A ‘clean up campaign’ for Fiji’s economy

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It appears that the military-imposed Interim Government will be in power in Fiji for a few years, with the deadline for a democratically elected government to be determined by the time needed for the carrying out of a census, the redrawing of electoral boundaries, and the compilation of the electoral rolls. In the meantime, the military has shown its firm intention to implement a ‘clean up corruption’ campaign. While corruption can impose considerable economic and social costs and the ‘clean up’ campaign may be able to reduce these, it would be an even more useful task for the military-backed government to implement a ‘clean up’ campaign of the economic distortions that are holding back the market component of the Fijian economy.

‘Cleaning up’ corruption and ‘cleaning up’ economic distortions

The economic costs of corruption

Corruption is costly for an economy and it is very important to minimise it. There are various forms of corruption with different kinds of effects—with some effects much less obvious than others. For example, nepotism—which Transparency International sees as being widespread in the Pacific—does not necessarily result in public money passing into private hands.1 The main potential cost of nepotism to an economy is that it results in the best person available for the job not being appointed. Therefore, the economy is not as well served as would be possible if selection were made on merit from the pool of candidates. Nepotism afflicts civil service appointments in all levels of government as well as appointments to the boards of public enterprises.

Bribery of public officials may not have serious effects, such as a bribe to speed up the processing of a form or the bribing of a police officer to avoid paying a fine. However, the acceptance of a climate where such bribery takes place frequently makes other more serious acts of corruption more acceptable. Bribery of a customs officer to classify imports wrongly into categories that attract a lower customs duty can mean avoidance of millions of dollars of tax. Such tax avoidance means that the government has less money with which to fix roads, build schools and medical centres, or make welfare payments to the less fortunate.
In most countries the ‘grand corruption’ usually takes place in public works, through acceptance of over-tendering for land or buildings or materials, or through skimping on the material inputs for a project. In these cases, large amounts of public money pass into private pockets and/or the public ends up with a much inferior investment such as a road which has a road bed that is not strong or deep enough—and which therefore requires continuing maintenance—or a school with foundations or walls that deteriorate rapidly, or even a bridge or building that becomes unsafe. The public funds appropriated may be spent within the country in the form of private consumption or investment. More detrimental to the economy is where the funds obtained illegally are sent overseas and are not spent within the economy.

The less well off may engage in some corrupt activities, such as lowly paid civil servants demanding a few dollars to speed up the issuing of a licence, or bribing a police officer not to issue a ticket. However, it is not the less well off who benefit from the grand corruption. The beneficiaries of grand corruption are the already well off—business people and higher-level civil servants and politicians. The upshot is increasing income inequality and an economy that is not performing as well as it should. As Satish Chand has pointed out in this issue, poverty is increasing in Fiji at a rapid rate. The poorly performing economy must be one of the reasons. And one of the reasons for Fiji’s poor economic performance could well be a high level of grand corruption.

So, where corruption is taking place, it is very important to minimise it as far as possible. However, it is important to bear in mind a couple of points. First, being inherently secretive, corruption is difficult to detect and difficult to prove. But these difficulties should not prevent the effort being made to sanction those responsible. Second, corruption, and bad governance more generally, is an outcome of inappropriate institutions or lack of enforcement of the institutions that are the framework around which a society is built. Therefore, as much or even more effort should go into developing appropriate institutions and trying to ensure that they are enforced. Otherwise, corruption will persist.

Removing economic distortions and restraints on economic growth

While corruption has detrimental effects on economic growth, the gains from removing other constraints on economic growth are likely to be much larger than the gains from reducing corruption. It is also likely that removing these other constraints can be achieved more quickly and the benefits realised more quickly. Given that the Interim Government is likely to remain in power for only a few years and that its goal is to develop a more efficient and a less discriminatory economy that grows strongly and with more equitable outcomes, the government should focus as much, or even more, on removing the other obstacles to growth. Because the interim administration is a once-only event, and those involved in the Interim Government really have nothing to lose and can only gain from leaving behind a robustly growing economy, they should concentrate on this objective.

Removing many of the obstacles to economic growth in Fiji is something that only a government such as the interim administration can do, or can do within a reasonable time. The constraints to economic growth seem to be fairly obvious. Most, if not all, exist because they serve some particular political or economic interest and do not serve the interests of society as a whole.
Therefore, in the absence of the military take-over, it is most unlikely that they would have been removed any time soon. Indeed, under the Qarase administration even more inefficient and discriminatory policies were being put in place.

So what are the constraints to the economy growing robustly, and which should be given priority? Because private sector investment is the driving force of economic growth, the most important institutions for the effective and efficient functioning of a market economy are secure property rights (particularly to land) and impartial enforcement of contracts. In the agricultural sector, the lack of secure property rights to land for non-indigenous farmers over the past decade or so has severely inhibited investment and led to falling productivity in the sugar industry—and most likely in other agricultural activities. The political impasse over the renewal of the agricultural land lease system that served the economy so well for so many years has been hugely damaging to the economy. This damage has been felt both directly in agricultural activities but as well indirectly throughout the economy by giving rise to uncertainty about investment in general. The latter impact is not measurable but must have been very large.

Putting in place an effective leasing system for agricultural use of customary land seems to me to be the major priority in establishing the basis for strong economic growth; and is something that the Interim Government could do within a relatively short time. It is clear that the resource owners wish to have an efficient and fair leasehold system. Their willingness to grant 99-year leases for resort hotels is one of the foundations for the success of the tourism industry in Fiji. This willingness has been reinforced by the development of fair contracts that involve a share in the equity of the resort, the provision of education and training for the resource-owner communities, and employment opportunities in the resorts. Such contract provisions will ensure that the contracts will be honoured by the landowners, as they will not strike against their own assets.

As I have suggested in the past, a new agricultural leasehold system should be market-based for the setting of the lease rentals and any other payments such as goodwill. As I have also suggested, the Native Land Trust Board as the trustee for the landowners has served its time. The landowners should be allowed to manage their own resources, including the leasing of land, otherwise they will never develop the needed expertise.

The impartial enforcement of contracts, the other basic requirement for the effective functioning of a market economy, needs the full and non-discriminating support of the government and an effective and impartial legal system. If contracts made in good faith are not effectively enforced, the result is a reduction in investment and business activity. Investors will go to countries where contracts are effectively enforced. Long-term authoritarian regimes, such as in Chile, Indonesia, China and Vietnam, recognised the necessity of secure property rights and contract enforcement for economic growth and achieved a record of high rates of growth over a long period. However, meeting these objectives is at the whim of the regime. When the regime no longer exists, the arrangements usually collapse. Such a collapse is evident in Indonesia following the removal of the Soeharto regime. Since the removal of Soeharto, a great deal of attention has been paid in Indonesia to putting in place the principles of democracy; but little attention has been given to reforming the bureaucracy and the judiciary and to seeing that arrangements for ensuring secure property rights and impartial contract enforcement are in place.
(see Duncan and McLeod 2007). As a result, the economy has not been performing very well, with investment reluctant to return.

The lesson to learn from these successful authoritarian regimes is not to adopt an authoritarian regime but to have a democratic regime that provides the basic economic institutions needed for the private sector to operate effectively. An essential difference between an authoritarian regime such as Indonesia, which was able to have sustained strong economic growth, and a democracy that achieves the same results is that when the authoritarian regime collapses the property rights and contract enforcement that sustained the growth no longer exist and must be created again. So far, Indonesia has not been able to achieve this transformation. In contrast, Chile was able to make the successful transition from an authoritarian regime to a democracy that has in place the institutions essential to good economic growth.

Fiji’s ranking of 86th out of 175 countries with respect to the Costs of Enforcing Contracts shows that much still has be done to create an encouraging environment for investors (World Bank and International Finance Corporation 2006). In this World Bank report it is estimated that, on average, enforcing a contract in Fiji requires 26 procedures, takes 397 days, and costs 62 per cent of the claim. These figures show that the court system is not working well. The interim administration should make impartial and efficient enforcement of contracts another reform priority. Therefore, it should see that the court system becomes much more efficient and that it makes well known that the government and the bureaucracy will not intervene in any contract dispute; that contract disputes are matters for the court system. This is an important standard to put in place for future governments.

Other actions that are necessary to remove constraints leading to the low rate of private investment in Fiji and which must be taken if Fiji is to have sustained, robust economic growth are the following: privatisation of government business enterprises and essential services, removal of tariffs and other import restrictions, reducing the power of labour unions, removing tax holidays for investment, and making affirmative action programs less discriminatory.

Government business enterprises and essential services utilities have a very poor record in Fiji. Yet the private sector is highly reliant upon them for the infrastructure needed to carry on business efficiently. Unfortunately, most government business enterprises have a record of loss-making, they take up much of government investment, and their boards reflect nepotism, conflicts of interest, and lack of expertise in the enterprises’ activities. There appear to be good reasons for the majority, if not all, to be privatised.

The Interim Government has already followed the recommendations that came out of the Prime Minister’s Summit on Corporate Governance held on 11–12 March 2005. The recommendations that were sent to the Qarase administration included reducing the number of board appointments a director could hold, requiring appropriate expertise from board members, reducing the size of boards, and ensuring training for appointees in board duties to ensure good corporate governance. The implementation of these recommendations should ensure better board performance while these enterprises remain in government hands.

The Interim Government has also indicated that it will move quickly to open up the telecommunications sector in Fiji. As I argued a few years ago (Duncan 2004), by adopting high-cost, monopolistic arrangements for the several arms of the telecommunications sector, Fiji effectively locked itself out of the industrial revolution.
sweeping the world. This revolution has relied on low-cost telecommunications. There have to be doubts that as a ‘late starter’ Fiji can now benefit greatly from attracting overseas activities by opening up its telecommunications sector and lowering prices. Still, substantially lower telecommunications costs will be of great benefit to the development of domestic industry such as agriculture, as well as for education purposes.

Opening up the telecommunications sector appears to be the essential service that the interim administration should move on most urgently. Such action will have the support of the majority of the population. The decision about which other government business enterprises should be deregulated should be determined by a judgment about which activities the government (or corporatised body) is most ineffective in running. This is an empirical question. Global experience—and Pacific experience—has shown that governments do not run airlines well, nor do they run telecommunications services well, nor shipping, nor water or electricity services. Of course, in many of these cases of essential services, such as water, electricity, telecommunications, and ports, governments have two very important roles to play. One is to acquire the land needed for the service. The other is to put in place the appropriate regulation.

Tariffs and quotas on imports are very economically distorting actions that only serve the interests of the favoured industries being protected and reduce growth. It is a difficult concept for the layperson to understand, but restrictions on imports act as a tax on exports. This can be seen most clearly in the Qarase government’s November 2006 Budget, which sharply raised tariffs on a range of products, mostly agricultural, consumed by the tourism sector and the expatriate community. What the tariffs did was to raise the costs of production of the tourism sector and make it less competitive internationally. The government’s objective was to help the agricultural and horticultural sectors gain a larger share of the resort hotels’ demand for these products. Like many well-intentioned actions undertaken without a proper understanding of the consequences, the effects will have all been bad. Developing an agricultural sector behind import barriers has been shown over and over around the world only to lead to the establishment of inefficient enterprises that cannot survive without the assistance of the import barrier. At the same time, the ‘goose presently laying the golden eggs’, the tourism sector, will have been hurt.

The tariff increase was not the only action of the Qarase administration that hurt the tourism sector. In the 2006 budget, a turnover tax on hotels was put in place. The argument has often been made in justifying these ad hoc policies that the tourism sector is not contributing much to government revenues. But this is the result of past governments providing tax holidays for resort developers. It is doubtful that tax incentives increase the level of investment, as is hoped by their proponents. Most likely, all that is accomplished is that investment is shifted from taxed activities to untaxed activities. It was also further distorting of investment for the Qarase administration’s 2007 Budget to raise the tariffs on construction materials from 3 per cent to 27 per cent while providing tax holidays for investment. It would be much better to have a completely undistorted tax system so that Fiji could develop according to its comparative advantage.

Getting rid of import restrictions will also help reduce the impact of another constraint on development in Fiji, which is the power of the unions. Opening up to trade is an effective, indirect way of doing this, as the
comprehensive trade reforms in Australia have shown. Freer trade and the increased competition from imports not only reduces the prices of goods to both consumers and other users of imports such as exporters but also reduces the power of unions to raise wages in the protected sectors. In the long run, the more efficient industries that develop will be more labour-intensive than the protected industries and therefore employment opportunities will increase. With the increased economic growth that results, incomes will be increased for all, including for the labour that will move out of the no-longer protected firms.

Public sector unions in Fiji are very strong, as shown by the no-redundancy policies of past governments when it comes to attempting to undertake any reforms in the civil service or in government business enterprises. Reducing the power of public sector unions is likely to be very difficult. However, the Interim Government is taking on the public sector unions in adopting its policy of lowering the retirement age as a means of reducing the number of civil servants. While this action shows that the Interim Government is willing to confront the unions, it is fighting on the wrong battlefield. Lowering the retirement age appears to be a least-best policy for reducing the costs and improving the performance of the civil service. A much better strategy would be to take a close look at the civil service and decide which ministries and departments are necessary for good government and which are not, and scrap those that do not appear necessary for effective operation of the economic and social policies of the country. Further, retention and promotion of civil servants should be on the basis of merit, not on the basis of age. The Interim Government has expressed its desire to see the country move away from the affirmative actions of the past—actions which have operated in the civil service since the 1987 coups. Therefore, its policies towards the civil service should reflect its desire to have an efficient service, free of discrimination.

Finally, the affirmative action programs adopted by the Qarase Government were based on a false premise, as Satish Chand (this issue) shows—that is, that poverty in Fiji is much greater among indigenous Fijians than among Indian Fijians. In fact, poverty is just as bad and increasing just as fast in both ethnic communities. Chand (2007) also shows that there is the strong possibility that the affirmative action programs have contributed to the increasing poverty in both communities. Moreover, the affirmative action programs have most likely mainly served to make the wealthy in both communities even better off—another unfortunate, unintended consequence.

There is no doubt that government actions are needed to reduce poverty. But as experience around the world has shown, the best way to do this is to have high levels of economic growth. Putting in place discriminatory policies that only serve to make the already wealthy even wealthier is not the way to achieve this goal. The poor need jobs, they need good roads and transport to get to and from markets, and they need good access to education and schools. Creating these conditions is also one of the ways to have strong economic growth.

Conclusion

As shown in other conflict-ridden countries around the world, such as Northern Ireland, a high rate of economic growth can remove much of the basis for the conflict and lead to peaceful reconciliation. The
opposite is clearly true. Rural indigenous Fijians justly feel anger at the long-term lack of development of essential services and provision of better access to health and education services. When people feel such anger they lash out irrationally at anyone who is different and who they think may be receiving benefits that they are not. The failure of the Fijian economy to grow at a rate rapid enough to provide the government with increasing revenues for the provision of essential government services, particularly to rural areas, is largely the fault of government interventions in the economy.

Once granted, these interventions—usually comprising favours to particular interest groups—are very difficult to remove. The 2006 coup and the Interim Government that will likely be in power for a few years, offers an opportunity to ‘clean up’ the economy so that it can function free of distortions. I am reminded of Mancur Olson’s theory about why the southern part of the United States has, for a long time, grown at a faster rate than the north (Olson 1982). Olson argued that the destruction of the South by the Northern army destroyed not only buildings but also wiped out all the regulations that had been put in place by governments over the years to serve one favoured interest group or other, and that had led to a ‘fossilisation’ of the economy. Following the destruction, the South was freed of all the regulations inhibiting the private sector. Even today, the South is seen as a much more open economy than the North.

Just as I am sure that Mancur Olson would not have suggested the destruction of the US South in order to achieve this goal, I am certainly not recommending coups where government regulations and policies are stifling enterprise. However, given that the coup has taken place and the interim administration wishes to see a much more efficient, less discriminatory, more equitable, and faster growing economy establishing, I am suggesting actions that it seems that only such an administration can achieve in a relatively short period of time. The alternative seems to be a continuation of the inefficient, discriminatory, slowly growing economy, which is sure to lead to even more conflict in the future—not only conflict that is based on ethnicity but also conflict between the haves and the have-nots.

Therefore, my priority list for the economic ‘clean up’ campaign is the following. First, immediately remove all customs duty increases announced in the 2007 Qarase Budget; and later, remove all tariffs. Second, as soon as possible, establish a new, even more effective, agricultural leasehold system for customary land. Third, put in place a more efficient court system for settling commercial disputes and announce a promise that the government will not interfere in contract disputes. Finally, as soon as possible, privatise the telecommunications system and quickly work towards privatising the most inefficient of the other government business enterprises.

Notes

1 Transparency International (2004) reported that kickbacks for public services, bribery of public officials (for example, customs and income tax), nepotism, undue influence of public officials, inappropriate public procurement, abuse of public funds, and conflicts of interest were prevalent in Fiji.
References


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