DEVELOPMENTAL LEADERSHIP PROGRAM

Policy and Practice for Developmental Leaders, Elites and Coalitions

Background Paper 13

The Politics of State Business Relations in the Pacific

What is already documented and what do we need to know?

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DEVELOPMENTAL LEADERSHIP PROGRAM

The Developmental Leadership Program (DLP) is an international policy initiative informed by targeted research and directed by an independent steering committee. DLP is supported by a global network of partners and currently receives its core funding from the Australian aid program.

Contents

Executive Summary

This paper provides a critical survey of research on state-business relations (SBRs) in the Pacific Island countries. To that end, the paper offers an appraisal of what is known about SBRs in the region, and identifies lessons within the broader SBR literature that are particularly relevant to the Pacific context. Moreover, what is documented about SBRs is compared to what others have identified as developmental elements of SBRs, more generally, i.e. trust, information sharing, reciprocity and credibility. Finally, avenues for future research within the gaps of existing research are also identified. The main points of interest are as follows:

On the literature

- There has been little detailed attention given to this topic, and thus what details exist can only paint a patchy picture of the overall state of SBRs in the region.

Emerging Generalizations

- The descriptions available depict relations between state and business actors as plagued by a high level of misunderstanding, frustration and mistrust.
- State bureaucrats often find it challenging to establish strict boundaries between their professional duties and their close-interpersonal relations with members of society.
- Several examples of SBRs in the literature on the Pacific portray them as collusive in nature, and state actors as having conflicts of interest between industry and policy making roles. Because of this, the state and policy making processes and enforcements appear especially vulnerable to capture by a few influential private interests.
- Opportunities for formal dialogue have thus far been few, but have grown in recent years, thanks in large part to the encouragement of foreign donors and organizations.

Further Hypotheses Generated by Context

- The developmental nature of SBRs in the region appears to be compromised by the overtones of clientelist motivated economic policy-making. Because of the political benefits that come from protecting a *status quo* that benefits their clients, policy-makers will have decreased political incentives to work with those that want reform, and a greater motivation to collude with private sector actors that they depend upon for political support.
- Political instability in the region directly undermines a government's ability to make credible policy commitments, and thus reduces the confidence that the private sector would have in anticipating the policy-making environment, and disincentivizes investment. A fear of political instability may also shelter the *status quo* by discouraging policy makers from working for reforms, due to the concern that even modest changes could disrupt fragile coalitions.
- Ethnic tensions, where they exist in the region, tend to erode or prevent trusting relationships between rival ethnic groups, and thus, potentially, also across actors in different sectors of business or between the private sector and the state.
- Governments' extensive presence in the economies of the Pacific Island Countries (PICs) has to

a certain extent 'crowded out' the opportunities for the private sector to grow, and may shape a perception among state actors that consultation with the private sector is not needed, and therefore to effectively ignore them would be of little consequence.

Avenues of Future Research

New research should move towards answering the following broad questions:

- How have the particular contextual features of the region—for example, the size of the state and political instability—impacted on SBRs?
- How, if at all, do SBRs differ across the region, and why?
- What impact has the nature of SBRs in the region had on actual policy making and reforms?

01

Introduction

Sustained economic growth has been found to be one of the most powerful drivers of poverty reduction and is also a necessary condition for countries to achieve other developmental outcomes (Roemer & Gugerty, 1997; Gallup *et al*., 1999; Dollar & Kraay, 2000; Timmer, 1997). It is generally accepted that the state has to rely upon an effective and dynamic private sector as an engine of economic growth and development. The private sector contributes to growth by providing jobs, goods and services, and tax revenue to governments. However, for developmental growth to ensue, simply unleashing the potential of the private sector is not enough. Of equal importance is the presence of local state-institutions that can both encourage and shape economic behaviour. Such institutions need not only to facilitate the growth of the private sector, but also to protect society against potential abuses by businesses, including collusive and corrupt relations with parts of the state. Thus, the trajectory of economic development is at least partially determined by the somewhat delicate and interdependent ***relations*** between the private sector and the state. At their core, state-business relations (SBRs) are political. It is only through the analysis of the political incentives of actors that we can make sense of when and why SBRs become collusive, and/or the state becomes captured by private interests. And equally, it is the political dynamics between leaders of both sectors that determine when they can work together to harness the potential of the private sector to contribute to economic growth, and to other development goals, like poverty reduction.

This paper presents an analytical review of the existing literature and evidence on SBRs in the Pacific Island countries (PICs). In cases like that of the PICs, where the record of economic growth, the adoption of prescribed economic reforms, and the effectiveness of foreign aid have been disappointing for some, an examination of SBRs can highlight several of the political dynamics behind why economic collective action problems have gone unresolved. To that end, such an examination sets out to explore whether, when and why state and business actors in the region have colluded to safeguard the economic policy *status quo* and whether and why a more developmentally consultative relationship between the two groups has not yet developed.

An investigation into these issues is especially important for the Pacific's foreign donors, and arguably especially for Australia—the region's main donor. Over the last five years, Australia has given over 25% of all its bilateral foreign aid to the PICs. This amounts to over AU$3.5 billion, and close to half of the total foreign aid received by the Pacific (OECD, 2012). This investment has contrasted starkly with the few success stories that such aid has been associated with in the region (Hughes, 2003).

This paper focuses on and summarizes what has been written about SBRs in the PICs, and identifies lessons within the broader SBR literature that are particularly relevant to the Pacific context, and to other small island countries. Specifically, it does not focus on the ways in which state governance, the capacities of the state's bureaucracies, or other political dynamics impact on private sector growth, but on the *relations* between the two parties. To this end, the following sources have been consulted:

- Academic papers (standard google-scholar search),
- Pacific Islands Development Program (PIDP) research papers,
- Asian Development Bank research and reports (all research, searching for 'Pacific Islands', and all regional country-specific private sector assessment reports),
- World Bank publications (searching for 'Pacific'),
- UNDP Pacific Centre documents
- Pacific Islands Private Sector Organization (PIPSO) reports, and
- Pacific Institute of Public Policy (PIPP) reports and discussion papers.

Also noted is where the literature falls short in providing a comprehensive view of SBRs in the region.

I proceed first by briefly discussing how the academic literature characterizes 'developmental' SBRs and through what mechanisms SBRs are assumed to impact upon development. I also provide a short discussion about some of the common economic features across the Pacific, so as to briefly describe the economic context for SBRs within the region. Next, I describe the general impression that the existing literature and evidence gives of SBRs in the region. Before turning to outline what significant gaps are left in the current literature, I also apply several SBRs hypotheses to political-economy features prominent in the Pacific context.

02

What do developmental SBRs look like and how do they impact on development?

SBRs are often discussed in a normative tone. Put differently, the discourse on SBRs usually implicitly references a continuum where, at one-end, are SBRs that are harmful to the prospects of development and, at the other-end, are SBRs that are good, or 'developmental,' for growth. And while it is clear that there is no single prototype for 'good' SBRs (Leftwich, 2009), there is a general degree of consensus on what general characteristics makes SBRs developmental or harmful.

Elements of Developmental SBRs

Developmental SBRs are most often characterized as a collaboration between state and business actors that avoids a 'negative synergy' between the actors, as well as predatory behaviour by the state on the private sector, or the capture of the state by powerful private interests (Leftwich, 2009; Maxfield & Schneider, 1997; Lange & Rueschemeyer, 2005; te Velde, 2009). Moreover, Maxfield and Schneider (1997: 7-15) note that developmental SBRs are characterized by the following four key elements:

1. Information Flow

The timely flow of reliable information from the business sector to the state can assist policy makers in their evaluations of whether private sector-targeted policies have the intended effect. Close relations also ensure that relevant state-gathered information on markets is shared with the right leaders in business. And, information flowing from the state to business can assist the private sector in its investment planning, can shape expectations about government intentions and enhance the credibility of the government. Moreover a degree of ***transparency***—a passive form of information exchange—on both sides is beneficial. Transparency in government decision-making can reduce policy uncertainty for investors, and transparency in business operations can reduce the costs of government monitoring (Maxfield & Schneider, 1997: 7-9).

2. Reciprocity

In this context, 'reciprocity' refers to whether, in direct exchange for state subsidies, the private sector is expected to and does delivers what it has promised in return (Amsden, 1989: 146). Thus, reciprocity depends mostly on the private sector to prove to the state that it can uphold its end of the bargain. The enforcement of reciprocal agreements requires that the state have information on a firm's performance, as well as the capacity and political will to punish non-compliance (Maxfield & Schneider, 1997: 10).

3. State Credibility

When actors from the private sector can believe what state actors say, they feel comfortable to act accordingly. Whether a policy is considered credible depends on the type of policy, degree of information shared across parties, the reputations of associated officials, the degree of institutionalization of the rules involved, and the political backing of the government (Maxfield & Schneider, 1997: 11). Without a perceived credible commitment to a policy, the private sector will be hesitant to invest and expand,

and will thus become inhibited in its ability to contribute towards economic growth (Leftwich, 2009; North, 1993; Stasavage, 2002; Serven, 1997; North & Weingast, 1989; Dixit & Pindyck, 1994).

4. Trust

Trust is essential to developmental SBRs. To build an effective, collaborative partnership, state and business actors must become somewhat vulnerable, as they will need to mutually rely on each other to share information and execute their side of any agreements. The state needs to trust that the private sector will follow through with its end of a reciprocal agreement, and the private sector must trust that state actors will stay politically committed to backing a specific policy (Maxfield & Schneider, 1997: 12-13).

These elements do not operate in isolation. Instead, their interactions work to reinforce or undermine each other. For example, information and transparency is required to build trust among actors, illustrate the credible commitment of state actors towards policies, and assist the government in monitoring compliance of firms to reciprocal agreements. Similarly, a bond of trust across the two parties enhances perceived government credibility and is bolstered when reciprocal agreements are fulfilled.

How Do SBRs Impact Development?

Developmental SBRs are thought to be important for growth because of the following three basic assumptions.[1]

1. **The market, left alone, cannot achieve optimal allocation.**
2. **The state, by itself, cannot as efficiently and effectively fix market failures.**
3. **Developmental SBRs address both market and government failures (te Velde, 2009: 5).**

Moreover, the impacts of SBRs on growth are understood to occur through three 'umbrella' mechanisms.

1. Address Market Failures

First, effective SBRs lead to the addressing of market failures. For example, through developmental SBRs, the state will have the information necessary to plan and target its intervention towards shared goals of industry development that the private sector cannot achieve alone, as in the provision of infrastructure or investment into significant technological development (te Velde, 2009).

2. Address Policy Failures

Developmental SBRs will also identify and work to address policy or government failures (te Velde, 2009). For instance, through developmental SBRs, policy constraints on industry will be identified by the private sector and communicated to state actors. This consultative interaction can result in the more appropriate and up-to-date design of regulatory and other policies that can more efficiently relieve bottlenecks that the private sector experiences as a result of bureaucratic or other state failures.

3. Reduce Policy Uncertainty

Finally, developmental SBRs also work to reduce the private sector's sense of policy uncertainty (Sen & te Velde, 2009: 1269). To the extent that firms operate in an uncertain policy environment, they will be less likely to invest, and especially so when investment involves irreversible costs (Dixit & Pindyck, 1994). As relations with the government improve, businesses will be able to better anticipate policy decisions. However, when relations become collusive, policy planning can be captured by the interests of only a few firms (Hellman, Jones & Kaufmann, 2003; Grossman & Helpman 1994).

1 Much of the following short review was drawn from te Velde (2009)

When and Where are Developmental SBRs Likely to be Cultivated?

State-Side Conditions

Peter Evans's (1995) work on "embedded autonomy" might be the most cited message on this topic. In short, he argues that developmental SBRs are most likely to form when a state's bureaucracy adopts classic Weberian norms, i.e. when selection and promotion is based on merit, and when salary levels are reasonably competitive with the private sector. When this is achieved, bureaucrats have incentives within the bureaucracy to do well to get promoted, and are thus fairly insulated from the influences of private actors, which prevents collusive behaviour with the private sector. While considerable evidence exists in support of this thesis (Evans, 1995; 1998; Rauch & Evans, 2000), other cases illustrate that these bureaucratic qualities might not be necessary for developmental SBRs to form. For instance, Peiffer (2012) provided a review of several documented cases of coalitions between state and business actors that have formed to invoke 'developmental' policy reforms. Among other points, Peiffer (2012) illustrates that SBRs can vary within one country along industry lines, effective SBRs can operate informally or within a formal institutional framework, and have definitely developed in countries where the bureaucracy would not be characterized as 'Weberian' (see Abdel-Latif & Schmitz, 2009 for an example in Egypt).

Private Sector-Side Conditions

Also hypothesized is that the organization of firms into multi-sectoral and encompassing business associations facilitates the development of effective SBRs. Such associations are believed to have more incentives to press for policies that promote growth throughout the general economy, rather than those that would grow a particular industry (Olson, 1982; Maxfield & Schneider, 1997: 21). Additionally, encompassing peak associations help to overcome other collective action problems of coordinating effective communication and consultation efforts with the government (Weiss, 1998). Finally, business associations with the organizational capacity to monitor and sanction the behaviour of their members are also more powerful partners to the state in consultation (Brautigam, Rakner & Taylor, 2002; Donor & Schneider, 2000: 270; Maxfield & Schneider, 1997: 25).

What then do we know about how the SBRs in the Pacific measure up to the 'developmental' SBRs the literature describes? What evidence do we have about any impact that SBRs might have had on development in the region? And what might we expect of the impact that the political and economic context has on the nature of SBRs for the PICs? I turn to these questions after a brief description of the general economic context in the region.

03

Notes on the general economic context of the PICs

There is a considerable degree of economic diversity across the Pacific, including the extent to which recommended economic reforms have been adopted or resisted. And while many of the economic commonalities of the region are referred to in the later discussion on SBRs in the region, I summarize some of them here, with the aim of providing a broad-brush picture of the general economic context within which SBRs have developed.

- First, a majority of the population of the PICs live in rural areas, surviving on a mix of subsistence and cash income. Thus, most PICs have small industrial sectors, which are mainly protected by the states' import restrictions (Duncan & Nakagawa, 2007; Holden *et al*., 2004).
- Moreover, the industries that usually become established are generally those that require minimal economies of scale, like small-scale agriculture, boutique tourism and manufacturing or assembly activity (Duncan & Nakagawa, 2007).
- Exports are largely natural resource-based (e.g. indigenous root crops, fishing, specialized agricultural products, and lumber). However, the states, individually, have a relatively narrow resource base which causes a specialization in commodities that is highly vulnerable to natural disasters and changes in the terms of trade (Holden *et al*., 2004; Duncan & Nakagawa, 2007).
- Most of the PICs operate with significant merchandise trade deficits that are in part compensated by remittances, tourism and foreign aid (Duncan & Nakagawa, 2007).

The table below highlights the range across the Pacific on some key economic and development indicators:

Table 1: The Range for Basic Economic Indicators Across the PICs

	Minimum		Maximum		Mean
Population (in 1,000s; 2011	9.8	Tuvalu	7013.0	PNG	924.6
FDI (inflows % of GDP; 2010)	0.1	Samoa	35.1	Solomon Islands	6.8
Av. Annual GDP Growth (2002-2011)	0.2	Fed. Sts. of Micronesia	5.4	Solomon Islands	2.3
Foreign Aid, per capita (ODA; 2010)	74.6	PNG	1677.2	Marshall Islands	712.1
GDP per capita, PPP (in 1,000s; 2005 USD)	2.2	Kiribati	4.2	Fiji	3.3
Internet users, per 100 (2010)	5.0	Solomon Islands	25.0	Tuvalu	12.4
Telephone lines, per 100 (2010)	1.5	Solomon Islands	30.0	Tonga	10.6

Source: World Bank's World Development Indicators Database.

To some extent, the performance of the economies of the Pacific is often related to the geographical diversity of these states and thus, like other small island countries, disappointing economic performance in the Pacific is often attributed to their unique geographical context. To summarize this point, as Holden *et al*. (2004: 6) note:

> "[P]art of the problem arises from the natural characteristics of the countries, namely the increased unit cost of inputs due to remoteness; the difficulty in capturing economies of scale due to small markets; the market power of distribution channel owners; increasing costs; and long, infrequent, and exorbitantly costly communication lines."

Commonly, these and other characteristics are used to explain why Pacific economies have not performed to their assumed potential, but poor cultural attitudes towards work, a lack of savings, capital goods, land, and labour skills have also been suggested as partial explanations for the region's slow growth trajectories (Holden *et al*., 2004). Though, according to Holden *et al*. (2004), these are largely unsatisfactory explanations, for the following reasons:

- Savings rates in the region are not actually low by international standards.
- Capital proves not to be scarce; the rates of return to capital are low.
- Limited landmass has not inhibited the development of Hong Kong, Mauritius, or Singapore.
- High emigration rates and the prosperity of Pacific communities in places like Australia, New Zealand, and the US, attest to the adaptability and willingness to work hard within the Pacific culture

However, according to a World Bank report (2011), if we take into account the geographic context within which the PICs exist, the economic performance of the region has actually been quite strong. Specifically the report argues that the PICs are even more disadvantaged than other small countries because, by almost any measure, the PICs are further away from the centres of economic production and population than other small countries and have low population densities within their own centres of production, which further disadvantages them (World Bank, 2011: 11). This report concludes: "once the extent of geographical obstacles to economic growth are taken into account, Pacific Island Countries have performed unexpectedly strongly in developing their economies and improving the standards of living of their populations."

04

General impressions of SBRs from the literature

What do we know of SBRs in the Pacific? In contrast to the fairly sizeable comparative and case study literature on SBRs in other countries and regions, there has been relatively little written on this topic with respect to the Pacific.[2] To my knowledge, SBRs in the PICs has not been the sole or primary focus of any academic article or policy document. Apart from a few exceptions, when discussed SBRs are only mentioned in passing in political economy analyses of the region or of a country in the region, and such discussions are largely limited to a small subset of the analysis or even confined to a few sentences.

As a result, there is little detailed attention given to the topic, and what details there are, paint a patchy picture of the overall state of SBRs in the region. When discussing SBRs some documents might record only one aspect of them i.e. forums between private and public partners (see Tuioti, 2012 for example), or discuss SBRs in one country or one sector within one country (see Holzknecht & Golman, 2009 for example). Thus, what seems to be missing is the focused attention of observers on the topic and a general 'bird's eye view' of the state of SBRs, as well as how SBRs may be impacting on development in the PICs. However patchy or unevenly SBRs in the region have been documented, a reading of the papers on the Pacific nonetheless yields a few broad impressions that are discussed below.

Perceptions, Trust, and Communication

As Maxfield and Schneider (1997) note, at the foundation of developmental SBRs is trust among actors and a willingness to cooperate with those from the other side. Descriptions of how the private sector perceives the government in the Pacific, and vice versa, paint a bleak picture with respect to the likelihood that both sides have developed the type of rapport that is conducive to building cooperative relationships. In general, the descriptions depict relations plagued with a high level of misunderstanding, frustration and mistrust between the two parties (ADB, 2008a; Holden *et al*., 2004; Tuioti, 2012). For example, descriptions of perceptions from the private sector's point of view often characterize the government as unresponsive and unwilling to listen (Holden *et al*., 2004; Tuioti, 2012). Tuioti (2012: 7) specifically states that, "government approaches to dialogue are often perceived as just a 'ticking-the-box' exercise." Relatedly, the private sector can be left feeling as if it is ultimately not being adequately consulted or informed (Cox *et al*., 2007) and that its concerns are being effectively ignored (ADB, 2008a).

From the government side, private sector organizations are often perceived to be self-serving, focused on the profit of a few in industries and uninterested in more general social development issues, and are thus viewed with suspicion (Tuioti, 2012: 7; Holden *et al*., 2004: 98). Additionally, inputs from the private sector are regarded with scepticism, as they are alleged to be advanced without a strong technical or evidence-based approach, and national private sector organizations are thought not to have the capacity to make timely and informed contributions to policy development (Tuioti, 2012: 7).

2 See Brautigam, Rakner, and Taylor, (2002); Evans (1995) and Peiffer (2012) for examples; each of which examine or summarize the nature of SBRs across a wide range of cases and studies.

Furthermore, governments in the region may feel that their efforts to consult the private sector have gone unappreciated and unrecognized. In Samoa, for example, Asian Development Bank (ADB) observers (2008b: 45) found that the government feels as if it consults with the private sector, but gets no credit from businesses leaders for doing so. In this case, it is likely that at least part of the problem was a function of the level of turnover in both the business and public sectors. Specifically, some in the private sector claimed that there had been little consultation before the Companies Act was drafted and passed. However, it was learned that consultation had taken place, but that was lost due to a "lack of institutional memory due to high staff turnover" in both camps (ADB, 2008b: 45).

State bureaucracy, autonomy, and interpersonal relations

As noted earlier, according to Peter Evans (1995), SBRs have a greater chance of becoming developmental in nature when the state's bureaucracy has Weberian characteristics, such as meritocratic recruitment and advancement, and when salaries are commensurate with comparable positions in the private sector. When this occurs, state actors are most able to achieve an embedded autonomy—the incentives to resist rent seeking from interest groups and pursue developmental goals, while having the ability to maintain a collaborative relationship with the private sector. In contrast, when merit is not rewarded, and instead bureaucratic positions are awarded through nepotism or as patronage, and when too close interpersonal relationships exist between the state and private sector, bureaucrats have fewer incentives to contest rent-seeking moves by the private sector.

So, how do bureaucracies in the Pacific measure up? The political and economic literature that touches on bureaucracies in the Pacific describes them as displaying many of the pitfalls that Evans identified. Specifically, business and political relationships in the region have been described as 'too-close' (Duncan & Nakagawa, 2007) or heavily 'intertwined' (Tuioti, 2012). For example, Batten (2011: 192) notes:

> "[P]ublic sector managers are exposed to a much higher degree of conflicting pressures arising from close interpersonal relations, limited promotion opportunities, and senior officials having to act in multifunctional roles. [The PICS] also face difficulties recruiting high-quality civil servants due to the limited supply of candidates and the tendency of the most capable individuals to seek employment in larger markets."

Additionally, bureaucracies across the region are often accused of relying on nepotism, rather than meritocracy, in their hiring and contract-awarding decisions (see Vanuatu Daily Post, 2012; Radio New Zealand International, 2012 for a few recent examples).

Collusion, conflicts of interest, and state capture

Several examples of SBRs in the literature on the Pacific portray them as collusive in nature and state actors as having conflicts of interest between industry and policy making roles. In the Cook Islands, for example, within parliament there exists a "high concentration of wealthy business men" which has meant that the private sector has been able to "wield a large degree of political power" (Duncan & Nakagawa, 2007: 14). In Fiji, "there are many instances of collusion between government and business where there are clear conflicts of interest" (Taylor, 2002: 311). Taylor (2002) also observed that the government-connected business elite in the country is able to access state funds through the Fiji Development Bank and the National Bank of Fiji, which are then used to further their own businesses.

The logging industry, in particular, has received attention in the literature in a couple of country-cases for the collusive relationships that have developed between the state and private sector. For example, in the Solomon Islands, Allen (2011) describes a growing collusion between foreign logging companies and local politicians, since the first logging boom in the late 1990s, which resulted in weak monitoring and enforcement of pre-existing regulations. He documented that politicians often had and still have direct involvement in the industry as the directors of landowning companies and that bribes and inducements by foreign logging companies were frequently used to influence government policies, or to manipulate various aspects of forestry procedures (Allen, 2011: 289). Additionally, because of these interdependent ties, private sector actors were able to capture the state in an effort to avoid enforcement of a policy that would normalize the price of logs towards that of the international market (something that civil society groups fought strongly for). Specifically, in response to the government's intentions to enforce such a policy, logging companies threatened to stockpile the resource and layoff many, and used their allies in the state to politically frustrate the enforcement of the price policies (Allen, 2011).

Policy makers in Papua New Guinea have also colluded with the actors in the logging industry to limit civil society requests for reform. According to Holzknecht and Golman (2009), landowner companies are often headed by local entrepreneurs, who are also frequently provincial political representatives or national MPs. Instead of representing the interests of the leadership of customary resource owner's organizations, these policy makers went to bat for 'their' particular logging company (Holzknecht & Golman, 2009: 193). Additionally, when state agencies have tried to implement reforms that were perceived to be negative to their industry interests, landowner companies leveraged their political power to ensure that those policies were effectively suspended (Holzknecht & Golman, 2009: 194), which is a clear sign of state capture by industry.

Forums for Dialogue

The impression gathered of state-business dialogue in the PICs is that opportunities for formal or institutionalized dialogue have thus far been few but that they have been growing in recent years, and that foreign donors and organizations have been at the forefront of many efforts to encourage it (Holden *et al.*, 2004). At the frontline of this trend seems to be the efforts of the Pacific Islands Private Sector Organization (PIPSO). PIPSO is supported in large part by the Pacific Leadership Program (PLP), a regional initiative of the Australian Agency for International Development (AusAID) based in Suva, Fiji. With the support of AusAID and the PLP, PIPSO organizes and facilitates several workshops among national private sector organizations aimed at strengthening the capacity and ability of private sector organizations to interact with the government, as well as forums for dialogue to occur between the two parties. The following (a non-exhaustive list) are some examples of relatively recent forums or arrangements that have been established to bring both parties and/or private sector actors across countries and industries together in the region, some of which PIPSO and other foreign funded institutions have encouraged.

- A private sector meeting was held in Samoa in November of 2010; The PIPSO, Samoa and Tonga Chambers of Commerce and the PLP met to discuss more effective engagement with the government through public-private dialogue opportunities (PLP, 2010).
- In 2010, PIPSO, along with the Pacific Island Forum Secretariat (PIFS) facilitated dialogue on access to finance between business and government leaders during a Pacific Islands Forum Leaders meeting; both parties expressed their interest in dialogue becoming a permanent feature of annual meetings (PLP, 2010).
- In Papua New Guinea, the private sector has been included in advisory groups for public sector reform (May, 2009: 31), and specifically private sector associations in agriculture have acted as "watch dogs" and have lobbied the government on many issues (McKillop *et al.*, 2009: 69). Maybe most significantly for the country, the private sector has been included in several discussions of how to distribute the national wealth from petroleum industries; "the deliberations of this body may well have constituted the most extensive process of consultation between the government and the private sector over any piece of sectoral legislation since independence" (Filer & Imbun, 2009: 100).
- In Fiji, the private sector expressed concerns over an investment approval process, and in response

the government launched an investigation. As a result of this specific reforms were adopted, and a task force consisting of 5 public and 5 private members was formed, with the help of World Bank assistance. This institutionalized setting for dialogue was "well received with positive feedback from the private sector. [The task force] produces a newsletter titled 'Regulatory Reform News', which is circulated to stakeholders, both public and private" (Koyamaibole & Roberts, 2006: 3).

- The Tonga Chamber of Commerce and Industry (TCCI) organizes regular dialogues with government and also prepares annual business surveys of the private sector across Tonga, the results of which are presented to the government (PLP, 2010).
- In 2011, PIPSO facilitated a public-private dialogue session between private sector representatives from Palau, Federated States of Micronesia (FSM) and the Republic of Marshall Islands (RMI) with relevant government ministers and public officials (PIPSO, 2011).

06

Further hypotheses generated by context

Within the region, there are several political and economic characteristics that a majority of countries in the PICs share. By drawing on the lessons learned from the broader SBR literature, the following section discusses how some of these characteristics might influence or shape the nature of SBRs in the Pacific. Although the impacts that many of these characteristics may have on the economies or political economies of the Pacific have been discussed elsewhere, to my knowledge they have not been specifically discussed with respect to the nature of SBRs in the region. I focus here on developing hypotheses about the likely influence these characteristics may have on the nature of SBRs in the region.

Clientelism

The prominence and reliance on networks of clientelism in the organization of political support by elites is a particularly common observation made of the PICs (Duncan & Nakagawa, 2007; Duncan & Hassall, 2011; Duncan, 2008; Hanich & Tsamenyi, 2009). At the heart of a clientelist system is an asymmetric relationship, wherein political actors, or those with access to significant resources (patrons), rely and leverage upon the subordination and dependence of citizens (clients) by redistributing private goods to them in exchange for political support (Hicken, 2011). As is usually the case in countries where clientelism is prominent, political parties in the Pacific lack strongly developed ideological positions (Rich *et al*., 2006; Ray, 1999) and politicians are generally observed to concentrate on delivering individual or private benefits or goods ('club goods'), rather than widespread public goods, in seeking to maintain or gain political support (Duncan & Hassall, 2011; Fukuyama, 2008). Clientelism, it has been hypothesized, may be so pervasively relied upon in the region because of the geographical distances and historical clan rivalries that exist between its small communities (Duncan & Nakagawa, 2007). These features may have made the costs of appealing to a wider group of voters with the promise of the provision of public goods very high. Also, because of the high degree of ethnic fractionalization in many of the countries in the region, politicians are able to get elected with a small percentage of the votes. This is but another possible reason why the logic of redistributing privately targeted goods to specific communities tends to dominate as the method of political mobilization.

Clientelism is very likely, therefore, to impact significantly on the economic policies and reforms that policy makers are willing to support, and thus also the SBRs in the region. In a clientelist system, patrons seek to create and capture rents from the state so as to establish a resource base for redistribution to their clients, in exchange for political support. Duncan and Hassall (2011: 267) note that, in the Pacific, rents are often created through policies that impact on the private sector and the general economy. Specifically, policy makers in the Pacific are likely to capture rents from bureaucratic hurdles that are put up to start a business or the import tariffs or other restrictions that raise the costs of imports, thereby sheltering certain domestic industries from competition, a form of patronage to certain actors. Also, the creation of monopolistic government business enterprises is another means of redistributing rents. Through such enterprises, patrons can award supporters with positions of employment, or even a position on the board of directors.

Through a politics of clientelism perspective, the *status quo* of policies that impact on the private sector serves an important *political* role. It provides a mechanism to create and redistribute rents to known political supporters. Thus, due to the pervasiveness of clientelism in the Pacific, prescribed economic reform programs, or even modest changes to policies that might have a positive impact on other segments of the private sector and the broader economy, fail to gain the political commitment needed to see them through to fruition because they may threaten an existing *politically* important *status quo*.

The developmental nature of SBRs in the region likely suffers due to the overtones of clientelist-motivated economic policy-making. To conceptualize its potential pitfalls, it is useful to think of the private sector as divided into two groups: those that benefit from the *status quo* and are included in a clientelist network, and those that are not. Within the sub-group of the private sector that benefits from the *status quo*, relations with the state may be close and based on shared information, and policy makers may have illustrated their credible commitment to policies that benefit the "in-network." *However, there is a real danger that the relationships between policy makers and those from the private sector who benefit from current policies will be characterized by a collusive drive to protect a* status quo *that undermines the pursuit of broader developmental goals of the state.* Moreover, those in the private sector that will gain from a reform of the *status quo*, and are outside of the "in-network", are likely to be frustrated with the lack of interest or credible commitment the government has shown towards reforms, and will thus be deterred from trying to work with state actors as well as from making further significant investments into their business endeavours. Using this conceptualization, SBRs are hypothesized to exist along two sides of a dichotomous line, with both sides conjectured to be vulnerable to the pitfalls of harmful to development relations.

Political Instability

Since independence, political instability—in the form of government discontinuities and high levels of party fractionalization—has been common in many countries in the region. For instance, Fiji has experienced three coups since independence. However, a more common expression of political instability in the region, and especially in Melanesia, has been removing governments by the seemingly excessive use of no-confidence votes in Parliament (Connell, 2007). An extreme example is found in Papua New Guinea, where outside of the current government, every government in power since independence has been removed from office through a vote of no-confidence (Reilly, 2004). One measure taken to avoid such votes has been to not have parliament meet for several months. Some parliaments meet for only a few days out of the year (Duncan & Nakagawa, 2007). This has not only limited legislation, but has rendered certain governments hostage to their party-political uncertainties.

A history of political instability creates a fear of future political instability. On the private sector side, political instability directly undermines a government's ability to make credible commitments. It reduces the confidence that the private sector would have in anticipating the policy-making environment, and thus, disincentivizes investment (Duncan & Hassall, 2011; Dixit & Pindyck, 1994; Alesina & Perotti, 1996). When actors in the private sector cannot predict the policy environment, out of a fear that policies will change to their disadvantage, they will be hesitant to invest in industry, and especially so when industry requires large and immobile investments. Also, in an unstable environment, politicians fearful of losing power if the delicate political winds shift, will be less likely to support significant economic reforms with long time horizons and be more likely to protect a potentially hazardous *status quo* (Duncan & Hassall, 2011). Backing for policies that would remove the existing businesses' rent-seeking opportunities could destabilize the fragile ruling coalition's base of support and therefore the government. Thus, for governments that are challenged with maintaining fragile coalitions, the political opportunities for overpowering highly determined vested interest groups are few (Duncan & Hassall, 2011).

Through each of these mechanisms—the disincentives that policy makers face to challenge the *status quo* and the resultant policy uncertainty—political instability is likely to impact negatively on the prospects for developmental SBRs in the Pacific. In the first instance (as with the effects of clientelism), those in the private sector who do not benefit from the *status quo*, are likely to be frustrated in their relations with state actors that have reduced incentives to change economic policies in their favour. Additionally, those in the private sector who benefit from current policies gain leverage from their position as a source of vital political support in an environment of weak political parties and fragile coalitions. *Instability thus helps to enable a capture of the state by private interests*, in that the fear of destabilization from 'rocking the boat' and losing their ruling coalition is ever present among policy makers.

Finally, to the extent that political instability results in a shuffle of those that would interact with the private sector, SBRs will suffer due to the lack of time actors have had to develop a positive pattern of relating to one another and from the absence of an expectation that continuities in SBRs will persevere when another shuffle of policy makers occurs. SBRs are first and foremost based on the *relationships* between state and business actors; to invest in developing trust, and patterns of communication and consultation that are indicative of developmental SBRs, actors on both sides need a certain degree of institutional and personal continuity.

Ethnic Divisions in State, Society, and Business

The Pacific is one of the most culturally diverse regions in the world. However, the PICs differ in the degree to which their populations are divided ethnically, and the extent to which tensions have risen between ethnic groups. The relatively homogenous cases of Samoa and Tonga, contrast starkly with those of Melanesia, Papua New Guinea, Solomon Islands, and Vanuatu, which are each home to large number of ethnic groups (AusAID, 2012). Further, 'ethnic rivalries' have been blamed for bouts of political instability in several countries in the region, including for Fiji's 1987 and 2000 *coups d'état* and a civil war in Solomon Islands, which ultimately forced the resignation of a prime minister (Davies, 2005; Hameiri, 2007).

Ethnic diversity may negatively impact SBRs, but only to the extent that ethnic divisions have been made salient and subsequently, ethnic tensions have developed. In the first instance, ethnic tensions may arise among groups that control different segments of the private sector. In a situation like this, one can imagine that such strains would limit the private sector's ability to organize itself effectively, and to present itself as a unified partner to the state. Put differently, ethnic tensions may be one factor that frustrates the emergence of unified 'peak' business associations. Possibly more harmful for SBRs, however, is a situation where ethnic rivalries boil over among groups that tend to inhabit different sides of the equation: the state or business sectors.

Fiji's case helps to illustrate this point. Fiji's most salient and politically relevant ethnic division has been between indigenous Fijians and Indo-Fijians, each of which made up to close to half of the population, respectively, until the more recent departure of many Indo-Fijians (Taylor, 2002: 305). The two groups have historically had different roles in society; in general, politics and the public service were and still are the preserve of the indigenous Fijians, and business has been the domain of Indo-Fijians (Taylor, 2002: 305). When significant ethnic tensions arose among these ethnic groups, the abilities of actors to work with each other in any meaningful way were likely reduced tremendously, as trust between the two groups imaginably eroded. Further, as Taylor (2002: 313) notes: "because of the long-standing racial disharmony in Fiji, and the essentially second class status of Indo-Fijians as a whole, it is likely that Indo-Fijians in business will always shy away from long-term investment in the country. They are likely always to be concerned about the need to flee, as huge numbers have done so in the past 12 years."

Relative Size of the Government

The size of the governments in the economies of the PICs, relative to the size of the private sector, is unusually large. A report from the World Bank showed that governments are larger there than in almost all other comparable states at similar stages of development (size being measured by the proportion of public expenditures of GDP) (1998: xi). Governments in the Pacific have expanded their roles, especially in the form of state-owned enterprises, into activities like production, marketing, and trading (World Bank, 1998: 7; ADB, 2012a). State owned enterprises typically enjoy a few advantages over their private sector counterparts. They are heavily subsidized by the government, not always held accountable for losses or low profitability and are sometimes sheltered from private sector competition by state policies. Thus, in many countries, state owned enterprises are not expected to compete with the private sector in the services they provide, and are inefficient and unprofitable in their operations. For example, from 2002-2009, the total profits generated from Fiji's state owned enterprises undershot the amount invested in them by the government by about $5 million (ADB, 2012b).

The government's extensive presence in the economies of the PICs has to a certain extent 'crowded out' the opportunities of the private sector to grow (Holden *et al*., 2004: 44; World Bank, 1998; Duncan & Nakagawa, 2007). Formal sector employment is largely concentrated in the public sector, and particularly in the state owned businesses (Duncan & Voigt-Graf, 2008; ADB, 2012a). In Kiribati, for example, the government owns 28 enterprises and is by far the state's major employer (Duncan & Nakagawa, 2007).

How might the size of the government impact on SBRs? Within the SBR literature, there is not much that directly addresses the impact of asymmetries in the economy between the state and the private sector on the nature of SBRs. However, some cases in the literature highlight one likely effect. Specifically, in the 1990s in Zambia, Brautigam, Rakner and Taylor (2002) argued that due to its small size in the economy, relative to that of the state, state actors regarded the private sector as an insignificant element of society to have to work with. The state thus pursued policies without meaningful consultation with private industry actors. One might expect a similar attitude by political and state officials in the Pacific. As Moore and Schmitz (2008: 37) observe, "politicians might not need to cooperate with and support investors because they have alternative ways of obtaining state revenue, financing politics, and funding the institutions that support the political *status quo*. These alternatives comprise some combination of: a profitable and sizeable state-owned economic sector; large foreign aid inflows; or substantial revenues from the export of natural resources (oil, gas, diamonds, bauxite and other minerals)". Thus without a notion that the state is truly interdependent with the private sector, there may be little incentive to develop institutions or relationships to facilitate meaningful consultation between the two parties.

06

Residual gaps

The documents that touch on SBRs in the Pacific fall short of providing a complete view of SBRs in the region. Below I list several questions, related to the nature of SBRs that remain unanswered.

Variation?

The general impression is that there is very little and rather patchy research on this topic in the Pacific. It is thus hard to make any confident generalizations. But this gives rise to a series of questions that need to be explored, and the first set must be about variation in SBRs in the region.

- Do interpersonal relationships—as marked by the degree of trust and perceptions of each other—between state and business actors vary in the region (across space and time)? And, subsequently, if they do, why do they vary? Put differently, what factors have contributed to the development of more positive interpersonal relations between actors in the region?
- Do bureaucratic qualities in the region vary cross-nationally? Does any variation along this dimension impact on SBRs? If so, to what effect?
- What industries within the private sector are most likely to enter into a collusive relationship with the state? Which countries in the region are most vulnerable to state capture by the private sector? And why?
- With respect to dialogue among actors, is there variation across the region regarding the reliance on informal or formal forums of interaction? If so, why?

With what effect?

Much of what has been documented about SBRs has been descriptive and there has been less discussion of the effect that the nature of SBRs in the region has had on actual policy making and reforms. Thus, the second series of questions is concerned with how might the observations made of SBRs impact on policy making.

- What effect has the international community's efforts had on real and measurable improvements in SBRs in the region? Related to the several forums that international actors support to encourage state-business dialogue, how have SBRs changed, if at all, as a result of these initiatives? Possibly more importantly, indirectly or directly, how has policy making changed as a result of these forums?
- Are SBRs affected in small island states by the relatively small size of the population, and hence the elites, and thus by the pervasiveness of informal relationships? In what specific ways does a relatively insular form of politics impact SBRs, and the role that the private sector is able to play in economic reform agendas?
- How important are SBRs to reform agendas in a context where the private sector plays a relatively small part in the economy, because it is otherwise state-led or fuelled by foreign aid?

Drafting a more comprehensive map

The 'patchiness' of the existing evidence on SBRs in the PICs raises several questions, and answers of which would contribute towards drafting a more comprehensive map of how and through what institutions SBRs are structured. Thus, the third series of questions is mainly concerned with how the state and business sectors are organized, and with what capacity to deal with each other:

- How is the private sector organized, staffed and trained to represent private sector interests and negotiate with the state and other external official bodies? What level of capacity do national private sector organizations have to negotiate with, and provide policy evaluations to governments?
- How are the departments of the state organized, staffed and trained to deal with economic affairs and to interact with the private sector?
- Who or what are the key economic players? What is the source and nature of their power and/ or influence?
- Several examples of formal forums for state and business dialogue in the region can be found. What types of informal arrangements exist for interaction? Do formal or informal institutions and relationships dominate state-business interactions? And, what informal opportunities are there for organizations of the private sector to provide input to the formation of economic policy?

07

Conclusion

The literature on SBRs in the PICs is patchy, at best. Further, if we accept that the characteristics of trust, reciprocity, information sharing and credibility are a good measure of the developmental nature of SBRs in a country, what is documented paints a relatively negative picture of the developmental nature of SBRs in the region. To summarize, existing descriptions reflect the following factors.

- **SBRs in the region generally suffer from mistrust and miscommunication from both sides** of the equation; certain members of the private sector have felt ignored and some state actors have been sceptical that private sector organizations have the capacity to work effectively with them.
- At times, **close interpersonal and private ties between actors from the state and business bodies incentivize state actors to work in collusion with the private sector** to protect certain industries, rather than in the state's broader economic interests.
- Relatedly, there are many instances where collusion between the two sides have been documented, and equally where such collusion was encouraged by the conflicting interests that certain policy makers have had, because they too financially benefit from the current status quo. **Thus, the state appears to be vulnerable to being 'captured' by the interests of a few in the private and public sector.**
- One significant factor highlighted in the documents is that, thanks in large part to foreign encouragement, **state and business actors seem to have more opportunities than ever to meet for dialogue, and ostensibly work on developing SBRs in a positive, developmental way.**

This paper has also drawn from lessons learned in the broader SBR literature to develop hypotheses about the state of SBRs in the Pacific, given some commonly shared contextual features in the region. They can be summarized as follows:

- **The pervasiveness of a politics based on clientelism is likely to negatively influence SBRs, as it lends itself to further collusion** with businesses that are sheltered and benefit from the *status quo*, and thus is likely to enhance the frustrations felt by those in the private sector that have difficulties making inroads to meaningfully work with state actors on policy reforms.
- For **countries particularly plagued by political instability, it is likely that the private sector is sceptical of viewing policy promises from state actors as credible,** and especially so if such policy programs have a long-time horizon. **Political instability is also likely to have undermined the extent to which private actors are willing to invest further in a country.** And, like clientelism, political instability is likely to work to protect the *status quo*, as policy makers will be hesitant to meaningfully work for reforms that might unsettle their precarious political positions.
- For those **countries where ethnic tensions have arisen, SBRs are likely to be negatively affected by a loss of trust** or lack of foundational trust across ethnicities.
- Finally, the **relatively large size of government presence in the economy, relative to that of the private sector, has been likely not only to have 'crowded out' parts of the private sector** from certain economic activity, but it may also have worked to **reduce the perception of state actors that the private sector is significant enough to work with in a consultative fashion.**

Finally, also noted are what seem to be important remaining gaps in the collective knowledge of SBRs in the region. Specifically it was argued that the current state of knowledge would benefit greatly from further research that gathers information on the organizational structure and capacities of the state and private sector to relate to one another. Such information will assist in drafting a more comprehensive map of how and through what institutions SBRs are structured. Additionally, research should move towards answering the following broad questions.

- How have the particular contextual features of the region—like the size of the state and political instability—impacted SBRs?
- How, if at all, do SBRs differ across the region? And why do these differences exist?
- What impact has the nature of SBRs in the region had on actual policy making and reforms?

Because of their potential importance for whether states in the PICs reach their developmental goals of achieving sustained economic growth and significant poverty reduction, SBRs in the Pacific deserve much more attention than has been given thus far. An understanding of the underlying interpersonal and institutional dynamics of how the state and business relate to one another will help to characterize the developmental nature of SBRs. Also, such an examination promises to shed light on the political reasoning of why certain economic collective action problems have gone previously unresolved through policy making processes. Thus, collectively, this insight is potentially very valuable for the region and the region's development partners.

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Policy and Practice for Developmental Leaders, Elites and Coalitions

DEVELOPMENTAL LEADERSHIP PROGRAM

The Developmental Leadership Program (DLP) addresses an imporant gap in international thinking and policy about the critical role played by leaders, elites and coalitions in the politics of development. This growing program brings together government, academic and civil society partners from around the world to explore the role of human agency in the processes of development. DLP will address the policy, strategic and operational implications of 'thinking and working politically' - for example, about how to help key players solve collective action problems, forge developmental coalitions, negotiate effective institutions and build stable states.

The Developmental Leadership Program

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