"Economy"

Chapter 28 in Moshe Rapoport (ed.)

The Pacific Islands: Economy and Society

Bess Press, Hawaii, 1999

Geoff Bertram

School of Economics and Finance
Victoria University of Wellington
Geoff.Bertram@vuw.ac.nz

CHAPTER 28

Economy

Geoffrey Bertram

Introduction

Pacific Island economies are small and isolated, but except for Papua New Guinea (Booth 1995:208) they are not poor by the usual standards of world poverty. Provision of basic needs has seldom been under threat for the indigenous populations of the islands, and living standards across much of the region continue to be underwritten by official transfers and private remittances. There is considerable geographic mobility of individuals, which makes migration a central issue for economic policy and ensures that most of the region's labor markets are open, with wages in the islands indexed to wage rates obtainable in the outside world.

Smallness brings with it relative insignificance on the global scale. In 1994, Melanesia, Micronesia, and Polynesia, excluding Papua New Guinea and Hawai'i, had a combined population of 2.5 million, only 0.04% of the world population of 5,630 million. Adding in those two larger entities brings the total to 7.6 million, still only 0.13% of the world total (United Nations 1995, Table 1). Including New Zealand as part of the island Pacific adds another 3.5 million people.

Almost all of the Pacific Island states have, since the nineteenth century, been colonies, associated territories, or integrated parts of larger industrialized countries. (The term "state" is used here to refer to any politically defined entity, including dependent territories as well as sovereign nations.) Trade flows, capital flows, asset ownership, official languages, government structures, and currencies in use have been determined over the past century by the existence of eight main spheres of influence—British, French, U.S., Australian, New Zealand, Chilean, Japanese, and German, the last two of which became absorbed by the others during and after the two world wars of the century. A revival of Japanese influence, in the context of rapidly increasing linkages between the island Pacific and the East Asian economies in general, is a major trend of the 1990s.

The ongoing importance of close links between individual island economies and their out-of-region metropolitan patrons is evident in Table 28.1, which provides some basic data.

The characterization of Pacific Island communities as economic units is problematic. This is reflected in the nature of the economic data that are available, as well as in the political status of the islands and the general tone of outside commentary on economic development prospects in the region. Of the twenty-five entities apart from New Zealand listed in Table 28.1, only nine (Papua New Guinea, Samoa, Fiji, Kiribati, the Solomon Islands, Tonga, Vanuatu, Nauru, and Tuvalu) are independent nation states; only six (Papua New Guinea, Samoa, Fiji, the Solomon Islands, Tonga, and Vanuatu) have their own currencies; and only nine (Papua New Guinea, Samoa, Fiji, the Solomon Islands, Tonga, Vanuatu, the Marshall Islands, the Federated States of Micronesia, and Kiribati) are members of the World Bank and IMF. Major parts of the regional economy, such as Hawai'i, New Caledonia, and French Polynesia, as well as the smallest units (Tokelau, Easter Island, and Norfolk Island) are politically integrated parts of larger countries whose metropolitan economies are located around the Pacific Rim or in Europe. Several other island states are constitutionally "self-governing in free association" with larger countries to whose currency areas they belong.

Pacific Island economies are embedded in wider markets; to only a limited extent are they national market arenas in their own right. The internationalization of markets for goods, services, and factors of production during the 1980s and 1990s was less of a change for Pacific Islanders than for the inhabitants of most of the world's non-OECD (Organization for Economic Development) countries, because of the Pacific's pre-existing freedom of trade and capital flows and its long history of labor migration both within the region and to metropolitan economies. (The OECD is a grouping of the world's wealthy industrial economies.)

To explain income levels in the Pacific it is advisable to use only with great caution, if at all, the two most familiar "modernization" models of economic development: the classical closed-economy model of industrialization on the basis of domestic capital accumulation (Lewis 1954, Rostow 1960); and the outward-oriented export-led growth model pursued by the Asian "tigers" and widely advocated in recent years by agencies such as the World Bank (for example World Bank 1991). The past half century's economic development in most of the island Pacific has been import led, and it has been the struggle to finance rising imports without incurring unsustainable indebtedness that has dictated the various economies' structural evolution.

Output, Trade, and the Balance of Payments

The usual benchmark statistic used to rank economies in the world scene is Gross Domestic Product per head. For only some of the Pacific Island economies is this available on a consistent basis over time, and for many of the smaller ones the statistical concepts underlying GDP are less applicable than for large "developing economies" because of the importance of external sources of income and the extent to which modern-sector economic activity has moved offshore to the neighboring metropolitan economies. Nevertheless, the data on GDP and the balance of payments do have a story to tell.

TABLE 28.1

Background Data on Twenty-Six Pacific Economies

Territory	Population	Political classification	Currency	GDP/GNP US$m	Per capita US$
US Pacific					
Hawai'i	1,186,000	Integrated	US$	32,724	27,592
Guam	153,700	Integrated	US$	3,128	20,351
Northern Marianas	63,000	Integrated	US$	550	8,733
Federated States of Micronesia	109,200	Associated	US$	203	1,860
Palau	16,900	Associated	US$	98	5,813
Marshall Islands	59,800	Associated	US$	96	1,598
American Samoa	58,900	Integrated	US$	253	4,295
Total	1,647,500			37,052	22,490
French Pacific					
French Polynesia	229,200	Integrated	Pacific franc	3,418	14,914
New Caledonia	196,800	Integrated	Pacific franc	3,017	15,330
Wallis and Futuna	14,800	Integrated	Pacific franc	25	1,689
Total	440,800			6,460	14,656
Australian Pacific					
Papua New Guinea	4,141,800	Sovereign	Kina	4,600	1,111
Kiribati	82,400	Sovereign	Australian $	55	662
Solomon Islands	395,200	Sovereign	Solomons $	209	529
Vanuatu	173,900	Sovereign	Vatu	187	1,078
Nauru	11,200	Sovereign	Australian $	81	7,205
Tuvalu	10,200	Sovereign	Australian $	4	373
Norfolk Island	2,367	Integrated	Australian $		
Total	4,817,067			5,135	1,066
New Zealand Pacific					
New Zealand	3,480,000	Sovereign	NZ$	50,777	14,591
Samoa	170,000	Sovereign	Tala	170	1,000
Cook Islands	19,600	Associated	NZ$	51	2,596
Niue	2,500	Associated	NZ$	7	2,825
Tokelau	1,800	Integrated	NZ$	1	667
Total	3,673,900			51,006	13,883
Independent Central Pacific					
Fiji	800,500	Sovereign	Fiji $	1,801	2,250
Tonga	99,000	Sovereign	Pa'anga	125	1,262
Total	899,500			1,926	2,141
South American Pacific					
Easter Island	27,770	Integrated	Chilean	n.a.	
Galapagos Islands	15,000	Integrated	Ecuadorean		
Total	42,770				

Main Source: Bank of Hawai'i "Pacific Facts Sheet"

TABLE 28.2

Per Capita GDP by Political Status, US$

	All	Excl PNG	Excl PNG and Hawai'i
Sovereign territories*	1,229	1,510	1,510
In free association	2,187	2,187	2,187
Dependent	22,615	22,615	14,423
Region average	6,351	11,979	5,046

* Excluding New Zealand.

Source: Table 28.1.

The first outstanding stylized fact to emerge is that with the exception of New Zealand (an OECD member better classified as part of the metropolitan Pacific Rim economy for reasons discussed below), the GDP per head of island economies listed in Table 28.1 tends to be inversely related to their degree of political independence. Table 28.2 shows that the collective per capita GDP per head of fully sovereign island territories is only 5% that of politically integrated or dependent territories. Exclusion of the very large (by regional standards), very poor sovereign state Papua New Guinea raises this only to 7%. Further exclusion of Hawai'i, the largest and highest-income nonsovereign territory, raises the figure to 10%. Only tiny Tokelau, fully integrated with very low estimated GDP per

head, breaks the pattern.

The figures in Tables 28.1 and 28.2 show each economy's GDP converted to US$ at current market exchange rates. This procedure tends to understate the recorded GDP of the poorest countries, because it undervalues their production of nontraded goods, which sell locally at prices well below the prices of equivalent goods and services in rich economies and have to be revalued to "purchasing power parity" in order to make like-with-like comparisons across countries (World Bank 1996:225). Adjusting the GDP of Papua New Guinea, Fiji, the Solomon Islands, Vanuatu, and Samoa on this basis roughly doubles their estimated GDP per head (World Bank 1996:222, Table 28.1a; Booth 1995:210, Table 28.3), whereas Hawai'i, as part of the benchmark U.S. economy relative to which the revaluation is carried out, would be unaffected. The French Pacific territories, in which prices for many nontraded services are inflated by French wage and salary policies (Poirine 1994b), would also be little changed.

Adjusting the poorer island economies' per capita GDP using purchasing power parity might thus raise them only from 5% to 10% of the dependent territories' GDP per head, or to just over 20% with both Hawai'i and Papua New Guinea excluded. Measurement error, in other words, contributes only marginally to the pattern revealed by Table 28.2.

While the data in Table 28.2 show a correlation between political integration and economic prosperity, they do not prove causality: does political integration lead to relative economic prosperity, or does relative poverty result in decolonization? The cases of French Polynesia and the Federated States of Micronesia—both extremely resource-poor but with high incomes because of official transfer payments—provide support for the first hypothesis. Kiribati, decolonized by Britain in the year its phosphate resource was exhausted, gives some credibility to the other.

Provisionally, it seems reasonable to regard political connections as the source rather than the consequence of economic welfare. This proposition, that in the Pacific relative wealth flows from "dependency," and relative hardship from independence, has seemed paradoxical to many social scientists familiar with the larger developing economies of Latin America and Asia. It is nevertheless a feature of small-island economies not only in the Pacific but also in the Caribbean, Atlantic, and Indian oceans.

A second main stylized fact about Pacific Island economies is that across the region, economic growth as measured by GDP during the past two decades has been slow and often outpaced by population growth, so that per capita incomes have been flat or falling slightly according to the official statistics. The region-wide pattern of slow output growth is common across a wide variety of income levels, political regimes, and trade orientations. It represents a significant slowdown compared with the rapid material progress of the region up until the early 1980s and is attributable directly to the end of a period in which government was a strongly growing "leading sector" for the island economies. From the World War II until the late 1970s, with the international political spotlight focused on issues of development and decolonization, the dominant metropolitan powers (particularly the United States, Britain, France, and New Zealand) financed and organized the project of extending to their island dependencies many of the attributes of their own welfare states, especially in the fields of education, health, and public works. However once the dependent territories had been raised to levels of material welfare consistent with the desire of the metropolitan governments to emerge with credibility from the decolonization process, the impetus of state expansion slackened (except in French Polynesia, where the nuclear testing program resulted in a continuing economic boom through the 1980s). Decolonization was usually followed by a drop in or leveling-off of ongoing aid funding provided by former metropolitan powers and a corresponding loss of the previous momentum of public-sector expenditure.

The era of government-led growth left a valuable legacy of physical infrastructure (roads, ports, energy and telecommunications systems, public buildings, education and health), and economies with employment heavily concentrated in the externally financed public sector. However, as public expenditure leveled off, there was no subsequent takeoff of private-sector-led growth in GDP except in Fiji, where sugar, tourism, and manufacturing provided high-linkage export sectors. In most island economies, private investment has remained concentrated in nontraded goods and services such as commerce, construction, transport, communications, and financial services. Because local markets are small, the growth potential of these sectors is limited, and hence investment opportunities are limited.

The slow growth of GDP is certainly not due to any lack of finance for investment. The Pacific Islands do not have a "savings gap"; on the contrary, a common theme in the literature on island finance is the existence of excess liquidity due to the shortage of bankable projects (Nagai 1996). It is low capital absorption capacity, due partly to small scale and geographical isolation, that limits the possibilities for textbook growth models based on large-country experience.

A third stylized fact is the lack of economic integration, as usually understood, among the Pacific Island economies. Trade statistics show the Pacific to be the least-integrated region in the world, with trade between the island states amounting to less than 2% of their total exports (McGregor et al. 1992:20–21). Each island economy trades mainly with bilateral partners outside the region, with former or actual metropolitan patrons the preferred trading partners. Only in nontradable economic activities—government, education, scientific research, transport, communications—is there a tendency toward integration among the island states.

A fourth major feature of the region is its unusual combination of very large trade deficits with a generally healthy current account on the balance of payments. Figure 28.1 plots for fifteen Pacific Island economies the balance of trade in goods and services over the two decades to 1994. This balance, sometimes termed the "commercial balance," is calculated by adding together all of a territory's foreign-exchange earnings from the sale of exported goods and services including tourism, transport, and communications, and then subtracting all foreign-exchange payments for imported goods and services, including services such as transport and insurance that enter into the cost

of imported goods. This gives a measure of the extent to which the sale of local output on world markets enables an economy to pay for its import needs. For purposes of cross-country comparison, the data for each economy have been averaged for each five-year period between 1975 and 1994 and expressed as a percentage of merchandise imports (that is, imports of goods, excluding services purchased overseas). Only one of the fifteen economies, Fiji, has shown a positive commercial balance over two five-year periods. The remainder show deficits ranging from around 10-20% of imports (Hawai'i, American Samoa, New Caledonia) to around 100% or more (Tuvalu, the Marshall Islands, French Polynesia, the Federated States of Micronesia).

Because of the very open nature of these economies, the trade deficits are also large relative to GDP. Across the six countries surveyed in detail by the World Bank in 1991, Fiji, Papua New Guinea, Vanuatu, Kiribati, Samoa, and Tonga (World Bank 1991:12), exports averaged 55% of GDP and imports averaged 67%, so that their collective commercial deficit was 12% of GDP—a very high ratio by international standards.

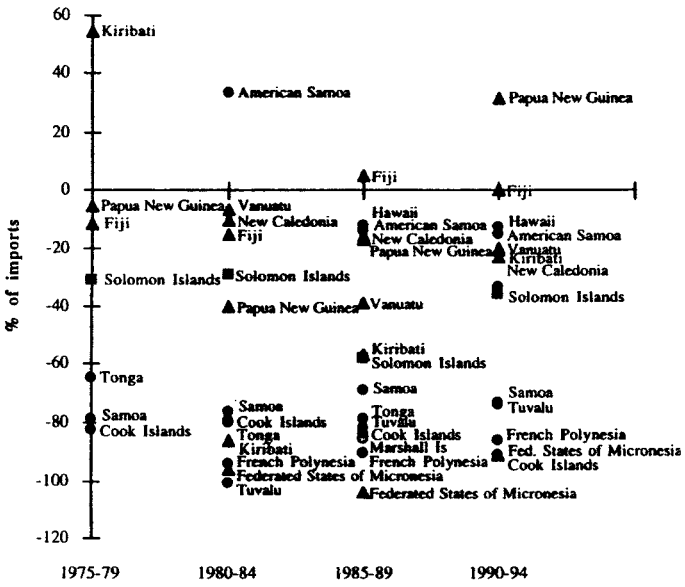


Figure 28.1. Goods and services balances of fifteen Pacific territories.

Some possible classifications suggest themselves in Figure 28.1. Melanesia and Hawai'i, with larger land masses and populations, have relatively "strong" commercial balances (small deficits). Small-island Polynesia and Micronesia have conspicuously large deficits. With the exception of Hawai'i and American Samoa, the Polynesian and Micronesian microstates shown in Figure 28.1 have commercial deficits between 50% and 110% of imports, which means that more than half the imports to those economies are financed either by current transfers (repatriated overseas earnings, private remittances, and official aid) or by capital inflow (borrowing plus direct foreign investment).

These two possible means of financing trade deficits have radically different implications for economic sustainability. Economies with trade deficits financed by capital inflows face rising overseas indebtedness over time and so must eventually raise their export revenues to the level required to service that debt, or reduce their imports sufficiently to move their current accounts back to surplus. This is a familiar situation in Africa and Latin America, but does not apply to Pacific Island economies, whose overseas debt has never been allowed to rise above modest levels. A recent World Bank study (World Bank 1996:240-241) classified the degree of indebtedness of 210 economies, including 13 Pacific Island economies. No Pacific Island states were among the 53 "severely indebted low and middle income" economies. Only 2 (Samoa and Papua New Guinea) appeared among the 31 "moderately indebted" countries. The other 11 Pacific economies covered were ranked "less indebted" or had no classifiable external debt. As Table 28.3 shows, the level of public overseas indebtedness in the seven economies for which data are readily available is seldom more than one-third of GDP except for Samoa, which moved into the "moderately indebted" category from the late 1980s, partly because of the heavy public cost of repairing cyclone damage in the early 1990s.

TABLE 28.3

Public and Publicly Guaranteed Overseas Debt of Seven Pacific Economies

Country	Debt US$m	GDP US$m	Debt as % of GDP
Fiji:			
1989	301.6	1,254.4	24.0
1994	195.2	1,869.4	10.4
Kiribati:			
1990	3.4	32.4	10.5
1994	9.3	34.3	27.1
Papua New Guinea:			
1989	1,314.2	3,558.9	36.9
1993	1,571.5	5,088.5	30.9
Samoa:			
1989	71.9	109.0	66.0
1992	117.8	120.0	98.2
Solomon Islands:			
1989	99.4	167.6	59.3
1993	94.9	245.0	38.7
Tonga:			
1989	38.1	115.8	32.9
1992	42.6	147.1	29.0
Vanuatu:			
1989	20.8	147.9	14.1
1993	39.4	181.8	21.7

Sources: UN Statistical Yearbook 1994, Table 28.81; Asian Development Bank 1994.

The Micronesian/Polynesian combination of large trade deficits and low overseas debt has been sustained for several decades now by large flows of current-account transfer payments into the island economies. These transfers come from three main sources. First is the payment of interest and dividends on financial assets held overseas—income from overseas investments such as Kiribati's Revenue Equalization Reserve Fund, Nauru's large portfolio (both derived from saved phosphate revenues) and Tuvalu's Trust Fund. Second is the flow of remittances sent home by migrants living and working in metropolitan economies such as Australia, New Zealand, the United States, and Canada. Third is official aid provided in the form of "unrequited transfers"—that is, payments for which no subsequent repayment is required, so that the local government budget can be funded with no weakening of the government's balance sheet.

Table 28.4 assembles some figures that demonstrate the various ways in which Pacific Island economies maintain strong current accounts in their balance of payments despite having generally large commercial deficits. Only two of the twelve countries in Table 28.4 have strong trade balances. Fiji, as already seen in Figure 28.1, is an economy that does not have a significant trade deficit and so pays its way on the basis of export earnings. Papua New Guinea is the largest single aid recipient

TABLE 28.4

Financing of the Current Account in Twelve Pacific Economies (Annually in US$ Millions)

Country	Exports: goods & services	Imports: goods & services	Commercial balance	Interest,dividends, etc.	Remittances	Official transfers	Current account balance
American Samoa							
1985-89	292.33	337.67	-45.33	na	na	na	na
1990-93	331.50	390.00	-58.50	na	na	na	na
Cook Islands:							
1985-89	20.43	29.66	-9.23	na	na	na	na
1990-92	25.85	50.37	-24.52	na	na	na	na
Federated States of Micronesia:							
1985-89	16.83	83.74	-66.91	a	6.53	113.75	53.36
1990	50.30	170.70	-120.40	a	2.40	114.93	-3.07
Fiji:							
1985-89	581.46	565.78	15.68	-25.22	-10.42	24.04	4.04
1990-94	905.08	922.84	-17.76	-13.70	8.28	34.32	11.14
Kiribati:							
1985-89	20.42	41.41	-20.99	7.43b	2.10	19.67	8.21
1990-94	29.18	62.76	-33.58	15.62b	7.08	25.38	14.48
Marshall Islands:							
1986-89	22.26	57.96	-35.70	a	6.01	52.80	23.10
1990	35.14	78.61	-43.46	a	5.68	64.12	26.34
Papua New Guinea:							
1985-89	1303.74	1494.34	-190.60	-150.30	-105.46	214.08	-232.28
1990-94	2256.36	1867.98	388.38	-305.22	-96.22	228.64	245.92
Samoa:							
1985-89	32.85	71.01	-38.16	0.08	32.41	12.92	7.25
1990-94	42.60	113.03	-70.43	2.61	33.37	13.78	-21.36
Solomon Islands:							
1985-89	92.60	137.34	-44.74	-7.18	-0.54	26.77	-25.69
1990-92	116.09	167.25	-51.16	-8.06	3.06	35.40	-20.77
Tonga:							
1985-89	24.99	57.05	-32.07	3.23	21.57	5.65	-1.61
1990-93	33.26	74.33	-41.07	3.25	30.70	6.95	-0.17
Tuvalu:							
1985-89	4.35	7.86	-3.52	a	c	3.53	0.02
1990-93	6.55	10.54	-3.99	a	c	6.17	2.18
Vanuatu:							
1985-89	51.10	84.82	-33.72	-0.45	6.84	25.81	-1.52
1990-94	86.43	100.11	-13.68	-24.52	11.16	15.58	-11.26

a) Included in export and import data. b) Reserve Equalization Reserve Fund income.c) All transfers included in aid column.

Sources: IMF Balance of Payments Yearbook and International Finance Statistics; United Nations Statistical Yearbook 1994; Asian Development Bank Key Indicators of Developing Asian and Pacific Countries 1994; UNCTAD Handbook of International Trade Statistics.

in the region, reflecting its very low income and large population; but aid funding is only about 10% of export earnings and serves mainly to offset the outflow of dividends, interest, and repatriated earnings. (Private remittances flow out from Papua New Guinea because of the large number of expatriates employed there. The small number of Papuan migrants overseas means that remittances in the other direction are small.)

The Federated States of Micronesia, the Marshall Islands, Tuvalu, and the Solomon Islands all have heavy commercial deficits financed by large official transfers. French Polynesia (not included in Table 28.4) also funds its commercial deficit in this way. These economies can be described as aid-driven. In contrast, Tonga and Samoa rely mainly on private remittances to fund their trade deficits; in both these economies remittance flows are on a par with export earnings, and aid provides a top-up. The Cook Islands, Niue, and Tokelau (not included in Table 28.4) all have similar dual reliance on private remittances and official aid. This group of economies can be described as driven by migration and remittances.

A third funding pattern is that of Kiribati, with its large inflow of dividends and interest from offshore financial assets, although official aid remains an important component of its financing. Nauru (not in Table 28.4) has an even stronger role for investment income in its current account and receives only a trickle of aid. These economies can be described as rent-led.

The relative stability over time of these various models of current-account financing is demonstrated in Figure 28.2, which compares the current accounts of Fiji, Tonga, Samoa, Kiribati, and the Federated States of Micronesia from the mid-1970s to the early to mid-1990s. In each chart the solid line shows the funding required in each year to pay for imports of goods and services, including interest and dividends on overseas investment in the local economy. The sources from which funding was obtained are shown by the vertical columns, with exports of goods and services forming the bottom segment of each bar, and other sources of current-account financing added on top. So long as the columns stand higher than the imports line, the current account is in surplus and the economy is able to pay for its full import needs without having to borrow overseas. (Gaps in the charts for Kiribati and the Federated States of Micronesia represent years for which data was not available.)

To a first approximation it is convenient to regard these economies as operating under a foreign-exchange constraint represented by the requirement to keep the current account in balance, so that expenditure on imported goods and services (including outflow of profits and expatriate incomes) exhausts the current financing available in each period. This means not only that any increase in aid, remittances, or export earnings flows through directly to increased imports, but that the opposite is also true: any reduction in external sources of funding places an immediate squeeze on imports and living standards.

The comparison between Fiji and Samoa in Figure 28.2 is instructive. Fiji's current account is financed almost entirely by exports of goods and services, with the current account virtually in balance throughout the two decades shown. Samoa's current account is more than half financed by transfers, with private remittances moving ahead of official aid over the two

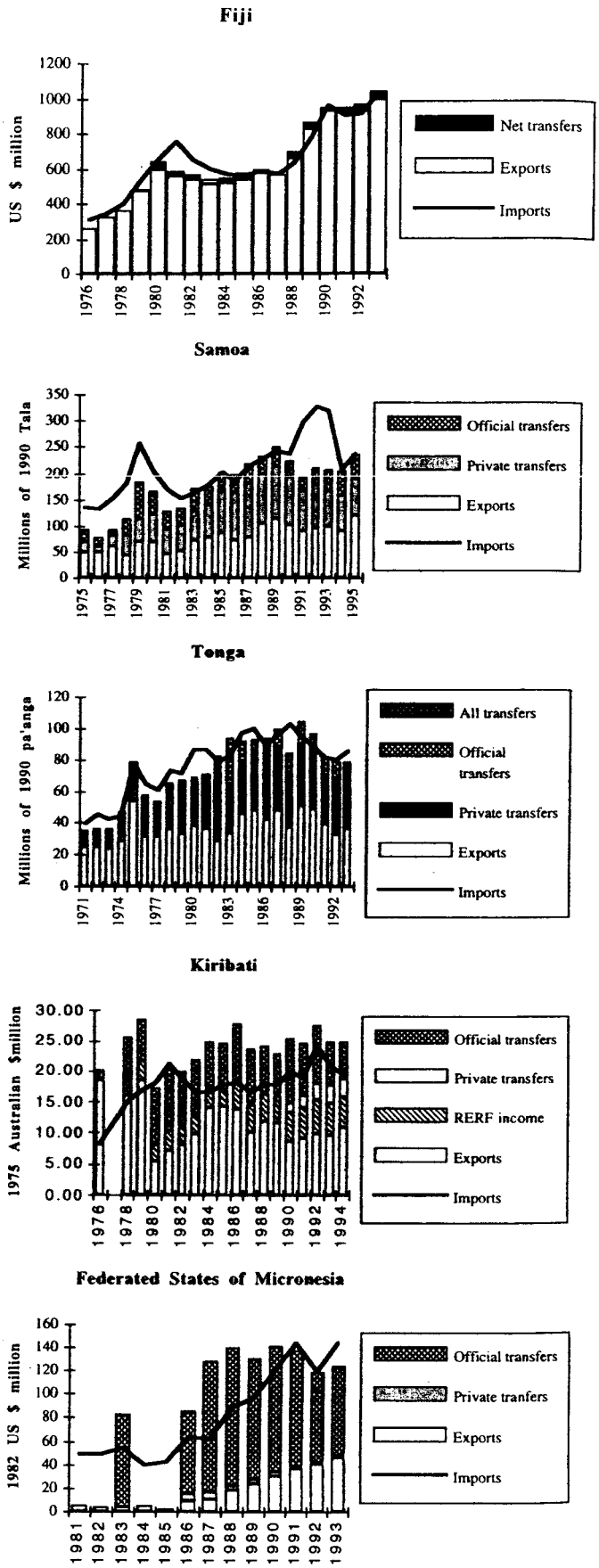
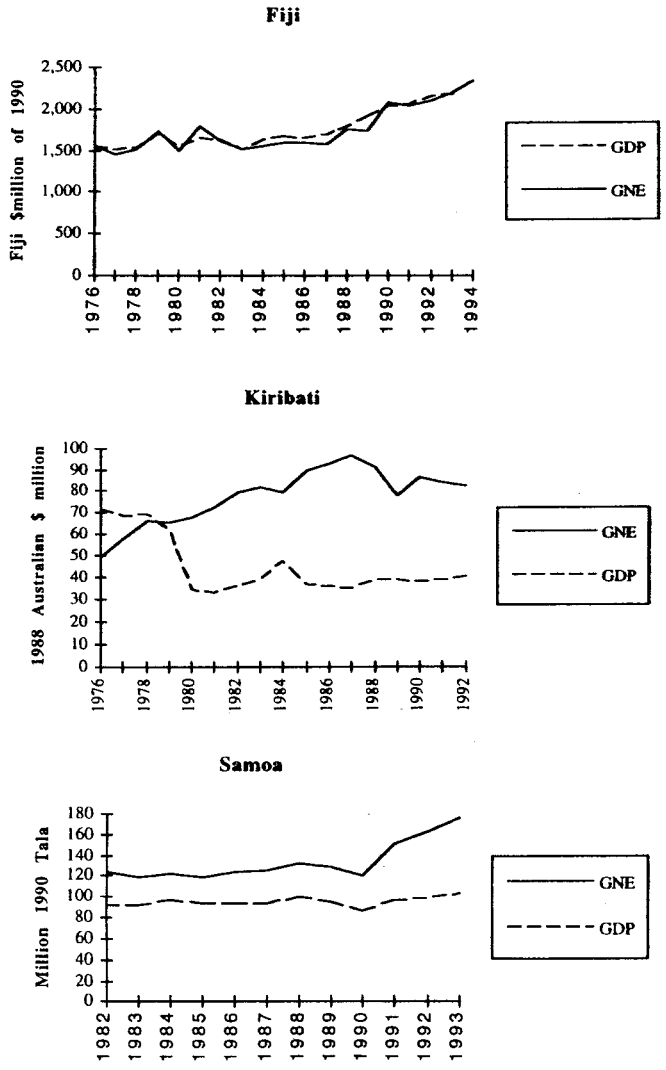


Figure 28.2. Current account balances of five Pacific economies: financing of import expenditures including factor payments.

decades, and with exports static from the late 1980s to the mid 1990s. (More recently Samoa's manufactured exports have risen, due to the success of the Yazaki auto-loom plant.)

The current account structures shown in Figure 28.2 imply the absence of a binding link between expenditure and output. Growth statistics commonly focus on the trend of domestic product; but what determines living standards is the ability of ordinary people to purchase goods and services. This is measured in national income accounting not by GDP, but by Gross National Expenditure, GNE. To measure Gross National Expenditure we have to adjust the published GDP statistics by adding imports of goods and services (which supplement local living standards) and subtracting exports (which take goods and services away from local use). Figure 28.3 shows the result of doing this for a number of Pacific economies. Fiji's material living standards are clearly tied to output; Kiribati's are not—indeed, only half the absorption of goods and services in Kiribati is supported by domestic production. Similarly, in the 1980s Samoa's expenditure ran steadily about one-third above product, and in the first half of the 1990s it moved up to a 60% margin.



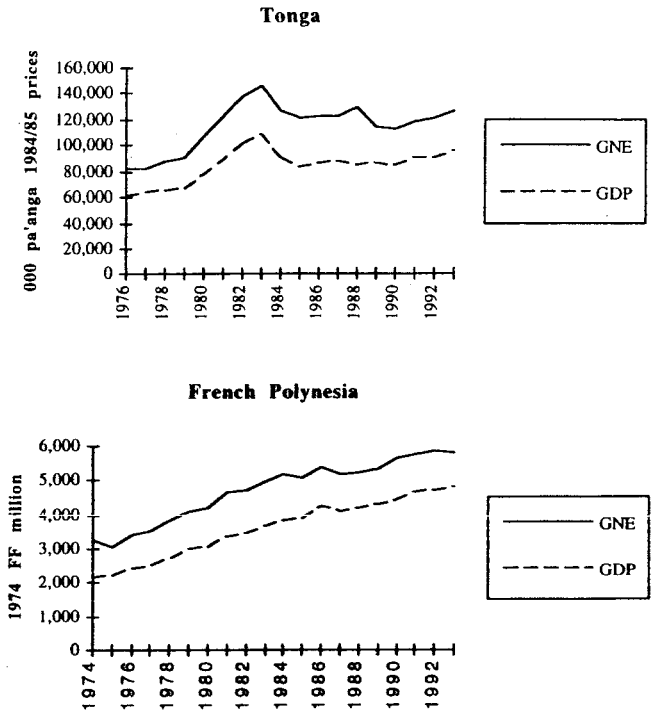


Figure 28.3. National expenditure and domestic product.

Island Economies and Economic Development Theory

The theoretical literature on so-called "microstates" and their economic status has burgeoned in recent years. The debate can be traced back to the end of the 1950s, when the newly established field of development economics turned its attention to the issue of whether the size of a nation-state influenced its economic development. Two books of collected papers from that period (Robinson 1960, Benedict 1967) set the framework for most work until the 1980s and presented a puzzle that still lies at the heart of the microstate literature. This can be stated in the following terms:

Modernization theories predict that small size should be a handicap for growth and development. Yet the world's very smallest autonomous political units are not located at the bottom of the development ladder, nor is there any robust statistical evidence that small size correlates with low standards of living (Milner and Westaway 1993). Considering the countries in Table 28.1, the contrast between tiny Nauru and large Papua New Guinea makes the point nicely.

The conventional economic wisdom further predicts that physical isolation should, other things equal, result in weaker economic performance; yet it has not been possible to show statistically that small-island economies in the world economy are less "developed" than those of states of the same size located on continents (Armstrong and Read 1997).

Theoretical interpretation of these empirical regularities is clearly important for policymaking purposes. By the early 1990s the literature on growth, trade, and migration in the Pacific Islands could be characterized in terms of the emergence of two competing paradigms (Hayes 1991). The dominant mainstream

paradigm regards the observed economic success of island microstates as an anomaly that cannot persist unless a "big push" is mounted to promote investment, output, and commodity exports; otherwise, it suggests, in the long run the theoretical disadvantages of smallness must assert themselves. An alternative paradigm is built around the idea that the observed economic condition of island microstates should be seen as normal rather than anomalous and that the mainstream theory should be revised accordingly. Thumbnail sketches of the two paradigms may clarify their essential areas of divergence.

The Classical Modernization Model

In the modernization approach, development is treated as synonymous with the achievement of economic and political autonomy by means of a self-sustaining, endogenously driven process of economic growth. In turn this requires strong investment, either by local capitalists or by the state, to increase domestic productive capacity and hence achieve sustainable growth of output and employment. On the basis of such capital accumulation, sustained by domestic savings effort, the expected outcome of development is a balanced economic structure, comprising both tradable goods and services that can be sold on world markets and nontradable goods and services, including the infrastructure for a modern economy.

The modernized economy is thought of as being incorporated into the world economy by commodity trade, with outward-oriented "leading sectors." Internally, the mass of the population is incorporated into the development process by means of the payment of wages by modern enterprises, with the real wage rate reflecting an equilibrium balance between population and local production; real wages and living standards thus rise in step with modern-sector output. Population growth is seen through Malthusian spectacles; if it continues unchecked, diminishing returns will eventually force wages and living standards down.

Policies drawn from the modernization model have been highly influential over the past half-century. Political independence from "colonial" attachments is encouraged, and self-reliance based on local capital accumulation thus becomes a goal in its own right. Because of perceived inefficiencies in state-owned production of traded goods, the government sector is frequently assumed to be a drag on growth performance, so that reducing its share of economic activity should favor growth. Recent examples of major Pacific Island studies conducted within this paradigm are Browne and Scott (1989), World Bank (1991), McGregor et al. (1992), Asian Development Bank (1995), and Fairbairn and Worrell (1996). The Malthusian model is presented with stark simplicity in Tisdell and Fairbairn (1984). Growing unease over the limitations of the paradigm when applied to Pacific Island microstates is apparent in Brookfield (1972), Shand (1980), and Connell (1988).

When economic development is seen through this theoretical window, smallness and distance both appear to be disadvantages. From Adam Smith on, most economic theorists have considered that large economic units able to trade with each other at low cost should have the edge in economic performance because of their ability to gain economies of scale while sustaining diversified economies. In contrast, small economies that lack a large enough local market to achieve scale economies in production for that market will be forced to overspecialize in one or two tradable activities, with consequent high exposure to instability and lack of intersectoral spillovers. Isolation raises transport costs and thus reduces the exporter's share of the revenues from sales to outside markets. In combination, these factors would be expected to reduce the economy-wide economic surplus and so limit investment and growth.

A clear statement of this view is Streeten (1993). Similar ideas for the Pacific Islands are in Chapter 1 of Shand (1980). The problem of economic development for small islands is therefore perceived by agencies such as the World Bank as more acute than for larger states; and relatively high living standards supported by means other than domestic production, based on local capital accumulation, are almost automatically characterized as unsustainable.

The MIRAB Model

The modernization approach to Pacific development summarized above lays heavy emphasis on export promotion and private investment, both of which have rather poor track records in the island Pacific over the past half-century, with a few exceptions.[1]

The main alternative paradigm of Pacific Island development shifts the theoretical spotlight to three other types of economic activity that have performed more strongly in many Pacific Island economies: international sale of factor services rather than produced goods and services; long-term sustained financial transfer flows; and domestic production of nontraded goods. The acronym MIRAB encapsulates this trinity: Migration (of factors of production), Remittances/Aid (financial transfers), and Bureaucracy (nontradables production)(Bertram and Watters 1985; Bertram 1986; Poirine 1994b). The underlying proposition is that globalization of the Pacific economy has been well advanced for several decades now and has rendered the model of self-contained, territorially bounded national economies increasingly inadequate to explain economic performance.

The starting point for the MIRAB analysis was the observed empirical anomaly noted above (that small-island economies exhibited higher standards of living than predicted by the classical model), combined with a critique of the common assumption that economies based on migration, remittances, and aid are inherently unsustainable. In relation to development planning and economic policymaking, the MIRAB approach highlights the extent to which conventional plans and analyses limit themselves to the goal of stimulating the economically marginal tradables sectors, while downplaying the main existing economic locomotives in much of Polynesia and Micronesia. A good example of this tendency is the study of private- sector development options in the Pacific by McGregor et al. (1992), which restricts its definition of "private sector activity" entirely to domestic (that is, local) productive activity and regards export earnings as the sole sustainable source of foreign exchange.

Having acknowledged the dominant role of labor remittances in the Tongan and Samoan balances of payments, the authors dismiss the entire topic of factor exports in a single sentence (McGregor et al. 1992:10): "[R]eliance on remittances is precarious should barriers to migrant labor arise and as ties to home become weakened through time." Yet barriers to migration have proved consistently easier for Polynesians and Micronesians to overcome than the barriers to successful entry into export markets (McGregor et al.'s preferred strategy), and remittance flows have been empirically more sustained and more stable than export proceeds (Brown 1997).

The essential issue addressed by the MIRAB model is the ability of many island economies to sustain levels of expenditure (i.e., standards of living) that run consistently, and apparently sustainably, ahead of local productive activity as measured by GDP. The MIRAB model suggests that external sources of financing that do not leave a residue of debt—that is, current account transfers—are the key to the economic performance of small islands.

In a MIRAB economy the indigenous population maximize their material well-being by means of globalization. Subsistence production from land, most of which remains unalienated under customary tenure, puts a floor under living standards by providing for basic needs and possibly also for some modest cash sales of produce to urban or export markets. However, it is the release of family members and family savings from village agriculture and fishing, and their outward movement not merely to other sectors, but to other islands and other countries, that opens the way to securing higher incomes and wealth. Released factors and cash are allocated across whatever geographical and economic space the local population has access to, with the resulting income shared between migrants and their home communities by means of remittances. This process includes employment in the large aid-supported government sectors, which puts cash into the hands of all households with members engaged in such employment.

The size and persistence of financial flows into island economies from overseas, and of labor migration out, has the effect of making capitalist private-sector activity unprofitable in traded-goods production (especially manufacturing and agriculture) because of the resulting combination of strong exchange rates and high wages.

Aid and Decolonization

A historical perspective makes it easy to "explain" the high levels of per capita expenditure in small Pacific islands by reference to the character of colonialism in the region. In all colonial Pacific spheres of influence from mid-century on, the living standards of indigenous island populations were raised and maintained by financial transfers from the metropolitan powers. The fear that decolonization might go hand in hand with "aid fatigue" among donors underlay a widespread ambivalence toward political independence and contributed to a general willingness of island populations to retain a high level of political tutelage. As Brookfield (1972:141-142) noted in the midst of decolonization:

> [I]f the available local resources in these countries are inevitably insufficient to support either the transformation or maintenance of welfare at present and desired levels, then there is no alternative to dependence but stagnation and retrogression. Independence may give a nation self-respect, . . . but it is a self-respect that must be severely constrained by awareness that the power of economic decision making is greatly limited. To maximize self-respect [in this sense] is not accordant with maximization of either income or welfare.

Poirine (1995, Ch. 5) has developed, and investigated statistically, a model of the factors determining per capita aid flows (including government budgetary support) to a developing economy and hence its ability to sustain expenditure levels in excess of domestic production. His three hypotheses are that, controlling for other factors:

i) islands receive more aid than nonisland economies because of their greater geostrategic importance and greater per capita control over territory (including sea and air space);
ii) aid per capita is inversely related to island population (consistent with diminishing returns on an aid flow determined by territorial factors);
iii) aid per capita varies inversely with the degree of political autonomy of the territory.

In contrast to models that view aid flows as altruistic transfers subject to "donor fatigue," Poirine argues that financial transfers are generally determined by maximization of self-interest on the part of donors and hence will change only as the margin of donor calculation shifts. Aid donors to small island territories are in effect purchasing a valued service in the form of a geostrategic footprint, the loss of which would have negative spillover effects on the metropolitan country.

Aldrich (1993, Ch. 3) gives a similar account of French aid motivations. Gaffaney (1995:50), addressing the issue "why didn't the United States completely abandon Micronesia after the development of detente and the ICBM?," makes a similar argument but with a subtly different flavor: international moral and political pressure made it impossible for the United States to abandon prior commitments without offending international opinion. Gaffaney suggests that

> even great powers in the international state of nature become bound to commitments and may change their policies towards their dependencies for reasons other than the great powers' own interests. . . . [S]uperpowers may not be completely autonomous agents, but have become involved in a complex web of international norms and standards for the treatment of nonthreatening states.

Applicability of the MIRAB Model

Casual inspection of the size of aid flows and degree of mobility of labor and financial capital suggests that the MIRAB approach is likely to apply more to Polynesia and Micronesia than to Melanesia. The Melanesian economies are characterized by large size and natural resource endowments and by low international labor mobility. Melanesian island populations do, however, reproduce internally via interisland movement the patterns of migration and remittances found on an international scale in Polynesia (Hayes 1990, Flinn 1992).

Outside the New Zealand sphere of influence where it was formulated (Tokelau, Niue, the Cook Islands) the MIRAB model seems applicable to French Polynesia (Poirine 1994b, 1995, Blanchet 1996); the Federated States of Micronesia (Cameron 1991, Gaffaney 1995, Hezel and Levin 1996); the other small U.S.-associated former Pacific Trust Territories; Tonga and Samoa; Chile's Pacific outpost of Easter Island, outlying islands of Papua New Guinea and the Solomon Islands (Hayes 1993, Friesen 1993); Tuvalu and Kiribati.

The relative importance of remittances, aid, and staple export earnings varies from case to case and from period to period. For a very small economy, the transition from staples export economy to MIRAB economy and back again is an easy one. Consider, for example, the small twentieth-century phosphate economies, Nauru and the preindependence Gilbert Islands (now Kiribati). Both of these exhibited the classic colonial export-economy pattern of a staple-based trade surplus, with the resulting foreign-exchange surplus being the object of a growing struggle between indigenous and metropolitan claimants. Neither economy industrialized on the basis of diversification from the staple—another classic colonial pattern. Both have, however, confronted phosphate depletion by engineering partial (Kiribati) or complete (Nauru) transitions to postphosphate MIRAB systems supported by rent income from overseas investment of retained phosphate earnings rather than the more usual factor, labor.

For larger island states, MIRAB status is harder to establish and sustain because international labor and financial flows reach a critical mass at which political and economic resistance arises. Large-island economies, even when fully politically integrated, like Hawai'i's, require strong per capita export performance in addition to financial transfers to sustain living standards. Those that lacked the leverage to become politically integrated have, of necessity, been forced to attempt the orthodox transition from staple exports to industrialization. This is the situation for most of Melanesia, given neighboring Australia's lack of interest in political integration and constraints on per capita aid availability. Only Fiji has been successful in making the modernization transition; apart from rentier Nauru, the other independent Melanesian states (Vanuatu, Papua New Guinea, and the Solomon Islands) have struggled to establish any sustainable economic dynamic and remain dependent on export sectors with limited backward and forward linkages. New Caledonia, in contrast, exhibits the material benefits of its political integration with France (note its GDP per capita figure in Table 28.1, compared with the rest of Melanesia).

Settler Colonies

The causal association of external political integration with relatively high material living standards raises important and controversial issues about the roots of economic "success" and "failure" in the Pacific. Observers of New Zealand (or Hawai'i) are sometimes inclined to attribute the relative prosperity and historically strong growth performance of the economy to factors such as the large nonindigenous components of the population, higher skill levels of the labor force, and the establishment of an autonomous capitalist dynamic. By drawing a contemporary cross-sectional contrast between the region's "lead" economies and the rest, a case is then made for encouraging autonomy and capital accumulation in the "follower" economies in order to achieve economic development on a stand-alone basis.

An important theme of this chapter is that comparisons of this sort are fundamentally misdirected because they do not address the long-run historical sequencing of economic development. Rather than drawing comparisons with present-day New Zealand, Pacific analysts ought to be casting back to the New Zealand economy of a century ago for clues to economic success. By the last decade of the nineteenth century, New Zealand was already among the world's top three or four economies in terms of real income per head, a status from which it has since slipped, but to which it was originally driven by a particular combination of circumstances among which three deserve special mention.

First was the high degree of political integration with Great Britain, of which New Zealand was still a colony, although progressing through the stages of formal decolonization. The special political access that New Zealand enjoyed in British government circles remained formidably effective through the Great Depression of the 1930s (when at the 1932 Ottawa Conference New Zealand secured preferential markets for its agricultural exports at the expense of South American export economies) and on into the 1970s. Only in the last two decades has the political linkage failed in the face of European integration; this coincided with a pronounced slowdown in New Zealand's growth performance.

Second was the very open and fluid labor market, which caused real wage rates in New Zealand to be indexed to rates both in Britain and in the other "settler capitalisms" of Australia, South Africa, Chile, Uruguay, and Argentina, as well as with the west coast of the United States (Denoon 1983). (The same effect might apply to Hawai'i, though it is not included in Denoon's study.) Even once British migration to New Zealand slowed down after the 1960s, a close migration nexus has continued to bind together the New Zealand and Australian labor markets, with large numbers of New Zealand–born workers resident in Australia on a long-term basis. This extreme openness of the labor market renders closed-economy modernization models as inapplicable to New Zealand economic history as they are today to most other Pacific Island economies.

Third, New Zealanders were always intensely conscious of their economic dependence and hence torn culturally between the desire to stand more on their own feet, and the recognition

that continuing prosperity hinged on preserving the terms of their country's integration into the world economic system. "Colony or nation?" has been a recurring theme in New Zealand literature and political discourse, and only in the past two decades has a more self-confident national identity entrenched itself.

The lesson of New Zealand is not, therefore, that growth can be induced by independence, but rather that economic prosperity can be secured under conditions of dependence, laying foundations for a possible later transition to greater autonomy. For settler capitalism in general, Denoon (1983:228) concludes:

> From their inception, settler states were dominated by social classes committed to an imperial link, and to the production of export staples. State institutions reflected that fact, and in turn influenced the manner in which different social classes interacted upon each other. That strategy could generate tremendous wealth, and rapid demographic growth, which naturally created dangerous tensions within each of the societies.

New Zealand is differentiated from the other Pacific economies included in this book primarily by the timing of its breakthrough to prosperity. In terms of the institutions of the world economic system of the 1990s this translates into OECD membership and inclusion in the "Pacific Rim," both of which give New Zealand, for the moment at least, separate status even from U.S. outliers such as Guam and Hawai'i, which enjoy OECD and Pacific Rim status at one remove. The Rim concept however is theoretically problematic, suggesting as it does that a geoeconomic core can be created out of a geographic periphery. Both New Zealand and the South American members are likely to be reperipheralized as the Asian economic core coalesces and draws in its boundaries from the Rim to the island economies of the North Pacific.

Migration

Economic development is conventionally defined (see section on Island Economies and Economic Development Theory, p. 343) in terms of the output produced by the resident population of a territory. For many Pacific Islanders, however, development means capitalizing on economic opportunities across a wider international arena. The migrant can plug in to income-earning opportunities, investment opportunities, and educational and lifestyle opportunities that are not available in the home territory and which could be provided there only at unwarranted cost. Wherever they are not restrained by legal barriers, Pacific Islanders are geographically mobile in pursuit of economic opportunity.

A feature of many of the small-island economies, especially those of Polynesia, therefore, is that a significant proportion of their indigenous population reside and work away from their home islands. Correspondingly, an important feature of larger regional economies such as New Zealand's and Hawai'i's is the presence of large communities of migrants who retain strong ties with their home communities. Other Pacific Rim economies such as Australia, California, and British Columbia also have substantial Pacific Islander communities living and working there. Most host countries unfortunately lack detailed census data on these migrant communities; only New Zealand has consistent census data on its islander population by place of birth since the 1950s.

Hayes (1991:3-9) assembled figures from a range of sources to construct an estimate of the geographic distribution of several Polynesian ethnic groups in about 1986. Of his total 500,000 ethnic Polynesians, excluding the indigenous peoples of New Zealand, Hawai'i, and French Polynesia, nearly 40% were resident in the three main metropolitan destinations New Zealand, Australia, and the United States (including Hawai'i). The proportion of these ethnic Polynesians resident outside their homelands in 1986 ranged from 22% for Tongans to 78% for Niueans. Migration has continued in the decade since 1986, and it is probable that the proportion of externally resident Polynesians from the islands covered by Hayes (1991) is now approaching 50%.

Ahlburg and Levin (1990, Ch. 1) found that of 83,000 islands-born migrants living in the United States in 1980, about 27,500 were from Polynesia. The other two significant migrant communities were Guamians (36,782) and Fijians (7,538, mainly Indo-Fijians). Relative to the home populations, over one-third of Guam's indigenous population was living in the metropolitan United States in the early 1980s. Fiji-born migrants in the United States, New Zealand, Australia, and Canada totalled over 33,000.

Ahlburg (1996:8-10) notes that in the 1990s the Federated States of Micronesia, Guam, Palau, and the Northern Marianas all became major host countries for in-migrants from Asia, while the migration of Micronesians themselves continued, resulting in an increasingly complex and dynamic demographic picture in that part of the Pacific. Within Micronesia, large-scale migration movements from smaller to larger islands have reproduced internally the wider pattern of movement; Hezel and Levin (1996:95) estimated 6,330 citizens of the Federated States of Micronesia residing in Guam in 1994 and a further 2,420 in the Northern Marianas—a total of nearly 10% of the FSM population.

Economic interactions between the home-resident and the migrant parts of each islander community remain important, especially as sources of remittance income and of potential employment opportunities for the home residents. Migrants have colonized selected economic sectors and residential neighborhoods of major Pacific Rim cities such as Auckland, Sydney, and Los Angeles, and as their numbers have grown, the links between standards of living in those metropolitan economies and the feasible expectations of island residents have been reinforced and multiplied, effectively indexing many of the economic parameters of the islands to the economies of their larger patrons.

The typical Pacific migrant does not become separated from the home community simply by virtue of migration. On

the contrary, migrants exhibit strong tendencies to retain close ties with their home kin groups and to maintain patterns of return visiting and remittances in cash and kind, which continue to bind them to their places of origin and to enable kin groups to live and earn on the international, rather than the national, stage.

Economic development for islander communities is thus not restricted to economic development of island territories. Economic research on these globalized communities, which began with Marcus (1981), is still in its infancy but has been progressing rapidly during the past decade (Loomis 1990, Ahlburg and Levin 1990, Ahlburg 1996a, Brown 1995, Brown and Foster 1995, Brown 1997). One outstanding point to emerge is the sustainability of migrant remittances. Many writers have predicted that remittance effort by migrants should tend to decline over time as ties to the home community wither away; but the evidence from the Pacific Islands does not support this prediction. As Connell and Brown (1995:17-18) remark:

> [W]hat is striking in every case, and well-documented in the case of Tongans and Cook Islanders overseas, is just how long and at what levels remittances are maintained, with only slight evidence of the anticipated decay. From their econometric analysis of recent cross-sectional data from a survey among Tongan migrants in Brisbane, Walker and Brown found that while the propensity to remit was negatively related to the age of the migrant, it was positively related to the migrant's length of absence from home.

Because the economic activities of Pacific Island communities span multiple geographical locations, the analysis of key aspects of economic behavior such as saving, investment, employment, and income has to be conducted in terms of an integrated, internationalized household model. Many islanders plan and act transnationally, either as individuals or as members of more or less organized kin groups; and they allocate their available resources across geographical niches with an eye to maximizing the life chances for themselves and their kin. The "modern sector" of many island economies is located offshore and hence is missing from the usual statistical indicators; yet the individuals who participate in this externally located modern sector remain part of the aggregate productive and spending behavior of their home communities. It is not clear to what extent skills and assets acquired offshore are later returned to the island economies. Brown and Foster's survey work in Australia, for example, supports earlier suggestions that return migration of human capital is not a major feature of the island communities they studied. But this does not remove the basic fact that as capital is acquired in metropolitan economies by individuals who continue to regard themselves as islanders, the balance sheet of the islander population as a whole is increased accordingly and repatriation of assets is not necessary (nor, probably, economically sensible) given the relative rates of return to real investment in the islands as compared with those in the metropolitan host economies.

Anthropologists have recognized, more readily than economists, the ability of communities and kin groups to maintain their organic unity and identity as they become geographically dispersed across geographic space, within island nations as well as internationally. Flinn, writing of migratory links between the islands of Pulap and Moen in Micronesia, captures the essence of this process (Flinn 1992:13):

> In many cases, the social structure spans more than one location. People who leave a home village can nonetheless operate within one social structure, especially with ties they can activate or create when they move. Rather than a geographic focus, we need to take a sociocultural one. As people move in space, they may remain within one social structure. In fact, they can culturally construct geographical space to correspond with social space. Social structure thus adjusts to accommodate movement, and interpretations of place shift to fit social structure.

Social structure here includes both formal and informal economic activity.

Macroeconomic Management

The governments of independent or self-governing small-island economies typically have less room to maneuver in their economic policymaking than do the fiscal and monetary authorities of large countries. Fiscal prudence is inescapable because these small resource-poor economies are not able to sustain large external debts; the mid-1990s fiscal crisis in the Cook Islands demonstrated the very limited ability of governments to sustain deficit financing. Governments thus must operate within their current income, which rises and falls with the flow of external aid, since the local tax base does not change much. The usual instruments of monetary policy are available in few of the countries of the region. Even countries with their own currencies, such as Papua New Guinea, Vanuatu, Fiji, and Tonga, tend to peg these to the main metropolitan currencies so that the typical exchange rate regime is fixed or quasifixed. Economies that use metropolitan currencies are bound to the purchasing power of those currencies in their countries of issue. The quantity of money in circulation within most island economies is determined by the combination of fiscal policy (including government overseas borrowing) and the balance of payments.

To evaluate problems of macroeconomic management in small-island economies one must therefore begin from a model of the very small open economy with free capital mobility, a fixed exchange rate, and an open labor market. The goals that government can pursue within this framework are limited. On the demand side, fiscal policy sets the level of domestic activity and incomes, with the money supply adjusting passively. Government, in other words, sets the level of income for the

local population subject to its externally determined budget constraint. Because that constraint changes only when aid flows change, fiscal policy is in effect controlled by the aid donors rather than the local governments. No crowding-out mechanisms are operative, since the interest rate is externally fixed and the domestic price level is set by the purchasing power of the externally issued or pegged currency.

Many commentaries on the Pacific Island economies appear to assume that crowding-out of private activity by government occurs, which implies that a reduction of the size of the government sector should be a sufficient condition for expansion of private activity (see e.g. Fairbairn and Worrell 1996). The theoretical basis for this position is seldom spelled out, however. The only transmission channel through which government could adversely affect private sector employment and investment is the tax rate, to the extent that taxes represent a deduction from private sector saving and diversion of this purchasing power to consumptive purposes. There is, however, no evidence that shortage of private savings is a constraint on investment levels in any of the Pacific Island economies; most studies suggest that capital absorption capacity presents the binding constraint on private investment (e.g. Connell and Brown 1995:25).

Government can borrow prudently only to the extent that it has reasonable certainty of a future increase in the local tax base to fund servicing and repayment or assurance by aid donors of willingness to underwrite those debt-servicing costs. While in the short run some island governments may escape from this discipline to the extent that lenders are willing to bear the resulting high default risks, over the longer haul government borrowing is not a means of sustainably raising the government sector's permanent income and expenditure. Fiscal policy in the Pacific is revenue-driven and revenue-constrained.

On the supply side, the main determinant of the structure and profitability of private sector output is international competitiveness, as measured by the real exchange rate. Anything that lowers the cost of local products relative to competing suppliers overseas represents a lowering of the real exchange rate and will provide a spur to the growth of the local economy. In larger economies this can be done by lowering the exchange rate of the currency or by lowering real wages or profit markups in those sectors producing tradable goods in competition with other countries. Nominal exchange rate changes are possible only for those economies that have their own currencies, such as Papua New Guinea (which until the 1990s held the exchange rate of the kina high to support anti-inflation objectives, probably contributing to slow growth) and Fiji (which gained rapid advantage from devaluations of the Fiji dollar in the late 1980s). For most small-island economies, however, the nominal exchange rate is not available as an instrument.

With the nominal exchange rate fixed, local costs—especially wage costs—are the main means of changing the real exchange rate. However, in those island economies whose labor markets are flexible and open to migration flows, real wage reductions are more likely to cause outmigration of the most productive workers than increased local output. Raising the productivity of labor at existing wage rates is then the only means of lowering the real exchange rate.

Under these conditions the real exchange rate is determined almost entirely by forces that are exogenous to the typical island economy, with no necessary tendency to settle at a long-run level consistent with the hypothetical equilibrium that seems to be in the minds of most outside observers and aid donors. There is no obvious reason to suppose that real exchange rates will automatically fall to levels at which export activities become the profitable leading sectors for a private-sector-financed takeoff.

Limited Dualism

As in most developing countries, the central microeconomic issues in the Pacific Islands arise out of the interplay between small-scale local production and consumption systems and the forces of the wider market. The dualism that has characterized twentieth-century developing economies in Latin America, Africa, and Asia is, however, muted in the Pacific except for Papua New Guinea, where the gap between primitive and modern remains stark and large segments of the precapitalist economy remain relatively little modified.

Elsewhere, the pre-European economic order has long vanished, to be replaced by a neotraditional village economy built on the pillars of kinship, reciprocity, subsistence affluence, the missionary impact, and trade in simple goods (copra, taro, handicrafts, fish, and similar products exchanging for basic imported consumption goods such as flour, rice, sugar, alcohol, and tobacco). Alongside this village economy but not separate from it have arisen various activities usually classified as in the "modern sector"—government services, plantations, mines, manufacturing, tourism.

In the Pacific, the modern and neotraditional economies are generally integrated rather than separate and tend to become more rather than less integrated over time. Modern activities involve fully monetized transactions in the context of formal markets for labor and goods, together with the deployment of relatively advanced technology. Neotraditional activities include nonmonetary transactions mediated by networks of social relationships and deployment of economic resources on the basis of a combination of market and nonmarket calculations. However, the technological level of the two sectors is not diverging over time. Village fishing is done from motorboats with nylon lines and nets; people and goods are transported in the village sector by motorbikes, cars, and bicycles; radio and television penetration of the village sector is high. Most important, and associated with high literacy rates in most island economies, intersectoral labor mobility is high, and most kin groups have individual members at each end of the modern-neotraditional spectrum.

The articulation of modern formal-sector activities such as government administration with the informal village economy has inevitably produced a degree of social stress. Writing on developments on the Tokelau atoll Fakaofo, Hooper (1993:242, 256, 262-263) notes that

> Between 1967 and 1981 Fakaofo was transformed from a cohesive community based on traditional economic exchange and an established customary order, to one dominated by salary and wage incomes, and two openly conflicting principles of social order. . . .
>
> Wages, salaries, remittances and copra receipts are distributed fairly widely among close relatives . . . so that marked discrepancies in income become evened out to some extent. Nevertheless, they do not become completely equalized. . . .
>
> [A]lthough public servants live in the village, retain access to land, and participate in village activities, this has also altered the village economy, since the public servants' participation is very much on their own terms. . . .With their material base thus altered, many traditional village social relationships have been leached of their former significance . . .
>
> In these ways, then, both the neo-traditional mode of production and "way of life" have been altered, probably irrevocably.

The result of this interpenetration of the two poles of the developing economy is that the modern sector in most Pacific Island states has a distinctive flavor attributable to the incomplete proletarianization of the labor force. Wage workers have other dimensions to their economic lives as members of village-based kin groups, with access to land and a variety of life opportunities. Possibilities for the exploitation of labor are limited both externally by migration opportunities (especially in Polynesia and Micronesia) and internally by the scope for involution offered by the neotraditional village economy. The fluidity of the labor market, indeed, is probably the characteristic of Pacific Island economies that most clearly sets them apart from their continental counterparts.

Fundamental to this flexibility is the persistence of "traditional" land tenure, with most cultivable land retained in family ownership and used for subsistence agriculture (including production of foodstuffs for exchange). Commercial plantation agriculture, mainly for copra and sugar, has existed in the region since the late nineteenth century, but has never become a sufficiently dominant rural sector to dissolve the integrity of smallholder subsistence cultivation. On the contrary, outside Hawai'i, both copra and sugar production have tended to slide back toward small-scale cultivation due to an apparent lack of scale economies under Pacific Island conditions.

The high degree of labor market flexibility puts a perennial squeeze on the rate of profit in capitalist enterprises. Hemmed in from above by fixed or semifixed nominal exchange rates and high transport costs, the private sector capitalist can obtain no relief from below by downward pressure on the real wage, because labor costs are indexed to opportunity costs of labor at the involution and migration thresholds. Not surprisingly, private sector entrepreneurship encounters substantial obstacles within the island economies (see e.g. the case studies in Fairbairn 1988) and succeeds best when it modifies capitalist rationality to fit the demands of customary practices and traditions (Fairbairn 1988:273). Many of the most talented entrepreneurial individuals from Pacific Island communities are drawn out to the metropolitan economies around the rim of the Pacific where there are wider opportunities for profitable enterprise and investment. Vancouver, Los Angeles, Auckland, and Sydney contain a growing number of successful Pacific-Islander-owned businesses—a pattern foreshadowed in Marcus's (1981) study of the outward movement of Tongan economic activity.

Conclusion

This chapter has traversed a range of economic issues that define a substantial research agenda for economists working in the Pacific region. The rapidly improving statistical coverage of Pacific Islanders' economic activities, due both to major database development by international agencies and to a growing body of census material and questionnaire research on the migrant communities, has opened the way for a new round of empirically grounded theoretical work on the characteristics and history of economic development in these globalized, flexible, and much-underestimated economic systems.

Notes

[1]Fiji is the only small-island economy in the Pacific whose performance to date has lived up to the modernization image of locally financed, export-led industrialization on a primary-commodity export base. New Zealand has long been one of the world's developed economies, structurally more akin to the other metropolitan industrial economies of the Pacific Rim than to those of the island Pacific. Like Australia, the United States, and Canada, New Zealand hosts large communities of migrants from the islands and in doing so provides those island economies with an offshore modern sector. New Zealand is a source, not a recipient, of remittance and aid flows and has its own internal economic dynamic.

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