THE ROLE OF DEVELOPMENT FINANCE INSTITUTIONS IN THE SOUTH PACIFIC

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Development Finance Institutions (DFIs) in the South Pacific are very much a phenomenon which developed and strengthened in the post-colonial era. When the first settlers, merchants and planters began their exploitation of the resources of the region, the bankers were not far behind. Their concern, however, was not for the indigenous population but their fellow countrymen with assets to pledge and from whose activities income could be gleaned. It was not until the late 1950's that the first attempts were made by the British colonial administration to provide for the local population some form of development finance system in order to underpin their hesitant efforts to enter the modern economy. To this end, Agricultural and Industrial Loans Boards (AILB) were set up, initially in Fiji and later in the new Hebrides (now Vanuatu) and the British Solomon Islands Protectorate (now Solomon Islands). Managed by amateurs, starved of resources, they did little to meet the emerging needs and hopes of the indigenous people to participate in a meaningful way in the economy of their countries.

As the decolonization process began in the South Pacific in the mid-1960s, the colonial powers began to seek to strengthen the capacity of individual island colonies to stand alone, in economic terms, in order that they might avoid being burdened by the fiscal needs of these countries in the post-Independence period. Through the budget and tariff, efforts were made to create a favorable investment climate for those who might be persuaded to invest in and exploit the often limited natural resources of the island countries. At about the same time AILBs were upgraded to development banks, or where local financial institutions did not exist, as in Papua New Guinea and Western Samoa, DFIs were set up and financial and technical support for their operations sought from multilateral and bilateral donor agencies. It was not, however, until the 1980s that all Pacific island states (by now independent and most of them members of a range of international institutions) had their own individual development finance institutions.
While each Pacific island country now has its own credit institution, responsive to Government policies for economic development, it is important to recognize that there are very real differences between them: this is crucial to a proper understanding of the region. Indeed, the first

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lesson to be learned by a person or institution venturing into the South Pacific, for whatever reason, is that while the individual nations are to be found within the boundaries of a common body of water, they are very different one from the other. It is true that on many international issues the island states of the Pacific present a common front: issues relating to the environment, the law of the sea, and quarantine, for example, generally find common ground amongst island governments. On the other hand, there are many differences: differences of ethnic background, population size, geography and perhaps more importantly, resource endowment. These differences clearly dictate the nature and functions of individual Pacific DFIs. However, with the possible exception of Papua New Guinea they are all regarded as small to micro economies and their credit institutions provide for the whole gamut to private sector funding (except deposit facilities) from agriculture to transport, from mining to trading. Whatever their sister institutions might undertake in more sophisticated economies, they do with only the scale of operations varying; and what is more they cover every aspect of development finance activities. Naturally this places a considerable strain on available management and technical skills but, perhaps surprisingly, South Pacific institutions manage to fulfill the functions which are expected of them, if not wholly effectively, at least with enthusiasm.

All financial institutions in the region are wholly owned by their governments but fortunately boards of directors or management committees exercise a degree of independence which allows these bodies to respond to identified problems and needs in a manner which is essentially non-bureaucratic and thus sensitive to the needs of individuals and local business organizations. Most are established and subject to legislation which requires them, inter alia

- to provide finance for the purpose of primary production or for the establishment, development or acquisition of industrial or commercial undertakings;
- to provide advice and assistance with a view to promoting the efficient organization and conduct of primary production of industrial and commercial undertakings;
- to assist with equity subscriptions, guarantees and underwritings;
- to promote any scheme which will benefit the national economy;
- to provide particular assistance to the development of the indigenous population.

POLICY GUIDELINES

While such legal functions, common to most institutions, may owe something to the influence of the Asian Development Bank (ADB) (which has played a major role in the strengthening of all aspects of the operations and finances of most DFIs in the region), policy guidelines very much reflect the individual economic and social challenges of the countries as well as the resources with which they are endowed. Much attention is devoted by governments to encouraging these institutions to support the economic endeavours of the indigenous population, many of whom, by force of circumstances, are considered to be disadvantaged vis-a-vis more recent arrivals in their countries. Particular examples of the type of policies adopted by DFIs which go beyond such routine requirements as lending for 'technically sound and financially viable activities' are described hereunder.

Tonga Development Bank

The bank provides provides finance within the general framework of the government's economic policies, plans and priorities giving emphasis to

- the use of local raw materials in processing and manufacture;
- contributing effectively to broadening the base of local entrepreneurship and ownership;
- the need to increase the incomes and living standards of people, particularly those at the village or at the grass roots level.

Development Bank of Western Samoa

Apart from normal financing activities, the Bank endeavors to achieve special development objectives, e.g.

- gradually increase the proportion of its financing to Savaii Island (the second largest island in the nation);
- to participate in the development of a lending program in support of the Rural Development Program and the Passionfruit Production Program;
- to advertise its services in local and overseas newspapers that promote joint ventures of benefit to Western Samoa.

Having been established with an impressive range of legal functions, having adopted a variety of policies aimed at supporting the national interest, and after being endowed with almost sufficient resources, how have Pacific DFIs responded to the challenge presented to them? A simple answer such as 'adequately' or 'well' is not enough, but to provide a comprehensive response in the case of each institution is not, in this paper, practical. Nor is it possible in the case of these institutions, because of their broad band interests, to apply accepted quantitative criteria to assess economic viability as many of the institutions, on policy grounds, undertake activities which would normally be regarded as "high risk" when judged against normal commercial banking criteria. Perhaps the best method of evaluation of these diverse, highly original institutions, is to examine them in the light of the entrepreneurial and promotional activities which they have undertaken. The following, while by no means exhaustive, gives a fairly good representation of the type of activities undertaken by three of the institutions operating in the region.

Fiji Development Bank (FDB)

Since the split up of the Papua New Guinea Development Bank on functional lines, FDB is questionably the largest multi-purpose DFI in the South Pacific. It has an authorized capital of $F25 million paid to $F20.5 million and outstanding term loans of just under $F62 million of which all but $F8.2 million have been raised locally.

In addition to normal term lending the Bank has taken an equity position in a number of local firms with the intention of disposing of shares to residents over a period of time.

The Minister of Finance in his budget speech for 1985 recognized the important role the Bank has to play in the future economic development of Fiji, saying that FDB 'continues to be an important source of development finance. It is an appropriate avenue for channelling government resources to stimulate private investment'.

Among the Bank's innovative practices are:

- a Joint Venture Loan Scheme designed to promote joint ventures between Fijians and non-Fijians so as to accelerate the establishment of industrial and commercial enterprises involving indigenous and other races.
- the granting of commercial and industrial loans to Fijians, some with Government guarantees, to accelerate the introduction of the indigenous race into such activities in the country.
- development of an equity financing scheme which enables the Bank to take up shares in companies where the proponents cannot raise sufficient equity themselves.
- taking positive steps in lending to women; although the quantum of loans is currently low, such a positive approach will ensure that this often neglected segment of the community is encouraged to participate in economic enterprise.

The Bank has been selected as the vehicle to assist in the rehabilitation of the crucially important sugar cane industry both through redevelopment loans to cane farmers affected by drought and loans to the Fiji Sugar Corporation for capital projects.

The Bank has a wholly indigenous staff of 160 and has recently installed a modern computer based accounting and records management system. A recent review carried out under the auspices of ADB has resulted in the development of an organizational structure designed to increase the Bank's efficiency of operation such as will meet the demands placed on it over the next ten years.

Development Bank of Solomon Islands (DBSI)

Established in 1977 the Bank had the unique experience of making, in its first year, 287 loans to a value of some $S1.5 million as compared with 753 loans for $S2.6 million approved by its predecessor, the AILB, in 22 years of existence. The Bank had an authorized capital of $S5 million paid to $S3.5 million at the end of 1981 and borrowings for just under half a million dollars.

Perhaps the most challenging role falling to DBSI is in client education, due largely to the under-developed state of the nation at the time of Independence. The Bank is endeavoring to promote an understanding of the management and use of credit through its micro loans scheme whereby branch managers are authorized to approve loans for economic projects up to a value of $F1000. Experience to date indicates that while the scheme was welcomed with a degree of enthusiasm, a large arrears problem has still to be dealt with, indicating an alarming lack of understanding of repayment obligations.

In addition to the Bank's major role, the education of indigenous borrowers, it has a substantial responsibility for training of local staff and at the same time ensuring that adequate attention is paid to the functions set out for it by the national government; creation of employment, the development of the indigenous plantation sector, and the transfer of assets to Solomon Islanders all occupy a considerable amount of the Bank's policy considerations.

Tuvalu Business Development Advisory Board (BUDAB)

Tuvalu became independent in 1975 upon separation from the Gilbert and Ellis Islands Colony. It was founded with no banking system and virtually no other national financial services. Recognizing the need to promote self-reliance and to discourage the indigenous population of just 8,000 people from looking to the government as the sole employer the BUDAB was established 'to assist economic and social development in Tuvalu, within the overall national development plans and strategies'. The Board has no financial resources of its own and a staff of three. Its function is to evaluate requests for finance designed to promote the establishment of new enterprises and to assist in the expansion and modernization of existing ventures. On recommendation to the National Bank of Tuvalu by the Board, funds are made available to customers, which are then under-written by the BUDAB through resources which have been made available via the Australian Aid Program.

In the mobilization of human resources Pacific DFIs are reasonably well endowed with talent: all senior management posts are filled by national staff and only in one or two instances are expatriate specialists engaged on a contract basis. All institutions have a reasonable quota of graduates from regional universities and technical institutions in a variety of appropriate disciplines. To make up for a lack of experience advantage is taken of the wide range of training courses offered by a variety of aid agencies.

MOBILIZATION OF FINANCIAL RESOURCES

Insofar as the mobilization of financial resources is concerned, again Pacific DFIs have a relatively easy time, due largely to the recognition by governments of the crucial role they have to play in the provision of credit for development in line with national policies, and the rather specialist position that they have as a major interface between government and the private sector. The two major bilateral donors in the region (Australia and New Zealand) have made substantial grants to most DFIs, both in terms of funding of staff positions and training, but more particularly through provision of capital to governments, enabling them to increase their equity in the institutions. This type of aid is particularly meaningful, both on account of the multiplier effect, and the fact that money is recirculated following repayment and particularly as donors, through the institution's rural development activities, are able to reach down into the least advantaged sector of Pacific economies, that is, the agricultural sector. Benefits also arise through the fact that aid to development banks adds to the local currency resources of the institution: this may seem strange when often the need in developing countries is foreign exchange. However, in the case of Pacific DFIs foreign exchange is often no real constraint to their activities as it is the responsibility of persons receiving loan finance to negotiate their own foreign currency requirements through the commercial banking system. Increases in the paid up capital of the DFI enables it to maintain the 3:1 debt equity ratio introduced as part of the ADB's pre-lending conditions to those bodies. The multilateral agencies operating in the region (the ADB, World Bank, European Investment Bank) have also made substantial contributions in terms of loans and technical assistance and more recently the ADB has opened a regional office in Port Vila, Vanuatu, to enable it to play a more meaningful role in relation to its island member countries. The ADB is now acting on behalf of the World Bank, undertaking appraisal and evaluation missions which are accepted as a basis for co-financing activities. Loans by the multilateral agencies are nominated in foreign currencies and claimed for reimbursement after implementation of the individual sub-loans so that it is necessary for the banks to put their own money 'up front', as it were, in the first instance. This is not always easy when their own local funds are in short supply, so again this is an area where bilateral grants are valuable, as they are paid in local currency through the home government which has the benefit of the foreign currency grant.

In addition to borrowing from the multilateral institutions, the larger banks have tended to rely heavily on local loan raising. For example, Fiji's total borrowings are in excess of $F70 million of which all but $F8.2 million has been raised by local bond issues or directly from the Fiji National Provident Fund. Local banks have supported DFI activities through overdraft and standby credit facilities.

INITIATIVES AND CHALLENGES

To this point, the paper has endeavored to demonstrate that South Pacific DFIs, established by their governments and with the support of aid agencies and multilateral donors, are in a position to carry out their functions and implement approved policies in response to the economic and social challenges of their island environment. To this extent they are in a juxtaposition with their commercial colleagues: they lend money, they provide advice and assistance to clients in the interests of economic development. However, in the field of innovative lending their role diverges from their commercial counterparts and indeed so it should be as DFIs have been specifically set up to take risks in the development of new fields of economic endeavor. The question is do they take sufficient initiatives and do they accept challenges in supporting the development of the islands they are established to serve? So often in the region there are murmurs - often shouts, from the political sector - that DFIs are too harsh in their security requirements, too narrow in the interpretation of their functions, and too strict in the scheduling of repayment requirements. Are these criticisms really fair and justified? They are to the extent that no banker likes to risk losing money, to see a loan turn bad or to watch a client turn from an enthusiastic borrower to a disillusioned failure, but this is something which can and will happen no matter what steps the DFIs take in terms of supervision because this is the sort of climate in which they have to operate. To dispel any thought, however, that institutions are not working on the frontiers of development credit the following are examples of some initiatives which have been taken in recent years.

Stret Pasin Stoas

In 1973, PNG Development Bank's senior management was concerned at the lack of national involvement in the retail store business and introduced a scheme whereby Papua New Guineans were encouraged and trained to take over trading enterprises acquired from expatriate businessmen. Experience had indicated that the effort and time put into supervising small scale commercial activities was simply not worth it, but if a trading operation, capitalized to say $40,000, were established specialist supervision and training could be justified. Over the years, 68 stores have been acquired and transferred to successful managers trained by the Bank under this scheme: turnover in 1982 reaching K10.2 million.

Micro/mini Loan Schemes

In many South Pacific countries the rural population has virtually no experience with loan management and banks in Solomon Islands, Vanuatu and Papua New Guinea have established mini or micro loan schemes whereby branch managers may authorize loans to $1,000 for approved purposes. These loans have proved particularly popular, but also particularly difficult to manage as the discipline demanded in terms of repayment cannot often be met. Loans for chain saws, fishing boats, copra driers, outboard motors and the like depend on markets for the produce or activity to which the loan is related and thus are often uncertain or non-existent. While the mini loan scheme is imaginative it needs to be more carefully defined so that loan purpose and loan repayment systems are in line with the potential income from the activities funded.

Clan Land Usage Agreements

In Papua New Guinea one of the potential constraints to development was lack of any form title to the land (which might provide security) for intending borrowers. A system of clan land usage agreements was established whereby clan leaders agreed that potential borrowers should have rights over a certain area of land, subject to the traditional or usufructuary rights being maintained. This has enabled plantations of coffee and cocoa, as well as cattle development, to go ahead on land which would normally have been very difficult to alienate for anything other than a clan activity.

CONCLUSION

Clearly, there is an ongoing need to challenge the economic problems of the island states of the Pacific and this is not a task which banks and DFIs can handle on their own. Nor is it an area where multilateral donors are capable of providing the sort of assistance which DFIs need. Their role is clear, that is, to provide technical assistance in staff training and management, and to provide resources for on-lending. If DFIs are to undertake initiatives and provide the sort of innovative support for economic development that is still clearly necessary in the region, there is a real need for the development of research and development capacity in the larger banks which can, in turn, provide support and advice to their smaller counterparts in the less well endowed islands of the region. The Papua New Guinea Development Bank had a well-developed capacity for research and development from 1982 and the Fiji Development Bank has recently established such a capacity. This is an area where a bilateral aid agency could provide assistance for all DFIs in the region from those as small as Tuvalu's BUDAB to those as large as Fiji. What must be avoided in efforts to establish a multi-country program of support for DFIs is that any initiative should flounder because of bureaucratic hesitancy, based on an inability to appraise and evaluate a project prior to giving it the "aid seal of approval". A multi-country program of assistance for DFIs in the South Pacific needs to emerge over time, melding identified needs into a program of support which underpins training, technical evaluation techniques based on micro-computers, and the development of innovative lending practices and systems which will work on the frontiers of development finance. It is crucially important that those involved in appraising any such scheme do not look at costs and benefits before they consider the potential for the development of outward looking, innovative DFI activities which will operate on the frontiers of economic development in the region.