

State-Owned Enterprises and the Arm's Length Concept: The Case of Government Commercial Companies in Fiji

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Influenced by the rhetoric of the arm's length concept, Fiji's public enterprise reform of 1993 took off with high hopes of better things to come for the struggling government commercial companies (GCCs) that had been posing a significant burden on the government's limited resources. Unfortunately, the prevailing sense of optimism faded after more than a decade of inconsistent performance by the majority of GCCs. There was an oversight right from the outset. Responsible authorities were easily carried away by the finesse of the concept and were largely ignorant of the realities in Fiji that stifled progress following the 1993 reform..

Introduction

In 1993, Rabuka's *Soqosoqo ni Vakaluewa ni Taukei* (SVT) government, in a desperate effort to revive Fiji's coup-derailed economy following the political events of 1987, initiated a broad public sector reform that comprised three main components: civil service reform, financial management reform, and public enterprise reform. The public enterprise reform took advantage of the arm's length concept using principal-agent theory as the structural design to address the problems facing Fiji's government commercial companies (GCCs).

For the period 1993-2006, the performance of GCCs in Fiji remained indifferent. The political events of 1987 and 2000 are often used as the scapegoat, and rightly so in many ways. However, there is more than just the political turmoil that the country encountered. In fact, there are profound and complicated issues this article highlights as critical to the demise of the arm's length concept in Fiji. In particular, it focuses on the critical issues embracing the relationship between the principal (minister) and the agent (a GCC's board of directors). Among the many reasons, this relationship is central to the success and failure of state-owned enterprises. This is often ignored in theory and practice.

The Arm's Length Concept and Principal-Agent Theory

The arm's length concept is about placing government operations

(commercial operations in particular) at an arm's length from direct government or ministerial control. The main purpose is to grant these agencies the autonomy to make decisions without political influence. The autonomy needed for government agencies to perform their duties is nothing new. Thynne and Wettenhall (2004), in a review of earlier thinking on autonomy, acknowledge the contributions of Macmahon, Seidman, Selznick and Follett. These earlier insights provide comprehensive and multi-dimensional analyses of autonomy and its importance for organisations and managers.

A significant manifestation of legal-structural autonomy is that of corporatization (Lane 1997). It is of particular interest here because it is widely practiced in Fiji (McMaster 2001) and most Pacific Island Countries (PICs). Broadly, it is about transforming the structure and operation of government authorities engaged in commercial operations to resemble those of commercial companies (Collier & Pitkin 1999; Guthrie & Johnson 1994). It has been attractive to Fiji and other PICs largely because of its assumed success in New Zealand, with which PICs have many ties.

Corporatisation entails an important principal-agent relationship in which there is a need to align the interest of the agent with that of the principal by improving transparency and accountability using various means, predominantly contracts and incentives (Boston et al 1996; Moe 1997; Rainey 1991). This form of relationship is compelled by the underlying assumption that the agent maximises one's self-interest at the expense of the principal and, thus, that the principal needs to adopt mechanisms by which such behavior can be countered or kept in check.

The importance of autonomy (both political and managerial) and accountability of state-owned enterprises is well documented. A recent study by the United Nations (2008) of a number of developing and developed countries highlights that autonomy is a key to the effective management and success of state-owned enterprises. Another study, by the World Bank which also covered both developed and developing countries, pinpointed managerial autonomy as one of the factors that "distinguishes successful public enterprises from poorly performing ones" – the argument being "that excessive control of and interference with the operational decisions of public managers (in investment, product mix, pricing, hiring and firing of staff, wage-setting, and procurement policies) by the government unit with oversight can suffocate managerial initiative and result in a loss of accountability and costly operational inefficiencies (Ayub and Hegstad 1987: 28).

While autonomy is widely hailed as a condition of success for public enterprises, its effectiveness requires a specific political, social and administrative environment in which to flourish. This is the challenge many small developing countries have faced when introducing autonomy-based reforms using the agency theory framework to revive their ailing public enterprises. While some have managed to acclimatise with ease,

others have struggled, as in the case of Fiji.

Essential Background

Post-independence Social Developments

Fiji, like other countries, faced a multitude of social issues and challenges following independence from Great Britain in 1970. Some of these issues have been resolved while others continue to feature on the agenda of successive governments in the country and society as a whole. Among others, racial discrimination between the two main ethnic groups – Indians and indigenous Fijians – is the acute social challenge that continues to be addressed. It is considered here because of its relevance to state enterprise reform.

In brief, Indians were brought to Fiji by the British between 1879 and 1916 as indentured labour to work on sugarcane farms (Alley 2000; Lawson 2004; Kelly 1998; Trnka 2005). Following the termination of the indentured labour scheme in 1920, some Indians returned home while others stayed in Fiji and continued to work on sugarcane farms under leasing arrangements that were first introduced in 1915 by indigenous landowners (Prasad & Tisdell 1996). Due to their hardworking nature and their ability to do well in commercial businesses and education, several became successful economically and politically compared to the indigenous community (Emde 2005; Trnka 2005). As a result, the indigenous community felt unease about the sudden control of business life and the growing political influence of Indians; hence several negative assumptions (mostly wrong) and stereotypes emerged to reshape their perception and relationship with the Indian community (Tedeschi 2005). Ratuva (2000: 184), for instance, claims that Fijians often stereotype Indo-Fijians “as greedy, selfish and cunning, but also as hardworking and ambitious”. Further, some Fijians are under the impression that Indians are after their land, and that one day Fiji will be totally ruled by Indians. In fact, some landowners have preferred not to renew land leases with their Indian farmers, for whom personal security and private capital has become a serious concern.

Post-independence Political Developments

Following independence in 1970, the Alliance party led by Ratu Kamisese Mara took office with its leader as the Prime Minister. The Alliance was in power for 17 consecutive years. During that period, the National Federation Party (NFP), which is dominated by Indians in the business sector and the sugar industry (Alley 2000; Norton 1990), was the opposition. The Alliance motto of “Unity in Diversity” was perceived as an attempt by its leader to promote tolerance in cultural diversity, especially between the two main ethnic groups (White 2002).

In 1987, the Alliance lost office to the Fiji Labor Party (FLP) and the NFP coalition following the general election in April. The FLP which was launched two years earlier and dominated by Indians is a mixture of Indian and Fijian academics and trade unionists. The party excelled to centre stage due to their promise to help the poor and the working class in Fiji. It was a timely move as the Alliance was perceived to be corrupt, indiscrete and too elitist (Alley 2000; White 2002). Following the demise of the Alliance in the 1987 general election in April, the NFP-FLP coalition took office with Timoci Bavadra (who was the FLP leader) as the Prime Minister. But several days later, their reign was cut short by a military coup led by Lieutenant Colonel Sitiveni Rabuka. His main reason for the coup is well known: to protect the interest of indigenous Fijians. According to Rabuka, the indigenous Fijians had become “second class citizens” and “minorities in their own land” (Dean & Ritova 1988; Scarr 1988).

In 1990, a new constitution was introduced under the interim government to replace the 1970 constitution abrogated by the coup makers of 1987. Its contents were racially biased towards the indigenous Fijians (Alley 2000). For instance, out of 70 parliamentary seats, only 27 were allocated to the Indian community. In addition, the posts of president and prime-minister, as well as top positions in the civil service, were to be occupied only by indigenous Fijian.

The 1992 general election, which was the first one held after the coup of 1987, put Rabuka and his *Soqosoqo ni Vakavulewa ni Taukei* (SVT) party into power, with Rabuka at the helm. The SVT joined forces with the NFP in 1994, and introduced another constitution in 1997 to amend the flaws and ills of the 1990 constitution by advocating multiculturalism.

In 1999, the SVT lost office to the FLP in the general election. Mahendra Chaudry, who was the leader of the FLP at the time, became the Prime Minister. The SVT's demise was perceived as retribution for compromising indigenous interests in the 1997 constitution and also for the abuse of the National Bank's resources (Alley 2000).

On 19 May 2000, which is the day of its first anniversary in power, the FLP administration was overthrown by a civilian coup led by a struggling businessman by the name of George Speight who was supported by an indigenous mass. The underlying rationale for the coup replicated that of the 1987 coup: power must be returned to the hands of the indigenous people. After months of civil unrest, the Fiji military took over and an interim administration headed by Laisenia Qarase was appointed to office until the general election in 2002.

Qarase's newly formed SDL party won the 2002 election and governed for a full term. It gained victory again over the FLP at the 2006 general election held in April. But, unfortunately, this time its term in office was disrupted by the military coup led by Commodore Frank Bainimarama in early December 2006. Unlike the 1987 and 2000 coups, the 2006 military takeover was said to be a “clean-up” campaign. According to Bainimarama,

Qarase's government was corrupt and racist. Central to the allegation are two pieces of legislation the SDL government had introduced in Parliament: the *Qoliqoli Bill* and the *Promotion of Reconciliation, Tolerance and Unity Bill*. The former sought to give the indigenous community property rights to fishing zones and the foreshores, while the latter to grant amnesty to the perpetrators of the 2000 coup (Lal 2007; Prasad 2008). To date, Fiji's political leverage remains in the hands of the military regime with Bainimarama as the Prime Minister. A roadmap is now in place to rid of corruption and racial division in the country.

The Role of Government Commercial Companies (GCCs)

State-owned enterprises in Fiji are divided into two categories in line with the Public Enterprise Act of 1996. As presented in Table 1, the categories are government commercial companies (GCCs) and commercial statutory authorities (CSA). The majority of the GCCs (on which this discussion focuses) were established following independence in 1970 through the corporatisation of previous departmental enterprises.

Fiji's first independent government inherited extensive operations from the colonial administration. Some of these operations were established because the private sector was not equipped adequately to produce or provide many goods and services in response to community needs. For instance, the Fiji Ships and Heavy Industries body was formed to provide ship-building and maintenance service for the government fleet that was servicing isolated communities and other countries in the region (McMaster 2001: 237). Other countries also faced similar challenges. Tonga's government, for instance, was involved in hotel and duty free operations, while Samoa's government once owned a soap factory (Amosa 2007).

Besides an under-strength private sector, some GCCs in Fiji were established to protect the interests of vulnerable resource owners from domestic and foreign exploitation. This is a special feature for Fiji, mainly because 80 percent of the land is customary land and landowners lack the expertise in these areas. For example, the Fiji Hardwood Corporation (FHC) which was established in 1998 is mandated to safeguard the interests of landowners from domestic and foreign logging firms. It is required to ensure that landowners are well compensated for their land and other resources and to protect the environment.

Import substitution has also underscored the role of some GCCs such as Rewa Rice, the Yaqara Pastoral Company, and Food Processors Limited. The Yaqara Pastoral Company was established in 1973 to promote cattle farming and to supply quality meat for public consumption. This and the other enterprises mentioned provide competition for imported goods and secure a market for local farmers.

Table 1
List of Government Commercial Companies (GCCs)
and Government Statutory Authorities (GSAs)

Government Commercial Companies
1. Airports Fiji Ltd
2. Fiji Broadcasting Corporation
3. Fiji Ships and Heavy Industries Ltd
4. Post Fiji
5. Fiji Ports Corporation
6. Ports Terminal
7. Rewa Rice Ltd.
8. Unit Trust of Fiji
9. Viti Corps Ltd.
10. Yaqara Pastoral Company Ltd.
11. Fiji Hardwood Corporation Ltd.
12. Food Processors Ltd.
Government Statutory Authorities
1. Fiji Electricity Authority
2. Fiji Meat and Industry Board
3. Housing Authority
4. Public Rental Board

The Reform: Rationale, Objectives and Influence of the New Zealand Model

The reform process instigated in 1993 has involved the corporatization of a number of government departments using the principal-agent structure as the practical expression of the arm's length concept in Fiji. The main aim has been to provide the entities with management structures that grant the boards of directors and managers with the appropriate discretion and autonomy to make decisions critical to the successful running of the organisations (Ministry of Public Enterprises 1999).

Following the political events of 1987, Fiji's economy hit an all time low. The government's commercial entities were among the other factors at the centre of the problem. Most were operating with heavy losses and continuing to rely on government for operational and financial survival. In the first half of the 1990s, they incurred an average loss of F\$11 million and drained F\$25 million from government annually (Appana 2003; Ministry of Public Enterprise 1999). Part of the problem was their abuse by portfolio ministers responsible for them. Much of this was provoked by the 1987 coup, which pushed for an indigenous-dominated public sector, at least at the senior management level. The result was devastating for the entities as opportunists and poorly qualified people were appointed to their boards. Most were grossly overstaffed, often with inadequately qualified staff

(Reddy 2000). Good governance practices gave way to cronyism, nepotism and patronage (Appana 2003; Lal & Vakatora 1997). Compounding matters, the resources of the entities were used to reward the supporters of the 1987 coup. This was especially obvious in the operation of the National Bank of Fiji, and led to its demise in 1995. Loans were granted to many of the coup advocates (Appana 2003) without following the proper procedures. In 1995, the bank was faced with a F\$250 million debt (Review November 1995).

The reform was also a timely transformation, as Rabuka's SVT government was desperate for recognised international practices to uplift its profile in the region and the international community following serious revelations of abuse of government resources following the 1987 coup. Implementing a reform driven by an ideology that had already produced sound results abroad (especially in New Zealand) and had the confidence of the international community seemed an almost perfect means for the SVT government to refurbish its political image by reassuring the public of its commitment to good governance practices.

The objectives of the reform were to make public enterprises more efficient and productive, more accountable, and better managed. Hence, from 1993, public enterprises that were eventually transformed to GCCs were tasked with the principal objective of operating successfully as a business in terms of generating profits similar to operations in the private sector. The process started with commercialisation followed by corporatisation (Samy 1994). Agencies were required during the process to identify their commercial operations and to define clear objectives for them. Accountability mechanisms and other commercial practices for sound management were also required, including performance appraisal systems, long-term business strategies and corporate plans.

New Zealand's state-owned enterprise reform blueprint – particularly the State-Owned Enterprises Act of 1986 – influenced Fiji's reform. In brief, the New Zealand model was seen as a sound example of the principal-agent theory at work, in which responsible ministers (as the principals) are responsible for defining objectives and performance monitoring, while the boards and chief executive officers of the enterprises (as the agents) are responsible for delivering set objectives (Boston et al 1996; Treasury 1987; Wistrich 1992). Boards and managers are given extensive autonomy to make decisions pertaining to the profitability of their operations, while the ministerial role is mainly confined to objective setting and performance monitoring (Schick 1996; Scott 2001; Wistrich 1992).

The influence of the New Zealand model on Fiji's state-owned enterprises reform is not surprising considering the international recognition of the New Zealand reform. Authorities in Fiji responsible for the reform could not ignore international accolades embracing the New Zealand model, especially when it was regarded as a neighbouring friend. As a result, assistance was sought from New Zealand in the form of expertise and funding. Several senior public officials from Fiji were

seconded to the New Zealand Treasury to understudy the New Zealand model. Also, financial institutions like the Asian Development Bank (ADB) and the World Bank (WB) were campaigning strongly for Pacific Island countries to adopt the New Zealand model as the way forward for improving public services and to curtail wastage of financial resources. This was mainly done in a series of awareness seminars conducted in the early 1990s for senior public officials in the region.

Fiji's drawing on the New Zealand model needs further analysis, especially since architects and observers of the reform in New Zealand issued warnings to other countries, and in particular developing states, of the danger of emulating such a model (Bale & Dale 1998; Schick 1998; Scott 1996). Schick (1998) stresses the need for developing states contemplating adopting the New Zealand model to develop their institutional capacity and potential to respect and adhere to the rule of law prior to any engagement with such a model. A key reason for this concerns the prominence of contracting and greater autonomy in New Zealand's reform. These features require a rule-abiding culture in order to flourish. Where countries have an "informal sector" that favors some individuals to ignore the law in order to maximize benefits (De Soto 1989), any attempt to introduce elements of the New Zealand reform is bound to fail.

Significant Features of the Reform

The Public Enterprise Act 1996 provides the mandate and the design of the reform. In particular, a structural design is assumed that ensures clarity of ministerial and board roles, the relative autonomy of GCC, sound accountability mechanisms, and competition. The proceeding discussion focuses on the first three of these elements

Clarity of Roles

The role of the Minister of Public Enterprises under the Act is to appoint and terminate (when necessary) board members following consultation with the Prime Minister. The minister is also tasked with the responsibility of setting financial targets for GCCs. For instance, the current return on equity (ROE) target for GCCs is 10 percent per annum. The minister through the Ministry of Public Enterprises monitors the performance of GCCs in order to achieve set targets.

The board, on the other hand, is in charge of the affairs of the enterprise in order to advance the interests of the state, which is the sole shareholder. Accordingly, the board is responsible for the GCCs commercial policy and direction, for ensuring it achieves its principal objectives, and ensuring it is performing its functions in a proper, effective and efficient way.

Autonomy Mechanisms

Schedule 1 of the Act prescribes that the board has the autonomy and authority to make decisions on the entire operations of a GCC. In assuring the autonomy of the board, members are selected and appointed on merit and are supposed to be independent of political partisanship. A list of criteria is in place to ensure that those who are appointed have the necessary expertise to provide direction for GCCs to reach their performance targets. This includes core competencies such as sound leadership, relevant practical experience, and commercial skills.

Since 1993, all boards in charge of 12 enterprises have included individuals with credentials and proven records in the private sector. Their proficiency in directing their own private ventures in an autonomous environment acts as a check for the government to commit to the arm's length relationship. The fact that they are accountable to the state for the successful achievement of GCCs' performance targets compels them to defend their autonomy quite vigorously; otherwise, their task becomes unbearable.

Chief executive officers of GCCs also enjoy considerable freedom under their terms of employment. All CEOs have extensive discretion to discharge funds and power to oversee human resource matters. They also have the authority to redirect funds and change business strategies in extreme circumstances that might compromise the survival of their enterprises.

Accountability Mechanisms

Increased autonomy is conditioned by increased accountability for results. In Fiji, strict accountability is required under the Act. The board in particular reports to the Minister of Public Enterprises using such documents as statements of corporate intent, audits reports, bi-annual and annual reports, and any other information that is required or requested by cabinet. The minister presents these documents to cabinet and some, especially annual reports and audit reports, are eventually tabled in Parliament.

The CEOs report to their respective boards on their performance targets outlined in their employment contracts. They are not board members but are normally required to sit in board meetings when information or advice is required.

In addition to these internal mechanisms, there are external institutions that scrutinize the operations and performances of GCCs. The Office of the Controller and Chief Auditor (CCA) in particular is required under the constitution to audit and to table the accounts of all GCCs in Parliament. In a significant report, the CCA (2006) was very critical and concerned about the poor performance of the majority of GCCs.

The Ministry of Public Enterprises, while not having the mandate of the

CCA, nevertheless plays an important role in monitoring the performance of GCCs. Its main role is to keep GCCs on track by providing them with guidance, support and advice.

Challenges and Issues

Despite the efforts of authorities responsible for the reform, the first few years following the change were disappointing. Most GCCs failed financially to turn things around as expected: see Table 2. Profits were well below expectation, losses were common, and dividends that were supposed to be paid to the government were not forthcoming. In its 2009 report, the ADB (2009: 1) highlighted an average return on equity of -0.7 percent for state-owned enterprises in Fiji between 2002 and 2006, despite a high investment of 16-25 percent.

A particular concern is the failure of political parties to conform to the reform regulatory framework in their attempts to score political support. An example is the reinstatement of 400 workers who were made redundant by Airports Fiji Limited (AFL) in the late 1990s under the SVT government that championed the reform. When it lost office to the Fiji Labor Party (FLP) in 1999, the FLP government reinstated all workers made redundant by AFL and other GCCs. This honored a vote-winning promise the party had made during the election campaign, which contributed significantly to the party's victory (Appana 2003). The outcome completely undercut what had been planned by the AFL board and senior managers to raise the AFL's performance.

The selection of board members is also far from being independent as required under the Act. This is an oversight under the Act as the Minister of Public Enterprises makes the appointment rather than an independent party. Without doubt, the majority of board members are business people and individuals who support the government of the day. A recent report by the ADB (2009: 12) suggests that "board membership in Fiji has been quite volatile", referring to the frequent changes of board members over time depending on the party in power. This raises serious questions about the apolitical status of board members.

The politicisation of board appointments has created some problems. Corruption in various forms among board members has been prevalent. However, because of the cordial relationships many members have had with the regime in power, swift action against corrupt individuals has rarely been taken. The sacking of all board members appointed by successive governments in the wake of the 2006 coup, together with legal cases made against them by the interim government, has exposed some of these "done deals" between board members and previously elected governments.

Another factor that is central to the problem of board membership is Fiji's political climate. As already discussed, politics in Fiji is racially driven.

Table 2
GCCs Profit/Loss 1997-2006 (\$FJ million)

GCCs	'97	'98	'99	2000	'01	'02
1. Airports Fiji Ltd	-	-0.42	0.49	1.9	1.8	0.34
2. Fiji Broadcasting Corporation	-	-1.61	0.08	0.19	0.25	0.13
3. Fiji Ships and Heavy Industries Ltd	-	-	-	-	-0.12	-0.24
4. Post Fiji	-	-	-	-	-	-
5. Fiji Ports Corporation	-	-	-	-	-	-
6. Ports Terminal	-	0.41	0.39	0.54	0.85	-
7. Rewa Rice Ltd.	-	-	-	-	-	-0.13
8. Unit Trust of Fiji	-	-	0.04	0.09	0.13	0.15
9. Viti Corps Ltd.	-0.94	-0.47	-0.64	-0.59	-0.64	-0.24
10. Yaqara Pastoral Company Ltd.	-0.18	0.17	0.24	0.25	-0.13	0.48
11. Fiji Hardwood Corporation Ltd.	-	-0.55	-3.98	-2.93	-2.97	-1.84
12. Food Processors Ltd.	-	-0.95	-0.87	-0.02	-0.09	-

GCCs	'03	'04	'05	'06
1. Airports Fiji Ltd	0.54	2.95	2.56	-
2. Fiji Broadcasting Corporation	-0.12	-0.72	0.08	-
3. Fiji Ships and Heavy Industries Ltd	-0.20	-0.1	0.04	-
4. Post Fiji	-	1.26	-0.91	-1.68
5. Fiji Ports Corporation	-	-	1.60	-
6. Ports Terminal	0.98	-0.23	-	-
7. Rewa Rice Ltd	-0.33	0.57	0.06	-
8. Unit Trust of Fiji	0.07	0.04	0.13	0.13
9. Viti Corps Ltd	-0.47	-0.40	-	-
10. Yaqara Pastoral Company Ltd	0.30	0.13	0.56	-
11. Fiji Hardwood Corporation Ltd	-3.66	-2.35	-1.43	-
12. Food Processors Ltd	0.04	0.05	0.04	-

Source: Ministry of Public Enterprise (2006)

This poor and uncongenial political relationship is perceived as one of the main reasons for the demise of public enterprises in the country in pre- and post-reform periods. Generally, whichever ethnic group is in power has attempted to consolidate its political grip and, in doing so, its supporters are placed in key administrative offices, including boards of public enterprises. While this is a common practice elsewhere, Fiji's situation is particularly complicated and interesting. It is a contest between two ethnic groups: the owners of the country's resources and the immigrants. The former fight to secure their supremacy and ownership

of the land and natural resources while the latter battle for recognition, identity and equal rights. When in power and looking for political allies to consolidate political control, political relationships become the priority as so much depends on them.

The autonomy enjoyed by CEOs to exercise extensive power, while perceived as the ideal way to manage GCCs, depends in the final analysis on the incumbents. Those with a strong will to succeed and with a high regard for the best interests of their enterprises and stakeholders are in a better position to use their authority appropriately and effectively. Unfortunately, this has not always been the case with some CEOs in charge GCCs. They have exploited such privilege to their own advantage. Six CEOs have been sacked since the interim government took over in 2006 and are now awaiting court proceedings against them for corrupt practices.

CEOs' effective use of their discretion relies heavily on their relationships with their boards. Usually, if CEOs are on good terms with board members, their autonomy to make decisions is unlikely to be compromised. However, once the relationship turns sour, boards normally flex their muscles and strip CEOs of their discretion.

The extent to which the relationships work also depend on the beliefs and styles of board members and CEOs. Boards dominated by members with a "hands-on" approach prefer to micro-manage, while those at the opposite end provide broad direction and wait for results. On the other hand, CEOs lacking the confidence, pride and senses of recognition and personal achievement can undermine the relationship, while those with strength of character and commitment can make the relationships flourish. A report by the Auditor General (2006) suggested that, at the time, most CEOs lack required competencies and are a significant cause of the poor performance of GCCs.

Strict accountability of GCCs falls short of expectations. Despite the significant formal reporting arrangements between boards and the responsible ministers, these measures are overshadowed by the genial relationships between board members and the government of the day. Hence, hardly any action has been taken to address the poor performance of GCCs since the reform was initiated. This reflects the reality of Fiji's political and social practices discussed above.

To compound matters, the rewards of board members have not been tied to performance. Irrespective of the level of performance of GCCs, board members have continued to receive compensation and other benefits as part of their contracts. This has contravened efforts in the principal-agent relationship to ensure the agent acts in the best interest of the principal.

Lessons for Small Island States

Fiji's experience raises several issues for other small island states with respect to the principal-agent model. In particular, Fiji's problem strongly

lies with the principal – the minister – which concerns the ultimate political survival goal of any party in office. While this is a prevalent goal elsewhere, Fiji's case is much more desperate and demanding as a lot is at stake as a result of the existing social tension between the two main ethnic groups. Hence, to maximise any chance of political survival, strengthening relationships with existing supporters and securing further support becomes the priority rather than the performance of government organisations. Also, political accountability with respect to performance and integrity while in office are of secondary importance to the voters because the majority of voters vote along racial lines.

The political environment is the breeding ground for the informal sector mentioned above. For the principal, relationships become the order of the day rather than contracts and administrative obligations. The agent, on the other hand, is hardly committed to contractual obligations because the cordial relationship with the principal is of central concern. The flow-on effects can be devastating: the agent, for instance, is compelled to engage in operations outside the mandate of the enterprise, as well as corrupt practices, in order to maximise self-interest. Collusion with the principal is also inevitable mainly because of a sharing of a common interest. In the end, the principal has the tendency to overlook accountability measures in place for potentially disciplinary action.

For small island states, the political environment is the platform for the arm's length concept using the principal-agent setting. Fiji's experience raises questions about the political systems and institutions in place that are responsible for electing credible political representatives and parties, as well as for holding them accountable. If the capacity of the political mechanisms is below par because of social, cultural and economic deficiencies, then it is most likely that any attempt to ensure that commercial operations operate at arm's length from political control in a principal-agent structure is doubtful. A recent report by the ADB (2009: 12) on the performance of SOEs in Fiji, Samoa and Tonga following reforms in these countries supports this view. In particular, the report emphasises political commitment as paramount to the reform of SOEs, otherwise any sound legislative framework in place is ineffective. Critics of the New Zealand model have also made this point, as indicated above.

Perhaps for small island states and in particular Pacific Island countries, the best option to take is privatisation either partially or in full depending on the importance of the service to society. The ADB (2009) also advocates this option. In essence, it relieves political parties from the pressure of appointing party supporters to the boards of SOEs. Most small island states with parliamentary systems are still young and are going through a learning process. Some may mature quickly, while others may take awhile to do so. Hence, to retain SOEs while struggling politically may carry enormous risks, as in the case of Fiji. It depends in large part on whether privatisation can be achieved and give depth to the private sector to

respond efficiently and effectively to society needs.

Fiji's experience also exposes the limits of the principal-agent theory in the public sector context. Agency theory fails to recognise the many relationships and common interests shared by the principal and the agent in the public setting. It also pays no attention to the nature and quality of the political systems, institutions and processes in place that principals have to go through, especially in small island states. If these mechanisms do not conform to their ideal theoretical underpinnings, then it is most likely that principals will behave irrationally.

Conclusion

Fiji's arm's length model needs further fine-tuning to gain better results. While the Public Enterprise Act 1996 needs strengthening, especially with respect to the roles of the responsible minister and the board, the key to improvement lies in the ability of ministers and board members to perform their duties effectively under the regulatory arrangement in place. However, the relationships between the two parties are personally and politically close. There is a lot at stake should the relationships be rejected in favour of statutory obligation and if the rule of law is overlooked.

The effective functioning of the system is largely in the hands of the government of the day. A regime that respects the rule of law and holds the best interest of GCCs in high regard irrespective of the unfavourable political consequences is without doubt the key to activate basic assumptions crucial to the success of the arm's length concept in Fiji. This is a real challenge for the present and future regimes in the light of the country's political conditions and other circumstances.

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