

PRIVATE SECTOR DEVELOPMENT IN THE SOUTH PACIFIC:

SOME ISSUES OF GOVERNANCE: A CASE STUDY OF VANUATU

T. K. Jayaraman*

INTRODUCTION

The development performance of the South Pacific island countries (SPICs) during the past two decades has been described as a paradox. Despite a favourable natural and human resource endowment and high levels of external aid, mostly in terms of grants from the bilateral governments and loan assistance on concessional terms from the multilateral agencies, the per capita real income grew by a mere 0.1 one percent per year during the eighties, compared to growth rates of four to five percent per year in the similarly placed island countries in the Caribbean and Indian Ocean regions (World Bank 1993).

Due to the initiatives on the part of the multilateral agencies and the metropolitan powers in the region, which are the major donors to the SPICs, development strategies adopted by SPICs were critically reviewed (World Bank 1993, 1995, AusAID 1993, 1994, 1995). These reviews revealed that the dominance of the public sector has been one of the major causes behind poor economic performance and a more appropriate way towards exploiting the growth potential was through the encouragement of private sector initiatives and by

restricting the role of the public sector. The oft-quoted success stories of the East and Southeast Asian nations (Wade 1990), now widely regarded as an Asian economic miracle (World Bank 1993), have been cited as examples for emulation for the SPIC governments to foster development-partnerships with the private sector.

The focus of the envisaged development-partnership between the state and the private sector was on achieving four objectives: (i) ensuring macroeconomic stability; (ii) creation of a conducive environment for private sector development through provision of regulatory, institutional and financial frameworks; (iii) promotional and information dissemination activities; and (iv) provision of physical and social infrastructure (World Bank 1995: 9).

Rapid changes have taken place since the nineties, especially in regard to macroeconomic policies aiming at stability. As Chhibber (1997) points out, these policy changes do not require any major overhaul of institutions, as they can be effected by administrative orders by involving a small group of competent technocrats.

In contrast, reforms relating to public sector including

*Research Scholar, Macmillan Brown Centre for Pacific Studies,
University of Canterbury, Private Bag 4800, Christchurch, New Zealand.

e - mail: t.jayaraman@pacs.canterbury.ac.nz

Phone: (64-3)364 2938

Fax: (64-3)364 2002

streamlining the civil service, closure/privatisation/corporatisation of a large number of poorly performing public enterprises, and increased investments in physical infrastructure, need radical changes in institutional structures and they require considerable time.

Appropriate initiatives were made in terms of an Action Plan which was drawn in the First Forum Economic Ministers' Meeting held in Cairns, Australia in July 1997. The Finance Ministers reaffirmed their commitment to "pursue a common goal of free and open, liberal and transparent investment policies to create investor-friendly environments" (South Pacific Trade Commission 1997a). The Action Plan was further given a ringing endorsement by all the leaders of the region at the 28th South Pacific Forum in Rarotonga in September 1997 (South Pacific Trade Commission 1997b).

Perhaps due to various reasons, letting alone the slow pace of implementation of reforms, growth in private sector investment has been very poor. This raises the question as to what has gone wrong. One possible field of investigation is governance. In recent years, there have been new initiatives on the part of academics to identify deficiencies in this critical area and as a result substantial output (NCDS 1995, Larmour 1997, Lawson 1997) has been produced. However, the number of country specific studies focusing on governance issues in the region is very limited (Ambrose 1996, Macdonald 1996).

The clinical definition of the term governance, without any specific reference to the type of political system prevalent in a given country, has been given by the World Bank (1992) as "the manner in which power is exercised in the management of a country's economic and social resources for development". If it is given a Western political interpretation, the term would encompass a set of competitive democratic policies with explicit mention of free expression and independent press as well as concern for administrative improvement (Leftwich 1993: 606).

Regardless of the orientation of the interpreter

concerned, the basic thrust of the term governance is a "good" government and such "good governance is perceived and accepted as legitimate, committed to improve welfare and responsive to the needs of its citizens, competent to assure law and order and deliver public services, able to create an enabling policy environment for productive activities and equitable in its conduct" (Landell-Mills and Serageldin 1991, 310).

Viewed in this light, the objective of the paper is to examine various aspects of governance in the South Pacific setting and how far they had impacted private sector development. For an intensive examination, Vanuatu is taken up as a case study. The reasons behind the choice are two-fold. First, Vanuatu is considered in the region as the most open economy with all the attractive incentives for both domestic and foreign investors as it enjoys a tax haven status with no direct taxes of any kind and total absence of exchange rate controls. Second, despite this apparently favourable background, the economy has remained stagnant in the past three years.

Obviously, the reasons are not far to seek. Private sector activities in Vanuatu declined primarily due to a poor investment climate which has been associated with callous indifference of politicians to issues of governance, resulting in three unstable governments in a period of two years ever since the national elections held in December 1995. The continuing political instability assumed such proportions in late November 1997 that the country's President issued an order to dissolve the parliament and called for an early election in January 1998, nearly two years ahead of the next elections scheduled in 1999.

However, the President's decision was reversed within a week by the Supreme Court after the opposition MPs filed a petition challenging it on legal and constitutional grounds. Although normalcy seemed to have returned soon after the Supreme Court decided in favour of the opposition, the truce between the warring factions within the major party in the ruling coalition appears to be only temporary and political stability continues to be as elusive as before ¹.

¹ The background of these events is as follows: During the November 1997 session of the parliament, the government successfully got passed a private member's bill for repealing the Ombudsman Act in a bid to dislodge the current incumbent, who has unearthed scandals of many government officials including the ministers and members of the parliament belonging to the ruling coalition. The attempts to remove the Ombudsman were clearly unpopular among the public and utilizing the opportunity the opposition tabled a no-confidence

The happenings behind the deteriorating governance situation in Vanuatu, one of the youngest SPICs which attained nationhood in the eighties and inherited the British and French political and administrative traditions, would be of immense interest. The paper is organised into three sections. The first section deals with governance in general, whereas the second section gives a brief background of Vanuatu's economy and discusses governance in Vanuatu in detail; the last section outlines some recommendations for consideration.

I. ROLE OF STATE AND GOVERNANCE: A GENERAL DISCUSSION

Neoclassical Theory

Prior to the Asian economic miracle, the development theorists and practitioners were mainly preoccupied with pure neoclassical prescription of non-intervention by state except in the case of market failures.² After observing the evolution of the simulated free market (SFM) theory and the adoption of the governed market (GM) theory in the East and the Southeast Asian nations (Wade 1990), greater attention is increasingly being paid to government roles in terms of their being directive (Leuedde-Neurath 1988, Johnson 1982) and facilitative (Vogel, 1991, Henderson and Applebaum, 1992) in nature.

Facilitative Approach

The SFM theory or facilitative approach aims not

only at removing distortions caused by the earlier policies of import controls and administered prices, but also eliminating the possible distortion-inducing institutions directly, thus bringing about competitive conditions, as if by simulating a free market (Berger 1979: 64). Prominent examples are Hong Kong's efforts toward building a legal, social and institutional framework necessary for effective market operation and forecasting investment requirements in key industries by the private sector and Singapore's Jurong Town Ten Year Master Plan for reclamation and development of the Southern island, the ten big public projects of Taiwan and the emphasis given by Singapore and Taiwan on technical and vocational education.

Directive Approach

On the other hand, the GM theory or the directive approach is one of making the government a participant for influencing business decisions (Hassan 1976, 29). In fact, the aggressive attitude on the part of the government is primarily with the objective of interacting with the private sector from the position of prominence so as to secure implementation of development objectives. Johnson (1982) and White (1988) call the emerging picture as a developmental state. Building upon the theory of developmental state, Wade identifies the following essential ingredients of a directive state: (i) very high levels of productive investment contributing to introduction of new technology in production; (ii) greater investment in key industries than would have occurred in the absence of government intervention; (iii) exposure of industries to international competition; (iv) set of economic policies which include incentives and

motion in the government. Two of the senior ministers who deserted the government and joined the opposition in their bid to topple the government, were sacked by the Prime Minister. Sensing the likely successful outcome of opposition efforts, the government advised the parliament speaker to close the session. These desperate efforts of the ruling coalition to survive in the midst of growing scandals provoked the President to issue an order on 26 November 1997 dissolving the parliament and calling for fresh elections. Immediately the opposition MPs petitioned the Supreme Court which ordered on 27 November 1997 that the premature closing of the parliament session was illegal as it had an agreed business agenda. The Supreme Court also ruled the President's decision to dissolve the parliament unconstitutional as the parliament was yet to discuss the no-confidence motion as part of its unfinished business agenda. Soon after the decision, an appeal was filed by the government which was allowed by the Supreme Court's Appellate Division and a date has been fixed in mid December 1997. As a fresh bench of the Supreme Court has to be set up for the hearing of the government appeal, it appears it may take a while to decide the case. However, the Supreme Court ordered on 27 November 1997 that no general elections should be held on 20 January 1998 and the government should not make any attempt to dissolve the parliament and the sacked ministers be reinstated until further orders of the Supreme Court (Trading Post, 6 December 1997)

² Market failures occur when market imperfections are present in terms of externalities in production and consumption, monopoly or oligopolistic conditions, public goods and common property resources. In such eventualities, there is a case for state intervention to restore Pareto-optimality conditions for achieving optimal allocation of resources so as to make the producer/consumer better off and none worse off.

mechanisms to spread risk; and (v) sector specific policies, leading the market in a big way by assisting private sector firms in a specific industry providing "big followership" (Wade 1990, 27-29.)

Entrepreneurial State

As an extension of the GM theory, Yu (1997) has developed the concept of an entrepreneurial state. Under this, the government encourages entrepreneurs in the private sector to nurture and display their talents. A set of policies are evolved and implemented (Deyo, 1987: 18, Soon, 1994: 145-148). These include guaranteeing against nationalisation, incentives for outward looking industries and absence of bureaucratic control for encouraging new productive combinations, protection of industries for giving the managers and workers greater experiences but still exposing them to foreign competition. Prominent examples in this regard are Hong Kong's assistance to entrepreneurs picking up the right industries by furnishing limited consultancy assistance through the Hong Kong Productivity Centre and Trade Development Council, Singapore's and Hong Kong's provision of public housing facilitating saving of private sector's resources for direct investment in key export oriented industries, efforts of Hong Kong, Taiwan and Singapore to attract foreign entrepreneurship and investment by offering minimal profit taxes and maximum provision for remittances of profits and repatriation of initial capital. Taiwan in particular during 1958-62, allowed foreign investors 100 percent equity holdings, 100 percent remittance of profits and repatriation of initial capital at the rate of 15 percent per year starting two years after completion of the project. In addition, the foreign entrepreneurs received equal treatment with domestic producers in regard to domestic credit and incentives (Yu 1997: 60).

It should however, be noted that almost all these successful entrepreneurial states at one time or another, exceeded their democratic briefs and in the process emerged as authoritarian in character. Relevant in this regard are the legislative measures adopted for suppressing the activities of interest groups. These included anti-labour legislation in Korea, banning trade union activities and the incorporation of labour in the

industrial structure, which have been called as brutal (Castells 1992: 40). Taiwan achieved full control over labour and the wage workers were denied any bargaining rights. Similarly, in Singapore independent trade unions were banned during 1961-65 and Hong Kong repressed the labour movement. As a result, in all the four economies of Korea, Taiwan, Hong Kong and Singapore, labour costs were kept low, thus enabling them to win export markets in the USA and Europe.

Authoritarian Corporatism

Although in normal circumstances they would have been immediately labelled as undemocratic, their scintillating economic performance dazzled the critics and they were kindly looked upon as examples of "authoritarian corporatism", providing guidance for markets (Wade 1990, 27). Some others were frank. They could not hide their preference for authoritarian governments which suppressed labour and environmental groups and other special interests for furthering economic development, when they made a passionate plea for "a courageous, ruthless and perhaps undemocratic government to ride roughshod over special interest groups" (Lal 1983 , 33). Islam (1995, 556) notes that this prompted Shapiro and Taylor (1990, :867) to suggest that neoclassical authors leaned towards authoritarianism as a device to preclude special interests from taking over the state.

This naturally raises a normative question whether authoritarian governments, however instrumental in promoting private sector development and being a catalytic agent in bringing about an economic miracle could provide good governance. Before examining the question, one should recognise the possible occurrences of government failures under non-authoritarian states as well, which adopt either facilitative or directive economic policies. These failures take place, as government interventions for promoting certain specific sectors or activities through interest rate subsidies and other incentive measures create conditions for promotion of the rent seeking propensities of the private sector. These lead to activities ranging from plain lobbying within legal limits to outright bribery and corruption. These activities are unproductive as they do not add

to social output but only yield income or profits (Bhagwati 1982). In addition, over-zealous officials can commit excesses of intervention or an incompetent civil service might commit blunders. It is also likely that well meaning officials due to lack of training might fail miserably to deliver goods.

In this regard, it might be worthwhile to refer to the results of a recent survey conducted by the World Bank as a background material for its World Development Report with the theme on "the State in a Changing World" (World Bank 1997). The survey covered more than 3,600 local businesses in 69 countries who were asked to evaluate the institutional framework in their countries in terms of (i) predictability of changes in laws and policies; (ii) government stability; (iii) security of property; (iv) reliability of judiciary; and (v) corruption. The business firms in 27 countries reported that the triple curse of corruption, crime and an unpredictable judiciary was a powerful deterrent to private investment (World Bank 1997, Levy 1997).

Noting the possibilities of excesses under the authoritarian states and government failures under the soft-democratic regimes as well, Islam (1995, 555) points out that the true challenge lies in seeking institutional arrangements that minimise the government and market failures as well. Before elaborating the issues involved, Islam hastens to add that the inference that the neoclassicals were in favour of developmental state being authoritarian is false. Thus, the principles of neoclassical theory, though seemingly compatible with authoritarian regimes, are necessarily part of democratic institutions, when we recognise the latter entails: (i) constitutional safeguards, contributing to good governance; and (ii) principle of compensation (Islam 1995, 562).

Principles of Democratic Governance

Constitutional safeguards in this regard generally refer to provision of constitutional restraints on fiscal, money and debt creation capacities of the government on the lines of adopting a fiscal constitution (Nisakanen 1992). Further, it means full independence and autonomy of the central bank from the government of the day. Such restraints would discourage monetary expansion

and prevent runaway inflation, by rendering fiscal deficits and deficit financing illegal. By principle of compensation, it is meant provision of compensation for those affected by policy reforms so that conflict resolution becomes transparent and the reforms acceptable. The principle is that gainers should adequately compensate losers. Such compensation may not occur voluntarily, given the transaction costs and free rider problem and the state alone can implement a programme. Examples are worker adjustment compensation for private sector industries to face international competition when wages are cut or frozen; and retrenchment benefits and provision of re-training facilities and placement for the workers displaced by privatisation or closure of public sector enterprises. The principle of compensation is based not only on the principle of fairness but also on the principle of political correctness that since productive policies might harm members of special interest groups, compensation would be necessary if the society is to approach the optimal configuration of productive policies (Rausser 1992, 150).

Viewed in this light, Islam (1995:562) lists the following principles of governance:

- (i) the state should allow market-based, private sector-driven initiatives in the mobilisation and allocation of resources to growth-promoting as well as production and consumption activities;
- (ii) the state should intervene only in cases of market failures;
- (iii) the state should provide pure public goods (law and order, national defence, public infrastructure);
- (iv) the state should enforce property rights;
- (v) the state should provide a stable and predictable macroeconomic environment by appropriately coordinating fiscal, monetary and exchange rate policies;
- (vi) the state should observe free trade policies so that such neutral policy regime restrains the government from making sector-specific interventions.
- (vii) the state should provide constitutional safeguards;
- (viii) the state should apply the principle of

compensation for creating a constituency for good governance;

It will be of interest to note that nowhere in the above list are explicitly included an independent media including a free press for ensuring freedom of expression and an independent judiciary, although the item (iv) implies the presence of independent courts and appellate procedures for enforcing property rights. Perhaps Islam, while evaluating the governance issues in regard to Malaysia and Singapore has considered expedient to drop these two on the grounds of sensitivity. However, giving due recognition to the growing world-wide awareness of human rights and the associated appreciation of economic liberalism that man does not live by "cake alone", one can venture to say that freedom of expression is critically needed to gauge the feelings of the special interest groups, sometimes in the minority who are apparently harmed by productive and other state policies, and for ascertaining the pulse of the nation in regard to the need for an appropriate quantum and methodology of compensation for creating a constituency for good governance.³

As to enforcement of property rights, the assumption that conflicts might be confined only between private groups and that legal remedies should be confined only to property rights might not be valid at all times. Conflicts between the state and the individuals, and conflicts between the central government and the local or provincial governments have increasingly become real in regard to property rights, let alone conflicts relating to civil liberties between the state, provincial and the local governments on one side and the individual on the other. Due regard to these aspects would certainly give rise to the need for adding to the list the two critical elements: freedom of expression with independence to media and independent judiciary.

Areas for Empirical Examination

For an initial empirical investigation and for further monitoring the progress of a given country's performance, it would be necessary to look at certain

tangible areas of governance. Drawing upon Islam (1990), Landell-Mills and Serageldin (1991) and Macdonald (1995), Table 1 identifies the areas for detailed examination. The indicated areas are by no means exhaustive but only indicative at the present stage of accessibility to data :

- (i) Accountability:
 - (a) political accountability;
 - (b) bureaucratic accountability;
- (ii) Predictability:
 - (a) legal frameworks;
 - (b) legal processes.
- (iii) Openness:
 - (a) transparency;
 - (b) public participation;
 - (c) free press and independent media.
- (iv) Constitutional Safeguards:
 - (a) free elections;
 - (b) rule of law;
 - (c) protection of property rights and contractual obligations;
 - (d) legal remedies and appellate procedures and principle of compensation;
- (v) Public sector management:
 - (a) competency of civil service;
 - (b) neutrality and tenure of service;
 - (c) audit systems;
 - (d) public enterprises;
 - (e) regulation of public utility monopolies.
- (vi) Economic and financial management:
 - (a) macroeconomic stability;
 - (b) financial sector development;
- (vii) Private sector development:
 - (a) incentives;
 - (b) privatisation;
 - (c) encouragement of foreign direct investment

However, it would be necessary to keep in mind the unique situational characteristics of SPICs before undertaking the analysis. As Macdonald (1995:23) cautions us, the preconditions for competition might not simply exist in SPICs, being geographically fragmented and remote from major markets and transport networks.

³ Referring to the observation of A. K. Sen at the 1990 Annual World Bank Conference on Development Economics that there has never been a famine in a country with a free press, Summers (1991:13) raises the question whether democracy, while not essential to growth, would not in a whole set of ways improve development performance on other dimensions as well.

Further, he points out that more importantly, governance literature shows a preoccupation with democratic constitutional models and that some SPICs maintain these structures for international credibility, which are inherited from the colonial regimes and might still prefer to remain as feudalistic, appearing to be "western" only for obtaining aid from the previous colonial masters.

There is considerable merit in these observations. However, one has to give due recognition to the fact that there is a rising trend in adopting the western democratic institutions due to international demonstration effect. As Chibber (1997) points out, a shift to a more democratic government is one of the new challenges which have emerged in recent years besides the rapid diffusion of technology, environmental degradation, the globalisation of markets and increasing demographic pressures. Further, there has been an increase in the number of returning overseas-educated young men and women to take up employment in key government agencies and the private sector as well as an emergence of liberal and enlightened public leaders who appear to have a substantial influence on the policy makers.

The next section takes up the empirical investigation of Vanuatu.

II. ISSUES OF GOVERNANCE IN VANUATU

Background:

The Republic of Vanuatu (land area of 12,190 square kilometres and population of 170,000), is an archipelago in the South Pacific, comprising about 80 islands and was formerly known as New Hebrides Condominium and ruled jointly by the English and French colonial administrations, before becoming independent in 1980. Due to the colonial past, the nation inherited both English and French educational systems, business practices and legal and governmental procedures. Further, the Government adopted both English and French as official languages while declaring Bislama, an English-based pidgin spoken throughout the archipelago, as the national language.

The country has adopted the parliamentary system of government, with the President as the titular head of the state. He is elected by the parliament and by the presidents of the six provincial governments, for a period of five years. The legislative power rests in a unicameral parliament of 46 members, elected by the people once in four years. The executive power is vested in the Council of the Ministers, (the cabinet) which is appointed by the Prime Minister (PM). According to the constitution, the number of ministers in the Council cannot exceed 11. The constitution also lays down that all lands in Vanuatu belong to custom owners and their descendants. Further, it is provided that custom rules govern the ownership and use of land and all transactions are to be carried out with the permission of the government.

Although the country has adopted the Westminster style of government, the civil service is not strictly on the British pattern. In addition to the regular and permanent bureaucracy with regular heads of ministries/departments, there is a ministerial wing consisting of three Secretaries known as first, second and third, who are attached to the office of each minister and they are appointed by the minister concerned. There is no requirement of them, being a member of parliament (MP) and the appointments are purely political in character.

The country's economy is dominated by subsistence activities with about 80 percent living in the rural areas. The remaining 20 percent of population are in the two urban towns of Port Vila (population of 30,000), which is the country's capital on the Efate island and Luganville (population of 8000) on the island of Santo, the biggest island of the country. Economic growth is highly dependent on the export performance of four commodities: copra, beef and veal, timber and cocoa. The newly emerging commercial crops, namely kava and squash have shown promising signs of being foreign exchange earners. Manufacturing is limited to value added activities in the coconut industry such as the production of coconut oil and cream and coconut oil-based soap and detergents. Tourism, at present is mainly confined to the two urban centres and some islands notably, the island of Tanna which has a live volcano, as a major tourist attraction. The off-shore financial

centre activities, which are confined only to Port Vila, and tourism are the two major economic activities significantly contributing in terms of creation of urban jobs as well as towards modernisation of the economy.

Recent Trends

The country had stable governments which lasted full terms until 1991. After 11 years of uninterrupted period of enjoyment of political power, the then ruling Vanua'aku Party (VP) underwent a split. In the elections held in December 1991 for the first time in the country's history, none of the parties secured a majority. A coalition of the Union of Moderate Parties (UMP), National United Party (NUP), a faction of VP and other splinter groups came to power in late 1991, which surprisingly lasted four full years. The apparent stability was only due to a temporary truce between two personalities (Maxime Carlot Korman, who was the Prime Minister during 1992-96 and the present Prime Minister Serge Vohor) in UMP, which was the lead party in the coalition government.

A head-on collision between the two leaders following the December 1995 elections created a split between the factions led by the two, causing political instability of unknown proportions in the country's history (Ambrose 1997). There have been three governments of fragile coalition arrangements ever since then. The first government which assumed power in January 1996 under Prime Minister Serge Vohor lasted only for a short period and was toppled by Korman. The Korman ministry survived just for four months and in January 1997, Serge Vohor staged a come back to form the government which has been in office since then. The apparent stability until now which encouraged the donors to undertake initiatives for a comprehensive reform program (CRP) was due to an uneasy compromise by PM Serge Vohor with the Korman faction within UMP. This arrangement was itself a great help for Korman for regrouping the forces within UMP. It also resulted in the sharing of the ministerial berths and appointment of Korman as the Chairman of the

country's power utility, a government joint venture with a French company.⁴

However, as noted earlier, an opposition move to dislodge the government by introducing a no-confidence motion in the November 1997 session was thwarted by the government by closing the session prematurely. In late November 1997, the President announced the dissolution of the house and called for an early election in January 1998. The opposition got the President's decision overruled by the Supreme Court. Since the government appealed in December 1997 against the court decision, the matter is once again before the Supreme Court. These events created an unprecedented political instability in the country.

Macroeconomic Conditions

Although the economy's lacklustre performance in recent years can be attributed to political instability, fiscal and monetary management since the inauguration of Vanuatu as an independent nation has been prudently conservative. The existence of an offshore financial centre (OFC) much before Vanuatu's independence and its continued thriving operations have been responsible for the strong commitment of the government not to introduce any direct taxation even on the citizens under the impression that direct taxes on incomes and profits of citizens and domestic companies would scare away capital inflows. Although reports by international lending agencies including the World Bank (1993) have cited the experiences of the countries in the Caribbean as well as Hong Kong and Singapore levying low rates of taxes on profits of OFC institutions without any adverse effect, Vanuatu has been steadfastly adhering to the principle of a pure tax haven (Jayaraman 1997). The result has been that the country heavily relies upon indirect taxes of all kinds, including import and export duties and turnover taxes as well as fees such as business licenses and work permits.

The country's recurrent budget was in the balance until 1991 and the capital works were funded by external

⁴ In September 1997, Prime Minister Serge Vohor dismissed his finance minister Willie Jimmy, who belonged to the Korman faction for not supporting CRP. This heralded further changes, including the realignment of parties. In subsequent months, more ministerial changes were effected which included the downgrading of Barak Sope from Deputy PM to a minister (*Pacific Report*, Nov 17, 1997).

grants. External borrowing was low, well below 20 percent of GNP and was limited to physical infrastructure. Major departures were observed only since 1992, when domestic borrowing was extensively resorted to. This was for the purpose of undertaking capital investments which were approved by the Special Projects Implementation Committee. Balanced recurrent budgets were no longer the order of the day and the annual deficits were observed too large for accommodation within domestic resource availability (Jayaraman 1994). The external borrowing exceeded the observed limit of the eighties. Annual inflation has been on the rise and the rate of growth has been only modest at about 3 percent. Since annual rate of population growth has also been close to 3 percent, annual per capita income has remained stagnant during last ten years (Table 2).

Environment for Private Sector Development

Vanuatu is far ahead of the rest of the SPICs in privatisation of government enterprises. The power generation and distribution in the country as well as water supply in Port Vila are already in the hands of a private sector monopoly. The government is contemplating privatisation of urban water supply in the second largest town of Luganville. Similarly, many department undertakings have been privatised. It will be worth noting, as a result of reduced commercial operations, Vanuatu has one of the lowest number of government servants per hundred country inhabitants. The figure for Cook Islands in 1990 was 18 per hundred, followed by Tuvalu (8) and Fiji (6) and Vanuatu's figure was only 3. Only Papua New Guinea and Western Samoa had lower figures with 2 and 2.4 respectively. While annual inflation is low, the Reserve Bank of Vanuatu (RBV) has followed an exchange rate policy in alignment with real exchange rate determined by relative inflation rate in trading partner countries. Further, the country has no exchange control and no artificial impediments on capital inflows. Thus, a relatively favourable macroeconomic environment marks the monetary and exchange rate policies of the country (Jayaraman 1996).

However, the narrow tax base combined with a large number of exemptions required high rates for maintaining the yield, has pushed up costs of raw materials and intermediate goods for private investment as well as on consumption goods so essential for tourism, which is one of the major economic activities. Further, the cost of labour is very high compared to other SPICs and the minimum wage legislation is out of tune with factor endowment and coupled with compulsory contribution on the part of the employer to Vanuatu National Provident Fund, the input cost has been disproportionately substantial. Furthermore, the high utility costs such as for power and communications have been very serious constraints to private investment.

While the ni-Vanuatu private entrepreneurship is in short supply, the country has to rely on foreign direct investment which has been declining. The obvious reason has been poor investor confidence, much of which cannot be blamed on political conditions alone. Inertia and lack of political will to push through a number of reforms to streamline investment promotion measures, including the enactment of an Investment Code, a draft of which has been pending since 1991 have been the major causes. Added to these, certain ministerial actions, which were mostly discretionary measures, without being subject to legal reviews and remedies have also caused consternation among foreign investors, who were ready to move out rather than go through tedious and uncertain procedures of negotiated settlements. All these come under the issues of governance, which will be discussed below in detail.

Accountability

Political accountability, which means persons holding elective offices, including parliament members and ministers, should be accountable to the nation through its legislature, is nearly absent in Vanuatu. Primary reason is the legislature is weak and unable to exercise control. The legislature is more of an instrument in the hands of the executive to have the annual and supplementary budgets passed and for enactment of new laws and amendments to any existing legislation. There are no effective committee procedures and singularly absent are the public accounts and estimates committees.

If these were in existence, the audit reports would be discussed in greater detail in committee rooms and the parliamentary procedures would then require these reports be submitted regularly and discussed in a routine manner. Thus, the watchful hand of the legislature is sadly missing. Absence of the committees also means that no second line of leadership is built, as the young and junior MPs who are shy and prefer being backbenchers in the house, can be more open and forthcoming in the small sized committees and can learn the intricacies of public sector revenues and budgeting procedures.

The legislature did not have any opportunity so far to discuss the several reports prepared by the Ombudsman, a provision for which was made in the 1980 Constitution but given effect to only in 1994 by the appointment of the country's first Ombudsman under a specially enacted Ombudsman Act ⁵. Several of the Ombudsman's reports in recent months have exposed cases of corruption as well as cases of abuse of power by the ministers. However, these reports though formally submitted, were not presented to the parliament as there were no watchful committees such as those of public grievances or assurances. It should, however, be recognised that efficient functioning of parliamentary committees once set up, need enormous staff and logistic support, which the young nation can still ill afford at this stage of development.

However, before considering setting up committees, at least efforts should be made to table before the parliament the reports of audit accounts regularly and the Ombudsman reports as and when they are submitted to the government. It is understandable why the parliament itself was not interested in the reports, as some ministers and MPs belonging to the member parties in the ruling coalition governments in last two years and some in the opposition who had been ministers earlier, were exposed and they did not want to have the reports see the light of day. For example, an Ombudsman report in mid 1997 named 23 MPs, who

lost seats in 1988 due to non-attendance of parliamentary sessions for three consecutive terms, were retrospectively paid an illegal sum of Vt 1.5 million (US\$13,200) and these MPs included the Prime Minister Serge Vohor and two ministers in his cabinet as well as the former Prime Minister Korman. Since the Vohor government did not initiate any measures, including tabling the report and recoveries of money from the MPs, the Ombudsman approached the judiciary for a legal remedy in July 1997 [(Pacific Islands Monthly (*PIM*) August 1997)].

Besides the aforementioned reports, the Ombudsman has unearthed several scandals, including the one relating to a 24-hour open bottleshop owned by a former finance minister who allegedly forged the signature of the home minister authorising him to have the shop opened for 7 days a week in contravention of a general order closing liquor shops on Sundays. However, the "mother of all scandals" so far investigated by the Ombudsman was the one relating to US\$ 100 million guarantee scam (*PIM*, September 1996), which scared away some possible direct foreign investment (Seniviratne, 1997). Under this scam, ten letters each of US\$ 10 million worth were signed by the then finance minister Barak Sope, the then Prime Minister Korman, the Governor of the Reserve Bank of Vanuatu (RBV) and the First Secretary in the ministry of finance (MOF). These guarantees were allegedly traded for a commission by a foreign businessman, who was favoured with a Vanuatu diplomatic passport (Larmour 1997).

Due to timely exposure by the Ombudsman and intervention by Scotland Yard in the United Kingdom, the letters of guarantee were located in London and returned to the Government. The political system is such that none of the *dramatis personae* has been taken to task, let alone punished.⁶ Although mounting pressures led to the dropping of Barak Sope from the cabinet, he was back in less than six months when Korman was replaced by Serge Vohor as Prime Minister. The "revolving door" mechanism of the same persons coming

⁵ The parliament passed on 20 November 1997 a bill for repealing the Ombudsman Act. However, the President did not sign it into law as he has asked the Supreme Court to rule on the legality of the parliament's decision.

⁶ The foreign businessman was found guilty of various offences including fraud, deception and dealing in securities without a license and sentenced to 18 months in jail, on December 1997. However, the politicians named in the Ombudsman report have not been proceeded against.

back to power despite the stigma of past scandals attached to them is not unusual in the Melanesian politics of *wontok* (principle of belonging to same kinship) (Larmour 1997).

Unable to withstand the onslaught of exposures of his colleagues, one after the other since mid 1996, the cabinet under the direction of Prime Minister Serge Vohor decided formally in July 1997 that a petition be drafted and signed by all MPs, party leaders, presidents of provincial councils and general public requesting the President to dismiss Ms. Marie Noelle Ferrieux Patterson, the current incumbent from the office of Ombudsman. The cabinet also decided to repeal the Ombudsman Act and enact a fresh Act in the ensuing November 1997 session of the parliament so that the powers of Ombudsman could be curtailed. Following the cabinet decision, Prime Minister Serge Vohor publicly called for the removal of Ms. Patterson on the grounds that she was not culturally sensitive to politics in Melanesia and that being a naturalised ni-Vanuatu, she did not know the working of the *wontok* system (Coco-net Wireless, Aug 20).

In the midst of these moves for removal, fuel was added to the raging fire against her office, as Ms. Patterson was awarded in August 1997 the annual Pacific Freedom of Information Award by the Pacific Islands News Association. The award citation praised her contribution by "combining in her the knowledge of law, and accounting she brought to the public domain all sorts of questionable practices by people in public office" (PIM, September 1997).

In late September 1997, a few officials of Air Vanuatu who were under investigation by the Ombudsman went to the court for obtaining a ruling that her appointment was unconstitutional and that the proceedings against them should be stopped forthwith. The case was watched with great interest, as the Ombudsman had also charged the cabinet secretary, who has since resigned, and other officials close to the Prime Minister with corruption for illegal grant of passports to certain aliens. After the hearing, the Acting Chief Justice ruled that her appointment was legal, thereby laying to rest any speculation that the government might terminate her appointment on constitutional grounds.

Fearing that the cabinet decision of July 1997 might be implemented soon, Ms Patterson took the Attorney General and the government to the Supreme court seeking the move to dismiss her from office declared unlawful and unconstitutional. The case was decided in her favour on 30 October 1997, when Justice Oliver Saksak observed that the cabinet did not have authority to dismiss the Ombudsman and that rules of natural justice and procedural fairness should be observed, which it did not. Further, the court said that the cabinet had taken in to account irrelevant consideration in coming to its decision, namely strong criticism of ministers in the reports of the Ombudsman and the court action by the Ombudsman for recovering the ex-gratia payment of Vt1.5 million which was found illegal by Ombudsman. Justice Saksak also ruled prohibiting the government "from making any further decision or acting to dismiss, attempt, or purport to dismiss the Ombudsman otherwise as expressly provided for in the provisions of Article 61 of the Constitution and Section 9 of the Ombudsman Act." (*Pacific Report*, 17 November 1997) .

Soon it was found that the relief provided by the highest court in the country was only temporary since the government went ahead to have the Ombudsman Act repealed in the November 1997 session of the parliament. In doing so, the government utilised the ongoing preparations for implementing the widely publicised CRP with funding assistance from the donors under the pretext that another version of the Ombudsman Act would more appropriate than the present one. The parliament repealed the Ombudsman Act on 20 November 1997 with 32 members voting for the bill and 15 members against it. The passing of the bill by the parliament to repeal the Ombudsman Act received strong criticism from the coordinator of Vanuatu non-governmental organisations (VANGO) that the move was against the true spirit of the proposed CRP. The VANGO announced that as the parliament's decision was against the wishes of the majority of the people and hence undemocratic, it would approach the donor agencies including the Asian Development Bank, which is the main funding agency of CRP to reconsider their commitment to the reform program (Pacnews, 21 November 1997).

The government denied it saying it was very much in the spirit of CRP and that the Ombudsman reports caused instability in the government. The Prime Minister Serge Vohor also went on record indicating that the government would set up a committee to draft a new bill for the Ombudsman to replace the one repealed by the parliament and that the committee would include technicians and would be financed by the Asian Development Bank (Pacnews, 25 November 1997).⁷

While public accountability of the elected officials is poorly enforced during their term in office, there is at least some possibility of their not being returned to the parliament and rejected by the public when they face elections. In the case of another breed of political officials, there is no question of facing elections at all and they end up going scot free. Here, reference is made to the ministerial wing comprising the three political Secretaries, who are rewarded with ap-pointments for their electoral campaign services or for just being part of *wontok*.⁸ These Secretaries, who have no legitimacy of their own, function as though they are Deputy Ministers and wield considerable power by issuing orders in the name of their minister using the seal of the government. They are responsible only to the minister who has brought them.⁹

The political secretaries knowing fully well that they are not part of the permanent civil service usurp all advantages and perks of the civil service. For example, during the three changes in the government, when they had to go away with the outgoing minister, they even

claimed three months of salaries as severance benefits, which are applicable only to civil servants when the latter are dismissed without adequate notice. In addition to fat salaries, these political secretaries in each ministerial office are provided with a government car and driver, besides fully furnished government housing and gardener.¹⁰ Further, when the political secretaries left their offices, they took away all the files, the computers together with all office supplies of fax machines and phones. It has been estimated that the ministerial wing of the government expenditure has been rising from about 9 percent of total government expenditure in 1992 to 11 percent in 1996.

Use of power, especially discretionary power, without proper advice has also landed the country's President into trouble and in fact has become something of an embarrassment (Economic Intelligence Unit 1996). Consequently, an unusual case was filed against the President by the government for damages but was withdrawn later to save further embarrassment. This relates to release of 26 criminals and the freeing of a Taiwanese fishing boat that had been caught fishing illegally in Vanuatu's waters.

Bureaucratic Accountability

A Public Service Commission is in place as part of the Prime Minister's office. However, it is mainly concerned with recruitment to the civil service and fixing the salaries of the newly recruited. The functions of

⁷ It appears that the government successfully carried along with its decision a certain doubtful element of legitimacy and an ambiguous stamp of approval from the donors, as it were. This was unfortunate as it is obvious that the donor agencies have been caught in the cross-fires between the disgruntled and unscrupulous politicians both in the government and in the opposition alike on one side, and the Ombudsman and the general public and the non-governmental agencies, including church groups and community leaders who were in support of Ombudsman on the other side. The current feud has also introduced some doubt in the public mind whether donor agencies have inadvertently intervened in the decision making process of the government in regard to an institution which has become understandably controversial. In fact, the dismissal of the Finance Minister Willie Jimmy in October 1997, a confidante of Korman, on the ground that he did not support CRP seemingly started the process of politicisation of CRP. Willie Jimmy defended his stand on the ground he feared CRP would disproportionately affect members of UMP. He also blamed the donors for his sacking. Barak Sope, the then Deputy Prime Minister in Vohor's cabinet publicly supported Willie Jimmy and criticised the donors for interference in the internal matters of the country (Pacific News, 17 November 1997). Korman, the UMP leader accused the donor agencies of trying to pressure Prime Minister Serge Vohor into broadening the government by bringing Vanua'aku Party (VP) MPs into the cabinet following a pledge of support for CRP from the VP National Congress. Noting growing opposition to the parliament's passing the bill for repealing of the Ombudsman Act, the President while announcing dissolution of the parliament on 27 November, indicated that he would seek a ruling of the court on the constitutionality of the legislation before signing the bill into law. (Pacnews, 27 November 1997)

⁸ In a few cases, there was clear nepotism as a son and wife of a minister were employed as political secretaries.

⁹ Anecdotal evidence has it that a Second Secretary in MOF gave a large number of gambling and night club licenses when the finance minister was away and had to be sacked by the minister not for the number of licenses he issued but for issuing a license to one of his sworn enemies for consideration for a big sum of money.

¹⁰ It is reported many political secretaries learn car driving during their assignments, as they are provided with cars and usually when they get involved in accidents, they claim ministerial immunity.

monitoring the performances of and meting out punishment to erring civil servants are yet to develop. In fact, the civil servants under each ministry are entirely at the mercy of the minister and the latter has full control. There have been several instances of ministers suspending or dismissing the civil servants without any prior consultation with the Public Service Commission or observing procedures for giving an opportunity to the erring civil servant concerned for explanation, before the penalty is imposed. Most of such decisions are challenged later on the ground that the ministers have no powers of dismissal, as the consent of the Public Service Commission was not obtained ¹¹

Scams of the proportions associated with the elected politicians are not yet common among the civil servants, since most of the decisions are taken at the ministerial level, including the grant of licenses and permits. However, possibility of bad advice or collusion between the civil servant and the minister concerned cannot be ruled out. No significant action appears to have been taken against any civil servant for exercising bad judgement or for corruption, except in the cases of those convicted of misappropriation of public funds, by courts of law. A case in point is the aforementioned US\$100 million guarantee scam. Besides the politicians, the letters of guarantee were signed by the Governor, RBV. Obviously, the Governor as the custodian of the country's foreign exchange reserves was aware that the country's total foreign exchange holdings were only about US\$ 50 million and the amount involved in the guarantee scheme was much more. Apparently, he was part of the group of politicians' game plan and because of the fact that both Prime Minister and the finance minister were let free, the Governor of RBV went unscathed and still continues to hold office.¹²

This raises a question whether civil servants can be made accountable without a provision for enforcing political accountability. The plain answer is in the negative: bureaucratic accountability is possible only when political accountability is in place. Towards this

objective, a leadership code bill which was prepared by the Ombudsman has been pending for introduction in the parliament since 1995 (*PIM*, August 1997). Apparently, the present not-so-cordial relationship with the Ombudsman seems to be the primary reason for the government's unwillingness to have it passed in the parliament.

Predictability

Predictability of changes in legislation and administrative rules and regulations is possible when there are clear legal frameworks within which the executive action is taken and made visible. For example, business licenses and residence/work permits are given to expatriate investors and employees in the country after observance of certain procedures and payment of fees to the government. While the business licenses are given by the finance minister, the residence permit/work permits are granted by the ministry of foreign affairs, which regulates immigration matters. There are however, no well-laid down procedures for their revocation. Often such revocations have been sudden and on personal grounds. No prior notice is given to the persons concerned providing an opportunity to be heard before the decision is taken.

Further, since the revocations are done by the finance minister himself with a clear order given on a green-coloured sheet of paper (known as the "dreaded green letter") to leave the country within 24 hours or less, there is no appeal against the order in the executive wing of the government and the only way is to approach the legal court. As the investor is given very short notice, he is unable to do so as he would be more keen to get out of Vanuatu, winding up his business and taking away his capital and working funds than to fight it out.

The general consensus after the 1992 case resulting in the diplomatic expulsion¹³ was that there should be due process of law incorporating a provision for administrative remedies, preferably within the ministry.

¹¹ Notable cases of sudden termination of services/suspension of services of civil servants include a wide range of officers in the hierarchy such as a Principal Planning Officer in the National Planning Office, the Attorney-General and the Chief Justice of the Vanuatu.

¹² The Ombudsman's report exposing the scam, however, called for RBV Governor's dismissal

¹³ This case refers to the issue of green letter to the Australian businessman during a week-end in early 1992 when there were no scheduled air flights out of the country and the quick and spirited defense of the then acting Australian High Commissioner who went

If the termination order of business licenses was given by the Director of Finance or a designated officer in the ministry, the appeal could be made to the minister, which would enable an opportunity to the aggrieved party to have the decision of revocation of license examined on facts, as the appeals to judicial courts are examined only on points of law. Although the government was receptive to the idea of limiting the exercise of discretionary powers by the minister, nothing has been done since then. In these circumstances, predictability of government decisions in such crucial matters as affecting direct foreign investment matters still continues to be a serious issue for consideration by the government.

Another area of concern is with regard to land lease matters, which are regulated more by custom laws than by ordinary laws relating to contracts between the lessor, which is generally the land owning community/kinship and the lessee. The process to lease land is longwinded and drawn-out. Even after successful negotiations and signature, it is quite likely any member of the community can rake up the issue for another round of discussion, especially if it falls under custom law. Questions of compensation, once thought finally settled are opened up from time to time by the land owning community, as in the case of urban lands acquired by the government for declaring Port Vila urban municipal limits some twenty years ago. As land tenure is a delicate issue, the subject needs careful handling for evolving a sound and reliable legal apparatus.

Openness

Sensitive to the adverse notice of events in the country by the overseas media, the government has taken considerable efforts in recent years in rendering the decision making process more transparent. A notable example has been the review of existing forestry legislation and monitoring of logging by the foreign

loggers. Following the widespread criticism of logging activities in the Solomon Islands, the government in Vanuatu decided to involve various community groups, especially the environmental interest groups represented by non-government organisations (NGOs) and held various seminars and announced its decisions of cancelling some existing licenses and advocating further stricter regulatory measures. Yet, another example has been the government's attempt to involve all sections of the community in preparing the aforementioned CRP for about six months in 1997 by setting up committees representing various interest groups including women, labour and custom chiefs, which culminated in the holding of a two-day national summit in June 1997 for endorsing the reform agenda (*PIM*, Aug 1997: 11).

Public participation was enlisted in the preparation of a draft CRP, by inviting views and ideas by issue of advertisements in the Government-run radio and two newspapers of the country, one owned by the government and the other by the private sector. The government sponsored chamber of commerce is another forum¹⁴ through which the private sector is sought to participate and ventilate grievances. However, in case of many matters affecting government and the public alike, such as hikes in levies by the municipalities and water and electricity rates of public utilities, public notices and public hearings have yet to become a routine affair.

As mentioned above there are only two newspapers: the government owned *Vanuatu Weekly*, each issue having three language sections, in English, French and Bislama. The other one, known as *Trading Post*, published bi-weekly, is a private sector effort by an expatriate editor and a team of ni-Vanuatu editors. The paper, started as a tabloid for sale/exchange of used goods, launched a full coverage of political news in mid-1995 and instantly became popular. In the process, it had many brushes with the government, particularly

on the air in an interview with Radio Australia saying that the order of the minister was unjust as no opportunity was given to the aggrieved businessman. In a matter of few hours, the minister of finance, who was irked by the criticism on Radio Australia, instigated the issue of expulsion order to the Australian official. This gave rise to a diplomatic row causing a rupture in bilateral relations between Vanuatu and Australia, which led to the cancellation of the planned official trade delegation visits and suspension of the annual joint sea patrol exercise until the new Australian government was sworn in 1993.

¹⁴ The Chamber of Commerce is set up under an Act of the parliament, which is patterned after the Act followed in the French territory of New Caledonia and the elections to the office bearers are conducted under the government auspices.

before, during and after the national elections in November 1995. Fortunately, those parties when in opposition enthusiastically supported the newspaper had to reluctantly accept its continued existence even after coming to power during the unstable period. If the 1995 election results had been different with a single party emerging with majority of votes and consequently assuming power, it is likely that *Trading Post* carrying the exposes of corruption and misdeeds at high places as being done today would not have been tolerated.

In other words, political instability which has persisted since January 1996 has been a blessing in disguise for the free and independent press. It is through *Trading Post*, several unpublished reports of the Ombudsman came to light, first in trickles and then published as extracts prior to 1995 November elections as if they were printed as press scoops. Tired of leaks and also disappointed with the government's unwillingness to table the reports in parliament, the Ombudsman in mid 1996 decided to release them to the press, both inside and outside the country, which in fact led to the PINA award for her. The powerful First Secretary in the Prime Minister's office has gone on record acknowledging the contribution of free press when he observed: "Because of political instability in the past 18 months, every party and its politicians had been at one time or another in opposition, thus realising the importance of free media to be able to carry their views to the public" (Decloitre 1997).

Constitutional Safeguards

To the credit of the country, periodical elections once in four years, as provided in the country's constitution have been conducted in a free and impartial manner. The rule of law generally prevails in terms of protection of civil liberties. The judiciary and the Office of Attorney-General have been in recent years ably assisted by bilateral assistance from Australia, the UK and other Commonwealth countries in terms of provision of judges and legal experts for drafting legislation. The events illustrating the country's high respect for the rule of law, reliance on the constitution and acceptance by all sections of the society of the role of the supreme court as the final arbiter have been vividly illustrated

by Ambrose (1996) in his extensive account of the political instability in the early part of 1996 just after the 1995 elections.

However, unbridled use of discretionary powers by the ministers which were not envisaged by the constitution have been the root causes of uncertainties and lack of transparency. The absence of immediate and inexpensive administrative remedies as well as the long drawn out procedures and lack of lawyers and the related high expenses involved in seeking overseas lawyers for approaching legal courts have been major hurdles for ordinary citizens and expatriate businessmen to go through the ordeal of resolving conflicts.

The protection of property rights, especially associated with land lease matters as observed before, is always interpreted within the four corners of custom laws governing land tenure. Often, the interpretation is in favour of the customary land owning community, which is a problematic issue coming in the way of major investments such as hotel resorts or plantation activities requiring large chunks of land for construction. The effective supply of land is thus limited in a country which has fairly abundant land resources, for attracting overseas private investors.

Public Sector Management

The country's civil service still continues to attract young men and women, despite growing privatisation efforts. With recently observed stagnation in private sector investment and operations, and less opportunities in the private sector, a greater number are knocking at the door of government departments and public enterprises. As part of CRP, further downsizing of the already depleted civil service after dismissal of nearly 20 percent of the civil servants who participated in the illegal strike action in 1993 is under consideration. It is not exactly accurate to assume that all the dismissed people were inefficient and their removal has not led to any deterioration in quality. In fact, the dismissal took place along political party lines and on grounds such as whether the civil servant was related to a politician in opposition or not belonging to *wontok* of the minister. A review of the dismissal cases did result in reinstatement of a few with back pay. However, a large

number of them did not return to work.

A former British permanent secretary (Stowe 1992 :391) lists five attributes which mark a professional civil service. These are: merit, financial probity, political neutrality and impartiality under law, commitment to serve any government in power and accountability. While Vanuatu's civil service is not found wanting in any of these attributes, one particular attribute, namely political neutrality of civil service is seriously undermined by the politicians, when exercising their ministerial powers. Those civil servants whom they find inconvenient for not towing their lines or for the reason of not being part of "wontok" are suspended or dismissed without assigning any specific reasons. Further, during the three changes in the governments since January 1996, the ministers preferred their own men and women appointed to the departments and ministries, without going through the public service commission procedures.

Although an audit system is in place, it needs further strengthening in terms of staff and expertise. Many departments/ministries have not been audited on a regular basis. Since there is a time lag in the tabling of reports to the parliament and there is no detailed discussion or any committee in existence to discuss, not much public interest is aroused unless the *Trading Post* publishes extracts of some sensational interest. Procedures for award of contracts to the private sector from the government departments are regulated by Financial Regulations. However there have been instances of departures and these were observed to be instigated by the ministerial wings of the departments. Most of the political secretaries have abused their authority by not observing the regulations for apparently personal gains. The regulations need careful enforcement, besides strengthening provisions for preventing wilful negligence.

Public enterprises in Vanuatu are not as many as in other SPICs. As mentioned earlier, country's electricity supply and Port Vila's urban water supply are in the hands of the private sector and the Luganville's water supply is scheduled to be privatised in the near future. However, in one particular area of commodity marketing for the purpose of exports, the country has still retained

the Vanuatu's Commodity Marketing Board (VCMB) in the public sector, whereas all other SPICs have moved away from procurement at prices higher than at international prices which have proved a heavy drag on public exchequer. The commodities involved namely copra and kava are grown in the remote islands and the cash earnings are very critical to the rural population. The procurement operations of VCMB have resulted in serious losses, which are to be met with heavy subsidies from the government. However, VCMB is looked upon as an instrument of income redistribution and balanced regional development. While there is a considerable social justification for VCMB's existence at the present stage of development of the country, the operations of VCMB need to be streamlined and transparency to be improved so that income transfers are clearly seen.

Besides VCMB, there are seven statutory corporations which include National Bank of Vanuatu (NBV), Development Bank of Vanuatu (DBV) and National Housing Corporation (NHC). While NBV was set up as a government owned commercial bank for specially meeting the ni-Vanuatu banking needs and improving competition in the banking sector, which is dominated by the existing three foreign owned commercial banks, it needs capital strengthening besides better management. Various studies have also suggested that in the current context of privatisation, NBV should be a serious candidate. Recent increases in insider loans do indicate that further inefficient government management of a financial sector institution would adversely affect the country's otherwise better economic record.

The DBV was set up with a specific mandate for promoting ni-Vanuatu entrepreneurship in various undertakings, which are not normally financed by commercial bank loans. However, the past record of DBV is very poor, since losses associated with non-performing loans which are sanctioned at the behest of politicians have been mounting. Consequently, losses have seriously eroded the capital base of DBV and both additional capital contribution and better management procedures are needed. The NHC, which is another government undertaking with management problems, needs to be rehabilitated.

All the statutory corporations have boards of directors appointed by the government. Unfortunately there is no fixed tenure and the boards are replaced as each government changes. For example, during 1996-97 when there were three governments, the boards were changed thrice. The board membership has nothing to do with any professional expertise or experience and appointments are made on political consideration. Expenses incurred on the board members in terms of sitting fees and remuneration are fairly heavy and any pruning in regard to the size of the board and other streamlining matters would contribute to considerable savings. Monitoring of public enterprises is poor. Although the top officials of MOF are on the board, their time devoted to the public enterprises performance is limited. A separate unit, with appropriate technical assistance needs to be set up for monitoring the public enterprises.

Although the efforts of Vanuatu in entrusting the electricity supply and urban water supply to the private sector are laudable, public utilities need careful monitoring and regulation. Vanuatu's electricity rates are regarded as the highest in the region, which is one of the serious constraints to private investment. Since there is no agency in the government for monitoring the performance of public utilities, there is a total absence of control on monopolies with adverse effects on investment climate.

Economic and Financial Management

Vanuatu's economic and financial management during the eighties, which won high praise from the international lending agencies (World Bank 1993, 1995) was marked by fiscal prudence in adhering to balanced budgets, both recurrent and capital. Further, external borrowing was kept to the minimum and foreign assistance in terms of grants has comfortably cushioned the adverse balance of trade. The invisibles, including tourism earnings lent a helping hand and the current account balance, although in deficit in some years was sustainable. However, an unprecedented fiscal expansion witnessed during 1992-1995 in terms of projects under Special Project Implementation Committee funded through public borrowing, and avoidable recurrent

expenses such as mounting expenditures on the political wing of administration including payments of three-month severance salaries for the outgoing ministerial wings twice in 1996, had all created a near-fiscal crisis in late 1996. Substantial cuts on recurring expenditures, which unfortunately fell on the maintenance of physical assets such as roads and public buildings, had to be made to reduce budget deficits. Further, all new projects had to be postponed.

Since the domestic saving rate of Vanuatu is much higher than in other island countries (Jayaraman 1993) and private investment has been slack for a while, the usual adverse effects of public sector dominance in terms of crowding out private investment have not been felt. However, the growth impact of the past government investment has been negligible raising doubts about the quality of investment. It is clear that there is a need to improve the project preparation capacity in key departments such as public works and ports and marine. The projects so prepared should be screened further by the National Planning Office (NPO) from the point of view of national development objectives for consideration for inclusion in a Public Sector Investment Program (PSIP) which can be a guiding document for a three-year period. Such a PSIP can also be presented to external aid agencies. Annual development budgets can accommodate them in case external funds are available or government savings are sufficient to do so. No *ad hoc* addition to the list of projects under PSIP once finalised and accepted by the National Development Committee (NDC) should be made to meet politicians' whims and fancies. A firm decision by NDC in this regard would keep away half-baked projects from implementation.

This brings us to a highly desirable practice, as adopted in other SPICs, of presenting a development budget in addition to the annual recurrent budget each year. Although a decision in its favour was made as early as 1996, it has yet to be implemented. Before doing so, it may be worthwhile bringing the NPO which has an independent existence as part of the Prime Minister's office, under MOF so that its contribution in terms of PSIP preparation and annual budgetary exercise can be significantly integrated. Those functionaries in NPO, who are not involved in project screening but involved

in policy and impact analyses can be assigned to a newly created policy analysis unit within MOF. Presently MOF has no capability in any of these areas and hence the lack of a policy analysis unit was deeply felt when the turnover tax was introduced as part of the budget effective 1 January 1995 without any prior impact analysis. These changes are suggested on the pattern of changes implemented successfully since 1992 in Western Samoa, where the Treasury Department has got under it both planning and policy divisions for assisting in PSIP preparation and undertaking impact analyses.

Noting that there has been no coordination between MOF and RBV in regard to fiscal and monetary matters¹⁵, the government took a corrective decision by appointing a Macroeconomic Committee since mid 1996. The Committee consists of key officials from NPO, MOF and RBV and meets twice a month. This is an excellent arrangement as experiences of such committees in Fiji and Western Samoa have proved very useful for execution of coordinated policies in fiscal and monetary areas (Siwatibau 1993).

The country's financial management efficiency, especially in regard to public enterprises and regulation of private sector monopolies in power and water can be well improved by creating units for undertaking regular public enterprise evaluation and monitoring and control of public utility monopolies in MOF. Since the country does not have adequate expertise in these areas, technical assistance would be needed for an extended period. In the banking sector, the question of increasing competition among the banks deserves paramount consideration. The spread between deposit and the lending rates is considerable. It has been noted that despite high liquidity in the system, the lending rate seems very high, indicating some degree of collusion between the banks. In addition to privatisation of the government owned NBV, encouragement to entry of additional foreign banks can be considered. The DBV needs additional capital injection in the context of its poor capital base, which has been eroded by losses. Reducing political interference and ministerial in-

tervention in DBV for sanctioning loans to favourites would also contribute to reduction in the number of non-performing loans.

Although no serious fraudulent loans by the National Bank of Vanuatu have come to light, concerns have been expressed from time to time regarding growing incidence of insider lending and lack of supervision by RBV. The possibility of a major banking failure on the lines of Fiji's National Bank cannot be ruled out in future unless the banking supervision capability of RBV is raised. Besides developing the key elements of an effective banking system which include capital adequacy and entry criteria, restraints on insider lending, rules for banks to classify the quality and risks of their loan portfolio and minimum auditing standards and disclosure requirements, there is also a critical need for making RBV fully independent and autonomous so that its supervisory functions are effectively carried out.

Private Sector Development

Although there are visible incentive packages in terms of no direct taxes and absence of exchange controls, there are certain formidable hurdles which face the private sector. These include land lease problems, high utility and labour costs together with a minimum wage legislation as well as the country's heavy reliance on taxes on imports which push up costs of imported capital intermediate goods and raw materials. Reforms in all these areas are urgently needed. The economic ministers of SPICs, including Vanuatu, have already decided in a meeting held under the auspices of the South Pacific Forum in July 1997 to support a list of guiding principles for tariff reform. These include; (i) protective tariffs should not be used; (ii) a standard general rate should apply to all goods except when publicly known and clearly defined criteria are met; (iii) a duty drawback system should be available to exporters; and (iv) *ad valorem* rates should be used except in cases where there are serious valuation problems (South Pacific Trade Commission 1997a). In addition, Vanuatu needs an early review of utility rates.

¹⁵ The introduction of a turnover tax from January 1, 1995 resulted in an unprecedented rise in prices of all consumption goods during the first quarter of 1995. The RBV which is charged with the responsibility of maintaining price stability was caught unawares, as there was no prior consultation by MOF with RBV as the country's monetary authority.

Specifically, the private sector in Vanuatu and potential investors from the overseas would appreciate policy clarity in terms of an investment code, a draft of which is now pending for nearly five years, for laying down the much awaited streamlined procedures for sanctioning the business and investment approvals and grant of work permits. Other areas needing improvement, as noted before and which have a great relevance in regard to private sector development, include predictability and transparency in administrative procedures and reduction in the usage of discretionary powers by the ministers and provision of quick administrative remedies.

Ni-Vanuatu entrepreneurship is understandably hesitant to undertake activities which have high risks. Simple value added activities, meeting tourist needs such as handicrafts and souvenirs which tourists can take with them are now being identified together with business and trading opportunities in the retail sector. A more formalised and well-staffed Business Advisory Unit in the Department of Industries can prepare investment profiles and assist the prospective entrepreneurs with training, guidance and credit from DBV. The emerging squash export industry is a good example, where a large number of squash producers were encouraged to enter into contract with an expatriate exporter based in Port Vila with credit from DBV and the repayment of loans and interest were arranged through the exporter, who deducted the DBV dues from the payments made to the participating producers. The DBV, which was set up with specific objectives to encourage local businessmen and small entrepreneurs should develop loan appraisal criteria which are related to clients' capabilities and past records, rather than the elusive land lease titles and third party guarantors. New opportunities can also develop for the indigenous entrepreneurs, when certain routine departmental activities are decided to be sub-contracted to the private sector under the contemplated privatisation program.

There are major commercialisation prospects, which exist in the proposed privatisation of postal services, port operations and the government-owned commercial company for meat and livestock development. However, these are opportunities for major players who will have to enter as direct foreign investors. Here comes the

need for evolving a proactive foreign investment policy. It has been recognised officially in the Third National Development Plan document that the country lacks a clear foreign investment code. As mentioned earlier, the draft is ready. Also available is a well researched UN study (Chand 1996) on the subject of improving investment promotion and approval process. The government has to gather sufficient will and put its officials to work and push through a workable framework.

III. CONCLUSIONS

Vanuatu today has yet to blossom into a developmental state. Its approaches to development are neither facilitative or direct. The private sector investment in recent years has been stagnant and state policies have been indifferent. Embroiled in power struggle, the young nation is drifting without leadership and vision. It is time for the public spirited men and women to put aside divisive forces and gather sufficient will and forge policies with the sole objective of development.

Investigation into aspects of governance reveals Vanuatu's track record of observance of rule of law is remarkably good. Its high respect for the country's constitution and deep faith in and acceptance of the Supreme Court as the final arbiter augur well. The macroeconomic policies adopted in the eighties were sound. There were, however, some disturbing deviations from the previous trend during the nineties, which are now being corrected. The public sector and the civil service are, by regional standards, small. Therefore, immediate reforms lie not in the reduction of the civil service but in the better reallocation of the existing number of the country's skilled civil servants among departments and agencies after administrative reorganisation, and eventual quality improvements. The civil servants seek due recognition of their professionalism, and desire security of tenure, freedom from undue political interference and protection from victimisation on grounds of *wontok* or any such bias.

Administrative reorganisation and streamlining of ministries and departments include bringing NPO under MOF and utilising the personnel of NPO in setting up

policy analysis and planning units so that the planning and impact and evaluation exercises are well integrated with the budgeting functions of MOF. Quality improvements can be undertaken through generous overseas training programmes which are already available under various technical assistance schemes from different bilateral sources.

The new units for monitoring the performance of public enterprises and regulation and control of public utility monopolies, require additional skills which are in short supply and hence need to be obtained under technical assistance from overseas. The contribution of these units lies in reducing waste in public expenditures for better allocation of resources as well as rationalising public utility rates for encouraging private sector activities. Additionally, the enactment of the pending investment code is immediately called for towards the objective of policy clarity and improving the environment for private investment.

The major reforms of a long term nature for consideration are the following:

- (i) abolition of the ministerial wing with three political secretaries for each minister and the paraphernalia of their supporting staff and perks;
- (ii) reduction in discretionary powers of ministers primarily through self-denial and greater delegation of authority to the civil service;
- (iii) neutrality and impartiality of the civil service and development of professionalism and security of tenure;
- (iv) vesting in the public service commission full powers of recruitment and disciplinary actions, including suspension and dismissal, against erring civil servants;
- (v) development of parliamentary committees; greater transparency in administration; and enforcement of public accountability and readiness to redress grievances.

The major reforms are tough. Their implementation requires support from all parties and total commitment to the ultimate national interests rather than personal or party gains. Once a firm decision is made to implement reforms, appropriate signals would announce that the state has taken a facilitative path towards

development. Given the scarcity of indigenous skills in management and entrepreneurship, a direct approach would not be necessary. A simple, private sector friendly environment would be more than adequate.

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Table 1 and 2 continued on the following pages.

TABLE 1

Guiding Principles of Governance and Development with Emphasis on Role of Private Sector

Neoclassical Theory	Principles of Democratic Governance	Areas of Empirical Investigation
1. Market based private sector driven initiatives in mobilization and allocation resources for production and consumption activities.	1. Legitimacy: (a) accountability (b) predictability (c) openness	1. Accountability (a) political (b) bureaucratic
2. State intervention only in case of market failures.	2. Constitutional/Legal Issues (a) government by consent (b) rule of law (c) protection of contract (d) protection of property rights (e) independent judiciary with appropriate appellate procedures (f) public participation through free elections (g) formal systems of representation in government	2. Predictability (a) legal processes (b) legal frameworks
3. Provision of public goods by state.		3. Openness (a) transparency (b) public participation (c) free press and independent media
4. State enforcement of property rights		4. Constitutional safeguards (a) free elections (b) rule of law (c) protection of property rights and contractual obligations (d) legal remedies and appellate procedures (e) principles of compensation
5. Macroeconomic stability.		
6. Free Trade Policies.		
7. Freedom and Independent Media including Free Press	3. Public Sector Management (a) financial and audit system (b) skill levels of public service (c) capacity for policy formulation and implementation (d) independent judiciary (e) accountability of civil servants/ levels of corruption	
8. Constitutional safeguards including independent judiciary		
9. Principles of Compensation		

Guiding Principles of Governance and Development with Emphasis on Role of Private Sector

Neoclassical Theory	Principles of Democratic Governance	Areas of Empirical Investigation
	<p>4. Resource Acquisition and Allocation</p> <ul style="list-style-type: none"> (a) rents including aid, vs. taxation (b) participation for those affected by projects (c) transparency of allocation/decision making (d) military spending (e) institutional pluralism(unions, NGO's etc) (f) corporatism, linking private organizations to government <p>5. Human Rights</p> <ul style="list-style-type: none"> (a) freedom from discrimination (b) freedom of speech/association (c) free media (d) universal education (e) freedom of movement 	<p>5. Public Sector Management</p> <ul style="list-style-type: none"> (a) competence of civil service (b) neutrality and tenure of service (c) audit system (d) public enterprises (e) regulation of public utility monopolies <p>6. Economic and Financial Management</p> <ul style="list-style-type: none"> (a) macroeconomic stability (b) financial sector development <p>7. Private Sector Development</p> <ul style="list-style-type: none"> (a) incentives (b) privatization (c) foreign direct investment

Sources: Islam (1995)
 Macdonald (1995)
 Landell-Mills, P. and I.Serageldin (1991)

TABLE 2**Key Economic Indicators of Vanuatu**

Indicators	Average 1981-1990	1991	1992	1993	1994	1995	1996
Annual Growth Rate (percent)	1.4	4.4	1	4	2.6	3.2	3
Per Capita Income Growth Rate(percent)	1	1.5	-1.7	1.3	0	0.7	0.6
Govt. Revenue (percent of GDP)	NA	24.5	24.7	23.3	25.7	26.5	26.4
Govt. Expenditure (percent of GDP)	NA	38.4	33.4	31.5	38	37.5	38.3
Overall Fiscal Balance (percent of GDP)	NA	-13.9	-8.7	-8.2	-12.3	-11.1	-11.9
Gross Domestic Investment (percent of GDP)	32.3	35.5	34.8	34.2	NA	NA	NA
Gross National Saving (percent of GDP)	7.2	7.7	7.5	9.5	NA	NA	NA
Inflation (percent)	NA	6.4	4.1	3.6	2.5	2.3	2.5
Growth rate of Import (percent)	NA	-16.0	1.2	8	2.6	7.2	8
Growth rate of Exports (percent)	NA	-3.2	30.2	-4.2	10.1	13.2	6.7
Current Account Balance (percent of GDP)	NA	-10.8	-9.9	-9.7	-9.9	-8.5	-8.7
Foreign Direct Investment (US Dollars)	13	25	26	27	30	25	NA
External Debt/GNP (percent)	NA	22.8	23.2	24.8	24.7	NA	NA
Debt/Service Ratio (percent)	NA	1.4	1.3	1.4	1.6	1.5	0.7

Sources: Asian Development Bank(1996)
World Bank(1996)