations Development Program 1991:190).

The implications of fast-growing school-age populations are clear. More school-age children require more spending on education, even if the objective is just to maintain current enrolment rates and current standards. As all the countries
in the region need to improve their schools both quantitatively and qualitatively, they will have to generate more national savings or else divert investments from other areas such as health, power or transport. If a country is unable or unwilling to make those sacrifices, spending must be spread over a larger group of school children, to the detriment of school quality, or a growing number of children will have to be excluded from education (World Bank 1984).

The expenditure implications of a rising school-age population for the relevant countries have been calculated (Tables 3–8). The procedure was to start with population projections derived from the latest census data in each country, project the growth of the relevant school-age groups, making assumptions about future enrolment rates for those school-age groups and then derive the number of students projected to be enrolled in future years. Under a further assumption that the unit cost of the different levels of schooling will remain constant in real terms at their current level, it was possible to calculate the total cost of schooling provision for the forecast numbers, and to relate that total cost to projected GDP (Tables 3–8).

A glance at the results for Vanuatu will illustrate the procedure (Table 7). Columns 1, 2 and 4 show the numbers of children in the relevant age groups. These projections assume that Vanuatu will achieve 100 per cent primary enrolment by 1994, 50 per cent enrolment of the 13–15 age group in lower secondary school by 2014, and 25 per cent enrolment of the 17–18 year group in upper secondary by that year. If the additional assumption that educational costs will be held constant at their 1990 level is made, the total cost of educating these numbers is readily calculated. This assumption implies that there are no economies of scale appropriate for this region of scattered villages and small schools. The total cost is shown in Column 5 and is expressed as a percentage of projected GDP in Column 9. The GDP forecasts used were those recently made by the World Bank, and in the case of Vanuatu they assume a fast rate of GDP growth (4.2 per cent per year) from 1990–94 and even faster growth of 4.6 per cent per year thereafter. Under this set of assumptions it can be seen that by 2014 education spending in real terms would be absorbing nearly 6.5 per cent of GDP.

While these assumptions may well be a realistic estimate of what Vanuatu will be able to achieve with expansion of enrolments, they do imply that even 20 years from now Vanuatu will still be unable to offer the basic 10 years of schooling to all its children. Given the progress made with primary enrolments during the 1980s, together with Vanuatu’s present very low human resource endowment, it could well be argued that on both economic and social grounds Vanuatu should aim for 100 per cent enrolment of the 12–14 age group by 2014. Columns 1, 3 and 4 of Table 7 show the implications of this higher enrolment target. It can now be seen that providing everyone in the 6–14 age group with schooling, in a situation of rising numbers in that age group, will require an almost five-fold increase in educational spending.
### Table 3  Fiji: projections of school enrolments and educational expenditure, 1991–2011

<table>
<thead>
<tr>
<th></th>
<th>School enrolments*</th>
<th>Expenditure</th>
<th>Proportion of GDP(^e) (per cent)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Primary 6–11 years(^b)</td>
<td>Secondary 12–17 years(^c)</td>
<td>Total(^d) (US$ million)</td>
</tr>
<tr>
<td>1991</td>
<td>106940</td>
<td>66290</td>
<td>66290</td>
</tr>
<tr>
<td>1996</td>
<td>103480</td>
<td>75760</td>
<td>79880</td>
</tr>
<tr>
<td>2001</td>
<td>101710</td>
<td>74270</td>
<td>82660</td>
</tr>
<tr>
<td>2006</td>
<td>108100</td>
<td>72130</td>
<td>85760</td>
</tr>
<tr>
<td>2011</td>
<td>112080</td>
<td>74220</td>
<td>93260</td>
</tr>
</tbody>
</table>

Unit cost at 1989 prices: US$248, US$525

---

a Projections based on population projections derived from census data.

b Assumes enrolment rate increases from 92 per cent in 1986 to 100 per cent in 2011.

c Column 2 assumes a moderate increase in the enrolment ratio from 78 per cent at junior secondary (12–15 years) and 41 per cent at senior secondary (16–17 years) in 1986 to 81 per cent and 45 per cent respectively in 2011. Column 3 assumes a more rapid increase in enrolments, reaching 100 per cent of the junior secondary age group and 60 per cent of the senior secondary group in 2011.

d Column 4 shows the cost of enrolments in columns 1 and 2. Column 5 shows the cost of enrolments in columns 1 and 3.

e Columns 6 and 7 express columns 4 and 5 respectively as a proportion of GDP, where GDP is projected to grow at the same low rate as the 1980s. Column 8 expresses column 5 as a percentage of GDP, where GDP is projected to grow during the 1990s at the high rate forecast by the World Bank.

Table 4  Kiribati: projections of school enrolments and educational expenditure, 1990–2010

<table>
<thead>
<tr>
<th>Year</th>
<th>School enrolments</th>
<th>Expenditure</th>
<th>Proportion of GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Primary 6-12 years</td>
<td>Junior 13-15 years</td>
<td>Senior 16-19 years</td>
</tr>
<tr>
<td></td>
<td>(1)</td>
<td>(2)</td>
<td>(3)</td>
</tr>
<tr>
<td>1990</td>
<td>11646</td>
<td>1461</td>
<td>1461</td>
</tr>
<tr>
<td>1995</td>
<td>13662</td>
<td>1533</td>
<td>2603</td>
</tr>
<tr>
<td>2000</td>
<td>13614</td>
<td>2572</td>
<td>4180</td>
</tr>
<tr>
<td>2005</td>
<td>13455</td>
<td>2709</td>
<td>4967</td>
</tr>
<tr>
<td>2010</td>
<td>15080</td>
<td>2960</td>
<td>5920</td>
</tr>
</tbody>
</table>

Unit cost at 1990 prices

- US$107
- US$230
- US$230

a Projections based on population projections derived from census data.
b Assumes enrolment rate increases from 90 per cent in 1990 to 100 per cent in 2010.
c Column 2 assumes an increase in the enrolment rate from 30 per cent in 1990 to 50 per cent in 2010. Column 3 assumes a more rapid increase in enrolments, reaching 100 per cent of the age group in 2010.
d Assumes an increase in the enrolment rate from 22 per cent in 1990 to 30 per cent in 2010.
e Column 5 shows the cost of enrolments in columns 1, 2 and 4. Column 6 shows the cost of enrolments in columns 1, 3 and 4.
f Columns 7 and 8 express columns 5 and 6 respectively as a proportion of GDP, where GDP is projected to grow at the same low rate as the 1980s. Column 9 expresses column 6 as a proportion of GDP, where GDP is projected to grow during the 1990s at the high rate forecast by the World Bank.

Source: Primary school unit cost is from World Bank, Pacific Regional Post-Secondary Education Study, Washington, DC, 1992:8. Secondary unit cost was calculated as the enrolment-weighted average of costs at the government secondary school and the Catholic schools, where costs in each type of school were taken from World Bank, Post-Secondary Education and the Labor Market in Kiribati, Washington DC, 1992. The GDP projections are calculated from World Bank, Pacific Islands Economies: towards higher growth in the 1990s, Washington, DC, 1991:26, 182 ('Low GDP') and 170, 182 ('High GDP').
## Table 5 Solomon Islands: projections of school enrolments and educational expenditure, 1991–2011

<table>
<thead>
<tr>
<th>School enrolments</th>
<th>Expenditure</th>
<th>Proportion of GDP (per cent)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Total</td>
</tr>
<tr>
<td></td>
<td>8–13 years</td>
<td>14–16 years</td>
</tr>
<tr>
<td></td>
<td>b</td>
<td>c</td>
</tr>
<tr>
<td>Primary</td>
<td>(1)</td>
<td>(2)</td>
</tr>
<tr>
<td>Junior secondary</td>
<td>1991</td>
<td>49650</td>
</tr>
<tr>
<td>Senior secondary</td>
<td>1996</td>
<td>56010</td>
</tr>
<tr>
<td></td>
<td>2001</td>
<td>66280</td>
</tr>
<tr>
<td></td>
<td>2006</td>
<td>78500</td>
</tr>
<tr>
<td></td>
<td>2011</td>
<td>93560</td>
</tr>
</tbody>
</table>

Unit cost at 1990 prices


| a | Projections based on population projections derived from census data. |
| b | Assumes enrolment rate increases from 90 per cent in 1991 to 100 per cent in 2011. |
| c | Column 2 assumes an enrolment rate increasing from 40 per cent in 1991 to 50 per cent in 2011. Column 3 assumes an enrolment rate increasing to 100 per cent in 2011. |
| d | Assumes a constant enrolment rate. |
| e | Column 5 shows the cost of enrolments in columns 1, 2 and 4. Column 6 shows the cost of enrolments in columns 1, 3 and 4. |
| f | Columns 7 and 8 express columns 5 and 6 respectively as a percentage of GDP, where GDP is projected to grow at the same low rate as during the 1980s. Column 9 expresses column 6 as a percentage of GDP, where GDP is projected to grow during the 1990s at the high rate forecast by the World Bank. |

Table 6 Tonga: projections of school enrolments and educational expenditure, 1989–2014

<table>
<thead>
<tr>
<th></th>
<th>School enrolments</th>
<th>Expenditure</th>
<th>Proportion of GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Primary 6–11 years</td>
<td>Secondary 12–19 years</td>
<td>Total (US$ million)</td>
</tr>
<tr>
<td>1989</td>
<td>13976</td>
<td>12960</td>
<td>4.9</td>
</tr>
<tr>
<td>1994</td>
<td>14866</td>
<td>12150</td>
<td>4.8</td>
</tr>
<tr>
<td>1999</td>
<td>12540</td>
<td>13050</td>
<td>4.7</td>
</tr>
<tr>
<td>2004</td>
<td>11240</td>
<td>11960</td>
<td>4.3</td>
</tr>
<tr>
<td>2009</td>
<td>11100</td>
<td>9820</td>
<td>3.7</td>
</tr>
<tr>
<td>2014</td>
<td>12100</td>
<td>9770</td>
<td>3.8</td>
</tr>
</tbody>
</table>

Unit cost at 1989–90 prices US$110 US$257

a Projections based on population projections derived from census data and a continuation of the existing enrolment rate of 98 per cent for primary and 78.5 per cent for secondary school.

b Low GDP assumes that GDP will continue to grow at the same rate as during the 1980s. High GDP assumes that GDP will grow during the 1990s at the high rate forecast by the World Bank.

Source: Cost data are from Tonga, Development Plan Six, 1991: 295. GDP projections are calculated from World Bank, Pacific Island Economies: towards higher growth in the 1990s, World Bank, Washington, DC, 1991:26, 261 ('Low GDP') and 251, 261 ('High GDP').
Table 7  Vanuatu: projections of school enrolments and educational expenditure, 1989–2014

<table>
<thead>
<tr>
<th>School enrolments</th>
<th>6–12 years</th>
<th>13–15 years</th>
<th>17–18 years</th>
<th>Total (US$million)</th>
<th>Proportion of GDP (per cent)</th>
<th>Low GDP</th>
<th>High GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>Primary</td>
<td>(1)</td>
<td>(2)</td>
<td>(3)</td>
<td>(4)</td>
<td></td>
<td>(5)</td>
<td>(6)</td>
</tr>
<tr>
<td>1989</td>
<td>19993</td>
<td>2600</td>
<td>2600</td>
<td>1170</td>
<td>6.2</td>
<td>4.3</td>
<td>4.3</td>
</tr>
<tr>
<td>1994</td>
<td>23748</td>
<td>3672</td>
<td>4896</td>
<td>1890</td>
<td>8.6</td>
<td>5.6</td>
<td>6.1</td>
</tr>
<tr>
<td>1999</td>
<td>30420</td>
<td>4746</td>
<td>7463</td>
<td>2820</td>
<td>11.3</td>
<td>6.9</td>
<td>7.9</td>
</tr>
<tr>
<td>2004</td>
<td>35140</td>
<td>6136</td>
<td>10738</td>
<td>3540</td>
<td>13.6</td>
<td>7.7</td>
<td>9.5</td>
</tr>
<tr>
<td>2009</td>
<td>40720</td>
<td>7970</td>
<td>15054</td>
<td>4670</td>
<td>16.8</td>
<td>8.8</td>
<td>11.3</td>
</tr>
<tr>
<td>2014</td>
<td>46660</td>
<td>10290</td>
<td>20580</td>
<td>6150</td>
<td>20.8</td>
<td>10.1</td>
<td>13.4</td>
</tr>
</tbody>
</table>


a Projections based on population projections derived from census data.
b Assumes that 100 per cent enrolment will be achieved by 1994.
c Column 2 assumes that the enrolment rate will rise to 50 per cent by 2014.
Column 3 assumes that the enrolment rate will rise to 100 per cent by 2014.
d Assumes that the enrolment rate will increase to 25 per cent by 2014.
e Column 5 shows the cost of enrolments in columns 1, 2 and 4. Column 6 shows the cost of enrolments in columns 1, 3 and 4.
f Columns 7 and 8 express columns 5 and 6 respectively as a percentage of GDP, where GDP is projected to grow at the same rate as during the 1980s.
Column 9 expresses column 6 as a percentage of GDP, where GDP is projected to grow at the high rate forecast by the World Bank.

Ken Gannicott

Table 8  Western Samoa: projections of school enrolments and educational expenditure, 1991–2011

<table>
<thead>
<tr>
<th>Year</th>
<th>School enrolments(^a)</th>
<th>Expenditure</th>
<th>Proportion of GDP(^d)</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Primary 5–14 years(^b)</td>
<td>Secondary 15–19 years(^c)</td>
<td>(US$ million)</td>
<td>Low GDP</td>
</tr>
<tr>
<td>1991</td>
<td>35200</td>
<td>17500</td>
<td>6.6</td>
<td>5.8</td>
</tr>
<tr>
<td>1996</td>
<td>38100</td>
<td>16500</td>
<td>6.7</td>
<td>5.4</td>
</tr>
<tr>
<td>2001</td>
<td>42100</td>
<td>17200</td>
<td>7.3</td>
<td>5.3</td>
</tr>
<tr>
<td>2006</td>
<td>44100</td>
<td>18300</td>
<td>7.7</td>
<td>5.1</td>
</tr>
<tr>
<td>2011</td>
<td>45300</td>
<td>19800</td>
<td>8.0</td>
<td>4.9</td>
</tr>
</tbody>
</table>

Unit cost at 1989–90 prices US$98 US$182

\(a\) Projections based on population projections derived from census data.

\(b\) Assumes an increase in the enrolment rate from 84 per cent in 1991 to 100 per cent by 2011.

\(c\) Assumes an increase in the enrolment rate from 84 per cent in 1991 to 90 per cent by 2011.

\(d\) Column 4 expresses column 3 as a percentage of GDP, where GDP is projected to grow at the same rate as during the 1980s. Column 5 expresses column 3 as a percentage of GDP, where GDP is projected to grow during the 1990s at the high rate forecast by the World Bank.

**Source:** Cost estimates are from World Bank, *Pacific Regional Post-Secondary Education Study*, Washington, DC, 1992:8; The GDP projections are calculated from World Bank, *Pacific Island Economies: towards higher growth in the 1990s*, World Bank, Washington, DC, 1991:26, 339 (‘Low GDP’) and 324, 339 (‘High GDP’).

It will be clear that the proportions of GDP absorbed by educational costs are themselves a function of GDP projections which may not be borne out. In its recent survey of growth prospects in the South Pacific, the World Bank forecast GDP for the region on the assumption that structural reform of the South Pacific economies will permit much more rapid growth than the virtual stagnation (apart from Tonga) which was a feature of the 1980s. We have referred to this as the high GDP assumption (Tables 3–8). Given the long time period, the magic of compound interest means that an assumption of high GDP growth generates a very different picture from the financing burden that would be incurred if the region’s countries were to continue at the very slow growth rates characteristic of the recent past. Columns 7 and 8 of Table 7 for Vanuatu thus adopts the low GDP assumption showing the proportion of GDP taken by education if GDP grows in the future at the same low rate as during 1980–88.

207  Pacific islands at the crossroads?
A number of general comments can be made. First, there is again a clear difference between the Melanesian countries (Solomon Islands and Vanuatu) and the others. The results for Fiji and Western Samoa show a very slow rise in the school-age population, and in the case of Tonga the underlying demographic assumptions of a gradual decline in the total fertility rate and emigration result in a declining school-age population. Moreover, these latter countries have already achieved virtually universal primary enrolment and very high secondary enrolment. In these circumstances, the total cost of educating the school-age population will be roughly constant in real terms and thus will fall as a percentage of GDP if GDP grows as fast as projected by the World Bank. Even on low GDP assumptions, the financing burden for Kiribati, Samoa, Tonga and Fiji will not be such as to prevent attention to the persistent problems of skill shortage and low average quality.

In contrast, Solomon Islands and Vanuatu not only start from much lower enrolment rates (particularly at secondary level) but face large increases in the underlying school-age population. Both countries are facing a doubling of their school-age population over the next 20 years. In Vanuatu even the conservative assumption that leaves 50 per cent of the school-age group without secondary education in 2014 implies a tripling of expenditure in real terms and in the Solomon Islands the same assumption implies that real expenditure will virtually have to double.

It should be remembered that the total education budget is not measured (Tables 3–8). Inclusion of administrative and tertiary expenditure (such as that for the Solomon Islands College of Higher Education) would add around 20 per cent to the total costs and an additional percentage point to the GDP proportions shown. Even if their economic growth performances improve substantially beyond the very low rates recorded in the recent past, the financing burden is substantially higher than either country managed to sustain during the 1980s (Tables 5 and 7). If the financing task looks daunting even under optimistic assumptions of future GDP growth, it hardly needs to be added that the financial burden under the low GDP assumption permits only one plausible conclusion: the combination of rapidly growing school-age population and slow-growing GDP will make it impossible for the Melanesian countries to make much quantitative progress with their education systems. Even 20 years from now, for children not yet born, it will not be possible for Solomon Islands and Vanuatu to provide a basic ten years of schooling to everyone in the school-age group.

This deeply pessimistic conclusion is no stronger than the assumptions underlying the calculations. An obvious but important characteristic of school-age populations is that their rate of growth will start to slow five or six years after a decline in fertility, and it is entirely possible that the forecasts will turn out to be wide of the mark (Tables 3–8).

Despite the uncertainties, the projections provide a plausible scenario of the future, and focus upon what needs to be done if these countries are to succeed in extending schooling to everyone. First, a population policy can play a role by
reducing the numbers in the underlying age group. Second, more children can be educated if school unit costs are reduced. In a region where there is considerable evidence that school quality is low because of insufficient expenditure, this comment needs to be interpreted cautiously. Nevertheless, the logic of the calculations suggest that an important avenue of policy must be to find ways of reducing costs (Tables 3–8). Perhaps most importantly, these predictions bring home the close relationship between population, education and economic growth. In an economy which is experiencing slow economic growth, the burden of trying to extend schooling to a greater percentage of the school-age group, while the absolute size of that age group is itself increasing, imposes impractical financing requirements. If, however, economic growth is faster, the financial burden falls to a more manageable level.

This argument in turn raises another. While it is obvious that faster economic growth is essential for providing the wherewithal to finance human resource development, is there a two-way relationship, so that human resource development is itself an important or even essential ingredient of faster economic growth in the South Pacific?

**Human resources and economic growth**

Since the birth of modern human capital economics thirty years ago, the contribution of education to economic growth has been a major area of research. Indeed, it can be argued that human capital became a fashionable area not so much from possible improvements in the micro allocation of educational resources, but because it sold the promise that investment in education would produce economic growth (Denison 1962). Today, there is a 'deepening pessimism about the importance of education...[because] the simple fact is that the field has failed to deliver the goods' (Blaug 1989:331–2). A recent literature review argued that ‘it is the decline in rates of economic growth in much of the First and Third World which has left educational economists as salesmen without a product’ (Gannicott 1990:43).

East and Southeast Asia are, by contrast, regions of high economic growth. The ASEAN countries, and more recently China, use the newly industrializing economies and Japan as a model of what they too can achieve. In all these countries there remains great optimism about the role of education in contributing to economic growth. In the context of the present paper, it is useful to ask whether there are any lessons for the South Pacific in the successful record of their neighbours to the northwest.

It is relevant to note that both the Republic of Korea and Taiwan are former Japanese colonies, and their tremendous progress in human capital formation after 1945 is sufficiently familiar to need little documentation. In 1944, 12 million out of 14 million Koreans had no education at all, but by 1960 only 6.5 million out of 14.8 million had no education and over a million had more than ten years of formal education (Behrman 1990:66). In Taiwan, literacy rose from 45 per cent in 1945 to 85 per cent in 1977. Whereas there were very few
opportunities after primary school in 1945, by 1970, 50 per cent of the relevant age group was enrolled in secondary school (Krause 1989:8).

Choo (1986) brings out Korea’s success in extending education to high proportions of the relevant age groups and current policies call for continued educational growth, including a massive expansion of higher education (Korean Educational Development Institute 1985). Scitovsky (1986) singled out the very high educational and skill levels of both Taiwan and the Republic of Korea as a major explanation of their economic success. Krause argued that the lesson to be drawn from both [Korea and Taiwan] is that their successful industrial expansion was greatly facilitated by their educational systems. Whether or not [the elaborate worker training plans] were a success is a matter of dispute since many people were trained for careers that they did not pursue. The fact that they were trained and that the training was transferable to many different activities, however, is widely accepted (1989:9–10).

This widely accepted lesson has not been lost on other countries in the region. Lim (1983) and Shantakumar (1986) document the expansion of Singapore’s education after the separation from Malaya, and Krause et al. (1987) argued that, despite much progress, Singapore needed additional investments in formal education if its workforce quality was to be comparable with other newly industrializing economies. Other countries of Southeast Asia have begun to look East for lessons to be learned on human capital formation. Malaysia, Indonesia and Thailand have all attached great weight to the perceived role of education in contributing to economic growth. Throughout the 1980s, the Thai government was committed to continuing educational expansion, at least partly to meet economic growth targets (World Bank 1989). In Malaysia, the New Economic Policy gave high priority to the development of education, particularly the substantial expansion of post-secondary education (Mehmet and Hoong 1985). Daroesman (1985) and Booth (1989) both demonstrate the continuing commitment in Indonesia to modernise the economy through an educated labour force.

This line of argument is neatly summarized in the judgement of the Asian Development Bank on the economic record of the newly industrializing economies.

Human capital formation has been a crucial underlying factor in these countries’ growth. Examination also shows that education and skills became increasingly critical as these economies approached industrial maturity. Even though it is difficult to quantify the contribution of human capital to economic growth, there is virtually unanimity regarding its critical role (1989:153–4).

Unfortunately, this ‘unanimity’ of view raises as many questions as it answers for the South Pacific. While the Asian Development Bank’s line of argument provides a ready explanation for the poor economic growth record of Vanuatu and Solomon Islands in their low level of human resource development, it leaves unexplained why the long-standing and widespread level of literacy and basic
schooling in Fiji, Western Samoa and Tonga has not translated into faster economic growth. If the explanation lies in the low average quality of schooling in the South Pacific, it has to be remembered that quantitative expansion of primary and secondary schooling in the ASEAN countries has often been purchased at the cost of poor quality. Of the newly industrializing economies, there is convincing evidence that the quality of Korean schooling has not kept pace with the quantitative expansion (Lee 1983; Michell 1988). There is much rote learning and barely a decade ago, McGinn et al. (1980) claimed that education in Korea had not transmitted modern skills appropriate for growth.

If the explanation is that the countries of the South Pacific have not produced the type of skills necessary for economic growth, exemplified in the persistent labour shortages, it needs to be remembered that there is much evidence that it is, in general, a better use of resources for schools to concentrate on providing a broad-based general education, leaving skill-specific training as the responsibility of employers (World Bank 1988b). While Taiwan developed an extensive system of secondary vocational schools, this was not true of Korea. In Korea 'the academic side was more important and the vocational system much less important than in Japan or the post-colonial Republic' (Behrman 1990:66). Recent policies in Korea favour the strengthening of general secondary education as a preparation for the continued expansion of higher education (Presidential Commission 1986). Similarly, Singapore in the past put much emphasis on technical-vocational education, but now emphasises the role of schools in providing a broad-based education (Singapore, Report of the Economic Committee 1986).

Nor does the econometric evidence lend much support to the notion of human resource-led economic growth. Pemia (1990) found a positive association between economic growth and initial human resource stock in fourteen Asian developing countries, but Behrman's regressions produced some anomalous results. Reporting an earlier cross-country study of patterns in human resources, Behrman concluded that schooling investments were very imperfectly correlated with per capita income across countries (1990:73). He noted that, in the individual country results, Korea and Hong Kong scored as would be predicted by the view that high economic growth is associated with high schooling investments, but Singapore did not. Similarly, 'some of the countries that are in the top five of the distribution for 1981 (Peoples' Republic of the Congo, China, Philippines, Sri Lanka, and Togo) ... do not constitute a group that immediately comes to most peoples' mind ... as having had outstanding development experience' (Behrman 1990:73–4). Presumably, if it had been possible to include Fiji, Western Samoa and Tonga in the sample, these too would have been outliers for which an association between human resource investments and development does not appear to hold very well.

Behrman's summing up is judicious

there is surprisingly little systematic quantitative evidence for the proposition that human resource investments cause substantial development [and while the Korean and Taiwanese evidence] does demonstrate that
educational investment increased substantially with the process of development ... demonstrating association is not the same thing as showing causality (1990:89).

The implication is that the South Pacific countries cannot slavishly model themselves on the human resource experience in ASEAN and newly industrializing economies and expect labour-intensive economic growth to follow. Yet, if we must reject some of the more naive interpretations of the education/growth relationship in East Asia, there are at least two vital lessons from which the South Pacific countries could benefit.

The first of these is to be found in the work of Oshima. Oshima (1978, 1980) provided early insights into the role of human capital formation in the economic development of East and Southeast Asia, tracing the role of skills and work culture as twin components of human resource development. In subsequent work (Oshima 1986, 1988), he has emphasized the role of human resources and labour development in explaining the spectacular economic growth of the four newly industrializing economies, documenting the educational superiority of Taiwan, Singapore, Hong Kong and Korea compared to other Asian countries.

Oshima contrasts the Confucian heritage of Japan, Taiwan, Korea, Hong Kong and Singapore with the Hispanic Catholicism, Islam, Hinduism and Theravada Buddhism typical of other countries in Asia and the Pacific. But Oshima's argument cannot be taken entirely at face value. Islam as such does not appear to have been a constraining factor in Indonesia's recent economic performance, nor did Buddhism demonstrably limit Thailand's excellent economic growth during the 1980s. The crucial feature of Oshima's work is the pervasive argument that the educational superiority of the newly industrializing economies does not just depend upon the importance of past quantitative investments in human capital, but on the strong sense of a social culture and work ethic of which schooling in those countries is a part and to which it contributes. It will immediately be obvious that Oshima's argument accounts very neatly for Behrman's outliers such as Sri Lanka and Philippines, as well as the South Pacific countries of Fiji, Western Samoa and Tonga—all of which have high levels of educational attainment in the purely quantitative sense but poor records of economic growth. Those familiar with the South Pacific will have no difficulty applying the central thrust of Oshima's argument to the contrasting experience of Western Samoa, Tonga and the ethnic Fijians on the one hand, and the Indian Fijians on the other.

The second and closely related lesson from the East Asian experience is the need for complementary policies.

Human resources alone ... are not sufficient. Sustained economic progress depends critically on how well these resources are developed and how efficiently land, capital and technology are mobilized. Literacy and educational levels in Sri Lanka and Philippines, for example, were among the highest in developing Asia in the early postwar years. Nevertheless, their long-term economic performance was less satisfactory than several other
DMCs [Developing Member Countries of the Asian Development Bank]. Educated labour may be wasted if capital and raw materials are not available, if economic policies are inappropriate, if entrepreneurship is lacking, or if political structures are unstable. Accordingly, the context within which human and physical capital investments are made matters a great deal (Asian Development Bank 1989:170).

This means, in short, that policies for human resource development in the South Pacific will only pay off in faster economic growth if there is a much wider reform of their economic structures and policies. Much work has been carried out on economic development in the South Pacific, most recently by the World Bank (1991), and it is safe to say that the major issues inhibiting economic development in the region are now well understood. These issues are the dominance of a large aid-financed government sector, a climate of regulation, licensing and control, and of ad hoc interventions in the market. Inward-looking high-cost development, dominated by large investments in infrastructure, creates a policy environment inimical to private sector investment. What the World Bank (1991:viii) calls a 'lack of a supportive policy environment and an absence of dynamic growth strategies' is precisely the social and economic culture which, in Oshima's view, permitted human resources to contribute so successfully to the transformation of the newly industrializing economies.

The case for substantial investments in human resource development in the South Pacific, to expand educational coverage in Vanuatu, Solomon Islands and Kiribati, to raise educational quality throughout the region, to remedy specific skill shortages in Samoa and Tonga as well as Melanesia and to cope with population growth has been made. Whether the countries of the South Pacific then come merely to emulate Sri Lanka and the Philippines as well educated but slow growing economies, or whether those investments pay off in enduring economic growth, will depend crucially on whether the essential complementary policy reforms instill a dynamic culture of growth.
Human resource development in the South Pacific

References


Daroesman, R., 1985. 'Indonesia' in M.D. Leonor (ed.), Unemployment, Schooling and Training in Developing Countries: Tanzania, Egypt, the Philippines, and Indonesia, Croom Helm, London.


Ken Gannicott


Human resource development in the South Pacific


217 Pacific islands at the crossroads?
Some issues in the development and management of human and natural resources in the South Pacific

John Rofeta

The purpose of this paper is to highlight some issues in the development and management of human and natural resources in the context of human development in the South Pacific island economies. People are not just resources required for the production processes. Human well-being is the ultimate purpose of the development process. Furthermore, natural resources, an essential factor for the development process, are not available in great abundance in the Pacific island economies. Utilization of the available resources has to be undertaken in a sustainable manner.

A brief overview of the main physical resource and economic characteristics of the Pacific island economies is provided here and followed by a review of the concept and the state of human development in the Pacific island economies. The main issues and priority areas in the development and management of human and natural resources are highlighted.

The South Pacific island countries: an overview

Spatial and physical features

The countries of the South Pacific extend from the Republic of Marshall Islands in the northern Pacific to Tonga in the southern Pacific, and from Papua New Guinea in the south-western Pacific to Cook Islands in the south-eastern Pacific. They straddle both the International Dateline and the Equator. Of the thirteen Pacific island economies, four are freely associated with their former administering nations: Cook Islands and Niue with New Zealand; Federated States of Micronesia and Republic of Marshall Islands with the United States of America. Five of the Pacific island economies are classified by the United Nations as less developed economies: Kiribati, Solomon Islands, Tuvalu, Vanuatu and Western Samoa.

The Pacific island economies have a combined total land area of 0.53 million square kilometres. Most of the land area (88 per cent) is accounted for by Papua New Guinea. Excluding Papua New Guinea, the other twelve Pacific island economies have a combined land area of just 63,815 square kilometres (South Pacific Commission 1991). Three countries, Solomon Islands, Fiji and Vanuatu, account for about 63 per cent of the total combined land area, excluding Papua New Guinea. The land areas of the countries vary considerably in size. After Papua New Guinea, Solomon Islands has the second largest land area (27,556 km²). Nauru has the smallest land area (21 km²), after Tuvalu (26 km²) (South Pacific Commission 1991).
In contrast, the Pacific island countries have an extensive sea area amounting to a combined total area of 19.4 million km$^2$. The size of sea area varies between the countries. Kiribati has the largest (3.6 million km$^2$) and Western Samoa has the smallest (120,000 km$^2$) (South Pacific Commission 1991).

The Pacific island countries are archipelagoes, except for Nauru and Niue, which are single islands. Both compact and dispersed archipelagos are formed by the islands and both archipelagic types exist in most of the countries. Kiribati and Cook Islands are amongst the most dispersed archipelagic countries of the South Pacific.

Nearly half of the Pacific island countries consist mostly, if not entirely, of low-lying coral atolls. The countries are very fragile ecosystems. A number of the countries have relatively large volcanic islands with rugged mountains, rivers and flat lands. In general, the natural resource endowments of the Pacific island countries, except for Papua New Guinea, are very limited.

People of the Pacific islands

The population of Pacific island countries totalled 5.3 million people in 1990. Papua New Guinea, with 3.5 million people, accounts for 68 per cent of the population. Fiji, with the next largest population after Papua New Guinea, has just under three-quarters of a million people. All the other Pacific countries have a population of less than half a million people, with Solomon Islands having the largest population amongst them (324,000 people). Nauru and Niue have a population of less than 10,000 people, whilst all the others have populations of between 10,000 and 200,000 people (South Pacific Commission 1991).

In terms of geographical/regional grouping, 90 per cent of the population of the Pacific island countries is found in the islands of the south-western Pacific, i.e. the Melanesian islands, including Fiji. Excluding Papua New Guinea, the three Melanesian countries account for about 23 per cent of the total combined population. The countries of the central and northern Pacific (Micronesia) account for about 5 per cent of the population of Pacific island countries, whilst the countries of the eastern Pacific in Polynesia, account for another 5 per cent. The countries in Polynesia have a substantial number of their people settling overseas, particularly in New Zealand.

Population densities vary between the countries of the South Pacific region. Generally speaking, the larger island countries are sparsely populated, while the small island countries, which are coral atolls, are densely populated. Nauru is the most densely populated (443 persons per km$^2$), followed by Tuvalu (392 persons per km$^2$) and Marshall Islands (255 persons per km$^2$). Papua New Guinea (8 persons per km$^2$), Solomon Islands (12 persons per km$^2$) and Vanuatu (12 persons per km$^2$) are sparsely populated.

Within the countries there are areas of very high population concentration. The areas of high population concentration are mainly, though not exclusively, the
urban centres to which people migrate from the rural areas. South Tarawa of Kiribati accounts for more than two-thirds of the Kiribati population. Tarawa has a population density of about 2,200 people per square kilometre. Ebeye in Marshall Islands has a population concentration of nearly 60,000 people per square kilometre. In general, however, most of the people of the Pacific islands live in rural areas.

In general, males constitute a higher proportion of the population than females. Cook Islands and Kiribati have populations with a higher proportion of females than males. The Pacific island countries have young populations. Between one-third and a half of the population are younger than 15 years. Only about 5 per cent of the people are 60 years or older. The overall dependency ratio is high, the major proportion of which is youth dependency.

The populations of the Pacific island countries are composed largely of indigenous Pacific islanders. Only Fiji has a significant number of non-Pacific islanders, ethnic Indians, who now constitute 48 per cent of the population.

Some of the population growth rates in the Pacific island countries are amongst the highest in the world. Marshall Islands, with an annual population growth of 4.2 per cent, and Solomon Islands, at 3.5 per cent, have the highest population growth rates. The population of countries such as Niue, Cook Islands and Western Samoa have recorded very low growth rates or declining population as a consequence of emigration. As these countries have natural population growth rates of between 2 and 3 per cent, continued low growth rates in their population will be possible only to the extent that emigration continues.

The total population of the Pacific island countries has been projected to reach 6.1 million people in the year 2000 and 7 million people in the year 2010. Excluding Papua New Guinea, the population of the other Pacific island countries is projected to 2.1 million in 2000 and 2.4 million in 2010. Papua New Guinea will account for about two-thirds of the population of Pacific island countries. Population pressure, especially in the smaller island countries and its concentration in the urban and other areas in all Pacific island countries, will increase substantially with the attendant economic, social and environmental implications. According to the projections, Nauru and Tuvalu will have the highest population densities in 2010, about 600 people per square kilometre (South Pacific Commission 1991).

**Nature of the Pacific economies**

The Pacific island countries have dual economies; a relatively large subsistence sector exists along with a monetized sector. The latter is integrated into the world economy. The subsistence sector supports the majority of the people with their basic needs of food and housing. The cash needs of the people in this sector are met by their surplus production, mainly foodstuffs sold at the urban centres or tourism installations, as well as the production of export crops. Some of their cash needs are also met by remittances from relatives engaged in the
domestic cash economy or those working and living overseas. Even those in full-time wage and salary employment are engaged in subsistence production to supplement their incomes. Urban food gardening is becoming a significant feature of the Pacific cities and towns.

The monetized sector of the Pacific island economies is driven by production of exports. These export products are largely based on natural resources. Agriculture, forestry and fishing are particularly important and in a few economies such as Papua New Guinea and Fiji, minerals and natural beauty for tourism are valuable resources. The monetized sector of the economies is also driven, to a greater or lesser extent, by public expenditures funded by foreign aid.

The gross domestic product (GDP) estimates for the Pacific economies range from US$400 to more than US$2000 (not including Nauru). The contribution of foreign aid to the generation of income is significant. For the Marshall Islands, the Asian Development Bank estimated that when the GDP per capita for 1989 of US$1068 is adjusted for foreign aid, it would fall to a level between US$200 and US$600.

Total income and its purchasing power in the economies depend on the conditions in the world economy and availability of foreign aid. For some of the economies, remittances from relatives living overseas are significant. The United Nations Development Programme is funding a regional study, executed by the International Labour Office, on remittances focusing on how these funds can be channelled towards productive investment. In Western Samoa, private transfers amounted to US$38.2 million, compared with export earnings of US$12.9 million. Agriculture (including forestry and fisheries) and the service sectors are the major contributors to domestic production and national income. Manufacturing and processing industries are developing slowly.

The Pacific island economies are small, open and dependent. The size of their domestic markets is too small to sufficiently generate income and investment capital needed to drive a self-reliant development process. They depend on external trade to generate income and economic activity. Foreign aid per capita is very high for most of the Pacific island economies. It is provided in the form of both capital goods as well as technical assistance, reflecting the shortage of both capital goods and skilled, qualified and experienced personnel. Large-scale investment in the private sector also requires the import of foreign capital and technical/managerial skills. Domestic private investment continues to grow as local and indigenous entrepreneurship develops, but the private sector is, in general, dominated by foreign capital and foreign ownership.

The public sector is dominant in the economies of the Pacific island countries. In many cases, public enterprises, both financial and non-financial, are joint-venture undertakings between the public sector and foreign investors.
Human development: concept and situation in the South Pacific

The concept of human development

The primary objective of development is to benefit people and to improve their well-being. This basic objective is, however, often forgotten in the scramble to accumulate income and wealth. The concept of human development was first put forward by the United Nations Development Programme (UNDP) in the 1990 Human Development Report, the first in a series of global reports on human development. Human development is defined as a process of enlarging people’s choices.

Human development defined

Human development is a process of enlarging people’s choices. In principle, these choices can be infinite and change over time. But at all levels of development, the three essential ones are for people to lead a long and healthy life, to acquire knowledge and to have access to resources needed for a decent standard of living. If these essential choices are not available, many other opportunities remain inaccessible.

But human development does not end there. Additional choices, highly valued by many people, range from political, economic and social freedom to opportunities for being creative and productive, and enjoying personal self-respect and guaranteed human rights.

Human development has two sides: the formation of human capabilities—such as improved health, knowledge and skills, and the use people make of their acquired capabilities—for leisure, productive purposes or being active in cultural, social and political affairs. If the scales of human development do not finely balance the two sides, considerable human frustration may result.

According to this concept of human development, income is clearly only one option that people would like to have, albeit an important one. But it is not the sum total of their lives. Development must, therefore, be more than just the expansion of income and wealth. Its focus must be people.

Human development sees human well-being as the end of development and treats income as a means to achieving that end. It is about investing in people, people's participation in the development process and satisfying people's needs as well as generating the opportunities for people to pursue their aspirations.

The process of increasing people's choices, however, has to be pursued within two important constraints. First, enlarging the choices of one individual or a group in a society should not restrict the choices of others in the society. Second, increasing the choices of the present generation should not foreclose on the choices of future generations. Human development requires both equity and sustainability in the development process.

Human development encompasses the whole spectrum and complexity of human life. It is a broad and comprehensive concept, but the underlying principle is as simple as it is fundamental: people always come first.

**Economic growth and human development**

Income is only one of the human choices. It is a very important one since access to income enables people to exercise many other options. Income and its growth are necessary for human development, but they are not sufficient conditions for human development. High rates of economic growth and per capita incomes can co-exist with large sections of society living in abject poverty, who die young, are illiterate and face severely limited opportunities for improving their lives or those of their children. There is no automatic link between economic growth and human progress. What is required is to create and reinforce the link between the growth of incomes and human well-being and to translate economic growth into improvement in human lives.

Economic growth does provide the best opportunity for the prevention and alleviation of poverty, and to increase health care and education for people. The absence of economic growth makes it more difficult to improve human well-being and may, in fact, lead to a deterioration in welfare, if economic decline is sustained over a period of time. Economic growth is, thus, a pre-condition for human development. There should be no conflict between economic growth and human development provided that economic growth is regarded as a means and human well-being as the end. In many developing economies economic growth is not an option but an imperative. People contribute to economic growth and economic growth contributes to human well-being.

**Measuring human development**

It has long been recognized that gross national income and national income per capita do not provide a complete picture of the quality of life. Economic indicators as well as social indicators are usually taken into account in an attempt to get a more comprehensive picture of human progress. Attempts have been made to find a single measure of the quality of life.
Constructing a human development index

Human deprivation and development have many facets, so any index of human progress should incorporate a range of indicators to capture this complexity. But having too many indicators in the index would blur its focus and make it difficult to interpret and use. Hence the need for compromise—to balance the virtues of broad scope with those of retaining sensitivity to critical aspects of deprivation.

This Report has chosen three types of deprivation as the focus of attention: people’s deprivation in life expectancy, literacy and income for a decent living standard.

The first two indicators—life expectancy and adult literacy—are commonly used concepts, but the third—the purchasing power to buy commodities for satisfying basic needs—is not as well understood. The GNP figures typically used for international comparisons do not adequately account for national differences in purchasing power or the distorting effect of official exchange rates. To overcome these inadequacies, we use here the purchasing-power-adjusted GDP, and since there are diminishing returns in the conversion of income into the fulfilment of human needs, the adjusted GDP per capita figures have been transformed into their logarithms.

To construct a composite index, a minimum value (the maximum deprivation set equal to one) and a desirable or adequate value (no deprivation set equal to zero) had to be specified for each of the three indicators.

The minimum and desirable or adequate values are the end-points of a scale indexed from one to zero for each measure of deprivation. Placing an economy at the appropriate point on each scale and averaging the three scales gives its average human deprivation index, which when subtracted from 1 gives the human development index (HDI).

---

a The indicator for knowledge has been subsequently refined in the Human Development Report 1991 and changed to educational attainment which comprises adult literacy and mean years of schooling.

b For a technical note on how the human development index is constructed, see Human Development Report for 1990 and 1991.

Similarly, human development requires a comprehensive set of indicators to ascertain the level of achieved human well-being and the changing choices available to people. In an endeavour to provide a single measure of human development, three essential aspects of human life are considered. These are longevity, knowledge and a decent standard of living, and they are represented by three indicators: life expectancy for longevity, educational attainment, comprising adult literacy and mean years of school, for knowledge and an income indicator, per capita income, representing the access to resources for a decent standard of living. The income indicator is adjusted to reflect the diminishing returns of its contribution to meeting human needs. It is further adjusted in terms of its purchasing power parity to enable international comparison between economies.

The indicators are combined into a composite measure of human progress, the human development index. The human development index is not a measure of the absolute level of human development. It indicates how far an economy has moved forward, in relation to the other economies, from the lowest level of achievement and how far it still has to progress to reach the present highest level of achievement on each of the three indicators.

The state of human development in the South Pacific

As part of UNDP's sustainable human development initiative for the Pacific island economies, statistical data collection is currently underway to compile economic, social and other indicators of human development for each of the Pacific islands. These economy-specific indicators will provide the statistical basis for a situation analysis of human development in the Pacific region.

From the data that are currently available, life expectancy in the Pacific island countries ranges from 50 to 70 years. Females generally live longer than males. Infant mortality rates vary between the countries much more widely, ranging between 20 and 71 per thousand live births. Four of the countries have infant mortality rates above 50 per thousand live births whilst all the others have infant mortality rates between 20 and 50 per thousand live births.

Adult literacy rates vary between the countries. Papua New Guinea and Vanuatu have relatively low rates, while all the other countries have rates of between 75 and 100 per cent. Gross school enrolment rates in the countries also vary widely (Statistical Summary, Table 2).

Available per capita GDP figures show a wide range, from US$400 to more than US$2000, for the economies. Generally, more than 50 per cent of GDP originates from the services sector, followed by agriculture (including forestry and fisheries) and then industry. A significant proportion of GDP is estimated to come from subsistence production.
Formal employment is growing only slowly and does not keep up with the growth of the labour force in the economies. The public sector is the main employer in most of the economies. Increased opportunities in the public sector for employment are, however, limited, especially where the public sector is already considered too large to be sustained by the small economies. A number of Pacific island economies are considering down-sizing their public sectors including government administration.

A large proportion of the labour force of the economies is engaged in subsistence, semi-subsistence and self-employment in the cash economy. In the larger island economies, the rural sector and the informal urban sector continue to absorb part of the labour force. The smaller island economies have more limited opportunities. Open unemployment, especially in the urban areas, is evident. For those Pacific island economies that have free access to the developed neighbouring economies, emigration has eased the pressure on employment. Some of the smaller island economies have emphasized employment overseas as an essential part of their employment strategies and policies.

Whilst the abject poverty prevalent in some of the developing economies of Asia and Africa is not yet evident in the Pacific island economies, low life expectancy, high infant mortality rates, low adult literacy and low per capita incomes are indicative of a certain level of poverty in the Pacific islands. For example, Fiji has already addressed the issue of poverty by establishing a poverty alleviation fund, following the recommendations of a poverty task force in 1991. Certain sections of society are increasingly vulnerable to poverty. The conditions of subsistence affluence are being eroded away. The comments with regard to poverty in Papua New Guinea (in the Box which follows) are relevant to a number of the Pacific island economies.

In terms of a global comparison of the level of human development in the Pacific island economies with other developing and industrial economies, the global Human Development Reports for 1991 and 1992 provide human development indicators on five of the Pacific island economies (United Nations Development Programme 1991, 1992). These economies are Fiji, Papua New Guinea, Solomon Islands, Vanuatu and Western Samoa. The human development index for each economy and its ranking amongst the 160 economies covered in the Human Development Report 1992 showed that, of the five Pacific island economies, Fiji (HI 0.71) ranked the highest and Papua New Guinea (HI 0.32) ranked the lowest amongst them, compared with Canada which had the highest human development index and ranked first and Guinea which had the lowest human development index and ranked last in the world.

None of the Pacific island economies were in the high level of development category. Fiji, Samoa and Vanuatu were in the category of medium human development. Solomon Islands and Papua New Guinea were in the low human development category. It is obvious that all five Pacific island economies still have a considerable way to go to achieve a high level of human development, especially Solomon Islands and Papua New Guinea.
Poverty in Papua New Guinea

Many people say there is little poverty in Papua New Guinea. They argue that people have plenty of land and the means to grow their own food, and that when particular people or families have problems, their relatives and friends (their wantok) give them food and help. So, the story goes, the wantok system prevents poverty.

While it would be convenient if this were true, the evidence is not comforting.

Major social indicators suggest that the general standard of living in Papua New Guinea is very low. An infant mortality rate of 62 is unacceptable by any standards—more than 60 children in every thousand die before their first birthday. It reflects, among other things, poor maternal health and nutrition, poor access to health services and environmental health conditions.

In addition, particular families and individuals are more exposed to poverty than others. Studies have shown that in rural areas many households containing widows, the aged and the chronically sick are barely surviving on one meal a day. In urban areas households without a wage-earner but with many children are also in desperate straits (Morauta 1984a, 1984b).

What is of interest, given the view that relatives and friends will prevent poverty, is not that the very poor do not receive gifts from family and friends (although some people miss out on these too), but that the gifts are simply not enough to provide an adequate income. This is hardly surprising if most of the donors (wantok) themselves have incomes that only just meet their own needs.


UNDP's sustainable human development initiative for the South Pacific

Following its global study on human development and the publication, since 1990, of the annual Human Development Report, UNDP is extending the global initiative to focus specifically on sustainable human development in the Pacific region. The purpose of the sustainable human development initiative in the South Pacific is to provide information on the human development situation and issues in the Pacific island economies to assist the Pacific island countries and
Human Development Index (HI) and rank on world scale of five Pacific island economies

<table>
<thead>
<tr>
<th>Economy and level of human development</th>
<th>HI (zero to one)</th>
<th>Ranking (among 160 economies)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>High human development</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>[HI 0.80 and above]</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Canada</td>
<td>0.98</td>
<td>1st</td>
</tr>
<tr>
<td>Australia</td>
<td>0.97</td>
<td>7th</td>
</tr>
<tr>
<td>New Zealand</td>
<td>0.95</td>
<td>17th</td>
</tr>
<tr>
<td><strong>Medium human development</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>[HI 0.50 to 0.79]</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fiji</td>
<td>0.71</td>
<td>64th</td>
</tr>
<tr>
<td>Samoa</td>
<td>0.59</td>
<td>84th</td>
</tr>
<tr>
<td>Vanuatu</td>
<td>0.54</td>
<td>93rd</td>
</tr>
<tr>
<td><strong>Low human development</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>[HI 0.50]</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Solomon Islands</td>
<td>0.43</td>
<td>105th</td>
</tr>
<tr>
<td>Papua New Guinea</td>
<td>0.32</td>
<td>116th</td>
</tr>
<tr>
<td>Guinea</td>
<td>0.05</td>
<td>160th</td>
</tr>
</tbody>
</table>


territories in their formulation and implementation of national development strategies, policies and programs to enhance sustainable human development in the economies.¹

The Pacific initiative is also aimed at building and strengthening the capacities in the economies for the compilation of human development indicators as well as the analysis of human development and the strategy–policy–program formulation and implementation to address the specific human development issues and needs of the economies. The design of economic policies for sustainable human development is an area to which the economies will be encouraged to give particular attention. Through the Round Table process,

¹ Country human development indicators are compiled for Palau and Tokelau, territories with which UNDP also has development cooperation programs.
regional and national consultative mechanisms, the enhancing of human development in the Pacific region will be promoted.

Statistical data collection is currently being undertaken for the compilation of human development indicators for the Pacific island economies. A report on human development in the Pacific will be prepared following the completion of the statistical data collection and analysis. The report will provide a situation analysis of human development in the economies and the financing and strategies for human development in the Pacific region.

Close consultation and participation of the Pacific island economies will be involved in the analysis of the situation and the issues of human development, and in the consideration of strategies and policies that can be pursued. It is envisaged that the report on human development in the Pacific will be produced on a regular basis to assist economies in the monitoring of their progress and achievements in this area.

Apart from a regional approach in promoting human development in the Pacific island economies, country-specific initiatives will also be undertaken for those economies that support the human development approach in their national development process. This will involve a more detailed analysis of, and research into, the individual economy's human development situation, with a view towards the formulation of country-specific human development strategies, policies and programs to address human development issues of high priority in each economy. The countries will be encouraged and assisted to carry out human development analysis themselves, but technical assistance can be provided if required.

**Human resource development: some issues in the South Pacific**

Human resource development is the development of human capabilities or human capital formation. It is essential for economic growth as well as for human development. Equally important is the use, and opportunities for the use, of those human capabilities. It is therefore necessary to address both human resource development and the use of these capabilities in national strategies, policies and programs for economic growth and human development. Human resource planning must be carried out in a comprehensive manner and become the core of national strategy planning of the Pacific island economies.

The main issues in human resource development and utilization in the Pacific island economies include population growth, access to basic education, skills development, the quality and relevance of the education and training provided to people and access to education and training by the female segment of the population.
Improving the quality of human resources means ensuring that people stay healthy and live longer. Reducing the incidence of morbidity and infant and child mortality are the main issues to be addressed. There are, however, also an increased number of health problems caused by changes in the life styles of the Pacific people and increasing contact with the outside world. AIDS, for example, is a major threat to the Pacific island economies.

With regard to the use to which people put their capabilities, the main issue is to provide employment opportunities, especially given the young population in the Pacific islands and the rapid increase in the labour force. With women increasingly joining the labour force, the need for employment opportunities for women will also have to be addressed specifically. The issue of employment is not just that of increasing wage and salary employment, although this is important. It is making available the opportunity for people to earn a living, either in the rural subsistence sector, the informal cash or the formal wage sector, from self-employment or as employees. It also involves enabling people to make efficient and effective use of their capabilities.

The main issue with regards population in the Pacific island economies is the high rate of population growth in a number of the countries. For some countries population growth rates have been quite low as a result of emigration. This favourable situation is sustainable only to the extent that emigration continues to be possible. Because the natural population increase is higher than net economic growth rates, any restriction on emigration by the receiving economies will result in an increase in the population pressure in these economies.

For the economies which have high population growth rates, it is essential that population policies are put in place and implemented to slow down the growth in their populations. High rates of population growth in the island economies, given their limited natural resource endowments and the current levels of development, will make it more difficult to continue to improve human development in the economies without favourable external conditions in trade, aid and emigration. Fast rates of population growth, given the young population in the economies, will increase the demand for education, health services and employment. The capacity of the Pacific island economies to adequately meet such demand will be put under severe stress. Appropriate policies, strategies and programs are needed to build and strengthen the capacity of the economies in addition to population policies that directly address the issue of population growth. Policies that enhance human development will eventually have a positive effect in slowing down population growth, but this will take time to eventuate. Policies and programs that are directly targeted at slowing down population growth are also necessary.

In terms of building human capabilities, increased education opportunities are imperative. In a number of Pacific island economies, especially the larger island economies, priority should be given to primary education and nonformal education, especially for the youth and adult population who have no or little schooling.
The second area which needs attention is skills development. The skills required in the Pacific island economies range from vocational and technical to professional and managerial skills. Those economies which already have a high level of general education, at primary and secondary levels, will be able to concentrate their attention on skills development. The other economies will simultaneously have to address the provision of general education and skills development.

The quality and relevance of education are also areas to be addressed in human resource development in the Pacific islands. Trained and qualified teachers as well as adequate and relevant school instruction materials are needed. Much more attention needs to be given to the education of girls and women, especially in those economies where there is marked inequity in the education of females and males.

In the area of health, priority should be given to primary health care. The many causes of morbidity, especially infant mortality, can be addressed through relevant policies and programs in primary health care. Particular attention is needed in improving the health status of the female population. Education is an important factor in the improvement of health of the population, especially women.

Human resource development is just one aspect of improving human well-being. It is equally important to focus on the use to which people put their acquired capabilities. The priority is to provide an enabling environment for people to earn and have a decent standard of living.

Formal employment opportunities need to be expanded to keep up with the growth in the labour force and the demand for wage and salary employment. Development strategies and policies should focus, where appropriate, on a higher utilization of labour in relation to capital in the production processes. The development of the rural sector and informal urban sector, which has to absorb the labour force that is not in formal employment, will require appropriate supportive strategies and policies. Further processing of natural resource based products and encouragement of manufacturing industries, especially small enterprises, are the broad policy areas that require priority attention.

The subsistence and mixed-subistence sector, especially in the larger island economies, can absorb and support part of the increased labour force, provided that land continues to be available for their use. The availability of land is ultimately determined by its physical size, however, institutional factors also affect the availability of land for use. Priority needs to be given to addressing the institutional constraints on land use. Land is a very sensitive issue in the Pacific island economies and therefore has to be dealt with carefully.

The development of human capabilities and opportunities for the utilization of those capabilities are necessary for economic growth and human development. In addition, putting the acquired capabilities to efficient and effective use is
Issues in human and natural resource management

Equally important. Social and cultural factors as well as economic factors influence the extent to which people use their capabilities in an efficient and effective manner.

Natural resource management: some issues in the South Pacific

The proper management of the available natural resources in the Pacific island economies is of vital importance given their limited natural resource base, their fragile ecosystems, their growing populations and the dependence on natural resources for their livelihood and improvement in their living standards. The primary objective of natural resource management is to ensure that these resources continue to provide the means for the human well-being of the Pacific island people on a sustainable basis. There are both physical and institutional factors which have implications for the development and management of island natural resources. The pattern of resource ownership has implications for resource management and utilization and the distribution of direct benefits and costs arising from the utilization of the resources.

Continuing fast growth rates of population of the Pacific island economies, especially the smaller ones, will make it more difficult to manage these resources to ensure their sustainability. Policies and programs to slow down population growth will be beneficial to the sustainable use of the natural resources of the Pacific island economies. Regardless of the level and growth of population, however, efficient management of natural resources is imperative to ensure the sustainable utilization of these limited resources.

Natural resources directly support the livelihood of most of the Pacific island people and provide important contribution to income generation and export earnings. Sustainable economic growth and human development will depend on proper management and utilization of the available resources, not only to meet the needs of the present demands but also those of future generations in the Pacific islands. Population growth and unwise utilization of resources to meet immediate demands will put increasing pressure on the already limited resource base. The consequences of mismanagement and over-exploitation of the available natural resources will be felt immediately and quickly because of the small physical size of the Pacific island countries.

Land is a severely limited natural resource in the small island economies. Even where a relatively large area of land is available, except in the case of Papua New Guinea the nature of the terrain further reduces the productive capacity of the land. Forest resources are scarce in the atolls. Mineral resources are currently found in economic quantities and extracted in only Fiji and Papua New Guinea. There are, however, potential land-based and seabed minerals in the exclusive economic zones of the Pacific island countries.

232 The future of Asia-Pacific economies
Given the very narrow natural resource base of the Pacific island economies, increasing the productivity and value-added production of resource-based products is essential for sustainable economic growth and human development.

With limited land and the many demands on it for human settlements, agricultural and industrial activities, etc., better planning and management for land use is needed. The nature and pattern of the ownership of land is an important factor and close consultation and participation of landowners in the planning and management process is necessary. Land use planning and management by directives and coercion would be counterproductive.

Efficient utilization of agricultural land will require improvement in the current land use practices, farming systems and technologies. Ensuring food security, given the population pressure on the land, will require improved agricultural production methods and technologies. Land degradation and the associated negative environmental effects, which in turn aggravate the already poor quality of land, can easily result if farming systems, practices and technologies are not improved.

The slash-and-burn method of agriculture can continue to support increases in the rural population only if sufficient land is available. Where there is a high population/land ratio, fallow periods are increasingly short. This leads to a reduction in productivity and an increase in the deterioration of soil quality. Intercropping practices and methods of intensive land use that ensure soil quality need to be encouraged. This may involve the adoption of proven practices used elsewhere, or research and development of appropriate practices and methods for the Pacific islands.

Fisheries resource management involves both offshore resources and inshore or coastal fisheries. Harvesting of offshore fisheries is done by large commercial enterprises located locally or belonging to distant nations. Ensuring that harvesting is kept within the allowable catch and does not jeopardize other fishery resources is important. There is a need to improve surveillance and enforcement in this area.

Offshore commercial fishing is currently concentrated on highly migratory species. Fishing practices of other nations have implications for the migratory fish resources that are harvested in the waters of the Pacific islands. Coordination of fishing policies and resource management between the Pacific island countries and countries of the Pacific rim that harvest the same resources is needed.

Management of inshore, coastal and reef fisheries is needed to ensure sustainable utilization and to avoid over-harvesting and depletion of the resources. The reefs, inshore and coastal areas are owned by people who actually do or facilitate the harvesting of these resources. Consultation with, and the participation of, the resource owners is needed for effective management of these resources.
Issues in human and natural resource management

Presently, fishery strategies and policies are concerned mainly with harvesting and utilization of the resources in their natural marine environment. Pacific island economies need to consider and implement fisheries strategies and policies that also focus on fish farming through aquaculture and mariculture.

With regard to forest resources, logging is proceeding in some of the countries at a rate which is unsustainable and will deplete forest resources within a very short period of time. Current logging methods also have negative consequences for the environment. Forest cultivation is often neglected or given less priority because of the long lead time involved in generating cash incomes from investment in the cultivation of the forest crop. Forests provide the means for the livelihood of rural communities in food, housing and water, the latter for urban populations as well. The sustainability of forest resources is imperative.

A large part of forest production is exported in its primary state as logs. Pacific island economies which depend on forest products need to ensure that as much processing of the resource as is possible is done domestically. Investigation is needed into possibilities of product diversification and potential markets for such products.

Fresh water is essential for the sustenance of human life and it is also of vital importance to economic activities. In the smaller island countries of the Pacific region, the availability of fresh water is a major concern. What is available needs to be managed carefully. In the larger islands, with what should be adequate fresh water, human habitation, agricultural and forest activities jeopardize the availability of fresh water, especially safe drinking water. Watershed management is important, especially where the watershed area is encroached upon by human habitation, agricultural and logging activities. Water resources are also an important source of energy. In the larger island countries there is potential for harnessing this energy, particularly for electric power generation. This will assist economies in reducing their dependence, and expenditure, on fossil fuel for electricity needs as well as providing the benefits of electrification to the rural areas.

Conclusion

A general overview has covered the main issues in the development of human and natural resources in the Pacific island economies in the context of the human development situation of the economies. Priority policy areas have been identified and the countries and their development partners should concentrate their efforts to sustain economic growth and human development in these areas.
Further reading


Issues for the service sector in Pacific island development

Rod Falvey and Norman Gemmell

The economic significance of service activities is reflected in its large contribution to gross domestic product (GDP) in most economies. The importance of individual service activities is also well recognized. Transportation, telecommunications and utilities are essential parts of an economy's infrastructure. Products cannot reach consumers without the support of services, including transportation, distribution and the provision of information to buyers and sellers. Legal services and accounting play a key role in the integration of business activities. Likewise an efficient banking system, insurance industry and public administration are important to commerce in general.

In the last two decades or so economists have become aware that services are making a larger contribution to economic and social progress in developing economies than had appeared to be the case for industrial economies at a similar stage in their development. In addition, rapid expansion of informal services is a feature of many developing economies.

Our focus is on the role of services in the Pacific island economies. These are a particular group of economies which exhibit both strong similarities to, and major differences from, other principal developing economy groups. After a brief discussion of definition and measurement problems we review the evidence on the contribution of services to the growth and development process. The nature of the service activities found in the Pacific island economies is then documented and compared with this evidence. We outline some constraints on the growth of services and consider how these might affect the Pacific island economies. Finally, we consider how regional cooperation might foster further service sector development.

The role of services in economic growth and development

Definition and measurement issues

Defining services. The most appropriate way to distinguish services from goods is that the former are nonstorable while goods are storable (Hill 1977). There are two key characteristics of services.

- Services involve changes in the condition of some person or good as a result of the activity of some other economic unit. That is, one unit serves another, so that some change must occur in the recipient of the service. Since it is not possible to have a stock of changes it is for this reason that services are nonstorable.

- Because services are nonstorable, production and consumption are simultaneous activities. This does not mean that services are perishable. They
may be transitory (passenger transport, live entertainment) or permanent (surgery). Services may be applied to either goods (cleaning) or persons (health care).

**Classifying services.** Classifications of goods and services differ according to whether the focus of attention is at the industry (production) level or at the expenditure (consumption) level. Those industries usually regarded as producing mainly services include:

- trade—wholesale, retail, hotels, restaurants
- transport and communications—including storage
- commerce—finance, insurance, real estate, owner occupied dwellings
- government services—including education, health and administration
- miscellaneous services—hairdressers, street traders, domestic services.

Service expenditure categories are not always readily identifiable with equivalent industry classifications. Those dominated by services are

- housing
- health services
- purchased transport
- communications
- recreation services
- education
- government
- restaurants, cafes etc.

Expenditures with significant service elements include

- fuel and power
- household operations (for example domestic services)
- transport operating costs (for example, maintenance)
- construction
- miscellaneous goods and services.

Within services (and goods) a traded/nontraded distinction is important. Domestically-produced traded services compete with foreign substitutes while nontraded services (by definition) must be domestically produced. This distinction becomes relevant in later discussions regarding competition and the availability of domestic resources to match demand.
Measuring services. Given the absence of tangible outputs associated with many services it is not surprising that measuring this output has proved difficult. There are two distinct problems here. First, much service sector output is nonmarketed (for example public education), so that it is difficult to value this output in nominal and especially in real terms. Second, separating expenditure on marketed services into quantity and price components can be tricky, particularly where quality differences are important. As a result great caution is needed when assessing data on real output, prices and productivity levels in services.

Industrial classification systems typically allocate firms to categories by their major activity. A firm engaged mainly in manufacturing but undertaking the distribution of its own goods will appear within the manufacturing classification, but if it contracts out the distribution activity to a specialist distribution firm, the latter will appear under a service classification. As a result, if vertical disintegration of firms occurs over time an apparent increase in services will appear in official statistics. Finally, the tendency for official statistics to treat services as a residual category for activities not readily classifiable elsewhere, requires caution in interpreting service statistics.

Services and development

It has been recognized that development typically involves a relative decline in agricultural activity and simultaneous relative, and absolute, rises in manufacturing and service sectors (Kuznets 1966; Chenery and Syrquin 1975). The broad pattern suggests that this process begins fairly rapidly and continues at a declining rate until agriculture accounts for as little as 2–3 per cent of the total labour force. A significant feature of this process (though one which is not often recognized) is that the share of services in output and employment generally exceeds that in industry even at low income levels (World Bank 1991).

Recent data for industrial economies and developing economies indicate that services frequently grew faster than industrial production during the 1980s, and almost certainly grew consistently faster than goods-producing sectors as a whole (World Bank 1991). This was especially evident in the low income, developing economies, perhaps reflecting a tendency for some service activities to act as a residual sector for otherwise unemployed labour when industrial development could not keep pace with labour force growth. Service growth is therefore important in early, as well as later, development, with services expanding relative to both agriculture and industry at higher income levels (UN–ECE 1977; Gemmell 1982).

An important issue is whether it is the shift of resources into services which causes increased income levels (for example by moving resources to where they are used more productively), or whether it is development which causes these resource shifts towards services. Like industrial activities, services seem, in general, to exhibit better productivity performance than agriculture. Reallocation of this sort may therefore contribute to faster development though
present estimates do not suggest that the gains obtained are quantitatively very large (Denison 1967, 1983; Dowrick 1989; Dowrick and Gemmell 1991). A number of arguments have been advanced suggesting that forces associated with development may cause a rise in the share of services in output and employment.

**Final demand elasticities.** It has been argued that the demand for services is income elastic, especially once incomes exceed some threshold level. The hypothesis is that consumption demands change with increasing income levels from basic agricultural commodities such as food and clothing, to manufactured goods such as vehicles and consumer durables and then to tertiary goods which involve a large amount of services such as education, health and recreation. At any given income level, consumption will involve an array of goods and services with different income elasticities, with services especially represented at the higher elasticity end of the spectrum. This is due both to services substituting for goods in final demand and because increased production of goods creates increased demands for complementary services (for example, increased vehicle ownership requiring increased road networks and maintenance services).

Much of the early empirical literature found income elasticities for services apparently in excess of unity. Recently, however, it has been established that higher income levels are frequently associated with higher relative service prices. Correcting for price differences has produced more ambiguous results (Kraus et al. 1983; Bergstrand 1991; Falvey and Gemmell 1991; Summers 1985).

**Services as intermediate inputs.** Services are also demanded as intermediate inputs into other service and industrial activities. Here the issues are whether the demand for these is likely to rise more than proportionately with development and the extent to which there will be substitution of intra-firm for inter-firm trade or vice versa.

Evidence suggests that intermediate services are also important at both early and late stages of development. Infrastructure services, for example, tend to be important at early development stages. On the other hand the subsequent growth of manufacturing tends to be associated with growth of transport and distribution services. Particularly in early development stages, this service expansion reflects genuine increases in service activities, a response to the needs of manufacturing industries, which are often concentrated in urban areas. Service industry expansion in several industrial economies however, seems partly to reflect substitution of inter-firm for intra-firm trade (Gershuny 1978).

Final-demand services often use other services as inputs so, if ‘final’ services are income-elastic, development will tend to reinforce service growth via their use of intermediates.
Service and goods technologies. A prominent explanation directed specifically at service employment growth is the argument that services, because of their typically high labour content, are likely to be technologically stagnant relative to manufacturing activities since much technology is either embodied in capital or requires complementary capital inputs (Baumol 1967). As a result they experience slower labour productivity growth and, under plausible assumptions, will absorb an increasing fraction of the labour force. Notice that low service productivity growth is hypothesized here relative to that in manufacturing (or the industrial sector more generally) and not relative to the goods sector as a whole, which includes agriculture. Bhagwati (1984) has argued that development causes goods-for-services substitution (for example music records for live concerts), leaving a residue of low productivity services which are not substitutable (for example some live performances). In addition, services-for-goods substitutions occur where new service technologies are more efficient than existing goods-based versions (for example new telecommunications services).

These two hypotheses suggest that services may be categorized as progressive (high productivity) or non-progressive (low productivity). Two important implications for services in developing economies follow from this. If labour or other factor reallocations from agriculture to services are to boost the economy's income growth rate, they should be towards the progressive services. Second, technical progress may be creating the possibility of developing economies with reasonably skilled labour successfully exporting progressive services in competition with industrial economies without the need for the extensive labour migrations and remittances which have characterized a number of developing economies, including some Pacific island economies.

Does empirical evidence support the Bhagwati and Baumol predictions that development will be associated with the simultaneous growth of high productivity and low productivity services? While Baumol (1985) and Baumol et al. (1985) find some evidence of this for the United States, more generally, Dowrick (1989) could find no evidence of significant differences in productivity between industrial and service sectors in OECD economies. The proposition has not been rigorously tested for developing economies but a review of several studies of services productivity (Gemmell 1986) did not find that service productivity was consistently below that found in goods-producing sectors. Modern services, such as banking and retail trade, can be highly productive, while traditional or informal services typically use relatively primitive, unproductive technologies by these measures. Both types of services are expanding in developing economies.

The price of nontraded services. As noted above, increases in the prices of nontraded services, relative to traded goods and service prices, may result from the combined effects of the development process on supply and demand for services. Both this, and the Baumol arguments discussed, suggest that rising service prices along with rising income levels should produce, ceteris paribus, a tendency for demand to shift away from these services, so counteracting other mechanisms contributing to increases in service activities. One consequence
is that the share of services in expenditure or nominal output will exceed the sector's share in real output. Cross-economy comparisons of service sector shares will exhibit similar biases if nominal exchange rates do not reflect real purchasing power parities for traded and nontraded outputs.

Available evidence indicates higher service prices relative to goods prices at higher income levels. It is unclear, particularly for government services whether this reflects real phenomena or simply measurement difficulties associated with service outputs (Beck 1985; Dowrick 1992). For developing economies, the view of Passinetti (1982), Sundrum (1990) and others is that any service price increases will have limited demand-reducing effects relative to the increases brought about by income growth. This would be consistent with the industrial economy evidence noted above.

Income distribution and informal services. There is fairly reliable evidence that income distribution is less equitable in developing economies as a whole compared with industrial economies. Rather more contentious evidence suggests that increasing average income levels may be associated with first a worsening, and then an improving, income distribution. Some have argued that the widespread growth of the informal sector in many developing economies in recent decades reflects a worsening income distribution, with relatively poor residents in these economies providing themselves with goods and services. Evidence also points to services dominating informal activities (Gemmell 1986; Sethuraman 1981).

Despite quantification problems it is clear that the informal services sector is large in most developing economies and it is probable that the growth of these services will be related to income distribution changes which occur with development. If so, informal services could grow in relative importance in early development as they provide for both the consumption needs and employment of expanding poor populations. The size of the informal sector also appears to be positively related to urbanization (Sethuraman 1981; Gemmell 1986). Informal activities often appear as low productivity but since they also often substitute for rural under-employment their expansion can nevertheless add to income growth.

Individual service components

Given the diversity of service activities, and the variety of factor combinations used to produce them, it may be important to know which services in particular are likely to expand or contract with development. We have already seen that intermediate services such as distribution, which are complements to the industrialization process, can be expected to expand with development. Kravis (1985) explored this issue more widely for final demand service components. For a fairly small sample of nine industrial economies and eight developing economies he found that, on average, government, housing and education services represented 60–65 per cent of the total, and the addition of medical care, hotels and restaurants, etc. brought this share to 80–85 per cent.
Between industrial and developing economy groups, however, there were some differences in component shares. Public transport was more important in developing economies with private transport more important in industrial economies, but housing and medical care both have smaller shares in developing than in industrial economies. For both of these last two service categories, the difference between economy groups is greater when both sets of economies are measured at a common set of prices (i.e. measured in real terms) than when domestic prices are used.

Predictably, hotels and restaurant services are relatively more important in industrial economies while surprisingly, education appears to form a much larger fraction of service expenditure in developing economies, especially when measured in real terms. If this is representative of industrial–developing economy comparisons overall, it is a finding which is not readily explained but may be important. Government services, excluding public medical care, education and recreation services are relatively more important in developing economies for this sample. This probably reflects a relatively larger government wage bill in developing economies, mainly from higher relative wage levels rather than relatively more government employees.

A regression approach to the same data by Summers (1985) confirmed that these broad industrial–developing economy differences are also reflected more continuously along the income scale. The most recent estimates of income–expenditure elasticities for the major service categories are provided in Table 1. These estimates indicate that increases in real income per capita are associated with rising shares of housing, health and recreation in real expenditure, approximately constant shares of communications, education, government and services in aggregate, and a falling share for purchased transport.

The results reported in Table 1 also suggest that other characteristics of an economy are important in determining the composition of its expenditure. Other things equal, economies with larger populations can be expected to have lower per capita real expenditures on government and services in aggregate, indicating some scale economies in their consumption. More urbanized economies have higher expenditures on communications and recreation. A higher dependency ratio might be expected to affect expenditure on services consumed disproportionately by the young and the old. In this case, expenditures on health, housing and education rise, while expenditures on purchased transport fall.
Table 1  Service demand equations

<table>
<thead>
<tr>
<th></th>
<th>Income per capita (1)</th>
<th>Urbanization (2)</th>
<th>Dependency (3)</th>
<th>Adj. R^2 (5)</th>
<th>Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>Housing</td>
<td>1.361_{b,c}</td>
<td>0.984</td>
<td>0.910</td>
<td>Elastic</td>
<td></td>
</tr>
<tr>
<td>Health</td>
<td>2.071_{b}</td>
<td>2.668_{b}</td>
<td>0.824</td>
<td>Elastic?</td>
<td></td>
</tr>
<tr>
<td>Purchased transport</td>
<td>0.417_{c,d}</td>
<td>-2.983_{b}</td>
<td>0.693</td>
<td>Inelastic</td>
<td></td>
</tr>
<tr>
<td>Communications</td>
<td>0.971_{b}</td>
<td>0.650</td>
<td>0.835</td>
<td>Unity</td>
<td></td>
</tr>
<tr>
<td>Recreation</td>
<td>1.422_{b,c}</td>
<td>0.562_{d}</td>
<td>0.803</td>
<td>Elastic</td>
<td></td>
</tr>
<tr>
<td>Education</td>
<td>1.022_{b}</td>
<td>-0.088_{b}</td>
<td>0.832</td>
<td>Unity</td>
<td></td>
</tr>
<tr>
<td>Government</td>
<td>0.926_{b}</td>
<td>0.550</td>
<td>0.838</td>
<td>Unity?</td>
<td></td>
</tr>
<tr>
<td>Total services</td>
<td>1.026_{b}</td>
<td>-0.043_{b}</td>
<td>0.962</td>
<td>Unity</td>
<td></td>
</tr>
</tbody>
</table>

a The equation estimated was \( \ln E_s = a_0 + a_1 \ln Y + a_2 \ln P_s + a_3 \ln P_c + a_4 Z + u \) where \( E_s \) and \( Y \) are real expenditure per capita on services and real GDP per capita, respectively; \( P_s \) and \( P_c \) are the domestic prices of services and commodities, respectively; and \( Z \) is a vector of other characteristics, including population, urbanization, dependency (ratio of non-working-age to working-age population) and the share of agriculture in the labour force. Since this last variable was never significant it is omitted above. For details see Falvey and Gemmell (1992).

b Significantly different from zero at 5 per cent.

c Significantly different from unity at 5 per cent.

d Significantly different from zero at 10 per cent.

Tourism services have received little explicit attention in the services and development debate, perhaps partly because they tend to be dispersed across a range of service categories such as transport, hotels and retail trade. In some developing economies, however, they represent an important service sub-group in their own right. They are particularly well represented within the informal sector of some developing economies and in the formal sector can be major sources of employment and foreign exchange earnings. However, perhaps because tourism is seen as being fundamentally determined by an economy’s endowment of appropriate natural resources such as beaches and historical monuments, the sector’s development is likely to be economy specific. This does not mean that lessons for one economy cannot be usefully derived from the experience of another. One such lesson, which experience in a number of economies bears out, is that tourism can represent a classic case of an export enclave from which there is little spillover into other sectors.

The service sector in the Pacific island economies

By international standards, most of the Pacific island economies can be categorized as small remote island states (Srinivasan 1986). Smallness implies that they are unable to take advantage of economies of scale in
production. For traded goods and services, the disadvantage imposed in terms of higher costs can be reduced through international trade. Specialization can occur in the production and export of those traded goods and services in which the economy has a comparative advantage, presumably not goods and services characterized by substantial economies of scale. Such traded goods and services are imported. Remoteness limits this somewhat, since transport costs to, from and within the South Pacific are relatively high by international standards.

For those goods and services that cannot be traded, smallness is a disadvantage that cannot be overcome by trade. This group includes some important services, infrastructure for example. Some government activities tend to require a certain minimum level regardless of the economy’s size. Because of their location and smallness, the Pacific island economies are also vulnerable to external shocks, both economic and natural. Changes in the relative prices of major exports and imports will have significant effects, positive or negative depending on the direction of the price changes, on these economies. Many of the islands are also subject to cyclones. All of these features can be expected to impact on the structure of economic activity in general, including the service sector.

Almost all the Pacific island economies fall into what the World Bank calls the lower middle-income group of developing economies. The broad characteristics of this reference group will be used as a basis of comparison. It should be kept in mind that this comparison is based solely on income.

Relative to the other lower middle-income economies, the Pacific island economies have a higher share of agriculture similar to that typically found in the World Bank’s low income group, a lower share of industry and similar, though surprisingly diverse, shares of services. These differences presumably reflect the Pacific island economies smallness and resource endowments. Within the Pacific island economies the share of services is positively correlated with GNP per capita and negatively correlated with population and land area which is highly correlated with population (Statistical Summary, Table 4). This result is consistent with the international evidence reviewed earlier. Available data on labour force shares is given (Table 2). Unfortunately, only wage and salary employment data is available for some economies. These tend to underestimate the importance of agriculture in total employment. For Fiji both wage, salary and total employment data are available providing some indication of the bias in the former. Relative to the lower middle-income economies, the Pacific island economies have generally smaller shares of employment in agriculture, similar shares in industry and larger shares in services. These comparisons, considered together with those for GDP, suggest that the Pacific island economy labour productivities are higher in agriculture and lower in industry and services compared with the lower middle-income group. Again this reflects the impact of smallness, with agriculture being the major export sector and industry largely import-competing.
Table 2  Labour force shares: Pacific island economies

<table>
<thead>
<tr>
<th></th>
<th>Agriculture (1)</th>
<th>Manufacturing and mining (2)</th>
<th>Utilities (3)</th>
<th>Construction (4)</th>
<th>Total industry (2) to (4) (5)</th>
<th>Trade, hotels and restaurants (6)</th>
<th>Transport and communications (7)</th>
<th>Commerce (8)</th>
<th>Public administration and other (Public) (9) (Other)</th>
<th>Total services (6) to (9) (10)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Wage and salary employment</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cook Islands (1990)</td>
<td>6</td>
<td>7</td>
<td>4</td>
<td>9</td>
<td>20</td>
<td>19</td>
<td>12</td>
<td>4</td>
<td>(..)</td>
<td>38</td>
</tr>
<tr>
<td>Fiji (1991)</td>
<td>3</td>
<td>27</td>
<td>3</td>
<td>8</td>
<td>38</td>
<td>16</td>
<td>10</td>
<td>6</td>
<td>(..)</td>
<td>28</td>
</tr>
<tr>
<td>Kiribati (1985)</td>
<td>7</td>
<td>2</td>
<td>3</td>
<td>6</td>
<td>11</td>
<td>16</td>
<td>15</td>
<td>1</td>
<td>(23)</td>
<td>49</td>
</tr>
<tr>
<td>Solomon Islands (1989)</td>
<td>30</td>
<td>9</td>
<td>1</td>
<td>5</td>
<td>15</td>
<td>11</td>
<td>6</td>
<td>3</td>
<td>(13)</td>
<td>36</td>
</tr>
<tr>
<td>Employment</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fiji (1986)</td>
<td>48</td>
<td>..</td>
<td>..</td>
<td>..</td>
<td>15</td>
<td>..</td>
<td>..</td>
<td>..</td>
<td>(..)</td>
<td>..</td>
</tr>
<tr>
<td>Tonga (1986)</td>
<td>47</td>
<td>3</td>
<td>1</td>
<td>8</td>
<td>12</td>
<td>7</td>
<td>5</td>
<td>2</td>
<td>(8)</td>
<td>26</td>
</tr>
<tr>
<td>Papua New Guinea (1987)</td>
<td>32</td>
<td>16</td>
<td>1</td>
<td>6</td>
<td>23</td>
<td>20</td>
<td>8</td>
<td>6</td>
<td>(3)</td>
<td>11</td>
</tr>
<tr>
<td>Western Samoa (1986)</td>
<td>64</td>
<td>4</td>
<td>2</td>
<td>..</td>
<td>6</td>
<td>4</td>
<td>3</td>
<td>2</td>
<td>(..)</td>
<td>22</td>
</tr>
<tr>
<td>Niue (1984)</td>
<td>21</td>
<td>12</td>
<td>2</td>
<td>10</td>
<td>24</td>
<td>10</td>
<td>5</td>
<td>..</td>
<td>(..)</td>
<td>40</td>
</tr>
<tr>
<td>Lower middle income (1980)</td>
<td>71</td>
<td>..</td>
<td>..</td>
<td>..</td>
<td>10</td>
<td>..</td>
<td>..</td>
<td>..</td>
<td>(..)</td>
<td>..</td>
</tr>
</tbody>
</table>

Table 3 Activity shares in GDP: Pacific island economies (percentage of GDP at factor cost)

<table>
<thead>
<tr>
<th></th>
<th>Agriculture</th>
<th>Manufacturing and mining</th>
<th>Utilities</th>
<th>Construction</th>
<th>Trade, hotels and restaurants</th>
<th>Transport and communications</th>
<th>Commerce</th>
<th>Community, social and personal services (Govt)</th>
<th>Community, social and personal services (Other)</th>
<th>Imputed bank service charges</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cook Islands (1990)</td>
<td>18</td>
<td>3</td>
<td>1</td>
<td>2</td>
<td>22</td>
<td>12</td>
<td>17</td>
<td>(25)</td>
<td>27</td>
<td>(2)</td>
</tr>
<tr>
<td>Fiji (1989)</td>
<td>20</td>
<td>14</td>
<td>3</td>
<td>4</td>
<td>23</td>
<td>10</td>
<td>13</td>
<td>(..)</td>
<td>18</td>
<td>(..)</td>
</tr>
<tr>
<td>Papua New Guinea (1990)</td>
<td>30</td>
<td>25</td>
<td>2</td>
<td>6</td>
<td>10</td>
<td>7</td>
<td>5</td>
<td>(..)</td>
<td>19</td>
<td>(..)</td>
</tr>
<tr>
<td>Vanuatu (1987)</td>
<td>21</td>
<td>5</td>
<td>1</td>
<td>5</td>
<td>33</td>
<td>8</td>
<td>14</td>
<td>(..)</td>
<td>14</td>
<td>(..)</td>
</tr>
<tr>
<td>Western Samoa (1986)</td>
<td>35</td>
<td>13</td>
<td>2</td>
<td>2</td>
<td>19</td>
<td>6</td>
<td>9</td>
<td>(10)</td>
<td>12</td>
<td>(2)</td>
</tr>
<tr>
<td>Kiribati (1988)</td>
<td>33</td>
<td>2</td>
<td>2</td>
<td>5</td>
<td>13</td>
<td>15</td>
<td>7</td>
<td>(24)</td>
<td>27</td>
<td>(3)</td>
</tr>
<tr>
<td>Solomon Islands (1987)</td>
<td>44</td>
<td>2</td>
<td>1</td>
<td>4</td>
<td>14</td>
<td>5</td>
<td>7</td>
<td>(22)</td>
<td>23</td>
<td>(1)</td>
</tr>
<tr>
<td>Tuvalu (1989)</td>
<td>14</td>
<td>3</td>
<td>2</td>
<td>15</td>
<td>14</td>
<td>8</td>
<td>11</td>
<td>(31)</td>
<td>32</td>
<td>(1)</td>
</tr>
</tbody>
</table>

Source: South Pacific Economic and Social Database, National Centre for Development Studies, The Australian National University, Canberra.
Not unexpectedly there is considerable diversity in shares of individual economic activities, in employment and output respectively, across economies, reflecting differences in physical and human resource endowments (Tables 2 and 3). This is particularly true of manufacturing and mining. Generally, the major activities are agriculture, trade, hotels and restaurants and community, social and personal services. This pattern is broadly confirmed by the rather more limited data on employment shares, where agriculture clearly dominates, followed by public administration and other services. The importance of service activities in both employment and output is evident.

Considering the relative sizes of individual service groups in Tables 2 and 3, considerable diversity in both output and employment shares across economies for most activities is observed. The ranking for employment shares is: public administration and other services, trade, transport and communications, and commerce. In terms of average shares of output across economies, the ranking of activities is: community, social and personal services, trade, commerce, and transport and communications. Government provided services dominate the community, social and personal services category. This dominance is less obvious in the employment shares since only the public administration component of government employment is separately available. The importance of government in service output and employment is nonetheless unmistakable.

The option of international trade in goods and services is potentially very important to these small remote economies. It allows them to share in the economies of scale achieved by larger trading partners. Traded services may be classified into two broad types, factor and non-factor services. For most developing economies, the former is made up mainly of capital services (for example, property income), with labour factor services (mainly remittances from nationals working abroad) relatively unimportant. This is not the case for some Pacific island economies, for example, Western Samoa and Tonga, where net private transfers are quite significant relative to total goods and service credits (Table 4). Non-factor services are so called when some intermediate inputs are combined with factor services in the final output (Kravis 1985).

Although these two service forms are conceptually rather different (indeed labour and capital factor services are also quite different) they are not always separately identified in balance of payments accounts. The major traded services as reported, for example, in the annual IMF balance of payments statistics can be grouped as:

- transportation\(^1\)

\(^1\) Transportation includes: freight (shipment); passenger services; other transportation (for example ports); and travel expenditures. Travel expenditures may be on items which are not normally included within transportation and may be predominantly nontraded, hotels, restaurants and retail trade.
investment income (for example property income, direct investment earnings, reinvestment earnings)

official services (services of diplomatic and military personnel)

other goods and services

labour earnings (for example remittances).

Other goods and services in Pacific island economies are almost entirely services and, in total, can make a significant contribution to net service exports.²

A brief summary of trade in services by the Pacific island economies is given (Table 4). Again these data reveal considerable diversity across economies. The significance of nonfactor service trade is shown by the magnitudes of the ratios of service credits (debts) to total goods and service credits (debts). For five out of the seven economies for which data are available, the value of service credits exceeds the value of service debits, often by a considerable margin, making these economies net service exporters. Travel and other are the major sources of service earnings, while other and shipment are the major categories of payments.

There are difficulties in obtaining accurate statistics on the service sector due to the variety of activities it encompasses and the under-recording of informal services. We are therefore cautious in drawing inferences from these data. Nevertheless, a division of the Pacific island economies into two or three groups on the basis of the composition of their service sectors is possible (Table 5). The group 1 economies (Cook Islands, Fiji and Vanuatu) are those whose service sectors are dominated by tourism-related services. Visitors per capita and travel credits are relatively high, as is the overall share of services in output and the shares of trade and commerce in services. The government (CSP) share of services is low. For group 2 economies (Kiribati, Papua New Guinea, Solomon Islands and Tuvalu), tourism related services are less in evidence, visitors per capita are much lower as is the service share of output in general. Similarly, the shares of trade and commerce in services are lower and the share of government is higher. Tonga and Western Samoa fall into an intermediate category, with similar characteristics to group 1 except for generally lower overall service shares of output.

² This category can cover a wide range of activities including: commissions and agents fees; communications; merchandise transactions abroad; construction, assembly work and repairs; motion picture film rentals; non-merchandise insurance; professional and technical service fees; management and advertising fees. Separate items within other goods and services are too small to be separately enumerated in the published trade statistics in the Pacific island economies.
<table>
<thead>
<tr>
<th>Country</th>
<th>Service credits/ ( G + S ) Cr (per cent)</th>
<th>Service debits/ ( G + S ) Deb (per cent)</th>
<th>Net private transfers/ ( G + S ) Cr (per cent)</th>
<th>Net official transfers/ ( G + S ) Cr (per cent)</th>
<th>Shares of service credits (per cent)</th>
<th>Shares of service debits (per cent)</th>
<th>Service credits/ service debits</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fiji (1990)</td>
<td>47</td>
<td>36</td>
<td>-2</td>
<td>3</td>
<td>—</td>
<td>52</td>
<td>48</td>
</tr>
<tr>
<td>Tonga (1989)</td>
<td>72</td>
<td>33</td>
<td>70</td>
<td>29</td>
<td>2</td>
<td>29</td>
<td>69</td>
</tr>
<tr>
<td>Papua New Guinea (1990)</td>
<td>21</td>
<td>36</td>
<td>-6</td>
<td>15</td>
<td>..</td>
<td>..</td>
<td>..</td>
</tr>
<tr>
<td>Vanuatu (1990)</td>
<td>87</td>
<td>42</td>
<td>7</td>
<td>28</td>
<td>—</td>
<td>42</td>
<td>58</td>
</tr>
<tr>
<td>Western Samoa (1990)</td>
<td>80</td>
<td>24</td>
<td>89</td>
<td>35</td>
<td>3</td>
<td>39</td>
<td>58</td>
</tr>
<tr>
<td>Kiribati (1988)</td>
<td>78</td>
<td>42</td>
<td>11</td>
<td>70</td>
<td>..</td>
<td>..</td>
<td>..</td>
</tr>
<tr>
<td>Solomon Islands (1990)</td>
<td>22</td>
<td>52</td>
<td>—</td>
<td>39</td>
<td>—</td>
<td>36</td>
<td>64</td>
</tr>
</tbody>
</table>

**Note:** Cr = credits; Deb = debits; G + S = goods and services.

The service sector in Pacific island development

Table 5   Pacific island economy groupings

<table>
<thead>
<tr>
<th>Group</th>
<th>Total service share of GDP (per cent)</th>
<th>Trade and commerce service share (per cent)</th>
<th>Community, social and personal services share (per cent)</th>
<th>Visitors per capita&lt;sup&gt;b&lt;/sup&gt;</th>
<th>Net travel credits&lt;sup&gt;c&lt;/sup&gt;</th>
</tr>
</thead>
<tbody>
<tr>
<td>Group 1</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cook Islands</td>
<td>75</td>
<td>50</td>
<td>35</td>
<td>1.60</td>
<td>..</td>
</tr>
<tr>
<td>Fiji</td>
<td>59</td>
<td>55</td>
<td>28</td>
<td>0.38</td>
<td>+40</td>
</tr>
<tr>
<td>Vanuatu</td>
<td>67</td>
<td>70&lt;sup&gt;d&lt;/sup&gt;</td>
<td>18</td>
<td>0.23</td>
<td>+40</td>
</tr>
<tr>
<td>Group 2</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Papua New Guinea</td>
<td>38</td>
<td>33</td>
<td>49</td>
<td>0.01</td>
<td>..</td>
</tr>
<tr>
<td>Kiribati</td>
<td>58</td>
<td>34</td>
<td>42</td>
<td>0.05</td>
<td>..</td>
</tr>
<tr>
<td>Solomon Islands</td>
<td>48</td>
<td>42</td>
<td>47</td>
<td>0.03</td>
<td>+22</td>
</tr>
<tr>
<td>Tuvalu</td>
<td>65</td>
<td>38</td>
<td>50</td>
<td>..</td>
<td>..</td>
</tr>
<tr>
<td>Tonga</td>
<td>40</td>
<td>..</td>
<td>..</td>
<td>0.20</td>
<td>+18</td>
</tr>
<tr>
<td>Western Samoa</td>
<td>47</td>
<td>61</td>
<td>26</td>
<td>0.30</td>
<td>+31</td>
</tr>
</tbody>
</table>

<sup>a</sup> Mainly government.

<sup>b</sup> From Table 9.

<sup>c</sup> Difference between 'travel' as a per cent of service credits and 'travel' as a per cent of service debits in the balance of payments (Table 4).

<sup>d</sup> Includes 'other services'.

Constraints on the development of the service sector

In considering the potential or actual constraints on the growth of services in the Pacific island economies, as well as possible facilitating factors, a number of the distinctions previously drawn between types of services are relevant. The nature of the constraints on intermediate services, for example, can be expected to differ from those facing services in final demand. Similarly, the distinction between traded and nontraded services is important in a number of respects. The relevant constraints for traded and nontraded services are considered separately here.

Distinguishing between traded and nontraded services is complicated in a number of ways. In general, tradables are defined as goods (or services) the domestic prices of which are fundamentally determined by world prices. Nontradables prices are determined by domestic demand and supply interactions. International unit transport costs are crucial here because they determine the extent to which domestically-produced items face effective competition from imports. The absence of imports or exports of a particular
service does not necessarily imply that it is nontradable and an item which it is appropriate to treat as nontraded in one economy may be traded in another.

Some services can be traded directly without requiring the presence of the producer and consumer in the same location. International banking and insurance, trading in shares and commodities, information services, consultancies, engineering and other business services can be done at a distance. What is required is a 'vehicle' for the transfer of information, be it transport of printed material, the telephone system, or, increasingly, international data transmission through the telecommunications network. Technological improvements in the latter are making an increasing number of services of this type internationally tradable (Richardson 1987).

Other services require some degree of personal contact between buyer (or the buyer's goods) and seller. Indeed, this is often the characteristic that distinguishes services from goods. Such services are still considered to be internationally tradable, however, where the transaction involves the buyer moving (temporarily) to the seller's location. In this way international tourism and travel are fully internationally tradable.

International competition can still occur in the remaining services if it is possible for foreign producers to establish and maintain a commercial presence in the consumer's location. Often the need for contact between buyer and seller arises because services provided by different suppliers differ in (perceived) quality and consumers have limited information on the quality offered by unfamiliar suppliers. In such cases, producer reputation is important and there is a tendency towards long-term producer-consumer relationships. It is then desirable for foreign producers to have at least a temporary presence in the buyer's location during the reputation establishment phase. A minimum commercial presence may be needed simply to facilitate trade. The required degree and form of foreign producer involvement necessary to enter a particular market clearly depends on the type of service under consideration and the resources available in the host economy. In some cases a considerable establishment in terms of foreign direct investment, technology and personnel may be required. Richardson gives a preliminary breakdown on whether services are tradable (directly, or with some facilitation), and the degree to which foreign competition can occur indirectly for nontraded services (Table 6). As indicated, competition can take place through more than one channel.
## Table 6 Tradability of services

<table>
<thead>
<tr>
<th>Tradability</th>
<th>Foreign competition in nontradable services</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Directly</td>
</tr>
<tr>
<td>Travel expenditure</td>
<td>✓</td>
</tr>
<tr>
<td>Hotels</td>
<td></td>
</tr>
<tr>
<td>Restaurants</td>
<td></td>
</tr>
<tr>
<td>Travel operators</td>
<td>✓</td>
</tr>
<tr>
<td>International maritime and air transport</td>
<td>✓</td>
</tr>
<tr>
<td>Domestic transport</td>
<td></td>
</tr>
<tr>
<td>Basic telecommunications</td>
<td>✓</td>
</tr>
<tr>
<td>International finance</td>
<td>✓</td>
</tr>
<tr>
<td>Commercial banking services</td>
<td>✓</td>
</tr>
<tr>
<td>Credit card services</td>
<td>✓</td>
</tr>
<tr>
<td>Retail banking</td>
<td></td>
</tr>
<tr>
<td>Commercial risks</td>
<td>✓</td>
</tr>
<tr>
<td>Reinsurance</td>
<td></td>
</tr>
<tr>
<td>Personal insurance</td>
<td></td>
</tr>
<tr>
<td>Insurance broking</td>
<td></td>
</tr>
<tr>
<td>Information services</td>
<td>✓</td>
</tr>
<tr>
<td>Audio-visual services</td>
<td>✓</td>
</tr>
<tr>
<td>Cultural services</td>
<td></td>
</tr>
<tr>
<td>Construction</td>
<td>✓</td>
</tr>
<tr>
<td>Engineering</td>
<td>✓</td>
</tr>
<tr>
<td>Real estate</td>
<td>✓</td>
</tr>
<tr>
<td>Management services</td>
<td>✓</td>
</tr>
<tr>
<td>Consultancy</td>
<td>✓</td>
</tr>
<tr>
<td>Computer services</td>
<td>✓</td>
</tr>
<tr>
<td>Software</td>
<td>✓</td>
</tr>
<tr>
<td>Accountant/audit services</td>
<td>✓</td>
</tr>
<tr>
<td>Legal services</td>
<td></td>
</tr>
<tr>
<td>Advertising</td>
<td></td>
</tr>
<tr>
<td>Industrial cleaning</td>
<td></td>
</tr>
<tr>
<td>Security</td>
<td></td>
</tr>
</tbody>
</table>
Table 6 Tradability of services—continued

<table>
<thead>
<tr>
<th>Tradability</th>
<th>Medical services</th>
<th>Hospital services</th>
<th>Hospital management</th>
<th>Basic education</th>
<th>Specialized education</th>
<th>Government</th>
<th>Personal services</th>
<th>Government services</th>
<th>International trading</th>
<th>Wholesale/retail</th>
</tr>
</thead>
<tbody>
<tr>
<td>Directly</td>
<td>✓</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>With facilitation</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>Labour movement</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>Investment,</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>technology</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>transfer</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>


Traded services

Analyses of services in international trade have proliferated in recent years as the question of bringing services under GATT has come onto the political agenda. Developing economies are typically net importers of the major categories of traded services. This is not the case in general for those Pacific island economies for which data are available (Table 7). Net exports of services in total, where they occur, are essentially due to sizeable net travel receipts which more than outweigh a tendency towards net imports of shipment services. Although travel receipts, mainly from tourists, are the major foreign exchange earners, they are not the only services capable of producing an export surplus, especially in Fiji and Western Samoa, where passenger transport and 'other transport' respectively, have produced net service exports in recent years.
The service sector in Pacific island development

Table 7 Net trade for groups of services: Pacific island economies, 1983–90

<table>
<thead>
<tr>
<th></th>
<th>Total services</th>
<th>Shipment services</th>
<th>Passenger transport</th>
<th>Other transport</th>
<th>Travel services</th>
<th>Other goods and services</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fiji</td>
<td>XXX</td>
<td>MM</td>
<td>XX</td>
<td>X</td>
<td>XXX</td>
<td>MM</td>
</tr>
<tr>
<td>Tonga</td>
<td>XM</td>
<td>M</td>
<td>..</td>
<td>M</td>
<td>X</td>
<td>X MM</td>
</tr>
<tr>
<td>Papua New Guinea</td>
<td>MMM</td>
<td>MMM</td>
<td>MM</td>
<td>..</td>
<td>M</td>
<td>MMM</td>
</tr>
<tr>
<td>Vanuatu</td>
<td>XX</td>
<td>..</td>
<td>..</td>
<td>XX</td>
<td>X</td>
<td>X MM</td>
</tr>
<tr>
<td>Western Samoa</td>
<td>MX</td>
<td>M</td>
<td>M</td>
<td>X</td>
<td>X X MM</td>
<td></td>
</tr>
<tr>
<td>Kiribati</td>
<td>X</td>
<td>M</td>
<td>X</td>
<td>M</td>
<td>..</td>
<td>M</td>
</tr>
<tr>
<td>Solomon Islands</td>
<td>MM</td>
<td>..</td>
<td>M</td>
<td>X</td>
<td>M</td>
<td>MM</td>
</tr>
</tbody>
</table>

Notes: X (M) net exports (imports) during period.
XX (MM) substantial net exports (imports) during period—more than US$10 million in 1990.
XXX (MMM) net exports (imports) in excess of US$100 million in 1990.
XM/MX net exports and net imports during period respectively.

a 1982–89.
c 1979–86 data only available in SDR.
d Except 1979.

Although our concern is not primarily with trade in services as such, it is useful to examine the factors underlying international competitiveness in traded services as these factors will broadly determine the composition of traded services production in the Pacific island economies. In general four groups of factors can be considered.

Physical and human resource endowments. A low cost but reliable supply of the factors necessary to produce a particular service is obviously a precondition to successful production. Although, services in general are often labour-intensive, some traded services are particularly intensive in the use of human and physical capital. Technological innovations can change the factor intensity of production of a service, sometimes in quite radical ways. Information services are a good example, as innovations in recent years now allow these types of services to be produced without all their inputs being in the same location. Since most information services consumption is in industrial economies, previous technologies required international labour migration (with remittances) if developing economies were to participate in such production. Whether developing economies now succeed in attracting these activities from industrial economies is likely to depend, in part, on their ability to provide complementary inputs, domestic human capital via education and adequate infrastructure facilities, an efficient telecommunications network in particular.
Distance and transport costs. The relative geographical isolation of the Pacific island economies provides natural protection (in terms of high international transport costs) to their import-competing goods and traded-services activities. Exports in both categories are correspondingly discouraged. In tourism for example, the relatively high air transport costs within the Pacific diminish the Pacific island economies as tourist attractions for North American, European and Asian visitors. The result is a preponderance of Australian and New Zealand tourists (Table 8).

Economies of scale and scope. Recent trade theories have stressed the potential importance of economies of scale for comparative advantage in different goods and services. Small island economies are likely to be effectively excluded from producing those tradable goods and services characterized by substantial economies of scale. Economies of scope may also be relevant where limited domestic market size limits opportunities for marketing a variety of goods and services. Where services are labour-intensive we can expect scale economy issues to be less relevant since scale economies are usually associated with processes involving large fixed capital costs. (Some services could, of course, have large fixed capital costs but labour-dominated variable costs). Where economies of scale or scope are important for traded services there are good a priori grounds for considering cooperation between regional producers. This should facilitate lower prices in individual economies, greater regional trade and potentially raise the international competitive position of the region more generally. A key element of such an approach is identifying the relevant geographical region for cooperation. Issues relating to regional cooperation are examined later.

Government regulation. Government border interventions, such as tariffs, commonly benefit the import-competing sector by drawing resources away from the exportable and nontraded sectors. The latter frequently includes a large share of services. Government policies more generally can also affect traded services development. To the extent that general macroeconomic policies such as exchange rate policy, microeconomic policy such as domestic taxes and subsidies and government regulatory behaviour such as foreign investment codes, discriminate against, or in favour of, traded services, their development will be impeded or encouraged. The arguments underlying the extensive government regulation of services production, particularly nontraded services, are discussed in more detail later.

There have been efforts in recent years to explore which of these broad determinants of comparative advantage are important for individual traded services, using an approach analogous to the analysis of comparative advantage in traded goods (Sapir 1985; Richardson 1987). The following are the general conclusions for the main categories of traded services.

255 Pacific islands at the crossroads?
## Table 8 Visitor arrivals: Pacific island economies

<table>
<thead>
<tr>
<th></th>
<th>Total visitors</th>
<th>Visitors per capita</th>
<th>Other Pacific islands</th>
<th>Australia</th>
<th>New Zealand</th>
<th>North America</th>
<th>Europe</th>
<th>Asia</th>
<th>Other&lt;sup&gt;a&lt;/sup&gt;</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cook Islands (1985)</td>
<td>28811</td>
<td>1.60</td>
<td>7</td>
<td>14</td>
<td>48</td>
<td>22</td>
<td>8</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>Fiji (1990)</td>
<td>278996</td>
<td>0.38</td>
<td>6</td>
<td>37</td>
<td>11</td>
<td>20</td>
<td>16</td>
<td>8</td>
<td>3</td>
</tr>
<tr>
<td>Tonga (1989)</td>
<td>21029</td>
<td>0.20</td>
<td>13</td>
<td>13</td>
<td>20</td>
<td>20</td>
<td>12</td>
<td>...b</td>
<td>21</td>
</tr>
<tr>
<td>Papua New Guinea (1990)</td>
<td>40742</td>
<td>0.01</td>
<td>2</td>
<td>46</td>
<td>5</td>
<td>13</td>
<td>18</td>
<td>16</td>
<td>—</td>
</tr>
<tr>
<td>Vanuatu (1990)</td>
<td>35042</td>
<td>0.23</td>
<td>16</td>
<td>50</td>
<td>18</td>
<td>3</td>
<td>4</td>
<td>2</td>
<td>7</td>
</tr>
<tr>
<td>Western Samoa (1990)</td>
<td>48211</td>
<td>0.30</td>
<td>43</td>
<td>10</td>
<td>17</td>
<td>9</td>
<td>12</td>
<td>...b</td>
<td>8</td>
</tr>
<tr>
<td>Kiribati (1988)</td>
<td>3465</td>
<td>0.05</td>
<td>40</td>
<td>11</td>
<td>6</td>
<td>26</td>
<td>4</td>
<td>6</td>
<td>8</td>
</tr>
<tr>
<td>Solomon Islands (1990)</td>
<td>9915</td>
<td>0.03</td>
<td>19</td>
<td>37</td>
<td>14</td>
<td>8</td>
<td>9</td>
<td>6</td>
<td>8</td>
</tr>
</tbody>
</table>

<sup>a</sup> Other includes 'not specified'.

<sup>b</sup> Included in 'other'.

**Source:** South Pacific Economic and Social Database, National Centre for Development Studies, The Australian National University, Canberra.
Travel and tourism. Three different but related sub-markets can be distinguished in this category.

- Business travel is closely related to the general pattern of international economic activity, but can be particularly important where there is considerable foreign involvement in domestic production.
- General vacation activities can be consumed in most economies, but are likely to be more popular in locations with attractive natural endowments (climate, beaches). The Pacific island economies would appear to have some comparative advantage in this sub-market, relative to their Pacific rim neighbours.
- Sightseeing activities are drawn towards the world’s great natural wonders and the sources of its great ancient civilizations. The Pacific island economies would appear to be at a comparative disadvantage in this sub-market.

Air transport. Comparative advantage in this sector appears to depend mainly on capital costs and operating experience. International competition is also heavily regulated with landing privileges allocated on a reciprocal basis. This enables all national airlines to survive, despite considerable variations in efficiency.

Maritime transport. This sector has similar characteristics to air transport. While economies of scale only seem relevant at relatively low volumes of activity, they are particularly important at the levels of traffic operating in the South Pacific. The bulk market is relatively unregulated, unlike liner services. Technological developments through containerization and the development of multi-modal transport services have had an impact on factor use and hence comparative advantage in this sector.

Banking. Banking services can be divided into two types.

- International banking, which provides a package of traded services to agents operating internationally. There are economies of scale in banking and the established international financial centres have the advantage of contacts and accumulated expertise.
- Domestic retail banking, which in the past has usually required that the service be produced in the economy in which it is consumed, though advances in electronic banking and telecommunications are weakening this requirement.

Insurance. Like banking, the insurance sector has a domestic and an international, reinsurance, component. Both sub-sectors are concerned with the spreading of risk. Retail insurance often requires direct contact with customers, though this can occur through brokers, and except for large and special cases, little direct insurance is placed internationally. Reinsurance, on the other hand, is a wholesale activity, for which efficiency involves substantial international transactions. The national markets of the Pacific island economies would
appear to be too small, and subject to such major risks, like cyclones, to capture all the gains from risk pooling, even at the regional level. This is one service in which the gains from trade are likely to be substantial. Comparative advantage depends primarily on skilled labour such as actuaries and investment advisers. Since it is concerned with the handling of data, insurance has been substantially affected by advances in information technology.

**Information services.** Once the information is stored, and provided the necessary telecommunications infrastructure is available, there are considerable economies of scale in the supply of data banks. Certain service inputs to the construction of data banks can be traded internationally, again subject to the availability of the appropriate infrastructure.

**Other business services.** This is a heterogeneous group, including accountancy, consultancy, advertising and legal services, for which perceived quality and personal contact are important. These activities are intensive in the use of skilled labour, but knowledge of local customs, laws and regulations is often essential in their performance. They therefore tend to be nontraded or traded only when facilitated by the presence of a local subsidiary.

**Nontraded services**

Since there is nothing equivalent to the balance of payments accounts for nontraded services it is less easy to identify specific nontraded services. Treating services which are not actually observed to be internationally transacted as 'nontraded' the residual of services which do not appear in the balance of payments statistics can be regarded as nontraded. This will include

- (most) wholesale and retail trade
- internal transportation
- primary and secondary education
- public health services
- public administration
- (most) construction
- housing
- personal services (e.g. hairdressers and domestic service)
- hotels, restaurants, etc. (excluding tourist expenditures).

To the extent that any of these services are consumed by foreign visitors they become potentially traded. Even so, they may still best be treated as nontraded if visitor expenditures are small or insensitive to international price differences.

Some issues discussed above with reference to traded services are also applicable here. Government regulations are particularly important for nontraded services. Economies of scale are relevant in the wholesale and retail
trade sector, for example, and in internal transportation services. More geographically dispersed populations can involve higher service costs or poorer service access. For the same reasons, urbanization can enable scale (and scope) economies to be reaped in these services. There is a clear tendency for the expenditure share of services and urbanization to rise with development. Of course, urbanization can, and often does, produce other effects, such as congestion, which both worsen the provision of some services (road transport) and give rise to demands for other services to minimize the consequent externalities (public utilities, infrastructure services, law enforcement). In discussing nontraded services it is useful to make a distinction between those privately provided and those publically provided.

**Privately provided services.** In the list above, privately provided services in general include wholesale and retail trade, some housing, hotels and restaurants, some internal transportation, construction and personal services. Although these services themselves are not traded, there can be indirect international competition for those provided by the private sector, through direct foreign investment. The services of capital, labour and technology are then internationally traded with the resulting production by foreign affiliates treated as host economy output in the balance of payments statistics. Clearly, government attitudes towards, and regulation of, both foreign direct investment and the service sector in general, will be particularly important in determining the ownership, size and efficiency of the nontraded services sector. Both are typically heavily regulated by government, through, for example, control of the rates charged by utilities, control of entry into and rates charged in transportation, licensing or quantitative entry restrictions in the legal, accounting and medical professions, government ownership or control of telecommunications, broadcasting and other media and the supervision of banks, insurance and other financial companies (UNCTAD 1985). Since for many services it is difficult to make a distinction between the standard of the service supplied and the person supplying it, there is a natural tendency to attempt to regulate service quality by restrictions on entry.

Even accepting that a case for regulation can be made in some circumstances, there remains the issue of whether there is any reason for such interventions to discriminate against foreign suppliers, either foreign exporters or domestic affiliates of foreign producers. On the surface at least they should not. Indeed, the threat of entry by potential foreign suppliers can be important in constraining the behaviour of domestic suppliers. This discrimination occurs, however, and is often based on standard protective motives for intervention, such as national security, reduction in dependence on foreign supply, promotion of infant industries, increased domestic employment or value added, greater indigenous participation in private sector production and the protection of cultural values. Nontraded activities, including services, are particularly open to such regulation because the costs are less obvious when there are no border prices for easy comparison.
There are many ways in which government regulations can limit the indirect competition of foreign service providers. Restrictions may be imposed on both the entry of foreign producers and their operations after entry. Such limitations are particularly significant in the services sector. They include bans on entry (for example in banking), limitations on the degree of foreign ownership (for example franchising, construction, engineering) and restrictions on the range of services a foreign affiliate may be allowed to provide (for example banking, insurance, accounting, law). Even where establishment is allowed, exchange controls may restrict the repatriation of profits and royalty payments, foreign affiliates may be limited in their ability to employ expatriates, government procurement of construction, engineering, banking, insurance, shipping and aviation services may give preference to domestic (and locally owned) suppliers and, similarly, government incentives may be limited to locally owned suppliers.

In the past the Pacific island economies, with some exceptions, for example Vanuatu, have been characterized as operating excessively inwardly-oriented regulatory environments for direct foreign investment, through complex licensing systems, regulations and procedures, often with significant discretionary elements. There has been some liberalization of these regimes in recent years, with incentives, mainly in the form of tax relief, offered to new export-oriented industries, or those introducing new technology. Some service activities are included, particularly tourism, but most are still subject to regulations designed to encourage local participation and training by limiting the employment of expatriates and requiring programs of training for their replacement by locals. While the education and training of the local population is surely a worthwhile objective, governments should be aware that attempts to achieve it in this way involve costs in terms of a less efficient nontraded services sector than otherwise and reduced foreign investment.

The important point is that these regulations on foreign competition in the service sector, whether they are on direct imports or indirect competition through foreign establishment, have the same impact and are subject to the same criticisms as the corresponding regulations on commodities. Other things equal, they lead to an inefficient allocation of existing domestic resources, can discourage investment in those sectors in which the economy has a comparative advantage and eventually reduce the rate of growth.

**Government provided services.** Publicly provided services include the remainder of the list above, that is, primary and secondary education, public administration, some housing, some internal transportation and public health. Government services are particularly heavily represented among the nontraded services in most Pacific island economies, in both output and employment terms. The issue of what is likely to constrain or encourage the growth of such services is but another way of asking what determines the size of government. There is no consensus answer to this question, but a number of factors are commonly recognized as relevant in the context of developing economies.
An economy's geographical and cultural context can have a significant impact. The dispersal of population amongst many islands can increase the size of the public sector by requiring a larger expenditure per capita on physical infrastructure and administrative and social overheads to provide any given level of services. In the Pacific island economies public enterprises also play a significant role in economic activities often undertaken within the private sector elsewhere. Partly this reflects a leadership role undertaken by the government, where it sees private entrepreneurship as lacking for social, cultural or other reasons. However, if governments monopolize large segments of economic activity and heavily regulate the remainder, then entrepreneurship will naturally be stifled.

The availability of government tax and other revenues are clearly important. Musgrave (1969) introduced the notion of tax handles, that is, economic activities and agents that are more readily taxed than others. The more tax handles an economy has the more revenue it can raise, ceteris paribus, and the more it can expand service provision. Important tax handles in developing economies have been shown to be marketed agricultural output, foreign firms, indigenous natural resources and other resources in which the economy has a monopoly advantage (for example, Suez Canal revenues in Egypt), employees of government and large private firms and export enclaves. General growth of incomes and the spreading of the monetary economy will also contribute to increased tax sources, allowing increased service provision.

Access to large inflows of foreign aid can further enable nontraded government expansion. The smaller Pacific island economies in particular are the recipients of substantial aid flows measured on a per capita basis. The importance of this is indicated by the ratio of net official transfers to total goods and service credits (Table 7). These aid flows have been used primarily for public sector projects and have financed a major part of overall government expenditure. It seems likely that this has encouraged a more extensive provision of government services, both in terms of level and range, than would otherwise have been the case. The smaller Pacific island economies depend heavily on high aid flows to develop and support essential public services and facilities.

Government redistribution policies and social objectives are also obviously relevant for the size of the sector. Public provision of such services as education and health care are often less motivated by arguments concerning externalities than by a desire to give more equal access to these services. Where private wealth creation produces wider disparities in income levels, governments that are responsive to social needs are likely to be under more pressure to expand service provision. In addition, social and political stability are important factors in government growth. Volatility in government regimes is not conducive to raising tax revenues. External sources of funds are also usually adversely affected. It has been observed that developing economy governments tend to devote a larger proportion of their resources to military and other defence services than do their counterparts in industrial economies (Lim 1992). While this may not have been an important issue in the past for most Pacific island
economies, growing law and order problems and political unrest could force reallocations of government service expenditures in some cases.

Past decisions on government provision have also been shown to be important (Saunders 1988). Governments establish priorities via structures and programs which are difficult to alter. Radical or rapid change in the size and forms of government services are rarely observed except perhaps where revolutionary political change occurs. This provides for some predictability in future government growth, but may signal significant adjustment problems if foreign aid flows were to be cut substantially.

Regional cooperation in services

The production of many services (transport, banking, insurance, infrastructure), is characterized by economies of scale, particularly at the levels of demand likely in most Pacific island economies. Where services are traded internationally, the relatively low quantities demanded in these economies individually need not be a serious disadvantage as economies of scale can be indirectly exploited through imports. Where services are nontraded the unit cost of these services is likely to be high. There may be some services in this latter category which can be traded at the regional level, however, raising the possibility that some scale economies can be gained if the Pacific island economies could agree to coordinate their production, perhaps even in one location. Such agreement will inevitably involve compromises. For individual participants cooperation is likely to involve the prospect of consuming a lower cost, but less preferred, option.

Existing cooperation

Despite the somewhat ambivalent attitudes to regional cooperation of the smaller Pacific island economies in particular, a structure of regional organizations and institutions exists promoting cooperation in a range of areas including transportation, trade, fisheries, education, health and defence. Much of this cooperation occurs through the South Pacific Forum, composed of the independent self-governing states in the South Pacific region including Australia and New Zealand. The functions of the Forum Secretariat, the South Pacific Bureau for Economic Cooperation, include facilitating continuing cooperation and consultation between members on trade, economic development, tourism, transport and other related areas. Cooperative arrangements in some service activities have emerged from this structure (Gris 1982).

Regional shipping. The Pacific Forum Line was launched in 1978, with the aims of offering a regular, modem, moderately priced but economically viable shipping service to the region. The introduction of this cooperative venture is partly in recognition of the fact that the relatively small cargo volumes generated in the region make the offering of a full range of shipping services by commercial carriers unattractive. It is hardly surprising then that the Forum Line has had financial problems, particularly in its early years, despite substantial subsidies
by aid donors. The financial position does seem to have improved in recent years, although there will always be a conflict between its commercial viability and its other objectives (Pak-Poy and Kneebone 1989).

**Civil aviation.** The Association of South Pacific Airlines is concerned with staff training and aviation regulation within the region. The general question of cooperation in the aviation sector is discussed in more detail later.

**Regional telecommunications.** The South Pacific Bureau for Economic Cooperation has been designated by the Forum as the coordinating agency for the development of telecommunications in the region.

**Education.** Tertiary education is a traded service in which there are economies of scale, at least within degree programs at relatively low numbers of students. A regional university could take better advantage of these economies of scale than separate national universities. This is not the only option available, however, as students can study by extension (Massey University in New Zealand and Macquarie and Queensland Universities in Australia have large extension programs), or be sent outside the region to countries where such economies of scale have already been exhausted. The case for a regional university therefore rests on being able to satisfy demand at a lower cost than these extra-regional options. Despite some doubts that this condition was likely to be met, the opinions of aid donors and a variety of non-economic motivations led to the University of the South Pacific being established in 1968 as a regional university. The underlying assumption was that University of the South Pacific would teach those degree programs for which there was a relatively large demand in the region and where there was more limited demand students would go to other institutions (for example, the University of Papua New Guinea or tertiary institutions in Australia or New Zealand).

While the University of the South Pacific has been successful in establishing itself, dissatisfaction has been expressed at times about its operations. Fiji, the host nation, has complained of bearing a disproportionate share of the costs. Other states have argued that the university gives too much deference towards Fijian interests and therefore does not always act as a regional university. As a result there have been moves to establish tertiary institutions in other states (for example, Tonga, Western Samoa and Solomon Islands), and other economies send more students outside the region than to the University of the South Pacific. The future for cooperative university education in the region is somewhat uncertain. The University of the South Pacific is likely to remain as a regional university coexisting with smaller national universities, possibly linked with institutions in Australia or New Zealand. Some students will continue to study outside the region, a preferred option for many.

**Case studies in cooperation**

While arguments for regional cooperation in some services appear strong, the record on cooperation is mixed. In this subsection three service activities which
are often the subject of proposals for regional cooperation—aviation, tourism and telecommunications are examined in more detail.

Aviation. A combination of rugged terrains and archipelagic structures, has given the Pacific island economies a relatively high dependence on aviation for economies of their land size and incomes. Efficiency in aviation is therefore particularly important, though this is constrained by small populations and consequently thin markets. All existing airlines in the Pacific are of a size where scale economies are significant in most aspects of their operations and yet, even with cooperation to the point of effectively becoming a single airline, the group would not form a large or even a medium airline by international standards.

The main advantages in cooperation are that the efficiency gains thereby obtained would allow service of a higher quality or lower cost to be provided. Such gains are potentially available in several areas.

- **In operations.** One cost increasing factor is the atypicality of the routes flown by Pacific island airlines. To take advantage of economies of scale in aircraft construction, and in view of the nature of the demand elsewhere, aircraft manufacturers tend to concentrate on building large aircraft for long hauls and small aircraft for short hauls. In the South Pacific the ideal aircraft would be relatively small with long ranges. On any given route the cost per passenger therefore tends to be lower the larger the aircraft used, but the frequency of flights is also lower for any given number of passengers. Cooperation which increases aircraft utilization for any given frequency can then yield cost savings. This cooperation could take various forms, including sharing of aircraft and allowing airlines to purchase seats on each other’s flights.

- **In marketing.** Coordination of flight schedules may increase passenger convenience, particularly when flights are relatively infrequent. There are also efficiency gains from combining and coordinating reservation systems and advertising activities.

- **In infrastructure.** Economies of scale exist in activities such as maintenance, inventory holding, catering and staff training. To take advantage of many of these some form of hub must be established.

Though the advantages of cooperation in the aviation sector have long been recognized, it remains true that the many proposals for regional cooperation in this area largely have been unsuccessful. Clearly there are perceived disadvantages also. The most obvious, and perhaps the most significant, is the loss of sovereignty associated with the cession of some element of decision making authority to a regional body. This problem is compounded by the fact that most governments have multiple objectives for their national airlines.

3 The material in this subsection, which draws on a recent unpublished study of regional cooperation in aviation, was kindly made available by Peter Forsyth.
Although all governments benefit from a more efficient airline, national airlines are often given the objective of encouraging tourism, for example. This objective may be hindered rather than furthered by the type of cooperation that increases efficiency. Even where cooperation is feasible, there remains the problem of generating an equitable division of the gains from cooperation, and the further difficulty of ensuring that the result is not effectively a monopoly airline or so much collusion between national airlines that the potential gains to consumers are nullified.

Given the potential advantages from cooperation, it would be surprising if the Pacific airlines were not already cooperating to some degree. This is indeed the case, though it does appear that much of this cooperation is with the airlines of the Pacific rim (Table 9). Presumably, this reflects that rim airlines are larger, offer a wider range of services and are therefore better able to take advantage of economies of scale, particularly in maintenance and reservation systems. They can pass on some of the benefits to their partners. The choice of partners also reflects the role of national airlines in supporting their national tourism industries. In this area the Pacific island economies are competitors. Although some degree of proximity is required for aircraft sharing to be economic, cooperation between competing airlines can give rise to conflicts of interest. This may explain the degree of cooperation with the Australian domestic airlines.

In general, the structure of this cooperation appears to be largely ad hoc. Arrangements often break down because they are financially unsuccessful, or the circumstances of one party change, or there are disputes over the division of the benefits. Even so, unsuccessful arrangements are often replaced by fairly similar arrangements with other airlines.

On the basis of the extent of existing cooperation and other evidence, a recent survey concluded that the benefits to be gained from further cooperation among Pacific airlines are likely to be somewhat limited. After standardizing for differences in route densities and stage lengths, it appears that Pacific fares are higher than elsewhere, but not by a large margin (5 per cent to 10 per cent). The smallness of this margin could reflect subsidies. In comparison with US airlines, aircraft utilization rates are similar for large aircraft, but sometimes lower for smaller aircraft. Load factors are in general typical for scheduled airlines.

With some exceptions, there appears to be only limited scope for improving passenger convenience by rescheduling existing flights and there are good reasons for most of the exceptions. Nadi does appear to function fairly effectively as a regional hub. The intensive bilateral regulation of international air travel, implies that most airlines end up flying some sectors on which they have no landing rights, however, and there remains scope for increased aircraft utilization by greater cooperation in the granting of traffic rights and the sale of seats among airlines, as a consequence.
<p>| Table 9  Cooperative arrangements involving South Pacific airlines |
|------------------------------------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|</p>
<table>
<thead>
<tr>
<th></th>
<th>Air Nuigini</th>
<th>Air Pacific</th>
<th>Air Nauru</th>
<th>Air Caledonia</th>
<th>Air Vanuatu</th>
<th>Polynesian Airlines</th>
<th>Solomon Airlines</th>
<th>Royal Tongan Airlines</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Operational</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Joint ownership</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Full time lease</td>
<td>P</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Part time lease</td>
<td>P</td>
<td>x</td>
<td>x</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Cooperation in choice of aircraft</strong></td>
<td>X</td>
<td></td>
<td>x</td>
<td>N</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>Maintenance</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Spares holding</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Aircraft scheduling</td>
<td>x</td>
<td>x</td>
<td>p</td>
<td>x</td>
<td>x</td>
<td></td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>Crew scheduling</td>
<td>x</td>
<td>p</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td></td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>Seat purchase</td>
<td>X</td>
<td>X</td>
<td>x</td>
<td>P</td>
<td>x</td>
<td></td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>Pooling</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>x</td>
<td></td>
</tr>
<tr>
<td><strong>Sales and marketing</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Passenger scheduling</td>
<td>X</td>
<td>x</td>
<td>p</td>
<td>P</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Access to fifth freedom</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Reservation systems</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fares setting</td>
<td>X</td>
<td></td>
<td>x</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Promotion</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>p</td>
<td>x</td>
</tr>
<tr>
<td>Advertising</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Infrastructural</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Corporate seminars</td>
<td>X</td>
<td>x</td>
<td>x</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Ground handling</td>
<td>X</td>
<td>x</td>
<td>x</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Catering</td>
<td>X</td>
<td>x</td>
<td>x</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Staff training</td>
<td>X</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Accounting systems</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Multilateral negotiations</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Technical standards</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>Negotiation of traffic rights</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td><strong>Other</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cross shareholdings</td>
<td>N n</td>
<td>x</td>
<td>x</td>
<td>p</td>
<td></td>
<td></td>
<td>N</td>
<td>n</td>
</tr>
<tr>
<td>Managerial assistance</td>
<td>n</td>
<td></td>
<td>x</td>
<td></td>
<td></td>
<td></td>
<td>n</td>
<td>x</td>
</tr>
</tbody>
</table>

**Note:** X, x = current; P, p = possible in future; N, n = no longer present. Capitals denote cooperation between South Pacific airlines, lower case letters denote cooperation with rim airlines.

**Source:** Survey of Airlines (unpublished); Airlines' Annual Reports.
There already exists a considerable degree of regional cooperation in aviation, if one interprets the region to include the Pacific rim. While the bulk of the benefits from cooperation appear to be exploited, potential benefits remain in some areas. The issue then arises of how best to exploit these potential benefits.

Past proposals have tended to focus on specific organizational structures. In the early 1970s, Air Pacific was put forward as a potential regional airline on the Scandinavian Air Service (SAS) pattern, but the perception by other states that it was too much oriented towards Fiji led to the formation of other national airlines. A single regional airline would have the advantage of monopoly power in dealing with agents outside the region, but also the disadvantage of monopoly power in dealings within. This degree of cooperation has clearly been rejected by the governments involved.

Similarly, proposals for a Pacific aircraft leasing company have not received a favourable response. Such a company would allow airlines to maintain their separate identities, but would create a monopoly in their dealings with outside aircraft suppliers. Compromises on the type of aircraft to be used would be required and the arrangement is likely to be inflexible and therefore unstable.

Experience suggests that a more promising approach is to ensure that airline managements have incentives to be as efficient as possible and to let them negotiate the cooperative arrangements that will best meet this objective, rather than imposing arrangements on them. Governments have an important role in facilitating such cooperation through the harmonization of the regulatory infrastructure, and the provision of the appropriate incentives where the airlines are government owned.

Tourism. Tourism has become an important economic activity for many of the Pacific island economies and its importance is likely to increase. The export of tourist services takes advantage of their endowments of tourist resources, both natural (climate, flora, beaches) and human (culture, festivals). Tourist purchases include a wide range of services including hotel services, tours, transportation (including support services at terminals), financial services (including credit cards and travellers cheques), travel insurance and communications. Tourism is attractive to these economies because of the employment and income it generates for domestic residents and because it increases, diversifies and sometimes also helps to stabilize export earnings (Falvey 1986).

Earnings from the export of tourist services are included in the travel component of service credits in the balance of payments accounts. The measurement of this item under the International Monetary Fund's definition includes all receipts from goods and services provided to foreigners (including tourists, business travellers, students, patients undergoing medical treatment and military personnel on leave). Data on the actual numbers of tourists visiting each of these economies is difficult to obtain, both due to lack of accurate records and
because many visits are for a variety of reasons, tourism being only one of them. For both of these reasons, the overall importance of the tourist sector is difficult to quantify. Information on travel credits and debits is provided (Tables 4 and 7). The most recent data available on total numbers of visitors are given above (Table 8). The data on visitors per capita provide an indication (albeit imperfect) of the scale of the tourist sector in each economy. Note that these figures also include nationals returning temporarily.

With few exceptions, the Pacific island economies are not major sources of visitors for each other (Table 8). Most visitors are from the Pacific rim. This partly reflects the importance of air connections, particularly the significance of trans-Pacific flights. This dependence on external sources results in tourist earnings that are both seasonal and volatile. The volatility arises from several sources, both internal and external to the region. Exchange rate movements in the source currencies can promote or hamper tourism by their residents. Similarly, natural disasters in the destination markets, arising from cyclones for example, not only damage the infrastructure (natural and man-made), but also create a negative impression that takes some time to fade. Political disturbances have a similar effect.

Since a diverse range of services make up the tourist package, a diverse range of resources and other inputs are required to produce them. Not all of these resources and inputs are available locally (at internationally competitive prices) and so there has been considerable foreign participation in the industry, much of it involving foreign investment, sometimes in joint ventures with the local government. In general, foreign participation is concentrated in those activities in which one would expect foreign producers to have a comparative advantage, activities that are capital and skill intensive or are linked with providing a product or service of a quality or sophistication expected in high income economies. Local involvement tends to be concentrated in wage and salary occupations and in activities that require only modest amounts of capital (taxis), or are local human-capital specific (handicrafts) (Britton 1990). Local participation will probably increase with experience, but given the nature of this industry (for example, the importance of prepaid package tours), foreign involvement is always likely to be high. A more flexible attitude towards informal sector activities and trading hours on the part of (some) governments would help to increase local participation in tourist expenditures.

There appear to be two major constraints on the development of the tourist industry in the region. First, some Pacific island governments are concerned over the potential adverse impact of tourism on the local culture. Tourist developments are therefore often confined to specific sites. In this case the often criticized enclave nature of tourism may be seen as beneficial rather than detrimental. When binding, this site constraint will appear as inadequate hotel capacity which persists even though there is no shortage of local or foreign investors interested in tourism development. The second major constraint involves the access of tourists to the destinations. Most tourists arrive by air. Where significant growth in tourism has occurred, it has usually followed the
introduction or improvement of air services (Kissling 1990). The international flight arrival and departure times of foreign, mainly Pacific rim, carriers are determined by their wider scheduling interests, rather than the convenience of Pacific island tourists. These airlines also use a limited number of transit stops (Nadi and Papeete), so that tourists to other destinations must rely on connections from these hubs. As a result the smaller Pacific island economies have incentives to establish their own national airlines in support of their tourism industries.

In these circumstances, what is the scope for regional cooperation in tourist development? Facilitating cooperation and consultation in tourism is one of the functions of the South Pacific Bureau for Economic Cooperation. There are economies of scale in some aspects of tourism promotion (advertising, reservation systems). The advantages of coordination of airline services have already been discussed. One problem for the smaller Pacific island economies in particular, is that they do not have sufficient tourist attractions to justify the relatively lengthy stopovers their infrequent air services require. A cooperative solution to this problem would be to promote these destinations as complementary, with several being visited sequentially on one trip (Pearce 1990). This could raise tourist numbers to each destination and may justify more frequent air services. The problem at present is that these destinations are perceived as substitutes, by both governments and potential tourists, this naturally inhibits this form of cooperation. They are very similar in physical terms, so that any differentiation would have to be based primarily on differences in human resources. The group 1 economies, which have relatively well-developed tourist sectors, will have little to gain from cooperation in this area, and it is the group 2 economies who potentially can benefit the most from cooperation in tourism promotion (Table 5).

The threat of natural or political disturbances also discourages cooperation. If the Pacific island economies are marketed collectively as a tourist destination, then disturbances of any kind in any one of them tend to adversely affect the image of them all. This would be a particular problem where the disturbance affects a hub.

**Telecommunications.** With small total populations scattered over large areas, communications has always been an important sector for the Pacific island economies. Advances in satellite technology, where costs are less sensitive to distance, have opened the prospect of improved communications services by avoiding relatively expensive land-based systems. The economies of scale in telecommunications are sufficient to justify a regional system with shared satellite facilities. This is implicitly recognized by the establishment of the South Pacific Telecommunications Program at the South Pacific Bureau for Economic Cooperation (Cheah 1986).

An efficient telecommunications system could have a significant impact on productivity in the Pacific island economies. This would occur through increased access to information, which would enable easier coordination of economic
activities, thereby facilitating trade and investment. Advances in information technology permit improved access to international commodity, stock and financial information, the substitution of electronic mail for slower postal services and the substitution of teleconferencing for business travel (Rada 1987). In addition, distance education, training and health care delivery would become possible for smaller economic units. The possibility of remote diagnosis for some types of illnesses would allow improved health care to rural areas. Access to public administration and other services would also be improved.

The establishment of local television broadcasting would be more cost effective if done on a regional basis. Television broadcasting is physical and human-capital intensive and is likely to require considerable expatriate involvement, particularly where local content in terms of programming is desired. A regional television system could take advantage of economies of scale in such programming (Cheah 1986). Given the difficulties of achieving cooperation in other less sensitive areas, however, one cannot be optimistic over the possibilities of cooperation here.

Summary and conclusions

This paper began with a brief survey of the role of services in development. It was noted that growth in income per capita tends to be accompanied by a declining share of agriculture in GDP and rising shares of industry and services. The factors potentially responsible for changes in services share were discussed and the relevant empirical evidence was examined. It appears that the demand for services in aggregate has an approximately unitary income elasticity and a relatively low price elasticity. Growth in income per capita is accompanied by a relatively unchanged share of services in real expenditure, along with a rising relative price of services and an increasing share of services in nominal expenditure. There is no strong evidence to support the hypothesis that labour productivity in services is systematically lower than that in goods in general, though it may be lower than productivity in manufacturing.

The service sector is composed of a diverse group of activities. A description of its aggregate properties can mask a quite diverse pattern of behaviour of individual service activities. The evidence on individual service activities is less comprehensive. Increases in income per capita tend to be accompanied by rising shares of real expenditure on health, housing and recreation and a declining share of purchased (mainly public) transport. Our discussion of the development of services also highlighted the importance of complementarities between services and other industrial activities. Such services as freight transport, port facilities, communications and wholesale and retail trade are closely tied to the upstream activities which create a derived demand for these services. This means that the growth prospects for intermediate services, are very much subject to other developments in the economy.
In general, the Pacific island economies can be expected to follow this broad pattern of shifts in service demand with growth in income per capita. Their smallness and remoteness seem likely to influence their development. The Pacific island economies have larger shares of agriculture and smaller shares of industry in GDP than the typical lower middle-income developing economy. A permanently smaller industrial sector will clearly have an impact on the distribution of demand for services. For example, demand for those associated with high (low) urbanization is less (more) likely to increase.

The implications of all this for the provision of individual services depend on whether the service in question can be traded internationally. If so, shifts in the shares of expenditures can be accommodated by shifts in the composition of trade. From a policy perspective, the important point to note is that these shifts will be occurring and that policy should aim at facilitating rather than obstructing the resulting adjustments. This process may require allowing increased foreign involvement in the provision of services and the implications for government regulatory actions should be kept in mind.

For nontraded services the issue becomes one of how domestic production will adjust to shifts in demand. Again, for services that are provided privately, the role of foreign producers is likely to be important. Given the Pacific island economies' limited resources, advantage should be taken of foreign resources wherever possible. For publicly provided services, the important point is that governments need to recognize these shifts in demand when they occur, since there is no market in which they are automatically expressed, and move to meet this demand as efficiently as possible.

The service sector is likely to remain an area which generates proposals for regional cooperation that are met with a lukewarm response. Concerns over loss of sovereignty and the potential subordination of regional institutions to the wishes of the larger participants, particularly the host nation, make it necessary for clear gains to all participants to be evident (as in sea transport or telecommunications), before the smaller Pacific island economies are likely to be interested. The notion that regional cooperation may usefully extend beyond the Pacific island economies to include their Pacific rim neighbours, as appears to be the case with aviation, should not be ignored. Aid donors should not make their contributions conditional on a narrow perception of the appropriate area for cooperation. In many areas, tourism and related services for example, the Pacific island economies are really competitors and whilst there may be potential efficiency gains from cooperation, these may be outweighed by the potential losses where conflicts of interest become dominant.
References


The future of Asia-Pacific economies


Strategies to stimulate private sector development in the Pacific island economies

James McMaster

Future economic growth and employment generation in Pacific island economies over the next decade and beyond will be almost entirely dependent on the performance of their private sectors. The implementation of effective programs to accelerate the growth of private sectors is now crucial and the governments are strongly committed to a private sector led growth strategy recommended by the World Bank. The international agencies and donors have expressed strong support for the new emphasis on private sector development.

Over recent years there has been a considerable volume of research undertaken on private sector development issues in the Pacific islands. The strategies discussed in this paper are based on a major regional study on private sector development undertaken by the Pacific Islands Development Program at the East-West Center at Honolulu, Hawaii (Pacific Islands Development Program 1991).

Several aid donors have also recently completed studies on private sector development as groundwork for project identification and formulation. The United States Agency for International Development (USAID) has recently commenced a project called MARC, (Market Access and Regional Competitiveness) and the preparation for this project involved a comprehensive analysis of the constraints to private sector development through commissioned country studies. The Australian International Development Assistance Bureau (AIDAB) undertook a study in November 1991 on options for donor assistance in private sector development in the South Pacific.

Rationale for promoting private sector development

The Pacific island economies have a history of direct government involvement in the production of what are classified by economists as private goods and services. There are a variety of factors which motivate governments to invest in private sector activities. However, the main reason is that the private sectors lack the financial, managerial and technical capacity to develop opportunities and without government investment many new industries would not be established or developed. The access to international expertise and capital provided by the donors and international agencies places governments in a strong position to play the leading role in the development of the productive sectors.

During the 1980s, most aid donors and international agencies were very willing to finance government initiated projects in the main productive sectors which resulted in increased government involvement in design and implementation of numerous projects producing private goods. There was a growing realization that many of these aid assisted government projects were failing to deliver the
Strategies to stimulate private sector development

expected benefits and were not providing a major stimulus to economic growth. Pacific island governments increasingly experienced difficulty in financing further public sector growth. In response to a growing fiscal burden, several governments introduced freezes on public service recruitment and other fiscal measures aimed at reducing or restricting the growth of government expenditure. This situation was exacerbated by the poor performance of most government business enterprises, many of which recorded a continuous stream of annual losses and required annual government subsidies to continue operations.

The experience of the 1980s led many governments to re-evaluate the role of government in the economy. The World Bank, Asian Development Bank and other donors played a major role in promoting privatization programs in the Pacific island economies. At the same time the Pacific island governments sought policy advice and assistance in the formulation of strategies to further stimulate private sector development from the East–West Center, Pacific Islands Development Program. This request led to the regional study on the role of private sector development (Pacific Islands Development Program 1991).

The final report of the Pacific Islands Development Program study provided a sound rationale for the Pacific island governments playing a major role in private sector development, but it recommended a very different approach to past practices. In sharp contrast to the fragmented and uncoordinated approach which currently prevails in most Pacific island economies, characterized by ineffective support programs and excessive business regulations, the PIDP report recommends the implementation of a new, integrated approach requiring strong commitment of government as well as substantial adjustments to microeconomic policies to create a more appropriate business environment. This approach involves a major change in direction in government economic activities: away from the strategy of direct government investment in the establishment of new government business enterprises and aid-funded production projects, towards the implementation of an integrated set of programs. The latter provide direct support to private sector firms to nurture their establishment, growth and entry into export markets. In some cases it involves governments withdrawing from industries where their production activities have crowded-out or reduced the business opportunities of private firms.

An integrated approach

The main components of the integrated approach to private sector development recommended by the Pacific Islands Development Program’s study include a complementary set of policies and government programs which aim to

- increase the supply of development finance to the private sector
- improve the effectiveness of small business advisory services
strengthen entrepreneurial development programs and enterprise support services
- encourage a higher level of staff training and development and promote an adaptable and skilled workforce
- assist the establishment and growth of new firms and small established enterprises
- assist with new technology acquisition and development
- encourage new local and foreign investment in productive enterprises
- assist with export market development
- promote work and management practices which maximize the productivity of existing resources
- contract out the provision of more public services to the private sector
- increase the supply of land for development
- reduce the cost of government services to the private sector
- develop efficient public infrastructure in transport and communications
- introduce measures to increase competition and deregulate markets.

These strategies can be categorized into two groups. The first set of strategies are those that aim to create an enabling economic, social, legal and political environment which is conducive to private sector development. These include appropriate macroeconomic and microeconomic policies which foster private market development, competition and liberalization (business laws, land tenure, employment and social policies as well as measures to provide stability and consistency in the business environment).

The second set of strategies involves the implementation of measures to directly assist the private sector overcome some of the major constraints it faces. These strategies are usually translated into government programs to assist the private sector. These include development finance, export market development, investment promotion, joint venture schemes, small business development, small industries centres and industrial estates, human resource development and technology acquisition.

Constraints to private sector development

Comprehensive country studies undertaken by the Pacific Islands Development Program as part of the Private Sector Project have identified the following as the major constraints.

Access to credit

Shortage of capital is often reported by local entrepreneurs to be their major constraint to further expansion of their business operations or to the establishment of new enterprises. New entrepreneurs often have very little in the way of mortgageable assets to offer commercial banks as collateral for loans to
Strategies to stimulate private sector development

finance new enterprises. The lending conditions of banks are not always on par with the needs of small enterprises.

The high level of bad debt which most commercial banks have experienced in the past with loans to entrepreneurs has caused many of them to be more concerned with gaining adequate collateral than with the viability of the business proposals presented to them in loan applications. On the other hand, development banks in the region have often reported that the shortage of viable investment proposals is more serious than any shortage of funds to finance them.

Very little co-financing (sharing of risk) is done in the region between commercial and development banks. Lessons from experience with small business credit schemes elsewhere in the world, show that co-financing may assist the commercial banks to become more aware of the long-term potential that emerging small businesses represent as future business clients. This experience helps the development banks become more professional in their project appraisal and credit approval mechanisms.

Lack of demand and lack of awareness of business opportunities

Lack of demand is the problem most Pacific island businesses mention after shortage of capital. The small or even tiny size of the domestic market for goods and services limits the scope for new import substitution firms.

Access to export markets for niche products represent the main opportunities for new enterprises. Lack of information about export market opportunities is often an important constraint as these markets are dynamic and identifying opportunities is an expensive process for individual entrepreneurs to undertake.

Lack of skilled labour

Lack of technically skilled workers is a common constraint in Pacific island economies. This problem is exacerbated in Tonga and Western Samoa by the high level of migration of skilled persons. In other economies such as Solomon Islands it is due to the under development of the secondary and post-secondary education system.

Lack of managerial skills

A shortage of managerial skills has been identified in all Pacific island economies as a critical factor constraining private sector development. Many business managers lack training in financial management, basic accounting, financial planning, production management, marketing, cost control, productivity improvement methods, export techniques, insurance matters and human resource management.
Lack of access to production technology

There is inadequate assistance for small businesses to gain access to appropriate foreign technology and a lack of systems for the development of indigenous technology.

Constraints to Pacific entrepreneurship

Studies on indigenous entrepreneurs have identified a number of cultural factors which constrain the development of indigenous business enterprises.

- Structural conformity of traditional island society can inhibit innovative behaviour and stifle the initiative vital to entrepreneurial success.
- The expense of meeting communal commitments from any business profits. Available funds from businesses are often spent on extended family commitments, ceremonial expenses, church contributions, travel and gifts.
- The negative impact of remittance payments on local enterprise. In Cook Islands, Tonga and Western Samoa these are a mixed blessing as they undermine the incentive to work and are rarely spent on productive investment. They are normally used for unproductive ceremonial purposes or on imported luxury consumption items.
- As a result of the historical domination of the business sector by overseas entrepreneurs, it has been hypothesized that the role of the entrepreneur in the Pacific became institutionalized as belonging to foreigners. This has discouraged the development of indigenous entrepreneurs.
- The problem of obtaining land for business development.
- The easy subsistence lifestyle in the Pacific discourages Pacific islanders from taking on the stress and pressures of commercial life, especially when they are required to distribute the rewards of business to their community.

Inappropriate government policies

Studies on private sector development have revealed that inappropriate government policies have been a constraint to small business development. Some serious obstacles to small business identified in recent studies include

- the cost of high tariffs on imported goods, equipment and spare parts
- inappropriate price control
- a lack of industrial units for small business
- poor infrastructure in rural areas
- a lack of support programs or availability of business advice throughout the country
- high tax rates
- the delays in the granting of various forms of government approval
- the impact of restrictive legislation
unwarranted planning restrictions and onerous conditions for obtaining business licences.

The major constraints to private sector development for Pacific island economies are similar. Each economy is at a different stage of private sector development with differing degrees of constraints and differing capacities to address them. For example, Fiji has adopted an export-oriented model of economic development focusing on manufacturing and tourism. This has been accompanied by policy measures designed to deregulate the economy. The major constraints to such an export-led approach include

- Inexperience with the complexities of the larger export markets and lack of market information
- Limited availability of freight space, inflexible shipping, minimum loads, low shipping frequency, limited air cargo space, distance to markets and high freight costs
- Quota restrictions
- High volume market entry levels
- Market difficulty due to product quality and supply.

In contrast, Papua New Guinea’s private sector growth strategy focuses on the further development of the mining industry based on large-scale projects such as the Misima or Porgera Gold Mines and new mines planned for Lihir, Mt Kare and Hidden Valley.

The main constraints to natural resource development are the logistical challenges of the topography which has made it difficult to develop the national road system beyond the most rudimentary connections to sea and airports. The closure in May 1989 of Bougainville Copper Ltd mine, due to land disputes relating to mining operations, has made foreign investors concerned about the potential risks involved in land resource-based projects. The Bougainville mine was one of the world’s largest copper mines providing 35 per cent of Papua New Guinea’s export earnings and 15 per cent of the national budget before its closure.

A major impediment to private sector agriculture has been the low world market commodity prices for exports which have decreased incentives for production. There are few high value agricultural exports or value added products due to lack of local experience and skills. Foreign investment is impeded by the lack of a commercially run ‘one-stop-shop’ for investment approval and an organized system for investment promotion, and the slowness of processing of applications for investment approval and business registration which is exacerbated by lack of clear government policies on foreign investment.

The Kingdom of Tonga provides another example of specific constraints to private sector development.
Recent studies have cited investment as a key ingredient for future private sector growth with assistance needed in investment promotional materials, strategies and the establishment of a specialized agency to assist investors and exporters. There is a need to upgrade management training programs in key private sector areas including tourism and small business.

Other critical constraints include the land tenure system, absence of labour legislation, and shortage of managerial, technical and highly specialized skills and knowledge. There is also a lack of a cohesive government policy to assist the private sector overcome marketing constraints.

In Solomon Islands, the major private sector constraints include: inadequate domestic capital to finance new or expanding business activities, absence of a central agency to promote foreign investment and export market development, difficulties in accessing foreign technical and managerial expertise, inadequate government/business dialogue on issues of critical importance to efficient business operation, heavy reliance on a limited range of low value primary products and difficult access to land for commercial ventures.

Western Samoa faces similar constraints. Its main private sector exports consist of copra, cocoa, taro, bananas and timber. Agricultural production has been constrained by a poor national quarantine service, lack of information on pest control as well as lack of effective advice on hybridization and planting procedures for new high quality/volume commodities. Other constraints include cumbersome regulations, shortage of labour and technical skills, difficulties with the land tenure system with respect to commercial uses and shortage of electrical and water services.

Vanuatu’s private sector development is constrained by outmoded legislation, lack of business skills in local ni-Vanuatu mainly due to deficiencies in the national education system, lack of a ‘one-stop-shop’ for investment promotion and export assistance and a limited range of primary export commodities.

**Strategies to stimulate private sector development**

The most appropriate set of strategies to stimulate private sector development will vary from economy to economy due to the differing priorities of governments as well as the widely varying economic circumstances. Some governments have decided to implement export-oriented growth strategies while others are more concerned with achieving a higher degree of self sufficiency through pursuit of import replacement policies. Some governments are very keen to attract direct foreign investment while others restrict foreign investment to a very limited range of business activities in order to reserve areas of business for local entrepreneurs. There are different attitudes to resource development and utilization particularly in the area of forestry, fisheries and mining. Many governments are now much more concerned about the negative cultural, social and environmental costs of some forms of private sector development. There is increasing concern about the sustainability of some forms of agricultural
Strategies to stimulate private sector development

development which may lead in the longer term to soil degradation and a realization that some subsistence agricultural practices may have environmental advantages. Attitudes towards tourism development also vary widely. Private sector development strategies must take into account that some forms of private sector development are clearly preferred while other forms are to be avoided.

Economic policy for private sector development

A fundamental requirement for sustained private sector development is the provision by government of sound and consistent macroeconomic policy. Policy instruments are required to protect capital and permit repatriation of profits, maintain a stable business environment with an appropriate set of business regulations and secure favourable international trade agreements.

In terms of microeconomic policy, appropriate deregulation measures are desirable to increase competition.

Privatization as a strategy to promote private sector development

A key strategy for stimulating the growth of the private sectors is the implementation of privatization, corporatization and commercialization measures. These activities may be designed to generate new business opportunities for private sector firms through the greater use of contracting out, franchising, vouchers, and other forms of privatization or through the reduction in the cost of public utility services to the private sector. Privatization has been widely accepted by Pacific island governments as an appropriate policy instrument to stimulate private sector development. Despite substantial assistance from the international agencies, however, the actual impact on private sector development has so far been very limited.

The further development of contracting out government functions is the most promising strategy for promoting the growth of private sectors in the Pacific islands. The main areas include

- central government general support services
  - government printing
  - maintenance of government buildings, public housing quarters, schools and hospitals
  - maintenance of government vehicles, plant and equipment
  - office cleaning services
  - road maintenance
• minor construction works
  - alterations and extensions to government buildings
  - rural road construction
  - minor civil engineering works
• major infrastructure construction
  - construction of new roads
  - bridges, airports, ports and buildings
  - industrial estate construction
  - rural and urban infrastructure development.

There is also scope for the greater use of contracting out public services, especially municipal services in urban areas at the local government level. The main functions that offer opportunities for further privatization are

• public works and physical environment
  - solid waste collection (residential and commercial)
  - wastewater and sewerage treatment
• transportation
  - road/street maintenance and repair
  - maintenance of government vehicles and plants
  - construction of new urban subdivision roads
• parks and recreation/cultural and sporting facilities
  - maintenance of recreation facilities
  - operation of sporting complexes
  - park maintenance
• general municipal services
  - buildings and ground maintenance
  - street cleaning and grass cutting
  - legal services
  - urban planning services
  - ambulance services
  - fire prevention services.
Strategies to stimulate private sector development

Private sector absorptive capacity

In most Pacific island economies the capacity of the private sector to purchase and operate the government business enterprises which government may wish to divest is very limited. Several factors need to be considered when assessing the capacity of the private sector to participate in privatization activities.

- The cost and availability of finance to the domestic private sector and the extent to which domestic savings can be mobilized to finance privatization.
- The extent to which private sector entrepreneurs have the managerial skills and access to technical and professional skills necessary for effective participation.
- The extent to which the domestic private sector can provide a competitive environment through which the economic efficiency gains expected to be achieved through privatization can be realized.
- The extent to which the private sector is interested in participating in the different forms and scales of privatization activity.

In considering this last factor it is important to take into account the main characteristics of the small private sectors in the Pacific island economies. In general, the private sectors consist of small firms, with limited access to finance and limited technical and managerial experience. The number of firms in the market for many consumer products is small and competition among domestic producers is limited.

An important lesson that has emerged is the value of adopting a national integrated program in comparison to a piecemeal approach. In most Pacific island economies progress in implementing privatization activities has been slow and few economies have developed a comprehensive program with a specific timetable of activities and performance targets against which to measure achievement.

It is suggested that progress may be accelerated by

- establishment of a national privatization committee
- preparation of a comprehensive privatization program with a specific timetable and performance targets
- assigning responsibility for supervising the implementation of the program to a specific government unit reporting to a key ministry such as Finance and Planning
- enactment of overarching legislation on government business enterprises to assist with the corporatization process (i.e. such legislation as New Zealand's State Owned Enterprises Act and the Government of New South Wales' State Owned Corporations Act 1989)
- linking privatization activities to programs and projects to assist private sector development
- the use of modern program management systems.
A review of overseas experience indicates that the following conditions are necessary for a successful program:

- strong and consistent political support
- clarity of privatization objectives
- choice of appropriate privatization instruments or methods
- linking privatization to an integrated approach to private sector development
- implementing supporting microeconomic reform to create a competitive environment
- careful planning and programming
- provision of effective training and human resource development programs to support corporatization and commercialization strategies
- close monitoring of the impact of corporatization and privatization activities.

Domestic savings mobilization and capital market development

A major restriction to privatization in the Pacific island economies is the availability of finance for the purchase of government business enterprises by the local private sectors. There are two means by which the domestic private sector can acquire ownership of government business enterprises. These are through a privately negotiated sale or through equity participation in the form of a public share issue. There are a very limited number of private local firms in the Pacific island economies that have sufficient capital or capacity to borrow to enable them to directly purchase business enterprises from the governments.

Some innovative approaches are needed to finance Pacific island economy privatization programs. Aid donors could assist by providing funds to the development banks for lending for privatization and corporatization activities. Also, it may be possible to direct funds from the National Provident Funds into the acquisition of equity for corporatized public utilities.

Conflicts in the objectives of privatization

Most Pacific island economies have a variety of different objectives for their privatization programs. Situations have arisen where some of the objectives are in clear conflict and as a consequence the benefits of privatization activities may be reduced from those originally anticipated.

For example, in financially difficult times an overriding goal of privatization is often the reduction of the size of the government deficit through the quick sale of government business enterprises. This may clash with the basic rationale for privatization, enhancement of efficiency. Experience over the past decade in developing economies has shown that often only the more profitable
Strategies to stimulate private sector development

government business enterprises are able to be sold as these are the most attractive to private sector buyers. In many cases they have been sold at prices well below their real asset value to a small group of wealthy entrepreneurs. This practice conflicts with another privatization objective of broadening the base of share ownership by the general public. Privatization can sometimes result in a further concentration of ownership of business enterprises by a small elite group of entrepreneurs.

In other cases, privatization has resulted in the sale of government enterprises in monopoly situations to foreign-owned companies. This conflicts with the objective of using privatization as a means of accelerating the development of the local business community and broadening its base. A government owned monopoly is simply converted into a foreign-owned monopoly with potential to exploit its market power.

Corporatization and commercialization

Several Pacific island governments are currently implementing a range of reforms designed to improve the efficiency and effectiveness of their government business enterprises and particularly their public utilities. These involve the corporatization of public utilities and government business enterprises and the introduction of commercialization measures. If these reforms are successful, they will lead to the more efficient provision of services at a lower cost to consumers, including private sector firms. Such cost savings may result from withdrawing the provision of certain uneconomic services, using new cost-effective production methods and technologies, introducing better systems of cost control, contracting out some services that have been provided in-house, and obtaining production input from cheaper sources.

Corporatization means to reorganize a government business enterprise so that, as far as possible, it emulates private sector behaviour. This places the government enterprise on a commercial footing, while retaining government ownership.

Government organizations which have been corporatized are often required to undertake very substantial changes to their entire mode of operation as well as radical changes to their organizational structure and climate.

A key issue for Pacific island governments is the selection of appropriate public organizations for corporatization. The enterprises commonly considered as eligible for corporatization are distinguished from other parts of the government because they sell goods and services directly to the public. Much of their revenue is obtained from sales which bear some relationship to costs of production. These parts of public sector contrast to government activities which are financed out of taxation revenue rather than specific user charges.

In almost all cases, these sections of the public sector are producing what economists define as private goods rather than public goods. Private goods are
distinguished from public goods, in that private firms are willing to supply and sell them directly to consumers. In contrast, pure public goods will not be produced by the private sector because there is no practical method available to charge individual consumers for them. Examples include, national defence, police services, streets and footpaths, street lighting, environmental protection regulation.

The enterprises which are eligible for corporatization are variously referred to as government business enterprises, state owned enterprises and public trading enterprises.

Applying this definition in broad terms to the Pacific island economies, organizations which could be considered eligible for corporatization include

- electricity authorities
- water and sewerage boards
- civil aviation authorities
- posts and telecommunications
- broadcasting, radio and television
- fishing authorities
- urban land and housing agencies
- government shipyards
- government finance and insurance organizations
- government fleets of ships.

In most Pacific island economies, government business enterprises are a major component of the economy in terms of assets and resource utilization. In many cases they receive substantial annual subsidies from the government budget, and operate in a protected environment without the stimulus of competition.

There has been a considerable amount of speculation about the potential benefits of corporatization of government business enterprises in the Pacific island economies. To date, the number of Pacific island public organizations which have been corporatized is small and it is too early to evaluate the benefits.

In general, the benefits claimed to arise from corporatization are

- a reduction in employee numbers and a resultant increase in labour productivity
- improved customer service
- use of better, up-to-date technology
- decreases in real terms of average prices for various goods and services
- increased profits and returns to the government as a shareholder
- increased competition.
While there are likely to be substantial benefits to the Pacific island governments from corporatization there are also likely to be social costs. Experience has demonstrated that most corporatized organizations quickly implement measures to reduce their operating costs, often resulting in a sharp reduction in the number of employees. In social terms, this may represent a cost if those workers retrenched are unable to find other means of employment.

Also, in some situations, newly corporatized organizations need to revise their pricing policy in order to generate sufficient revenue to earn a satisfactory rate of return on capital. This may result in substantial increases in charges, tariff rates, or prices to consumers. Many public utilities in the Pacific islands have not implemented pricing policies designed to recover operating and capital costs fully. In many cases the prices charged have represented a high level of subsidy. Cross-subsidization has also been common, particularly with regard to the subsidization of rural services by urban consumers and commercial users.

Role of government in promoting private sector development

Perhaps the most important role for government is to put in place a set of microeconomic policy measures to simplify business regulation, encourage foreign investment and support export development. There is also a major role for government in coordinating, strengthening and improving the delivery of programs which directly support the establishment and development of small business and local entrepreneurs. There is also merit in allocating responsibility for the planning and coordination of all government programs designed to assist private sector development to a single government authority, and in adopting a one-stop-shop approach to the delivery of services to the private sector, rather than the current practice of fragmenting these responsibilities across a range of ministries and agencies.

Private sector development strategies and aid donor assistance

Most of the aid donors to the Pacific island economies have expressed a strong desire to increase the proportion of their assistance directed to private sector development. Their rationale is based on the assumption that it is likely to be more effective in stimulating economic and employment growth than the alternative uses of the aid resources. This argument can be supported by an analysis of the disappointing low or negative rates of return on foreign aid projects involving government implementation of production activities mainly focused in agriculture, fisheries and forestry. The channelling of foreign aid through the government sector has frequently resulted in it being allocated to fund capital investment projects in the productive sectors identified and proposed by government departments. Many of these projects have been formulated from a government perspective and have involved inadequate consultation with the private sector, including the main clients or stockholders.
for whom the projects are designed. Given the implementation record and generally disappointing performance of these types of foreign aid projects over the past two decades, it is understandable that donors are keen to explore more direct means for accelerating private sector development. A summary of some of the main areas where foreign aid donors could play a major role in assisting Pacific island governments develop their private sectors, through the implementation of an integrated approach as recommended by the Pacific Islands Development Program, is given here.

Advice on private sector development plans and programs

As yet, most Pacific island economies have not adopted an integrated approach to private sector development. At present, many programs and projects designed to assist private sector development tend to be uncoordinated and in some cases considerable duplication and fragmentation exists. The Pacific Islands Development Program is currently assisting Tuvalu formulate an integrated private sector development program. There is clearly a need for technical assistance from the donor in the formulation of such programs, a demanding task requiring a broad range of technical expertise.

The formulation of an integrated private sector development program may involve specifying the following in some detail.

- A realistic set of private sector development objectives expressed in quantitative terms with clear performance criteria and time-frame.
- A detailed implementation strategy designed to achieve the specified private sector development objectives, outlining the roles and responsibilities of the public and private sector agencies in the implementation process.
- An integrated set of projects designed to stimulate private sector development directly and specifically targeted at alleviating the main constraints to private sector growth.
- A complementary set of policy measures and reforms designed to stimulate private sector growth including proposals for deregulation and privatization.
- A financial plan indicating expected sources of funds including loan funds, grants and revenue to be raised through the application of user charges for the provision of services and the projected annual budgets and implementation schedule for the private sector development program, phased over a ten year period.
- An implementation chart and detailed network analysis of the steps and activities involved in the implementation of the plan. This should include a systems chart showing the relationships and lines of responsibility of the various private and public sector agencies involved in the program.
Strategies to stimulate private sector development

- An institutional development plan for each of the major public agencies involved, such as the development banks, the investment promotion agency and national small business centres.

It is considered desirable that the private sector be widely consulted and adequately represented in the formulation of a private sector development plan as well as be represented on the board of the agency selected to coordinate the implementation of the plan.

Advice on appropriate policy to support private sector development

International agencies have engaged in considerable policy dialogue to encourage Pacific island economies to implement microeconomic reforms, eliminate unnecessary regulation of business activity and to adopt appropriate macroeconomic policies. There is a continuing need for external technical expertise to assist in the design and implementation of economic policy reforms such as taxation reform, tariff policy and revision of business regulations.

Development finance

The efficient provision of credit to small business enterprises is an essential element in an integrated private sector program. The development banks play a key role in small business credit provision and there is now a need for further institutional strengthening of the development banks through a process of staff development. Technical assistance is also needed to design a new approach to micro-loans based on the Grameen Bank concept (Rahman 1990).

The development of high quality training, based on a comprehensive needs analysis, will require a substantial resource commitment, which may be too expensive for individual banks to undertake. This is due to the initial high cost of developing the training systems including curriculum design, development of training manuals, audio visual training aids, computer based exercises, self-instructional learning packages and video tapes.

There may also be educational advantages for some training to be undertaken at regional level to allow for interaction among participants from the different banks. A regional approach may be particularly valuable for senior managers as well as being a cost-effective means of delivering high quality training to a small group of participants.

This proposal could be implemented by Association of Development Finance Institutions in the Pacific (ADFIP) through its headquarters in Suva. ADFIP is already playing a valuable role in assisting the development banks. Some regional level training is also undertaken by ADFIP, such as the Project Appraisal Training Course for loan officers and the Management Development Training Workshop for senior and middle level management and their staff attachment.
The evaluation of alternative regional approaches to delivery of extension services will identify the most cost-effective strategy and could lead to the development of a model approach for other development banks.

The development of research capability is yet another area where substantial advantages could be achieved by adopting a regional approach. There is a large degree of commonality in the topic areas the banks have identified as high priority for research. The integration of the research programs of the individual banks into a regionally coordinated program could lead to avoidance of duplication, and the enrichment of each bank’s own program through cross-fertilization of methodology and research findings as well as providing a regular forum for interchange of information and expertise. The international agencies could play a leading role in the design and delivery of a program aimed to strengthen the research capacity of the development banks.

The commercial banks could play an expanded role in lending to private enterprises and there is a need for the development of co-financing schemes with the development banks to share the risks associated with lending to the small business sector. The development of credit guarantee schemes, with donor assistance, could provide greater encouragement to the commercial banks to lend to small business.

**Export market development agencies**

The World Bank has recommended that the larger Pacific island economies should adopt an export-oriented approach to private sector development in preference to the more inward looking import replacement strategies which have so far been common.

The adoption of an export-oriented approach has been successfully introduced in Fiji and Tonga. The Fiji Trade and Investment Board has played a major role in providing one-stop-shop services to export firms especially since the introduction of the Tax Free Factory Scheme. There is a need to develop similar agencies in most other Pacific island economies. Donors could play a major role in this institution building as they have done so for the Fiji Trade and Investment Board.

There is a need to establish a regional network of agencies involved in the promotion of export activities under the Forum Secretariat’s Trade and Investment Division. A Pacific Island Development Program study has recommended the establishment of an integrated Pacific Islands Trade Commission with the focal point at the Forum Secretariat in Suva and a network of telecommunications/satellite/ electronic mail links to the established trade offices in Sydney and Auckland and suggested new offices in Tokyo, Vancouver, Hong Kong and Brussels. The network could be integrated with the newly established Joint Commercial Commission at the Pacific Island Development Program, East-West Center in Honolulu as well as the South Pacific Investment and Trade Service in Washington, DC in the United States (Thomson 1989).
Strategies to stimulate private sector development

Investment promotion

Many Pacific island economies have implemented policy instruments such as generous tax incentives to encourage appropriate direct foreign investment in new business enterprises as well as joint ventures. Not all, however, have been successful in attracting productive foreign investment to create real economic growth and generate employment.

Development of small business advisory agencies

The provision of demand-oriented support services to small businesses is seen as a major policy instrument for accelerating the growth of the private sector. Most Pacific island economies do not have a strong national institution to plan and coordinate the delivery of a range of support services to small businesses and there is a need to develop them.

Entrepreneurial development programs

Another Pacific Islands Development Program report has recommended the implementation of a regional small business development networking project to link all the national small business development institutions and programs to a central regional facility based at the University of the South Pacific and linked to the ten University of the South Pacific centres (Briscoe et al. 1989). This would enable the sharing of information and gaining of economies of scale in the production of high quality training material such as the International Labour Office's Start Your own Business/Improve Your Own Business Training System, as well as to disseminate a range of information on the findings of research, lessons from economy experiences, and franchising opportunities.

Development of small industries and industrial estates

Small industry centres, such as the Tongan centre, can provide an effective stimulus for new enterprise development. The establishment of incubator centres in each of the Pacific island economies could provide impetus and a focus for small business development. In some Pacific island economies, the incubator centre could provide an ideal location for the establishment of a small business advisory bureau as well as a location for conducting entrepreneurial training.

The case for government involvement in industrial estate development relates to its advantage in the ability to accumulate land through compulsory acquisition, the authority to rezone land and the power to plan and execute the provision of all the public sector infrastructure services.

The development of well planned and located industrial estates with the right mix of infrastructure and technical support services is a complicated exercise.
requiring the professional services of a range of experts in areas such as civil engineering, urban planning, environmental planning and financial analysis.

Most Pacific island government ministries do not have the necessary professional expertise to undertake industrial estate development without the services of foreign technical assistance. In most cases, international agencies could play a valuable role in providing such technical assistance as well as loan or grant funds to support the development of industrial estates.

Well planned industrial estates can overcome a major problem for small enterprises by providing suitable factory buildings at reasonable rental rates. Also, industrial estate development can enable the government to provide a range of ancillary support services to businesses located at the estate efficiently. In comparison, dispersed industrial development of factories in widely scattered locations in urban areas can increase the cost of providing support services. Centralizing small manufacturing enterprises on an estate enables economies of scale to be gained in the provision of a range of support services.

Training in business management, finance and marketing for small business

A substantial amount of aid resources are allocated to human resource development, education and training. Only a small proportion of this assistance, however, is specifically targeted at providing practical in-economy, on-the-job training in the essential skills necessary for small business operation. The International Labour Office has played a leading role in the development of small business training systems for Fiji. The International Labour Office approach should now be extended to all other Pacific island economies. This will involve a considerable allocation of aid resources and provides an opportunity for donors to join together to co-finance the regionalization of a project.

Technology acquisition and development assistance

The transfer of appropriate technology can occur through work placements in overseas firms, through short-term attachments of experts to local firms or by schemes such as the Australian Executive Service Overseas Program. The outreach of current schemes is, however, limited and many small businesses are operating with antiquated technology and poorly organized production systems. New schemes to assist with the transfer of appropriate technology to small firms are recommended for aid funding.

Tourism development

Tourism in the region has received valuable assistance from the external agencies in recent years, especially since the establishment of the Tourism Council of the South Pacific, based in Suva.
Strategies to stimulate private sector development

Nevertheless, given the importance of the tourism sector to the overall development of the private sectors of most South Pacific economies, a substantial increase in assistance to tourism is now warranted.

There is a substantial requirement for expansion of training activities to meet the workforce needs of the growing tourism industries in Pacific island economies. Increased training effort is needed across all levels from senior management to junior staff. Briscoe et al. (1989) identify the need to provide specialized entrepreneurial training specifically designed for local entrepreneurs to establish small-scale tourist resorts and to support service businesses.

In terms of investment promotion, one approach is to establish joint private sector–public sector tourism development corporations responsible for planning, promoting and managing tourism investments in new resorts and support businesses. Aid donor joint venture schemes, such as the Australian Joint Venture Scheme, could participate with the national tourism development corporations to provide funding for development of corporation–government equity in new investment projects.

The development banks could also provide loan funds to support joint venture, foreign and local partnership projects sponsored by the development corporations. External agencies could play a valuable role in assisting the institutional development of the proposed development corporations, through providing technical assistance during the establishment phase, staff development training assistance, assistance with design and delivery of investment promotion material, and financing of local equity in tourism joint venture projects.

There is a need for the preparation of integrated national tourism master plans including implementation strategies. It is desirable that the location of new resort facilities is planned and coordinated at the national level.

Support for privatization programs

The international agencies and donor community have been active in assisting Pacific island economies implement projects to privatize and commercialize government business enterprises. Continued assistance in planning and managing this process is warranted. A greater use of contracting out by government as well as privatization of government business enterprises will provide a stimulus to private sector development. Support of privatization is part of an integrated approach to private sector development. The pattern of past and current external assistance to the private sector is summarized (Annexes 1 and 2).

Although there appears to be a wide range of assistance available, the real level of foreign aid which directly supports private sector and small business development is relatively small in comparison with overall external assistance.
In comparison to small business development, medium-scale business development is relatively well catered for, especially since the establishment of the South Pacific Project Development Facility. The Facility assists those starting new businesses in the preparation of bankable projects and identification of sources of finance and/or joint venture partners. It also provides management and export marketing advice.

The implementation of an integrated regional approach to private sector development provides a significant opportunity for donors to join together to co-finance a set of linked projects. Many of these projects could be included in country programs while others would be more appropriate as regional projects due to the economies of scale and regional network advantages.

**Annex 1**

**External assistance matrix**

The information in this matrix was compiled in February 1992, for the United Nations Development Program, Suva Regional Office. Most of the donor programs designed to provide assistance to the private sector are categorized here, in order to give an overview of the magnitude and direction of the allocation of resources.

**Categories of assistance to private sector development**

1. Assistance with private sector development policy.
   1.1 Advice on private sector development plans and programs.
   1.2 Advice on appropriate microeconomic and macroeconomic policy to support private sector development.

   2.1 Development finance institutions.
   2.2 International Finance Corporation South Pacific Project Facility Support Scheme.
   2.3 Asian Development Bank.
   2.4 Provision of micro-loans.
   2.5 Role of commercial banks and credit guarantee schemes.
3 Export market development.
   3.1 Export market development agencies.
   3.2 Information on overseas markets, market research, market niche identification and market feasibility assessment.
   3.3 Trade promotion programs.
   3.4 Trade promotion displays and trade fairs.
   3.5 Assistance with identification of foreign agents, export processes.
   3.6 Assistance with industry standards, packaging, labels, promotion and advertising for export markets.
   3.7 Training in export market procedures, quality control, packaging.
   3.8 Export credit insurance advice.

4 Investment promotion.
   4.1 Development of investment promotion institutions.
   4.2 Investment promotion programs.
   4.3 Joint venture schemes.

5 Enterprise support organizations, small business advisory agencies.
   5.1 Development of small business advisory agencies.
   5.2 Entrepreneurial development programs.
   5.3 Assistance with business plans and feasibility studies.
   5.4 Support for industry associations.

6 Development of small industry centres and industrial estates.
   6.1 Industrial estates, small industry centres.
   6.2 Incubator centres, nursery factory schemes.

7 Training in business management, finance and marketing for small and medium scale industry.
   7.1 Staff training assistance, on-the-job training, counterpart training.
   7.2 Assistance with preparation of industry training material, training systems, manuals, self instructional materials.
   7.3 Training of trainers.
   7.4 Overseas training, fellowship attachments in industry.

8 Technology acquisition and development assistance.
   8.1 Assistance with manufacturing technology transfer, technology development assistance schemes.
   8.2 Product development assistance and new product development.
   8.3 Plant layout and manufacturing productivity improvement for established firms.
9 Support for privatization programs.

10 Main areas of unmet need, comparison of needs with assistance currently available.

Annex 2

Review of aid funded programs to support private sector development (A list of aid projects/programs designed to assist private sector development by category)

1 Assistance with private sector development policy.
   1.1 Advice on private sector development plans and programs.
   - The Pacific Island Development Program—Asian Development Bank project on the Role of the Private Sector in the Pacific Islands Phase 1 Final Report was completed in June 1991. Phase 2, involving the preparation of country programs for private sector development, has commenced with a study for Cook Islands. Additional aid funds are required at this stage to support the preparation of implementation plans for private sector development programs in specific Pacific island economies.

   1.2 Advice on appropriate microeconomic and macroeconomic policy to support private sector development.
   - The World Bank and the International Monetary Fund have provided policy advice on appropriate macroeconomic and microeconomic and trade policies to stimulate more rapid growth of the private sectors.
   - The Asian Development Bank has provided financial assistance to the Pacific Island Development Program to fund the study on the role of the private sector in Developing Member Countries. Also the Asian Development Bank has provided a regular flow of policy advice and technical assistance on strategies to promote private sector development as well as privatization, corporatization and commercialization strategies.
   - The international agencies such as United Nations Development Program and aid donors have provided advice to Pacific island economies on appropriate economic policy measures to create an enabling environment for private sector development. Key policy areas include monetary and fiscal policy, exchange rate policy, deregulation of labour markets, taxation reform, reduction of tariffs...
and price controls, development of the financial sector, public enterprise reform and privatization measures, policies with respect to repatriation of profits and capital as well as the legal and regulatory framework.

- United States Agency for International Development has provided policy dialogue under the MARC Project and short term technical assistance is available to participating countries to assist with the creation of an enabling environment for private sector development.

2 Development finance.

2.1 Development finance institutions.

- Development banks in the region have continued to receive the support of donors for institutional development. For example, New Zealand has provided the following; US$600,000 (Fiji); US$780,000 (Tonga) and US$100,000 (Solomon Islands). The Asian Development Bank has played an important role in strengthening the development finance institutions through training, equity investment, loans and underwriting.

- The Association of Development Finance Institutions (ADRP) in the Pacific is playing a valuable role in assisting the development banks with staff training and institutional building through staff development. Some regional level training is being undertaken under ADFIP such as
  
  - project appraisal training course for loan officers of development finance institutions held in Tonga, 15 July–9 August 1991, twenty participants
  
  - management development training workshop for senior and middle level management for 2 weeks in October 1991, funded by Australian International Development Assistance Bureau (AIDAB)
  
  - staff attachment, assisted by Australian International Development Assistance Bureau
  
  - proposed activities include an economic development project managers conference and training managers conference

  Additional funding is now required to support an expanded training program as well as secretariat functions.

2.2 International Finance Corporation, South Pacific Project Facility Support Scheme.

The South Pacific Project Facility Support Scheme, established in 1990, is based in Sydney and operated by the International Finance Corporation, an affiliate of the World Bank. The overall objective of the South Pacific Project Facility Support Scheme is to initiate and accelerate the development of private enterprises. It provides technical
assistance during the implementation and start-up phase of enterprises, advice on export marketing, and sponsors special training programs to develop entrepreneurial skills. The South Pacific Project Facility Support Scheme assists in promoting projects ranging from tourism, general engineering and chemical processing, fabrication, fisheries, forestry and agribusiness through processing, distribution and manufacturing.

The South Pacific Project Facility Support Scheme normally supports projects requiring investments ranging in size from US$250,000–US$5 million, but there is some flexibility on these limits and discussions have taken place on lowering the limit to US$100,000.

The services of South Pacific Project Facility Support Scheme include

- assistance to entrepreneurs in the formulation and screening of project ideas
- provision of guidance and technical consulting services
- assistance to firms in identifying and obtaining appropriate technical and managerial personnel
- assistance in the selection of partners and sources of equity and loan finance on appropriate terms
- advice to foreign investors or financial institutions on investment opportunities and possible local partners
- advice to local entrepreneurs interested in acquiring local companies from foreign shareholders or in buying equity in public enterprises which are being privatized
- advice to entrepreneurs on export marketing of their products
- sponsorship of training programs to develop entrepreneurial skills
- location and provision of technical assistance on project implementation and the start-up of new firms
- advice and assistance to governments in the privatization of selected public enterprises

New Zealand has agreed to commit US$500,000 at US$100,000 per year for five years. Australia has authorized A$600,000 for the first five years of operation for the benefit of the seven Pacific island members of the World Bank.

2.3 Asian Development Bank.

- Asian Development Bank loan assistance to private sector projects, US$2m + equity US$0.1m–US$5m, up to 33 per cent project costs for small projects and up to 25 per cent shareholding.

2.4 Provision of micro-loans.

- Siwatibu in the UNDP Report on consultations with Pacific Governments suggests that the Grameen Bank concept needs to be
Strategies to stimulate private sector development

evaluated to see if it is workable in a Pacific island context. This form of bank has worked very well in Bangladesh and similar banks are being established in South and Southeast Asia. Individuals from the lower end of the income spectrum collectively own Grameen Banks and they impose discipline upon each other resulting in excellent loan recovery.

- Small project funds. A number of donors make available funds to support small scale projects. New Zealand, for example, has a small projects fund which aims to promote the development of private sector village and community projects such as fishing ventures, poultry production and other small businesses.

2.5 Role of commercial banks and credit guarantee schemes.
The Pacific Island Development Program's study on private sector development has recommended the Pacific island economies introduce credit guarantee schemes to provide risk coverage to the commercial banks to encourage them to lend a higher proportion of their portfolio to private sector business enterprises. Such schemes could be supported by the aid donors.

3 Export market development.
3.1 Export market development agencies.
- Forum Secretariat, Trade and Industry Division.
- Fiji Trade and Investment Board.
- Papua New Guinea Investment Promotion Authority (IPA).
- Joint Commercial Commission (USA-Pacific islands).

3.2 Information on overseas markets, market research, market niche identification and market feasibility assessment.
- Forum Secretariat, Trade and Industry Division. This division implements a range of programs to support export market development for the forum island countries.
- Fiji Trade and Investment Board. The Trade and Investment Information Centre provides a comprehensive range of services to foreign investors.
- Assistance is to be selectively provided under the United States Agency for International Development MARC Project.
- Joint Commercial Commission (United States-Pacific islands). This commission provides assistance with trade and investment with the United States. An important part of its mission is promotion of Pacific island economies' exports.
- International Finance Corporation South Pacific Project Facility Support Scheme in Sydney.
- Singapore's Globalink Trade and Investment Information system, annual cost US$60,000.

3.3 Trade promotion programs.

- Forum Secretariat, Trade and Investment Division. Main programs include
  - Forum Island Countries Marketing Support Fund, 1992 budget F$120,000
  - ASEAN Trade and Investment Mission 1992, budget F$50,000
  - an ASEAN business delegation will visit a number of Forum island countries to gain knowledge of trade and investment opportunities
  - Forum Island Countries' Industry Investigations, 1992 budget F$60,000, identification of business opportunities in forum island countries. In 1991, these included study of export oriented garment manufacturing in Tuvalu, export cutflower industry development in Western Samoa and Tonga and an evaluation study on Fiji's garment industry

- International Trade Centre UNCTAD-GATT. Members of International Trade Centre include Fiji, Kiribati, Papua New Guinea, Solomon Islands, Tonga, Tuvalu, and Western Samoa.

- Assistance is to be selectively provided under the United States Agency for International Development MARC Project.

- New Zealand Trade Office for the South Pacific. This office was established in 1988 in Auckland to promote Pacific islands business in New Zealand.

- Australian Trade Office for the South Pacific. This office was established in 1979. In 1990 its operating budget was A$510,000.

3.4 Trade promotion displays and trade fairs.

- AIDAB supports trade promotion displays under the Developing Countries Trade Assistance Program (DCTAP) at trade promotion centres in Sydney and Melbourne and participation in the International Cooperative Alliances Trade Exhibition in Sydney.

- Forum Secretariat, Trade and Investment Division 1992 South Pacific Trade Exhibition, Japan, budget F$65,000.

- APEC Working Group on Trade Promotion, Asia-Pacific Trade Fair. This is a long term project which is hoped will stage a fair that is original in concept.

- Economic and Social Commission for Asia and the Pacific (ESCAP) International Trade and Tourism Division offers assistance in trade promotion development.
Strategies to stimulate private sector development

- International Trade Centre UNCTAD–GATT offers assistance in trade promotion development.
- United States, Pacific island Nations Joint Commercial Commission offers assistance in trade promotion development.

3.5 Assistance with identification of foreign agents, export processes.
- Assistance is to be selectively provided under the United States Agency for International Development MARC Project.
- International Finance Corporation South Pacific Project Facility Support Scheme in Sydney.
- Joint Commercial Commission, (United States–Pacific islands) assistance with trade and investment with United States.
- Forum Secretariat, Trade and Investment Division.

3.6 Assistance with industry standards, packaging, labels, promotion and advertising for export markets.
- Assistance is to be selectively provided under the United States Agency for International Development MARC Project.
- Forum Secretariat, Forum Island Countries’ Industries Development and Training Scheme, 1991–93, 1992 budget F$257,000. This scheme aims to facilitate development assistance to the manufacturing and processing industries of the forum island countries in an effort to help their capabilities for export. This facility located at the Forum Secretariat will meet the requests from forum island countries’ governments for short term assistance.

3.7 Training in export market procedures, quality control, packaging.
- Assistance is to be selectively provided under the United States Agency for International Development MARC Project.
- Forum Secretariat, Trade and Investment Division, conducts sub-regional workshops on exporting fresh produce to Australia and to New Zealand, 1991. These workshops covered packaging, distribution, shipping, air freight matters, post harvest requirements, cool storage, quarantine issues and quality control issues.
- International Finance Corporation South Pacific Project Facility Support.
- Commonwealth Fund for Technical Cooperation Export Market Development Program.

3.8 Export credit insurance advice.
- Commonwealth Fund for Technical Cooperation Export Market Development Program.
4 Investment promotion.

4.1 Development of investment promotion institutions.

Institution building, human resource development, systems development.

- Fiji Trade and Investment Board has received assistance from a number of donors including UNIDO Project DPFU88009, Assistance to Industry through Fiji Trade and Investment Board, Expenditure US$416,000.

- Assistance is to be selectively provided under the United States Agency for International Development MARC Project.

- Papua New Guinea Investment Promotion Authority (IPA), a newly established statutory body whose joint board function is central to the government’s private sector economic reform strategy.

- There is a need to develop appropriate one-stop-shop investment and trade promotion institutions in most Pacific island economies. Under the MARC project a trade authority is planned to assist with the design of an appropriate agency for Vanuatu.

4.2 Investment promotion programs.

- Investment promotion policy development.

- Foreign investment promotion.

- Assistance is to be selectively provided under the United States Agency for International Development MARC Project.

- Joint Commercial Commission, (United States–Pacific islands).

- International Finance Corporation South Pacific Project Facility Support Scheme. Services include investment promotion, the formulation and screening of project ideas, the selection of partners and sources of equity and loan finance on appropriate terms.

- Investment missions assisted by the United States Agency for International Development MARC Project.

- Local investment promotion. The development banks play an important role in promoting investment projects with indigenous entrepreneurs. Some development finance institutions undertake project identification, formulation and feasibility studies on potential new projects and provide the information to local entrepreneurs.

4.3 Joint venture schemes.

- Australian Joint Venture Scheme (JVC) provides local equity capital for joint ventures with Australian companies.

- New Zealand’s Pacific Islands Industrial Development Scheme. Forecast 1991–92 budget: NZ$500,000. This scheme can provide support for up to 50 per cent of local equity capital for the Pacific
island partner in a joint venture with a New Zealand enterprise with a grant of up to a maximum of NZ$50,000.

- Centre for the Development of Industry (CDI) acts as a liaison between joint venture operations with Asia–Caribbean–Pacific companies and European Community partners.

- Assistance is to be selectively provided under the United States Agency for International Development MARC Project.

5 Enterprise support organizations, small business advisory agencies.

5.1 Development of small business advisory agencies.


Objectives: to achieve better coordination of the assistance provided to small businesses throughout Papua New Guinea and to improve the quality of assistance and counselling for small business. This involves support in the development of a Small Business Development Corporation to carry out research, develop information, arrange financial assistance and training for clients and develop the managerial skills of its staff and the staff of the provincial arms, the provincial small business agencies.

- New Zealand overseas development aid to small business in Tuvalu.

Objectives: to promote private sector development in Tuvalu through assistance to the Business Development Advisory Bureau (BUDAB).

Provision of cash grants to the Bureau.

New Zealand overseas development aid expenditure

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>NZ$</td>
<td>NZ$186,000</td>
<td>NZ$60,000</td>
<td>NZ$100,000</td>
<td></td>
</tr>
</tbody>
</table>

- United Nations Industrial Development Organization assistance to the Business Development Advisory Bureau, Tuvalu, project DPTUV88004, Expenditure US$63,000.

- Assistance for Institution Building for Industrial Promotion project DPPNG86002 in Papua New Guinea, 1987–92, total expenditure: US$1,928,000.
5.2 Entrepreneurial development programs and small business development.

- **Regional programs**
  According to a survey conducted by the United Nations Development Program, 100 per cent of forum island country governments need assistance in the implementation of entrepreneurship development programs.

  **Project title:** Industrial Development and Training Project.
  **Implementing agent:** Forum Secretariat, Trade and Investment Division, Suva, starting date, 1991.
  **Aim:** To establish an ongoing support scheme at the Forum Secretariat to facilitate development assistance to the manufacturing and processing industries of the forum island countries in an effort to help develop their capabilities for export. Japanese trust cost-sharing: US$300,000.
  The industrial development and training project will provide a continuous interface with UNDP funded national projects for small scale industries.

  **Project title:** Start Your Own Business (SYB)/Improve Your Own Business (IYB).
  **Implementing agent:** International Labour Office.
  **Aim:** Franchising and supervisory development for small entrepreneurs. Current system in Fiji should be extended regionally

  **Project title:** Small and Medium-Scale Industry and Entrepreneurial Development in Pacific Island Countries.
  **Implementing agent:** United Nations Industrial Development Organization.
  **Number:** UNIDO RAS/86/075.
  **Aim:** To identify technical and commercially viable opportunities in small and medium scale industries, upgrade the capabilities of existing industries and provide assistance in enhancing government capability to promote small and medium scale industries. The Project also aimed to upgrade management, production, marketing and other business capabilities of small and medium scale enterprises. This project completed activities in 1989.

  The Economic and Social Commission for Asia and the Pacific (ESCAP), organizes entrepreneurial development skills programs. International Finance Corporation South Pacific Project Facility Support Scheme functions include sponsoring training programs to develop entrepreneurial skills.

 305 Pacific Islands at the crossroads?
Strategies to stimulate private sector development

- **Country programs**

  **Tonga**
  
  
  *Implementing agent:* United Nations Development Program.
  
  *Number:* TCN/86/002/A/01/37.
  
  *Location:* Ministry of Labour, Commerce and Industry.
  
  *Aim:* To establish an Industrial and Business Advisory unit, counterpart training and development of policies and programs to stimulate the growth of the industrial sector, especially small industries.

  **Vanuatu**
  
  *Project title:* Development of ni-Vanua tu Entrepreneurs, Executives.
  
  
  *Number:* VAN/92/001.
  
  *Starting date:* March 1992.
  
  *Aim:* This project focuses on training led business development, the human resource development side of developing entrepreneurs. The project aims to create 40 new ni-Vanua tu businesses over the next two years.

  *UNDP contribution:* US$536,000

  *Project title:* Establishment of ni-Vanua tu Small and Medium Scale Industries.

  *Implementing agent:* United Nations Development Program.
  
  *Number:* UNIDO DPVAN88004.
  
  *Budget:* US$324,000.

  **Solomon Islands**
  
  *Project title:* Promotion and Development of Small and Medium-Scale Industries.

  *Implementing agent:* United Nations Development Program.
  
  *Number:* UNIDO DPSO188002.
  
  *Budget:* US$801,000.

  *Aim:* This project was completed in April 1991. It focused on foreign investment, institutional support for the Ministry for Trade Commerce and Industry, particularly the Foreign Investment and Industrial Development Unit and extension services to enterprises and entrepreneurs.
Project title: Promotion and Development of Small and Medium-Scale Industries Phase 2.
Implementing agent: Ministry of Commerce and Primary Industry, Foreign Investment and Industrial Development Unit
Number: UNIDO SOI/90/007 IPF.
Budget: US$692,000.
Duration: two years.

Papua New Guinea
Implementing agent: United Nations Development Program.
Number: DPPNG86002.
Budget: US$1,928,000.
Aim: To establish capability in the Department of Trade and Industry for industrial planning and policy analysis, identification, evaluation and promotion of industrial projects and preparation and implementation of small and rural industry development programs.

Federated States of Micronesia
Proposed project title: Creation of Micronesian Entrepreneur Development Centres (MEDC).
Project title: Small Scale Industries Development in the Federated States of Micronesia.
Implementing agent: United Nations Development Program.
Number: UNIDO TTP/89/200.
Budget: US$310,000.
Starting date: April 1992.

Tuvalu
Project title: Assistance to the Business Development Advisory Bureau.
Implementing agent: United Nations Development Program.
Number: TUV/88/004/A/01/37.
Budget: IFP US$36,250.
5.3 Assistance with business plans and feasibility studies.

- Canadian International Development Agency (CIDA), Business Co-operation Program, provides assistance with feasibility studies.

- Assistance is to be selectively provided under the United States Agency for International Development MARC Project.

- Pacific Islands Industrial Development Scheme (PIIDS) New Zealand forecast 1991–92 budget: NZ$500,000. Grants towards feasibility studies are financed by this scheme.

- International Finance Corporation South Pacific Project Facility Support Scheme provides assistance in project formulation and business plan development for projects involving an investment of more than US$250,000.

5.4 Support for industry associations.

- Assistance is to be selectively provided under the United States Agency for International Development MARC Project.

6 Development of small industry centres and industrial estates.

6.1 Industrial estates, small industry centres.

The Asian Development Bank has provided technical assistance and finance for the development of the small industries centre in Tonga. It has also assisted Vanuatu assess the feasibility of the establishment of an industrial estate at Lugganville.

6.2 Incubator centres, nursery factory schemes.

This is an area where there is a need for external assistance but there are no donor supported projects currently operational although United Nations Development Program has been involved in the initial formulation of an incubator project.

7 Training in business management, finance and marketing for small and medium scale industry.

7.1 Staff training assistance, on-the-job training, counterpart training.

- Training under the United States Agency for International Development MARC project.

- Forum Island Country Industries Development and Training Scheme, 1991–93, 1992 budget F$257,000. This scheme aims to facilitate development assistance to the manufacturing and processing industries of the forum island countries in an effort to help their capabilities for export. This facility, located at the Forum Secretariat, will meet the requests from forum island countries' governments for short term assistance.
- New Zealand overseas development aid short-term vocational training in New Zealand. Provision of awards to enable participants to attend short term courses and attachments in New Zealand.

- The Australian Executive Service Overseas Program (AESOP) provides technical and advisory services as well as on-the-job training to upgrade technical and managerial skills to Pacific island enterprises. It is a non-profit company which draws upon a pool of about 600 volunteers who are mostly retired Australian business executives. The volunteers undertake short-term advisory missions of up to six months and are mostly attached to private enterprises.

- International Finance Corporation South Pacific Project Facility Support Scheme. Some specialized training is available to support entrepreneurial development and to assist the acquisition of specific skills.

7.2 Assistance with preparation of industry training material, training systems, manuals, self instructional materials.

International Labour Office, Start Your Own Business (SYB)/Improve Your Own Business (IYB) franchising and supervisory development for small entrepreneurs.

7.3 Training of trainers.

International Labour Office, Start Your Own Business (SYB)/Improve Your Own Business (IYB) franchising and supervisory development for small entrepreneurs.

7.4 Overseas training and fellowship attachments in industry.

- Assistance is to be selectively provided under the United States Agency for International Development MARC Project.

- New Zealand Human Resource Development Attachments. This scheme provides vocational technical training in New Zealand through short-term courses and specialist training attachments.

8 Technology acquisition and development assistance.

8.1 Assistance with manufacturing technology transfer.

- Technology Development Assistance Schemes.


  *Implementing agent:* Forum Secretariat.

  *Budget:* F$257,000 (1992).

  *Aim:* To facilitate development assistance to the manufacturing and processing industries of the forum island countries in an effort to help their capabilities for export. This facility, located at the Forum Secretariat, will meet the requests from forum island country governments for short term assistance.
- Assistance is to be selectively provided under the United States Agency for International Development MARC Project.
- New Zealand Short-term Technical Assistance. This scheme enables governments to gain the services of New Zealand consultants to undertake specialist assignments.
- The Australian Executive Service Overseas Program (AESOP) provides technical and advisory services as well as on-the-job training to upgrade production technology and technical skills to Pacific island enterprises.
- International Finance Corporation South Pacific Project Facility Support Scheme. Assistance is available to support the transfer of appropriate technology through short-term technical assistance.

8.2 Product development assistance and new product development.
- Very limited assistance is available for this type of activity.
- New Zealand Short-Term Technical Assistance. This scheme could possibly be used to gain a New Zealand expert on a short term assignment to assist with some aspects of product development.

8.3 Plant layout and manufacturing productivity improvement for established firms.
- Very limited assistance is available for this type of activity.

9 Support for privatization programs.
- The Asian Development Bank has provided technical assistance for the study and implementation of privatization and corporatization programs in Western Samoa, Solomon Islands and Fiji.
- The World Bank has provided assistance with the corporatization of the Fiji Post and Telecommunications and the introduction of commercialization strategies.
- United States Agency for International Development will provide short term technical assistance for the preparation of a comprehensive national privatization strategy and with carrying out certain parts of it under the MARC project.
Further reading


Crocombe, T., 1990. Private Sector Development in the Cook Islands, Pacific Islands Development Center, East–West Center, Honolulu.


Socio-cultural aspects of development in the South Pacific

Antony Hooper

Prospects for economic development are conditioned to a large extent by the Islands social patterns ... this mosaic of cultural endowments exerts a profound influence over the pattern and prospects for development... Cultural traditions exert a powerful influence on social practices [and] the blending of diverse cultural traditions with modern commercial practices provides each nation with a unique set of characteristics and constraints (World Bank 1991:1-3).

Anthropologists in general are familiar enough with this sort of thing, which is normally dealt with in ethnographic accounts under the headings of magic or ritual behavior, consisting as it does of a precautionary genuflection in the direction of threatening but unknown forces, acknowledging them to have a profound influence over what has to be done before getting on with the task by the old familiar means, trusting that nothing will intervene to mess things up.

In considering some regions of the world, rituals of this sort may indeed be effective in keeping the profound influences at bay for long enough to enable one to make some sort of stab at economics, but they are not likely to be so effective in the Pacific, for a number of reasons.

In the first place (as everyone points out) it is a region of tremendous linguistic, cultural and geographical diversity, from relatively huge resource-rich nations like Papua New Guinea with over 700 district languages to much smaller states made up of tiny resource-poor atolls spread over huge expanses of open ocean. Second, it should be kept in mind that the Pacific region was the last in the world to be colonized by Europe, and the most recent to emerge from colonialism (Rubinstein 1992:v), and that in contrast to, say, the Caribbean, the region still has many cultures which, however much affected by colonialism, effectively predate any colonial experience. The loyalties and values engendered by these distinct traditions have a powerful sway over the way many people define their goals and expectations, and set about pursuing these ends, in many cases more powerful than those which might be expected of them as citizens of some wider national entity. A third factor is that independence and self-government have come to the region only within the past generation and many of the states have had to contend with the political and cultural uncertainties and trials of nation building.

As Wolfgang Kasper has succinctly put it, 'anthropological facts matter in the South Pacific' (1991:49), and I would contend that they count not only because of the cultural diversity, the recency of contacts with the open world system, or the problems of evolving national cultural identities. They count for the very
same reasons that Dube (1988) has drawn attention to. So-called ethnic movements have occurred in recent years, not only in the less developed economies, but in countries like the United Kingdom, the United States and the former USSR, which were considered both stable and developed. The ethnic movements in all these places have a very considerable cultural content which is allied to political goals. As such, they manage to cut across class interests and override many of the economic and development goals of the societies and nations of which they are a part.

... tradition and culture cannot be taken for granted, they do not necessarily adapt to the demands of development. They are intervening variables of considerable power. Policies of economic growth and development have to learn to live with them (Dube 1988:510).

All I would wish to add is that Dube's points ring even truer in 1992 than they did as recently as 1988, and that they apply with added force in the Pacific region.

I cannot, however, advise on how policies of economic growth which do not take tradition and culture for granted can be devised. It would certainly be superfluous to try and suggest how one might learn to live with such policies, as most economic advisers do not have to do that anyway. There also doesn't seem to be much point in simply listing all the socio-cultural obstacles to supposedly 'rational' economic behaviours which one is likely to encounter in one part of the region or another. They are well known: elaborate ceremonial systems of exchange which squander valuable resources of energy and material goods pointlessly, irrational commitments to collectivist systems of land tenure which bedevil plans for useful development, cavalier attitudes to wage employment, commitments to family and distant relatives. In a region of such diversity any or all of these factors are liable to turn up, and simply ticking them off as they appear obscures the ways in which they can be seen to be systematically related to one another and to spheres of cash-mediated social relationships which are commonly distinguished as the public and private sectors.

Economy, society and culture

The title of this paper juxtaposes large abstractions with some insouciance. In order to say anything useful about them and the ways in which they might be interrelated, it is necessary to go back to first principles and some elementary definitions.

Society is perhaps the most straightforward term. A society or a social system is perceived to be a more or less discrete, more or less integrated body of social relationships between individuals interacting in terms of more or less accepted social roles. Culture is defined simply as the body of shared understandings in terms of which the social interactions take place. Economy is concerned with the provision and circulation of the goods and services which provide the material means of human existence, and for comparative purposes I follow Karl
Polanyi’s distinction (1957:250) of three broad principles by which distribution is accomplished: reciprocity, redistribution and market exchange.

Certain points follow from these definitions and the ways in which they are related to one another. The first is that both society and culture are broader and more inclusive terms than economy. An economic relationship is a variety of social relationship, or, to put it another way, an aspect of every social relationship. In the time-honoured phrase, the economy is embedded within society, or the system of social relationships. The second is that the notion of an economy or economic system cannot be confined to the monetary economy, and still less to the market economy. Both of these are dependent upon the existence of specific systems of social relations and the shared understandings which underpin them. Neither should it be assumed that in the absence of money or the principle of market exchange there is no economy. If there is one important lesson that the considerable ethnographic record of the Pacific can teach us, it is that the peoples of the region have devised a truly prodigious variety of elaborate economic systems to adapt themselves to the material circumstances of their existence. As Donald Denoon (1985:119) has pointed out, tens of thousands of undergraduates must have absorbed at least some of the principles of Kula exchanges among the societies of the Massim region. These remain important ideas, not simply anthropological curiosities. Economists, for their own reasons, may have chosen to exclude them from their analyses, but in one way or another most Pacific peoples still hold them to be elementary truths.

A third point arising from this particular set of definitions is that one can speak of organizations and institutions as social systems (the less inclusive form of society) which have a particular culture. One can speak of a family, or a firm or a factory or the World Bank as a social system. Social systems and their associated cultures are not fixed and unchanging, although each does have its particular fixities, rigidities and certainties, which, in the nature of things are conservative—concerned to keep things as they are. Change does not usually arise from those who have a vested interest in the system as already constituted.

Culture

Culture has been defined in a very general way as the body of shared understandings in terms of which social interactions take place. In older anthropology the emphasis tended to be placed on describing and comprehending these shared understandings as rules, norms or customs, and with showing how they lent support to the social system. Ethnographers were concerned with the differences between social systems and the way that these persisted through time. Today, there is more interest in trying to comprehend where these ‘shared understandings’ come from—how they are produced and sustained. Issues of power are crucial to this comprehension. In the older anthropology, the individual was in most cases considered to be simply a passive carrier of culture or as being somehow in the grip of custom. Today, the individual is more
likely to be seen as reflective and manipulative, faced with many alternative courses of action which demand conscious choice.\textsuperscript{1}

The other point about culture is a much more obvious and important one. Over the past generation, and perhaps more particularly over the past decade, ethnic and cultural interests have surfaced as one of the most potent engines of political action throughout the entire world. Although relatively remote from the world's important centres of geopolitical upheaval, Pacific peoples (and more particularly their leaders) have not been isolated from these ideas. Most ethnic movements have a cultural content which involves objectifications (made by the participants themselves) of their own way of life and how it differs from that of others. Such objectifications, rendered as *kastom* or culture or by some descriptive phrase such as 'the Samoan way of life', entail obvious idealizations and often bear a problematic relationship to what others might see as the social reality. The anthropologist Colin Filer has recently addressed just this issue in a consideration of 'Melanesian communism'.

The myth of Melanesian communism is the story of a village which exists everywhere and nowhere, whose traditions were manufactured at the moment of their own destruction, and whose institutions are encapsulated in a national identity which cannot be distinguished from a hundred other national identities created by the same colonial experience. Once upon a time there was a community whose members lived in complete harmony with each other and with their natural environment, who jointly owned the land to which they had a mystical attachment, who chose their leaders by consensus, settled arguments by compromise, and redistributed the products of their labour to ensure that everyone enjoyed the same condition of subsistence affluence...

This vision of the ... Melanesian village in the sky is not only a source of comfort and inspiration to members of the national political elite; it has also been seen by all sorts of expatriates for as long as expatriates have been around to see it. Enlightened colonial administrators, romantic anthropologists, syncretizing Christian missionaries, fly-by-night consultants, and a host of other characters ... have all helped to construct this image of 'traditional Melanesian society'... Only in the villages themselves, the real ones on the ground, does it appear to be what it really is: a dream of something radically different from the present and the past (1990:9).

Filer's characterization can very readily be extended to other Pacific ideologies of culture such as fa'a Samoa or the Pacific way, all of which involve very much the same sort of vapid idealizations and are clearly underlaid by similar political motives. This does not mean, however, that such ideologies can be summarily dismissed. They are every bit as true (and as false) as statements about the American way of life or the British sense of fair play—or, for that matter, the economists' models of perfect competition.

\textsuperscript{1} For a recent overview of anthropological theory over the past thirty years, see Ortner 1984.
Socio-cultural commonalities

It would be platitudinous in this context to make too much of either the extreme social and cultural diversity of the Pacific region or the different degrees to which various segments are integrated into the world system. Nevertheless, as the World Bank clearly recognizes, these are facts of crucial importance for an understanding of the prospects for the economic development of all Pacific countries. An attempt is made to deal with them by emphasizing two socio-cultural commonalities which underlie the bewildering variety.

Smallness of scale

All Pacific societies are small-scale societies. This is not simply to say that they are small in territorial extent or in population numbers—though many of them are small in both these senses. The term small-scale is used in the sense intended by Burton Benedict (1967) to refer to a characteristic pattern of social relationships where there is

... a small social field, and many social roles are played by relatively few individuals ... the same individuals are brought into contact over and over again in various activities ... decisions and choices of individuals are influenced by their relations in many contexts with other individuals. Impersonal standards of efficiency, performance and integrity are modified by the myriad relationships connecting the individuals concerned.

In this kind of social field, relationships are intense and multi-faceted, with possibilities for all sorts of conflicting loyalties. The formal table of organization of many institutions in such settings may provide only a very rough guide to what actually goes on; very often, it matters more who you know than who you are. In societies of this sort, there can be extreme social cohesion against those who are outside the system, combined with an intense factionalism within—and with the ideologies of culture playing a crucial part in both processes.

Spheres of social relations

A second commonality should be obvious enough to anyone with experience of the Pacific. Each Pacific society is composed of three main parts, the government, business and the professions, and a traditional part. For the moment, these may be regarded as being roughly equivalent to sectors: public, private and traditional. The aim, however, is to move beyond a purely economic view of the parts and consider them as spheres of social relations, each with its characteristic norms, values and culture, its own characteristic ways that social relations are mediated, its own historical determinations and ways in which it is articulated with other spheres and with the outside world.

Traditional does not refer to something which has existed unchanged since the beginning of contacts with the outside world, even though it is sometimes represented (particularly in statements of the kastom kind) as being eternal.
Throughout most of the Pacific the first significant and enduring contacts that the people had with the West were with missionaries and traders of one sort or another. In many places these initial contacts spurred the impulses toward political expansion and centralization that were probably already present. Thus, the transformations of the Fijian polity under Cakobau, Tonga with Taufaahau, Hawaii with Kamehameha and Tahiti under Pomare (and there are other examples). These changes occurred very early in the contact period and were long-lasting and significant. The other early and profoundly significant change came with the adoption of Christianity. Christianity and the Church in the region cannot be regarded as a mere show of outward form. The principles of Christianity are deep within almost every traditional sector in the region, no matter how much they might also be combined with local syncretic elements. They are deep not simply because the Church has adapted, but because the traditional society changed.

To continue briefly with those broad historical determinations, the next phase would be one in which various traditional leaders, the missionaries and traders mediated the society’s articulations with the outside world. Following upon this, protectorates, annexations and the establishment of colonial regimes which, almost universally, rigidified the traditional societies through the codification of the land-tenure systems and institutionalized legal principles. This codification has been of lasting significance.

In many instances, all these changes to the traditional sectors took place while the indigenous populations were undergoing very drastic declines due to introduced diseases. This was particularly true in the Polynesian, eastern parts of the region, where the declines were not checked until the early years of this century. From then on, though, under the influence of better health care, population increases have been fairly spectacular and, again, very important.

Business and commercial sectors were established early in most Pacific societies, either through the alliance of outside traders with the local populations or through overseas-established firms, some with plantation interests. In both cases, though, this led very rapidly to the introduction of cash into transactions within the traditional sectors. The final phase that needs to be mentioned is the ‘indigenization’ and, in many instances, the tremendous expansion of the government and administrative sectors in the lead up to independence or self-government in the years following the second world war.

These remarks are, of course, rather rough history, nothing more than a sketch. They are introduced here only to draw attention to a simple fact which is very easily overlooked by those concerned with development. The point is that when dealing with Pacific societies it is not a simple matter of a modern sector (which many would take to be the public and private sectors) opposed to an unchanging and atavistic traditional sector which creates barriers to modernization and development. In most Pacific societies the three separate sectors have existed for generations and the exact nature of the public and private sectors is as much determined by historical contingencies and their relationships with the
traditional sector as by the innate (and supposedly universal) logic of bureaucratic and commercial relationships. The corollary also applies: the traditional sector is not unchanging but has itself been determined by history as much as by notions of its own innate and essential values. It follows from this that the sectors will differ significantly from society to society, from island group to island group. This is untidy, but it is also the very essence of the nature of the social and cultural facts within which any culturally authentic and thus, ultimately, sustainable development has to take place.

**Articulation of the spheres**

It is useful to visualize this sort of variation in terms of simple diagrams. The most straightforward represents a state where there is a relatively unified and unitary traditional sector, together with a substantial private sector of business, trade and the professions, and an administrative bureaucracy serving an independent political sphere (Figure 1). The arrows represent articulations between the spheres and with the outside world.

**Figure 1**

![Diagram](image)

There are also significant variants of the situation depicted in Figure 1. For example, a social formation such as that of Tokelau, where there is only a heavily modified traditional sector, an administrative sector, and no private sector at all (Figure 2). Again, the immensely more complex situation of a large multi-ethnic state such as Papua New Guinea can be represented as in Figure 3. Here, there is a host of small-scale decentralized communities which were, during colonial times, aggregated into administrative divisions, fostering new dimensions of ethnic consciousness which now underlie the system of provincial government developed since independence (Premdas 1989). Thus, in addition to the host of communities and the 700 or so distinct languages, there is also a further layer of regional and provincial identities and loyalties involved.
in what may be called the traditional sector of a state such as Papua New Guinea.

The diagrams are simply a heuristic device to draw attention to the connections which exist between the three sectors, commonly distinguished in the analysis of national economies. The point is that the connections between the three sectors are not only economic in the economist's sense of that term, they also have social and cultural dimensions which have very clear implications for development. It is precisely here, in the articulation of the spheres, that one may locate some of the barriers to supposedly rational economic behaviour.
Socio-cultural aspects of South Pacific development

Each sphere is considered separately and the kinds and varieties of articulations that may be seen in the region are described briefly. Inevitably, there is much more to be said about the traditional sphere than about the other two. The emphasis is due mostly to the available sources. There is an extensive and rich literature about the traditional societies of the Pacific. By contrast, even adequate sociological studies of the middle classes engaged in business and government service are exceedingly rare and analyses of political processes in the region remain very fragmentary.

The traditional sphere

Throughout the region, very significant proportions of the national populations (over 50 per cent in most cases) are classified as being involved in some form of subsistence production. These people, and their activities, roughly belong to what is termed the traditional sphere. It is important, however, to realize that the activities go far beyond the provision of material subsistence to include others which are basically concerned with the maintenance and reproduction of the whole traditional socio-cultural order.

Everywhere, the basis of this order is the land. Although they have been through many varied and profound historical changes, most countries in the region have not been subject to either large-scale colonization (New Zealand and some of the French territories being the obvious exceptions) or the perturbations and social disruptions so characteristic of European history. None of the countries has a significant body of peasantry nor large masses of people who might be compelled by material need to subsist only by selling their labour. What is far more characteristic of the region is that the great majority of lands (over 80 per cent in many cases) have persisted under indigenous control and, what is more important, with undivided rights held by members of some sort of kinship-based descent corporation. There is, thus, a strong material and historical base for traditional culture and there is in most places a clear sense of continuities with the past (often the very distant past), many shared experiences and memories and a sense of common destinies among quite large collectives of people.

Reciprocal exchanges and redistributions, often in ceremonial contexts, are the cement of this sort of social order, not market exchange. The variety and elaborations are truly prodigious and there is a vast ethnographic literature which describes them. Attention is drawn to two relevant points. First, the ceremonial exchanges are conceptually ‘thick’, gathering together a host of internal social processes and diverse cultural meanings on occasions which are loaded with drama and excitement. Moka exchanges in the Mount Hagen area of Papua New Guinea exemplify some of this multifaceted complexity. As Strathern has pointed out in a recent paper, the moka exchanges in the late 1960s,

... provided a vehicle whereby big men could compete to demonstrate their ability to give away large numbers of pigs and valuables, their influence over supporters, their command over labor, and their virtuosity in decorating, dancing and orating. In addition dozens of other individuals of middling
status and renown used these venues to pursue their own partnerships, strengthen their marriages, pay back debts, ensure the health of their children, and so forth (1991:207).

Examples like this could be drawn from all round the region, as readily from groups which are comparatively heavily involved in the modern monetary system as from those which are only marginally engaged. In such circumstances it is understandable that many people would not think of abandoning such occasions entirely for the aridity of a life devoted to the earning of often derisory wages in alien and uncongenial surroundings.

There is, however, more to it than occasional drama and excitement. Turning again to the Melpa example, Strathern has pointed out that although the people are heavily engaged in new commercial and monetary transactions, these

... do not in themselves constitute relationships between persons in the Melpa social system... They are all activities oriented toward others; other people, other structures. By preserving moka and certain associated key institutions, notably bridewealth payments, the Melpa have retained a sphere for their own continuous history, which acts as a filter in respect of the outside. It lets in enough to 'color' the moka actions and enable the moka itself to play a role in contemporary adjustments, but not so much that the outside world would swamp or sweep away the internal world of meanings the Melpa themselves continue to construct (1991:211).

Ultimately, then, ceremonial exchanges are due to meaningful social ties.

Second, money, perhaps paradoxically, is frequently used to construct and strengthen 'internal' social relationships and meanings. In most Pacific countries money has been an integral part of the traditional sphere for generations. It is used for minor capital expenses such as tools and fishing equipment as well as for consumer items such as sugar, rice and flour, but it also enters into many ceremonial contexts. In such contexts it does not appear simply as a means of payment and is not transacted according to the canons of market exchange. It appears as an offering, along with traditional valuables such as mats, whales' teeth and shells. Ravuvu (1987a), for example, has documented in great detail a whole series of such ceremonial occasions in Fiji involving drums of kerosene, kegs of salt beef and money as well as quantities of traditional foods and valuables. O'Meara (1990) has recently described comparable practices in contemporary Western Samoa.

The following quotation from Marshall Sahlins aptly characterizes what is going on.

Brought into the orbit of the capitalist world system, this global crusade of economic rationality, New Guinea Highlanders indeed prove themselves quick studies in commercial cunning—which they use to stage the most extravagant traditional ceremonies anyone could ever remember. More pigs have been eaten and more pearl shells exchanged in these recent festivals than ever was done in the good old days, not to mention the liberal consumption of such novelties as beer and tinned corned beef. Let the
Socio-cultural aspects of South Pacific development

neocolonial bureaucrats or the development economists complain as they may, this is neither ‘waste’ nor ‘backwardness’. Precisely it is development from the perspective of the people concerned; their own culture on a bigger and better scale (1992:26).

Rhetorically powerful though this passage is, it does not represent all that is going on. Sahlin himself acknowledges as much when he points to this indigenous way of coping with capitalism as being perhaps a ‘passing moment’, even though one which ‘in some places has managed to survive for over a century’ (1992:26). The money which is captured by the traditional sphere and may be used for the vast elaboration of aspects of traditional cultures comes from the other spheres, where social relationships are more clearly mediated by cash in the form of salaries, wages or commercial profits. There are four main sources, of which probably the most widespread throughout the region is small-scale cash cropping carried on in conjunction with subsistence activities. There are also indigenous businesses, perhaps most spectacularly successful and elaborated in the New Guinea highlands and other parts of Melanesia, waged and salaried employment in urban centres, and the remittances sent by emigrants (Finney 1973, 1988).

Kinship in one form or another can be said to be the conduit through which the transfers are made, especially if we understand kinship in this context to be not only relatives but also whole clans, villages and systems of ranked relationships which are often represented in a kinship idiom. Kinship ties at all levels are, however, subject to erosion from the diverse forces of commercialism, no matter whether the participants are engaged in business, wage employment in town or as migrants in a foreign land.

In the Papua New Guinea highlands, some Hageners have acquired land for their individual or corporate business enterprises by purchase, and profits from such enterprises are not at all readily convertible into such things as moka exchanges. Other commercial and monetary relationships have also made inroads in the area so that it is possible to foresee a time when such exchanges might simply collapse, along with the whole system of meanings which they express (Strathern 1991:214). Among wage and salaried employees in the towns of the region, much the same sorts of forces are also at work. Rutz (1987) has described the situation in Suva, where considerable numbers of Fijians live on a more or less permanent basis. Some 60 per cent are in rental accommodation of one sort or another, and there are a significant few, mainly high-level civil servants, who have bought their own residential properties on the open market. Over 30 per cent are in squatter settlements, while a further 6 per cent or so live in villages within the urban area under various sorts of customary arrangements. Virtually all of these kinds of living arrangements tend to erode traditional practices in one way or another. Privately owned accommodation can be regarded as being outside the claims of customary kinship obligations (or at least, in practice, as being largely dependent on the wishes of the legal owner). Together with rental accommodation, it draws money back into the private sector, encouraging its growth and leaving considerably less
discretionary income which might be transferred into traditional transactions. (Thus the well known dilemma of all Fijians in wage or salaried employment, the conflict between getting on and properly maintaining traditional social ties.) In the urban villages where customary arrangements might be theoretically possible, there is a fascinating mix of arrangements—from one instance where traditional canons are maintained virtually untrammeled by the contradictions which might be induced by the surrounding market environment, to others where the contradictions are fully apparent, leading to social disruption, obvious exploitations thinly disguised as custom, and legal suits.

Pacific migrants to metropolitan centres outside the region are also caught up in the sorts of conflicts as those who live in Pacific cities and towns. Here, though, there is potentially more opportunity for individuals to escape from the network of traditional obligations entirely and merge into a wider, more anonymous citizenry. Many have certainly done so, to a greater or lesser degree, but it is never a simple, inevitable process of ‘assimilation’. Macpherson (1984, 1991) has described the issues involved among Western Samoan migrants in Auckland, pointing out the complex choices which individuals have to make about identity, particularly when a full-scale commitment involves (as it certainly does for Samoans) a heavy obligation to send remittances to relatives back home.

These examples show that money, which is eagerly sought throughout the region, does not necessarily lead to what economists would regard as growth for the national economy. Nor does it automatically lead to the erosion of the traditional sphere, it might, on the contrary, lead to its elaboration. At the same time, however, in different ways and in different places, the desire for money fosters the steady expansion of the market economy and the commodification of services. Thus the conundrum, exemplified not only in the Pacific region, that as modernity and the global market reach further and further into previously little known places, culture and a sense of tradition are also, by the same seemingly implacable impulses, nourished and elaborated.

The government sphere

In the Pacific region, according to a recent estimate, there are some 300,000 wage-paying jobs, of which 125,000 are in the public sector (Callick 1992:48). As is well known, many of these jobs are currently supported by the relatively high levels of external aid flowing into the region. The economic implications of these aid flows are also well known, and have been fairly closely examined from a number of different points of view, so the following discussion is confined to some of the more obvious social and cultural aspects.

Although no details are given as to how this estimate was made, it is undoubtedly an informed one.
Forty or fifty years ago, Pacific governments provided many services which were not being catered for by relatively undeveloped private sectors. They were also directed largely by expatriate colonial officials. In the nature of things at the time, their positions were both powerful and prestigious, they also offered great security, with provision for families, regular periods of home leave and subsidized superannuation schemes. In the years leading up to independence or self-government, the government services of many countries were rapidly expanded, with corresponding increases in the numbers of administrative positions. Many of these continued to be filled by expatriates (as, indeed, many of them still are) in spite of the drive to localize them as rapidly as possible. With independence there was, in many cases, even further expansion, with the new positions being occupied largely with local people.

In these circumstances it is not at all surprising that government service attracted the more promising locals with the highest degree of formal education. In many places these were the very people who would previously have gone into the church, that being the only other opportunity which they had for social advancement. The new officials inherited the power and prestige which had formerly accrued to expatriate colonials, together with many of the associated securities and conditions of service. More than that, however, they became, in many cases, the guardians of the new states, concerned not only to maintain administrative services but with the formulation of the very principles underlying a developing sense of nationhood. Many of the people who entered government service around the time of independence or self-government are now in the most senior and influential public service positions. This has various implications, only two of which are considered here. In the first place, as Callick has noted, Pacific leaders ‘find the private sector difficult to deal with’ (1991:3). Callick goes on to explain that this may be in part due to attitudes inherited from an earlier era and in part to the fact that the private sectors of many Pacific societies are dominated by expatriates with interests directed more toward outside goals than to local ones.

Traditional leadership in the South Pacific is about control as much as consensus, and a leader who voluntarily steps back to accommodate private sector growth ... inevitably feels more vulnerable (Callick 1991:3).

The leaders to whom Callick is referring are the politically elected ones, but his observations are also relevant to the senior administrators who breathe the same political airs.

This leads to the second point, which has to do with the guiding principles of nationhood. Almost every Pacific nation came to independence or self government with a constitutional document which asserted some of its legitimacy and authenticity in terms of culture and tradition. Few went as far as Western Samoa, which declared itself to be founded upon God and Samoan custom, and few have had as much difficulty with the issue as Papua New Guinea, which has had to cope with the knotty problem of ‘which culture?’ (Premdas 1989, Lindstrom 1992).
Traditional culture, when pressed into the service of a modern nation state (no matter how quiet and non-assertive its nationalism might be) becomes something quite distinct from the way that it appears in natural settings. For one thing, it is in a sense detached from its moorings to traditional social units and linked to wider and much more diverse collectivities, each of which may be organized according to quite different principles. For another, it has to be formulated, objectified, written down and proclaimed in all sorts of alien settings. It takes on a definite ideological tinge. Since it is the political leaders, intellectuals and the elites of government service who are involved in the production and maintenance of culture in this sense, it is hardly surprising that that the principles which they invoke may be somewhat removed from what actually goes on amongst subsistence and small-scale cash crop producers in outback communities. The leaders, intellectuals and government officials might not in fact have ever had direct experience of life in such settings, where people tend to get on as best they can without conscious recourse to such ideas. In any case, the efforts of national leaders are quite properly directed more toward national than to local interests.

This sort of dissonance can, however, have very direct economic consequences, as when legal, state-wide, culturally correct principles of land tenure cut across what ordinary people might see as both profitable and feasible. (Fiji and Western Samoa provide good examples of this, which are detailed later in this paper.) There are also the difficulties which arise when projects designed to serve national interests and economic growth in the wider sense involve local people and resources which they quite legitimately regard as being theirs by traditional principles. Mining ventures have provided the clearest examples of this sort of conflict in the Pacific region, but there are also many others which had had far less dramatic consequences (Ravuvu 1987b). Such difficulties due to conflicts between national and local interests are of course by no means confined to the Pacific region. They do, however, have the potential to become much more complex and debilitating when the local setting is (as it almost inevitably is in the Pacific) part of a vigorous traditional sphere.

A third point about the government sphere and its relationship to the traditional sphere is the way in which formulations of national cultural principles can be seen to conceal class interests. An interesting and relevant argument about this developed a few years ago, springing from a brief characterization of ‘the Pacific way’ which Ratu Sir Kamissese Mara made in a speech to the United Nations in 1970 (Crocombe 1976). The phrase passed into general usage in the region, coming to connote those aspects of Pacific life (communalism, negotiated compromises, ‘brotherhood’ and a common rejection of colonial rule) which set Pacific people apart from others. All in all, it was a servicable enough doctrine, and it was not until Howard (1983) drew attention to its ideological aspects that local scholars began to pay much attention. Howard’s main point was that the Pacific way clearly supported the interests of traditional élites in places like Fiji, Tonga and Western Samoa, using consensus to avoid substantive debate and subsuming chiefly status within the ideas of communalism ‘...in such a way as to hide the class basis of the system’ (Howard
1983:181). With the debate opened up in these terms, it expanded to include the broader issue of appropriate models for national economic development. In response to Howard, Meleisea and Schoeffel (1984) damned both modernization theorists and paleo-Marxists alike for their views about the inevitability of class formation and the obsolescence of pre-industrial societies. Against such views, they pointed to the resilience, utility and adaptability of traditional institutions, their capacity to provide barriers to class formation and effectively disable the exploitative aspect of many development schemes. The debate has effectively fizzled, but the issues remain, and they continue to have relevance for policies of economic development.

As far as the directly political aspects of the government sphere in Pacific countries are concerned, the connections with the traditional sphere are dense and numerous. I shall draw attention to only a few. In addition to constitutioal references to cultural traditions, traditional hierarchies may be either explicitly recognized, or else allowed in practice to have considerable scope and influence. Electoral boundaries may follow traditional divisions, or whole systems of regional government built on such divisions. Church affiliations, themselves an indication of complex factions and allegiances in the traditional sphere, affect voting behaviour. In the most obvious cases of links between the traditional sphere and political life, Western Samoa, until very recently, allowed only chiefs to vote, and in Tonga the traditional hierarchy continues to have a much greater electoral weight than its numbers would (from a democratic viewpoint) seem to warrant.

The private sphere

In sociological terms, this is undoubtedly the least well documented of the three spheres in most Pacific countries. Although there have been some excellent recent studies of entrepreneurship in the region, notably those edited by Fairbairn (1988), these have concentrated for the most part on indigenous entrepreneurs, to the deliberate exclusion of 'local non-indigenous groups including Asian immigrant groups and persons of mixed ancestry' (Fairbairn 1988:4). Given the definite need to stimulate private sector activity among indigenous peoples of the region, this is understandable. The fact remains, however, that a very large proportion of the private sector in many Pacific countries is controlled by Indians, Chinese and those of part-European ancestry, most of whom are citizens of the particular countries if not truly indigenous. Furthermore, many of these people have intimate links (including those of marriage and kinship) with individuals and groups in the traditional sphere.

There is probably nowhere in the Pacific where these sorts of links are stronger than in French Polynesia, where there is a very extensive demi population which controls much of the quite vigorous private sector. A number of these demi families derive from European–Polynesian marriages four or more generations back and they have maintained links with their Polynesian kin, as well as extensively intermarrying with other demi families. Most are fluent in both French and Tahitian and (perhaps partly for this reason) have effective control
over the political life of the territory. An almost identical situation prevails in Western Samoa, and perhaps, to a lesser extent, in other countries of the region as well.

In both French Polynesia and Western Samoa there is quite obviously a well-developed indigenously-derived middle class. Tonga is another country where a steady increase in the importance of class-based relations has been noted (Marcus 1980, Bott 1981:67–71, Gailey 1987, Needs 1988, Benguigui 1989, Campbell 1992), with many of the commentators drawing attention to the ways in which class relations have been developing out of elements of the existing indigenous social structure. Needs’ study is perhaps of particular interest here since it details the part played by recent external aid in the development of class relations. His description of the process has close parallels to that described for the passionfruit industry in Western Samoa, where ‘middle class and upper class Samoans’ with access to freehold land near Apia were better able to take commercial advantage of a government-supported production program than the village planters for whom the scheme had originally been devised (O’Meara 1990:21–23).

Many recent writers have made reference to social class as an element in the contemporary social structures of other Pacific countries and many others (wishing, perhaps, to escape the necessity of making a thorough sociological analysis in class terms) have pointed to the importance of indigenous ‘elites’ made up of high-level civil servants, politicians and local business leaders. The phenomenon is glaringly obvious in many places and yet there are very few thorough academic studies of it. In view of the huge international literature on the relationships between economic development and class formation this is a hindrance to any serious and thorough commentary which might be made on a topic such as ‘Social Aspects of Development in the South Pacific’. Most of the work remains to be done and it should be given a high priority in future regional research.

Fiji is a special case, in this as in a number of other Pacific contexts. No other independent country of the region has such a large proportion of its population made up of people of non-indigenous origin. (Immigrant is hardly a suitable term when the people have been in the country for generations.) The Fiji Indians dominate much of the private sector sphere, but the country has for over a hundred years been divided along ethnic lines. This division began as a matter of colonial policy and has been continued, most recently by military force. The social, cultural and economic issues involved in this are too complex to allow an easy summary here, but good accounts are available (Lal 1986, Knapman 1987, Norton 1990).

**External articulations**

In the previous section a brief sketch was made of some of the ways in which the traditional sphere of Pacific societies is articulated with the government and commercial spheres. In doing so, examples drawn from all over were used
in an attempt to bring out some of the implications which these links might have for economic development. This might have made the argument seem schematic and rather artificial, since it has given little sense of how all the links might fit together (and with one another) in the setting of any particular national economy. That could be done, of course, though mercifully not here.

The external links through which each of the spheres is articulated with the wider outside world are now considered. Just as the national economies of the region are characterized as being very open, so too, in many instances, are the spheres. Even the traditional spheres of many countries have (paradoxically perhaps) very close and direct articulations outside the country and even outside the region altogether. These parallel many of the more obvious outside linkages of the government and commercial spheres.

There are two recent bodies of work which point up the importance of these outside linkages for at least some of the smaller countries of the region. The first is made up of two brief articles by Bertram and Watters (1985, 1986) in which they argue that the old colonial export economies of these small countries have irretrievably broken down and have been replaced by what they call a mirab economy, 'mirab' being an acronym for migration, remittances, aid and bureaucracy. These factors, all closely interrelated one with another and working together, so Bertram and Watters maintain, are no longer just subsidiary features of the local island economic systems. They are the driving force.

All of the countries considered have very low rates of population growth, or even negative growth. The overriding factor is of course emigration—especially from the Cook Islands, Niue and Tokelau (whose citizens are also citizens of New Zealand), but also from Western Samoa, which has special protocols governing immigration to New Zealand. The primary destination of emigrants from these countries has been New Zealand, although there is also movement to Hawaii, California and Australia. The home and migrant communities have remained closely linked. The migration which has occurred has not been, for the most part, a result of young people cutting ties and going off to make their fortunes in new lands, but of decisions made by family groups of various kinds. The result has been the formation of what one writer has called transnational kin corporations.

Although external aid flowing to these countries has usually been described as development aid it has for some time had more of the character of a straightforward supplement to local incomes and consumption. In balance of payments terms, the inflows finance between 40 per cent and 100 per cent of imports, and are, realistically, not aid at all but rent. Much of the aid has been used to finance public sector employment which accounts for between 52 per cent and 100 per cent of all formal employment in the countries concerned. Agriculture has stagnated and there are strong tendencies toward urbanization.

Bertram and Watters point out that in the rhetoric of the aid business it has always been maintained, by both the donors and recipients, that the aid support
Antony Hooper

is only temporary and designed to get the islands established on paths toward self-sustaining growth. They question this, pointing out that aid flows to the Pacific are relatively very large indeed, driven in part by the special conditions of island states and economies and partly by the geo-political interests of the main donor countries. They suggest, then, that the pattern is locked in and that, in cold economic terms, it is eminently sensible.

Some of the wider social and cultural implications of these mirab transformations have been set out by Hau'ofa in a paper in which he argues that

... there already exists in our part of the world a single regional economy upon which has emerged a South Pacific Society, the privileged groups of which share a single dominant culture with increasingly marginalized subcultures shared by the poorer classes (1987:1).

There is, he goes on to say, a pattern of patronage and growing inequality. The privileged interlocking elites who control the movement of resources through the region increasingly share the same language (English), ideologies and material life styles. Such cultural diversity as there is exists mainly among the under-privileged, especially those in the rural areas marginalized by export-oriented production. The poor, he points out, adhere to their traditional ways out of simple necessity, for their economic security.

There are several novel twists to Hau'ofa's analysis, not the least of which is that he uses culture to refer to the dominant culture of the educated, powerful elites (their common material lifestyles, ideologies and language) and his relegation of the various traditional ways of life to the status of ineffectual, marginalized subcultures. Much of his paper is concerned with tracing the different dimensions along which the region has become so integrated. Of these, the economic dimension is the most obvious and far-reaching, and he draws attention to matters of trade, industry, financial institutions, tourism, transport and communications. All of these activities link the countries of the region closely with Australia and New Zealand as the closest metropolitan centres and those with the highest levels of investment in the South Pacific. Then there is aid and the influence of education systems modelled on Australian and New Zealand prototypes. Migration is another factor. Some Pacific countries have more than half of their national populations resident in New Zealand, the obverse of this being the many thousands of New Zealanders and Australians living in the islands as migrants, diplomats, advisors, teachers and professionals of one sort or another.

Essentially, Hau'ofa is putting forward a regional class analysis. The elite groups in the islands have interests which merge more closely with those of their metropolitan counterparts than they do with the poor and underprivileged in their own countries. With them, it is as it is in Australia and New Zealand, except that the poor in the islands have the consolation of being able to maintain a few amusing subcultures. There is much in Hau'ofa's argument which can be agreed with. The integration to which he refers has undoubtedly occurred, in some countries far more than in others, but the class argument would be much
Socio-cultural aspects of South Pacific development

more convincing if it were supported by more detailed evidence from actual case studies. The main shortcoming, though, is the treatment of culture. Hau’ofa is undoubtedly correct about the new dimensions of stratification and the growing disparities of wealth, but he overlooks the fact that much of this stratification depends upon notions of culture and tradition for its legitimation and continued vitality.

The Mirab work, together with Hau’ofa’s notion of ‘the new South Pacific society’ does not cover all that might be said about the external articulations of the different spheres, but it does serve to give a good idea of the extent to which at least some Pacific countries are integrated with the metropolitan centres of Australia and New Zealand. Finally, the remittance elements of Mirab economies play an important part in the elaboration of traditional ceremonies in several countries—in much the same way that money from business ventures in the Papua New Guinea highlands is used to support moka exchanges. Here, though, it involves international linkages, so that wages derived from New Zealand factories appear as presentations in ceremonies which sustain the traditional ‘Samoa way of life’.

Two examples

Fijian culture and tradition

As Pacific states go, Fiji is a relatively complex and well-studied place, so that one might draw quite diverse points from the literature about it. Attention is drawn here to the notion of Fijian culture and tradition, how it was created, sustained and transformed, how it relates to development policies and to the lives and ideas of ordinary Fijians. The discussion draws heavily upon recent work by Overton (1989) and Rutz (1987).

Fiji, at the time of first European contact (and probably for some time before that) was made up of diverse tribal groups and chiefdoms, most of which were to some extent incorporated into one or another of several antagonistic political confederations. In the succeeding years the Bau confederacy gained ascendancy and led a short-lived government of the group before the cession to Great Britain in 1874. Methodist Christianity was well established by that time.

From the beginning, Fiji’s first resident governor followed a policy of protecting Fijians from what he took to be the deleterious influences of foreign traders and planters and established a separate administration for Fijians, ruling through the local authorities or chiefs. Gordon had his own ideas about the essential nature of Fijian society, many of them, interestingly enough, derived at second hand from the writings of an American anthropologist, L.H. Morgan, about the stages of evolution of human society! Fijian society was in fact diverse and fluid. Gordon standardized it for administrative purposes, emphasizing the communalistic elements and the hierarchical authority of chiefs, giving both elements the reinforcement of colonial law. Thus the notion of essential Fijian custom and tradition was born, subsequently subscribed to by Fijians
themselves. As Rutz (1987:538) has put it, 'Tradition was removed from and placed above the historical events that led to its creation. Henceforth, events had the appearance of unfolding within a given cultural order.'

Although there were attempts to dismantle this protective administrative structure at various times it survived basically intact until after the second world war. Elements of the traditional Fijian hierarchy were incorporated into the machinery of government and the public sector. The colonial government, by and large, supported the chiefly system and village based communalism—both of which it had in fact done much to create and systematize. Nowhere was the institutionalization of the chiefly system more evident than in relation to land, especially after the creation of the Native Lands Trust Board in 1940. The Board was charged with supervising all leases of Fijian land on behalf of the owners, thus allowing some lands to enter the market. For its services, the Board retained 25 per cent of the rent money, distributing 30 per cent among the chiefs associated with the land and 45 per cent among the landowners. In 1974, a few years after independence, the Board was augmented by a subsidiary Native Lands Development Corporation, charged with the active development of Fijian monetary and business interests by making more land available. The object was not, of course, to deprive Fijian communities of a sufficient land base. Village communalism and the chiefly system have always been closely intertwined. The move was intended more to make sufficient land available for general commercial development of one sort or other, leaving the village systems intact.

With independence in 1970 the Alliance party came to power and maintained control of the government until 1987. Broadly speaking, the Alliance supported Fijian and European interests against those of the Indian-led Federation party, and it continued the land policies instituted under the colonial regime. Led by high-ranking chiefs from the Eastern part of Fiji, the party supported a policy of traditionalism in the rural areas from which it drew its strongest support. It was also concerned with development, following the recommendations set forth by various advisors in the decade or so leading up to independence.

Overton (1989:114) gives a succinct account of the contradictions involved. The ideology of conservatism, he wrote,

... points to strategies which protect and strengthen Fijian communal ownership of land, respect chiefly authority, maintain customary (and non-monetary) economic relationships, and encourage communal enterprise. It also means that the social costs of labour reproduction can be delegated to the village economy (not the state) and that a 'reserve army of unemployed' can be maintained in a part-subsistence village economy.

The contradictory ideology is of economic development, a strategy which aims to raise material standards of living and increase production (for domestic and export markets) and generate more monetary employment... Money will replace reciprocity ... material wealth and differences in wealth will increase, there is no a priori reason why chiefly authority will correspond to economic power, and individual enterprise is likely to be more effective in a capitalist economy than communal co-operative ventures.
What Overton discovered in his own research in rural Fiji was that the assumption (or ideology) of a static and basic village system did not correspond at all closely with the on-the-ground situation in the communities which he studied. He found instead that all sorts of changes had already been made; money had become an everyday part of life, land usage in fact was quite flexible and some people were able to get secure access, household labour was much more important than large communal enterprises, and chiefs in fact had little part to play in daily economic life. Neo-colonial conservatism, he concluded, is ‘... an ideology that is based on a myth—a myth that villages are thoroughly “traditional” or, if they are not, that “traditionalism” can be recreated’ (1989:115).

Overton also notes that in spite of these changes, people still held many of the basic Fijian values of community and reciprocity and felt no particular strain in reconciling them with money, materialism and individualism. These, presumably, were ordinary Fijian people getting on reasonably well without arguing the ideological principles upon which their lives were based. Why, then, all the fuss about traditionalism in the Fijian way of life?

Part of the answer to this question can perhaps be found in some observations made by the anthropologist Henry Rutz (1987), who uses the term ‘moral economy’ to characterize Fijian customary etiquette and norms. As distinct from market relations, what he calls the ‘moral economy’ involves ‘production, distribution and consumption activities which occur within a context of social relations that are normatively prescribed, strongly obligatory, bounded by highly shared rules, meanings and symbols and perceived as more or less permanent or natural’ (1987:536).

The Fijian moral economy is supported by many sections of Fijian society, but for really quite different reasons. It is used by ordinary people and urban wage earners to keep out the most harmful effects of the expanding market. For such people it is a valuable form of social insurance. The new Fijian elites, ‘high chiefs who hold parliamentary and cabinet posts, managerial civil servants, and professionals’ (1987:555) who comprise the middle class also participate in the moral economy by giving to a wide range of kin and allies throughout the country. ‘Their election has come to depend upon it’ (1987:556). Thus, Rutz points out, ‘the moral economy is therefore strengthened by the market in two directions: urban wage earners use it as social insurance, and elites use it to ensure their retention of power’ (1987:556).

There is a strong tendency to pass off what Overton refers to as traditionalism and Rutz calls the moral economy as simply lingering aspects of the old Fijian culture. Economists may well decry them for the impediments they might put in the way of economic development. They are not basically cultural any more. They are political, and if they are to be changed it must be by political means, not by simply attributing them to the dead hand of cultural conservation.
Collective land tenure: Western Samoa

As in Fiji, the great bulk of the land (over 80 per cent) in Western Samoa is owned by the indigenous Samoans under a form of collective tenure which is known as the *matai* system. In contrast to Fiji this cannot be thought of as having been created by colonial policies. Although much modified by the acceptance of Christianity and other influences, many of the main governing principles of the system go back to a time before Western contact and have been notably resistant to changes which colonial authorities (German and New Zealand) actively sought to make.

Western Samoa has been an independent nation since 1962 and was the first nation in the South Pacific to make this change following the second world war. It is a physically compact country, supporting a population of over 150,000. Independence in 1962 came after nearly fifty years of New Zealand administration, first under a League of Nations Mandate and then, following 1946, as a UN Trusteeship.

A *matai* is, first and foremost, a named title rather than an individual. The title is bestowed upon a person, who then gains authority over associated lands and people. An important point is that, according to Samoan ways, the title is not simply hereditary; it is largely elective, determined at the basic level, by a group of people belonging to a descent unit known as an *'aiga*. It can thus be argued that the system is basically democratic. Until 1991, only *matai* could vote in the national elections.

The *matai* system is a customary one which is not explicitly defined in legal statutes. Samoan land is customary land under *matai* jurisdiction. Samoans live in villages which are to a large extent autonomous political entities, with their own lands and their own ruling councils which are made up of *matai* titles traditionally associated with the village. In theory at least, these are fixed and everlasting. It is a very strong and effective form of local government, exerting a lot of control over many aspects of communal life. *Matai* titles are graded in complex hierarchies extending upwards to a series of very high, nation-wide titles and culminating in four supreme ones, the holders being the only ones (thus far) considered for the position of Head of State or to be in the special Chamber of Deputies.

The *matai* system is thus closely integrated with the structure of the modern state. A *matai* is not simply a bumpkin out in the villages keeping alive an anachronistic, reactionary system while the business of commerce and government is in the hands of smart, educated people in town. The members of parliament all have titles, as, until very recently, did those who elected them. But then there are others in business, the professions, high public service positions who have titles because it is to their advantage to have them. It also works to the advantage of any *'aiga* to have educated people and urban sophisticateds as their *matai*, even if they do not live permanently out in the communities where their lands are and their titles are domiciled. In this way
Socio-cultural aspects of South Pacific development

the hierarchies of traditional rank and authority have come roughly into congruence with modern power structures and the nascent class system. The congruence is not by any means complete, but the tendency is there. It is all a rather unusual form of adaptation, very self-consciously Samoan, and with many ideological supports. In terms of the simple model, it is obvious that one cannot change the system of communal tenure without threatening the whole matai system, and to do that would necessitate change, not only in the traditional sphere, but throughout the other two as well—in fact, through the whole society.

One of the largest problems facing Western Samoa is that it is basically an agricultural country, exporting commodities such as copra and cocoa, all of which are in poor demand. Efforts to step up the production of cash crops have not in general succeeded and many commentators have laid the blame for this on the communal tenure system. Nor are these comments all recent. Toward the end of last century a Protestant missionary wrote that Samoa's 'communist system is a sad hindrance to the industrious, and eats like a canker worm at the roots of individual or national progress' (Turner 1884:160, quoted in O'Meara 1990:7). The economist Fairbairn (1985) lays out the general argument in terms of insecurity of tenure for the producers, chiefs controlling agricultural incomes, high levels of sharing and ceremonial gift-giving, limited wants, high preferences for leisure and a general reluctance to change things.

Another general feature of Western Samoa is that it exports labour. Some 60,000 or so Western Samoans live in New Zealand and there are others in Australia and the United States. The migrants are, on the whole, relatively generous in the remittances that they send back home. In 1991, the total amount of remittances received was about NZ$61 million, nearly five times the country's export earnings of about NZ$13 million. The great bulk of the remittance money goes directly through 'aiga channels straight into the rural areas. The argument can of course be made that this is all quite rational economic strategy, getting labour out to where the commercial and industrial action is and having the migrants send their surpluses back home. This may be so, particularly from the point of view of the individual actors, though it does have its risks when the action starts to slow down where the migrants are and when one considers the difficulties entailed in translating the remittance monies into genuinely productive capital (Macpherson 1992). As was pointed out with reference to Western Samoa many years ago, no country ever developed by relying on remittances from abroad.

With regard to land tenure and the general topic of development, a recent ethnographic study by O'Meara (1990) suggests that many aspects of the matai system may be undergoing the same sort of on-the-ground modifications that Overton (1989) noted for Fijian village life. His information comes from only one village and it is not entirely clear how general the trends which he reports might be. There are also some apparent inconsistencies in his report. Nevertheless, there are good observations of a wide range of village activities and concerns,
particularly those having to do with agricultural production and sources of income.

With regard to land tenure O’Meara argues that

... the conservatism of the land tenure system is more apparent than real. In fact, a change toward individual ownership has been taking place since shortly after World War I. This change is little known outside of the rural villages and has not been reported by previous researchers. The change to individual tenure is also without legal sanction... Nevertheless, the change has proceeded to the point where villagers now control the majority of their lands as individuals, rather than as extended families.

This ‘change in tenure’, he goes on to say, ‘is significant for two reasons’,

First, it shows that Samoans are not rigid or bound by tradition. They can and do adapt to changing economic conditions. Second, the new system increases the security of planters’ land rights because it assigns ownership to individual planters... [Thus] insecurity of tenure is not presently a significant cause of low farm productivity, as it may have been under the traditional tenure system (1990:129).

There are some contradictions in these arguments, the most obvious of which hinges upon the statement that the change to individual tenure is without legal sanction. If that is so the new practices hardly amount to a system of land tenure at all, and what he terms ‘individual tenure’ is not in the least secure. It is small wonder then that there has been no great move to develop lands owned in this way.

Nevertheless, the extent of the new practices might well be significant. O’Meara reports that of the 460 plots (having 80 owners spread over three villages) whose ownership he investigated, nearly two thirds were claimed under the ‘new tenure system’ (O’Meara 1990:149). The main economic reason for this, apparently, is the general desire of people to be able to keep the proceeds of cash cropping for themselves and their children. Allied to this is the fact that under modern conditions there is less need for large-scale collective enterprise (as, for example, in house-building) so that the need for cooperation has been diminished. O’Meara also points to the way in which the changes have been congruent with the proliferation of matai titles over the past generation or so in response to pressures for electoral advantage. In rural Savaii, nearly 75 per cent of males over 21 have received titles (O’Meara 1990:151).

The connections which O’Meara points to are undoubtedly significant, but it can be argued that the changes are not the deep seated, lasting alterations to Samoan culture which O’Meara claims, or even that the people themselves have been ‘...subverting the matai system—their most fundamental and revered social institution’ (O’Meara 1990:152).

The matai system will survive. The new system of land tenure is an interesting working adaptation to current conditions, as were the Fijian village practices noted by Overton, but there are no indications that it would survive testing in
the Land and Titles Court. In addition, the subversion of the system for electoral purposes has probably been effectively met by the recent introduction of universal adult suffrage. There are many facts which favour the retention of the system. For one, the large number of Western Samoans resident outside the country make very important contributions to the rural economy. As O'Meara notes (1990:186) the largest share of households' monetary income comes from 'overseas gifts'. One of the most important social functions of such remittances (apart from the fact that they indicate love and concern) is that they help keep alive the emigrants' stake in the affairs of a community or 'aiga, and the emigrants would be unlikely to maintain their contributions if land ownership were to be individualized to the point where their stakes dissolved just by virtue of absence. Again, as in Fiji, the traditional system is the basis for a great deal of social support and rural Samoans are by no means wealthy enough to be able to withdraw from the security which it provides.

Finally, the matai system is by no means just a phenomenon of rural life or the traditional sphere. It also pervades the modern spheres of government (both the political and administrative sectors) and commercial and business life. Elections are closely contested and candidacy is an expensive proposition, if only because it behoves those of high status (and those who aspire to it) to be generous. This is the basis of the often-noted links between the political and business sectors in Western Samoa. The matai system if thus not simply traditional; as with Fiji and what Rutz calls its moral economy, it is a system which is as much political, commercial and economic as it is anything else.

Conclusions

Much of the above argument has been somewhat discursive and undoubtedly a few key terms have been used in ways which might be unfamiliar. From the viewpoint of anthropology or of comparative sociology it is difficult to see the economy as a discrete entity in the way that many economists do, that is, as something quite distinct from the wider set of social, cultural and political relations in which it is empirically set. The discussion has not, therefore, been approached in this way, nor have the ways in which diverse socio-cultural factors either impede or stimulate independent economic existence and growth been detailed. Instead, the discussion began with what is perhaps a typically anthropological point of view, that 'things are much more complicated than that'. More specifically, the notion that things are very much more complicated when one is considering South Pacific countries where the great majority of the populations live much of their lives in a traditional sector of a kind that it is not present in many other regions of the world, is advanced. That has been the point of attempts to analyse matters according to spheres and the articulations between them.

In conclusion, some brief propositions which summarize the ways in which socio-cultural factors affect economic development in the South Pacific follow.

- There is in nearly every country of the region a large and vigorous traditional sector. It does not consist, as might be the case in other regions of the
world, of merely a few remnant groups up in the hills. In the Pacific region the traditional sector may be, in socio-cultural terms, relatively unitary (as in, say, the Polynesian states) or multiple and decentralized (as tends to be the case elsewhere). These differences are important since regionalism has political implications which directly affect development plans conceived as being for the national good.

- Almost everywhere, traditional societies and cultures have been heavily modified by historical experience, and these processes of modification and adaptation are continuing. In addition, traditional societies and cultures are seldom as integrated and complete as they might seem from the outside; they have their own internal differentiations. Economists should, therefore, not be surprised when they encounter what they consider to be inconsistencies of behaviour and attitudes; they should not expect them to be absent any more than they would in their own societies.

- Culture is a term that is used in (at least) two quite distinct senses and it is important to understand which sense is relevant. On the one hand, it refers to the constructions, usually made by outsiders, of what the shared understandings which underpin social interaction within a social system are. On the other, it may be an idealization, usually made by participants, of the underlying principles which guide their collective social action. This second usage frequently has political overtones, at both regional and national levels. (Which is not by any means to say that constructions of culture in the first sense have no political implications. They very obviously do.) Culture in the second sense is a potent force for political mobilization in the region, just as it is everywhere else in the world. The political issues will usually have at least some implications for economic development.

- An increased frequency of transactions involving money does not necessarily connote what economists might regard as growth for the national economy. Money is also used in wholly traditional transactions in ways which lead only to the elaboration of the traditional sphere. One needs to know, therefore, the specific social and cultural contexts in which particular development projects are to be located in order to make informed judgments about their possible contributions to economic growth.

- Since traditional cultural principles are by their very nature flexible, contingent and readily adaptable to the realpolitik of varying situations, they necessarily undergo a change when adapted as the goals of a modern nation state What might have been matters of contingency and (ideally) fairness, can very rapidly be transformed into legal disputes. This is particularly evident in the legal codification of traditional principles governing land tenure. Ordinary rural people, concerned with gaining both cash and a subsistence income, can make their own accommodations, but these do not necessarily lead to structural changes, which are subject to wider determinations.

- There is throughout the region a growing consciousness of the issues of power and the development of class systems (or, at least, at the most basic level, of the growing commodification of social relationships and new
Socio-cultural aspects of South Pacific development

systems of stratification). The economy lies at the heart of the changes which have caused this, and there is need for a better understanding of the processes involved in various national settings. Economic growth is widely sought in the region, indeed, it is vitally necessary in most places. It should not, however, be achieved to the detriment of social and cultural concerns. That may sound moralistic, but it is not meant to be. These are very small places, where social disruptions can have very widespread and corrosive effects.

The paper began with an expression of amazement that the World Bank, in its 1991 country study of Pacific economies, should give such weight to social and cultural factors in considering prospects for economic growth—and then virtually ignore them. The Bank did, however, get things right with its statement that "cultural traditions exert a powerful influence on social practices [and] the blending of diverse cultural traditions with modern commercial practices provides each nation with a unique set of characteristics and constraints" (World Bank 1991). The main purpose of this paper has been to draw attention to some commonalities and to suggest ways in which the unique blends of diversities might be understood.

References

Fairbairm, Te'o I.J., 1985. *Island Economies: studies from the South Pacific*, University of the South Pacific, Suva.


——, 1987b. ‘Contradictory ideologies and development’, in Antony Hooper et al. (eds), *Class and Culture in the South Pacific*, Institute of Pacific Studies, University of the South Pacific, Suva.


Sahlins, Marshall, 1992. ‘Goodbye to tristes tropes: ethnography in the context of modern world history’, manuscript of a Robb Lecture given at the University of Auckland.


A number of points in this paper have been developed in collaboration with Kerry James as part of PIDP’s Cultural and Social Issues in Development Program under the direction of Sitiveni Halapua. I am grateful to Sitiveni Halapua, Gerard Finin, Kerry James, Steve Pollard and Elwin Svenson for their help and comments.
The future of Asia-Pacific economies: Pacific Islands at the crossroads?

10–12 November 1992

Tuesday, 10 November 1992

9:00–9:15 Opening address by Prof. Suk Bum Yoon, Director, APDC

9:15–9:20 Welcome Address by Prof. George Kearney, Deputy-Vice Chancellor, Griffith University

9:20–9:40 Keynote address by The Hon. David John Hamill, Minister for Transport and Minister Assisting the Premier on Economic and Trade Development

Session I: Global economic development and the Asia–Pacific economies

Chairman: Suk Bum Yoon

10:15–11:15 Panel discussion on global economic development and its impact on Asia–Pacific economies

Panelists: Alan Bollard
S.P. Gupta
Joseph Lee
Augustine Tan

Session II: Outlook and key issues of South Pacific economies

Chairman: Savenaca Siwatibau

11:15–12:15 Key issues of the Pacific island economies: an overview

Gary Wiseman (represented by Dennis Miller)

Discussant: Brian Brogan

12:15–14:00 Lunch hosted by Assoc Prof. Edmund Fung, Dean, Faculty of Asian and International Studies

14:00–15:00 Changing international environment and its impact on South Pacific economies

Andrew Elek

Discussant: Gita Nandan
Program

Session III: Economic policy and management

Chairman: Mohamed Sadli

15:15-16:15 Macroeconomic management of small island economies
   Savenaca Siwatibau

16:15-17:15 Relevance of East Asian development experiences to the South Pacific economies
   David Lim

   Discussants: Malcolm Treadgold
                Hal Hill

19:30-22:00 Dinner hosted by the Acting Vice-Chancellor, Prof George Kearney and to be held in the Vice-Chancellor’s Suite, University Centre.

Wednesday, 11 November 1992

Session IV: External economic relations

Chairman: Tom Nguyen

9:00-11:00 External economic relations of South Pacific economies
   Rodney Cole

   External resource flows and their impacts on South Pacific economies
   Sione Kioa

   Discussants: Papali’i T. Scanlan
                Navitalai Naisoro

Session V: Human resource development

Chairman: Alexander Agafonoff

11:15-12:15 Human resource development in the South Pacific
   Ken Gannicott
   John Rofeta

   Discussants: Chang-Young Jung
                Lopeti Vulanono

344 The future of Asia-Pacific economies
**Session VI: Natural resource management**

Chairman: Malcolm Treadgold

14:00–15:00 Panel discussion on natural resource management in the South Pacific

Panelists: Brian Hardaker
          Samson Poluome
          John Rofeta
          Ruby Titiulu

**Session VII: Development of services and private sector**

Chairman: John Millet

15:15–17:15 The role of the service sector

Rodney Falvey

Strategies for stimulating private sector development in the South Pacific economies

James MacMaster

Discussants: James Mak
            Augustine Garae

**Thursday, 12 November 1992**

**Session VIII: Socio-cultural aspects of development**

Chairman: Ratna Rana

9:00–10:00 Socio-cultural aspects of development in the South Pacific

Antony Hooper

Discussant: John Connell

**Session IX: Future Asia-Pacific economic relations**

Chairman: Somsak Tambunlertchai

10:00–11:00 Panel discussion on future Asia-Pacific economic relations

Panelists: Chee Peng-Lim
          Joseph Lee
          T.P. Lavulo
          James Mak
          Mohamed Shihab
          Yuan Shu Xun
Session X: Summary and policy recommendations

Chairman: Alan Bollard

11:15–12:30  Summary of issues
   Rodney Cole
   Maree Tait
Conference participants

Dato Abdullah Hj Kuntom
Chief Administrative Officer
Asian and Pacific Development Centre (APDC)
Kuala Lumpur, Malaysia

Alexander Agafonoff
Deputy Director
National Centre for Development Studies
Australian National University
Canberra ACT, Australia

Alan Bollard
Director
New Zealand Institute of Economic Research
Wellington, New Zealand

Brian Brogan
Director of Research, Asia Program
National Centre for Development Studies
Australian National University
Canberra ACT, Australia

Richard Brown
Associate Professor
Department of Economics
University of Queensland
Brisbane Queensland, Australia

Mely Caballero-Anthony
Program Officer
International Trade and Regional Cooperation Program
Asian and Pacific Development Centre (APDC)
Kuala Lumpur, Malaysia

Rodney V. Cole
Research Director
Islands/Australia Program
National Centre for Development Studies
Australian National University
Canberra ACT, Australia

John Connell
Associate Professor
Geography Department
University of Sydney
Sydney NSW, Australia

John Conroy
Executive Director
Foundation for Development Cooperation
Brisbane Queensland, Australia

Jill Deck
Coordinator
Graduate Studies in Development Administration
National Centre for Development Studies
Australian National University
Canberra ACT, Australia

Andrew Elek
Senior Research Fellow
Department of Economics
Research School of Pacific Studies
Australian National University
Canberra ACT, Australia

John Fallon
Consultant
Australian International Development Assistance Bureau (AIDAB)
Canberra ACT, Australia

Rodney Falvey
Reader in Economics
Department of Economics
Faculty of Economics and Commerce
Australian National University
Canberra ACT, Australia

Edmund Fung
Dean and Associate Professor
Faculty of Asian and International Studies
Griffith University
Brisbane Queensland, Australia

Ken Gannicott
Professor
Graduate School of Education
University of Wollongong
Wollongong NSW, Australia
Conference participants

Augustine Garae
Managing Director
Development Bank of Vanuatu
Port Vila, Republic of Vanuatu

Norman Gemmell
Department of Economics
University of Nottingham
Nottingham, United Kingdom

Malakai Gucake
Director
Tourist Council of the South Pacific
Suva, Fiji

S.P. Gupta
Director
Indian Council for Research on International Economic Relations (ICRIER)
New Delhi, India

J. Brian Hardaker
Professor
Department of Agricultural Economics and Business Management
University of New England
Armidale NSW, Australia

Hal Hill
Senior Research Fellow
Department of Economics
Australian National University
Canberra ACT, Australia

Antony Hooper
Department of Anthropology
University of Auckland
Auckland, New Zealand

T.K. Jayaraman
Senior Economist
Asian Development Bank
South Pacific Regional Office
Port Vila, Vanuatu

Chang Young Jung
Professor
Department of Economics
Yonsei University
Seoul, Korea

Chris Karabalis
Assistant Director
Pacific Economic Policy Section
Australian International Development Assistance Bureau (AIDAB)
Canberra ACT, Australia

Neil Karunaratne
Associate Professor
Department of Economics
University of Queensland
Brisbane Queensland, Australia

George E. Kearney
Deputy Vice Chancellor
Griffith University
Brisbane Queensland, Australia

Anthony Joseph Kelloway
Director
Pacific Islands II Section
Australian International Development Assistance Bureau (AIDAB)
Canberra ACT, Australia

Vu Khoan
Deputy Minister
Ministry of Foreign Affairs
Hanoi, Vietnam

Sione Kioa
Deputy Director
Central Planning Department
Nuku'alofa, Tonga

T.P. Lavulo
Director of Planning
Central Planning Department
Nuku'alofa, Tonga

Joseph C. Lee
Vice President
Chung-Hua Institute for Economic Research
Taipei, Taiwan

Chee Peng Lim
Economic Affairs Officer
UN Economic and Social Commission for Asia and the Pacific (ESCAP)
Bangkok, Thailand

348 The future of Asia-Pacific economies
Conference participants

David Lim
Professor
Faculty of Asian and International Studies
Griffith University
Brisbane Queensland, Australia

Paul Anthony McGavin
Department of Economics and Management
University College
University of New South Wales
Australian Defence Force Academy
Canberra ACT, Australia

James McMaster
Dean, Faculty of Management
University of Canberra
Canberra ACT, Australia

James Mak
Professor
Department of Economics
Honolulu Hawaii, United States

D.T. Nguyen
Professor
Faculty of Commerce and Administration
Griffith University
Brisbane Queensland, Australia

Samson Polume
Economic Adviser
Department of Prime Minister and National Executive Council
Boroko, Papua New Guinea

Ratna SJB Rana
Centre for Economic Development and Administration
Tribhuvan University
Kirtipur Kathmandu, Nepal

John Rofeta
Senior Economist
United Nations Development Program (UNDP)
Suva, Fiji

Mohammad Sadli
Vice Chairman, Governing Council
Indonesian Chamber of Commerce and Industry
Jakarta, Indonesia

Papali‘i T Scanlan
General Manager
Central Bank of Samoa
Apia, Western Samoa

Mohamad Shihab
Director of External Resources
Ministry of Foreign Affairs
Male Maldives, Maldives

Savenaca Siwatibau
Head
ESCAP Pacific Operations Centre
Port Vila, Vanuatu

Maree Tait
Managing Editor
National Centre for Development Studies
Australian National University
Canberra ACT, Australia

349  Pacific islands at the crossroads?
Conference participants

Somsak Tambunlertchai  
Coordinator  
International Trade and Regional Cooperation Program  
Asian and Pacific Development Centre (APDC)  
Kuala Lumpur, Malaysia

Augustine Tan  
Department of Economics and Statistics  
National University of Singapore  
Singapore

K. William Taylor  
Chairman  
Foundation for Development Cooperation  
Brisbane Queensland, Australia

Clement Tisdell  
Professor  
Economics Department  
University of Queensland  
Brisbane Queensland, Australia

Ruby Titiulu  
Economic Adviser  
Office of the Prime Minister  
Honiar, Solomon Islands

Malcolm Treadgold  
Professor  
Department of Economics  
University of New England  
Armidale NSW, Australia

Somnuk Tubpun  
Associate Dean of Academic Affairs  
Faculty of Economics  
Thammasat University  
Bangkok, Thailand

Lopeti Vulaono  
Chief, Economic Planning  
Central Planning Office  
Suva, Fiji

Yuan Shu Xun  
Director General  
Foreign Affairs Department  
State Planning Commission  
Government of the People’s Republic of China  
Beijing, People’s Republic of China

Suk Bum Yoon  
Director  
Asian and Pacific Development Centre (APDC)  
Kuala Lumpur, Malaysia

Fang Wei Zhong  
First Vice-Chairman  
State Planning Commission  
Government of the People’s Republic of China  
Beijing, People’s Republic of China

350  The future of Asia-Pacific economies
The Pacific Island economies have for the most part suffered economic stagnation over the past decade. They continue to be reliant on substantial inflows of aid. Yet they are part of the Asia-Pacific region, the fastest growing region in the world. Will this proximity provide signposts showing the way forward, or are there too many roadblocks saying STOP?

Asian and Pacific Development Centre
Kuala Lumpur

and

National Centre for Development Studies
Research School of Pacific Studies
The Australian National University

Pacific Policy Paper
ISSN 0817-0444 ISBN 0 7315 1678 8