Institutions, good governance and economic growth in the Pacific Island countries

Biman Chand Prasad
School of Economics, The University of the South Pacific, Suva, Fiji Islands

Abstract

Purpose – The main purpose of this paper is to provide an overview of the main institutional and governance issues facing the Pacific Island countries (PIC) and to point out how they affect their economic performance. The paper also provides a description of the key characteristics of the PIC and points out why these characteristics may present special challenges to achieving sustainable levels of growth.

Design/methodology/approach – This paper discusses the issues of governance, institutions and economic growth in the PICs.

Findings – The main conclusion of the paper is that PICs would have to align their policies so that appropriate and better economic integration is achieved not only regionally but also globally.

Practical implications – This paper allows policy makers to take note of the main issues in governance and institution building.

Originality/value – This paper provides policymakers and scholars an overview of the institutional and governance issues facing the PICs.

Keywords Pacific region, Islands, Governance, Organizations, Economic growth

Paper type Research paper

1. Introduction

The Pacific Island countries (PICs) face numerous challenges in their pursuit for sustainable development through appropriate levels of economic growth. These challenges include overcoming the threats of political instability, economic and social inequalities, land pressures and conflicts, environmental degradation, increasing incidences of HIV/AIDS and non-communicable diseases, and poor governance. Many of the problems of social and economic deprivation of its people have been due to poor economic growth in the PICs. The key challenge facing the PICs is therefore the lack of vision in adopting appropriate economic policies to enhance economic growth. Over the last two decades, the PICs have been grappling with the issue of low-economic growth by changing their overall economic policy agenda. Supported by the international and regional organizations, such as the World Bank, the International Monetary Fund (IMF), the Asian Development Bank (ADB), and the World Trade Organisation (WTO), the PICs have moved away from the inward-looking import substitution policies towards an outward looking strategy for growth, where export of goods and services has been the main target.

To pursue these policies more vigorously, the PICs moved towards economic policy reform which included trade liberalization, and the deregulation of the product and factor markets to increase efficiency and productivity. The success of these reforms, however, has been very challenging and mixed and in many of the countries it has remained only partially completed. In the case of Samoa, Vanuatu and the Cook Islands,

International Journal of Social Economics
Vol. 35 No. 12, 2008
pp. 904-918

0306-8293
DOI 10.1108/03068290810911453

comprehensive reform programmes supported by the ADB have finally began to produce strong growth performances. In Samoa, for example, the GDP growth rate was 5.1 per cent in 2005. In the larger Melanesian countries, such as Fiji and the Solomon Islands, growth rates have remained low largely because of political instability and the bad governance. Fiji, for example, has had three coups since 1987 and its economic growth rate on average has remained below 3 per cent over the last 20 years.

To address the problem of low-economic growth and to address the issues of increased global impacts' on these economies, the PICs have adopted a "Pacific Plan", which provides a framework to develop regional policies, regulations and strategies to share resources at regional level to promote better economic growth prospects for all its 14 Pacific Forum Island members. This paper discusses the issues of governance, institutions and economic growth in the PICs. The next section provides an overview of economic issues facing the PICs. Section 3 provides a discussion of key characteristics of the PICs and how these present special challenges for institutional development and governance. Section 4 discusses some of the economic policy challenges facing the PICs in relation to governance and institutional problems.

2. Overview of Pacific Island economic and social issues

The PICs are uniquely imperiled with a number of problems. The vulnerability to natural disasters, economic challenges faced by increasing global economic integration, bad governance and corruption and lack of institutional efficiency in relation to most sectors of the economy. Economic challenges facing the PICs are daunting to say the least. Many of them are facing economic decline, grappling with the changing international trading environment. The global economic integration and the increasing move towards freer trade under the rules agreed to by the WTO has placed new pressures on the economies of these countries. Apart from erosion of preferential treatment of their exports the PICs have to grapple with declining export revenue, widening current account deficits and worsening levels of poverty. The Pacific Plan identifies further regional economic integration as the way forward to achieving economic success in the PICs. This involves sharing of resources and developing policies. Pacific leaders have called for the serious challenges facing the countries of the Pacific to be met through sharing scarce resources and aligning policies to strengthen national capacities to support their policies. They have called for a "Pacific Plan" to strengthen regional cooperation and integration as the main instrument for realizing their Pacific Vision. The Pacific Plan Task Force, managed by the Pacific Islands Forum Secretary General and consulting with a Core Group of Leaders, has developed the Pacific Plan through broad-based national and regional consultations and was endorsed by leaders at the Pacific Islands Forum meeting in October 2005. As a "living document", it will form the basis of ongoing strengthening of regional cooperation and integration for the benefit of the people of the Pacific.

Economic growth rates in the PICs have been erratically unstable and low in many of the countries (Table I). In 2005, Papua New Guinea – at the back of a mining boom – achieved more than 5 per cent growth rate with similar growth patterns for Samoa, where growth was tourism driven. In the Solomon Islands, growth has been driven by the reconstruction programme of the Regional Assistance Mission of the Australian Government.

While the broader regional agenda set by Pacific leaders is a noble step forward in recognizing the region's social and economic problems, it will be many more years before sustainable progress is made. Table II shows the human development index

Table I.
Economic growth rates for selected PICs: 2000-2005

Pacific DMCs	2000	2001	2002	2003	2004	2005
Cook Islands	13.9	4.9	2.6	8.2	4.3	0.1
Fiji Islands	−1.4	1.7	2.9	1.2	5.6	1.7
Kiribati	−0.1	−4.7	0.2	5.6	−3.1	4.5
Marshall Islands	−2.0	−1.5	4.0	1.8	0.4	3.5
Federated States of Micronesia	5.0	−0.2	1.7	3.7	−3.8	2.8
Nauru	3.1	0.6	0.7	2.1	2.6	...
Palau	...	3.8	−4.7	−0.1	4.9	5.5
Papua New Guinea	0.0	2.7	2.0	2.9	2.9	3.0
Samoa	6.1	7.0	1.0	3.5	3.7	5.2
Solomon Islands	−14.2	−8.2	−2.7	6.5	8.0	5.0
Timor-Leste	13.7	16.5	−6.7	−6.2	1.8	2.5
Tonga	5.4	2.6	3.0	3.2	1.4	2.3
Tuvalu	13.4	5.9	1.2	4.0	4.0	2.0
Vanuatu	2.7	−2.7	−4.9	2.9	...	...

Source: ADB (2006)

Table II.
Human development index for PICs, 2006

Country	Life expectancy index	Education index	GDP index	HDI value 2006	2006 HDI rank	HDI value 1998	1998 HDI rank
Cook Islands	0.77	0.95	0.65	0.789	1	0.822	2
Palau	0.73	0.92	0.68	0.774	2	0.861	1
Niue	0.75	0.91	0.57	0.741	3	0.774	3
Samoa	0.80	0.94	0.45	0.731	4	0.590	7
Tonga	0.76	0.95	0.44	0.718	5	0.647	6
Tokelau	0.75	0.92	0.37	0.679	6	na	na
Federated States of Micronesia	0.70	0.84	0.50	0.678	7	0.569	9
Fiji Islands	0.69	0.85	0.46	0.667	8	0.667	4
Marshall Islands	0.71	0.88	0.40	0.665	9	0.563	10
Tuvalu	0.64	0.94	0.38	0.653	10	0.583	8
Nauru	0.51	0.86	0.59	0.652	11	0.663	5
Kiribati	0.65	0.88	0.24	0.592	12	0.515	11
Vanuatu	0.71	0.76	0.30	0.586	13	0.425	12
Papua New Guinea	0.49	0.50	0.25	0.414	14	0.314	14
Solomon Islands	0.60	0.63	0.00	0.410	15	0.371	13

Source: Draft Pacific Human Development Report (2006)

(HDI) for the PICs for 2006 and Table III shows the 1998 HDI. Countries like Fiji and the Solomon Islands have had their rankings down graded. This is attributed to poor governance resulting from political instability which has affected the economic performance of the two countries.

The PICs generally face similar problems even though there is considerable diversity in terms of culture, history, resource endowment, environmental vulnerability and levels of economic growth. The PICs always have had a fair share of media coverage, although much of it for the wrong reasons. For the international media, it is always about political crises, instability, natural disasters such as cyclones,

	Rank
1998	
Palau	1
Cook Islands	2
Niue	3
Fiji	4
Tonga	5
Samoa	6
Tuvalu	7
Federated States of Micronesia	8
Marshall Is	9
Kiribati	10
Vanuatu	11
Solomon Is	12
Papua New Guinea	13
2006	
Cook Islands	1
Palau	2
Niue	3
Samoa	4
Tonga	5
Tokelau	6
Federated States of Micronesia	7
Fiji Islands	8
Marshall Islands	9
Tuvalu	10
Nauru	11
Kiribati	12
Vanuatu	13
Papua New Guinea	14
Solomon Islands	15

Source: Draft Pacific Human Development Report (2006)

Table III. Changes in HDI ranking of PICs, 1998 and 2006

floods, earthquakes, tsunamis and an idyllic paradise for tourists wanting to see beautiful beaches and undisturbed cultures and traditions. The regional and national media also tends to concentrate on many of the problems faced by many of the PICs and usually these are very helpful to create awareness and influence government policies towards improving the quality of life of people. However, there is always a tendency to ignore some of the real economic issues affecting many of the PICs. These include the new economic policy agenda which promotes an export-led economic growth strategy and one which requires fundamental changes to economic, social, political, and cultural institutions.

3. Key characteristics of PICs[1]

While PICs differ in some cultural and economic aspects, they also share several features which affect their development in similar ways. The World Bank (2003) calls this "exogenous factors" or "givens" that affect their development strategy. The exogenous factors include remoteness and isolation. Majority of the PICs have large exclusive economic zones and the many islands that constitute one country are widely dispersed. Kiribati, for example, has a population of about 100,000 that is spread over 33 islands that cover 4,000 km from East to West, and 2,000 km from North to South, while the 200,000 inhabitants of Vanuatu are spread over 80 islands in an 800 km chain.

Because of their remoteness and isolation, many of the PICs are far away from the major centres of their trading partners such as the EU, Japan and the USA. Even, Australia and New Zealand for many of them are isolated and present special challenges for communication.

The PICs can be divided easily into three groups. First the large Melanesian countries which include Fiji, Papua New Guinea, Solomon Islands and Vanuatu are endowed with better natural resources and have relatively large and growing-populations. In addition, Melanesian countries like Fiji and Solomon Islands have had a much bigger problem of political instability and ethnic tensions. Fiji, for example, has had four coups in 20 years, with the recent one being on 5 December 2006. Fiji has experienced ethnic tensions for some years and its economic performance has been severely affected following the first coup in 1987. The average growth rate for Fiji over the last 20 years has just been around 2 per cent. The Solomon Islands have had a serious civil strife and is currently undergoing a political transition with the help of the Australian Government. The Solomon Islands economy has been severely affected by the civil strife and it is likely to take sometime before the country is back to some sort of normalcy. Papua New Guinea continues to be stable although the crime rate in the country has affected its economic potential in a significant manner.

The second group includes the two large Polynesian countries, namely Tonga and Samoa. These two countries are relatively well endowed with natural resources and have been relatively stable, at least politically compared with Fiji and the Solomon Islands. Tonga, however, experienced political instability recently, although of a different type. There was rioting in Nukualofa, the capital of Tonga; which was a result of a long suppressed demand for political liberalisation. Tonga has been a constitutional monarchy and participation in the political process and governing of the country was largely decided by the King of Tonga. After the death of the King Topou IV, it is expected that Tonga will move towards political reform and embrace liberal democracy. Samoa, on the other hand, is a well-functioning democracy and socially a very cohesive society. Its economic performance has also generally been very good.

The third group includes the very small Micronesian countries with very little resource endowments. These small countries tend to be resource-poor, thereby posing some different development opportunities and challenges. Their political systems are the legacy of colonial experience ranging from countries such as Australia, Britain, France, Germany, Japan, New Zealand, Spain, and the USA. While the colonial experience left constitutional and democratic forms of government, many are still struggling to define themselves in a truly democratic manner. The link between democracy, constitutionality, property rights and economic performance is an important consideration for many of the PICs. Recent economic literature attributes many of the economic difficulties to inefficient and corrupt governments in many developing countries. The lack of democratic values and respect for rule of law has been a major factor in poor economic performance in Fiji and the Solomon Islands in particular.

The issue of property rights in land has caused many disputes in the bigger Melanesian countries and the solutions to these disputes are not yet in sight in many of the countries. Resource ownership conflicts in the Melanesian countries are also common and the communal nature of the property rights causes problems for both economic development and the environment. Ownership of natural resources is important for identification of family, clan, and lineage and this plays a significant role in the governance structures in many of the PICs. Close kinship ties and small communities sometimes make it difficult to bring about efficiency in the civil service and reduce corruption. The PICs are also very susceptible to natural disasters. Many of them experience regular extreme weather conditions. The economic and social impacts of these events are rising and are likely to cause serious hardship in the future. Climate change is increasingly becoming a an issue of major concern for the smaller countries such as Kiribati, Tuvalu and the Marshall Islands. In these countries, inundation due to storm surges could increase significantly, leading to loss of assets and salinization of groundwater sources. Climate change is also likely to cause more cyclones and droughts, reduce agricultural output and affect food security in the future.

Other characteristics include heavy aid dependence, large public sectors, high-debt levels, poor infrastructure and poor delivery of public services. All these characteristics present special challenges for development in the PICs. In addition to these, fiscal and monetary policies also play an important role in the overall management of the economies of the PICs.

3.1 Fiscal policy

Fiscal policy has been used as a major instrument for macroeconomic management. This is so because most PICs have a large public sector with government expenditure ranging from 30 to 50 per cent of GDP. Several studies on Fiji and the other PICs raise the issue of sustainability of the public sector and point out that these countries need to contain their public expenditures so that private sector investment is not impeded in the medium- to long-term.

The major challenges for PICs have been to reduce the size of the public sector. According to the recent Pacific Economic Update (Commonwealth of Australia, 2008) there has been considerable progress made in improving the macroeconomic performance in the PICs. The report points out that responsible fiscal policy has led to the reduction of deficits with sound monetary policies have helped to keep the inflation rate under control. In 2006, for example, Papua New Guinea, Tuvalu, and the Cook Islands, had a fiscal surplus, while Palau, Samoa, Vanutau, the Federated States of Micronesia, Fiji, the Marshall Islands, Kiribati, and Tonga, continued to record fiscal deficits. Papua New Guinea, in particular, has had a surplus due to massive increases in mineral revenues, which rose from 28 per cent of GDP in 2002 to 36 per cent in 2006 (Commonwealth of Australia, 2008).

3.2 Monetary policy

The effectiveness of monetary policy has its own limitations in the PICs due to the presence of a large subsistence sector (Jayaraman, 2003). The main objective of monetary policy in the PICs has been to monitor the foreign exchange reserve and maintain price stability. The PICs have adopted a managed system of exchange rate and, therefore, monetary policy effectiveness has been rather weak. Recent analysis of the exchange rate regime shows that for PNG and Samoa, real effective exchange rates are stationary meaning that shocks will have a transitory effect on real exchange rates whereas in the case of Fiji and the Solomon Islands, shocks could have permanent effects on real exchange rates (Narayan and Prasad, 2008). The future of monetary policy effectiveness, however, will depend on how the financial markets develop in the larger PICs. Currently, it is dominated by few major players and central banks have limited capacity to influence their behaviour.

4. Economic policy changes since the 1980s

Like many developing economies around the world, the PICs were also undergoing fundamental economic policy changes. The drive towards export-oriented growth strategies was a result of the deepening economic crises, such as the widening current account deficits, the balance of payment problems, and the inability to service debts in many developing countries. Led by developed countries, such as the USA and the UK, and supported by the IMF and the World Bank, the structural adjustment policies were designed to move these failing economies towards more outward looking policies. The main thrust of the new policies were to reduce government expenditures, promote private sector investment and privatization, remove high tariff rates and provide support to industries which produced for exports. The experience of some of the Asian countries, such as Singapore, Hong Kong, South Korea, and Taiwan, were produced as evidence that open economies with an emphasis on exports would achieve high levels of economic growth in these countries. The benefits of international trade has been actively promoted throughout the 1980s, 1990s and continues with much zeal in the 2000s. The role of the WTO in this has been particularly important. The current development in the multilateral trade negotiations have presented serious problems as the negotiations on the Doha Development Agenda have been stalled after the 6th Ministerial Meeting in Hong Kong in December 2005.

The PICs have continued to grapple with the rapidly changing global economic environment and have attempted to change their own economic policies to benefit from the global developments in economic integration. Tonga, Fiji, the Solomon Islands and Papua New Guinea are already members of the WTO, while Vanuatu and Samoa are in the process of acceding to the WTO. The membership of the WTO requires certain commitments from the members and, in particular, it requires them to reduce trade barriers such as tariffs, quotas and other non-tariff barriers. Many of the commentators who have argued against uncontrolled opening of trade regimes point out those small developing countries will always lose out as they would not be able to compete in the international markets with large countries. They, therefore, argue that the PICs need special provisions to allow them to be treated differently from the large and developed countries. Despite these views, most of the governments in the PICs supported by developed country trade partners and international organizations have continued to push for economic integration in the region. This is evidence from their support for the Pacific Plan which supports economic integration and regional trade. The adoption of the Pacific Islands Countries Trade Agreement (PICTA) and the Pacific Agreement on Closer Economic Relationship (PACER) further indicates that trade openness is going to be the cornerstone of economic policies in the region.

Thus, many of the PICs are trying to align their economic policies towards reaping the benefits of trade. Macroeconomic stabilization policies include reigning in on large government deficits, controlling the debt levels and maintaining adequate levels of foreign exchange reserves. On the trade side, attempts are being made to promote the exports of good and services in which these countries have comparative advantage.

For bigger Melanesian countries, agricultural and primary exports such as sugar, beef, and gold, copper are the main exports with Fiji and Papua New Guinea having some manufactured exports such as garments and food. Other small countries depend mainly on fish exports. The comparative advantage for many goods is restricted due to high costs of production. The export of services of which tourism is the main one, presents real opportunities for many of the PICs to improve their economic growth performances.

Most of the PICs apart from the few very small ones, such as Nauru, Tuvalu, Kiribati and Niue, have the potential for increasing tourism as a major sector of the economy. Fiji is already a leader in attracting tourists with well developed tourism infrastructure. Other countries such as Papua New Guinea, Solomon Islands, Vanuatu, Samoa and Tonga are also taking advantage of the growth of the tourism industry in the region[2].

5. Natural resources, economic growth, and conflicts in the PICs

Most economists believe that natural resources are not the key drivers of economic growth in developing countries (Katzman, 1987). Many cross-country studies have provided evidence that abundant natural resources have often been associated with low-economic growth (see, for instance, Sachs and Warner, 1997, 1999). The economic-growth literature has generally not been concerned with the role of natural resources in economic growth (Barbier, 1999). Scarcity of natural resources in promoting economic growth has not been a problem as results from endogenous-growth models are almost always optimistic. This implies that productivity gains through technological advancement may compensate for the problem of scarcity in particular regions or in case of particular types of goods and services. Barbier (1999) points out that even when natural resources are in scarce supply, high levels of economic growth are still feasible. In fact, there is evidence that as a country progresses to higher levels of development, industries based on natural resources make a declining contribution to its GDP and hold a declining share in the total distribution of income (see, for instance, Schultz, 1953, 1972; Kuznets, 1966). Recent evidence on the export performance of developing countries shows that those relying on primary exports have experienced a decline in economic growth. Perkins *et al.* (2001) point out that markets for primary products grow slowly. In addition, the prices received for these products have been in constant decline. Another reason for the decline of primary exports is that structural shifts have taken place in the developed countries. Demand in developed countries for primary goods such as food products grows more slowly than income; in the long run, the demand for primary exports from the developing world is expected to decline (economists refer to this as the Engel's law). Gillis *et al.* (1996, p. 467) summarize this view as follows:

> With slower growth in the industrial countries, the impact of Engel's law, and materials – saving innovations, it seems unlikely that the developed countries will import enough tropical foods and raw materials to fuel an era of rapid development for the third world as a whole over the next few decades. Nevertheless, some commodities will face brisk demand growth and some countries will benefit substantially from producing such exports.

Furthermore, it is contended that export prices will decline for primary products over a period of time (Prebisch, 1950; Singer, 1950). Primary product prices have also been declining and this has caused export earnings to decline in the developing countries. In some larger countries, what is commonly known as the "Dutch disease" was a cause for much concern. The Dutch disease refers to the recession caused in The Netherlands in the

1960s after a large discovery of natural gas. The export of natural gas created a huge balance-of-payment surplus, which did not translate into economic prosperity. Instead, it led to rising inflation, declining exports of other commodities, lower rates of income growth, and rising unemployment. However, despite declining growth levels due to over-reliance on primary exports, many developing countries have no alternative and are still highly dependent on natural resources.

While there is increasing debate about free trade and globalization, there is also increasing attention on the question of governance. For Fiji and the PICs the issue of governance is now at the forefront of public debate. Many economic failures in these countries are attributed to bad governance – that is, mismanagement of public resources, corruption in the public sector, and mismanagement of natural resources, such as forests, minerals, and fisheries.

Corruption has been a serious concern for developing countries. Its impact on economic growth has been investigated extensively by economists. Some have found that corruption has a negative impact on economic growth (see, for instance, Mauro, 1995; Murphy *et al.*, 1991, 1993; Krueger, 1993; Liu, 1985; Tanzi, 1998; Wei, 1997; Poirson, 1998; Rama, 1993). However, others argue that corruption has a positive effect on growth.

A recent study by Leite and Wedmann (1999) investigates the link between natural resources, corruption, and economic growth. They find that countries that derive substantial income from natural-resource-based industries have more corruption and mismanagement than those that do not. Other studies find a negative relationship between natural resource exports and economic growth (see for instance Barro, 1991; King and Levine, 1993; Mankiw *et al.*, 1992; DeLong and Summers, 1991).

The exploitation and control of natural resources has also contributed to conflicts, sometimes violent ones, in many developing countries – including the PICs, such as Papua New Guinea and the Solomon Islands. In Fiji, the question of resource use and ownership has been a source of constant conflict between indigenous owners and non-indigenous users. There is also a degree of conflict among the resource owners themselves. However, before discussing specific conflicts in Fiji, it is important to review some of the international literature on conflicts arising out of natural resource ownership and exploitation.

According to Ross (2002), many civil wars are caused by dependence on natural resources. He points out three ways in which this can happen. Over-dependence on natural resources can stunt economic growth; it makes governments weak, more corrupt, and less accountable; and it gives people in resource-rich regions incentives to secede. But dependence on natural resources is not the only reason for conflicts. They can also arise from complex sets of events and conditions such as poverty, ethnic or religious differences, and unstable governments (Ross, 2002).

There is also the question of natural resources adequacy. Given that natural resources are factors of production, they must be continuously available for production to continue. But it is well-known that there are limits to natural resources and this itself may be an impediment to economic growth for countries which rely heavily of the production and export of primary products. But through technological innovation the limits to natural resource use in production can be, to some extent, overcome (Dasgupta and Heal, 1979; Stiglitz, 1974).

From an environmental point of view, socially optimal rates of resource use – such as how much fish is being caught, how much forest is being harvested – are also crucial.

Causes of resource mismanagement arise when property rights are not well defined. Laws, customs, and regulations play an important role in governing access to natural resources and determine how people use or misuse them. Thus, resource use is not simply a technological matter but also depends on economic institutions[3].

In many of the PICs, resource use has often led to conflicts that have retarded economic growth in those countries. In the bigger Melanesian countries of Fiji, Papua New Guinea and the Solomon Islands, coups, ethnic conflicts and other civil disturbances have been largely based on resources use or fears of losing control of resources. In the case of Bougainville conflict, the rents derived from mining were considered to be unfair and the Bouganvillians felt alienated and hence a long drawn conflict affected the whole of Papua New Guinea. In the case of Fiji, the 1987 and 2000 coups were based on the fear of losing control of indigenous land in Fiji. In Fiji, conflicts about resource use take place at two levels: between indo- and indigenous Fijians, and within the indigenous Fijian community. Inter- and intra-ethnic conflicts are a result of people who use their power and influence to acquire wealth from the management of natural resources. In the case of the Solomon Islands, ethnic conflict also to a large extent was based on the allocation of resources and the exploitation of natural resources.

6. The Pacific Plan – how realistic is the Pacific Plan? Can it contribute to better economic growth

The Pacific Plan is a response to the perceived impact of globalization and trade liberalization on the PICs economics, politics, culture and environment. The plan is intended to provide a framework for further and deeper regional integration. More specifically, it calls for the development of initiatives to enhance cooperation in the development of regional institutions to better deliver services to the people. In smaller PICs, the economies of scale does not exist for the development mechanisms and instruments for effective delivery of essential services. On facilitating trade, the PICs need to cooperate in customs regulations and quarantine services in order to enhance cooperation and trade amongst themselves. The Pacific Plan is a good initiative as it allows the PICs to develop their own plans for sustainable development. While the plan focuses on other issues, such as management of natural resources and governance, it is mainly preoccupied with the trade issues. Even in the area of trade, PICs have gone ahead with the PICTA and are developing policies on various trade issues.

The ideas in the Pacific Plan are not new as it draws on the regional cooperation achieved in the past in the delivery of services such as education, environmental and economic services. The plan also recognizes the governance problems and has proposals to strengthen various governance institutions. These include justice systems, human rights institutions, development of good practices for leadership and general capacity building in terms of the human resources.

6.1 Institutional development in the PICs

Part of the strategy in the Pacific Plan is to create appropriate and quality institutions. First, many of the PICs suffer from lack of appropriate institutions. This includes political institutions which can ensure better governance. In the last ten years emphasis of Australian aid and New Zealand aid programs have been to strengthen various political institutions in order to enhance better political governance.

This includes strengthening the parliamentary systems, building capacity of the legislative staff to deliver better and timely services to politicians and other stakeholders. Secondly, many of the PICs are struggling to develop appropriate economic institutions to facilitate regional and international economic integration. These include reforming the public sector policies and institutions, labour market institutions and trade policy institutions. According to Gani and Prasad (2006), institutional quality matters for trade facilitation and enhancement of trade generally. They find that institutional quality; government effectiveness, rule of law, regulatory quality and control of corruption for six PICs (Fiji, Kiribati, Samoa, the Solomon Islands, Tonga and Vanuatu) are important determinants of trade. They conclude that improvements in these four indicators have a significant impact on trade enhancement. It is an important finding and has serious policy implications for improving trade. Many of the PICs have in the last decade pursued an export-oriented strategy for growth. Many have also struggled to attract investment in their export sectors. Apart from the high cost of doing business, inefficient and lack of appropriate institutions provide negative signals to the investors. The most obvious institutional inefficiency is that related to the land tenure. The inefficiency of property rights in land in almost all the PICs present special challenges to many of them. The communal nature of land tenure does not provide certainty to potential investors and productivity is affected throughout the economy.

7. Concluding comments and challenges for the future

The PICs have a number of governance and institutional challenges. The governance challenge includes the development of appropriate institutions to reduce corruption and mismanagement in government and in the management of natural resources. Fisheries, forestry and mining sectors attract a lot of rent-seeking behaviour and often politicians are involved in this. The PICs, which have these resources, have to ensure that appropriate legislative mechanisms are developed to minimize the mismanagement of resources. Countries, such as Vanuatu and the Solomon Islands, have to ensure that rents received from the exploitation of forestry and fisheries are invested into productive activities to further develop other sectors of the economy. In the case of Papua New Guinea, the mining boom has driven its growth rate to about 5 per cent but the development of the agricultural sector has suffered because the government has been unable to direct resources to the development of agricultural infrastructure. Resource rents, if not managed, could be a source of serious conflict and has the potential to destabilize the country as it has happened in Fiji and the Solomon Islands. The issue of property rights in land, fisheries, forestry and mining creates further difficulties and conflicts about rent distribution. Appropriate institutions for developing secure and efficient system of property rights, especially in land, is vital for raising production[4].

Another challenge for many of the PICs is to transform their economy to reap the benefits of global trading opportunities. The PICs, as a whole, are moving ahead with the regional trade agreements like the PICTA, the Melanesian Spearhead Group, the PACER and the Economic Partnership Agreement with the European Union. The PICs have major challenges to reform their trade policies – with many of them still having high levels of tariff protection and monopolistic market structures. This situation also raises governance issues. For example, telecommunication regulations are currently in support of monopolies and this has been adding significant costs to doing business in the region[5]. The PICs have to reform not only their trade policies but also their labour market policies. Having a more flexible labour market, competitive telecommunication industries, liberalized trade regime, and an open investment policy in the growth industries, such as tourism, could provide the edge for many of the PICs in the current global economic environment.

In terms of the institutions, the PICs face the challenge of not only developing new institutions for governance but also improving the existing ones to make them more effective. To do this, the PICs would need support from donor countries. Many of the PICs have small revenue bases and undertaking various forms of economic reforms will create significant adjustment costs for which they will need support. International organization like the World Bank, the IMF, the ADB, the WTO and donor governments, such as Australia, New Zealand and the EU, will have to support this adjustment costs. In addition, the PICs would need to be helped under the Special and Different Treatment provisions of the WTO, where they would need support for trade facilitation, customs valuation and an adjustment period for progressive tariff reduction. All this could support better governance and institutional development in a cohesive manner.

Notes

1. For related literature and discussions relating to many of the fiscal and monetary issues, see for example, Narayan and Narayan (2003, 2004a, b, 2005, 2007, 2008a, b), Narayan (2004b), Narayan *et al.* (2006) and Narayan and Prasad (2003).
2. For related literature on tourism, see Narayan (2004a, c, 2005a, b, 2007).
3. For recent studies on the impact of government institutions on economic performance see North *et al.* (1990) and Shleifer and Vishny (1993). They point out that lack of appropriate institutions severely harm economic performance in developing countries. Also see Prasad (2003) for a discussion of the role of institutions in economic development. For institutions and sustainable development, see Prasad and Tisdell (2006).
4. See, World Bank (2003) on land tenure and how it can support the reduction of poverty in developing countries.
5. See, Winters and Martins (2004) for cost advantages for various types of industries in small island states.

References

ADB (2006), *Asian Development Bank Outlook 2006*, Asian Development Bank, Manila.

Barbier, E.B. (1999), "Endogenous growth and natural resource scarcity", *Environmental and Resource Economics*, Vol. 14, pp. 51-74.

Barro, R.I. (1991), "Economic growth in a cross section of countries", *Quarterly Journal of Economics*, Vol. 106, pp. 407-33.

Commonwealth of Australia (2008), *Pacific Economic Survey 2008: Connecting the Region*, Commonwealth of Australia, Canberra.

Dasgupta, P.S. and Heal, G.E. (1979), *The Economics of Exhaustible Resources*, Cambridge University Press, Cambridge.

DeLong, J.B. and Summers, L. (1991), "Equipment investment and economic growth", *Quarterly Journal of Economics*, Vol. 90, pp. 455-502.

Gani, A. and Prasad, B. (2006), "The relationship between institutional quality and trade in Pacific Island countries", ArtNet working paper, UNESCAP, Bangkok.

Gillis, M., Perkins, D.H., Radelet, S., Snodgrass, D.R. and Roemer, M. (1996), *Economics of Development*, W.W Norton & Company, New York, NY.

Jayaraman, T.K. (2003), *Issues in Monetary Economics of the South Pacific Island Countries*, Economics Department, The University of the South Pacific, Suva.

Katzman, M.T. (1987), "Ecology, natural resources, and economic growth: under developing the Amazon", *Economic Development and Cultural Change*, Vol. 35, pp. 425-36.

King, R.G. and Levine, R. (1993), "Finance and growth: Schumpeter might be right", *Quarterly Journal of Economics*, Vol. 108, pp. 717-37.

Krueger, A.O. (1993), "Virtuous and vicious circles in economic development", *American Economic Review*, Vol. 83, pp. 351-5.

Kuznets, S. (1966), *Modem Economic Growth: Rate, Structure, and Spread*, Yale University Press, New Haven, CT.

Leite, C. and Wedmann, J. (1999), "Does mother nature corrupt? Natural resources corruption and economic growth", IMF working paper, International Monetary Fund, Washington, DC.

Liu, F.T. (1985), "An equilibrium queuing model of bribery games", *Journal of Political Economy*, Vol. 93 No. 4, pp. 760-81.

Mankiw, N., Romer, D. and Weil, D. (1992), "A contribution to the empirics of economic growth", *Quarterly Journal of Economics*, Vol. 107, pp. 407-37.

Mauro, P. (1995), "Corruption and growth", *The Quarterly Journal of Economics*, Vol. 106, pp. 503-30.

Murphy, K., Shleifer, A. and Vishny, R. (1991), "The allocation of talent: implications for growth", *Quarterly Journal of Economics*, Vol. 106, pp. 503-30.

Murphy, K., Shleifer, A. and Vishny, R. (1993), "Why is rent seeking so costly to growth?", *American Economic Review*, Vol. 83, pp. 409-14.

Narayan, P.K. (2004a), "Fiji's tourism exports: an ARDL approach to cointegration", *Tourism Economics*, Vol. 10, pp. 193-206.

Narayan, P.K. (2004b), "Do public investments crowd out private investments? Fresh evidence from Fiji", *Journal of Policy Modelling*, Vol. 26, pp. 747-53.

Narayan, P.K. (2004c), "Economic impact of tourism on Fiji's economy: empirical evidence from a CGE model", *Tourism Economics*, Vol. 10, pp. 419-33.

Narayan, P.K. (2005a), "The structure of tourist expenditure in Fiji: evidence from unit root structural break tests", *Applied Economics*, Vol. 37, pp. 1979-90.

Narayan, P.K. (2005b), "Did Rabuka's military coups have a permanent effect o a transitory effect on tourist expenditures in Fiji: evidence from Vogelsang's structural break test", *Tourism Management*, Vol. 26, pp. 509-15.

Narayan, P.K. (2007), "Testing the convergence hypothesis: evidence from Fiji's tourism markets", *Pacific Economic Review*, Vol. 12, pp. 651-63.

Narayan, P.K. and Narayan, S. (2003), "The sustainability of Fiji's budget deficit: an econometric analysis", *Pacific Economic Bulletin*, Vol. 18, pp. 77-90.

Narayan, P.K. and Narayan, S. (2004a), "Are exports and imports cointegrated? Evidence from two Pacific Island countries", *Economic Papers*, Vol. 23, pp. 152-64.

Narayan, P.K. and Narayan, S. (2004b), "The J-curve: evidence from Fiji", *International Review of Applied Economics*, Vol. 18, pp. 369-80.

Narayan, P.K. and Narayan, S. (2005), "Estimating income and price elasticities of imports for Fiji in a cointegration framework", *Economic Modelling*, Vol. 22, pp. 423-38.

Narayan, P.K. and Narayan, S. (2007), "Is devaluation expansionary or contractionary? Empirical evidence from Fiji", *Applied Economics*, Vol. 35, pp. 2589-98.

Narayan, P.K. and Narayan, S. (2008a), "Does military expenditure determine Fiji's exploding debt levels?", *Defence and Peace Economics*, Vol. 19, pp. 77-87.

Narayan, P.K. and Narayan, S. (2008b), "Estimating the demand for money in an unstable open economy: the case of the Fiji Islands", *Economic Issues*, Vol. 13.

Narayan, P.K. and Prasad, B.C. (2003), "Fiji national budget 2003: building a resilient economy?", *Pacific Economic Bulletin*, Vol. 18, pp. 91-107.

Narayan, P.K. and Prasad, B.C. (2008), "Are shocks to real effective exchange rates permanent of transitory? Evidence from Pacific Island countries", *Applied Economics*, Vol. 40, pp. 1053-60.

Narayan, P.K., Narayan, S. and Prasad, A. (2006), "Modelling the relationship between budget deficits, money supply and inflation in Fiji", *Pacific Economic Bulletin*, Vol. 21, pp. 103-16.

North, D.C., Calvert, R. and Eggerttson, T. (Eds) (1990), *Institutions, Institutional Change and Economic Performance*, Cambridge University Press, Cambridge.

Perkins, D.H., Radlet, S., Snodgrass, D.R., Gillis, M. and Roemer, M. (2001), *Economics of Development*, Norton and Co, New York, NY.

Poirson, H. (1998), "Economic security, private investment, and growth in developing countries", IMF Working Paper 98/4, International Monetary Fund, Washington, DC.

Prasad, B.C. (2003), "Institutional economics and economic development: the theory of property rights, economic development, good governance and the environment", *International Journal of Social Economics*, Vol. 30 No. 6, pp. 741-62.

Prasad, B.C. and Tisdell, C.A. (2006), *Institutions, Economic Performance and Sustainable Development: A Case Study of the Fiji Islands*, Nova Science Publishers, New York, NY.

Prebisch, R. (1950), *The Economic Development of Latin America and Its Principal Problems*, United Nations, New York, NY.

Rama, M. (1993), "Rent seeking and economic growth: a theoretical model and some empirical evidence", *Journal of Development Economics*, Vol. 42, pp. 35-50.

Ross, M. (2002), "Natural resources and civil war: an overview", paper presented at the Conference on the Governance of Natural Resources Revenues, World Bank and the Agence Francaise de Development, Paris, 9-10 December.

Sachs, J. and Warner, A. (1997), "Sources of slow growth in African economies", *Journal of African Economies*, Vol. 6 No. 3, pp. 335-80.

Sachs, J. and Warner, A. (1999), "The big push, natural resource booms and growth", *Journal of Development Economics*, Vol. 59, pp. 43-76.

Schultz, T.W. (1953), *The Economic Organization of Agriculture*, McGraw-Hill, New York, NY.

Schultz, T.W. (1972), "The increasing economic value of human time", *American Journal of Agricultural Economics*, Vol. 54 No. 5, pp. 843-50.

Shleifer, A. and Vishny, R. (1993), "Corruption", *Quarterly Journal of Economics*, Vol. 59, pp. 599-617.

Singer, H.W. (1950), "The distribution of trade between investing and borrowing countries", *The American Economic Review*, Vol. 40, pp. 470-85.

Stiglitz, J.E. (1974), "Growth with exhaustible natural resources: efficient and optimal growth paths", *Review of Economic Studies*, Vol. 41, pp. 123-37.

Tanzi, V. (1998), "Corruption around the world: causes, consequences, scope, and cures", *IMFStaff Papers*, Vol. 45, pp. 559-94.

Wei, S. (1997), "Why is corruption so much more taxing than tax? Arbitrariness kills", NBER Working Paper 6255, National Bureau of Economic Research, Cambridge, MA.

Winters, A.L. and Martins, P.M.G. (2004), *When Comparative Advantage is Not Enough: Business Costs in Small Remote Economies*, London School of Economics, Centre for Economic Performance, London.

World Bank (2003), *Land Policies for Growth and Poverty Reduction: A World Bank Policy Research Report*, World Bank and Oxford University Press, Washington, DC.

Further reading

Duncan, R. *et al.* (1999), "Pursuing economic reform in the Pacific", Pacific Studies Series No. 18, ADB, Manila.

Gillis, M. (1988), "Indonesia: public policies, resource management and the tropical forest", in Repetto, R. and Gillis, M. (Eds), *Public Policy and the Misuse of Forest Resources*, Cambridge University Press, Cambridge.

Sachs, J. and Warner, A. (1995), "Natural resource abundance and economic growth, national bureau of economic research", Working Paper No. 5398, Cambridge, MA.

UNESCAP (2007), *Economic and Social Survey of the Asia Pacific 2007*, UNESCAP, Bangkok.

Corresponding author
Biman Chand Prasad can be contacted at: Chand_b@usp.ac.fj