Empowering the region: a proposal for a Pacific Islands Investment Development Fund

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Maintaining the reform momentum

The last three annual meetings of the South Pacific Forum have developed and endorsed a clear economic and management reform agenda for the Pacific islands region. Australia and most other donors have encouraged the reform agenda. Building on this foundation, the task ahead is to help ensure that the momentum for reform is maintained in the longer term.

In order to contribute to consideration of how best to help maintain the reform momentum, we outline a proposal for a Pacific Islands Investment Development Fund. For the purposes of this note, we regard the region as comprising all the Pacific island counties, as incorporated within the South Pacific Forum, with the exception of Papua New Guinea. (Papua New Guinea has been excluded because it operates on a different scale from the other Pacific Island countries, and has a distinctive treaty relationship with Australia. Should the approach outlined below have merit, however, there may be scope to consider its applicability to Papua New Guinea).

The rationale for the proposed fund rests on the following assumptions:

- although aid has the potential to play an important role, the key requirement for economic stability and development in the island countries is sound government policy, and this can only come from within island governments
  - despite tight budgetary circumstances, Australia would wish to maintain its aid support to the region at about the same real level over the next decade
  - some island countries will need further stimulus to move beyond rhetoric and make hard decisions
  - that Australia would wish to help provide a stimulus for reform, while at the same time respecting island country sovereignty and avoiding claims that it is interfering with the sovereign rights and internal politics of the island countries
  - in committing themselves to reform, the island governments will be reassured and assisted in their efforts by the knowledge that overall Australian aid will be maintained at a substantial and predictable level over the forthcoming decade
  - Australia wants to strengthen regional institutions and to encourage the consolidation of a regional pro-reform consensus
  - Australia does not want the island countries to be permanently dependent on external aid, but accepts that some aid must continue on a long-term basis, over
several decades in some instances, and indefinitely in a few cases

- increasing present aid levels to the region would be counter-productive, because of aid absorption problems and because, unless domestic policy settings are correct, additional aid merely helps governments to postpone hard but necessary decisions.

The Pacific Islands Investment Development Fund

On the basis of these assumptions, we believe that there is scope for the establishment of a regional investment and development fund, under the wing of the South Pacific Forum. The fund could be developed in the following way

- in early 1997, Australia would announce that its aid spending on the island countries (not including Papua New Guinea) will be maintained at the 1996 level of some A$125 million per annum, in real terms, over the next decade
- from late 1997 it would establish a tax-exempt regional development fund
- in financial year 1997–98 it would provide A$20 million as start-up funding, diverted from the A$125 million or so allocated for aid to the Pacific region
- from 1998–99, further funds would be siphoned off, namely A$25 million in 1998–99, and in each successive year up to 2006–7, to give a total allocation of A$245 million (in 1997 dollar value terms), at which point the situation would be reviewed.

From 1997–98, these funds would be used as an investment base for the proposed Fund, under the following arrangements

- the Fund will be managed under strict guidelines, as a special South Pacific Forum project, in accordance with the regional reform agenda
- Australia will be the main donor, but other donors will be encouraged to contribute, particularly in the early years (several donors who wish to contribute to the development of the region might be expected to welcome an opportunity of this kind to do so while avoiding expensive aid-delivery overheads)
- the island countries themselves would be expected to make small, but symbolically important, annual contributions, to reinforce their sense of being stakeholders
- for its first three to five years, the emphasis would be on growing the Fund’s capital base, but after that it would begin to provide investment loans and aid grants
- the Fund investment program would be managed by a reputable firm of financial managers, under careful supervision, but operating autonomously within their sphere of responsibility, who would be responsible for investing the Fund’s assets and for maximising returns within an acceptable risk
- the loans and (the small number of) grants available from the Fund would be allocated in strict accordance with the principles of good economic management, responsible resource development, and good governance, with unspent allocations ploughed back into the Fund.

To begin with, the loans and grants from the Fund would only amount to a few million dollars a year. As the Fund grew, however, the total amount allocated would increase proportionately, so that within two decades the Fund itself would become a major ‘donor’ to the region.

In effect, given the principles and guidelines against which allocations would be made, access to the Fund would be on the basis of competition between potential recipients. This circumstance should encourage a high standard of proposals, and a sustained commitment to economic reform.
In a related initiative, and as the Fund gathers momentum, Australia could make it clear that for general support from Australia’s ‘direct’ aid spending, strict priority would be given to those national and regional projects which were in accordance with the reform agenda, with funds which could not be spent in an effective, accountable way in these programs henceforth routinely transferred to the Fund.

Management and accountability

The Fund would be governed by a Board including representation from the International Monetary Fund, the World Bank and the Asian Development Bank, and all donors and all recipients, but with votes weighted in proportion to financial contribution, to ensure a significant donor voice. All strategic decisions, such as changing the drawdown guidelines, would require a 60 per cent majority. The Governors of the Fund from the island countries would generally be central bank governors and finance secretaries, who are the strongest proponents of good economic management in the islands. Their domestic positions would thus be strengthened through regular contact with and support from regional colleagues. With a collective decision-making process and with meaningful participation from the islands, responsibility would lie with individual countries to present good proposals within the context of prudent economic management.

The Fund’s administration—recommendations to the Board for project loans and grants—and the oversight of implementation, would be undertaken by its own small administrative unit, comprising a director and (once fully in operation) a small number of professional staff. The Director would be appointed on secondment from the World Bank or the Asian Development Bank, while staff would also be seconded, in roughly equal numbers, but strictly on a merit basis, from the Australian or New Zealand public service and from island country bureaucracies, providing valuable skills enhancement for island country secondees.

The administrative unit would be located in an existing regional organisation (perhaps the Forum Secretariat), but with a clearly-established autonomous status, to ensure that it could use an existing organisation’s support services (for example, finance and personnel), while remaining answerable only to its own Board, so that the regional organisation did not have access to the Fund.

In due course, a small levy on the proceeds of the Fund would cover salary, operating, project development and other costs. The administrative unit would have access to information and analysis from AusAID and, under aid partnership and coordination arrangements, from the Asian Development Bank, World Bank, International Monetary Fund and other donors and international institutions. The administrative unit would require adequate funds to permit regular visits by its staff to the island countries, to collect complementary information and develop up-to-date assessments. (Given the small scale of the island countries, and the small number of key interlocutors, even brief visits would yield valuable results.)

The Fund’s guidelines would be negotiated from the outset with all founding members, and would outline both general criteria for projects and general economic criteria. The guidelines would be sufficiently flexible to take into account both specific country circumstances and specific events.

The Fund would be listed for Australian domestic purposes as a multilateral program under the auspices of a regional
organisation. To prevent the Fund being used by government agencies to bypass budgetary discipline by filling 'hollow logs' with unspent allocations, it would be established that Australian agencies would only be able to reallocate unspent aid funds on the basis of an agreement with Treasury and Finance that those funds were being reallocated to a multilateral program, in a manner similar to arrangements for our contributions to the International Development Agency and the Asian Development Fund.

A range of possibilities

The amounts indicated are for illustrative purposes only, and a range of possible arrangements would require consideration. It would be necessary, for example, to strike a balance between the Fund’s role as an allocation mechanism, and its capacity to become substantially self-generating in the longer term. One could argue that a more substantial commitment to the investment component of the Fund in its early years, though more difficult in the first instance for the island countries because of the greater reduction of immediately available funds, would prove of greater longer-term benefit by allowing the fund to become viable on a larger scale at an earlier time.

It may also be the case that there would be scope from an early stage to channel a larger proportion of Australian aid to the region through the Fund—perhaps, say, 50 per cent—rather than the proportion of about 20 per cent per year mentioned above, with a significant portion of these funds flowing on as short-term allocations.

Advantages for Australia

The Fund would serve Australia’s interests in four ways

- by shifting substantial responsibility for allocation decisions to island representatives, and thus upholding island country sovereignty, strengthening economic policy capacity, and increasing direct island participation in aid policy and management
- by removing Australia from direct conditionality in the aid program, while still encouraging responsible economic management in the region
- by providing a means for Australia to reduce direct aid to the region over the longer term. In due course the Fund would generate its own income and, provided Australia’s economic growth continues, a ten-year commitment to maintain spending at the real 1997–98 level would give a relative saving, in proportion-of-GDP terms, in the amount allocated to the Pacific islands region
- by relieving wasteful expenditure through reducing end-of-financial year pressure to spend individual bilateral allocations.

The success of the Fund would depend on prudent management. In the longer-term, however, it would have the potential to make a major contribution to the region. And the question arises: what if, since Australia began providing aid to the island countries, 20 per cent of the annual aid spent had gone into a competently-managed special fund, which would have grown through returns on investment, in due course generating funds for aid and investment? Had it been established, a fund of this kind might now be providing a substantial amount of development assistance to the region.

The authors are officers in the Australian Department of Foreign Affairs and Trade, but this note does not have, and should not be regarded as having, any official status. They have submitted it to the Pacific Economic Bulletin in their private capacities, as a contribution to debate.