Reflections on constraints to growth in Pacific Island countries

By Ron Duncan
26 June 2014

Today, I wish to reflect on the economic performance of the Pacific island states and, in particular, on what I see as the major binding constraints to better economic performance and living standards for the large part of their populations, who have seen little improvement in their welfare.

A major issue for the Melanesian countries and for Kiribati is their rapid population growth and the lack of formal employment opportunities. In Fiji, for example, the annual number of school leavers is around 17,000, while I have estimated that the annual number of jobs available is around 2,500. Without the outward flow of Indo-Fijians since 1987—5-6,000 in some years—the under-employment problem in Fiji would be much worse.

Unlike the Cook Islands, Samoa and Tonga, and the US Compact countries (FSM, Marshall Islands and Palau), the Melanesian countries do not have easy or reasonably easy access to migration or employment opportunities in the metropolitan countries—which in countries such as Cook Islands, Samoa and Tonga has served to reduce population growth. The rapid population growth—the "youth bulge"—together with the lack of formal employment opportunities and the rural-urban migration within the countries, has resulted in many social problems.

Unfortunately, there is little to no prospect of creating the number of formal jobs needed in these countries to relieve the economic and social pressures arising from the rapid population growth. The fertility and population growth rates are falling and the "youth bulge" cohorts are declining, but the problem will not disappear. The earlier cohorts of unskilled, inexperienced youth are now in their late-20s and early-30s and still without formal work experience.

The Pacific island countries cannot grow their economies in the same way as the countries of East Asia did. East Asian economies attracted investment in standard technology, labour-intensive, low-wage activities such as garments and footwear, IT-assembly, and toys that could provide employment for the large numbers of farm workers being released from the agricultural sector as its productivity increased. While these countries initially did not benefit from the economic rents from such investments, their living standards improved as a result of the agricultural labourers moving to a higher-productivity sector.

Pacific island countries do not have the large supplies of labour that allow them to be attractive to similar investments. Hence, I argue that innovation has a much more important role to play in these countries than in others. As I have argued previously, the land-rich Melanesian countries should and could benefit from improvements in agricultural productivity given the appropriate conditions (such as secure individual tenure to land). This would raise the living standards of the bulk of the population who live in the rural areas and it would release labour for possible employment in other sectors. But neither can the Pacific island countries be large-scale exporters of unprocessed or lightly processed primary commodities shipped in bulk, given their small size and their geographical isolation. Hence, they have to innovate to add value to their natural resources—whether in the form of tourism, in promoting their culture, or in adding value to primary commodities, as we have seen with Fiji's bottled water and cosmetics industries or Cook Islands and Samoa's high-end fashions.

Opening of migration opportunities for at least some of the population-stressed countries would be a "safety valve" to relieve some of the pressure. But this seems only politically feasible for the smaller countries. For the larger countries, such as Fiji, Solomon Islands and Vanuatu (let alone Papua New Guinea), having migration of a size that would make a decent dent does not seem politically possible.

The seasonal worker programs of New Zealand and Australia are a start; but I would like to see a much more integrated approach to this idea of Migration for Development (M4D). The seasonal worker programs cater for unskilled workers, albeit with some limited opportunities for training. But there is no incentive for families to invest in the education of their children with the aim of diversifying their household labour to higher-income jobs in other countries.

The idea of M4D is not altogether a good news story. Globally, the number of migrants involved and the volume of remittances have increased hugely. However, while the research evidence is that poverty levels are reduced and there is increased household expenditure on schooling, health, clothing and shelter, there is little expenditure on business ventures and there appears to be no positive impact on the economic growth of countries. The finding of a lack of impact on growth is a puzzle. Is it due to the researchers not allowing sufficiently for the delayed impacts of increased expenditure on education and health; or is it because of the lack of remittances going into business investments, perhaps due to the many obstacles to setting up a business; or is it because the more entrepreneurial people are migrating?

As I said, I believe that innovation is hugely important for these countries. As Professor Deirdre McCloskey recently reminded us here at the Crawford School, the 100- to 300-fold increases in per capita incomes that we have seen since the Industrial Revolution in the now high- or middle-income countries were due to innovations by the merchant class or bourgeois; and their incentives to innovate were stimulated by changes in societal attitudes that led to individuals being free to innovate and to trade. Making the same kind of investment incorporating the same technology over and over does increase the capital-labour ratio, but it does not lead to increases in capital productivity; and it contributes little to improvements in living standards. The early growth stage of the East Asian countries that I referred to earlier did not see them earning the large economic rents from their participation in the production networks established as part of the fragmentation of production. These rents were earned at the financing and retailing ends. It is investment that incorporates innovations that generates the large increases in economic rents and living standards.

If the Pacific island countries are to innovate and generate large economic rents and improved living standards, they must do all that they can to encourage innovation. This means being open to business, to both domestic and foreign investors, so that new ideas and technology will be invented domestically or introduced from elsewhere. Imagine how much value-added has been injected into Fiji spring water by putting it into a square bottle with an illustration of a waterfall on the front; or how much has been added to a few cents worth of coconut oil and butter by innovative branding and advertising. But these activities will not take place unless the economy is open to trade and investment, as well as to skilled workers.

Recent research by the ADB has looked into the factors responsible for the structural transformation of its member countries. Unfortunately, the Pacific island countries have demonstrated little in the way of structural transformation—they are said to be caught in a "low product" trap of exporting mostly unprocessed or lightly processed primary commodities. The two factors that the ADB research showed as most important in structural transformation were, surprisingly, the level and quality of primary schooling—not secondary schooling as we have long believed—and training to upgrade workers' skills so that they can more quickly be comfortable with introduced technology.

To me, these findings point to two issues needing attention: first, the poor quality of primary schooling throughout the Pacific—which a World Bank education specialist recently attested to in a meeting here at the Crawford School—and the difficulty of bringing in expatriate workers in many Pacific countries. Resistance to issuing work visas to skilled expatriate workers is justified on the basis that this will take jobs away from domestic labour. But research that I did in PNG years ago showed that the loss of a skilled expatriate work force led on average to a loss of 11 local workers. Hence, the Pacific needs to take much more seriously the training of primary school teachers. It also needs to be more open to the entry of skilled workers to help train locals in skills needed to work with new or introduced technology and new work practices.

Of course, I have been discussing these issues from an economist's viewpoint, with a primary concern for growth in incomes and living standards, as usually measured in terms of national income per capita. But also, I insist, with an economists' focus on what's best for the consumer—and here I include measures relating to their education, health and freedom from all forms of discrimination.

Some may not agree with this way of looking at a society's performance. There are efforts globally, including here in the Pacific, to look for alternative indicators of wellbeing—specifically, the Alternative Indicators of Wellbeing for Melanesia project being conducted in Vanuatu under the auspices of the Melanesian Spearhead Group. In their definition, "wellbeing" is correlated with access to natural resources, traditional knowledge and community vitality. Perhaps, not surprisingly, Vanuatu is measured as one of the happiest of countries. This work follows from that in Bhutan, with its attempts to measure and develop policy with respect to Gross National Happiness. However, that project has been abandoned due to the difficulty of implementing practical indicators and the policies that might follow

But I cannot get past the fact that Vanuatu was 124th in the 2013 Human Development Index, which takes into account the kinds of indicators that I see as important. For example, given its maternal mortality rates and its under-5 child mortality rates, I cannot see how any community can be comfortable with a "wellbeing" measure that ignores these statistics.

In many ways the culture of the Pacific presents challenges to those attempting to bring about change. Communal and egalitarian values are held very strongly; although to an outsider, this sits oddly with the power that the elite hold within communities. The strength of egalitarian values makes it socially difficult for individuals to demonstrate enterprise and accrue wealth. This attitude is an additional obstacle to private sector development, on top of the widespread lack of secure individual title to land and the lack of respect for contracts.

North, Wallis and Weingast (2009) described elite control of traditional economies as a *natural* state. In such a state an elite group holds power and tightly restricts the access of most people in society to resources and institutions. This is contrasted to what they define as *open access orders*: a democratic, market-based society in which there is open competition for all resources and institutions. An underlying reason for the difficulty of achieving economic reform in the Pacific has been the lack of motivation to take collective action because of the adherence to cultural obligations fostered by the elite, which are given priority over any other obligations or considerations. Thus, efforts to improve the efficiency and governance of the public sector are resisted because they would diminish the ability of the elite to control the resources managed by the public sector. Similarly, actions to promote individual enterprise, such as trade liberalization, providing more secure individual access to land, and privatizing SOEs are resisted because they would also weaken the power of the elite.

Getting back to what I consider my most important point—the need for innovation in the Pacific—I would point out that the elite have not been responsible for the innovations that have led to the exponential growth in incomes and improvements in living standards in so many countries around the world. The aristocracy of England, the Netherlands and Germany were not responsible for the Industrial Revolution. In fact, they resisted the changes needed to promote innovation. As North, Wallis, and Weingast argue, the elite in traditional societies exercise controls so that the conditions needed for innovation do not apply.

It is for this reason that I have sympathy for the actions taken by the military through Commander Bainimararma in Fiji. Since independence in 1970, the interface between traditional and modern authority systems has faced considerable challenges in Fiji's democratic evolution. The Fijian cultural ethos of the supremacy of what the late Ratu Sukuna described as the "three-legged stool" upon which Fijian society is based—the *vanua*,(the land or the chief), the church (largely the Methodist church), and the native provincial government, maintains a stranglehold over the Fijian psyche. In this worldview, the Fijian is bound to serve his/her chiefs, the church, and the Fijian administrative body that oversees the running of the 14 provinces. In return, the chief, as custodian of all moral authority, wisdom, resources and prestige, will ensure all aspects of village life function efficiently and the distribution of wealth is according to accepted traditional protocols.

This conception of culture/tradition has been sustained through oral tradition, accepted cultural norms and practices, and shared communal values, and is reinforced through the teachings of the Methodist Church. Thus has the *status quo* been maintained in which the chiefly elite continue to wield power, enforce traditional provincial loyalties through kinship ties, and perpetuate the people's acceptance of their traditional—and thereby divine—right to ownership of all land, sea, air space, resources and people within his/her traditional governing domain or confederacy.

It can be argued that many of the actions taken by the military government since the December 2006 coup have been designed to break down the traditional institutions that have supported the chiefly elite (such as the Great Council of Chiefs and the Methodist Church). Looked at in this light, these actions may be justified on the grounds of improving the prospects for economic growth and improving income and wealth distribution. However, the important questions are whether these actions will be successful or whether they will ultimately succumb to widespread resistance; or whether there is a better means of achieving these goals? The institutional reforms carried out by the military government have largely been carried out unilaterally; and history has shown that little in the way of changing cultural and social norms and structure can ever be achieved and sustained through force.

This is a copy of Ron Duncan's keynote address at the 2014 Pacific Update. You can listen to a podcast of his address, including Q&A, here.

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