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Special Issue: Issues in Banking and Finance in Fiji

Guest Editors: **Parmendra Sharma & Biman C. Prasad**

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Banking and Finance in Fiji: Introduction

Biman Prasad

Vigorous and sustained socio-economic development has been a major goal of many Pacific island economies, including Fiji. Historically, growth strategies in Fiji, as in many other developing countries around the world, have significantly been influenced by multilateral organisations such as the World Bank, IMF and ADB and have included 'filling the gap' with aid and investment, human capital development and loans linked to recommended policy changes. However, these strategies appear to have yielded little success (as summarised in ADB, 2004). In recent times, the government has also taken steps to reform the economy¹. The overall strategy has been to pursue a market-oriented sustainable growth which, based on the experiences of other countries, has largely included tax reforms, reduced trade barriers, civil service reforms, and corporatisation and privatisation of public utilities (Duncan et al., 1999). However, these reforms have again not had much success, and vigorous and steady growth remains elusive.

A number of analysts have suggested that a key to sustainable economic growth in Fiji would be a robust and vibrant private sector (ADB, 1999, 2004). The ADB identifies the *financial sector* as a crucial ingredient for the development of such a vigorous private sector.

In principle, a well-developed financial sector provides many essential services. Levine (2005a) summarised these as: (i) the production of information; (ii) the monitoring of firms' performance and exercise of corporate governance; (iii) risk amelioration; (iv) the pooling of savings; and (v) the facilitation of exchange of goods and services. In providing these services, financial sectors contribute, *inter alia*, to resource allocation, capital accumulation and technological innovation, which in turn may foster economic growth. As Levine points out, '...broad cross-

¹ Reddy, et al (2004) provide a chronological account of sectoral and institutional reforms in Fiji.

country comparisons, individual country analyses, and firm-level investigations point in the same direction: the functioning of financial systems is vitally linked to economic growth' (1997: 689–70). Thus, a better developed financial system is likely to contribute to improved economic growth performance.

The question now is: how can financial development in Fiji be promoted or accelerated? Intuitively, such development would require the enhancement of both the supply and the demand sides of the financial sector. With regard to the supply of funds to organised financial channels, many researchers agree that legal protection of the suppliers or investors (creditors and minority shareholders), as advanced by La Porta et al. (1998), is a key determinant. Politics (see Rajan and Zingales, 2003b), and endowment (see Licht et al., 2001; Acemoglu et al., 2001) may also play key roles. With respect to the demand for funds, while economic agents, especially those in the private sector, may obtain funds from many sources, only those obtained through organised channels would contribute to financial development. Thus, the degree of preference for competing funds determines the extent and magnitude of demand for financial sector funds; a high degree of preference for the former is likely to result in low demand for the latter. Intuitively, the determinants here appear to be cost, collateral requirements, paperwork and bureaucracy and disclosure requirements.

In addition to the above, corporate social responsibility (CSR) and governance issues appear to play important roles, especially from a demand perspective. While there may not be a consensus about the precise meaning of the concept of CSR, it is generally defined as a form of 'self-regulation by business, based on social or moral responsibilities towards society, an effort that goes beyond the existing government regulations' (Knippenberg and de Jong, 2010: 17). Thus, CSR is about proactively reconciling ethics and business, a rather ambitious and perhaps also somewhat complicated but necessary undertaking in today's business environment for the reason that business practices may have gradually become increasingly amoral. Accordingly, increasingly, it is being accepted that there is a need for ethical principles to correct flaws and/or generate a fairer distribution of benefits for better socio-economic outcomes.

Self-regulation also incorporates the nature and extent of accountability of particular individuals in an organisation aligned with the goal of minimising the inherent and potential principal-agent problems. In recent times, interest in corporate governance practices has increased significantly prompted mainly by the collapse of a number of high profile corporate scandals, including the infamous Enron scandal. Essentially, the

idea is to promote investor confidence and assist corporations meet stakeholder expectations. A broader goal of corporate governance, like that of CSR, is also to enhance socio-economic well being via equitable distribution of business wealth through accountable and transparent processes.

In light of the foregoing, this special edition of the *Fijian Studies*, attempts to do the following:

1. provide new empirical evidence on the financial development—economic growth nexus for Fiji;
2. add to the CSR and CG debate relating to Fiji's financial sector; and
3. provide insight into the importance of legal institutions and remittances for financial development in Fiji.

Accompanying volumes of this journal provide a number of papers containing detailed studies of the banking and financial sector operations.

New empirical evidence on financial development—economic growth

The first article, by Gounder, examines the correlation between financial development and economic growth in Fiji over a thirty five year period, 1970 to 2005. Using a newly available set of data and by constructing an index to measure financial development, rather than depend on measures relating to specific attributes such as size and depth, the author finds that financial development has contributed positively to economic growth in Fiji over the period under study. Previous scant literature appears to be lacking in rigour and data.

The CSR and GC debate

Three articles contribute to this debate. The first of the three, by Sharma and Brimble, looks at how the big two international banks in Fiji (ANZ and WBC), evidently the most powerful institutions in Fiji's financial sector, may have, intentionally or unintentionally, contributed to users being 'involuntarily excluded' from the financial system. The authors recommend a CSR policy response for these and other banks to minimise instances and/or practices of financial exclusion, noting that increased financial inclusion is likely to lead to enhanced economic growth via increased levels of financial sector financing.

Reddy and Sharma investigate the nature and efficacy of principle-based corporate governance initiatives in promoting better governance practices within the South Pacific Stock Exchange (SPSE) listed compa-

nies in Fiji. Noting that a root cause of the 2007 global financial crisis may well have been a breakdown of shareholder monitoring and ill-conceived managerial incentives, the authors find that insiders in Fiji own large proportions of listed companies, that is, block holding is relatively high and consequently, non-controlling shareholders hold very dismal proportion of shares in listed companies, having serious adverse governance implications. The authors suggest that there is a need to rigorously protect minority shareholders' rights in Fiji, which is likely to result in increased stock market liquidity, and in turn help develop the stock market and lead to economic growth.

Given that the above articles focus on CSR and governance issues relating to financial institutions and markets, one might wonder what the CSR practices are elsewhere in Fiji's private sector. Accordingly, the third article, by Reddy, examines and compares CSR commitments of firms across various sectors in Fiji. The author does this by attempting to construct, for the first time, a CSR Index. Findings reveal generally low levels of CSR commitment by corporations in Fiji. In light of increased calls from NGO's, civil society organizations and governments for the corporate sector to show increased care for the society and environment and become environmentally, morally and socially responsible, the author suggests, that raising the overall CSR commitment of the business sector in Fiji may require an appropriate policy response.

Legal institutions and remittances

In view of the prominent law-finance-economic growth theory and the continuing debate over it, Sharma and Nguyen attempt to examine, for the first time, the applicability of the law-stock market development nexus in Fiji. Results from an analysis of primary and secondary data indicate that stock market development over the 1997-2007 period has been very weak compared with 55 other developed and developing countries. The evidence provided does not support the frequently stated or implied proposition that strengthening legal institutions is an essential prerequisite for furthering stock market development in Fiji. This finding may have implications for other developing economies in the South Pacific and elsewhere.

Prakash and Gounder provide a new and interesting insight on the financial development debate. Noting that the flow of remittances into Fiji's economy has been relatively significant, the authors argue that these remittances can exert a positive impact on the country's economic growth via the financial sector, based on the concept that money transferred

through financial institutions paves the way for recipients to demand and gain access to other financial products and services, which they might not have otherwise. Empirical results show that remittances do increase the efficiency of Fiji's financial system through the proliferation of money transfer facilities and development of other financial products and services. However, the authors note that other factors such as the quality of legal institutions in the country, inflation, capital account openness and financial market liberalization remain crucial for the development of the financial sector through various other channels.

Regulation

In the final article in this issue, the Reserve Bank of Fiji's former Board member Dr. C P Dulare discusses the regulatory functions of the RBF. He proposes that for some time, the RBF had taken to itself the responsibility of maintaining price stability in Fiji. He proposes that the RBF should reconsider, what he calls, its 'self imposed objective of price stability', failing which the government needs to review the objectives in the RBF Act. Dulare argues that the overall purpose of these re-interpretations and reviews should be a focus on output and employment/unemployment. Given that levels of poverty and unemployment in Fiji are high, the objective needs to be growth in output and employment not mere stability in these.

Special article

We conclude this special edition of the Fijian Studies with special articles providing brief history of three of financial institutions in Fiji, the Australia New Zealand Bank (ANZ), Bank of Baroda, and the Bank of the South Pacific.

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