

Economic and security challenges facing Papua New Guinea and the Island States of the Southwest Pacific.

Submission to

Standing Committee on Foreign Affairs, Defence and Trade

By

Satish Chand
Crawford School of Economics and Government
The Australian National University.

Satish.Chand@anu.edu.au

Phone: 02 6125 0773

Fax: 02 6125 5570

5 August, 2008

Summary

I submit that the security challenges facing Papua New Guinea and the Island States of the South West Pacific are a symptom of the longstanding and sometimes intensifying economic problems they face. If not addressed soon, the continuing decline in per capita GDP in the some of the neighbours will lead to greater domestic strife, the effects of which will spill across to Australia. The challenge for the international community is to accelerate the pace of economic growth in PNG and the surrounding Southwest pacific. Australia can assist in this effort through: (i) allowing freer (reciprocal) access to its markets for goods and services including labour from the region; (ii) supporting improvement in access to basic healthcare and primary education; and, (iii) under-writing law and order within the states via the South Pacific Forum.

SUBMISSION

1. Introduction

Australia has offered, as of today, some A\$29 million in Official Development Assistance (ODA) to Nauru.¹ This was done following the closure of the detention centre put on the island by the previous government. With a population of some 10,000, this generosity to what was not long ago (in the 1970s) labelled, the ‘tiniest richest republic on the planet’ amounts to a transfer of some A\$2,900 per capita. That is, Australia taxpayers are handing out some A\$2,900 for each and every Nauruan. It is only legitimate to question the basis and the motivation for this generosity.

If provided solely for development, then this recent transfer to Nauru equates to the provision of A\$8 per capita per day for each day of the year. The magnitude of the transfer is sufficient to ensure that no one on this island nation is left in poverty – not for a year at least. But will it? The answer would have to be in the negative given that the funds will not be distributed uniformly or even equitably across the entire population. But the effectiveness of this ODA, however instituted, must be judged against the alternative of handing out each and every resident on Nauru a thick bundle of 29 one hundred Australian dollar bills! We don’t even have to convert this into local currency; the A\$ is their local currency. No fancy distribution mechanisms are required. All we need to do is ship Father Christmas across for a weekend with his large duffle bag full of cash.

As a taxpayer, I would be satisfied if the promised aid to Nauru, or any other recipient for that matter, catalysed economic growth leading to poverty reduction. I would judge the aid provided as being effective if, and only if, its need diminished over time. Economic growth is a necessary condition for the above. If not careful, a large unencumbered gift with the perception of this generosity continuing can do more harm than good.² This is not a reason to deny aid: only a caution against neglect of the potential for undesired consequences.

Nauru is not alone in terms of being a beneficiary of large Australian ODA. Australian assistance to the island pacific has increased significantly over the recent past. Australian ODA to Solomon Islands, for example, increased more than ten fold from approximately A\$20 million prior to the initiation of RAMSI in 2003 to a 2008-09 estimate of A\$236 million.³ Australian aid to Nauru and Papua New Guinea have also increased, but to a lesser extent. Notwithstanding a strong and sustained economic rebound, aid to PNG and the island-pacific is likely to increase further as the total aid budget in increased.

Australian aid to PNG and the island nations of the Southwest Pacific have been motivated by the desire to induce development. While economic accelerations require more than aid, the record in terms of catalysing growth from these transfers has been less than praiseworthy. The risk from rising transfers from Australia to

¹ Pacific Beat, 5th August 2008.

² The population of Nauru has had a much better social welfare system; particularly during the glory days of generous income from phosphate export.

³ The figures are in nominal terms and in Australian dollars. Sourced from AusAID website, accessed on 5th August, 2008.

nations in strife in the neighbourhood is that of Australian taxpayers underwriting bad policies and poor governance in this region.

The rest of the submission is structured as follows. Section 2 summarises the major economic and security challenges facing the nations located within the Southwest Pacific and the implications of the above on Australia. Section 3 canvasses policies that Australia could institute to accelerate economic growth within the neighbourhood. Size, particularly that of Australia vis-à-vis its impoverished near neighbours is an advantage. Concluding remarks bring the submission to a close.

2. Economic security within the impoverished Southwest Pacific

Long-term human security can only be built on the foundations of economic prosperity. Law and order and functioning states are critical for the efficient functioning of a modern economy. Unfortunately, law and order and poverty are both headed in the wrong direction in several of the island nations located in Australia's neighbourhood. Australian (or Australian-led) interventions such as those in East Timor in 1999, in Solomon Islands in 2003, and in Tonga in the aftermath of the riots in 2006 all point to the fact that Australia under-writes security in the region. There are strong moral, economic, and geopolitical reasons for such action. Rather than being left to pick up the pieces in the aftermath of a crisis, I submit that it would be better for Australia to be proactive in averting crises in the first place.

The facts are that several of our island neighbours have had persistently low, and for some negative, rates of growth in per capita income. Jobs creation in the majority of these states has often fallen well short of the number of people entering the workforce. Consequently, both absolute poverty and income-inequality has trended upwards. As an example, one in every eight persons in Fiji was in poverty in 1977; this figure rose to one in four by 1991 and one in three by 2002. While more recent data is unavailable, the last coup in Fiji in 2006 would have worsened the poverty count further. This is not exactly the recipe for peace founded on prosperity.

Fortunately, PNG, the largest and closest of our neighbours has had some recent success. The economy has grown for each of the past five years, political stability has prevailed for the first time in this country's history, and optimism in its economic prospects is at an all time high. It is instructive to look at reasons for this change, and for the better. Part of the economic rebound, as that for Australia in this same period, can be attributed to rising global commodity prices. This may be labelled as good luck. The political stability being enjoyed by the past and current governments could be attributed to reforms instituted by the Morauta Government in 2000, and for this very purpose. Stable monetary policies can also be attributed to reforms of the same era. But part of the explanation is also the feedback of an economic rebound on peace and stability. The Kina is stable partly because foreign reserves have rebounded to healthy levels. The improvement in terms of trade triggered a "virtuous feedback" on peace that in turn has helped to consolidate prosperity. But we do not want to get ahead of ourselves on PNG's prosperity. PNG is still a low income country with many of the development indicators that are far from satisfactory; an issue we return to later.

If it is true that a "virtuous feedback" exists between peace and prosperity, then the reverse must be equally true. That is, declining incomes can lead to an

unravelling where an economy ends up in severe poverty and conflict. The effects of such unravelling, moreover, spill across national borders. Post 1987-coup Fiji is a case in point. This first coup in Fiji caught everybody other than the perpetrators by surprise. This crisis then triggered a chain reaction where the initial coup created policy uncertainties, which in turn led to a collapse in investment, an outflow of skilled people and capital flight, culminating in sharp declines in domestic production.

This decline in GDP and the rise in poverty were visible; what was less apparent, however, was the erosion of institutions that formed the bedrock of a modern civil society. A series of scandals within the senior echelons of the bureaucracy and incidences of grand corruption slowly revealed their hold on society. This was brought home forcefully in the 2000 coup when criminals turned the national parliament into a prison, and the parliamentarians therein into prisoners. The coups, I submit, taxed civility in Fiji heavily. Other than making some muted protests, the international community sat on its hands and watched Fiji decline into more trouble. The catastrophic events of 9/11 and the subsequent bombing in Bali made us all take security threats, even in distant lands, seriously.

Nearly every institution in Fiji has been seriously compromised since the first coup of 1987. Questions, for example, are being asked about the impartiality of the judiciary; an institution that sits as the ultimate arbiter of all disputes. The unravelling of peace with increasing impoverishment of the population is not peculiar to Fiji. A similar mechanism was at work in Solomon Islands that led to a full-blown civil conflict. This was only brought to an end by the Australian-led Regional Assistance Mission to this nation in 2003.

The highly stylised caricature of the feedback between peace and prosperity and its ramifications for security that I have sketched above is an oversimplification. A lot more than what I have sketched out above, transpired in the lead up to coups in Fiji and the Solomon Islands. These details are important, but not for this submission. If anything, they confuse the clear lessons that should be drawn from them. A strong policy implication of the above is that, sending troops to quell fighting will help in providing a measure of stability and law and order in the short term, but longer-term peace also requires counterpart measures to revive the economy.

Why does a poor country need the urging of a donor such as Australia to do what is in its own interest? Why does Australia have to send in units of the Army and the Police, together with their Pacific Island counterparts to restore and sustain peace, say on Guadalcanal, when this fundamental task is what the Guadalcanalese should be striving for on their own? Similarly, why should anyone else help me do what is in my own self-interest? In short, what are the motivations for ODA?

Let me sketch out one answer; that is, one of the many answers to the last question. Each and everyone one of us desires to lead free and fruitful lives. Only a few of us are lucky, extremely lucky may I add, to realise this dream. My own personal experiences of having grown up in a rural household with very modest means are instructive in this regard. The recipe, as I see it to a successful life, comprises of four key choices: ranked as follows. First and foremost, you must choose your parents right. Second, you need to choose your country, sometimes even

the part of a country, of birth correctly.⁴ Third and important if you missed out on the above two is to choose your gender and place in the family right. Finally, you need to time your birthday right. Having some good intellect also helps, but only at the margin. These are necessary but not sufficient conditions for realising your potential. I am a good example of someone who missed out on three of the four necessary conditions; that is, I got three of the four choices wrong. Being a male, but then as the eldest son in a family with meagre means in rural Fiji, came the hefty responsibilities. I have (thus far) done fine. The reasons are few; these being: (i) I had a healthy dose of good luck on the way; (ii) I had access to educational facilities, mediocre as they were; and, (iii) I emigrated from Fiji to Australia, solely because of the schooling I had acquired. The second of the above would have been unavailable if I was born a decade earlier and/or a lot deeper into the mountains. Either of the above would have been enough to shut me out from emigration.

What does the above have to do with ODA? The challenge for us, those of us lucky enough to be born in the right family, in the right country (such as Australia), and at the right time (now) is to work towards reducing the handicaps nature has placed on many individuals less fortunate than ourselves. Sure, we may not be able to change the date or place of birth of an individual, but there is a lot that can still be done to improve the prospects of individuals to realise their potentials in our impoverished neighbourhood. Doing so is a moral responsibility; it is also in our economic interest, as well as a political and security imperative. What are these interventions? How can Australia help?

3. What can Australia do to raise economic prospects in the impoverished neighbours?

I am proposing three specific interventions: (i) allow for freer trade in goods and factors of production including labour from the neighbourhood; (ii) support improved access to basic healthcare and universal access to primary education; and, (iii) under-write law and order within Pacific states by cooperating with the members of the South Pacific Forum. Each of the above is elaborated upon next.

(i) Deepen regional trade links

There is considerable consensus within the economics profession that freer international trade improves economic prospects for the participating economies. Australia's own lessons with a century long experimentation with trade protection and productivity growth is instructive in this regard. The Closer Economic Relations Agreement (CER) with New Zealand is a stark and recent reminder of the above. I submit that serious consideration should be given to extending the CER facility to PNG and the rest of the island nations in the Southwest Pacific. This can happen progressively over time with continuous fine-tuning of policies.

The recent shift to allowing guest workers from the islands into Australia for fruit picking jobs under a pilot project, is a first step. The economic case demands a lot more. An open and deep market such as that founded on the CER arrangement will allow for two-way flows of goods, services, workers, investors, etc. I would like to see goods flow between the region as freely as workers, investors, retirees, and

⁴ Having chosen Australia, as an example, it is not enough if you happened to be born in a remote community up North.

tourists (but bearing in mind security implications, such as terrorism, some regulation will be required). Australia can initiate this unilaterally, possibly on reciprocal basis, but doing so multilaterally – say on the Most Favoured Nation (MFN) principle - could be even better. I am arguing for progression, with Australian leadership, towards a single economic market for the Pacific; and, solely on its economic merits. The ensuing political and security gains would be a bonus to the above.

(ii) *Support universal access to primary education and basic healthcare*

The level of access to basic services such as primary education and basic healthcare varies considerably across the nations of the Southwest Pacific. PNG ranks low, if not the last, on this count. Its geography in the form of the rough terrain and archipelagic nature, history in terms of a highly fragmented and sometimes strongly divided society, and climatic conditions which makes malaria (and other vector-borne diseases) endemic to the nation is major handicaps to universal and effective delivery of basic services. The recent arrival and galloping spread of HIV compounds the problems many fold.

Education is critical for development. The international community, via the 2nd Millennium Development Goal (MDG), committed itself to achieving universal access to primary education by 2015. This same MDG also targets the elimination of gender disparities in primary and secondary schooling. While this goal may be achieved at the global level, the same is unlikely to be true for the Pacific region. Australia, moreover, will carry some blame for this failure.

Any progress on MDG#2 within the Pacific Islands requires significant improvements in enrolment rates and primary school completions in Papua New Guinea. This is so for three reasons: (i) PNG is the largest country within the island-Pacific, accounting for some 6 million of the 8 million inhabitants for the region as a whole; (ii) PNG lags the most in terms of school enrolments; and, (iii) gender disparities are the largest for PNG.

Primary school enrolment statistics from the National Department of Education (NDOE) and population census from the National Statistics Office (NSO) show that only 53 percent of children in the 6-14 year age cohort are in primary school. This means that some 680,000 children of school age are not enrolled in school. Girls comprise 45 percent of children in elementary and primary school. But only 29 percent of girls who enter grade 1 complete primary schooling. And gender disparities widen as students move up the education ladder. Furthermore, the quality of education delivered is poor. A recent survey reported that some 37 percent of primary school graduates were unable to read or write. Australia shares some responsibility for the above.

PNG is the largest recipient of Australian aid. A significant proportion of this aid is channelled to the education and health sectors. PNG, as of 2006-07, accounted for approximately 30 percent of total Australian ODA. Education and Health sectors received some 10 and 11 percent, respectively, of the total. In terms of progress made on the second MDG, that of universal access to primary education, the most recent data – that of 2004 – reveals PNG ranking last within the Pacific Islands and only marginally above Nepal within the Asia-Pacific region. The reality could be worse

since some recent updating of the data suggests that the initial estimates may have been optimistic.

Australian aid is being scaled up. Some of this rise will flow on to PNG, and to the poorly performing island nations within Australia's neighbourhood. We could, with these additional funds, do more of the same old programs and projects. This would be a risk-averse strategy. Much of the efforts to date have been targeted at funding teachers, school buildings, road, etc; the focus, in short, has been on increasing inputs with the assumption that bumping up inputs will lead to increased outputs and improved developmental outcomes. Hindsight suggests that the assumption of a tight relationship between inputs and outputs is flawed.

I submit that we can be more ambitious in getting better value from our aid. Specifically, I submit that funds be used to directly purchase outputs from individual suppliers. The analogy of coffee shops takes us far on this proposal. Good coffee gets supplied wherever there is a market for the above. Could a similar model be used to improve access to quality primary education in PNG? Some experimentation and learning would be necessary to make this work with ODA.

I propose a Progress Education Fund (PEF) that will 'buy' progress on primary school completions and in terms of the number of students passing the national exam in the graduation year.⁵ This proposal has its genesis in the Cash-On-Delivery (COD) mechanism that has several advantages over the current system of input subsidisation.⁶ Five of these are enumerated below. (i) It uses existing machineries of the PNG Government, thus will strengthen existing delivery mechanisms. (ii) It takes resources to the frontline of service delivery, thus bypasses the centre. (iii) It is administratively low maintenance as the requisite data for PEF is already collected by the NDOE. (iv) The risks of gaming the system is contained by the fact that exams are set and administered nationally. (v) The proposed scheme is consistent with the 2005 Paris Declaration that seeks to increase local ownership of aid-funded programs, is focused on results (with flexibility on mix of inputs used for the deliverables), is aligned with Government priorities, and delivers funds on a predictable basis. The PEF pays for progress made in terms of throughput from primary schools and the quality of education delivered. The emphasis is on standards and outputs while structures to deliver the above are left to the discretion of local suppliers of the service.

(iii) Underwrite law and order via the South Pacific Forum

I am proposing a short-term, a long-term, and a bridging strategy to improve law and order within the island-pacific.

The short-term strategy entails members of the Pacific Island Forum, as a collective entity, under-writing law and order in each of its member nations. This will require members first agreeing to a regional external intervention should laws of any state be usurped. This does not tread on their sovereignty since each individual state has the right to form its own laws; but then has to abide by these laws which have already been approved and legislated by its own legislature.

⁵ This is not the place to provide details on the PEF. A concept note is available from me on request.

⁶ The COD scheme has been proposed by Nancy Birdsall and her colleagues at the Centre for Global Development based in Washington DC. I am a non-resident fellow of this institution.

Credibility is critical for this strategy to deliver on intent. Multilateral commitment would be necessary for the above. The South Pacific Forum is the natural home for such an agreement. If credible, the Agreement could be cost-effective in instilling law and order and insuring against coups in the region.⁷ Australia, as the largest and richest member of this Forum, would have a pivotal role in this initiative. A credible multilateral commitment to restoring law and order if and when it breaks down in any member state could be enough to deter civil disruptions in the first place. Australian backing to such a commitment and her willingness to lead a mission should the need arise, is critical for this strategy to deliver on its intent.

The long-term strategy is that of creating the conditions for voluntary compliance with the laws of the state by the majority of her citizens. The incentives for such compliance has to be founded in the belief that the rewards of complying with the rules and regulations of society, even without the threat of punishments by outsiders, far outweigh the costs of doing anything less. This requires raising the prospects of development for the region such that the incentives are for value-adding effort rather than those for predation. If economies grow sufficiently to absorb those requiring work and be in a position to provide opportunities for sustainable livelihoods for the majority, then prosperity would be the girder on which peace and stability could rest. Furthermore, a sufficiently large tax base would allow the nation state to control criminals with its own resources.

While under-writing law and order in the individual states will lower the risk premiums for private investors, the increased investment will be realised only after investors are convinced that the commitment will withstand the test of time. Thus, the rise in growth of income and jobs from an assurance that law and order will prevail can only be a long-term strategy. Temporary access to jobs in Australia for those in need of the above together with improved access to training and healthcare at home (as argued in (i) & (ii) above) has the potential to ‘jump-start’ the process of job creation and growth of production.

Conclusions

The recent Australian generosity to Nauru has the potential to reduce poverty and save the need for further transfers down the track. This would be the preferred outcome, but one likely to be achieved only if aid was effective in inducing development. There is no guarantee of that outcome. Worse still, large sums of unencumbered aid can undermine development by creating an expectation of ongoing support and the basis for a welfare state. As a taxpayer, I will be appalled by such an outcome.

What could be done to maximise the chances of aid being effective in inducing development? This is a question that has occupied the minds of many. Unfortunately there are no as yet known recipes for development. What we do know is that a few ingredients such as law and order, secure property rights, and widespread access to basic services such as primary education and basic healthcare are necessary

⁷ The Biketawa Declaration permits the above. I had raised this as part of my keynote address to the Forum Economic Ministers at their July 2006 meeting in Honiara.

for development. Targeting the above-mentioned could enhance the contribution of aid to development.

I have argued for three specific Australian interventions to enhance prospects for economic growth in PNG and the island Pacific. First, freer and deepened trade modelled on the Closer Economic Relations Agreement within the region, including freer flow of workers and investors is likely to improve economic outcomes both in Australia and the region more generally. This argument for a single economic market for the Pacific rests on the basic economic premise of gains from free trade. It is good for Australia and for the region as a whole.

The second contribution that Australia can make, in PNG particularly, is to improvements in access to primary education and basic healthcare. Given the poor access to these services now and the critical contribution such services make to improvements in human welfare, such support is likely to yield large developmental benefits. Some experimentation on the best means of achieving the above may be necessary, however. I have suggested a 'payment-for-progress' on access to quality primary education in PNG to be funded with aid as a pilot to break new ground on this front.

Third, Australia, given its size and geographic location, must become more proactive in preventing conflicts that have retarded development. Most of the responses to date have been reactive; sending troops into troubled island nations being an example of the above. I have put forward a challenging and ambitious proposal to use the South Pacific Forum as a grouping, where each member agrees in advance to allow foreign intervention should power be usurped within their country. Australian leadership will be critical for such a commitment to be credible. But if such an arrangement were in place, it would seriously challenge the calculus of would-be usurpers. Thus, the commitment in itself may never need to be demonstrated, but still deliver on its intentions. Furthermore, the Biketawa Declaration provides the foundations on which the proposed agreement could be built on.

Finally, security or the lack thereof is only a symptom of the underlying economic malaise. If the cause of conflict is not addressed, then there is little hope that enforcing security with external force will deliver long-term and sustained peace and long-term security.