ADB

Evaluation Study

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ADB Support for Public Sector Reforms in the Pacific: Enhance Results through Ownership, Capacity, and Continuity

Independent Evaluation Department

Asian Development Bank

ABBREVIATIONS

ADB	–	Asian Development Bank
ADF	–	Asian Development Fund
AusAID	–	Australian Agency for International Development
CRP	–	Comprehensive Reform Program
DBS	–	Development Bank of Samoa
DMC	–	developing member country
EMPAT	–	Economic Management Policy Advisory Team
ERP	–	Economic Restructuring Program
FDI	–	foreign direct investment
FFMP	–	fiscal and financial management program
FSM	–	Federated States of Micronesia
FSP	–	Financial Sector Program
GDP	–	gross domestic product
GFI	–	government financial institution
IMF	–	International Monetary Fund
MDG	–	Millennium Development Goal
MTFF	–	medium-term fiscal framework
OCR	–	ordinary capital resources
ODA	–	official development assistance
OECD	–	Organisation for Economic Co-operation and Development
PARD	–	Pacific Department
PCR	–	program completion report
PNG	–	Papua New Guinea
PPER	–	program performance evaluation report
PPR	–	program performance report
PSC	–	public service commission
PSDP	–	private sector development program
PSP	–	private sector participation
PSRP	–	public sector restructuring program
RMI	–	Republic of the Marshall Islands
SES	–	special evaluation study
SOE	–	state-owned enterprise
TA	–	technical assistance
UNDP	–	United Nations Development Programme
VAT	–	value-added tax

NOTES

(i) In this report, "$" refers to US dollars.

(ii) For an explanation of rating descriptions used in ADB evaluation reports, see: ADB. 2006. *Guidelines for Preparing Performance Evaluation Reports for Public Sector Operations.* Manila.

Key Words

pacific, reforms, policy-based lending, program lending, political economy, development effectiveness, evaluation, lessons learned, asia, asian development bank, adb

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APPENDIXES

SUPPLEMENTARY APPENDIX (available upon request)

Attachments:	Management Response DEC Chair Summary

EXECUTIVE SUMMARY

Evaluation purpose. This special evaluation study (SES) assesses the effectiveness of Asian Development Bank (ADB) support for public sector reforms in Pacific developing member countries (DMCs). The SES addressed three key questions: Was ADB support relevant to Pacific DMC reform needs? Was ADB's approach to supporting reforms in the Pacific and use of the program loan modality and technical assistance (TA) effective? How can ADB improve its support to Pacific DMCs for reforms? The SES evaluates 11 loans approved over 1996–2002 to 8 Pacific DMCs—2 in Micronesia (the Federated States of Micronesia [FSM] and the Republic of the Marshall Islands [RMI]); 3 in Melanesia (Papua New Guinea [PNG], Solomon Islands, and Vanuatu); and 3 in Polynesia (Cook Islands, Samoa, and Tonga).[1] The SES considers how reform processes and political economy factors have influenced the reform agenda, design, and results of ADB's support; and recommends ways to improve ADB's future support for Pacific DMC reforms and development.

Evaluation approach. The evaluation followed the Independent Evaluation Department's evaluation guidelines, principles, and procedures—with emphasis on the reform process from a political economy perspective. The approach involved identifying issues that positively or negatively affected the core political economy factors of reform, specifically reform ownership, the capacity of institutions to implement reforms, and their combined effect on risks and uncertainties to reform commitment. To understand the extent of reform ownership and capacity to implement, the reform process was assessed. This included factors that influenced formulation of the reform agenda, managing complexity, endorsing reforms, implementing reforms, and sustaining reforms. To accomplish the evaluation using this perspective, the SES combined a desk analysis of macroeconomic, mesoeconomic (e.g., economic structures and institutions), and microeconomic conditions prior to and after reforms; a program loan results indicator trend analysis; and in-country interviews and consultations with over 140 stakeholders to understand their perceptions on reform relevance, processes, and effectiveness. The team also consulted with other development partners that provide support to Pacific DMCs.

Initial conditions. Economic conditions and performance prior to the reform programs were generally weak and deteriorating in several countries. Pacific DMCs, seven of which are considered weakly performing states, generally exhibited slow economic growth and some had negative economic growth in the 1990s. Average annual gross domestic product (GDP) growth during the 1993–1997 pre-program period was 1.1%, compared to 2.6% during the 2002–2007 post-program implementation period (the last program loan included in the evaluation was approved in 2002). GDP growth rates were higher in some South Pacific countries. GDP per capita varies significantly between countries, from about $803 in Vanuatu to $5,584 in the Cook Islands. Large savings–investment gaps are characteristic of most countries. Inflation was relatively low until 2007 when rising oil and food prices led to rapid increases in inflation rates and triggered near crises in some countries. Large trade deficits pervade, with low export levels that reflect low domestic value added and dependence on imported foods. With the exception of PNG, public (especially in Micronesian countries) and private transfers (especially in Polynesia) accounted for a substantial share of current account inflows.

Pacific developing member country constraints. Melanesian countries have relatively large land areas relative to population, but the Micronesian and Polynesian countries studied have small land resource bases and are generally remote—many with sparse, dispersed

[1] Micronesia, Melanesia, and Polynesia are not formal subregions of the Pacific Islands; the groupings reflect location, historical, and social similarities.

populations throughout their numerous islands—which gives rise to diseconomies of scale and high costs of accessing domestic and especially export markets. In the 1990s, economies tended to be inward looking in terms of growth and development. Pacific DMCs became independent relatively recently, and building of modern institutions was work in progress when ADB support for reforms began. Governments are the dominant player and the largest employer in the Micronesian countries covered in the evaluation—largely financed by transfers from the United States under the Compact of Free Association. However, these transfers were significantly declining through the 1990s, reducing public expenditure and increasing pressure to reduce the size of government. The pervasiveness of government was not as dominant in the Melanesian and Polynesian countries. However, excessive intervention in private goods provision, while seen as responding to market failures, led to inefficient operation of monopolies (government-owned and natural) that were a drain on public resources and constrained private sector response. Nevertheless, the provision of physical infrastructure and public services was insufficient and inefficient. Skilled human resources, education, and training—except in Polynesia—remain relatively low, affecting public and private sector performance. Reconciling cultural diversity, the role of traditional leadership, and pro-reform and less supportive patronage systems within each country and in the region also presents a challenge for the institutional development processes. Constrained by limited public finances and access to local private financial capital, and thus limited domestic capital formation, Pacific DMCs have relied on external sources to finance growth and development.

ADB strategies. In the mid-1990s, ADB, in discussion with other development partners, developed strategies to tackle constraints to reform and development. These strategies focused on (i) creating an enabling macroeconomic environment; (ii) reducing the size and raising the productivity of the public service; (iii) creating an enabling environment for the private sector, and lowering costs for domestic and foreign business; (iv) increasing returns from productive sectors; and (v) regional cooperation, including resource management, trade, and transportation. In 1995, the Pacific Regional Department (PARD), then called Office of Pacific Operations, produced its first strategy covering operations in the Pacific for 1996–2000. In support of developing strategies for Pacific DMCs, ADB supported analytical work in the Pacific, much of which underpinned the rationale for supporting reforms leading to program loan formulation. In 2000, PARD prepared a new strategy, which included lessons from the 1996–2000 strategy, including the need to enhance DMC ownership of policy reform and investment programs.

ADB support. Partly due to the decline in official development assistance transfers to the Pacific in the mid to late 1990s, Pacific DMCs turned to agencies such as ADB to finance reforms and development. This was further justified by the suitability of the program loan modality for financing specific reform costs. ADB became the largest lender to the region, addressing both public investment constraints and facilitating the removal of systemic inefficiencies through reform. In line with the Pacific strategy and country needs over 1996–2002, ADB approved 11 program loans supporting public sector reform to 9 Pacific DMCs: Cook Islands, FSM (2 program loans and a related project loan), Nauru, PNG, RMI (2 loans), Samoa, Solomon Islands, Tonga, and Vanuatu.

Getting reforms on the agenda. Reform agendas in each Pacific DMC supported were initiated by incumbent governments. Individual reform programs varied in detail, but they generally addressed three areas: (i) sound fiscal and financial management, (ii) improved public service delivery, and (iii) enhanced environment for private sector development. Improved macroeconomic management was a relevant response to current or imminent fiscal crises and sluggish economic growth. All countries (except Samoa, which had earlier addressed a severe fiscal crisis) were faced with persistent budget deficits, some of which had reached crisis proportions. Most of the Pacific DMCs had large public services that budgets could no longer afford. Public sector productivity and service delivery reforms were related to the worsening fiscal situation, but even prior to the reforms the provision of most public services in the Pacific DMCs were deemed inefficient, and improving public service efficiency and delivery of services was a relevant agenda item. A third area was to reduce the role of the public sector in the economy and to enhance private sector development. ADB helped develop the reform agenda in all countries through TA and consultations. The degree to which the efforts built on an existing reform agenda, versus being developed by ADB, was a factor in determining local ownership and commitment to reform. The type and degree of consultation across countries varied together with the degree of ownership and commitment.

The main reform agenda driver was a fiscal crisis—current in the case of the Cook Islands and Vanuatu, imminent in the case of the FSM and RMI, and on the horizon in PNG and Tonga. The exception was Samoa whose financial sector reforms followed earlier fiscal reforms. Elsewhere, fiscal stresses hastened the need for reforms and prioritized immediate fiscal reforms. However, the dominance of the public sectors and structural imbalances in the economies dictated the need for reducing the size of the public sector and efforts to encourage growth in the private sector. ADB's analysis of economies and pending crises and understanding of government reform priorities identified a wide range of needed and relevant reform areas. Consultation with officials, politicians, and other stakeholders was carried out, although urgency led to contracted consultation in some cases. Greater emphasis was placed on economic diagnostics over institutional and organizational assessment.

Managing complexity. The sequential order, timing, and optimal pace of specific macroeconomic, structural, and institutional reforms are important for conceptual and practical reasons. A sequenced approach to reforms was largely accomplished in Samoa, following the Government's own macroeconomic and structural reform road map. For other countries, the reform programs' focus on downsizing the public sector to reduce expenditure, revenue-raising measures, and tax administration improvements (all designed to help attain fiscal stability) were considered necessary and urgent. However, several program loans had complex agendas that tried to accomplish too much simultaneously. Reform programs were mostly planned for implementation over 3 years. Some measures could be accomplished in the short term (e.g., budget cuts to reduce deficits quickly), but institutional and public enterprise reforms needed 5–10 years to implement.

To achieve shorter-term gains from fiscal balance and longer-term fiscal sustainability, Pacific DMCs appreciated that there would be short-term hardships, particularly for those retrenched from the public service and as a result of reform of state-owned enterprises (SOEs). It was recognized that these costs had to be borne if the economies were to be set on a better growth path. To mitigate the short-term negative social and economic impacts from the reform process, and in some cases to create needed fiscal space for improved public spending, program loan funds were provided and justified use of the program loan modality. However, covering reform costs and support from pro-reform governments and "champions" (pro-reform leaders or patrons) did not always overcome the complexity of reforms—in some cases they lost subsequent elections. For example, the assumptions that redundant public workers would be absorbed into the private sector and that structural shifts would occur even over the medium-term were not realistic given the lack of systemic advice and training for retirees and laid-off workers as part of the reform program. Thus, aspects of the short-term negative effects of reforms were underestimated or poorly managed, with incorrect assumptions made.

Attention was given to the preparedness of key oversight agencies such as departments and ministries of finance, economics, and planning. However, less attention was paid to the capacity of agencies, such as public service commissions, which are at the center of civil service reform; and insufficient analysis was made of how to implement such institutional reforms. Introducing reforms, such as performance orientation in public service, requires attitudinal changes and medium- to longer-term horizons. At the time, there was less consensus on the most effective ways to improve the private sector environment, both on the part of Pacific DMCs and within ADB—partly because of the political implications of reducing existing public sector roles in private goods' production and uncertainty over private sector responses. Privatization and reform of SOEs was a common feature of reform programs but took longer to materialize than expected or else stalled.

ADB played a key role in donor coordination, helping to explain the need and nature of the reforms, encouraging funding support, and holding several consultative group meetings. Cofinancing was limited and most development partners provided parallel assistance. Despite early development partner coordination, there were instances where ADB's role needed to be clarified over time. For example, ADB program loans financed retrenched public servants under the downsizing program, which could not be funded under the Compact of Free Association with the United States. This justified the initial ADB support. However, a complication for coordination arose when new development partners (such as Taipei,China grants to the RMI) provided unconditional development aid that, in effect, financed reversals of public wage bill restraints. The relative roles and effects of such transfers from development partners need careful consideration when determining respective development partner roles, as this can affect initial assumptions and increase risks to future commitments. Overall, better coordination between development partners was needed.

Endorsing reforms. Conditionalities can be the outcome of long periods of consultation and discussion that result in setting out a mutually agreed package of measures to achieve the chosen objectives of the program. Conditionalities can also take on an administrative function for loan implementation, including preconditions or actions for loan release compliance that trigger access to the next credit tranche. Excessive use of fixed policy conditionalities and policy actions (in the case of the Cook Islands, there were 124 policy actions and 44 tranche conditions), together with rigid implementation time frames, is not a realistic perspective for implementation. Of second tranche conditions, 49% were complied with (including the cancelled program loans to PNG and Solomon Islands), suggesting that governments had difficulty implementing the second phase of policy actions and conditions. As experienced elsewhere in ADB program lending, second and third tranches tend to experience delays—partly because realization of the implications of reforms caused hesitancy, or because of the complexity of the steps needed to fulfill a requirement such as difficult legislation. The deeper the change in the rules and incentives, the longer the time needed to make changes, let alone achieve a behavioral response.

Implementing reforms. Overall, funds were used by governments in the initial stages of program implementation and for their intended purposes. Economic management programs involved fiscal reforms to reduce or reverse budget deficits. Short-term fiscal targets were often achieved, entailing expenditure cuts and revenue raising measures, although the latter were only partly achieved in Micronesia. Elsewhere, measures to increase domestic revenue generation were implemented, with regulations developed and passed, and were relatively resilient. Fiscal management measures usually involved public service downsizing, mainly to help reduce expenditure; targets were generally met in the Cook Islands, FSM, RMI, and Vanuatu. In most cases, reform targets for public service delivery were not sufficiently strategic, given the lack of a longer-term view of a future public service focused on core activities. While employment and expenditure reduction targets were achieved within the life of programs, employment and wage bills crept back up, in some cases exceeding previous levels.

Strengthening public expenditure management was a component of most reform programs, and several governments introduced a form of performance or output budgeting. This initiated the first steps in improving allocative and expenditure efficiency. However, to analyze, plan, and effect budget realignments requires time and skills, significant policy decisions, and systemic institutional improvements. Voluntary retrenchment approaches can also undermine a reform agenda for public service improvement, as many qualified and experienced retirees availed of packages, left the civil service, and often emigrated. Overall, recurrent expenditure issues were addressed during implementation, but realignment for improved sector service delivery at line agency level was not significantly addressed.

A remaining institutional constraint in Pacific DMCs is their relatively limited, systemic capacity to manage reforms. The reform programs were more successful in Pacific DMCs where existing capacity levels were stronger, particularly in economic, financial, and development planning. Capacity development, therefore, formed a critical component of the reform programs. TA to support reforms was perceived as useful by respondents but tended to support policy advice and implementation support rather than organization-level capacity development, especially how-to aspects of reform. Individual-level capacity development through training was evident in most countries, but needed structural and institutional capacity development results, targeting organizational structures and institutional change, were limited, especially in line agencies. Better understanding is needed of the wider needs for institutional capacity development, including the role of nontraining support for processes and organizational change and change management processes needed to effect public sector management improvements and reforms.

Sustaining reforms. Most reform programs achieved the immediate need to stabilize finances at the macroeconomic level, but the sustainability of outcomes over the medium and longer term outcomes was mixed. Government expenditure as a proportion of GDP has seen a small decline in most countries, but after initial reductions, wage bills have in some cases increased again to unsustainable levels, particularly in the FSM and RMI. Budget deficits have reemerged in the FSM and RMI but improvements have been made in Cook Islands, Samoa, Tonga, and Vanuatu, with budget surpluses being maintained. The FSM and RMI remain grant dependent but program loans supported the establishment of trust funds to help prepare the countries for fiscal independence in 2023 when the Amended Compact of Free Association expires. In Melanesian and Polynesian countries, tax income became the main revenue source.

Public financial performance assessments carried out for the Cook Islands, Samoa, Tonga, and Vanuatu note that budget preparation and economic planning processes are generally adequate, but there is room for improvement in timeliness and accuracy. Although the ministries of finance in Polynesia have relatively good skill levels, institutional capacity for policy making, planning, and service delivery remains weak. However, despite several follow-on TA projects, there is still a serious shortage of local expertise in high-quality economic policy advice in Pacific DMCs. This suggests that TA provided together with the reform loans have not met capacity development expectations and designs were not sufficiently systematic, tending to provide short-term training to individuals rather than considering the needs for longer-term institutional capacity development.

Cultural aspects, and both positive and negative patronage networks, were not sufficiently considered. In PNG, traditions such as the *wantok* system of social obligations toward kinsmen are not necessarily consistent with modern public sector governance systems. Incompatibility between traditional customs and modern institutions sometimes affected the envisaged reform progress. Elsewhere, vested interests that opposed reforms (such as SOEs) and budget realignments and management also slowed reforms. Having a champion, including traditional leaders or patron (such as in the RMI), for a reform program is often cited as a key factor in the success of reform programs. However, reliance on a single champion or patron can have negative impacts if the champion is no longer in authority. Changes in government during and after program loan implementation periods affected the sustainability of reforms in the RMI, some FSM states, and Solomon Islands. Public consultation during reform design, implementation, and post-program follow-up is needed to ensure wide understanding and transparency of the intent of reforms.

ADB programs supported reforms to improve public sector efficiency, but the impact of reforms for private sector development has so far been modest. The reduction in the size of government may have reduced crowding-out effects in some economic sectors, but efforts to stimulate the private sector through specific institutions and incentive improvements have yielded modest results overall. In Polynesia, there is a better climate for investors, and a few key success stories, but key constraints remain (small markets, lack of resources, and high utility costs). Public enterprise reforms have not been implemented as envisaged in the FSM or RMI, but have made some recent progress in Vanuatu and the Polynesian countries. In all countries, legal and policy improvements were made to improve the enabling environment for private sector development, but effects have had a limited impact on private sector growth to date. Domestic investment and foreign direct investment remain relatively small in all countries and trade deficits persist in Micronesia and Polynesia, although external debt has been reduced in all countries. Overall, the structures of the economies have not changed significantly as a result of the reforms. Nevertheless, tourism has emerged as a growth source in the Cook Islands, Samoa, Tonga, and Vanuatu; and remittances are increasingly important in supporting the current account in several countries.

Evaluation. Overall, support for Pacific DMC reforms is rated “relevant”. Sound economic diagnostic work helped to deepen understanding of constraints facing Pacific DMCs and identify relevant reform needs. Program-backed reforms were generally high on government agendas, but variable understanding of measures and complex designs risked sustained commitment. Programs varied in the realism of the steps and time required for institutional capacity development, generally underestimating needs and reflecting optimistic assumptions on private sector response. Program formulation and implementation were coordinated with key development partners, but would have benefited from greater country leadership of the coordination process.

Overall, ADB assistance was rated “less effective”, with significant variation between “less effective” ratings in some countries and substantial effectiveness in other countries. Programs often achieved short-term fiscal and financial outputs and outcomes, but public service delivery and structural transformation objectives were elusive. Program finance, including counterpart funds generated from loan proceeds, was used to address the causes of immediate fiscal problems and initiate reduced dependence on external transfers, but progress has not met expectations in several countries. Institutional capacity development outcomes in economic and public financial management and line agency public service delivery were partly realized or not realized.

Outcomes were influenced by the depth of initial ownership of specific reforms, and later by varying levels of institutional capacity to implement reforms. Cultural and traditional perspectives and related behavioral factors affected reform progress. Wavering support for the reform agenda, complexity issues, delays in endorsement of reforms, and unforeseen implementation issues influenced the degree of domestic support for initial policy choices and ownership, which reshaped the reform approach and content in some cases. Lack of follow-through and continuity by ADB on policy support, and the slow shift to investment lending, contributed to aggregate negative net transfers to Pacific DMCs since 2002—some of which are fiscally stressed but continue to have sovereign loan repayment commitments. TA often provided the necessary support for reform agenda formulation and implementation but capacity-building efforts at the institutional level were less effective, which in part reflects the need for improvements in ADB TA design and management.

ADB assistance is rated “efficient” overall, but less so in some Melanesian and Micronesian countries because of delays as well as unrealized benefits and efficiency gains. Supported by prior TA, program loans were prepared on schedule, but implementation efficiency was lowered by delays in meeting second tranche conditions and wavering commitment by some previously pro-reform governments. Program loans implemented to address urgent fiscal problems were accomplished in the short to medium term, but reform cost mitigation and required complementary institutional capacity development were only partly addressed, delaying realization of the reform benefits.

The impact of reforms supported by ADB is rated “modest” overall—with a lower impact in Melanesian and Micronesian countries and in public service delivery and economic transformation, but substantial impact in Polynesian countries, and Samoa in particular. A key impact of programs was the reduced short-term fiscal stress achieved in several countries, although this progress was later reversed in some cases, and social costs of reform were only partly mitigated. The expectation that the private sector would absorb retrenched public sector workers was unrealistic because of the different skills and experience needed by private businesses, limited training for retrenched public sector workers, and other constraints to private sector expansion. Public service reforms take time and deliberate actions to effect, and a lag is expected in realizing program benefits. The lack of a systemic approach to capacity development also limited public service delivery reforms. Economic transformation and private sector growth expectations did not occur in FSM and RMI, and private sector-driven growth was modest and sector-specific elsewhere.

ADB assistance is rated “less likely sustainable” overall, ranging from “highly sustainable” in Samoa’s financial sector reforms to “less sustainable” in the Micronesian countries. Overall, ADB support for reforms to all Pacific DMCs is rated “partly successful”. By region, program loans in Pacific DMCs in the Polynesian countries were “successful” overall. Results were overall “partly successful” in the Melanesian and Micronesian countries that received ADB support for reforms. The SES ratings for the Vanuatu Comprehensive Reform Program improved slightly compared with program completion report ratings, while SES ratings in FSM and RMI were comparable or declined since the results of fiscal reforms have deteriorated.

Key findings and lessons identified. The following lessons from ADB efforts in assisting the reform process are highlighted.

(i) **Getting reforms on the agenda:** (a) where ADB support for reforms was embedded in the Government’s initial reform agenda, commitment was more effective; (b) wide public and intergovernmental consultation on the reform agenda facilitated better understanding of the reasons for reform, and expected benefits and costs; and (c) lack of consensus among stakeholders on the role of government and core public functions and services in the reform agenda led to wavering on reform commitments in areas such as SOE reform and some privatized public sector functions.

(ii) **Managing complexity:** (a) in small, close-knit developing island economies where the public sector is the main source of economic activity, the politics of reform can be complicated and needed close monitoring and regular dialogue; (b) identifying and supporting pro-reform leaders was important, but involvement of a wider support base may have helped to better manage the risks and uncertainties that underlie reform commitment; (c) political transitions required more intense reengagement in policy dialogue by ADB and increased flexibility; (d) pursuing moderate, sequenced reforms would have been more realistic, especially where institutional capacity was limited; and (e) reforms introducing modern systems needed to better consider historical, social, and cultural traditions and context in design and implementation.

(iii) **Endorsing reforms:** (a) further prior understanding of the purpose of legislation in the overall reform effort was needed by lawmakers when legislation was being passed; (b) reform targets were required, but their basis needed to be rationalized and explained better; and (c) excessive use of conditionality was not an effective approach to managing the reform process.

(iv) **Implementing reforms:** (a) program loan periods were too short to build the capacity required to develop and manage reforms; (b) more effective approaches to TA were needed to support reform implementation; (c) improved monitoring and evaluation of the outcomes and development impact of reforms (against targets) was needed to inform stakeholders of progress; (d) voluntary retirement can further reduce capacity during institutional reform; and (e) intensified dialogue and flexibility is required during a period of unanticipated political transition.

(v) **Sustaining reforms:** (a) economic and public service management reforms initiated management and attitudinal changes toward accountability, but fell short of reaching a critical mass in many cases; (b) assumptions on the response of the private sector needed to be more realistic and reviewed regularly; and (c) reform is a medium- to longer-term effort that needs continuous support from ADB and—whether through TA, program lending, or sector investment support.

Conclusions and recommendations. This SES concludes that the broad thrust of ADB support for public sector reforms in the Pacific is still relevant a decade later, even in the context of current global economic conditions. However, effectiveness was limited by overambitious objectives and designs that needed to better reflect government ownership—a challenge given the political trade-offs and choices, and often unavoidable short-term social costs arising from far-reaching reforms. Lending and nonlending operational designs underestimated reform complexities, and did not reflect the medium- to longer-term processes needed, especially in the context of Pacific DMCs' institutional capacity constraints to implement complex economic, organizational, and governance changes. Overambitious assumptions were also made on structural adjustment toward private sector growth. When ADB reform measures went beyond what was desired by the Pacific DMC governments, reforms were less successful or failed. ADB support was more successful where the aims of ADB reforms aligned themselves with the needs and capacity of governments—sector-specific reform for Samoa's financial sector was the most effective approach. The task of improving public service efficiency while cutting current expenditure was underestimated and, in some cases, further weakened already limited capacity. The outcome of the reform programs was also partly determined by the position taken by traditional and newer patronage systems within Pacific DMCs on the reforms, which can act as a positive or opposing force for reform, yet need to be understood for reforms to be effective. Fiscal reforms were more effective, but sequenced follow-on support was not sustained; this increased the risk to and uncertainty of reform commitment.

There is a significant unfinished reform agenda in Pacific DMCs that needs continued support. The medium-term nature of the reform process points to the need for reform road maps that consider the political economy of reform and related reform processes, risks, and uncertainties. Thus, a change is needed in the way support for reforms are designed and implemented to raise the relevance and effectiveness of support for reforms through program, project, and TA operations. This needs to start with a detailed stocktaking and dialogue on the status of the government's reform agenda and current stakeholder views for each Pacific DMC in economic management, public goods and service delivery, and private sector development. Operational designs need to ensure continuity of support in line with needs and absorptive capacity. It also suggests the need for focusing support on strategic areas in line with ADB's areas of comparative institutional advantage and committing to follow-through over the medium term. Emerging practices in policy-based lending can be applied in conjunction with better designed TA and investment operations that advance reforms where needed and justified. The following are key strategic recommendations for consideration by ADB Management in formulating future assistance programs.

Key Strategic Recommendations

Recommendation	Responsibility	Time Frame
Ownership. Enhance ownership by stocktaking and assessing the current state of reforms progress and stakeholder support in Pacific DMCs as a basis for considering further support by (i) reviewing unfinished economic management, public service, and private sector reform agenda items through dialogue with Pacific DMC governments and stakeholders; and (ii) strengthening ADB's regular policy dialogue and wider consultations on current issues and economic monitoring.	PARD	PARD policy dialogues and TA projects from 2009
Continuity. Ensure continuity in ADB support for government reform priorities through a mix of program, project, and TA operations—harmonized with other development partners, and in line with ADB areas of comparative institutional advantage by (i) providing continuity and predictability in support for reforms and development—with sequenced, medium-term, and where feasible cluster or single tranche operations against country targets, using prior conditionality approaches against government-owned targets; (ii) adopting programmatic approaches to reforms and development that are harmonized with development partners; and (iii) focusing ADB support on areas where it has comparative institutional advantage.	PARD	Address in next Pacific-wide and Pacific DMC strategy period
Focus. Enhance operations focus on priority removable binding constraints, and address economic and public resource management separately from sector goods and service delivery improvements or in sequence by (i) addressing reforms and development in well-defined operations that focus on macroeconomic and major crosscutting issues separately from sector level reforms or in sequence and in line with country capacity assessments; and (ii) ensuring that Pacific DMCs and ADB have consistent expectations on reform direction and progress reflected in strategies, business plans, and operational documents.	PARD	New program and TA designs and operations from 2009

Recommendation	Responsibility	Time Frame
Capacity. Focus TA on the institutional capacity development needed to support reforms through more effective designs by (i) using a "how-to" and demand-driven approach for TA; (ii) coordinating TA with development partners and expanding use of pooled, flexible, longer-term TA designs that effectively assist Pacific DMC institutions to acquire capacity; and (iii) improving the targeting of TA to address specific reform and capacity development issues for public service delivery in specific sectors.	PARD	New TA designs and operations from 2009
Facilitate Private Sector Development. Target removable constraints to private sector development in a better manner, and facilitate provision of industry and constraint-specific TA support: (i) target critical private sector enabling environment constraints that can be feasibly addressed; and (ii) provide needed industry and topic specific expertise, and more focused and continuous how-to type support for privatization processes to advance SOE reforms.	PARD	New TA and lending operations from 2009

ADB = Asian Development Bank, DMC = developing member country, PARD = Pacific Department, SOE = state-owned enterprise, TA = technical assistance.
Source: Asian Development Bank.

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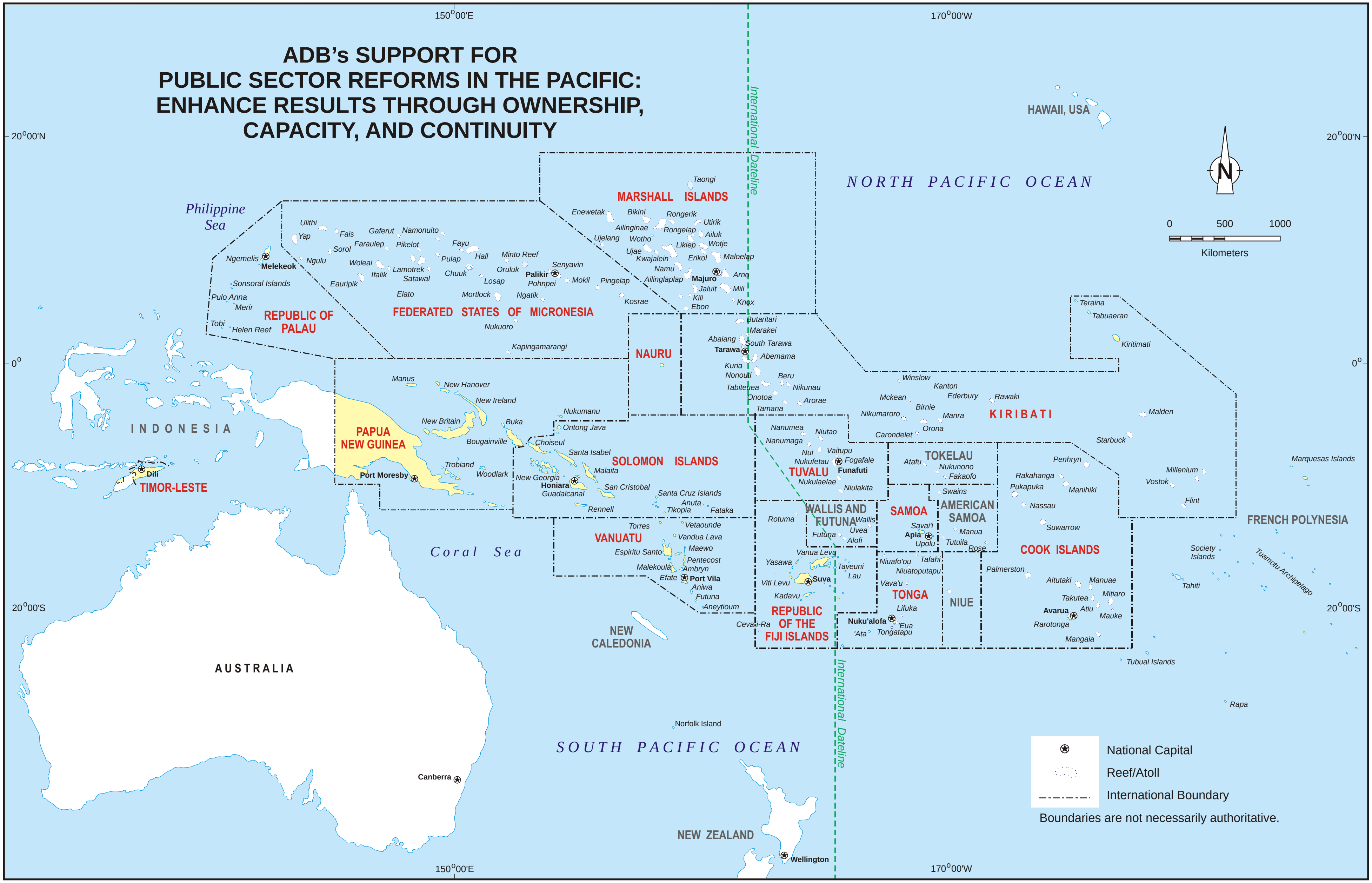
ADB's SUPPORT FOR
PUBLIC SECTOR REFORMS IN THE PACIFIC:
ENHANCE RESULTS THROUGH OWNERSHIP,
CAPACITY, AND CONTINUITY
150°00'E
170°00'W
20°00'N
0°
20°00'S
International Dateline
NORTH PACIFIC OCEAN
SOUTH PACIFIC OCEAN
Philippine Sea
Coral Sea
HAWAII, USA
MARSHALL ISLANDS
FEDERATED STATES OF MICRONESIA
REPUBLIC OF PALAU
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AUSTRALIA
NEW ZEALAND
Melekeok
Palikir
Majuro
Tarawa
Port Moresby
Dili
Honiara
Funafuti
Apia
Port Vila
Suva
Nuku'alofa
Avarua
Canberra
Wellington
Norfolk Island
Marquesas Islands
Society Islands
Tahiti
Tuamotu Archipelago
Tubual Islands
Rapa
N
0 500 1000
Kilometers
National Capital
Reef/Atoll
International Boundary
Boundaries are not necessarily authoritative.

09-2425 HR

I. INTRODUCTION

A. Study Purpose

1. This report presents the findings of a special evaluation study (SES) that assessed the effectiveness of Asian Development Bank (ADB) support for public sector reforms in Pacific developing member countries (DMCs). The SES addressed three key questions: Did ADB support relevant reform needs? Was ADB's approach to supporting reforms in the Pacific and use of the program loan modality and technical assistance (TA) feasible? How can ADB improve its support to Pacific DMCs for reforms? In addition to preparing program completion reports (PCRs) for each program loan, ADB has independently evaluated four program loans to Pacific DMCs through program performance evaluation reports (PPERs) (Appendix 1, Table A1.3).[1] This study evaluates a wider set of program loans to Pacific DMCs approved over 1996–2002 to identify cross-country and strategic issues that have influenced the development effectiveness of program loans. The SES considers how the domestic and regional economic context, ownership, institutions, and ties to traditional bilateral development partners influenced the results of ADB's support to reforms in the Pacific DMCs; and identifies ways to improve the relevance and effectiveness of future ADB approaches to support Pacific DMC reforms. The following Pacific DMCs were selected for this SES, that were grouped by regions of the Pacific for purposes of the study: (i) Micronesia: the Federated States of Micronesia (FSM), the Republic of the Marshall Islands (RMI); (ii) Melanesia: Papua New Guinea (PNG), Solomon Islands, and Vanuatu;[2] and (iii) Polynesia: Cook Islands, Samoa, and Tonga.

B. Approach

2. The study's approach (Appendix 1) evaluated ADB support to Pacific DMC reform efforts by assessing if ADB's response to Pacific DMC requests for assistance was relevant to the context and constraints (Appendix 2), and updated or identified results to date (Appendix 3). Prior studies of ADB support for reforms recognized that policy-based lending for reforms is often not implemented as planned, and can have unexpected consequences that can be explained by political economy factors.[3] This evaluation adopts a similar approach, which involves identifying core political economy factors that influenced Pacific DMC reforms. These factors include reform ownership and institutional capacity to implement reforms, and their effect on risks and uncertainties to reform commitment. To understand the extent of reform ownership and capacity to implement reforms, reform processes were assessed—including factors that influenced formulating the reform agenda, managing complexity, endorsing reforms, implementing reforms, and sustaining reforms. The political economy framework used in the evaluation is in Appendix 1, Figure A1.

3. The evaluation method involved two stages. The first phase reviewed PCRs and PPERs—program loan design and monitoring frameworks were used to identify key impact and

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[1] ADB. 2008. *Program Performance Evaluation Report on the Public Service Program in Papua New Guinea*. Manila; ADB. 2004. *Program Performance Audit Report on the Public Sector Reform Program in the Marshall Islands*. Manila; ADB. 2003. *Program Performance Audit Report on the Public Sector Reform Program in the Federated States of Micronesia*. Manila; and ADB. 2003. *Program Performance Audit Report on the Economic Restructuring Program in the Cook Islands*. Manila.

[2] The assessment of ADB support to the Solomon Islands is limited, as the ADB loan program was cancelled in October 2000 because of political uncertainty. The program loan to Nauru (Loan 1661-NAU: Fiscal and Financial Reform Program) was also cancelled because of Government's noncompliance with second and third tranche release requirements and is not included in the evaluation.

[3] See, for example, Abonyi, G. 2005. ERD Working Paper 70: *Policy Reform in Viet Nam and the Asian Development Bank's State-Owned Enterprise Reform and Corporate Governance Program Loan*. Manila. Available: http://www.adb.org/Documents/ERD/Working_Papers/WP070.pdf

outcome indicators to assess conditions before, during, and after program implementation. Second, to understand stakeholder perceptions of the reform processes in each country, semistructured interviews were carried out that reflected the political economy framework and evaluation criteria.[4] Appendix 4 summarizes Pacific DMC stakeholders' views provided in interviews of the relevance and effectiveness of reforms. Appendix 5 provides the Pacific DMC-wide summary of initial and post-reform conditions and factors that affected the reform process. The team consulted bilateral development partners in the region to obtain their views on ADB's performance in supporting Pacific DMC reform efforts.[5] The evaluation followed Independent Evaluation Department guidelines, principles, and procedures—ensuring the independence of the study and avoiding conflicts of interest.

II. PACIFIC DEVELOPMENT CONTEXT

4. **Macroeconomic Conditions.** Each country's sociopolitical context, key economic and social trends, and key indicators are in Appendix 2. The economic performance of the Pacific DMCs since the early 1980s has been generally poor compared with their East Asian neighbors. The small Pacific island countries, some of which are considered fragile states, generally exhibited slow and sometimes negative economic growth in the 1990s.[6] Average annual gross domestic product (GDP) growth during the 1993–1997 pre-program period was 1.1%, compared to 2.6% during the 2002–2007 post-program implementation period (the last program loan included in the evaluation was approved in 2002). GDP per capita varied from about $803 in Vanuatu to $5,584 in the Cook Islands. Inflation was relatively low until 2007 when rising oil and food prices led to rapid increases in inflation rates and triggered near crises in some countries. The RMI was worst affected by price shocks, with inflation reaching 23% in 2008. The Pacific island countries are small, isolated, and vulnerable to natural disasters and must look outside the domestic economy for sustainable growth. Large trade deficits pervade, with low export levels that reflect low domestic value added and dependence on imported food (Figure 1 and Appendix 2, Figure A2.6).[7]

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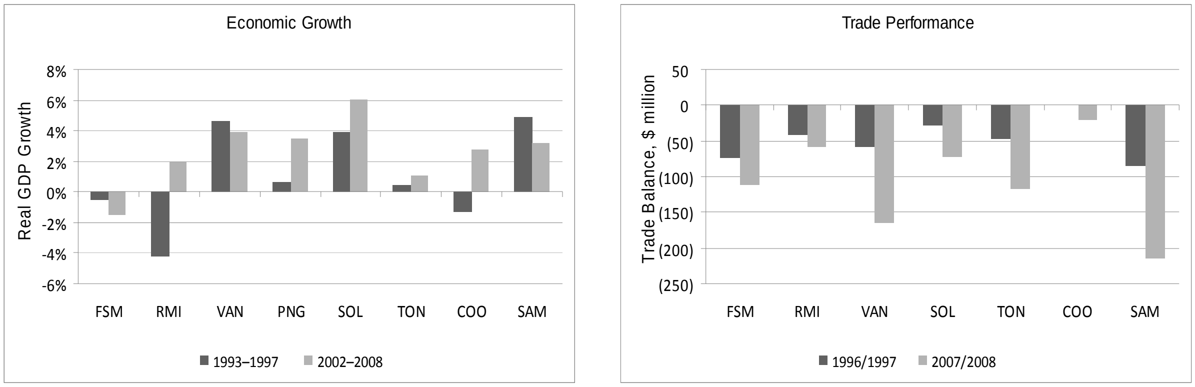
[4] The interviews were administered to over 147 policy makers, officials tasked with implementing reforms, stakeholders from six Pacific DMCs visited by the evaluation team, and development partner representatives from the Australian Agency for International Development, International Monetary Fund (IMF), New Zealand's International Aid and Development Agency, United Nations Development Program, and the United States Department of the Interior.

[5] Consultations were held with the Australian Agency for International Development; United States Department of the Interior; New Zealand Agency for International Development; IMF's Pacific Financial and Technical Assistance Center in Suva, Fiji Islands; and the United Nations Development Programme (UNDP), Fiji Islands.

[6] In 2007, seven Pacific DMCs were categorized as weakly performing countries—FSM, Kiribati, PNG, RMI, Solomon Islands, Timor-Leste, and Vanuatu. Source: ADB. 2008. *Working in Fragile Environments: A Midterm Review of the Pacific Strategy (2005–2009)*. Manila.

[7] Figure 1, Trade Performance, excludes PNG, given its large trade surpluses from 1993 to 2007 and sizable relative surplus in 2007 on account of higher oil and mining commodity prices valued at $7.3 billion.

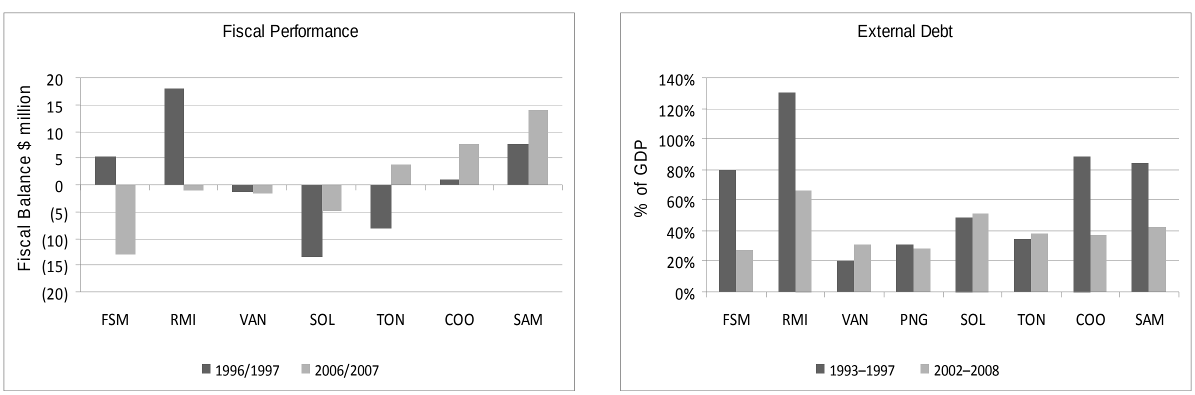
Figure 1: Economic Growth and Trade Performance



COO = Cook Islands, FSM = Federated States of Micronesia, GDP = gross domestic product, PNG = Papua New Guinea, RMI = Republic of the Marshall Islands, SAM = Samoa, SOL = Solomon Islands, TON = Tonga, VAN = Vanuatu.
Sources: Asian Development Bank Pacific Department and Economics and Research Department.

5. With the exception of PNG, public and private transfers (grants and remittances) account for a substantial share of current account inflows. Large savings-investment gaps are characteristic of most countries (Appendix 2). High levels of external financing for economic activity are used through foreign loans and grants, especially in Micronesia (Figure 2). External debt levels are falling but remain high in the RMI, where 2007 debt levels reached 67% of GDP of which 68% is owed to ADB. External transfers in the form of grants are a major source of government revenue, especially for the Micronesian economies that were largely grant-driven as a result of the Compact of Free Association (unique to the FSM and RMI) (Appendix 2). In Melanesia and Polynesia, government revenue sources increasingly include value-added tax (VAT), in part because of reform efforts. Government expenditures exceeded revenues prior to the reform period in most countries, as rising fiscal deficits were a driving force behind the need for reforms (Appendix 2). Overall, macroeconomic management improved over 2002–2007, with better control of fiscal deficits, debt, and inflation (Figure 2, Figure 5 for PNG, and Appendix 2, Table A2.1).[8] However, the sustainability of these gains is an increasing concern.

Figure 2: Fiscal Performance and External Debt



COO = Cook Islands, FSM = Federated States of Micronesia, GDP = gross domestic product, PNG = Papua New Guinea, RMI = Republic of the Marshall Islands, SAM = Samoa, TON = Tonga, VAN = Vanuatu.
Sources: Asian Development Bank Pacific Department and Economics and Research Department.

[8] In 2007, PNG posted a substantial fiscal surplus of $153 million.

6. **Meso-Level Influences.** Several meso-level factors contribute to the mixed economic and social performance. Constraints common to all Pacific DMCs include the geographic limitations of small and remote islands, many with limited resources and production bases, scattered over the vast Pacific Ocean. Together with restricted air and shipping connections and inadequate infrastructure, location disadvantages increase market access costs. Domestic markets are limited because of small, dispersed populations with a limited range of skills. Furthermore, Pacific DMCs have limited access to finance and traditional land rights systems that can be a disincentive to investors. Cultural factors and traditions vary widely between island groups and significantly influence public decision making, and the enabling legal and regulatory environment.

7. Contributions to growth from agriculture and industry are low, although subsistence activities continue to play a role in most countries (Appendix 2, Figure A2.2). Value addition from primary commodities (such as fish and other agricultural commodities) tends to be low, while tourism can be a good but localized employment generator (as in Cook Islands, Samoa, and Vanuatu). Scale diseconomies from the narrow production base, small domestic markets, limited access to resources and export markets are the key constraints to private sector opportunities and growth. There were successes in niche markets (e.g., tourism, agriculture, and fisheries fleet servicing); growth in the Cook Islands, Samoa, and Vanuatu was largely led by buoyant tourism. Recent political instability in Solomon Islands and Tonga has contributed to flat or fluctuating growth rates. Sharp rises in commodity prices favored PNG at least until 2009, while the same increases adversely affected other countries. Overall, services drive GDP growth, but this constrains growth in cases where the sector's largest client is the Government (Appendix 2).

8. The Government remains the dominant player and the largest employer in Micronesian countries. Governments in Melanesian and Polynesian countries may not be as dominant, but excessive intervention in private goods provision, while seen as responding to market failures, has led to inefficient operation of natural monopolies or further constrained a private sector response to possible market opportunities. Limited growth was often used as the justification for public sector involvement in private goods production (such as fisheries and agriculture) or low-return areas (such as buildings and rental properties). However, inefficient public enterprises crowd out private sector initiatives and curb the development of already limited markets. As a result, economic structures were dominated by the public sector, and the private sector was largely constrained to services and primary production with little value added (Appendix 2). Furthermore, even if transport and communications costs are reduced, coordination failures within countries and at regional levels result in the inability of Pacific DMCs to capture a larger share of the benefits from the Pacific's natural resources such as fisheries. Business transaction costs in Pacific DMCs remain high (Appendix 2, Figure A2.11).

9. At the same time, public goods investments and delivery were costly to provide, with mixed efficiency and relatively limited outreach and provision to rural and outer islands. Revenue and expenditure patterns also vary by country. Government investment in social infrastructure has been low, with most revenues spent on government operations (Appendix 2, Table A2.1 and Figure A2.9). A high proportion of public sector expenditure was used for salaries and wages. PNG, though, was recently able to increase its allocation for capital expenditure, due to high commodity prices and related export revenues. Income tax revenues were generally insufficient to finance investment in social infrastructure as well as improvement in public services because of the thin formal income tax base. However, in most cases, public sector wage levels exceed those of equivalent private sector jobs—resulting in scarce skilled employees moving away from the private sector. This has also reduced the availability of limited public funds for necessary social infrastructure and public services improvement. Inexperienced

and weak institutions, as well as political swings, constrain policy responses and service delivery. The result was often imbalanced and inefficient public expenditure allocations, with emphasis on recurrent versus capital expenditure.

10. **Microeconomic Response.** Progress in reforms to improve the response of business has been slow. Foreign direct investment (FDI) is not substantial although, for example, the introduction of competition in the mobile phone market in Samoa and Tonga has had a major impact by reducing costs and increasing subscriber numbers, and Vanuatu has attracted tourist, property, and niche export market-related investment. Better employment opportunities abroad have encouraged workers to migrate, which has increased current transfers through remittances. Pacific DMCs have high rates of out-migration. Negative net migration is high in the FSM, Samoa, and Tonga. Unlike in the FSM, the benefits of out-migration from increases in remittances are evident in Samoa and Tonga (Appendix 2, Table A2.1). However, progress toward achieving the Millennium Development Goals (MDGs) in many of the countries is slow, with more than half of the MDGs categorized as slow or regressing (over one-quarter) in 2006. Poverty and hardship in many of the countries remain serious and are increasing (Appendix 2, Table A2.2). The implication is that public services expenditure may have risen, but the impact remains mixed as evidenced by slow progress toward achieving MDGs. Governance indicators show variable performance among Pacific DMCs (Cook Islands, Samoa, and Vanuatu are the strongest performers) but others are below the 40 percentile rank (Appendix 2, Figure A2.10).

11. Pacific DMCs faced a number of inherent constraints. Their small land resource base and economic size, remoteness, and dispersed populations give rise to diseconomies of scale and high costs of accessing markets. The narrow economic bases and perceived slow market response were often used as the rationale for government involvement in inefficient, public resource-draining provision of private goods through state-owned enterprises (SOEs). Yet, provision of physical infrastructure and public services was costly, insufficient, and inefficient, despite access to substantial foreign grant finance in some cases. Skilled human resources—except in Polynesia—remain relatively low, which has constrained public and private sector performance. Cultural diversity within each country influenced the development of modern institution strengthening processes. Constrained by limited public finances, and restricted access to local private financial capital and limited investment (domestic capital formation), Pacific DMCs have relied on other external sources, such as development partners, to finance growth and development. Pacific DMCs have also turned to agencies such as ADB, which became the largest lender to the region supporting public sector reforms.

III. ASIAN DEVELOPMENT BANK SUPPORT FOR REFORMS

A. ADB Pacific Strategies

12. Key development partners in the mid-1990s discussed and developed strategies to tackle the reform and development constraints. Strategies focused on (i) creating an enabling macroeconomic environment; (ii) reducing the size and role of the public sector; (iii) creating an enabling environment for the private sector, including removing perceived anti-export biases, and lowering costs for domestic and foreign businesses (including wages); (iv) increasing returns from forestry, fisheries, and tourism; and (v) regional cooperation, including resource management, trade, and transportation. In 1995, the Pacific Department (PARD) (then called the Office of Pacific Operations) produced its first strategy covering operations in the Pacific as a whole, for 1996–2000.[9] Until then, strategies had been prepared for individual countries. A specific aim of ADB assistance to the region was to improve assistance effectiveness by

[9] ADB. 1996. *Strategy for the Pacific: Policies and Programs for Sustainable Growth*. Manila.

creating an environment that will lead to improved productivity, increased private sector investment, and sustained economic growth; and require ADB to take a more proactive role in reaching agreements with governments and other aid agencies on how to establish and implement improved policies.

13. In support of developing strategies for Pacific DMCs, ADB supported analytical work in the Pacific, much of which underpinned the rationale for supporting reforms through analytical work leading up to program loan formulation. The Pacific Islands Economic Report provided a comprehensive view of economies and strategic issues country by country. In 2000, PARD prepared a new Pacific strategy.[10] Based on lessons from implementation of the previous strategy, PARD recognized the continued disappointing growth performance and increasing poverty. Lessons from implementation of the 1996–1999 strategy included the need to (i) enhance Pacific DMC ownership of the policy reform and investment programs, (ii) design development interventions that take into account local culture and local capacities, (iii) pace and sequence governance and economic reforms to ensure effective institutionalization, and (iv) use consultants judicially without creating dependency. The strategy proposed continuing support for economic management, governance, and public sector reform; and called for the continued use of program and sector loans to support reform programs. In the event, no further loans were approved until 2009. Other studies, such as PARD's private sector development 2004 assessment,[11] identified the private sector as essential to growth and recommended further reforms to the enabling environment.

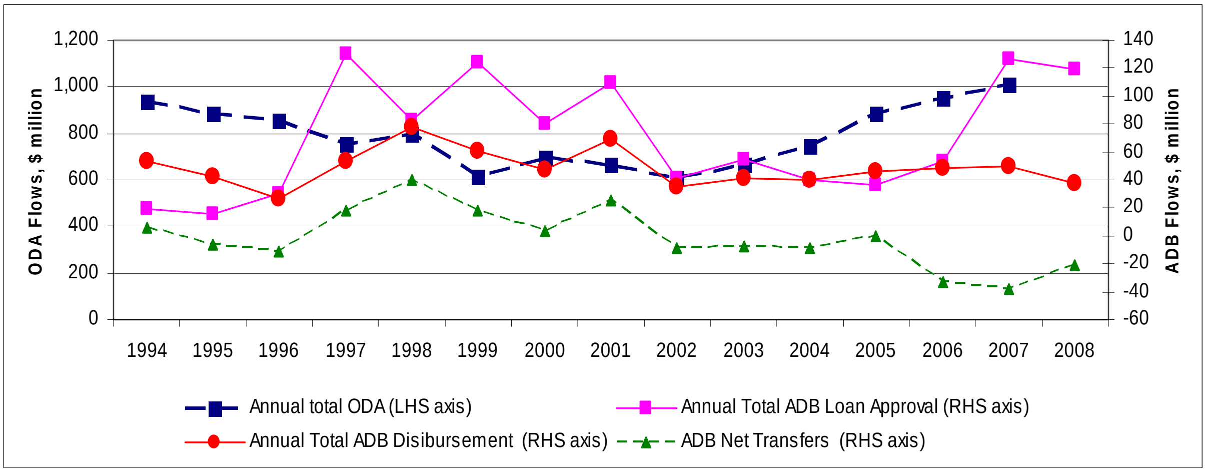
B. Lending Support for Reforms

14. In line with the Pacific strategies and country needs from 1996 to 2002, ADB approved 11 program loans supporting public sector reform to 9 Pacific DMCs—the Cook Islands, FSM (2 program loans and a related project loan), Nauru, PNG, RMI (2 loans), Samoa, Solomon Islands, Tonga, and Vanuatu. Table 1 summarizes the purpose and basic data for each program loan. The Samoa program focused only on financial sector reform, but this was part of the Government's broader public resource management reform program. TA grants were approved to support implementation of all the program loans. The 11 program loans drew on both ordinary capital resources (OCR) and Special Funds resources, and totaled $211.8 million equivalent, with the largest loan ($70.0 million) to PNG (Public Service Program Loan [Appendix 1, Table A1.3]).[12] ADB approved 18 associated TA grants totaling $10.8 million and 1 TA loan for $1 million. Summaries of the reform program loans and TA are in Appendix 3. Table 1 summarizes their purpose.

15. The program loans were a significant part of the lending portfolio to the Pacific between 1996 and 2002 (totaling 44% of lending), increasing finance to support the region at a time when total official development assistance (ODA) flows were declining (Figure 3). At the same time, the decline in program loan support after 2002 and the overall decline in lending after 2001, followed by a slow increase in investment project lending, led to net negative ADB transfers since 2002. However, approvals through project loans have increased since 2007 (Appendix 3, Figure A3.1). This is likely to return transfers to a positive trend on aggregate, but will still leave some countries with negative flows without new flows from ADB.

[10] ADB. 2000. *A Pacific Strategy for the New Millennium*. Manila.
[11] ADB. 2004. *Swimming Against the Tide: An Assessment of the Private Sector in the Pacific*. Manila.
[12] The private sector development program loan to FSM included a project loan of $8 million.

Figure 3: Development Assistance Flows to Pacific DMCs



ADB = Asian Development Bank, DMC = developing member country, LHG = left-hand side, ODA = official development assistance, RHS = right-hand side.
Sources: Asian Development Bank and Organisation for Economic Co-operation and Development.

Table 1: Program Loan Summary

Item	Cooks ERP	RMI PSRP	RMI FFMP	FSM PSRP	FSM PSDP
Loan Amount (tranches)	$5 million OCR ($3 million; $1.83 million)	SDR8.4 million–$12 million equivalent ($5.5, $3.5 and $3.0 million)	SDR6.32 million–$8 million equivalent—plus $4 million OCR ($4.3 million, $5.4 million, $2.3 million)	SDR12.979 million–$18 million equivalent ($10 million, $8 million)	Program loan SDR3.912 million–$5 million equivalent; Project loan SDR6.273 million–$8 million equivalent
Approval Date	September 1996	January 1997	May 2001	April 1997	December 2001
Objectives	Macroeconomic stability, particularly fiscal and external balance Reduction government role and increased private sector activity—agriculture, fisheries, tourism Mitigation social costs resulting from downsized public sector and rise in emigration	Fiscal stabilization and sound fiscal policies Privatization of public enterprises Public sector reform Stimulate private sector development	Ensure sustainable income flows for future generation Strengthen public sector financial and economic management Stabilize fiscal position Improve effectiveness of public service Enhance private sector policy environment	Reforming and reducing the size of the public sector to adjust to declining external resource transfers Shifting balance of economic activity away from the public sector to the private sector	Develop a sound economic and legal environment conducive to private sector development Improve access to and competitiveness of land, labor, and capital resources to increase business prospects and performance
Item	**Samoa FSP**	**Vanuatu CRP**	**PNG PSP**	**Solomon Islands PSRP**	**Tonga EPSRP**
Loan Amount (tranches)	$7.5 million ($4 million; $3.5 million)	SDR14.977 million–$20 million ($10 million + $5 million; $5 million)	$70 million (2 tranches of $35 million—2nd tranche cancelled)	SDR18.8 million–$25 million equivalent ($15 million, $10 million)	SDR8.02 million–$10 million equivalent
Approval Date	February 1998	July 1998	December 2001	August 1998	May 2002
Objectives	Promotion and establishment of sustainable market-based financial sector policies Privatization or corporatization of SOEs	Public sector reforms: redefine role of Government; enhance regulatory and public services Financial and economic reforms: increase productivity and growth of private sector Support improvement of social development indicators, particularly for disadvantaged, rural pop	Improve public service delivery in key sectors Increase private sector-led economic growth	Reform and reduce size of public sector, partly to adjust to economic contraction Shift balance of economic activity away from the public sector to the private sector	Fiscal reform Improved public sector service delivery

CRP = Comprehensive Reform Program, EPSRP = Economic and Public Sector Reform Program, ERP = Economic Restructuring Program, FFMP = Fiscal and Financial Management Program, FSM = Federated States of Micronesia, FSP = Financial Sector Program, OCR = ordinary capital resources, PNG = Papua New Guinea, PSDP = Power Sector Development Program, PSP =Public Service Program, PSRP = Public Sector Reform Program, RMI = Republic of the Marshall Islands, SDR = special drawing right, SOE = state-owned enterprise.
Source: Asian Development Bank database.

16. In 1999, PARD assessed the reform programs then under way in six countries (Cook Islands, FSM, RMI, Samoa, Solomon Islands, and Vanuatu).[13] Many of its key findings, noted below, remain concerns today:

(i) Political commitment to, and ownership of, the reform program is essential, as reform is a destabilizing process involving change and costs to segments of society; governments undertaking reforms invoke risks such as possibly losing mandates to rule, which ADB must be sensitive to and understand.

(ii) Stakeholders expect to see some immediate tangible benefits. Improved fiscal stability addressed immediate crises, but this did not produce obvious immediate gains to counteract the negative impacts of public sector downsizing.

(iii) Designs were too complex and ambitious in terms of time targets, and beyond the capacity of governments to implement without external consultant input.

(iv) The objective of fiscal stabilization took precedence over other reforms.

(v) A longer-term perspective was required, but most loans were of 2–3 years duration, raising the question as to how ADB remains actively involved and maintains its leverage with the government after loan closure.

(vi) Cultural traditions permeate society and social processes that affect decision-making and actions of public servants, particularly where newly proposed systems clash with traditions (e.g., *wantok* system of social obligations toward kinsmen). Culturally sensitive participatory approaches to introduce reform measures are needed.

17. Subsequent completion reports and postevaluations also reported mixed results. The program loans for the Cook Islands, FSM, and Samoa were rated “successful” in PCRs and PPERs. The others were rated “partly successful” (or “unsuccessful” in Nauru and Solomon Islands) since outcomes and impact were less than anticipated, largely because of political constraints and weak institutional capacity. Appendix 2 summarizes the outputs, outcomes, and impacts achieved for each reform program loan; and PCR or PPER ratings. In addition, PARD’s 2000 strategy document (footnote 10) recognized four lessons from implementation of the 1996–1999 strategy: (i) Pacific DMCs had to have stronger ownership of reforms, (ii) reforms had to take into account local culture and capacities, (iii) reforms had to be paced carefully to ensure that they become part of local institutions, and (iv) consultants were to be used judiciously.

IV. A POLITICAL ECONOMY PERSPECTIVE TO REFORMS

18. The PARD 1999 report (footnote 13) is a comprehensive and candid self-evaluation of ongoing efforts to address program lending performance. Of concern to this evaluation is that several findings from the PARD study remain today. Following completion of most program loans approved from 1996 to 2002, this evaluation provides an opportunity to revisit findings 10 years after PARD’s 1999 report from the perspective of an independent evaluation. Use of the political economy perspective also allows the evaluation to assess the processes underlying reform outcomes and the interaction of political economy factors. Other ADB studies recognized that viewing reforms as a “technical exercise in optimal policy design” is not always realistic and that reforms are a complicated, long-term, and uncertain process of societal change in incentives, behaviors, institutions, relationships, and power alignments (footnote 3). Reforms involve political considerations because choices often involve conflicting views and interests. Institutions influence the reform process and where reforms involve organizational change, which can also change authority and the control of resources causing resistance by vested

[13] ADB. 1999. *Reforms in the Pacific: an Assessment of the Asian Development Bank’s Assistance for Reform Programs in the Pacific*. Pacific Studies Series 17. Manila.

interests, there are further risks and uncertainties. This is exemplified in recent evidence of how politics and patronage systems can result in policy capture in favor of vested interests in the Pacific.[14] Although more difficult to reflect in the context of this evaluation, because of the less visible nature of traditional leadership systems and patronage networks that can help or hinder reforms, observations from literature are included on how they can influence reforms. Thus, ownership, conflicting interests, and institutional factors are shaped by reforms involving a process that might involve several different attempts. The reform process and its evaluation summarized in this section can be broken down into the following five steps:

(i) **Getting reforms on the agenda.** Assessment of the motives for how reforms were included in the reform agenda and their relevance in addressing constraints.
(ii) **Managing complexity.** The extent to which influences on factors affecting the reform agenda were considered, including reformers and the status quo, decision-making processes, and whether gains and losses were factored into designs.
(iii) **Endorsing reforms.** Assessment of reform outputs in relation to goals and objectives, including the use of conditions, tranche releases, and program loan proceeds.
(iv) **Implementing reforms.** Assessment of issues that affected reform design and implementation, including capacity to analyze and manage reforms; the perceived value of ADB advice, and the influence of governance structures, culture, and traditions.
(v) **Sustaining reforms.** Issues supporting or constraining reform sustainability and assessment of the change management process used.

A. Getting the Reform on the Agenda

19. **Was ADB's response relevant to constraints and government reform agendas?** Individual reform programs varied in purpose and scope, but generally addressed three key areas: (i) sound fiscal and financial management, (ii) improved public service delivery, and (iii) enhanced environment for private sector development. These areas were in line with ADB's Pacific Strategy (footnote 10). The first area addressed macro-level economic management, which was a relevant response to a current or imminent fiscal crisis or deteriorating budget, and sluggish economic growth. All countries (except Samoa, which had already reformed in response to a fiscal crisis) were faced with persistent budget deficits, some of which had reached crisis proportions (e.g., the Cook Islands). Most of the Pacific DMCs had large public services that budgets could no longer afford, so most programs included reduction-in-force efforts (except in Samoa). The second broad reform area addressed public sector productivity and public service delivery. In part, this was related to the worsening fiscal situation, but even prior to the reform programs, the provision of most public services in the Pacific DMCs was deemed inefficient. Thus, improving public service efficiency and delivery of services was a relevant agenda item. A third area was to reduce the role of the public sector in the economy and to enhance private sector development, which was identified in many reports as essential for economic growth and development.

20. A key reform agenda priority was the existence of a budget crisis—current in the Cook Islands and Vanuatu, imminent in the FSM and RMI, and on the horizon in PNG and Tonga. The crises hastened the need for reforms and prioritized immediate fiscal adjustment. However, at the same time, the dominance of the public sectors and structural imbalances in the

[14] Duncan, R., G. Hassall. 2008. How Pervasive is Clientelist Politics in the Pacific? Paper presented to the *Second Annual Interdisciplinary Social Science Conference, Economics and Democracy* at the Australia National University 8–10 December.

economies dictated the need for reducing the size of the public sector and for efforts to encourage private sector growth. This led to the program loans focusing on the three main areas cited above. Features of the program loans to Cook Islands, FSM, RMI, and Vanuatu are seen in the first program loans to these countries. Even if these loans were addressing local needs, they gave the impression of a common ADB model, according to respondents. In Samoa, on the other hand, with no immediate crisis, the Government developed the agenda of the reform program; ADB was asked to support financial sector reforms only, not the whole government agenda. The key factor within ADB's influence that affected the relevance of the reforms was appropriate in-depth analysis of the economy and the pending crisis. Needed analysis included gaining an understanding of government priorities and capabilities, and understanding the feasibility of reforms—given political, cultural, and institutional factors. Political and institutional aspects, in particular, required widespread consultation with officials, politicians, and the public. However, more emphasis was placed on economic diagnostics over institutional and organizational assessments, although this was progressively examined as reforms proceeded (in cases such as the FSM). Thus, support for improving economic management was relevant, but design measures to ensure effective transmission through meso-level agents and institutions was less evident.

21. **Was ADB's approach to policy dialogue and public consultation effective?** In all countries, ADB helped to develop the reform agenda through TA and consultations. ADB-facilitated in-country economic summits were useful in facilitating public ownership but could have been more widely and continuously used in some countries, including during implementation of the reform programs. In other cases, consultation was reported as inadequate. In Vanuatu, for example, public consultations were held but respondents said that more time and wider stakeholder consultations were needed to consider the reforms. This also contributed to the impression that ADB was applying a common model. The provision of large TA projects covering several years (such as in the FSM) was a new and welcome approach given the extent of assistance needed, as was the alternate approach in Samoa of providing a series of TA projects over several years. This clustered, intermittent, and phased approach to TA had merits, such as continuity and better opportunity for counterpart learning-by-doing. Thus, the degree to which the reforms built on an existing reform agenda contributed to local ownership and commitment for change. As shown in the summary reform process matrix in Appendix 5 (based on individual country reform process matrixes), commitment and ownership continue to be key factors in the success and sustainability of the reform agendas and actions.

B. Managing the Complexity of Reform Issues

22. **Were program designs feasible for facilitating reforms?** The general intended effect of macroeconomic stabilization is to restore balance to rekindle economic growth in response to external and internal imbalances. At the sector and microeconomic levels, low domestic and international market competitiveness—caused by chronic inefficiencies in production factor use and low productivity, falling export prices, or rising imported raw material prices—may require more specific structural reform action as a subset of first generation reforms. Similarly, for public services, allocative and expenditure efficiency improvements and improved benefit incidence often require far-reaching human and organizational change and capacity development. The sequence, timing, and pace of macroeconomic, structural, and institutional reforms and their interrelationships are important for conceptual and practical reasons. Generally, fiscal imbalance and control should be addressed as a prerequisite to attending to financial sector reforms, for example, to avoid the risk of inflation and debt overhang. This suggests the need for a phased plan or a reform road map.

23. A well-sequenced approach to reforms was accomplished in Samoa, following the Government's own reform road map. For other Pacific DMCs, the reform programs' focus on downsizing the public sector to reduce expenditure, revenue raising measures, and tax administration improvements (all designed to help attain fiscal stability) were considered necessary and urgent. However, it is evident that several program loans had a complex agenda that tried to accomplish too much simultaneously. Reform programs were generally planned for implementation over 3 years; some measures could be accomplished in the short term (e.g., budget cuts to reduce deficits quickly), but capacity development and institution-related reforms often require medium- to longer-term horizons. Greater consideration regarding the timing and sequencing of the often wide-ranging reform measures was needed.

24. Improving the efficiency and effectiveness of the public service was a feature of most reform programs. Targets were set for downsizing, with insufficient analysis and consensus (including political) of the core activities that government should maintain and which activities to reduce. In Vanuatu, targets were set at 10%–15% reduction, with inadequate prioritization. A target for reduction-in-force of 400 public sector jobs was met and in the short-run reduced the fiscal pressure of the public wage bill, but the basis for approaching cuts was not clear. The RMI's Public Sector Reform Program (PSRP) targeted a reduction-in-force of 1,484 public workers to reduce the wage bill. Implementation experience has shown that prioritization requires time to be achieved, and needs consultation and sufficiently strong public service commissions (PSCs) to manage force reductions effectively. Thus, redundancy exercises were largely budget-driven and generally not linked to substantive reforms of the public service, including PSCs and line agencies. A trade-off is also apparent in reducing government expenditures and the number of public servants. For example, introducing a performance orientation into the public service requires attitudinal changes that take time and deliberate actions to effect, and a lag is expected in improved service delivery as a result of reforms. Initiating wide-sweeping and ambitious reforms in a low capacity institutional environment with vested interests to maintain or reverse job cuts undermined otherwise successful short-run macroeconomic reforms in some cases. Partial analysis was made at preparation of how to manage and implement such reform complexities.

25. Reducing the size of the public sector had an impact on the market for the private sector in most countries as the private sectors were often focused on the service sector, serving the needs of the government and public servants. Several respondents considered, even at the time of program loan formulation, that it was unrealistic to expect the private sector to absorb retrenched public servants, and for former public servants to become entrepreneurs. Nevertheless, improving the regulatory environment for the private sector was an integral feature of several reform programs to promote private sector growth. At the time, there was also less of a consensus on the most effective ways to improve the private sector environment, both on the part of Pacific DMCs and within ADB—partly because of the far-reaching implications for existing public sector roles in private goods production as well as uncertainty over private sector response. TA often provided advice and reports on how to encourage private sector development, but this was at a strategic and generic level, with limited specifics on measures to be taken or and how-to advice—a common observation of respondents. The outcomes of private sector development initiatives in program loans did not meet expectations, although recent changes in the approach in some Pacific DMCs have seen some progress.

26. Privatization and reform of SOEs were a common feature of the reform programs, but respondent views were that too much was expected too quickly, with a narrow idea of alternative solutions. There was also limited capacity and experience as to how to privatize SOEs, and the model initially proposed by ADB was not generally supported by either the government or SOE management—alternative scenarios should have been considered, as they are now (e.g., in

Tonga). In the Cook Islands, Samoa, and Solomon Islands, it was believed that pressure from the Treasury to raise cash through the sale of SOEs, together with pressure from ADB to remove these operations from the public sector, led to this rush. Reform attempts were also affected by influential members on the boards and management who were concerned about losing their positions and privileges. In addition, not surprisingly, there was resistance to privatizing SOEs given the implications for loss of asset control. Flexibility was needed in designing reforms to fit each SOE's circumstances. In Tonga, where reform of SOEs had been slow, ADB is now assisting through a more targeted approach.

27. **Did program designs reflect understanding of institutional capacity to carry out reforms?** The reform programs were developed and coordinated with finance and economic management agencies, the focal point of contact for ADB. These agencies worked closely with TA support who helped to develop the reform programs. These counterpart agencies generally had sufficient capacity and understanding to carry out the fiscal reforms. However, understanding and capacity outside the key ministries varied, with respondents in Samoa and Tonga noting that the reform agenda and implementation were too focused on, and driven by, the Ministry of Finance—with other agencies not being adequately involved in conceptualization and design. Overall, short-term public sector downsizing measures were sufficiently understood and owned by reformists of the day. However, cases of later upsizing (e.g., FSM, RMI, and Vanuatu) reflect the reversible nature of fiscal and public service reforms under political interests that changed over time. Sustaining fiscal adjustment measures that depend on sustained institutional reforms was more complex to manage within the program loan time frame than expected because of the risks to commitment.

28. There was less understanding and ownership by stakeholders of reforms targeted at improving institutional and service efficiency and effectiveness. Effective implementation of this required the PSCs in each country to be the key agency for reforms, but commissions were inadequately skilled to fulfill this function. Development and application of administrative rules and procedures needed greater attention, as did understanding of line agency constraints and needs. In some countries, restructuring plans designed to reduce the number of ministries or departments, and eliminate unnecessary public services to improved efficiency, were impeded by political interests and even reversed in some cases (e.g., the RMI's wage restraints). These risks emerged where public sector jobs were not necessarily valued for the services provided by the position, but for the employment and income they generate. Thus, cuts were not necessarily based on the importance of the position to the public. In other cases, a lack of technical understanding of how to go about reductions results in blunt (poorly targeted) approaches to downsizing. PARD's approach to addressing capacity development is further discussed in Appendix 6.

29. **Were gainers and losers arising from reforms identified and handled the right way?** The adverse social and economic impacts were assessed and identified.[15] In most reform programs, particularly those addressing current or pending crises (Cook Islands, FSM, RMI, and Vanuatu), there were few alternatives. The nature of reforms involved public spending cuts; changes in the control of public assets such as SOEs; and highly political public sector work force reductions, involving short-term gainers and losers. In reform programs involving downsizing, the public sector had immediate social impacts and mitigation measures were included, such as lump sum payments. However, the reform programs assumed that the private sector would be able to absorb some of the retrenched public servants, and that some of them would become

[15] A good practice example is the poverty impact assessment for the FSM Public Sector Reform Program (Appendix 1, Table A1.3); see Appendix 6 of the report and recommendation of the President.

entrepreneurs. Coalition governments and governments with slender majorities had to be cautious, needing to keep coalition partners on side, handling opposition from specific groups, and softening reform impacts to keep the public on side. Several respondents recognized the risk to commitment where governments relied on coalition partners to remain in power, and pointed to the need to align reforms with political and electoral cycles.

30. Overall, Pacific DMCs appreciated that, to achieve the short-term gains of fiscal balance and longer-term fiscal sustainability, there would be hardships—particularly for those retrenched from the public service. To mitigate the negative social and economic impacts, and in some cases to create fiscal space for improved public spending, program loan funds were provided, which justified use of the program loan modality. For example, program loans funds were used to help repay government debts where due, and to finance retrenchment of public servants. The size and specific use of loan financing is summarized in Appendix 3, Table A3.2. Thus, governments and other respondents recognized the program loan as an appropriate reform financing modality. Program loan tranching was used as the incentive for continued reform progress. Finance agencies in the respective countries generally responded that the loan sizes were adequate for reform needs, although they indicated that more funding was needed for TA support in implementing the reforms, especially for SOE privatization. Covering reform (adjustment) costs and support from pro-reform governments and champions did not always overcome the political complexity of reforms. Thus, the political value of adjustment cost payments can be short-lived if the intended effects of reforms are not realized as expected.

31. **Was reform support coordinated among Pacific DMCs and development partners?** In addition to in-country summits, PARD adopted the concept of consultative group meetings. The first consultative group meeting for the Pacific was held in Manila in 1995 for the first reform program loans in the FSM and RMI. The meetings were convened to help donor partners understand the need for reform reforms, with the respective governments presenting their reform agendas and seeking funding support. Consultative group meetings were held for the Cook Islands in June 1996, at which the Government presented its reform agenda; and in June 1997, to gain funding support. A consultative group meeting was also convened for Vanuatu in June 1997. For later loans, ADB played a key role in donor coordination, helping to explain the need and nature of the reforms and encouraging funding support. The consultative approach led to a generally coordinated development partner response at the time, but total cofinancing was limited—with most partners self-financing parallel but often complementary support (Appendix 7 provides a summary of development partner roles).

C. Endorsing Reforms

32. Conditionalities can be the outcome of long periods of consultation and discussion that result in setting out a mutually agreed package of measures to achieve the chosen objectives of the program. Agreed and implemented conditions and policy actions can be a measure of reform endorsement. Conditionalities can also take on an administrative function for loan implementation, including preconditions or actions for loan release compliance that trigger access to the next credit tranche. While this administrative function may be needed, it can affect the relationship between conditionality and policy changes. Used judiciously, conditionality can address moral hazard, keep reforms on track, and strengthen the hand of reform champions. However, excessive use of fixed conditionalities and rigid implementation time frames may not provide a realistic perspective for implementation. ADB-wide program lending reviews, carried

out in 1996[16] and 1999,[17] found that a large number of policy conditions included in program loans incurred implementation delays compared with the original schedule.

33. The Pacific DMC program loans evaluated shared a similar range of experiences. Program loan tranching and conditionality were used for ensuring that reform steps are undertaken. In terms of policy actions and tranche condition numbers, Appendix 5, Table A5.1 shows that tranches were generally front-loaded but a key feature of the program loans were the large number of conditionalities and policy action requirements used. In the case of the Cook Islands, there were 124 policy actions and 44 tranche conditions; together with rigid implementation, time frames were not realistic for effective implementation. Second and third tranches experienced more delays—partly because realization of the implications of reforms causes hesitancy, or because the complexity of the steps needed to fulfill a requirement such as legislation. Of the second tranche conditions, 49% were complied with (including the cancelled program loans to Nauru, PNG, and Solomon Islands), suggesting that governments had difficulty implementing the second phase of policy actions and conditions. Thus, initial allocations of loans were successful, but second tranche releases were delayed by an average of 1 year in two-thirds of the program loan cases. In cases where the Pacific DMC reform priorities were for short-term budget solutions, while program loans were designed for long-term solutions, this outcome is to be expected. Overall, it appears that the deeper the change in the rules and incentives, the longer the time period needed to meet the condition, let alone achieve a behavioral response.

D. Implementing Reforms

34. **Were loan funds used for identified reform costs?** The loans provided essential funds to help repay government debts and to help pay for the adjustment costs of the reform programs, such as retrenchment of some public servants—thus, they were appropriate. Second tranche releases were often delayed because of difficulties in compliance with conditions, but once released, they were used in line with program objectives. Overall, funds were used by governments in the initial stages of the programs and for the intended purpose, but this did not guarantee outcome realization as evidenced by later reversals of the public sector downsizing programs. Thus, any service efficiency gains have in some cases been dissipated with the creeping increases in the size of the public service. Some respondents in the Cook Islands said that the country had paid a high price for the downsizing reforms but now they faced the possibility of a further round of painful adjustment, a sentiment also voiced in the FSM and RMI.

35. **Were reform measures accomplished within the time targeted?** Economic management programs involved fiscal reforms to reduce or reverse budget deficits. Short-term fiscal targets were generally achieved, entailing expenditure cuts and revenue raising measures, although the latter were only partly achieved in the FSM and RMI. Elsewhere, measures to increase domestic revenue generating measures were implemented and became a more resilient aspect of the reforms in most countries, helping to increase fiscal sustainability. However, budget deficits reemerged in the FSM and RMI. In the Cook Islands, Samoa, Tonga, and Vanuatu, surpluses were generally maintained.

36. Fiscal management measures included public service downsizing as a key reform component to help reduce expenditure, which was achieved in the Cook Islands, FSM, RMI, and Vanuatu. Expenditure reduction targets were generally achieved, but employment and wage bills have often crept back up, in cases exceeding previous levels. In the RMI, the

[16] ADB. 1996. *Review of the Bank's Program-Lending Policies*. Manila.
[17] ADB. 1999. *Review of ADB's Program Lending Policies*. Manila.

400 positions that were shed reduced the wage bill by about $1.0 million, but over the past 8 years, the public service has increased by nearly 1,000 employees, raising the annual payroll by $13.5 million. Strengthening public expenditure management was a component of most reform programs, with several governments attempting to introduce performance or output budgeting. While macro-level and function expenditure (in particular wage bills) were addressed, realignment for sector service delivery through line agencies was not significantly addressed. It is also apparent that a voluntary retrenchment approach can undermine a reform agenda for public service improvement. This was seen in the FSM and Tonga, where many skilled and experienced public servants left the service. The first steps in improving allocative and expenditure efficiency were attempted. However, to analyze, plan, and budget for realignment requires time and skills; and significant meso-level policy improvements based on a longer-term view of a future public service focused on core activities. Some respondents suggested that where fiscal crisis was not as pressing, a more sequenced approach was needed—addressing key fiscal concerns sorted prior to large-scale downsizing and reorganization of the public service (this was not possible where the wage bill was beyond fiscal capacity). This occurred in Tonga, where public service reforms were delayed until after the main revenue raising measures were introduced and budget surpluses achieved.

37. Regulatory and legislative changes needed to improve government efficiency and market functions, including privatization efforts, were generally accomplished. However, while the legislation may be drafted and enacted in a relatively short time, its effectiveness depends on institutional capacity to implement; and ultimately, the behavioral response by markets, people, and interest groups. In the FSM, the private sector development program (PSDP) was designed to follow on from the PSRP, reinforcing the reforms while providing greater focus on private sector development. However, the 3-year delay in approval and implementation meant that reform momentum was lost. Upon eventual commencement, it met with resistance on issues such as land and foreign investment reforms. In the Cook Islands, three pieces of legislation were enacted in 1995/1996 (the Ministry of Finance and Economic Management Act, Public Expenditure Review Committee and Audit Act, and Public Service Act that became the pillars of the reform program. The first two of these were effective, given the strengths of the agencies concerned. However, the Public Service Act has had lesser effect because of the weaknesses in the PSC and difficulties in implementing a performance-based public service assessment system—a challenge experienced in other Pacific DMCs.

38. **Was adequate support provided to help implement reforms and build capacity?** Pacific DMCs recognized their capacity limitations in economic, financial, and development planning. Capacity development formed a critical component of the reform programs and related TA. Not surprisingly, the reform programs were more successful in Pacific DMCs where pre-reform capacity levels were stronger. Prior minimum capacity and effective capacity acquisition during the reform process was important to reform program performance. TA was seen by respondents as having high utility but tended to support policy advice and implementation, rather than organization-level capacity development, especially the how-to aspects of reform. Some immediate individual-level capacity improvements were seen in most countries, but needed structural capacity development efforts, targeting organizational and institutional levels, were limited. Better understanding is needed of to the wider needs for institutional capacity development, including the role of non-training support for processes and organizational change that underlie public sector management and reforms.

39. **Was reform ownership maintained during implementation?** A feature outside ADB influence that affected the ownership and commitment to reforms, and hence the manageability of the process, was the presence or absence of a strong pro-reform advocate or leader

(champion). In the Cook Islands, the Prime Minister championed reforms and led the program through its implementation period, helping to ensure that reform efforts continued. When he lost the premiership in 1999, the commitment to reform subsequently waned. In the RMI, the President was the champion of reform but passed away before implementation, and commitment waned thereafter. In Tonga, the minister of finance led the reform effort, which initially focused on revenue generation and expenditure controls; progress on the public sector and public enterprise reforms only really got under way because changing social circumstances (civil disturbances and public service strike) demanded political change, which led to pressures for wider reforms. Emphasis was placed on the need for a champion during implementation but over time it became evident that a wide support base, such as that achieved in Samoa, helps to broaden the support base and lower the risks and uncertainties to commitment for reforms. Overall, respondents in the Cook Islands, Tonga, and Vanuatu were in partial agreement that key pro-reform stakeholders are still able to support reforms today. Respondents in the FSM and RMI were also less confident of this.

E. Sustaining Reforms

40. **Were macroeconomic level outcomes realized and sustained?** Given reform process and progress to date, Appendix 3 summarizes current outcomes and impacts for each program. Reforms in the Cook Islands, Micronesia, and Vanuatu, in particular, focused on the immediate need to stabilize finances at the macroeconomic level. Key short-term reform outcomes were eventually achieved in most cases, but budget deficits have reemerged in the FSM; surpluses were achieved in the Cook Islands, Samoa, Tonga, and Vanuatu (from 2004) and PNG (from 2006). However, surpluses are currently declining or deficits reemerging in the context of the recent inflation events and the current global economic crisis, and thus sustainability of any gains from the reforms will be tested. Internal revenue efforts have improved in the Melanesian and Polynesian countries, where tax income is now the main source of revenue. Savings investment gaps remain unchanged, and trade deficits persist in Micronesia and Polynesia. Transfers via remittances have become more important in Samoa and Tonga (Appendix 2, Figure A2.7). Government expenditure as a proportion of GDP saw a small decline in most countries, but government wage bills after initial reductions have risen again in some cases (Appendix 2, Figure A2.9).

41. Management of external debt was an objective of program loans, particularly in the Cook Islands, FSM, and RMI. Despite the reduction in overall debt levels (PNG is an exception as its external debt is rising sharply as shown in Appendix 2, Figure A2.6), debt to ADB has risen and became high in the RMI (Appendix 2, Table A2.1). Furthermore, overall ADB net transfers to Pacific DMCs have been negative since 2002, a situation that will change for some countries given recent increases in project loans and Asian Development Fund (ADF) grants (Appendix 2, Figure A2.12 provides a breakdown of the lending portfolio structure).

42. In Micronesia, the program loans and TA helped the governments undertake (and finance) a major fiscal adjustment process that allowed the countries to avert what would have been a more serious fiscal crisis. A key contribution leveraged by the program loan was the establishment of trust funds for the FSM and RMI, which ensure that a proportion of Compact Funds are paid into a trust for future drawdown to finance government operations (Appendix 8 contains a summary of key trust fund issues). The sustainability of the reforms was put into doubt by the reemergence of fiscal deficits and reversals in the size of the public sector following significant rehiring after the fiscal and financial management program (FFMP) was completed, which was in part an issue of lack of follow-through by ADB on fiscal management reforms. Subsequent FSM government initiatives with non-ADB advisory assistance have helped to resolve some resurgent

state-level problems. Nevertheless, the reform programs were less than transformational, particularly in terms of public sector productivity and private sector growth.

43. The programs in the Cook Islands, Samoa, Tonga, and Vanuatu were better sustained at the macroeconomic level than elsewhere. In Samoa, the program addressed monetary policy including the introduction of market-based interest rates and other liberalization measures, which has increased the availability of finance for business. Progress is also being made in reforming and privatizing SOEs. In Tonga, progress in fiscal reforms was sound, but little happened on public sector reforms until the public service strike in 2005. Civil strife in 2006 also created greater urgency for reform. Progress is also now being made in reform of SOEs. Vanuatu's economy has been growing, and the Government remains committed to a reform path based on the Comprehensive Reform Program (CRP). Reforms to the National Bank of Vanuatu were particularly successful, including establishment of a rural finance outreach program. However, growth in rural areas significantly lags behind urban areas. While public expenditure management has improved, areas such as public wage and nonwage expenditure structure, public accounts, and audit need advancing.

44. **Were meso-level outcomes realized and sustained?** Programs supported reforms to improve public sector efficiency and enhance the environment for private sector development reforms but outcomes were modest. Reforms to ministries of finance were more successful. Recent public financial performance reports for the Cook Islands, Samoa, Tonga, and Vanuatu note that generally the budget preparation and economic planning processes are adequate, but there is room for improvement in timeliness and accuracy. There continues to be a shortage of local expertise in the area of high-quality economic policy advice in Pacific DMCs, and the TA that was provided with the reform loans did not sufficiently sustain post-program to progress improvements.

45. Needed complementary reform areas, such as reforms to PSCs, were weak or nonexistent, as were reforms of auditor general offices and other forms of ombudsmen positions. Reforms to line ministries and SOEs were slow to implement and in cases stalled. Cuts to public sector positions were reversed when the crisis was over, yet effective staff were lost as part of downsizing exercises. Some reexpansion was necessary where essential services and positions were eliminated during the reforms. Near-term downsizing of the public service was largely achieved (with some reversals), but improvements in the efficiency and effectiveness of the public service and in delivery of public services are not readily measurable. Based on mixed MDG achievements (Appendix 2, Table A2.2), coupled with rising expenditure on social services, the reform efforts to date have not brought about the expected higher productivity and efficiency in public service.

46. These mixed service delivery outcomes can in part be explained by the success or failure to build capacity as well as the patronage networks that can influence a reform process, including the success or failure to inform and include traditional leadership and patrons not necessarily opposed to reforms. In PNG, for example, traditions such as the *wantok* system of obligations constrain the anticipated adoption and acceptance of modern public sector behavior and standards (PNG Public Service Program [footnote 1]). The cultural clash between traditional tribal customs and modern institutions constrained reform progress. The domains of governance—including its conceptual, legal, regulatory, and institutional frameworks—were overlain on a society with no such traditions, which was then expected to embrace and adopt,

and ultimately to be assessed by, these new values and norms.[18] Changes in government and related political, traditional, and patron support have affected the sustainability of reforms in the FSM, RMI, and Solomon Islands. Nevertheless, attitudinal changes toward responsibility and accountability were evident in, for example, the Cook Islands and Samoa. Respondents in the RMI indicated that attitudinal changes among public servants and the public would make understanding and acceptance easier for future reform efforts, but there is still significant resistance by vested interests.[19]

47. In general, there is limited evidence of significant improvements in public service delivery, and modest change in the balance of economic activity between the public and private sectors and accelerated private sector growth. Such structural change takes time. Although they were relevant components of reform agendas, they need to be seen as medium- to longer-term activities—with greater recognition of the range of political, cultural, institutional capacity, and behavioral issues and needed support follow-through—to ensure that the reform process was sufficiently advanced. Without sufficiently considering these meso-level dimensions, the conduit between macro and micro outcomes, or allowing sufficient time needed for the reform process to advance, the risk and uncertainty and thus overall commitment to reforms was increased.

V. EVALUATION

48. The political economy framework identified factors that influenced the reform process and thus the relevance and effectiveness of ADB support for reforms as reflected in Pacific DMCs' commitment to reforms and related causes of risks and uncertainties. This section uses standard evaluation criteria that underlie the political economy framework to rate the development effectiveness of ADB support to reforms in the Pacific. Key subcriteria used to assess the relevance, effectiveness, efficiency, impact, and sustainability of reforms are summarized; followed by the overall rating for key criteria and the justification for the rating, highlighting key evidence at the outcome and impact level. Appendix 1 provides further details of the approach, rating system, ratings for individual country programs, and related scores.

A. Relevance

49. Overall, ADB support for Pacific DMC reforms is assessed as "highly relevant" to "relevant" in all countries except PNG.

50. **Sound economic diagnostic work helped to deepen understanding of constraints facing Pacific DMCs and identify relevant reform needs.** Prior TA diagnostic work identified or confirmed serious existing or looming fiscal constraints and their underlying causes in most countries. However, as the causes of problems were often numerous, with the exception of Samoa, the needed solutions were also broader than originally envisaged by governments. In Micronesia, analysis confirmed that Compact step-downs had left the governments facing fiscal deficits and that the solution needed to extend beyond governments' initial focus on expenditure

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[18] It has been argued that in PNG the requisite legal frameworks and institutions were in place for functional democratic governance, but "neither the constitution nor the rule of law are respected by the government and the bureaucracy, undermining their claim to legitimacy. [Consequently], the lack of respect for the institutions and structures of democracy… also make it difficult for the principal-agent relationship between the three main actors (society, government, bureaucracy) to be effective." Thorogood, N. 2008. Governance: a question of principled agents. *Pacific Economic Bulletin* 23 (1) p. 122. Available at: http://peb.anu.edu.au/pdf/PEB23-1-Thorogood.pdf

[19] An example of how traditional leaders, when consulted and informed, can support reforms is the case of land registration in Yap State, FSM. This was initially opposed by the Council of Chiefs, but through consultations in the design of the reform component under the PSDP, the Council subsequently supported a combination of traditional and modernized methods to land title management.

management such as wage cuts, to deeper cuts in public services and a reduction in SOEs, and revenue-side solutions such as tax reforms. The PSDP preparation was a timely response following the commitment at the Second FSM Economic Summit to accelerate private sector development, but by delaying approval, momentum to reform was diminished. Macroeconomic diagnostic work, including the preparation of a social accounting matrix and projections, provided the basis for estimating the needs for future transfers and the setting up of a trust fund of sufficient size to allow the FSM to self-finance government operations.

51. Among the Melanesian countries supported, Vanuatu's economic deterioration since 1989 and the Government's precarious financial situation, as well as weak government service delivery, made the CRP relevant and timely. Preparation of the CRP was initiated in February 1997 and the proposed CRP document was presented to a national summit in June 1997, which received bipartisan support. In PNG, the need for improved public sector performance had been a subject of analysis and discussions between ADB and the Government since early 1998. However, it was not until a reformist-minded government came to power in 1999 that the impetus to undertake significant public sector reforms was created. ADB provided TA to help develop a governance and public sector reform agenda, with the new Government recognizing that the country's weak economic performance was the result of poor governance.

52. Among the Polynesian countries, the Cook Islands was facing a severe fiscal crisis, which had been identified since 1992 through diagnostic work. However, this prospect was not made public until the economic crisis was upon the country. The program response was relevant in terms of the wide range of issues that needed to be addressed, including reducing the size of the public sector by over a half, but in particular the need for immediate correction of fiscal and external deficits. In Samoa, the reform program and program loan were not in reaction to a crisis, but a step of an ongoing reform process. TA provided to Tonga during the 1990s had addressed both fiscal concerns and the need to improve the efficiency of the public sector and SOEs, but the Government had not seen the need for any major reforms. The stagnant economy and a deteriorating fiscal and foreign exchange reserve position in the early 2000s encouraged the Government to address needed reforms including revenue-raising measures, achieving sustainable fiscal balances, strengthened public expenditure management, and improvements in public sector efficiency and resource use.

53. **Programs variably considered realistic steps and time needed for institutional capacity development, and reflected optimistic assumptions on private sector response.** In Micronesia, the reform agenda was relevant, but the design of the reforms carried some major assumptions on the private sector's capacity to respond to reforms. Similar assumptions were made in the FSM PSRP, but quick realization of the limited capacity of the private sector to respond by way of public sector reforms led to the PSDP. However, the PSDP's design addressed a wide range of enabling environment issues that are now seen as a necessary but not sufficient condition to stimulate private sector growth. The assumption that redundant civil servants, although compensated, could be absorbed by the private sector was unrealistic—given the small size and even temporarily contracting economies and significantly different skill and attitude sets needed by the private sector.

54. In Melanesia, the reform program loans in PNG and Solomon Islands emphasized reforming and reducing the size of the public sector with a view to shifting the balance of economic activity to the private sector. In PNG, the linkage between program components and the goal of increased private sector-led development was indirect. In Vanuatu, reform measures simultaneously covered wide-ranging economic management, public service, and private sector enabling environment issues. Private sector enabling environment issues were broadly relevant

(passage of the Foreign Investment Act (2001), a credit guarantee scheme and nongovernment organization support for channeling credit, and a national infrastructure plan), although their feasibility in terms of impacting in rural growth was untested.

55. Among the Polynesian countries supported, Samoa had a series of reforms under way prior to the FSRP, encompassing tax and tariff reforms; introduction of performance budgeting and devolution of financial management; new governance frameworks for public financial management, SOEs, and private corporations; a restructuring of government departments and devolution of responsibility for human resource management; strengthening of government departments and SOEs; health sector reforms; and transport, telecommunications, and postal sector reforms. Much of this was under implementation by 1996, and in 1997 the Government recognized more specific constraints to private sector investment. Thus, Samoa's reform response was targeted to specific issues constraining the private sector's access to capital and the crowding out effects and fiscal drain of SOEs. The PSRP in Tonga included measures to improve public investment and enterprises, but did not include specific measures targeted at private sector development.

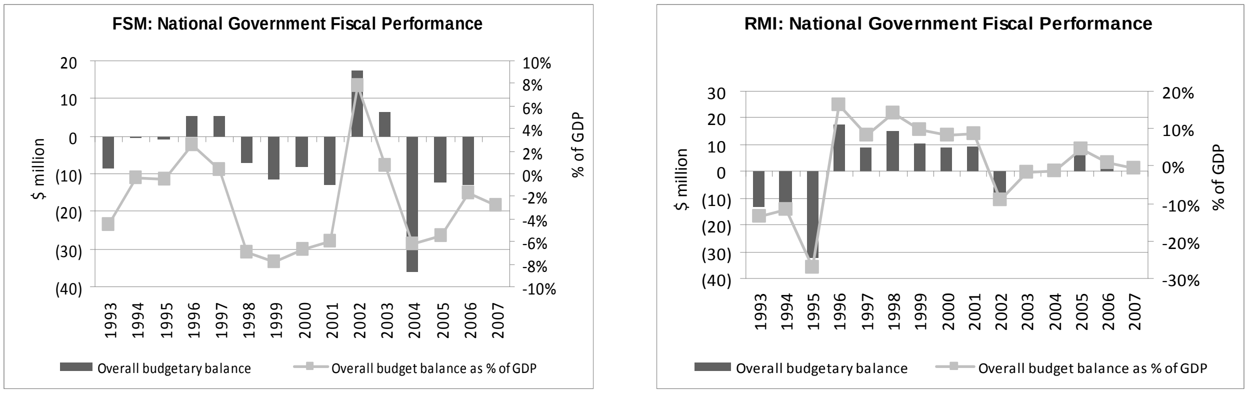
56. **ADB coordinated with key development partners but would have benefited from greater country leadership of the coordination process.** As reforms and programs were developed, the role of ADB and other development partners was discussed through consultative group meetings. In most cases, ADB chaired these meetings for the Cook Islands, FSM, RMI, and Vanuatu, which were attended by development partners including the World Bank and International Monetary Fund (including representation by the Pacific Financial Technical Assistance Center), European Union, Australian Agency for International Development, New Zealand, Japan, People's Republic of China, and others as parallel financiers of assistance both targeted and broad-based. In retrospect, the missing element of this approach was country leadership of donor coordination, as exemplified by cases of countries agreeing to receive seemingly contradictory assistance (e.g., the RMI's use of grant development funding from Taipei,China for reexpansion of its civil service in apparent contradiction to the objectives of the PSRP and FFMP).

B. Effectiveness in Achieving Reform Objectives

57. ADB assistance for support reforms is rated "less effective", with wide variation between "less effective" in some countries and substantial effectiveness in other countries.

58. **Programs often achieved short-term fiscal and financial outputs and outcomes but longer-term structural transformation is proving elusive.** The RMI PSRP and FFMP achieved most of their outputs and some major outcomes over the short to medium term. At the most critical juncture, during the FY1997 step-down in Compact transfers, the reforms facilitated the RMI's adjustment to new fiscal circumstances, and thus avoiding a more severe economic downturn. However, the reforms were less effective in transforming public sector management, a stated objective of the program. Wage bills were reduced and other expenditures better controlled, but gains were later reversed. Tax revenue did not increase sustainably and fiscal balances returned to deficit shortly after program completion. The FSM and RMI continue to depend on grants as the main source of government revenue. Some outputs were achieved in an effort to improve the environment for private sector growth, but expected increased growth has not materialized so far.

Figure 4: Fiscal Performance of FSM and RMI

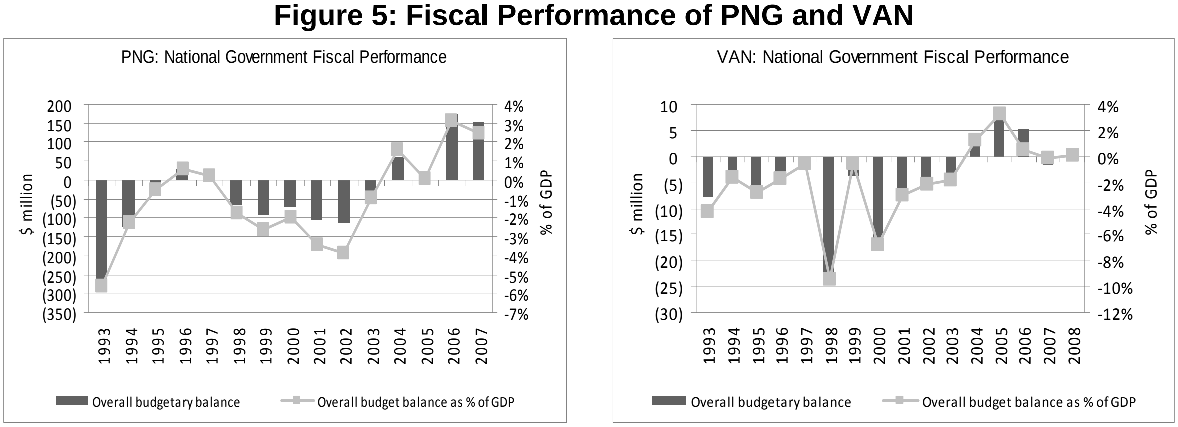


GDP = gross domestic product, FSM = Federated States of Micronesia, RMI = Republic of the Marshall Islands
Sources: Asian Development Bank Pacific Department and Economics and Research Department.

59. The FSM PSRP and PSDP achieved most of their key outputs, and the PSRP was effective in helping the FSM adjust and avert a major economic crisis in the late 1990s. As with the RMI, other outcomes for improved public service delivery and private sector performance have yet to be realized. Nevertheless, selected FSM states achieved significant outputs including establishing secured transactions systems using goods and chattels mortgaging, improved land registration systems, and strengthened development banking.

60. Vanuatu's CRP led to improvements in public financial management (Figure 5), in particular within the Ministry of Finance. The financial health of government financial institutions (GFIs) was restored over the medium term with the National Bank of Vanuatu recording a significant return to profitability and progressing beyond expected outcomes to develop a rural finance outreach program. In Solomon Islands, initial success in raising revenue and curtailing expenditure was overtaken by political unrest. PNG's program was consistent with the government reform agenda and ADB's country strategy, but its outcomes were less effective. The program supported legislative and regulatory frameworks, piloted an effective diagnostic tool to analyze and reformulate service delivery processes, and utilized existing government public sector reform implementation arrangements. However, its second tranche was not released because of increased uncertainty over commitment to reforms. Later, private sector participation contributed to further development of PNG's legal and regulatory framework.

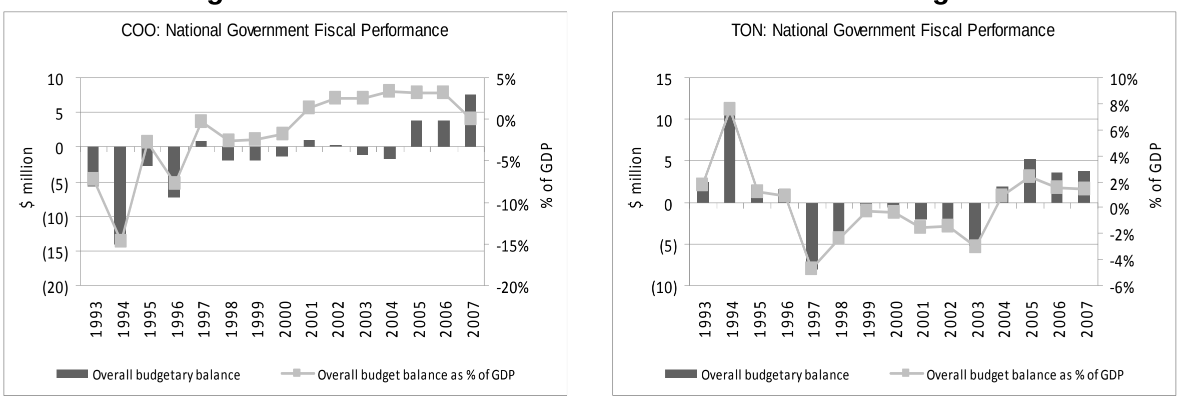
Figure 5: Fiscal Performance of PNG and VAN



GDP = gross domestic product, PNG = Papua New Guinea, VAN = Vanuatu.
Sources: Asian Development Bank Pacific Department and Economics and Research Department.

61. In the Cook Islands (Figure 6), the Economic Restructuring Program (ERP) played a major role in reducing the severity of the economic downturn in 1996–1998, returning the country to macroeconomic stability, and inducing relatively strong economic growth led by the private rather than public sector—particularly tourism, retail and wholesale trade, black pearl production (which has since declined significantly), and financial services. Agriculture and fisheries were also targeted for growth, but reforms in these areas were poorly implemented or ineffective, resulting in negative real sector growth. The downsizing of the public service and sale of government assets to the private sector enabled the Government to pull back from bankruptcy and move on to a renewed growth path. Cash liquidity was restored within 9 months. In Tonga, fiscal reforms were implemented, but little happened on public sector reforms until the public service strike in 2005 and the Government initiated civil service reforms in 2006. Civil strife in 2006 created a greater urgency for reform. Progress is also now being made in the reform of SOEs.

Figure 6: Fiscal Performance of Cook Islands and Tonga



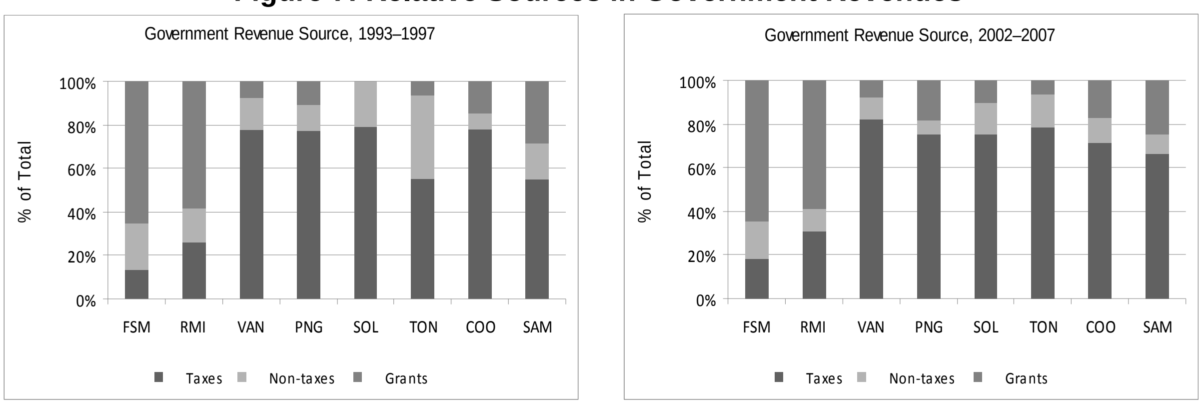
COO = Cook Islands, GDP = gross domestic product, TON = Tonga.
Sources: Asian Development Bank Pacific Department and Economics and Research Department.

62. In Samoa, the Government began fiscal reforms several years prior to the financial sector reforms support by ADB, so its fiscal situation had already improved (Appendix 2, Table A2.1). This enabled a more focused effort on remaining constraints in the financial sector. The Samoa Financial Sector Program Loan was generally effective in achieving the goals for financial sector reforms. Creating a level playing field for the sector before the SOEs were privatized helped to improve the business environment for the private sector. Elimination of fixed interest policies improved access of the private sector to finance. The supervisory role of the Central Bank of Samoa was extended beyond the National Provident Fund and Development Bank of Samoa to insurance companies, which contributed to improving the private sector business environment. However, privatization and corporatization reforms faced social and political issues that delayed implementation. Follow-on support led to the 2001 Companies Act, which simplified and reduced costs for structuring commercial activities in the private sector.[20] This was followed by the 2006 Companies Amendment Act, which was enacted in 2008; this exemplified the evolving nature of reforms and related legislation.

[20] The 2001 Companies Act was supported under ADB. 2000. *Report and Recommendation of the President to the Board of Directors: Proposed Loan and Technical Assistance Grant for the Small Business Development Project and a Proposed Equity Investment in a Venture Capital Fund in the Independent State of Samoa*. Manila (Loan 1785-SAM[SF], for $3.5 million, approved on 21 November).

63. **Program finance and counterpart funds were used to address the causes of immediate fiscal problems and initiate reduced dependence on external transfers, but progress has not met expectations in several countries.** In most cases, the size of the program loan was a broad estimate, and the amount was justified on the basis of the strength of the reform measures rather than a precisely known reform cost amount (with the exception of packages needed to effect retirement and reduction-in-force schemes and public debt settlements). Nevertheless, over the life of programs, loan and related counterpart funds were used for their intended reform purposes. This was evidenced in the use of funds for civil servant retrenchment and early retirement schemes needed to control public spending, costs of restructuring GFIs, retirement of governments' short-term commercial debt liabilities, temporary compensation for revenue losses arising from levy elimination and SOE privatization, and fiscal stabilization. Tonga kept loan proceeds for reform uses beyond the program loan's life because of delays in effecting some measures. The FSM and RMI loans and Compact funds were used to initiate the channeling of a rising portion of future Compact flows to trust funds for future financing of government operations. In the FSM, Compact "bump-up" funds (an increase in economic assistance from the United States during the 2-year renegotiation period of the Compact of Free Association between the RMI and the United States—see Appendix 7, Box A7.1 for further explanation), and loan proceeds were also used to establish escrow accounts to help repay program loans. The loans contributed to leveraging increased tax revenue in Samoa, Tonga, and Vanuatu (Figure 7). Despite establishing trust funds in the FSM and RMI, both countries remain dependent on external transfers from the United States. The program loans did not foresee the full cost of capacity development needs to realize strengthened public service delivery, or track the recurrent cost implications of restructured and reorganized line agencies in particular.

Figure 7: Relative Sources in Government Revenues



COO = Cook Islands, FSM = Federated States of Micronesia, PNG = Papua New Guinea, RMI = Republic of the Marshall Islands, SAM = Samoa, SOL = Solomon Islands, TON = Tonga, VAN = Vanuatu.
Sources: Asian Development Bank Pacific Department and Economics and Research Department.

64. **Institution capacity development outcomes in economic and public financial management and line agency public service delivery were partly realized or not realized.** Progress toward meeting expected outcomes in capacity development for economic and public financial management, improved public service delivery, and support for improving the private sector development enabling environment was mixed. Overall, ADB provided TA that helped to design and implement the reform programs, and this assistance often included capacity building components. However, outcomes tended to support individuals rather than having systemic institution-wide effects. Evaluation details are provided in Appendix 6.

C. Efficiency

65. Overall, ADB program support is rated "efficient", but was less so in some Melanesian and Micronesian countries because of delays and benefit deferral.

66. **Program loans were prepared to schedule but wavering commitment led to delays in meeting second tranche conditions.** The RMI PSRP was prepared on schedule but was not efficiently implemented because of political transitions that affected ownership, and skepticism over the assumption that the private sector would be able to absorb retrenched public servants. Thus, the PSRP completion was delayed by over 1 year and some outputs were not achieved. Implementation of the RMI FFMP was more straightforward, facilitated by (i) more easily achievable objectives than those under the PSRP, (ii) design and implementation of the program during the same political administration, and (iii) stronger demonstration of reforms by the RMI induced by the concurrent RMI-United States economic negotiations. The FSM PSRP was completed on time and subsequent PPERs rate its administration efficient. The context of working in a federation of four widely dispersed states with sometimes disparate perspectives, priorities, and performance poses challenges, but these were largely overcome with the collaboration of the Economic Management Policy Advisory Team (EMPAT) with the four states and public support.

67. In the Melanesia countries, the Vanuatu CRP processing was on track with bipartisan support until the 1998 general election delayed appraisal. Changed political circumstances had an adverse impact on the ability to address crises in a timely manner. Implementation and tranche releases were also delayed by weak institutional capacity to fulfill conditions and delayed Parliamentary sittings to consider the education master plan and other legislation. Legislative decisions were further delayed following reappointment of political advisers. Loan counterpart funds were sufficient to address immediate fiscal needs but a later decline in the fiscal situation meant some measures such as remuneration improvements could not be achieved. In PNG, the second tranche was not released, although 10 of the 11 tranche release conditions and 30 of 34 policy actions were fully complied with.

68. In Samoa, the implementation phase of the financial sector reforms was largely efficient. Based on the relative size of total assets of the SOEs, a focus on improving the performance of the top five SOEs would be a more efficient approach than focusing on the privatization of one SOE. In the Cook Islands, over 80% of the 124 ERP measures were implemented or substantially completed. Major reforms to downsize government staff by almost 60% and increase civil service productivity, and passage of key legislative reform measures were completed shortly before loan approval. In Tonga, progress on revenue generation and expenditure controls was good, led by the Ministry of Finance. However, progress on the public sector and public enterprise reforms only got under way because of changing social circumstances (civil disturbances and public service strike) demanding political change, which led to pressures for wider reforms. The reform impetus increased from 2006 with the appointment of a new Prime Minister, who took a lead role in this process. However, the public sector reform process has become intertwined with the political reform agenda, with the latter providing a sense of urgency for progress prior to the elections in 2010.

69. **Program loans implemented to address urgent fiscal problems were accomplished, but complementary institutional capacity development was partly addressed, delaying reform benefit realization.** The short-term benefits of program loans were relief of short- to medium-term fiscal constraints arising from, in particular, unaffordable wage bills, loss-making GFIs, and SOEs. In Micronesia, the RMI's PSRP and FFMP met their immediate short-term fiscal and financial purpose; and in both cases avoided more severe

short- to medium-run economic problems. However, expenditure realignments were not maintained over time and were reversed in 2003. The future fiscal costs of repaying unsustained fiscal benefits of the program loan (and underperforming projects), and reversal of the public wage bill without performance improvements, is a fiscal burden in itself. Overall, sustained improvements in the FSM's fiscal stability leveraged by the PSRP (albeit with reversals in some states) implies that the overall benefits to the FSM have outweighed the overall costs incurred by the reforms, but without gains in service efficiency and the efficiency gains from economic transformation. The PSDP was delayed. The FSM maintained overall fiscal balance improvements until 2004, while service improvements and expected economic transformation outcomes are yet to be realized.

70. In Melanesia, Vanuatu reduced the fiscal balance by cutting the wage bill, but gains were short-lived, with reemployment taking place. The introduction of VAT occurred largely as planned and became a major source of revenue for the Government. The National Bank of Vanuatu performance improvements resulted in the development of an asset that by 2007 had a value that exceeded the original loan value. The rise in FDI, especially for investment in tourism and real estate, suggests lowered costs to investors. However, the preparation of oversight and line agency corporate plans was not efficiently linked to aligned budgets, with expenditure efficiency gains yet to be realized.

71. The Polynesian programs also underestimated the time, cost, and capacity building needed to implement aspects of reforms. Implementation of the SOE reforms in Samoa was slower than expected, given the additional costs needed to prepare the target SOEs for privatization and social and political issues. In the Cook Islands, the reforms enabled government to pull back from bankruptcy, with cash liquidity restored within 9 months. Key legislation helped institutionalize the reform principles, and TA provided by ADB and New Zealand enhanced capacity to implement the program. The use of consultants and local skilled people was critical in managing and communicating the reform change process but fell short in building lasting capacity in policy making and planning. In Tonga, revenue raising measures were introduced and budget surpluses achieved from 2004. Respondents noted that this was partly due to curtailment of expenditure rather than improved expenditure management, and lacked devolvement of financial responsibility in other ministries with TA focused on the Ministry of Finance. Capacity outside Tonga's Ministry of Finance is relatively weak and inhibits plans for more devolution.

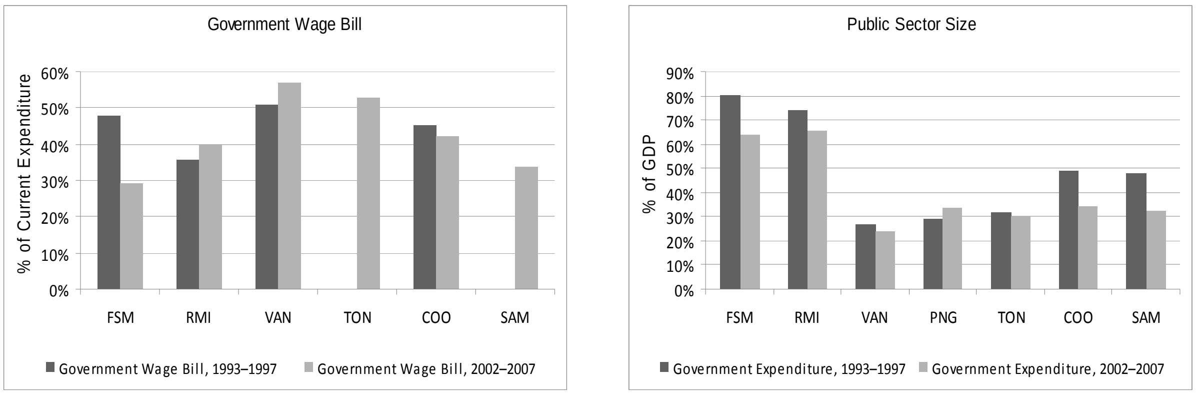
D. Impact of Outcomes

72. Overall, the impact of reforms supported by ADB is rated "modest", with lower impact in the Melanesian and Micronesian countries, although some impact indicators are higher in Vanuatu, and higher impact in Polynesian countries. Impact on economic management was better than public service delivery and private sector development.

73. **A key impact of programs was reduced short-term fiscal stress that was achieved in most countries, but later reversed in some cases, and social costs partly mitigated.** The PSRP accomplished its key objective of helping the RMI avert a major fiscal and economic crisis in the short term—with the program helping to reverse the budget deficit position in 1996 and achieve a surplus from 1996 to 2001, which the FFMP further consolidated. The overall balance remains relatively stable, and the deficit stood at $1 million in 2007. The RMI's PSRP reduction-in-force component impacted deeply, socially, and economically, particularly the PSRP. Its retrenched workers were not employed by the private sector and the hiring freeze was reversed in 2000. By 2007, the wage bill exceeded pre-reform days—the main reason

behind the Government's original reform agenda—and the Government remains the largest employer (Figure 8). Increased revenue efforts were limited to border duties, while privatization of shipping services occurred but were later reversed, and short-term debt management improvements in other SOEs such as Air Marshall Islands were achieved but not sustained. The Compact Trust Fund has been established as planned but the reliance on external assistance is still substantial, and the size of the public sector remains large.

Figure 8: Public Employment and Public Sector Size



COO = Cook Islands, FSM = Federated States of Micronesia, GDP = gross domestic product, PNG = Papua New Guinea, RMI = Republic of the Marshall Islands, SAM = Samoa, TON = Tonga, VAN = Vanuatu.
Sources: Asian Development Bank Pacific Department and Economics and Research Department, Pacific countries websites, and IMF Article IV Consultation Country Reports.

74. The FSM PSRP also accomplished its key objective of helping the FSM to avert a fiscal and economic crisis over the medium term, as reflected in the relatively stable overall budget balance as a percentage of GDP from 1998 to 2001, but the deficit rose again in 2004. In the FSM, rehiring has occurred but public service numbers have not returned to pre-reform levels. In the case of both the FSM and RMI, the main safety valve for retrenched workers who were not rehired was out-migration. The impact of efforts to strengthen public sector productivity and effectiveness in the FSM and RMI was very limited, and ratings on the effectiveness of public sector management by ADB country performance assessments and the World Bank (governance indicators) suggest that this remains an area of weakness.

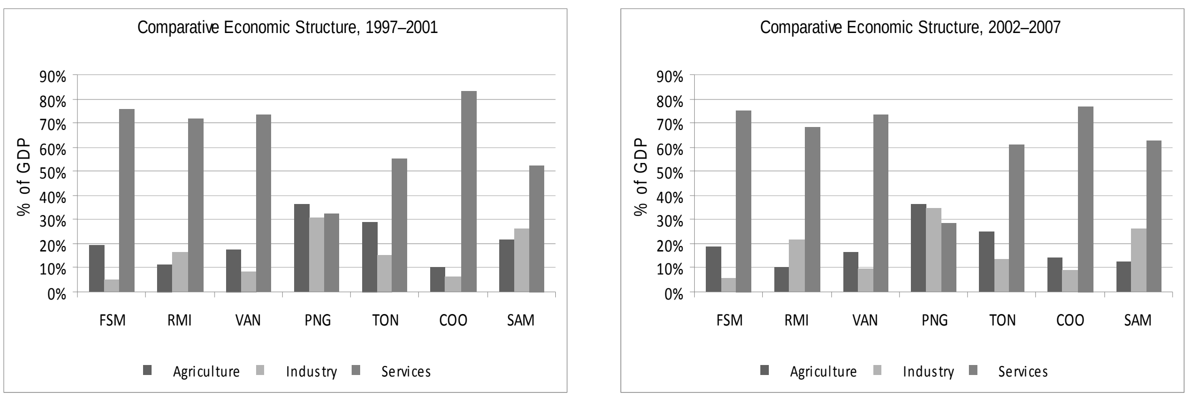
75. In the Melanesian countries, the Vanuatu CRP had the expected impact of lowering the budget deficit, with improvement in the fiscal position beginning in 2001, which continued to 2007. In Vanuatu, of the 500 retrenched workers, again many later returned to public service or emigrated. In PNG, strong commodity prices led to increased government revenues, but this has not been translated into nonmineral sector growth and poverty reduction programs.[21] In Polynesia, Tonga achieved a reversal of budget deficits to a surplus in 2004. The Cook Islands had persistent budget deficits from 1993 to 1996, but the situation was positive between 2000 and 2007 when the surplus declined again. The Cook Islands had a similar experience as Micronesia, with many qualified retirees moving to New Zealand for employment; this further

[21] The IMF 2006 Article IV Report noted that PNG was enjoying its fourth year of recovery and macroeconomic stability, which was supported by broadly sound economic policies and record mineral revenue flows. However, the IMF 2007 Article IV Report noted that progress on the structural reform agenda, designed to improve growth prospects and the investment climate, had stalled in 2007, particularly with respect to public sector reform. The report recommended the Government should accelerate progress on structural reform "without which the outlook for more rapid nonmineral sector growth, job creation and poverty alleviation is dim" (IMF. 2007. *Papua New Guinea Staff Report for 2006 Article IV Consultations*. Washington, DC. Available: http://www.imf.org/external/pubs/ft/scr/2007/cr07111.pdf).

undermined the downsized public service. The small service sector-oriented economies that depended on the government sector prior to reforms had limited opportunity for absorbing former public servants. Generally, policies that increase total government expenditure on services have not significantly progressed household access to services. The reduction in the size of government may have reduced crowding out effects in some economic sectors, but efforts to stimulate the private sector through institutions and incentive improvements have yielded a modest overall contribution.

76. **Economic transformation and private sector growth expectations did not occur in Micronesia, and private sector-driven growth was modest and sector-specific elsewhere.** On the whole, the RMI PSRP, FFMP, and related reforms have not resulted in significant and sustained economic growth. In the FSM, the predominantly service and retail sector-based private sector responded weakly to the crowding out effects of a large public sector with retrenched public sector workers emigrating rather than finding local employment and business alternatives. However, despite relevant efforts through the PSDP to improve the private sector enabling environment, this has so far proved insufficient to incentivize a private sector response. This suggests that there are other binding constraints. Neither the PSRP nor the PSDP led to the objective of transforming the economy (Figure 9).

Figure 9: Economic Structure



COO = Cook Islands, FSM = Federated States of Micronesia, GDP = gross domestic product, PNG = Papua New Guinea, RMI = Republic of the Marshall Islands, SAM = Samoa, TON = Tonga, VAN = Vanuatu.
Sources of basic data: Asian Development Bank Pacific Department and Economics and Research Department.

77. Exacerbated by sharp swings in PNG's GDP, the expected impact of improved living standards has yet to materialize, which inevitably has a negative effect on incomes and public spending on services. Benefits from trade have not yet trickled down to disadvantaged groups either. In Vanuatu, the turnaround in the trade deficit was slow to materialize, with erratic performance in copra, beef, and timber exports, but a more steady increase in tourism beginning in 2003. A reduction in the savings–investment gap and increased FDI inflows played an increasing role in financing economic activity, with much lower dependency on external debt and transfers. However, this aggregate improvement has not been inclusive of rural areas, many of which remain isolated from the cash economy. The creation of the Vanuatu Investment Promotions Authority had a role in boosting investor confidence. FDI remains relatively small in all countries (Appendix 2, Table A2.1 and Figure A2.11), but tourism has emerged as a key growth driver in the Cook Islands, Samoa, and Tonga, and is important in Vanuatu.

78. In Polynesia, the investment climate has improved and there were some key success stories, but constraints remain such as small markets, lack of resources, high cost of electricity,

and port services. In Tonga, the public sector was not dominant in the economy at the time of the program loan's commencement. While the private sector continues to be the driver, this is largely from services and private consumption, in part fuelled by growth in remittances rather than major productive sectors. FDI also plays a key and rising role in financing economic activity. In the Cook Islands, government participation in economic activity reduced from a peak of 56% in 1994 to 32% in 2007. However, sharp swings in GDP and inflation have contributed to unpredictable growth. Furthermore, trade surpluses and service exports are largely within the tourism sector, which is the main driver of economic growth. Thus, while the program aimed to restructure the entire economy, improvements are largely reflected in a reduction in public ownership of existing tourism services rather economic diversification.

79. In Samoa, improved growth rates in 1997–2007 cannot be directly attributed to the ADB program support for financial sector reforms, but liberalization of interest rates and some progress on SOE reforms led to improved access to finance and market entry following SOE reforms. Liberalization of the telecommunications sector, for example, and the significant improvement in services following the entry of a foreign private operator, are likely to accelerate privatization and the introduction of modern business practice and commercial discipline to the private sector. Importantly, though, the recent failures of internationally recognized banks have highlighted the value of the supervisory oversight role of the Central Bank of Samoa in maintaining a sustainable and stable financial sector.

E. Sustainability of Results

80. Overall, ADB assistance is rated "less likely sustainable overall" but ranging from "most likely sustainable" in Samoa's financial sector reforms to "less likely sustainable" in the FSM, PNG, and RMI.

81. Of the six objectives for the RMI's PSRP, few have been sustained. A number of reform outputs were met, but others have effectively been reversed, in particular the cap on civil service size, merging of some ministries, and privatization of some services (such as outer island shipping). There is a recognition of the need to reform, but the RMI's capacity to reform has not generally improved, and the limited institutional capacity to plan and manage reform processes strongly suggest that the RMI will again have to embark on another difficult restructuring process. While the reforms accomplished some results, some of the most important reform measures that would have had longer-term impacts on the future of the public sector and economy were not sustained, including continued confusion over the role of the public sector. Similarly, the sustainability of the FSM's reforms was put in doubt by the reemergence of fiscal deficits, reversals in public sector downsizing, and stalled implementation of previously agreed measures. The amended Compact, other aid flows, and continued debate over the role of the state contributed to this. The reforms raised awareness on the importance of prudent economic management and improved capacity among local economic managers. However, institutional development was not a major, tangible outcome of the reforms.

82. The programs in the Polynesian countries were better sustained at the macroeconomic level than elsewhere. For example, in the Cook Islands, the reform program, and particularly the downsizing of the public service and sale of government assets to the private sector, enabled the Government to pull back from bankruptcy and move on to a renewed growth path. Cash liquidity was restored within 9 months. In Samoa, the program facilitated financial sector reforms, including the introduction of market-based interest rates and other liberalization measures, has increased availability of finance for business. Progress is also being made in reforming and privatizing SOEs. The reforms are sustainable if the institutional capacity

constraints are addressed and the funding arrangements for the Central Bank of Samoa securities are formalized. However, the social and political issues that have resulted in resistance to the privatization and corporatization reforms need to be addressed if long-term sustainability of the reforms is to be achieved. In Tonga, progress in fiscal reforms was sound, but little happened on public sector reforms until the public service strike in 2005 and the reforms in 2006. Civil strife in 2006 created greater urgency for reform, and progress is now being made in reform of SOEs. It is also important to maintain the momentum of tax revenue collection while containing government spending priorities. A sound public wage structure remains important to reduce fiscal vulnerability.

83. In the context of the current global financial and economic crisis, current accounts and debt sustainability (Table 2) need close monitoring, especially as some weakly performing Pacific DMCs (FSM, PNG, RMI, and Vanuatu) do not have access to ADF grants (footnote 6). This also highlights the need to ensure that past reform and development efforts are brought to fruition to ensure economies have the capacity to grow and finance needed reform and development investments.

Table 2: Pacific DMC Current Account, Debt, and Country Performance Indicators

Country	Total External Debt Outstanding as % of GDP	External Debt Service as % of "Exports and Services"	ADB Loans as % of Total External Debt Outstanding	Compact Trust Fund (period end, $ million)	Average Country Perform-ance Ratings[a]
Cook Islands	19.1	—	45.4		
Marshall Islands	63.0	17.1	67.3	106.7	2.7
Federated States of Micronesia	27.5	6.4	69.2	118.2	2.8
Papua New Guinea	15.6	3.5	40.1		3.1
Samoa	39.4	4.1	43.4		4.1
Solomon Islands	30.3	2.9	38.1		3.0
Tonga	29.8	11.0	56.5		3.3
Vanuatu	16.6	1.7	74.1		3.2

ADB = Asian Development Bank, GDP = gross domestic product, na = not available, DMC = developing member country.
Note: Most recent data—2006, 2007, and 2008.
[a] Sourced from the Annual Report on the 2006 Country Performance Assessment Exercise. The ratings are an average for ratings of economic management, structural policies, policies for social inclusion and equity and public sector governance.
Sources: International Monetary Fund Article IV Consultation country reports and Asian Development Bank.

84. Overall, ADB support for reforms to all rated Pacific DMCs is “partly successful”. Program loans in the Cook Islands and Samoa performed successfully. Results were overall “partly successful” elsewhere. SES ratings for the Vanuatu CRP improved slightly compared with PCR ratings, while in Micronesia SES ratings were comparable or lowered owing to a decline in the results sustainability in fiscal reforms.

VI. CONCLUSIONS, LESSONS IDENTIFIED, AND RECOMMENDATIONS

85. This SES addressed three key questions: Did ADB support relevant reform needs with feasible designs? Was ADB’s approach to supporting reforms in the Pacific and use of the program loan modality and TA effective? How can ADB improve its support to Pacific DMCs for reforms? The SES concludes that the broad thrust of ADB support for public sector reforms in the Pacific continue to be relevant a decade later, even in the context of current global economic conditions. However, effectiveness was limited by overambitious objectives and designs that needed to better reflect government ownership—a challenge in itself given the

political trade-offs and choices, and inevitable short-term costs. Lending and nonlending operational designs underestimated reform complexities and did not reflect the medium- to longer-term processes needed, especially in the context of Pacific DMCs' institutional capacity constraints to implement complex economic, organizational, and governance changes. Overambitious assumptions on structural adjustment toward private sector growth were made. When ADB reform measures went beyond what was desired by the Pacific DMC governments, reforms were less successful or failed. ADB support was more successful where the aims of ADB reforms aligned themselves with the needs and capacity of governments—the sector-specific reform for Samoa's financial sector was the most effective approach. The task of improving public service efficiency while cutting current expenditure was underestimated and in cases further weakened limited capacity. The outcome of the reform programs was also partly determined by the position on the reforms taken by traditional and newer patronage systems within the Pacific DMC, which can act as a positive or opposing force for reform, yet need to be understood for reforms to be effective. Fiscal reforms were more effective but sequenced, follow-on support was not sustained, which increased the risk and uncertainty to reform commitment.

A. Key Findings

86. **Reform efforts occurred in a challenging small island economy context.** The Pacific island countries face inherent constraints caused by their isolation and distance from global markets, small production base, small domestic consumer markets and diseconomies of scale, and relatively recent status as independent nations, with many bound to varying degrees by cultural norms that can clash with modernity. In the 1990s, several Pacific DMCs were facing immediate or looming macroeconomic problems caused by natural disasters, poor economic management, or shocks arising from changes in the terms of transfers from major bilateral partners. ADB provided a generally relevant response to requests for assistance with technical support leading to program loans to finance the costs of reform measures, which were consistent with national development challenges and priorities, and the policies and strategies of ADB and other major development partners.

87. **Program designs were often ambitious, raising risks and uncertainties to commitment.** While programs were embedded in governments' recognition to reform, designs often went beyond the original reform agenda and institutional capacity to manage wide-ranging measures. The time frame for design, while generally carried out in a consultative manner, was reduced and regarded as insufficient—partly out of urgency. In some cases, even in their more complex form, reforms were led by a single advocate, so support for reforms was narrow rather than reflecting wider ownership. This led to delays and even policy reversals when the patron (or champion) for needed change was no longer in authority. These stakeholder swings and uncertain institutional capacity to carry out wider ranging and complex reforms effectively explain why the commitment to reforms wavered in several cases or failed to materialize more deeply.

88. **Fiscal and sector focused reforms were more effective but needed continuous follow-through, including through investment projects.** The most complex reforms and less successful programs simultaneously covered substantial issues from economic management to public service delivery to private sector development. Economic management reforms such as fiscal consolidation often achieved short- to medium-term targets because of expenditure cuts in areas such as the government wage bill, government agency downsizing, and other expenditure restraints. However, progress in improving fiscal performance was not always sustained. This could have been accomplished through ADB's shift in its lending portfolio from program loans to

projects by applying needed improvements in areas such as public financial management and performance-based budgeting. Broad-based public service improvements and private sector development, while linked to fiscal management reforms, were less successful as the necessary sector-level capacity development was not systematically provided. In several cases, the simultaneous cutting of budgets and personnel while attempting to improve service delivery was contradictory in the short term, especially where the most qualified people were retired or made redundant. Service delivery improvement is a complex task, and required time and inputs tailored to each country.

89. **ADB financing needed to effect reforms has in cases such as the RMI led to high debt levels to ADB that needed close monitoring.** The total debt levels in Pacific DMCs have fallen, in part because of reform effort. However, in FSM, RMI, and Vanuatu, a high proportion of external debt is to ADB. This does not present a risk of an overall debt concern in Vanuatu. In the FSM, internal arrangements to service ADB debt helped to reduce general fund allocations for debt payments.[22] However, in the RMI, external debt payments from the general fund have reached about 6% of GDP, of which 68% is to ADB, which contradicts the principles of prudent fiscal management. Past reform and development efforts needed follow-up to ensure that desired effects were realized in a better manner, including the capacity to develop, grow, and repay needed reform and development investments.

90. **Optimistic assumptions on structural adjustment were made, risking commitment.** Attempts to address a wide range of structural reform issues involved making major assumptions that proved erroneous, placing reform programs at risk. Several reform programs assumed that redundant civil servants could be absorbed into the country's private sector, and that a smaller public sector would be compensated by a larger private sector through structural transformation. SOE reform outcomes have gradually progressed in some countries but often needed more intense facilitation to advance various forms of privatization. While private sector response in services is occurring in some countries, facilitating adjustment and change takes time and requires a well thought-out, targeted, stepwise, and flexible set of actions and support, which needs to be reflected in the appropriate combined use of programs, TA, and investments.

91. **Program loan designs and use of conditionality did not reflect the medium to longer term nature of reforms.** Reforms supported involved addressing fundamental public sector and structural inefficiencies. Generally, the program loan modality was appropriate given that most reforms involved costs to effect structural and functional improvements. However, designs are needed to consider in a better manner the significant investments in continuing political commitment, capacity development, service delivery improvements, and private sector development. Use of conditionality should provide the basis for a reform road map rather than serve as an administrative function for compliance. The budget support role of program loans can be justified for the one-off costs of reform and to supplement and leverage an investment program (whether in capacity or public goods and services), but the purpose must be clear, effectively linked to reforms and development, and reflect a better understanding of the costs incurred and benefits realized from reforms over time.

92. **Technical assistance needed greater focus and better design to focus on the how-to aspects of managing and implementing reform.** TA was a relevant and integral part of supporting reforms, often providing high quality and timely advice on the design and

[22] The FSM, on the advice of EMPAT TA advisers, established escrow funds using savings from government downsizing as part of the PSRP as well as a portion of the Compact bump-up funds to ensure payments could be met. Thus, it is less of a concern.

implementation of reforms, but greater emphasis was needed on institution-wide skill and knowledge on how to reform. Diagnostic work tended to focus on the economic and financial aspects, given the urgency of the situation, with implementation often handled by TA. This left capacity development focusing on individual counterparts rather than a systemic institutional level. Pacific DMCs have learned much about reforms processes, and attitudinal changes are evident. To reduce commitment risks arising from weak institutional capacity, more attention was needed on how to carry out specific aspects of reforms, especially in the weaker institutions such as line agencies and for SOE reform, and how to retain trained personnel, and managing wider civil service reform. This includes the need for institutional diagnostics to clarify roles and responsibilities and expenditure efficiency and effectiveness. TA has contributed to strengthening public financial management in finance agencies, but this has not led to timely audit and routine public accounts committee hearings, which are crucial to furthering accountability and facilitating the transaction cost reduction for support (through, for example, programmatic approaches).

93. **Regular monitoring and dialogue during and after support for a reform process is crucial.** During the design and implementation stages of program loans, dialogue and supervision was carried out intermittently by PARD staff, but was largely fulfilled by short- and medium-term TA consultants. However, post-program follow-up tended to taper off, especially when it was evident the Melanesian and Polynesian countries would not receive follow-on program loan support (no further program loans were approved after 2002 until 2008), raising two issues. First, irrespective of whether follow-on reform-related operations are planned, continual monitoring and dialogue are needed to assess the need for further ADB response in the event reform progress is wavering or new issues and circumstances are arising. Monitoring and dialogue may be specific to the program or carried out in the context of routine exercises such as the country performance assessment process (for ADF recipients), which covers macroeconomic management, structural policies, policies for social inclusion and equity, and governance issues. Second, as the reform progresses and new situations and needs arise, an appropriate response is needed.

94. **Reform requires continuity of support with a medium-term perspective.** Given the substantial reform agenda challenges yet expressed need by Pacific DMCs to advance reform agendas, continuity in policy reform and institutional development assistance is important. This requires careful sequencing of crosscutting macroeconomic (fiscal and financial management) and meso-level (such as civil service and PSCs) issues, with separate targeted support for sector-level reform and development. Consideration is needed for the use of hybrid program support, based on reforms achieved over a period of time or a combination of policy and investment where such a modality is more relevant and feasible, entailing a medium-term (minimum of 5 years) reform framework with strong monitoring and real-time evaluation mechanisms and capacity in place. A continuous and sequenced approach will also help to reduce the inevitably high overhead costs of preparing support to Pacific DMCs with limited borrowing capacity.

95. Table 3 summarizes key factors that determine and detract from success.

Table 3: Strengths, Weaknesses, Opportunities, and Risks to Reform in the Pacific

Item	Factors Contributing to the Desired Result	Factors Detracting from the Desired Result
Factors internal to ADB program designs	**Strengths to build on** Economic diagnostic work was sound Program loan designs supported key elements of government reform agendas Successful fiscal reform led to deficit reversals over the short to medium term in most countries (not always sustained) Some evidence of improving private sector performance in service sectors, and niche markets in agriculture Public financial management systems in finance agencies were leveraged through several programs SOE reforms progressed over time as part of some programs in some countries Financial sector reforms were substantially advanced in Samoa, improving access to capital Finance and economic oversight agency capacity progressed in some cases Attitudinal change as a result of reform process—varied, but strong in some countries (e.g., the Cook Islands and fiscal responsibility)	**Weaknesses to address** Reform agendas were too wide-ranging, extending beyond government agendas, had too many conditions, and were inadequately sequenced in the face of limited capacity Fiscal consolidation deteriorated or reversed in cases Some programs had contradictions (budget cuts and service improvements) in part because the most qualified personal were retired or made redundant PSC line agency institutional capacity was insufficiently assessed and addressed Traditional leadership and patronage systems (for and against reforms) were insufficiently considered Program targets for introducing new approaches to public resource management (performance-based budgeting) were optimistic Broad improvements to the private sector enabling environment were a necessary but not sufficient condition for improving private sector growth Optimistic assumptions on structural transformation to private sector driven economies Progress in audit and public accounts committee functionality was limited
Factors external to ADB program designs	**Opportunities to take** Reform agendas have evolved but are still relevant a decade later, deserving systematic revisiting as a way to reopen dialogue Traditional leadership and newer pro-reform patronage networks can be used as a positive force for change In some cases, the reform agendas are now more feasible because of changed political and economic circumstances In cases where individual countries are progressing in public and private sector development, there is opportunity for using local expertise to advise and train within the subregional context. CPAs and World Bank governance and doing business indices provide an opportunity for combining required assessments with reform monitoring and dialogue	**Risks and Uncertainties to manage** Commitment to reforms as a collective choice can change as a result of government interest and must be closely monitored Commitment to reforms as a collective choice can change because of weak institutional capacity to implement reforms and must be closely monitored for preemptive action Pacific DMCs are highly susceptible to global downturns, with regular economic monitoring being closely linked to ongoing reform monitoring Anti-reform patronage networks

ADB = Asian Development Bank, CPA = country performance assessment, PSC = public service commission, SOE = state-owned enterprise.
Source: Independent Evaluation Department compilation.

B. Lessons Identified

96. To better inform program loan designs that reflect reform processes and to reflect success factors identified in Table 3, it is necessary to have a detailed prior political economy assessment anchored in a thorough understanding of the economic and social conditions and priority needs leading up to the design. The following lessons identified are organized in line with a reform process and political economy factors.

1. Getting Reforms on the Agenda

97. **Reform efforts embedded in governments' reform agendas were more effective.** In general, ADB programs were more successful when the aims of ADB-supported reforms aligned themselves with the reform agendas of Pacific DMC governments. When ADB support reform measures went beyond the original agendas of Pacific DMC governments, reforms were less successful or failed. Sufficient understanding of the reasons and timing for progressing reforms is needed. For example, there was inertia to reform within Tonga during the 1990s as the view of the leadership was that there was no need for reforms. The changed public mood from 2003, and particularly from 2006, gave the reform process impetus from the new leadership. Thus, financial crisis may be a trigger in some countries for reforms to gain momentum, but social change and new leadership can also trigger reform.

98. **Wide public and intergovernmental consultation on the reform agenda facilitated better understanding of the expected benefits and costs and their timing.** Sufficient public and intergovernmental consultations on reform measures and their implications were needed prior to reform program implementation. Where this was done, it helped to create a better understanding of the reform process and the expected costs and benefits. Two contrasting examples were the FSM PSRP and the RMI PSRP, with the former taking greater steps to inform stakeholders on the rationale for reform measures. Furthermore, deep reform measures such as those made in the RMI PSRP needed better understanding on where cuts can be made with low impact on service delivery and overall reduced social and economic impact.

99. **Lack of agreement on the role of government and core public functions and services in the reform agenda led to later wavering on reform commitments in areas such as SOE reform and some privatized functions.** In some countries, such as the FSM and RMI, there is continued debate over the role of the state, which complicated the reform process, particularly the reduction-in-force component. Because of this continued confusion over what the Government's most important functions are, the PSRP intended to reduce unnecessary roles and expenditure in government, but made excessive cuts in some social sectors, while leaving some loss-making SOEs intact. Better upfront determination and agreement was needed of required core government functions and services. This process was attempted during the reform planning and consultative exercises in several countries in the lead-up to the reforms, but apparently insufficiently (perhaps because of limited time). Without adequately analyzing and determining what functions and services are more or less critical, downsizing exercises lacked strategic underpinning and ran the risk of eliminating areas that are essential to the effective operation of the government. PSCs needed to have a key role in determining the core roles and functions of the public service, and in designing a restructuring or rightsizing plan; where PSCs were weak, specific TA support was needed. Greater consultation between the Government and the private sector was needed to ensure that priorities were more appropriate, assumptions more accurate, and responses more predictable.

2. Managing Complexity

100. **In small, close-knit developing island economies where the public sector serves as the main source of economic activity, the politics of reform can be complicated that needed close tracking.** It is likely that the outcome of the reform programs has been at least partly determined by the position taken by vested interests within the Pacific DMCs on the reforms. Patronage networks and their power bases, which may be for and against reforms, are an important factor and need to be considered in the political economy analysis to the extent

possible. The reform planning and design process also needed to consider election cycles and timing, electorate expectations, and awareness levels.

101. **Identifying and supporting pro-reform leaders was important but involving the wider support base can help to manage risks and uncertainties to reform commitment.** Having a single agency to lead the design and approve reforms is simpler, but a wide understanding is needed and it cannot be assumed that subsidiary agencies will automatically support reforms. The FSM reforms were well discussed publicly during the economic summits, public consultations, and through media dissemination. This ensured that there was public awareness and understanding of the difficult reform measures to be undertaken. Not all reform programs in the Pacific followed this approach. In Tonga, limited public consultation led to partial understanding outside the Ministry of Finance of the need for reforms. In the Cook Islands, the reform program was promoted to the nation through stakeholder meetings as the only option for addressing the country's financial and economic problems. Thus, while the public was not consulted on the reform design, their support was nevertheless gained. Each oversight and line agency and other public bodies must be given sufficient attention for their role and reform and development needs.

102. **Political transitions required more intense reengagement in policy dialogue by ADB and flexibility.** Reforms in the Cook Islands, RMI, and Solomon Islands highlight the importance of champions, but support needs broad endorsement so that the reforms are not derailed if the leadership changes. The RMI's reform period took place over three government administrations, which affected ownership and commitment. The reform champion President Amata Kabua passed away at the outset of the PSRP, and implementation of the program was left to a new, less convinced administration. This resulted in delays and non-implementation of some measures. The imperatives and timing of the reforms may have made this difficult, but reform programs need to be designed and managed in a way that they can adjust to unforeseen changes in political leadership. This requires a period of more intense reengagement by ADB and use of flexible approaches (e.g., a series of single tranche operations).

103. **Pursuing moderate, stepwise reforms in sequence was more realistic, especially where institutional capacity was limited.** To the extent that many of the reform programs surveyed were generated by short-term crises, ADB reform programs suffered from overreach and thus were not fully aligned with client Pacific DMC expectations. Short-term fiscal and financial outputs and outcomes were achieved but longer-term structural transformation proved elusive. Where Pacific DMCs were seeking deeper reform, this needed to be seen as an evolving process with more moderate, midcourse, and ongoing reform measures. The scale and scope of a reform effort is linked with risk and uncertainty—smaller stepwise reforms are easier to plan and implement and carry less uncertainty than major reforms. The reform process under the RMI PSRP had short-term costs for many people. However, not implementing reforms, the counterfactual situation, would have resulted in more severe social and economic consequences, which may still occur given the reemergence of fiscal stress. In hindsight, a better approach in the RMI would have been to initiate earlier more moderate, sequenced changes (versus waiting until a near-crisis occurred), with more continuous support and advice against agreed fiscal performance targets over the medium term. This lesson is important as the RMI currently faces the same set of circumstances. Tonga's reforms also show that a measured and longer-term approach is needed and that learning from past experience to do things better in the future is needed.

104. The Cook Islands ERP and the FSM's PSRP and PSDP were ambitious programs that aimed to transform the economic landscape. While the key objective of fiscal adjustment was

achieved, the broader aspirations of creating a far more efficient and productive public sector and shifting the balance of economic power to the private sector remain elusive. Designing more modest, stepwise, and flexible reform programs are a safer and more realistic approach. In the case of the Cook Islands, the crisis generated undue haste which led to inadequate assessment of alternatives and inadequately prepared legislation. In Tonga, the timing of public sector reform slipped, in effect taking a more gradualist approach (i.e., job review and classification first while continuing the hiring freeze).

105. **Reforms that introduce modern systems needed to better reflect historical, social, and cultural context.** Some reforms were designed and implemented without sufficient consideration of some of the underlying historical, social, and cultural factors that heavily influence modern decision making. A more informed design process would have resulted in less ambitious and more realistic programs. Understanding cultural systems, including patronage systems supporting and opposing reforms, is important where societies are heavily fragmented along ethnic, tribal, and linguistic lines. The domains of modern governance systems—including its conceptual, legal, regulatory, and institutional frameworks—were overlain on societies with no such traditions, but which were then expected to embrace and adopt these new values and norms of modern systems.

3. Endorsing Reforms

106. **Further understanding by policy makers and lawmakers at the time of legislation passage was needed to help legislators understand their purpose in the context of the overall reform effort.** Early consultations and ownership building are important, but the preparation and debate of legislation and regulations needs to involve sufficient technical explanation and debate among policy makers and lawmakers to ensure that passage is based on sufficient understanding of policy changes and new laws and regulations.

107. **Reform targets were needed, but their basis needed to be better rationalized, explained, and understood.** The only quantified measure that the Government highlighted and commonly discussed in public during the RMI's PSRP was the 1,484 target for the reduction-in-force. A core set of fiscal, economic, and social management and progress measures can help the consultative processes to help raise capacity on both the supply and demand sides. More effective consultation and mutual understanding on a common set of indicators can facilitate understanding, and goal congruence and alignment, among key stakeholders.

108. **Excessive use of conditions was not an effective approach to managing the reform process.** Conditions in the form of agreed policy measures, steps, and triggers guide reform implementation and help reformers to manage the process.[23] They should be used to monitor and manage, not to control the reform process. How reformers and stakeholders respond and maintain a reform effort is largely in their hands. ADB's continuous effective dialogue during and after the program period is necessary to help sustain results and inform the next steps for aiding further reform as needed. As a signatory to the Paris Declaration on Aid Effectiveness, ADB is committed to basing conditions as far as possible on a partner's (client's) national development strategy or its subsequent reviews.[24]

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[23] ADB. 2007. *Policy-Based Lending: Emerging Practices in Supporting Reforms in Developing Member Countries. Special Evaluation Study Update.* Manila.
[24] ADB. 2005. *Paris Declaration on Aid Effectiveness*. Manila.

4. Implementing Reforms

109. **Program loan periods did not provide sufficient time to develop capacity and institutionalize reforms.** The capacity to plan, execute, monitor, and evaluate ongoing reform measures internally required a longer-term approach. The capacity to plan and implement reforms needed to be systematically institutionalized, with incentives to change identified and promoted. Some effort to institutionalize better economic policy analysis and planning was made in several countries, but the outcomes of this were short of expectations. In several countries, more assistance over a longer period was needed to build how-to capacity to implement reforms. An emphasis on TA models that facilitated advice provision, capacity acquisition, and organizational change over a sufficient period of time and at an absorbable rate by institutions would have likely yielded better results.

110. **More effective TA designs and management were needed.** More effective approaches to TA were needed to facilitate and support reform implementation. The Policy Advisory Team TA to the RMI was intended to provide the Government with policy analysis and advice, as well as to build policy analysis capacity. It provided the former but failed to do the latter, in part because the TA did not gain the confidence of the leadership. In the Cook Islands, a combination of international consultants and national consultants was effective, with national consultants providing local understanding of institutions and culture; returned nationals were also used. A better balance between advisory services, implementation, and capacity development, as well as organization change management was needed in designs. Under any circumstances, ADB is responsible for effective design and delivery of TA, including the effective management of consultants.

111. **Better monitoring and evaluation of the outcomes and development impact of reforms against targets was needed to inform stakeholders of progress.** Reforms were rarely a linear process, involving a change process that needs to adjust as required to achieve the intended outcomes. Numerous issues arose that, while needing to maintain the overall direction, would have benefited from midcourse corrections because of changing circumstances and realizations, with implications for the adherence to some conditions and detailed policy actions. To identify issues early and to assess alternatives required regular monitoring and real-time evaluation of output, outcome, and impact indicators, with follow-through after the life of the program to ensure an appropriate post-program response where needed.

112. **Voluntary retirement can be costly at a time of institutional reform.** Voluntary redundancies were made in several public sector reform programs, and this resulted in the loss of many talented and productive civil servants in several countries. While voluntary redundancies were seen as more politically feasible, the costs in terms of lost productivity were probably significant.

5. Sustaining Reforms

113. **Economic and public service management reforms initiated management and attitudinal changes toward accountability but fell short of reaching a critical mass in many cases.** One of the shortcomings identified during the reforms was the shortage of local counterparts with economic planning, management, and analysis skills, which was especially severe in Micronesia. This problem persists today. A process was needed through which young and talented students are regularly selected for training in economic policy and management and related fields to generate a steady flow of trained economic analysts and managers. There was a noticeable attitudinal change, such as development of a culture of fiscal responsibility in

the Cook Islands, but this needs to be backed up with a critical mass of skills in both the executive and legislative branches of government.

114. **Assumptions on private sector response needed to be more realistic, with regular review.** A key assumption and identified risk of the PSRP was that retrenched public servants would be able to transition to private sector employment with some advice, training, and financial support. While financial support was provided to retrenched workers, no advice and training was provided and the majority was not able to transition into the private sector. Furthermore, the expected structural shifts in economies away from dominant public sectors have either not happened or have been slower than expected to materialize.

115. **Reform is a medium to longer term process that needed continuous support, to better manage ownership and institutional capacity factors that affect the risks to reform commitment.** Continuity in support for reforms was needed to maintain gains and address weaknesses. This could have been achieved by better linking the gains from the first program loan to follow-on loans (e.g., the RMI FFMP and FSM PSDP), as well as follow-on investment projects and related advisory and capacity development TA. The mix of TA, program lending, or sector investment support needed further strategic consideration and planning to more effectively facilitate reforms and change.

C. Recommendations

116. There is a significant unfinished reform agenda in Pacific DMCs that needs continued support. The medium-term nature of the reform process points to the need for reform road maps that consider the political economy of reform and related reform processes, risks, and uncertainties. Thus, a change is needed in the way support for reforms are designed and implemented to raise the relevance and effectiveness of support for reforms through program, project, and TA operations. This needs to start with a detailed stocktaking and dialogue on the status of the government's reform agenda and current stakeholder views for each Pacific DMC in economic management, public goods and service delivery, and private sector development. Operational designs need to ensure continuity of support in line with needs and absorptive capacity. It also suggests the need for focusing support on strategic areas in line with ADB's areas of comparative institutional advantage and committing to follow-through over the medium term. Emerging practices in policy-based lending can be applied in conjunction with better designed TA and investment operations that advance reforms where needed and justified. The following are key strategic recommendations for consideration by ADB Management in formulating future assistance programs.

1. Enhance ownership by stocktaking and assessing the current state of reforms progress and stakeholder support in Pacific DMCs as a basis for considering further support

117. Review unfinished government economic management reform agenda items and current stakeholder views. The reemergence of fiscal and external imbalances and modest progress in public service delivery outcomes highlight the partial introduction and continuing limited capacity in key areas of economic and public service management. Better understanding is needed of the implementation status, support for, and advancement of the following reform areas: (i) links between policies, plans, and the budget including support for extension of performance-based budgeting from ministries/departments of finance to line agencies; (ii) economic and public financial management mechanisms; and (iii) public accountability functions including internal audit, external audit, public accounts committee, expenditure, and revenue review committees.

118. Strengthen ADB's regular policy dialogue and economic monitoring, including external debt, holding wider public consultations to assess the current status of support and to enhance understanding of reform issues. To improve ADB's relevance and response, better follow-through is needed on reforms, including continuous and regular monitoring and dialogue supported by ADB staff with expertise or through hired external experts. Monitoring and dialogue may be specific to the program or carried out in the context of routine exercises, such as the country performance assessment process. To increase public awareness of reform and development issues, there is a need to involve traditional leaders and other stakeholders, increase transparency on reform and development issues, and hold wide public consultations at opportune times. This is also expected to advance domestic and wider governance agendas.

2. Ensure continuity in ADB support for government reform priorities through a mix of program, project, and TA operations—harmonized with other development partners, and in line with ADB areas of comparative institutional advantage

119. Increase the continuity and predictability of support for economic management reforms and development with sequenced, medium-term, and where feasible single-tranche operations against country-owned targets. Given the scope and challenge of reforms but expressed need by Pacific DMCs to advance reform agendas, continuity in policy reform and institutional development assistance is a priority. Future support requires better sequencing of reform steps in the context of a medium-term fiscal framework.

120. Adopt harmonized programmatic approaches to reforms and development over the medium term. Consider the use of hybrid program support based on *ex-ante* reform achieved, or a combination of policy and investment where such a modality is more relevant and feasible—entailing a medium-term (minimum of 5 years) reform framework with strong monitoring and real-time evaluation mechanisms and capacity in place. Use budget-aligned, programmatic support to leverage expenditure efficiency, and allocative efficiency improvements. Promote country-led development partner coordination in line with emerging country capacity to lead dialogue on their articulated agendas and in line with areas of ADB comparative institutional advantage and capacity to support reforms effectively. Explore options for supporting the provision of regional public goods and services to realize scale economies.

121. Adopt prior conditionality approaches. Conditions need to reflect clear policy measures, steps, and triggers in the context of output targets as the basis for effective implementation of reform measures. Use of conditions is unavoidable in the sense that agreement is needed about policy changes, whether financed retroactively or beforehand. As increasing use is made of cluster or single-tranche loans for supporting medium-term reform agendas, the distinction and application between prior and post-action conditions will need to be clarified in ADB-supported policy-based loans. In the event that the full costs of reform cannot be identified *ex-ante*, more flexible program designs are needed against progressively understood targets through monitoring of medium-term fiscal frameworks, and use of prior conditions that reflect key targets and indicators. Further developing fiduciary obligation and government spending discipline is a useful basis on which to proceed, but in the context of wider policy reform and institutional development efforts.

3. Enhance operations focus on priority removable binding constraints, and address economic and public resource management separately from sector goods and service delivery improvements or in sequence

122. Address reforms and development in well-defined operations that focus on macroeconomic and major crosscutting issues, either separately from sector level reforms and development or sequentially. This will reduce operational design complexity, improve Pacific DMC oversight and sector agency absorptive capacity, and facilitate ADB and other development partner focus on issues. Ensure support is consistent with assessed country capacity.

123. Ensure that Pacific DMCs and ADB have up-to-date and consistent expectations on reform direction and progress through strategies, business plans, and operational documents. Use regular dialogue and wider consultations to align ADB's and client Pacific DMCs' expectations and direction on reforms to ensure that ADB's expectations do not outpace host country government expectations.

4. Focus TA on the institutional capacity development needed to support reforms through more effective designs

124. TA support is an integral part of facilitating effecting reforms. Using a capacity acquisition (demand-driven) approach that emphasizes 'how-to' TA, coordinate TA with development partners considering relative partner approaches and options; and expand use of pooled, flexible, and clustered TA approaches that focus on medium-term institutional capacity development, including change management. TA design and implementation needs to distinguish between and balance advisory, implementation support, and capacity development objectives; and be reflected accordingly in improved TA designs and management—for which ADB is ultimately responsible. A focus is needed on how to carry out specific aspects of reforms, especially in weaker institutions such as line agencies and for SOE reform, and how to retain trained personnel, and managing wider civil service reform. This includes the need for institutional diagnostics to clarify roles and responsibilities, and expenditure efficiency and effectiveness.

125. Target capacity-specific public service delivery reform and development support at selected sectors. Avoid broad-based, umbrella approaches to public service delivery improvement, with further reform efforts being focused and sector-specific. Some next steps include (i) greater focus on performance, accountability, and responsibility; (ii) prioritize development of effective PSCs with needed qualifications, experience, and clear roles, responsibilities, and authority; (iii) selective focus on line agencies in coordination with development partners and ADB's core competencies; and (iv) assess alternative service delivery approaches, including outsourcing to achieve local efficiencies and even regional scale economies; and the use of nongovernment organizations and other agencies for outreach programs to rural areas. Coordinate TA with development partners using pooled TA with the use of experienced, proven Pacific-based resource persons.

5. Target removable constraints to private sector development in a better manner, and facilitate provision of industry and constraint-specific TA support

126. Given the mixed performance of broad-based approaches to supporting private sector development, a targeted approach is needed. Target critical private sector enabling environment

constraints, including advancing financial sector reforms; and provide industry-specific expertise and expert support in areas that improve access to capital and other resources. To accomplish this, target and prioritize support toward proven successful enabling environment interventions for private sector development, such as secured lending and lowering the transaction costs and barriers to foreign investment. Build on individual successes in country-specific financial sector reforms, such as use of market-based interest rates, liberalization and strengthened regulation, and support reforms of GFIs with an emphasis on exchanging success stories among Pacific DMCs. Related capacity development should focus on capacity acquisition in specialist and industry-specific areas rather than broad-based advice. Use industry and topic-specific expertise with a more focused support of the privatization process to advance SOE reforms. Where initial commitment to SOE reform in feasible forms is evident, there is need to target advisory support to focus on how-to type TA sufficient to complete the reform process for individual SOEs.

SUMMARY EVALUATION APPROACH

1. To assess the relevance and effectiveness of the support of the Asian Development Bank (ADB) for public sector reforms in the Pacific, the special evaluation study (SES) focused on three key questions:

(i) **Did ADB support relevant reform needs?** The SES examined whether the reform programs identified and addressed priority constraints to economic growth and welfare improvements.

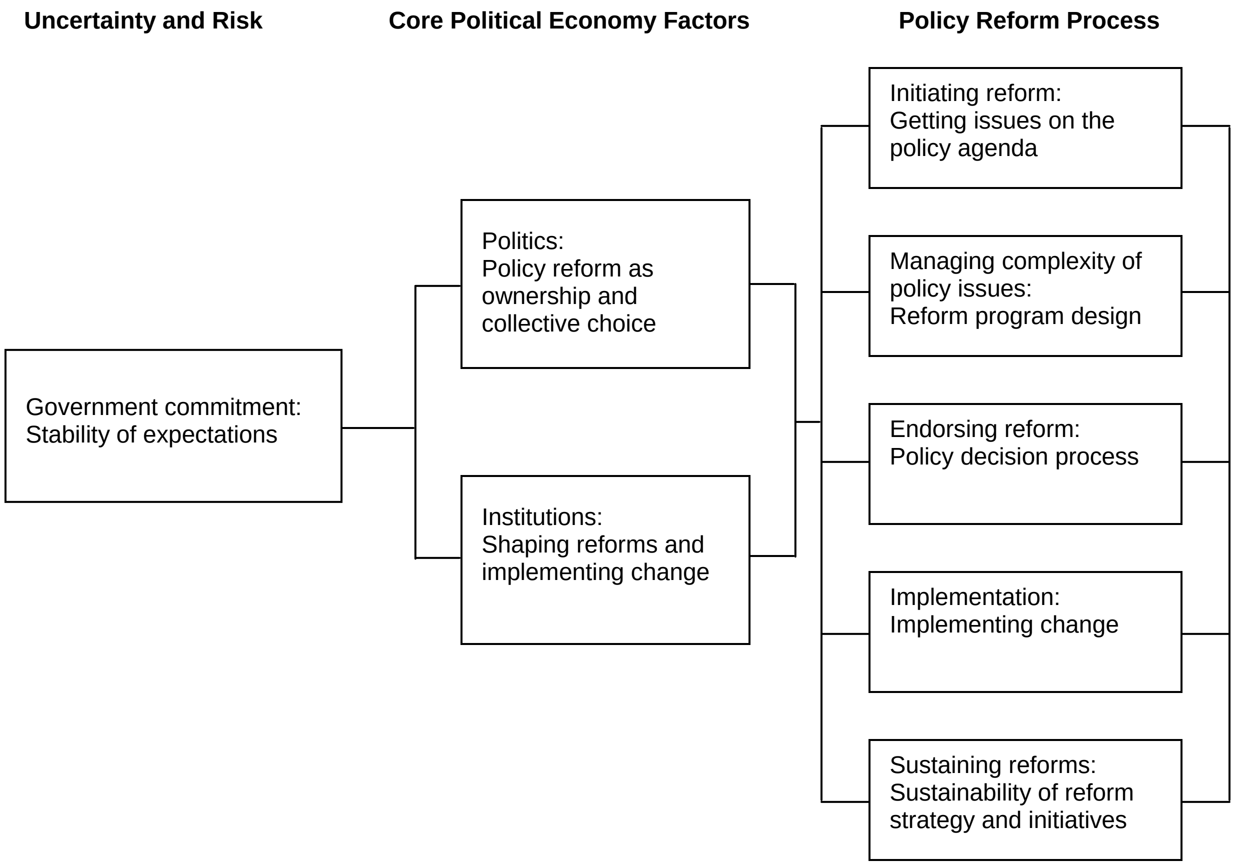
(ii) **Was ADB's approach to supporting reforms in the Pacific and use of the program loan modality and technical assistance feasible?** To assess the feasibility of ADB's support for reforms among Pacific developing member countries (DMCs), the SES assessed the suitability of the program loan modality and its application to designs. In considering designs and implementation, the SES adopted an analytical framework for assessing the political economy of reforms in Pacific DMCs.

(iii) **How can ADB improve its support to Pacific DMCs for reforms?** Based on findings on the relevance and effectiveness of past support for reforms and related technical assistance (TA) projects, and the analysis of conditions and loan tranche releases for programs, the SES identified strengths to build on, weaknesses to address, opportunities to capitalize on, and risks to manage. This included an examination of the program loan modality compared with other forms of assistance such as policy dialogue, TA support through sector-specific channels, and collaborative work with other development partners.

2. Phase I of the SES adopted a meta-evaluation approach, involving a desk review of existing Pacific Department documents and other reports, and review of the 10 program completion reports and 4 program performance evaluation reports. The SES augmented existing work by further desk review and trend analysis of studies and data using the program loan impact and outcomes statements and indicators to assess prior and present conditions, as well as to update program loan results.

3. Phase II of the SES involved in-country validation and assessments of the political economy of reforms, with a view to understanding factors that influenced formulation of the reform agenda, reform complexity and its management, achievement of reforms, institutional capacity to effect reforms, and reform sustainability. The political economy framework is shown in Figure A1. Interviews were held with key stakeholders involved in the design and implementation process, including officials, politicians, members of civil society, and officials of other international development partners in Pacific DMCs to draw on their experience. In addition to reviews of the program loans, the evaluation assesses TA projects carried out in support of reforms as part of a broad assessment of capacity development.

Figure A1: Political Economy of Policy Reform



Source: Abonyi, G. 2005. Economics and Research Department Working Paper 70: *Policy Reform in Viet Nam and the Asian Development Bank's State-Owned Enterprise Reform and Corporate Governance Program Loan*. Manila. Available: http://www.adb.org/Documents/ERD/Working_Papers/WP070.pdf.

4. The strategic assessment of ADB assistance addressed the following questions:

(i) **Reform context.** What were key country conditions, trends, and constraints in Pacific DMCs? Were ADB reforms consistent with the country's overall development strategy? Were reforms consistent with ADB's country and/or regional assistance strategy?

(ii) **Selectivity.** Did the reforms address key constraints within contextual circumstances? Did ADB operations consider government priorities, reform initiatives, and reform ownership? How did ADB complement the activities of other development partners supporting similar issues?

(iii) **Sequencing and continuity.** Were ADB operations sequenced, taking into consideration country development strategies, the Government's reform agenda and process, capacity constraints, and other influences (e.g., major development partner assistance)? Was there sufficient continuity in ADB's country assistance to maximize the development effectiveness of operations?

5. To assess ADB's contributions to development results, the following issues and questions were addressed:

(i) **Formulation, analytical work, TA, and policy dialogue.** Was ADB's economic and sector work in Pacific DMCs valid, did result in a focus on key constraints, and how did findings and dialogue feed into the design of reform programs? Was ADB equipped to handle policy dialogue? Was adequate reform ownership built? Was ADB's assistance formulated and designed to address relevant objectives? Was the program loan the right modality and what was the justification of its selection?

(ii) **Outputs and outcomes.** What were the key outputs and outcomes of ADB's reform support in Pacific DMCs and how do they compare to envisaged policy and institutional objectives? What and how did political economy factors affect the achievement of program objectives? Have public sector reforms leveraged private sector development where envisaged? Was conditionality effective? How did exogenous factors influence outcomes (positively and negatively)? Has ADB assistance helped to build capacity? How does the standard of ADB assistance compare with other similar development partners? What approaches to providing advice and capacity development have worked or otherwise?

(iii) **Sustainability.** Has the borrower continued to commit to the reform objectives? What sociopolitical and macroeconomic factors have positively or negatively affected reform sustainability? Were there any major policy reversals? Did institutions have the capacity to support reform implementation? What is the likelihood that these outputs and outcomes can be sustained, considering fiscal, political, and social conditions? To what extent were successful ADB-supported reforms disseminated and replicated to other Pacific DMCs?

(iv) **Impact on institutions and development.** What was ADB's contribution to improving national and institutional capacity and at what level? Did ADB reform efforts contribute to improving the role and effectiveness of civil society capacity? What was ADB's role compared with that of other development partners? To what extent has ADB contributed to changes in development conditions? How has ADB contributed to sustainable economic growth, human development and good governance, and to ADB's thematic priorities, in particular capacity development and gender development? Were expectations met?

6. Based on the strategic and development effectiveness assessments, ADB support to reforms was evaluated using relevance, effectiveness, efficiency, institutional development, impact, and sustainability criteria; and the key criteria used. As the evaluation includes an assessment of the impact several years after programs loan were completed, the rating system combines the rating criteria guidelines from the *Guidelines for Preparing Performance Evaluations of Public Sector Operations* with the bottom-up weighting system used on the *Guidelines for Preparation of Country Assistance Program Evaluation Reports*.[1] Key evaluation criteria used were as follows (Table A1.1):

(i) **Relevance:** validity of diagnosis; focus on critical constraints to development and consideration of conditions in the country and scope for reform; consistency with the policy and institutional reforms of the government and reform ownership, supportive of essential coordination with other key development partners; and design feasibility.

(ii) **Effectiveness:** extent to which key reforms continued to be supported and institutions were sufficiently strengthened to implement reforms; extent to which factors favoring or detracting from influencing the outcome were managed.

[1] ADB. 2006. *Guidelines for Preparing Performance Evaluations for Public Sector Operations*. Manila; and ADB. 2006. *Guidelines for the Preparation of Country Assistance Program Evaluation Reports*. Manila.

(iii) **Efficiency:** extent to which assistance was formulated and implemented in a cost-effective, timely, and efficient manner; extent to which ADB assistance efficiently leveraged realization of outputs and outcomes; effective use of conditionality; public expenditures made adequate provision for meeting the government's share of costs; and socioeconomic benefits compared to costs.

(iv) **Sustainability:** extent to which intended outcomes and impacts have been sustained, extent of lasting improvement of government institutional capacity for formulation and implementation of policies and the management of sector programs and investments, contribution to improving civil society and nongovernment organization capacity to support reforms, and contribution to private sector development.

(v) **Impact:** extent to which anticipated and unanticipated impacts identified were realized, extent to which the program contributed to realization of the government's reform program and met expectations.

Table A1.1: Rating System for ADB Support for Reforms in the Pacific

Evaluation Criterion	**Description**	**Rating**	**Score** (points)
Relevance	Relevance refers to the alignment of ADB's sector strategy and program with evolving development challenges and priorities of the developing member country.	Highly Relevant Relevant Partly Relevant Irrelevant	3 2 1 0
Effectiveness	Effectiveness refers to the extent to which the outcomes of the assistance program were achieved.	Highly Effective Effective Less Effective Ineffective	6 4 2 0
Efficiency	Efficiency describes the extent to which ADB's resources were used to achieve results.	Highly Efficient Efficient Less Efficient Inefficient	3 2 1 0
Sustainability	Sustainability focuses on the likelihood that the achievement of results will be sustained into the future and will prove resilient to identified risks. Sustainability has fiscal, social, political economy, and environmental dimensions.	Most Likely Likely Less Likely Unlikely	6 4 2 0
Impact	Impact refers to ADB's contribution to long-term changes in development conditions, including attainment of the Millennium Development Goals, goals of the ADB assistance program, and improved institutional capacity.	High Substantial Modest Negligible	6 4 2 0
Performance of the Assistance Program	The overall performance rating of the assistance program is derived by summing the scores given to each evaluation criterion for each program (relevance, effectiveness, efficiency, sustainability, and impact), and deriving the simple average of the total rating for each completed program loan.	Highly Successful Successful Partly Successful Unsuccessful	≥20 >15 and <20 >10 and ≤15 ≤10

ADB = Asian Development Bank.
Sources: ADB. 2006. *Guidelines for Preparing Performance Evaluations for Public Sector Operations*. Manila; and ADB. 2006. *Guidelines for the Preparation of Country Assistance Program Evaluation Reports*. Manila.

7. Based on the evaluation of ADB's assistance program and overall results and development effectiveness, the implications for ADB's future assistance for supporting reforms in Pacific DMCs were assessed for lessons learned, future better practices, and strategic considerations.

Table A1.2: Evaluation Ratings

Evaluation Source		Evaluation Criteria										Overall	
		Relevance		Effectiveness		Efficiency		Sustainability		Impact			
1466-COO: Economic Restructuring Program	PCR											S	
	PPER	HR		E		Ef		L		Moderate		S	
	SES	**R**	2	**E**	4	**Ef**	2	**L**	4	**Sb**	4	**S**	16
1520-FSM: Public Sector Reform Program	PCR											S	
	PPER	HR		E		Ef		L		NE		S	
	SES	**HR**	3	**E**	4	**Ef**	2	**LL**	2	**M**	2	**PS**	13
1873-FSM: Private Sector Development Program (Program Loan)	**SES**	**R**	2	**LE**	2	**LEf**	1	not rated		not rated		not rated	
1874-FSM: Private Sector Development Program (Project Loan)	**SES**	**R**	2	**LE**	2	**LEf**	1	not rated		not rated		not rated	
1828/29-RMI: Fiscal and Financial Management Program	PCR	R		LE		LEf		LL				PS	
	SES	**R**	2	**LE**	2	**Ef**	2	**LL**	2	**M**	2	**US**	10
1513-RMI: Public Sector Reform Program	PCR											S	
	PPER	R		LE		LEf		U		Moderate		PS	
	SES	**R**	2	**LE**	2	**LEf**	1	**LL**	2	**M**	2	**US**	9
1608-SAM: Financial Sector Program	PCR	HR		E		Ef		L				S	
	SES	**HR**	3	**E**	4	**Ef**	2	**ML**	6	**Sb**	4	**S**	19
1624-VAN: Comprehensive Reform Program	PCR	R		E		Ef		LL				PS	
	SES	**R**	2	**E**	4	**Ef**	2	**L**	4	**M**	2	**PS**	14
1627/28-SOL: Public Sector Reform Program Loan	PCR	R		Inv		Ef		U				US	
	SES	not rated		not rated		not rated		not rated		not rated		not rated	
1875-PNG: Public Service Program	PCR	HR		LE		LEf		U				PS	
	PPER	PR		LE		LEf		LL		NE		PS	
	SES	PR	1	LE	2	LEf	1	LL	2	M	2	US	8
1904-TON: Economic and Public Sector Reform Program	PCR	R		LE		Ef		LL		NE		PS	
	SES	**R**	2	**LE**	2	**Ef**	2	**L**	4	**Sb**	4	**PS**	14
Overall	**SES**	**R**	2	**LE**	3	**Ef**	2	**LL**	3	**M**	3	**PS**	13

E = effective, Ef = efficient, HE = highly effective, HR = highly relevant, HS = highly successful, I = irrelevant, Int = inefficient, Inv = ineffective, L = likely, LE = less effective, LEf = less efficient, LL = less likely, M = modest, ML = most likely, N = negligible, NA = not available, NE = not explicitly indicated, PR = partly relevant, PS = partly successful, R = relevant, S = successful, Sb = substantial, U = Unlikely, US = unsuccessful.
Source: Asian Development Bank.

Table A1.3: List of Approved Loans in Public Sector Reform in the Pacific (1996–2002)

Loan No.		Title	Approved Amount ($ million)	Approval Date	Completion Date	Rating PCR	Rating PPER
1466(SF)	COO	Economic Restructuring Program	5.000	26-Sep-96	18-Mar-98	S	S
1513(SF)	RMI	Public Sector Reform Program	12.000	30-Jan-97	28-Jun-00	S	PS
1520(SF)	FSM	Public Sector Reform Program	18.000	29-Apr-97	14-Jun-99	S	S
1608(SF)	SAM	Financial Sector Program	7.500	19-Feb-98	16-Nov-01	S	-
1624(SF)	VAN	Comprehensive Reform Program	20.000	16-Jul-98	14-Dec-00	PS	-
1627(SF)	SOL	Public Sector Reform - Program Loan	25.000	27-Aug-98	27-Oct-00	US	-
1628(SF)	SOL	Public Sector Reform Program- TA Loan for Privatization of State-Owned Enterprises	1.000	27-Aug-98	27-Oct-00	US	-
1661	NAU	Fiscal and Financial Reform Program	5.000	16-Dec-98	02-Oct-02	US	-
1828	RMI	Fiscal and Financial Management Program	4.000	7-Jun-01	30-Oct-03	PS	-
1829(SF)	RMI	Fiscal and Financial Management Program	8.000	7-Jun-01	30-Oct-03	PS	-
1873(SF)	FSM	Private Sector Development Program (Program Loan)	5.000	12-Dec-01	07-Feb-07	-	-
1874(SF)	FSM	Private Sector Development Program (Project Loan)	8.017	12-Dec-01	ongoing	-	-
1875	PNG	Public Service Program	70.000	12-Dec-01	31-Mar-05	PS	PS
1904(SF)	TON	Economic and Public Sector Reform Program	10.000	28-May-02	10-Mar-05	PS	-

COO = Cook Islands, FSM = Federates States of Micronesia, NAU = Nauru, PCR = program completion report, PNG = Papua New Guinea, PPER = program performance evaluation report, PS = partly successful, RMI = Republic of Marshall Islands, S = successful, SAM = Samoa, SF =special funds, SOL = Solomon Islands, TON = Tonga, US = unsuccessful.

Sources: Loan, technical assistance, and private sector approvals database; program completion reports; and program performance evaluation reports.

PACIFIC DEVELOPING MEMBER COUNTRY CONTEXT AND TRENDS

1. The 2000 Pacific strategy[1] of the Pacific Department (PARD) identified six key constraints to development among Pacific developing member countries (DMCs): (i) vulnerability of the economies because of their remote locations, narrow resource base, susceptibility to natural disasters, and the influence of global markets; (ii) lack of political stability and good governance; (iii) limited availability of skilled human resources; (iv) wide range of sociocultural factors influencing politics and productivity; (v) rising population rates; and (vi) inadequacy of physical, technological, and financial sector infrastructure to underpin sustainable growth. This appendix further summarizes the overall country-specific context and development constraints, and related public and private sector development issues and trends.

A. Country Context

1. Micronesia (the Federated States of Micronesia and the Republic of the Marshall Islands)

2. The Federated States of Micronesia (FSM) is a grouping of 607 small islands in the Western Pacific about 4,000 kilometers (km) southwest of Hawaii, lying above the Equator. The country's total land area amounts to only 701 square kilometers (km^2), but it occupies more than 2.59 million km^2 of the Pacific Ocean. The FSM attained independence in 1986 under a Compact of Free Association (the Compact) with the United States. The FSM's 107,008 people inhabit its confederation of four states—Chuuk, Kosrae, Pohnpei, and Yap. Each of the four states centers around one or more high islands, and all but Kosrae include numerous atolls. Each state has its own government, languages, culture, and identity. The FSM is heavily reliant on external assistance, which accounts for more than half of government revenue. The Compact is a major source of external assistance, which was amended in 2003 (Box A2.1).

3. The Republic of the Marshall Islands (RMI) is located in the central Pacific Ocean, some 3,700 km southwest of Hawaii. The RMI is composed of two nearly parallel chains of low coral limestone and sand islands known as the Ratak (sunrise) group and the Ralik (sunset) group. The total land area of the RMI is only 181 km^2, but 70% of its 57,000 population of ethnic Micronesians is concentrated on the atolls of Majuro and Ebeye. The islands (along with most of those in the rest of Micronesia) were notionally a Spanish colony from the 1500s, but the Marshallese had little contact with Europeans until 1860. From then until 1914, German trading companies operated a network of copra trading stations. In 1914 at the outset of World War I, Japan occupied the islands and took over the copra trade until World War II. The United States then occupied the islands for the next nearly 4 decades as part of the United Nations Trust Territory of the Pacific Islands (which covered most of the islands in the Micronesia region). During this period, atolls in the northern RMI were used by the United States for nuclear testing (between 1947 and 1962). The RMI attained independence in 1986 under a Compact of Free Association with the United States. Kwajalein Atoll, a World War II battleground, is still used as a United States missile test range. Other sources of foreign exchange earnings are fees paid by international fishing fleets to access fish resources in RMI copra production and adventure tourism.

[1] ADB. 2000. *A Pacific Strategy for the New Millennium*. Manila.

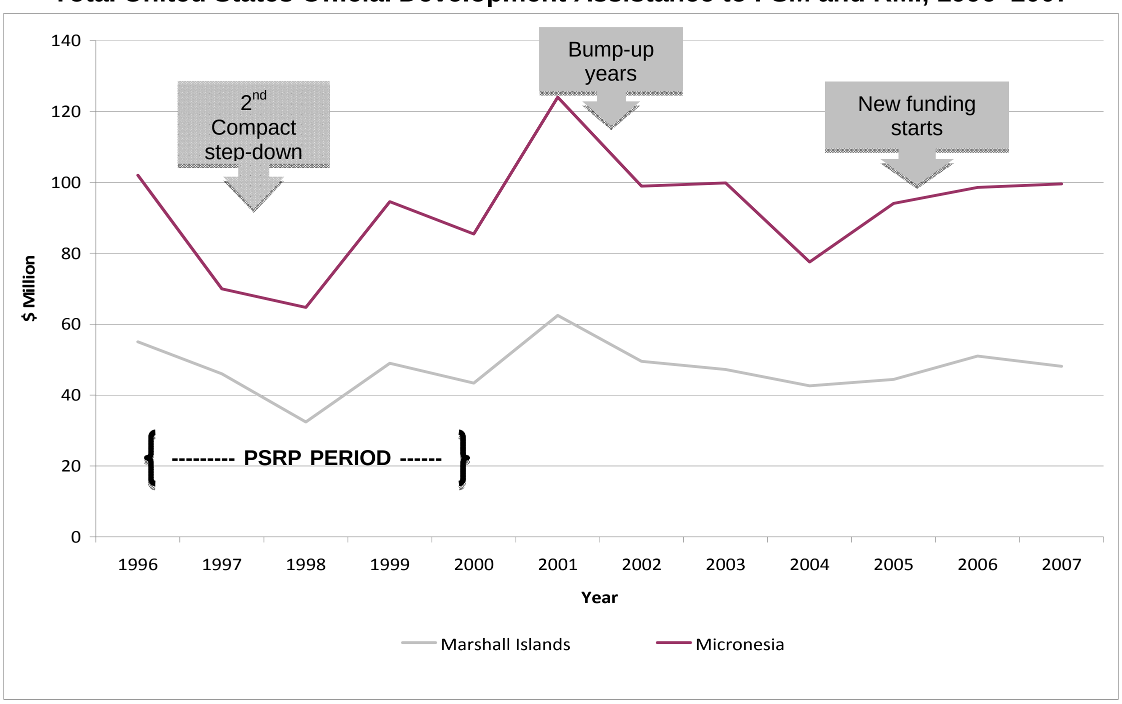
Box A2.1: The Amended Compact of Free Association[a]

In 2003, the United States (US) approved separate amended compacts with the Federated States of Micronesia (FSM) and Republic of Marshall Islands (RMI) that (i) continue the defense relationship, including a new agreement providing US military access to Kwajalein Atoll in the RMI through 2066 with a possible extension to 2086; (ii) strengthen immigration provisions; and (iii) provide an estimated $3.6 billion in financial assistance to both nations from 2004 through 2023. The additional 20 years of grant assistance intend to assist the FSM and RMI governments in their efforts to promote the economic advancement and budgetary self-reliance of their people.

Financial assistance is provided in the form of annual sector grants and contributions to each nation's trust fund. The amended compacts and their subsidiary agreements, along with the countries' development plans, target the grant assistance to six sectors—education, health, public infrastructure, environment, public sector capacity building, and private sector development—prioritizing two sectors, education and health. To provide increasing US contributions to the FSM and RMI trust funds, grant funding decreases annually and will likely result in falling per capita grant assistance over the funding period and relative to the original compact. For example, based on US Census Bureau population projections in 2004 US dollar terms, FSM per capita grant assistance will fall from around $1,352 in 1987 to around $562 in 2023, and RMI per capita assistance will fall from around $1,170 in 1987 to around $317 in 2023.

Under the amended compacts, annual grant assistance is to be made available in accordance with an implementation framework that has several components. For example, prior to the annual awarding of compact funds, the countries must submit development plans that identify goals and performance objectives for each sector. The FSM and RMI governments are also required to monitor day-to-day operations of sector grants and activities, submit periodic financial and performance reports for the tracking of progress against goals and objectives, and ensure annual financial and compliance audits. In addition, the US and FSM Joint Economic Management Committee and the US and RMI Joint Economic Management and Financial Accountability Committee are to approve annual sector grants and evaluate the countries' management of the grants and their progress toward Compact goals.

Total United States Official Development Assistance to FSM and RMI, 1996–2007



PSRP = Public Sector Reform Program.

[a] This box draws on Government Audit Office [of the United States]. 2006. *Compacts of Free Association: Development Prospects Remain Limited for Micronesia and Marshall Islands*. Washington, DC.

Source: Organisation for Economic Co-operation and Development database.

2. Melanesia (Papua New Guinea, Solomon Islands, and Vanuatu)

4. Papua New Guinea (PNG) comprises a group of islands that includes the eastern half of the New Guinea Island, the second largest island in the world. PNG shares New Guinea Island with Indonesia, on the west. To the south of PNG lie the Coral Sea and Australia, while the South Pacific Ocean lies to the north. The country is mostly mountainous, with coastal lowlands and rolling foothills, and one of the world's largest swamps along its southwest coast. The total land area is 452,860 km^2, home to about 5.3 million people. Melanesian, Papuan, Negrito, Micronesian, and Polynesian ethnic groups make up the bulk of the population. However, PNG is characterized by enormous linguistic and cultural diversity. The eastern half of the New Guinea Island was divided between Germany (north) and the United Kingdom (south) in 1885. The latter area was transferred to Australia in 1902, which occupied the northern portion during World War I. Australia continued to administer the combined areas until independence in 1975. A 9-year secessionist revolt on the island of Bougainville ended in 1997. PNG is richly endowed with natural resources, including forestry, fish, nickel, cobalt, oil, copper, and gold. The country's rugged terrain, however, makes for high infrastructure costs and low population densities, hampering exploitation of resources. Complex customary land tenure systems, a serious peace-and-order problem, poor human resource development, and a population growth rate of over 3% also constrain development.

5. Solomon Islands is made up of 992 islands and covers a sea area of more than 1.35 million km^2. Solomon Islands is the third largest archipelago in the South Pacific, located just east of PNG, with its islands having mostly rugged mountains and some low coral atolls. The land area of Solomon Islands totals 27,540 km^2. Over 90% of the population of about 500,000 is Melanesian, with Polynesians and Micronesians making up most of the remainder. The United Kingdom established a protectorate over Solomon Islands in the 1890s. Because of its strategic location on sea routes between the South Pacific Ocean, Solomon Sea, and Coral Sea, some of the most intense fighting of World War II occurred on these islands. Self-government was achieved in 1976 and independence 2 years later. Ethnic violence, government malfeasance, and endemic crime undermined stability and civil society in 2000. Solomon Islands is rich in undeveloped mineral resources such as lead, zinc, nickel, bauxite, phosphates, and gold. Potentially rich fishery and forestry resources have been overexploited and run the risk of depletion. Solomon Islands is one of the least developed among ADB's Pacific DMCs, ranking the lowest among all Pacific island countries in the United Nations Human Development Index.[2]

6. Vanuatu is located in the South Pacific on the New Hebrides Islands, just west of the Fiji Islands. The country comprises more than 80 mostly mountainous, volcanic islands with narrow coastal plains. The total land area of Vanuatu is 12,200 km^2, but only about 65 of the islands are inhabited. Some 80% of the total population of about 200,000 lives on the eight largest islands. Most live in rural areas, mainly along the coast. British and French settlers arrived on the New Hebrides Islands in the 19th century. In 1906, the two countries agreed to an Anglo-French Condominium, which administered the islands until independence in 1980. Vanuatu has considerable agriculture, fisheries, and tourism resources; and the economy is based primarily on small-scale agriculture, which provides a livelihood for about 65% of the population. Tourism, fishing, and offshore financial services are other contributors to the economy. Economic growth over the past 2 decades has barely kept pace with the rapid increase of population, but growth rates have risen recently, even though, so far, this is marginally inclusive of rural areas.

[2] UNDP. 2008. *Human Development Report 2007/2008*. New York.

3. Polynesia (the Cook Islands, Samoa, and Tonga)

7. The 15 islands and atolls of the Cook Islands lie in the Pacific Ocean south of Hawaii and the Equator, and west of Tahiti. Spread across an exclusive economic zone of nearly 2 million km^2, they comprise a total land area of 240 km^2. The seven northern islands are low-lying, sparsely populated coral atolls. The eight southern islands are more elevated, fertile, volcanic isles, and home to most of the population of about 13,900. Population has declined over 25% since 1996, however, mainly because of out-migration to Australia and New Zealand. The islands became a British protectorate in 1888. By 1900, administrative control was transferred to New Zealand. In 1965, the Cook Islands residents chose self-government in free association with New Zealand. The Cook Islanders thus enjoy access to New Zealand citizenship and unrestricted access to residence, work, and social benefits in New Zealand (and by extension, in Australia). Tourism is the most important income generator, and tourism expenditure was estimated at about 40% of gross domestic product (GDP) in 2004–2005.

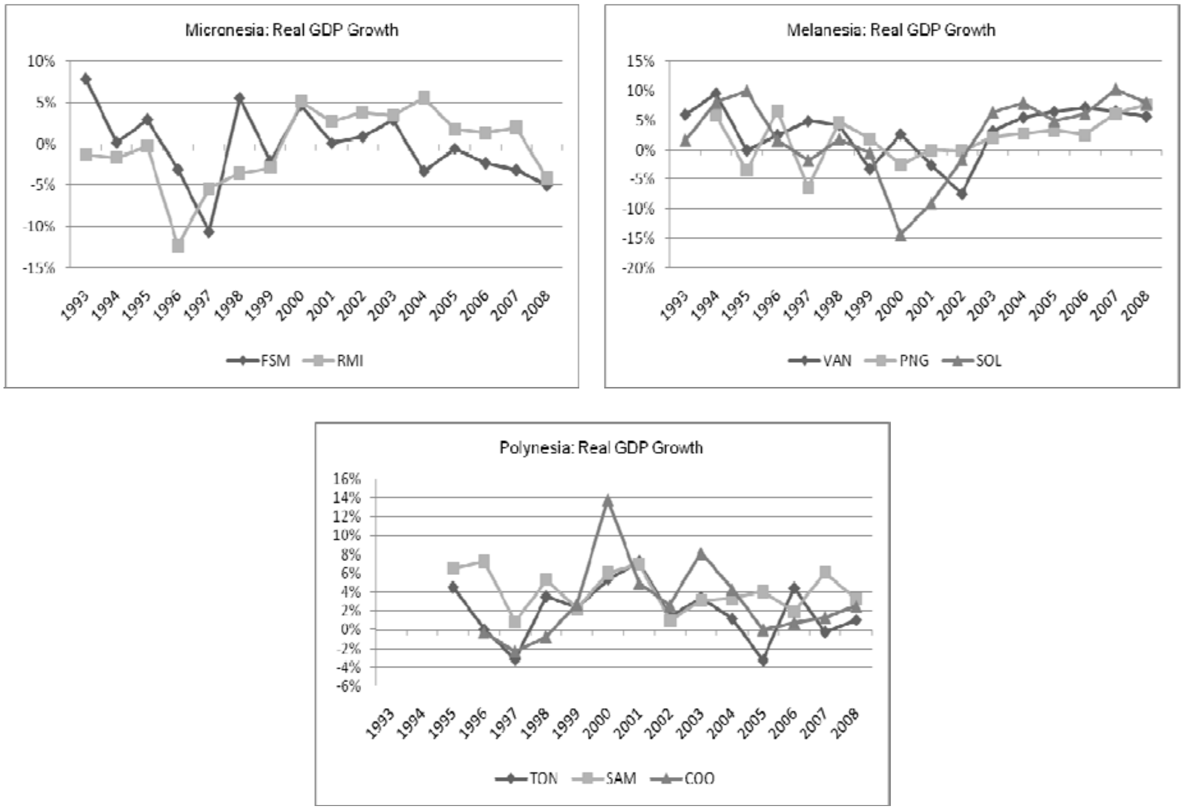
8. The 10 volcanic islands of Samoa lie south off the Equator and about halfway between Hawaii and New Zealand. They are dominated by rugged mountain ranges and surrounded by coral reefs and lagoons. The two relatively large islands of Upolu and Savaii account for about 96% of the country's total land area of 2,934 km^2. They are also home to the majority of the country's 180,000 people. Some 93% of the population is native Samoan and almost all the remainder are of mixed Samoan and European heritage. New Zealand occupied the German protectorate of Western Samoa in 1914 at the outbreak of World War I. It continued to govern the islands until 1962, when the islands became the first Polynesian nation to reestablish independence in the 20th century. The country dropped "Western" from its name in 1997. The economy of Samoa is dependent on agriculture, fishing, family remittances from abroad, and development aid. Mixed subsistence agriculture, forestry, and fishing employ two-thirds of the labor force and produce 90% of exports. Exports are otherwise heavily based on fish, garments, and coconut- and taro-based products. Tourism is an expanding sector, accounting for about 25% of GDP.

9. The 170 volcanic and coral islands of Tonga lie directly south of Samoa, and are spread across 360,000 km^2 in the South Pacific Ocean. The islands are divided into three groups: the Tongatapu Group, Ha'apai Group, and Vava'u Group. The total land area of the islands is about 750 km^2, but only 36 islands are permanently inhabited. About 70% of the population of about 101,000 resides on the main island of Tongatapu. Tonga is at the heart of Polynesia and nearly all the inhabitants are ethnically Tongan. The archipelago was united into a Polynesian kingdom in 1845. It became a constitutional monarchy in 1875 and a British protectorate in 1900. Tonga acquired its independence in 1970 and is the only remaining monarchy in the Pacific. Agricultural crops provide the narrow export base, consisting mainly of squash, coconuts, bananas, and vanilla beans. Agricultural exports make up two-thirds of total exports. Tourism has been expanding in recent years and is the second largest source of hard currency following remittances from Tongan communities overseas. These currency sources are supplemented by external aid to offset the country's trade deficit.

B. Economic Structure and Trends

10. The Pacific island countries included in the special evaluation study have generally exhibited erratic, sharp swings in growth rates over the past 15 years (Figure A2.1). Micronesia and Melanesia tend to experience negative growth rates compared with Polynesia. The recent oil crisis negatively affected all Pacific island countries except PNG.

Figure A2.1: Economic Growth in the Pacific[a]



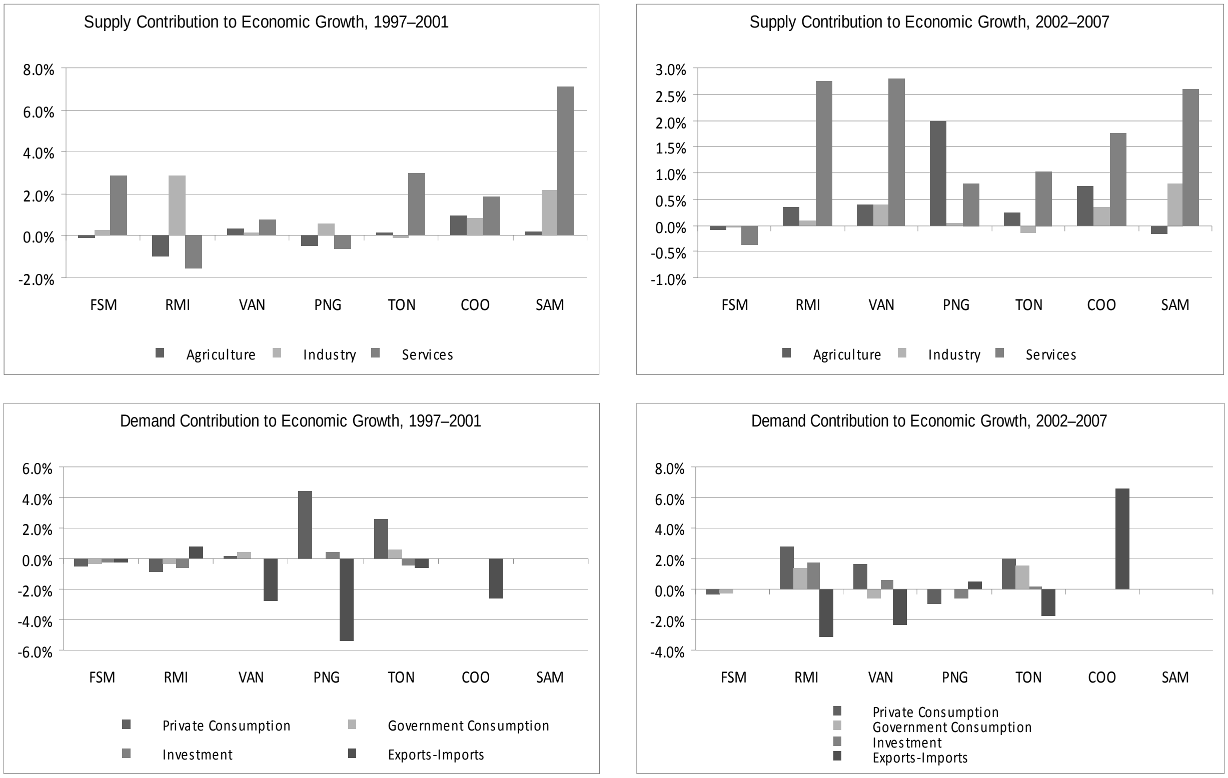
COO = Cook Islands, FSM = Federated States of Micronesia, GDP = gross domestic product, PNG = Papua New Guinea, RMI = Republic of Marshall Islands, SAM = Samoa, SOL = Solomon Islands, TON = Tonga, VAN = Vanuatu.

[a] The following Pacific developing member countries have changed the base year for computing real GDP: Papua New Guinea, Tonga, Samoa, Cook Islands. Thus, data for some years—1993, 1994, 1995—were not used for consistency purposes.

Sources: Asian Development Bank Pacific Department and Economics and Research Department.

11. The economic structure of these Pacific island countries has remained largely unchanged over the last 15 years. The services sector dominates economic activity and has become more pronounced during 2002–2007 (Figure A2.2). On the demand side, consumption—both private and government—drives economic activity.

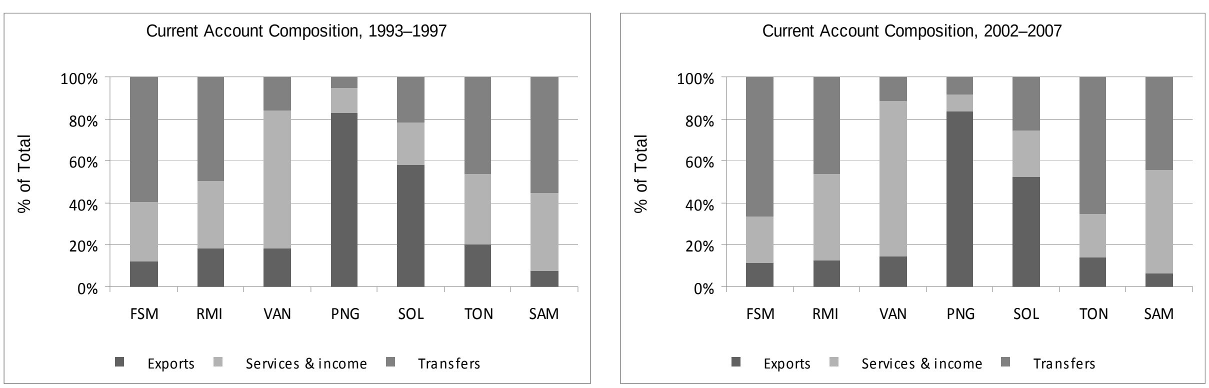
Figure A2.2: Growth Drivers of the Economy



COO = Cook Islands, FSM = Federated States of Micronesia, PNG = Papua New Guinea, RMI = Republic of Marshall Islands, SAM = Samoa, TON = Tonga, VAN = Vanuatu.
Sources: Asian Development Bank Pacific Department and Economics and Research Department.

12. The composition of current account inflows has likewise remained unchanged (Figure A2.3). For Micronesia, transfers (mostly grants) on average account for more than half of current account inflows (55%). In Melanesia, the major source of current account inflows is mixed—services and income for Vanuatu (70%), exports for PNG (83%) and the Solomon Islands (55%). In Polynesia, services and income as well as remittances (i.e., private transfers) account for a large share of current account inflows—83% in Tonga and 93% in Samoa.

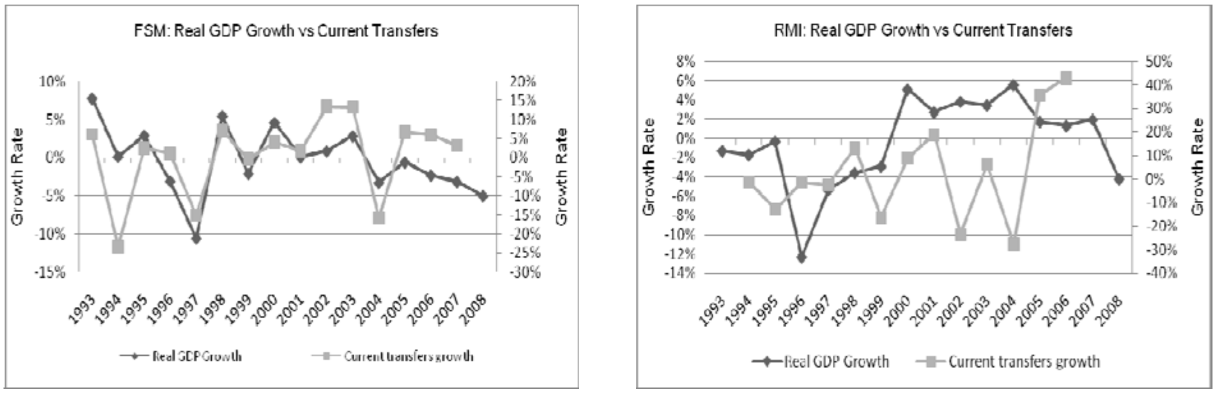
Figure A2.3: External Sources of Income



COO = Cook Islands, FSM = Federated States of Micronesia, PNG = Papua New Guinea, RMI = Republic of Marshall Islands, SAM = Samoa, TON = Tonga, VAN = Vanuatu.
Source: Asian Development Bank Economics and Research Department.

13. The public sector dominates economic activity in Micronesia. The FSM economy is characterized by a private sector that produces mostly non-traded goods and that relies heavily on demand for services by the Government—which is also the biggest employer. The same is true of RMI. The FSM and RMI economies have remained grant-driven over the last 15 years (Figure A2.4).

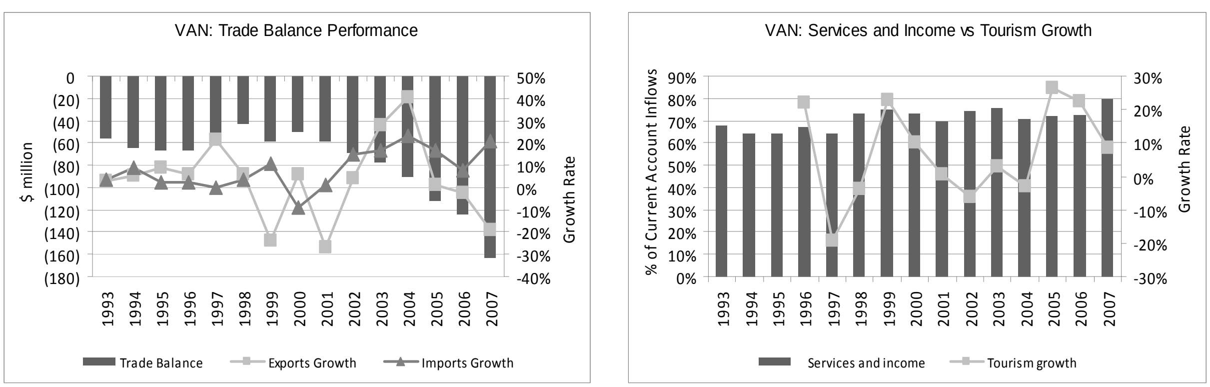
Figure A2.4: FSM and RMI: Grant-Driven Economies



FSM = Federated States of Micronesia, GDP = gross domestic product, RMI = Republic of Marshall Islands.
Sources: Asian Development Bank Pacific Department and Economics and Research Department.

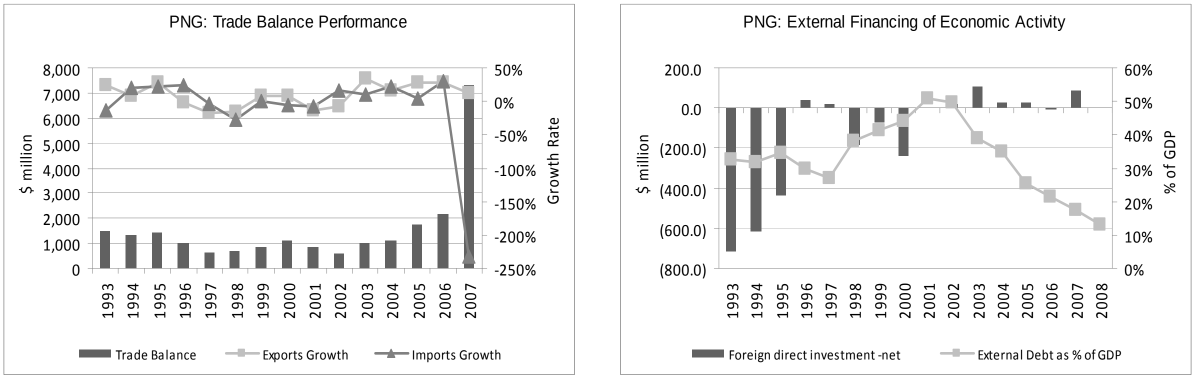
14. Grants do not play a major role in Melanesia, and the public sector is not the dominant player in the economy. However, each country is characterized by diverse economic circumstances. Vanuatu has tourism to mitigate the weak performance of lower value exports (copra, cocoa, beef, and timber) (Figure A2.5). PNG has high value exports (gold, copper, and crude petroleum). The gains are either not invested in the domestic economy (as evidenced by the negative foreign direct investment-net) or not efficiently invested (Figure A2.6). Solomon Islands has low value exports (timber, fish, and palm oil) and no tourism or remittances to mitigate weak export performance.

Figure A2.5: Vanuatu – Trade and Tourism Performance



VAN = Vanuatu.
Sources: Asian Development Bank Pacific Department and Economics and Research Department.

Figure A2.6: Papua New Guinea – Trade and Investment Performance

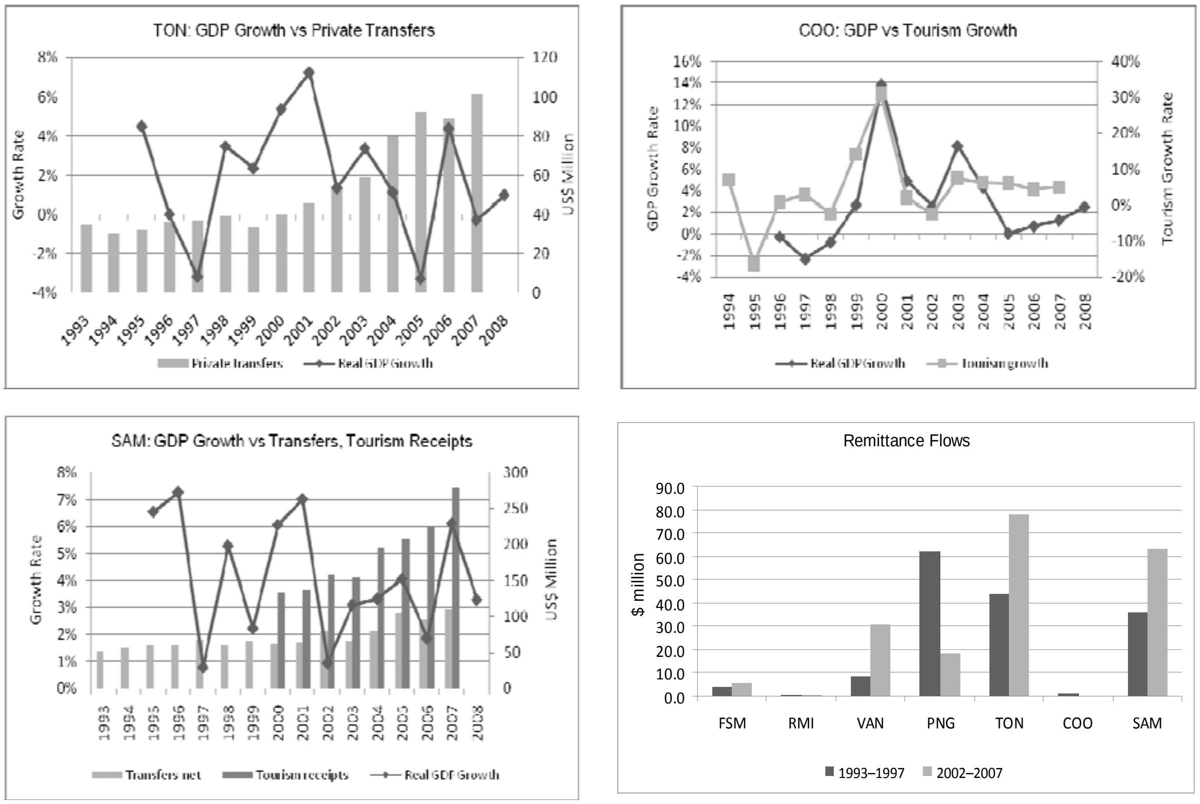


GDP = gross domestic product, PNG = Papua New Guinea.
Sources: Asian Development Bank Pacific Department and Economics and Research Department.

15. In the Polynesian countries, grants also do not play a major role in the economy. The public sector is a key but not dominant player. Tourism and remittances have mitigated weak export performance in other areas (remittances are prominent in Tonga, tourism in the Cook Islands, and both tourism and remittances in Samoa). Over the last 15 years, the Polynesian countries had significant amount of remittance flows compared with the Micronesian and Melanesian countries (Figure A2.7). Tonga had the most significant remittances inflow increase representing 65% of current account inflows in 2002–2007 from 46% in 1993–1997. Tourism and remittances have also taken on an important role as sources of employment and foreign exchange.[3]

[3] Connell, John, and Richard P.C. Brown. 2005. *Remittances in the Pacific: An Overview*. Manila: ADB; and ADB. 2008. Pacific Studies Series. *Navigating the Global Storm-A Policy Brief on the Global Financial Crisis.* Manila.

Figure A2.7: Polynesia: Tourism, Remittances, and Economic Growth



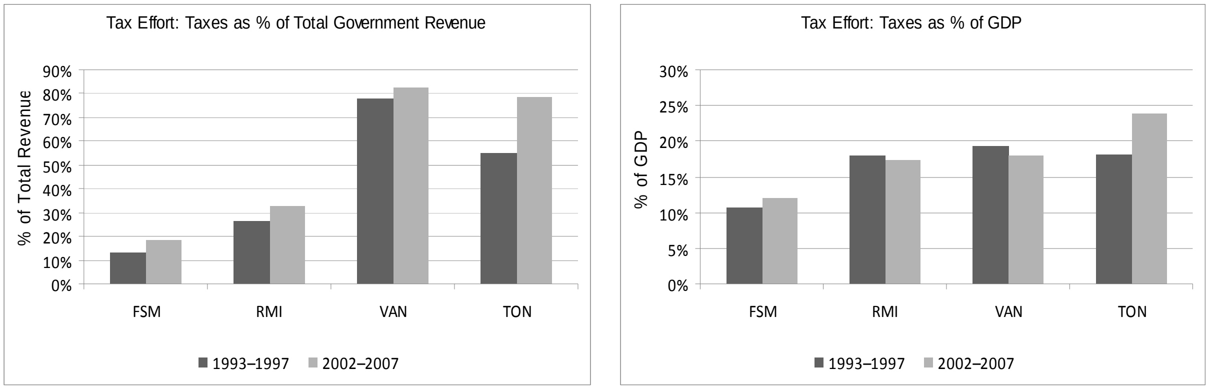
COO = Cook Islands, FSM = Federated States of Micronesia, GDP = gross domestic product, PNG = Papua New Guinea, RMI = Republic of Marshall Islands, SAM = Samoa, TON = Tonga, VAN = Vanuatu.
Sources: Asian Development Bank Pacific Department and Economics and Research Department.

C. Public Sector Trends

16. In the 1990s, several Pacific DMCs were weighed down by persistent fiscal deficits. Following program loan support, there was improvement with some periods of fiscal balance or surpluses but these were often not sustained. In Micronesia, the FSM performed better in fiscal management than the RMI. Melanesia also experienced persistent fiscal deficits. Among the Polynesian countries, fiscal deficits were not as large as in Micronesia and Melanesia (Table A2.1). There was some improvement in the tax effort (Figure A2.8). Over the last 15 years, a large proportion of government revenue in the Pacific DMCs was allocated to finance operations with relatively low capital expenditure from own resources. A recent exception was PNG where there was a marked improvement in capital expenditure during 2002–2007 compared with 1993–1997.

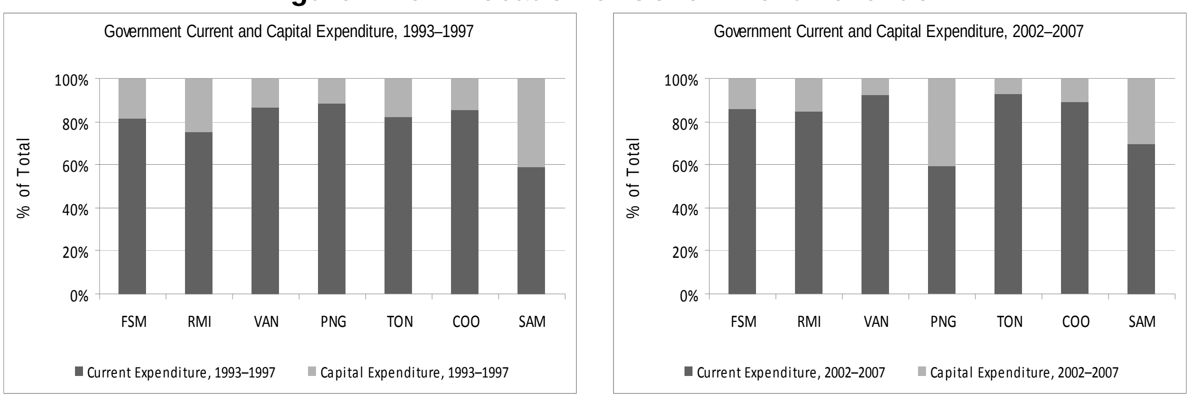
17. Political instability takes a toll on effective fiscal management. The 2000 coup in Solomon Islands reversed the fiscal position from a surplus of $17 million in 1999 to a large deficit of $46 million in 2002. The failure to fully institutionalize government processes has also constrained prudent fiscal management. Politicization of public enterprise reforms over the last 10 years has also limited progress toward management improvements.

Figure A2.8: Tax Effort



FSM = Federated States of Micronesia, GDP = gross domestic product, RMI = Republic of Marshall Islands, TON = Tonga, VAN = Vanuatu.
Sources: Asian Development Bank Pacific Department and Economics and Research Department.

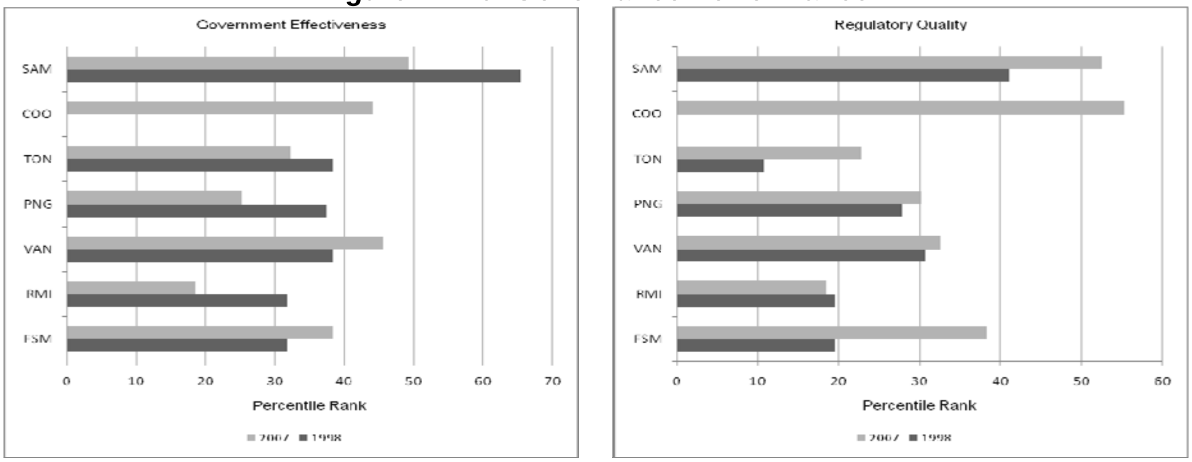
Figure A2.9: Allocation of Government Revenue



COO = Cook Islands, FSM = Federated States of Micronesia, PNG = Papua New Guinea, RMI = Republic of Marshall Islands, SAM = Samoa, TON = Tonga, VAN = Vanuatu.
Sources: Asian Development Bank Pacific Department and Economics and Research Department.

18. Generally, there was weak governance performance among the Pacific DMCs in the following indicators—government effectiveness, regulatory quality (some improvements in control of corruption were also noted)—which ADB had influence on through its program loans. As shown in Figure A2.10, some indicator improvements in 2007 compared with 1997 are seen in government effectiveness in Vanuatu and the FSM, and in regulatory quality in all countries except the RMI.

Figure A2.10: Governance Performance



COO = Cook Islands, FSM = Federated States of Micronesia, PNG = Papua New Guinea, RMI = Republic of Marshall Islands, SAM = Samoa, TON = Tonga, VAN = Vanuatu.
Source: www.worldbank.org/wbi/governance/data.

D. Private Sector Trends

19. Since support for private sector reform and development began in the late 1990s through program lending and related technical assistance, PARD has carried out a number of more systematic assessments on constraints and support needs. A PARD report[4] prepared in 2004 examining the private sector and related development needs concluded for Pacific DMCs as a whole that:

(i) modernization is a necessary condition for development but does not necessarily mean forgoing tradition and custom;
(ii) effective solutions can only emerge at the will and leadership of the countries themselves;
(iii) the governments must engage their citizens in a dialogue so that there is a general understanding of the need for change and support for it;
(iv) the agenda is large and issues of sequencing selectivity and priority will arise;
(v) bold political leadership will be required; and
(vi) there is no alternative to change if the future and aspirations of the younger generation in the Pacific are to be met.

20. In 2009, PARD further assessed ADB's experience in reform of state-owned enterprises (SOEs) and the key results are summarized in Box A2.2.[5]

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4 ADB. 2004. *Swimming Against the Tide: An Assessment of the Private Sector in the Pacific*. Manila.
5 ADB/PARD. 2009. *Finding Balance: Making State-Owned Enterprises Work*. Manila.

Box A2.2: Pacific Department Experience with State-Owned Enterprise Reforms and Development

A. Key Issues

- SOEs provide low returns on investment. SOEs absorb a significant amount of scarce capital stock, while providing returns below the true cost of that capital.
- SOEs can crowd out the private sector. Although private sector firms are generally more efficient, SOEs often compete on an unequal basis with private competitors limiting their growth.
- SOEs have large social opportunity costs. SOEs absorb government funds that could be spent on social sectors.

B. Key Lessons Emerge from the State-Owned Enterprise Reform Experiences in the Fiji Islands, Samoa, and Tonga

- Political commitment to reform is paramount.
- Legislative and governance frameworks will not improve SOE performance unless there is political will.
- Successful SOE reform explores all available restructuring mechanisms, including but not restricted to privatization.
- Successful reform programs are driven from within, not imposed from outside.
- Competition is a driver for SOE reform. The most efficient SOEs are those that compete with the private sector on an equal footing.
- Continued financing for poorly performing SOEs does not result in improved performance unless there is substantial restructuring.
- The private sector is sufficiently developed to invest in SOEs and should be given the opportunity to do so.

ADB = Asian Development Bank, PARD = Pacific Department, SOE = state-owned enterprise.
Source: ADB/PARD. 2009. *Finding Balance: Making State-Owned Enterprises Work*. Manila.

21. Private sector performance has continued to lag in the FSM, despite many direct efforts to improve the overall policy and legal environment, improve factors of production, and promote and facilitate new investment. In FY1995, the private sector contribution to GDP was $58.6 million (in nominal terms), representing 28% of total GDP. By FY2000, the private sector's relative share of GDP increased slightly to 30%, but since that year it has fallen back to its pre-reform levels, averaging around 28%. In terms of formal employment, in FY1995 the private sector reported 6,848 employees. In line with the second major step-down, public expenditure contracted to 6,349 by FY1997 and has averaged around 7,000 employees from FY2002 to FY2006 with no clear upward trend. Reported wages and salaries paid by the private sector from FY1995 to FY1998 ranged from $23 to $25 million. From FY1999 to FY2006, levels have generally increased and are now approaching $30 million (although better reporting may account for part of this increase).

22. FSM exports averaged $20 million annually (in free on board terms) over the past decade, but ranged widely from $17 to $24 million (fluctuations in fish catch account for part of this). Export levels in FY2004 to FY2006 have ranged from $17 to $18.5 million. Tourism was identified early by all FSM states as a key industry for development. Visitor arrival data for all of the FSM, however, show little growth over the past decade, averaging around 1% rise per annum. Only Chuuk State and Yap State have shown tangible growth in arrivals over the past decade, with Chuuk State registering an annual average growth rate in arrivals of 9.6% and Yap State growing at 1.9% per annum.

23. The RMI's private enterprise contribution to GDP saw a contraction from FY1997 to FY1999, illustrating the private sector's high dependence on government expenditure. Private enterprise's share of GDP fell from 30.5% to 27.8% over the 3 years. Private sector GDP has remained relatively flat from FY2000 to FY2007, ranging from 30% to 32% with no clear signs of growth. While the RMI has seen investment and growth in some industries, mainly in commercial fisheries and to a lesser extent in tourism, in general the private sector remains poorly diversified, slow-growing, and heavily dependent on government expenditure. The data on private sector employment, meanwhile, do show some positive growth over time. While FY1997–FY1999 did not show much growth (with the private sector employing an average of 2,600 employees), FY1999–FY2004 was a period of strong and steady growth, during which private employment jumped from 2,683 to over 4,000. Part of this increase reflects more complete coverage by the job data system (more companies with existing employees who were not previously part of the social security system joined that system during these years). However, in several industries, there was genuine job growth, most especially in the commercial fishing industry (where one large employer, the PMOP tuna processing plant added over 600 new jobs in the 5-year period). Overall, the fishing industry added over 900 new jobs. Wholesale and retail trade businesses added some 300 new jobs. Wages and salaries paid by the private sector have risen (albeit with some volatility) from around $15 million in the late 1990s to around $17 million in FY2007.

24. In the Polynesia countries, the increase in business activity is largely driven by tourism and remittances. In the Cook Islands, the primary sector accounted for 21% of GDP—this includes the black pearl industry, which was once buoyant then but has suffered serious decline because of overproduction in lagoons and consequent diseases (in 2007, the value of pearl exports was $2.1 million). New Zealand was once the Cook Islands' only market for its agricultural produce, but after New Zealand opened its doors to other countries for produce and required stricter import regulations, the exports of tropical fruits, oranges, avocadoes, and mangoes from the Cook Islands to New Zealand became difficult. Exports of agriculture products declined from 15% of GDP in the 1970s to less than 2% in 2006. At present, the only viable products are pawpaw and noni juice to New Zealand and the fern maire to Hawaii. Wholesale and retail trade accounted for 15%, indicating the consumption character of the economy. The private sector is also encouraged to supply the consumption needs of the Government and its employees. Tourism continues to be the main driver of the economy, with 60% of the visitors coming from New Zealand and 23% coming from the northern hemisphere. Government participation in private goods provision has declined—the expenditure share of GDP dropped to 32% in 2007 from 56% in 1994. The expectation would be for the private sector to expand. However, private sector growth is constrained by limited domestic capital and local opposition to foreign investments.

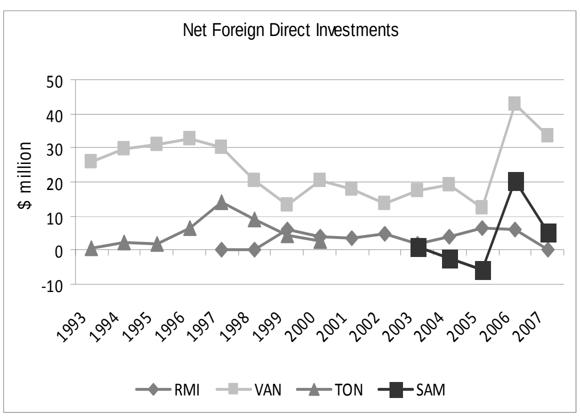
25. In Samoa, the primary sector contributed 45% to GDP in 1990, declining to 37% in 1996. Subsistence output comprised about two-thirds of this, while coconut, copra, kava, timber, banana, and fish dominated the cash economy—much for export. The government contribution in 1996 was down from 12.8% in 1991 to 10.3% in 1996. The secondary sector (manufacturing, electricity, and construction) grew from 17.6% in 1991 to 26.6% by 1996, while the tertiary sector (tourism and services, including transportation) rose from 24.8% to 27.5%. Since 1997, the private sector has become progressively dominated by the services sector, which has increased its contribution to GDP from 53% in 1997 to 63% in 2007. However, agriculture has declined from 22% in 1997 to 12% in 2007 of GDP. The increasing dominance of the services sector is expected to continue in the near future, given the stagnant agriculture and manufacturing sectors and growing tourism and financial services. At the end of 2000, the Government had total equity in the 29 SOEs of $659 million compared with $480 million in 1998. The main contributors to this increase were improvements of the Accident Compensation Board, National Provident Fund, Samoa Shipping Services, Samoa Water Authority and Telecom

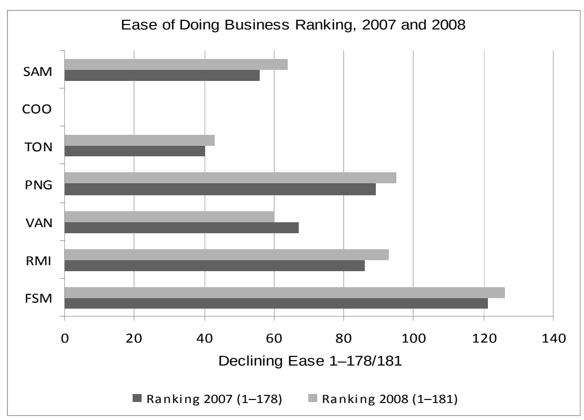
Cellular Samoa Ltd, and Samoa Housing Corporation; and establishment of Samoa Ports Authority and Samoa Communications Ltd (later renamed as SamoaTel). These more than offset the losses registered by Electric Power Corporation and Polynesian Airlines.

26. Subsistence or small-scale agriculture in Vanuatu provides a living for 65% of the population.[6] Fishing, offshore financial services, and tourism (with about 60,000 visitors per year plus an additional 60,000 cruise ship visitors) are other mainstays of the private sector. A small light industry sector caters to the local market. The cost of doing business in Vanuatu is high. Electricity, water, and telecommunications costs have been among the highest in the Asia Pacific region. Infrastructure development is limited to a few areas, making business development difficult throughout the country. Storage facilities are needed for perishable products, which are in plentiful supply in rural communities. Opening up of the shipping industry in Vanuatu has allowed other investors to come in and offer additional sea transport for business and traveling purposes.

27. Access to credit for local investors is difficult. Financial institutions consider lending to local businesses as high risk, partly stemming from the experiences of banking institutions such as the Development Bank of Vanuatu, which had high rates of loan default and delinquency. Land disputes are also an impediment to business and other development. On the other hand, financial sector reforms led to success stories such as the National Bank of Vanuatu. The Vanuatu Women Development Scheme is a microcredit scheme established in the 1990s to assist women in starting businesses. The scheme now has over 3,000 members and is extending its coverage to other islands of Vanuatu. Land ownership in Vanuatu belongs to traditional landowners and can be leased but not sold. Unregistered land cannot be used as collateral. Overall, expansion of private sector activity has been mostly limited to urban centers such as Port Villa. Selected foreign direct investment flows and ease-of-doing business ranking are provided in Figure A2.11.

Figure A2.11: Foreign Investments and Doing Business in the Pacific





COO = Cook Islands, FSM = Federated States of Micronesia, PNG = Papua New Guinea, RMI = Republic of Marshall Islands, SAM = Samoa, TON = Tonga, VAN = Vanuatu.

Sources: Asian Development Bank Pacific Department, Economics and Research Department, and World Bank. Available: http://www.doingbusiness.org/economyrankings/?direction=Asc&sort=1

[6] PNG is not covered in private sector performance as the program focused on public sector reforms.

Table A2.1: Selected Pacific Developing Member Countries Key Indicators

Key Indicator	Period	COO	FSM	PNG	RMI	SAM	SOL	TON	VAN
A. Real GDP, Period Average[a] ($ million)	1993–1997	104.2	213.0	6,174.8	124.4	217.2	92.8	192.3	129.9
	2002–2007	140.1	208.0	2,554.1	122.5	338.9	120.5	128.3	154.5
B. Real GDP Growth, Period Average (%)	1993–1997	(1.3)	(0.5)	0.7	(4.2)	4.9	3.9	0.4	4.6
	2002–2007	2.8	(1.5)	3.5	1.9	3.3	6.0	1.1	3.9
C. Trade Balance ($ million)	1996/1997	0.8	(73.4)	650.2	(41.8)	(85.1)	(28.1)	(47.0)	(58.7)
	2007/2008	(20.0)	(111.4)	7321.1	(58.2)	(213.2)	(71.9)	(116.6)	(163.6)
D. Current Account Inflows Structure, % of Total, Period Average									
1. Exports	1993–1997	—	11.8	83.0	18.3	7.4	58.2	20.0	18.5
	2002–2007	—	11.6	83.3	12.5	6.1	52.7	13.6	14.7
2. Services and Income	1993–1997	—	28.8	12.2	32.1	37.4	20.4	33.6	65.7
	2002–2007	—	22.0	8.4	41.6	49.6	22.0	21.4	74.2
3. Transfers[b]	1993–1997	—	59.4	4.8	49.3	55.2	21.4	45.7	15.8
	2002–2007	—	66.2	8.3	45.9	44.3	25.3	64.8	11.1
E. Fiscal Balance ($ million)									
1. With grants	1996/1997	1.0	5.5	10.7	17.9	7.5	(13.5)	(8.0)	(1.4)
	2006/2007	7.7	(12.9)	153.3	(1.0)	13.9	(4.7)	3.8	(1.6)
2. Without grants	1996/1997	(6.7)	(84.5)	(81.8)	(24.2)	(19.8)	(13.5)	(11.2)	(7.0)
	2006/2007	(7.9)	(98.2)	(89.9)	(63.9)	(23.7)	(20.0)	(2.7)	(8.8)
F. Fiscal Balance as % of GDP, Period Average[c]	1993–1997	(6.3)	0.0	(1.5)	(5.5)	1.2	(3.1)	1.3	(2.2)
	2002–2007/2008	1.0	(1.3)	0.5	(1.2)	(1.5)	(4.0)	1.5	0.1
G. Government Revenue Sources, % of Total, Period Average									
1. Taxes	1993–1997	78.1	13.4	77.1	26.2	55.2	79.1	55.3	77.9
	2002–2007	71.8	18.4	75.5	32.5	66.4	50.1	78.8	82.6
2. Non-Taxes	1993–1997	7.1	21.1	12.0	15.9	16.4	20.9	38.3	14.2
	2002–2007	11.4	17.2	6.4	11.1	9.0	9.8	15.1	9.9
3. Grants	1993–1997	14.7	65.5	10.9	57.9	28.4	0.0	6.4	7.8
	2002–2007	16.8	64.2	18.1	61.8	24.6	6.8	6.1	7.5
H. Savings-Investment Gap									
1. Gross Domestic Investment, % of GDP	1997	—	37.9	21.1	56.5	—	—	19.5	18.8
	2002/2005/2006	—	39.3	21.2	57.0	—	—	16.7	21.6
2. Gross Domestic Savings, % of GDP	1997	—	(43.6)	22.4	(45.7)	—	—	(13.1)	20.3
	2002/2005/2006	—	(46.9)	12.6	(44.5)	—	—	(27.6)	17.8
I. External Debt, % of GDP, Period Average	1993–1997	89.0	80.2	31.2	129.9	84.5	48.4	34.7	20.8
	2002–2007	37.3	27.6	28.6	66.9	42.8	51.5	38.3	31.1

Key Indicator	Period	COO	FSM	PNG	RMI	SAM	SOL	TON	VAN
J. Supply Component Contribution to GDP, Period Average[d]									
1. Agriculture	1993–1997	1.0	(0.1)	(0.5)	(1.0)	0.2	—	0.1	0.3
	2002–2007	0.7	(0.1)	2	0.3	(0.2)	0.0	0.2	0.4
2. Industry	1993–1997	0.8	0.3	0.6	2.9	2.2	—	(0.1)	0.1
	2002–2007	0.3	(0.0)	0.0	0.1	0.8	0.0	(0.1)	0.4
3. Services	1993–1997	1.9	2.9	(0.6)	(1.6)	7.1	—	3.0	0.8
	2002–2007	1.8	(0.4)	0.8	2.7	2.6	0.0	1.0	2.8
K. Demand Component Contribution to GDP, Period Average[d]									
1. Private Consumption	1993–1997	—	(0.5)	4.4	(0.9)	—	—	2.6	0.2
	2002–2007	—	(0.4)	(1.0)	2.8	—	—	2.0	1.7
2. Government Consumption	1993–1997	—	(0.4)	0.0	(0.3)	—	—	0.6	0.4
	2002–2007	—	(0.2)	0.0	1.4	—	—	1.6	(0.6)
3. Investment	1993–1997	—	(0.2)	0.4	(0.6)	—	—	(0.4)	0.0
	2002–2007	—	0.0	(0.6)	1.8	—	—	0.2	0.7
4. Exports–Imports	1993–1997	(2.6)	(0.2)	(5.4)	0.8	—	—	(0.6)	(2.8)
	2002–2007	6.6	0.0	0.5	(3.1)	—	—	(1.7)	(2.3)
L. GDP by Sector, % Share of GDP									
1. Agriculture	1997/1998/2002	10.3	19.2	36.3	11.7	21.7	—	29.3	17.6
	2006/2007	14.0	18.9	36.3	10.0	12.3	31.3	25.3	16.6
2. Industry	1997/1998/2002	6.4	5.3	30.9	16.7	26.2	—	15.6	8.7
	2006/2007	9.2	5.7	35.0	21.4	26.4	26.8	13.5	9.8
3. Services	1997/1998/2002	83.2	75.5	32.7	71.7	52.6	—	55.1	73.8
	2006/2007	76.8	75.5	28.7	68.6	62.6	41.9	61.2	73.7
M. Government Finance, % of GDP, Period Average									
1. Government Expenditure	1993–1997	48.9	80.2	29.0	74.2	47.8	29.8	31.9	27.0
	2002–2007	33.9	63.8	33.7	65.6	32.5	37.7	30.4	24.2
2. Government Revenue	1993–1997	42.3	79.7	27.5	68.7	44.8	26.8	33.2	24.9
	2002–2007	35.0	62.6	34.1	64.4	33.2	37.7	0.3	24.3
N. Government Expenditure by Type ($ million)**, Period Average**									
1. Current Expenditure	1993–1997	37.8	128.0	1,308.8	59.9	51.6	90.1	42.0	52.1
	2002–2007	49.0	133.6	907.0	74.6	86.1	96.5	56.9	71.5
2. Capital Expenditure	1993–1997	6.3	29.3	163.2	19.8	35.7	6.6	9.1	8.1
	2002–2007	6.0	21.9	612.2	13.2	37.7	17.0	4.3	5.8

Key Indicator	Period	COO	FSM	PNG	RMI	SAM	SOL	TON	VAN
O. Government Wage Bill, % of Current Expenditures, Period Average[e]	1993–1997	45.3	47.7	—	35.5	—	50.9	—	51.0
	2002–2007	42.0	29.3	—	39.7	33.6	31.2	52.9	56.9
P. Government Expenditure on Public Services, % of Current Expenditure, Period Average[f]	1993–1997	30.0	—	34.7	—	35.9	—	30.9	29.5
	2002–2007	33.9	—	21.7	—	47.9	—	38.4	40.2
Q. Migration - Net, Persons per 1,000 population[g]	1995–2000	—	(25.4)	—	—	(16.2)	—	(19.5)	(7.9)
Asian Development Bank Pacific Department and Economics Department; Pacific countries website; World Bank, International Monetary Fund Article IV consultation country	2000–2005	—	(17.9)	—	—	(16.6)	—	(16.1)	—
R. Remittances ($ million)**, Period Average**[h]	1993–1997	1.3	4.0	62.0	0.5	35.7	19.4	44.1	8.6
	2002–2007	—	5.7	18.0	0.6	63.4	12.8	78.1	30.6
S. Foreign Direct Investment-Net ($ million)**, Period Average**[i]	1993–1997	—	—	(340.4)	0.1	—	—	4.9	30.0
	2002–2007	—	—	42.7	4.6	3.7	—	—	23.1
T. Governance Indicators, Percentile Rank[j]									
1. Government Effectiveness	1998	—	31.8	37.4	31.8	65.4	16.6	38.4	38.4
	2007	44.1	38.4	25.1	18.5	49.3	20.4	32.2	45.5
2. Regulatory Quality	1998	—	19.5	27.8	19.5	41.0	10.7	10.7	30.7
	2007	55.3	38.3	30.1	18.4	52.4	12.6	22.8	32.5
3. Control of Corruption	1998	—	49.0	29.6	31.1	54.9	31.1	49.0	49.0
	2007	82.6	42.5	9.2	36.2	64.3	32.9	12.6	63.3
U. Ease of Doing Business (Ranking 1–175/181)[k]	2007	—	121.0	89.0	86.0	56.0	85.0	40.0	67.0
	2008	—	126.0	95.0	93.0	64.0	89.0	43.0	60.0

( ) = negative, — = not available, COO = Cook Islands, FSM = Federated States of Micronesia, GDP = gross domestic product, PNG = Papua New Guinea, RMI = Republic of Marshall Islands, SAM = Samoa, SOL = Solomon Islands, TON = Tonga, VAN = Vanuatu.

[a] "Period average" is the average of the data for the following periods being looked into in the study—1993–1997 and 2002–2007.

[b] Transfers include official and private transfers.

[c] Includes official grants and transfers. Current account balances excluding official transfers in RMI and FSM in 2008 were estimated to be -43.1% and -45.2%, respectively.

[d] Supply and demand contribution to GDP growth data availability started in 1997.

[e] For RMI, data availability 1997 onward; 1993–1997 data refers to 1997 data only not period average. For VAN, data availability 2000 onward; 1993–1997 proxied by the 2000–2001 average.

[f] Public services defined to include health, education, environmental, and social protection. For consistency with Millenium Development Goals.

[g] Data from the United Nations Economic and Social Commission for Asis and the Pacific (UNESCAP) 2007 Statistical Yearbook for Asia and the Pacific.

[h] "Remittances" proxied by "gross private transfers receipts." Data for 1993–2002 taken from Connell & Brown, "Remittances in the Pacific: An Overview" ADB March 2005 except for FSM. For said period FSM 1997 data only.

[i] For RMI 1997 data only.

[j] Out of 6 World Bank Governance Indicators, only the 3 were included as these are the areas within ADB influence through the program loans conditionalities. The following are deemed external to ADB: "voice and accountability," "political stability," and "rule of law."

[k] Rank 1–178/181 countries, declining ease of doing business.The 2009 report ranking covers April 2007 to June 2008. The 2008 report ranking covers April 2006 to June 2007. The 2008 rankings were recalculated to reflect changes to the methodology and the addition of three new countries.

Sources: Asian Development Bank Pacific Department and Economics Research Department; Pacific countries website; World Bank, International Monetary Fund Article IV consultation country reports, Pacific countries official websites; Pacific Regional Information System, and UNESCAP.

Table A2.2: Key Millennium Development Goals Trends

Social Indicator	Period	COO	FSM	PNG	RMI	SAM	SOL	TON	VAN
A. **Population** (in thousand)	1997	18	106	4,240	49	170	380	98	177
	2007	20	108	6,331	52	180	510	101	229
B. **Population Growth Rate** (%)	1997	(8.5)	0.2	1.9	1.5	0.9	3.8	0.3	2.6
	2007	(5.2)	0.1	3.8	0.7	0.5	2.8	0.3	2.6
C. **GDP per Capita** ($)	1997	5,584	1,817	1,226	2,218	1,321	665	2,005	803
	2007	7,885	1,737	624	2,386	2,326	730	1,505	874
D. **GDP per Capita Growth Rate** (%)	1993–1997	2.0	(1.5)	17.3	(5.5)	3.7	(4.3)	1.7	2.2
	2002–2008	0.1	(1.4)	1.0	1.3	3.0	3.4	0.8	1.0
E. **Labor Force** (in thousand)	1997	6 (1996)	35	2,413 (2000)	14	57 (1991)	—	34 (1996)	98 (1999)
	2007	7 (2001)	37 (2002)	—	15	56	—	36 (2003)	—
F. **Labor Force Growth Rate** (%)	1997	—	12 (1998)	—	3	—	—	—	—
	2007	—	—	—	0.7	—	—	—	—
G. **Unemployment**[a] (%)	1993–1997	13 (1996)	7 (1994)	—	35 (1997)	4 (2001)	11 (1999)	13 (1996)	2 (1999)
	2002–2007	13 (2001)	13 (2000)	3 (2000)	31 (2007)	1 (2007)	—	5 (2003)	—
H. **Underemployment**[a] (%)	1993–1997	—	—	—	—	—	65 (1999)	—	68 (1999)
	2002–2007	—	—	—	—	—	—	—	—
I. **Poverty Incidence**[b] (%)	1993–1997	12 (1998)	28 (1998)	38 (1996)	20 (1999)	—	—	—	—
	2002–2007	—	37 (2005)	—	—	20 (2002)	23 (2006)	22 (2002)	16 (2006)
1. Urban	1993–1997	—	30 (1998)	—	—	—	—	—	—
	2002–2007	—	42 (2005)	—	—	23 (2002)	32 (2006)	24 (2002)	33 (2006)
2. Rural	1993–1997	—	33 (1998)	—	—	—	—	—	—
	2002–2007	—	35 (2005)	—	—	18 (2002)	19 (2006)	23 (2002)	11 (2006)
J. **Literacy Rates**[c] (%)	1993–1997	99 (1996)	71 (1994)	74 (1997)	74 (1989)	99 (1997)	62 (1991)	99 (1996)	34 (1989)
	2002–2007	—	—	67 (2004)	—	99 (2004)	—	—	—
K. **Net Enrolment Ratio in Primary Education**[c] (%)	1993–1997	—	94 (1994)	66 (no year)	90 (1988)	82 (1991)	39 (1986)	92 (1986)	75 (1989)
	2002–2007	92 (2001)	92 (no year)	77 (no year)	84 (1999)	87 (2001)	56 (1999)	89 (1996)	78 (1999)
L. **Primary Education Completion**[c] (%)	1993–1997	88 (1999)	—	52 (1998)	—	96 (1998)	72 (1991)	—	82 (1998)
	2002–2007	—	—	54 (2003)	—	96 (2004)	—	—	87 (2004)
M. **Maternal Health, Mortality per 100,000 Live Births**[c]	1993–1997	—	83 (1992)	390 (1995)	—	140 (1991)	60 (1995)	39 (no year)	32 (1995)
	2002–2007	—	274 (1999)	300 (2000)	74 (2002)	29 (2001)	130 (2000)	78 (2000)	32 (2000)
N. **Access to Drinking Water, % of Population**	1993–1997	94 (1990)	88 (1990)	39 (1990)	96 (1990)	91 (1990)	61 (1990)	100 (1990)	60 (1990)
	2002–2007	94 (2004)	94 (2004)	39 (2004)	87 (2004)	88 (2004)	70 (2004)	100 (2004)	60 (2004)
O. **Access to Sanitation, % of Population**	1993–1997	94 (1990)	29 (1990)	44 (1990)	74 (1990)	98 (1990)	16 (1990)	96 (1990)	50 (1990)
	2002–2007	100 (2004)	28 (2004)	44 (2004)	82 (2004)	100 (2004)	31 (2004)	96 (2004)	50 (2004)

( ) = negative, — = not available, COO = Cook Islands, FSM = Federated States of Micronesia, GDP = gross domestic product, PNG = Papua New Guinea, RMI = Republic of Marshall Islands, SAM = Samoa, TON = Tonga, VAN = Vanuatu.

[a] Based on census years falling within or close to the periods 1993–1997 and 2002–2007. Indicated below the data.

[b] Comparative tables from Abbott presentation *Definition & Trends of Poverty & Hardship in the Pacific* , May 2008. Basic data from Household Income and Expenditure Surveys years indicated below poverty incidence. Defined as "national basic needs poverty incidence."

[c] Closest available year to period. Pacific Islands Regional Millennium Development Goals Report 2004. Note variance between the United Nations and country-specific definition.

Sources: Asian Development Bank Pacific Department, various United Nations agencies, Pacific Region Information System, and Regional Millennium Development Goals Report 2004.

SUMMARY OF PROGRAM LOANS DESIGNS AND RESULTS TO 2008

Table A3.1: Program Loan Designs and Key Results to 2008

Loan	Outputs: Reform Measures	Outcomes: Reform Objectives	Impact: Reform Contributions
RMI Public Sector Reform Program Loan Amount: SDR8.4 million–$12 million equivalent (tranches of $5.5 million, $3.5 million, and $3.0 million) Date Approved: January 1997 Date Closed: PPER Rating: Partly successful	**Outputs at design** Short-term stabilization of government finances. Long-term structural stability of public finances. Create improved enabling environment for private sector. **Outputs at completion/evaluation** Tax revenues: (i) import regime simplified and basic rate increased from 10% to 12% in 1996. Rolled back prior to 1999 elections, and increased to 8% in October 2000; at PPER, collections were below pre-reform levels; (ii) removal of tax exemptions far less than envisaged; (iii) strengthening of tax administration. VAT, tax on rentals, and road user charger changes not introduced. Reduced expenditure—SOE subsidies—targets met for AMI, Marshall Energy Company, and Majuro Water and Sewer Company, but not Tolabar. RIF—Targets eventually achieved by 2000, with some restructuring of ministries, with a view to long-term reduction expenditure. Rationalization of public service was meant to follow PSMIP framework (UNDP-assisted) but no evidence of wider rationalization. Private sector environment—major objective was to place AMI on sound basis; three planes sold and over half of staff retrenched. Private sector unit established with TA.	**Outcomes at design** Fiscal stabilization and sound fiscal policies. Privatization of public enterprises. Public sector reform. Stimulate private sector development. **Outcomes at completion/evaluation** Tax strengthening measures had no sustained impact on improved tax administration, though some improvement in tax collection. Grants are still a major source of government revenue—increasing share. Official transfers share of current account inflows still substantial in 2002–2006 (46%) but lower than previous periods; share of other goods, services, and income improved (33% in 1993–1996 to 42% in 2002–2006). Reversal in budget deficit position in 1996; surplus from 1996–2001; remains relatively stable as % of GDP from 2003 to 2007. Management of trust funds—MISSA managed soundly; MIITF established in 2002 and funds from PSRP and FFMP transferred; resources at PPER, $32 million. No resources appropriated for Road User Trust Fund. AMI operations remain fragile. Private sector unit had limited effect on SOEs and disbanded on TA termination. Regulatory environment—some success in improving transparency but minimal program impact; work permits are serious impediment; foreign direct investment regime needs review; land leasing yet to be accepted and implemented.	**Impact at design** Design impact – Return economy to financial stability, and set it on a more sustainable course for economic growth and development. **Impact at completion/evaluation** Overall aim of fiscal stability achieved, but fiscal policy remains weak and structural problems not diminished. No institutional mechanisms to ensure well-informed decisions; leadership seemingly remains unaware of sound financial management. Public service numbers have risen rapidly and reduction at PPER only 4% compared with 24% target; wage bill 8% higher than before reform started. SOE subsidies now back to pre-reform levels. Program did not reinvigorate the economy; severe impact on real wages. Real GDP dropped 6.6% 1995–2001, ending up 22% lower than when Compact began; 1993–1996, negative GDP growths, and high inflation worsening in 1996. Improvement in 1997–2007, albeit slower growth in 2005–2007. Reversal expected in 2008 as economy hit oil price rises. Inflation contained beginning 1998 (2%), sharp rise in 2008. Government still dominant player in the economy (public expenditure was 67% of 2007 GDP though much lower than highest level 93% in 1995); services drive GDP growth (though share in GDP reduced); and the sector's biggest client is government. Some improvement though as share of industry increased (17% in 1998 to 21% in 2006). Persistent huge trade deficits. S-I gap unchanged, substantial negative savings rate. External debt has been reduced substantially, while maintaining an almost balanced budget.

Loan	Outputs: Reform Measures	Outcomes: Reform Objectives	Impact: Reform Contributions
			Net FDI low but increasing Private sector failed to replace level of economic activity generated by the public sector. Large impact on out-migration, population growth dropping from very high 4.3% to 1.5% World Bank Ease of Doing Business Index: slipped from 86 (2007) to 93 (2008). Relatively costly. World Bank governance indicators 2007: relatively poor performance in government effectiveness and anticorruption.
RMI FFMP SDR6.32 million– $8 million equivalent plus $4 million OCR (tranches of $4.3 million, $5.4 million, $2.3 million) May 2001	**Outputs at design** Strengthened governance of the fiscal stabilization trust fund; resource allocation to trust fund. Strengthened public sector financial management. Increased government revenue; restrained government expenditure. Improved effectiveness of public service. Enhanced policy environment for private sector. **Outputs at completion/evaluation** Sustainable income for future generations: (i) fiscal stabilization fund governance strengthened—MIITF established, superseded by Compact Trust Fund; (ii) allocation resources to Trust Fund—$25 million meant to be deposited from MIITF to Compact Trust Fund on effective date, with further transfers; $31.1 million in MIITF meant to be invested in low-risk securities, but not completely followed with loan given to Marshall Islands Development Bank for local business. Strengthen public sector financial management system—Financial Management Information System established to improve monitoring and reporting; Economic Policy Planning and Statistical Office established within Office of President, with ADB TA. Stabilized fiscal situation: (i) increased government revenue—increases in uniform import duties; training of tax auditors;	**Outcomes at design** Ensure sustainable income flows for future generation. Strengthen public sector financial and economic management. Stabilize fiscal position. Improve effectiveness of public service. Enhance policy environment for private sector. **Outcomes at completion/evaluation** Reduction in force implemented—but 20% increase since reductions; insufficient attention to improving efficiency. Reversal in budget deficit position in 1996; surplus from 1996 to 2001; remains relatively stable as % of GDP from 2003 to 2007. Revenue from taxes improved. Grants still major source of government revenue—increasing share, though some improvement in tax collection. SOE subsidies reduced in 1996 but started to rise in 1999. Share in total government expenditure small—does not impact significantly on overall budget balance. Government investment in social infrastructure remains limited; most revenues spent on government operations. Enhanced policy environment for private sector—some progress on land development registration law, but not in freeing land; recent assessment of private sector identified other	**Impact at design** Sustainable growth and poverty reduction without continued reliance on external assistance. **Impact at completion/evaluation** As above, small growth in GDP from 2005 to 2007, but sharp reversal in 2008. Unemployment rate remains high at 31% in 2007 (35% in 1997). High youth unemployment.[a] Net FDI insignificant compared with official transfers. External debt as % of GDP remains high (58% in 2008). Managed to reduce external debt from 149% of GDP in 1994 to 58% in 2008. S-I gap unchanged, substantial negative savings rate. World Bank Ease of Doing Business Index: slipped from 86 (2007) to 93 (2008). Relatively costly. (Rank 1–175/181, declining ease of doing business). World Bank governance indicators 2007: poor performance in government effectiveness and anticorruption.

Loan	Outputs: Reform Measures	Outcomes: Reform Objectives	Impact: Reform Contributions
	(ii) restraint in government service expenditure—general fund kept within 5% growth target during program to allow buildup of MIITF. However, limited restraint outside public services has limited overall progress in restraining overall expenditures; improved linkages in health referral system should help health fund arrears; subsidies to SOEs have continued. Improved effectiveness of public service—RIF reduced service by 30%.	impediments to development.	
FSM PSRP SDR12.979 million–$18 million equivalent (tranches of $10 million, $8 million). Second tranche release delayed and made in two releases (different states, different progress) April 1997	**Outputs at design** Reduced size and operating costs of the civil service. Increased domestic revenue generation. Restructured government operations and public enterprises, with divesture of some SOEs. Successful mitigation of negative social and economic impacts of the adjustment in public expenditure. Improved conditions for private sector development.	**Outcomes at design** Reforming and reducing the size of the public sector to adjust to declining external resource transfers. Shifting balance of economic activity away from the public sector to the private sector.	**Impact at design** Transformation and development of a more efficient FSM economy.
	Outputs at completion/evaluation Reductions in size of public service and operating costs achieved, although varied across governments—but downsizing was not tied to strategic plan for future public service focused on core activities. Public sector still largest employer (50%). Domestic revenue generation—valuation basis for import duties changed from FOB to CIF. Coverage extended to previously exempt government-owned enterprises. Receipts 69% higher as a result. Non-tax revenues declined—fishing license decline; and lower investment returns because of drawdowns to meet expenses. Increases in user charges—electricity, water. Grants still major source of government revenue. Very little government investment in social infrastructure; negligible in 2005–2006 as most revenues spent on government	**Outcomes at completion/evaluation** Government is still dominant player in the economy (government expenditure 64% of 2007 GDP) albeit at lower levels than the 1993 high of 87%. Services drive GDP growth; and the sector's largest client is government. Share of agriculture and industry changed slightly. Transfers did not decline as Compact of Free Association was extended in 2001; still accounts for substantial current account inflows, in fact higher than in 1993–1996. Establishment of the FSM Trust Fund provides a basis for future funding of Government operations although set-aside funding levels need to be higher.	**Impact at completion/evaluation** Little economic transformation—socioeconomic conditions shaped by public policy environment over 30 years frustrated intent of increasing private sector activity. Sharp swings in GDP growth. Inflation contained to 1-digit though they doubled from 1998 to 2008. Hit by negative growth and doubling inflation rates. Recent oil crisis took its toll on economy. Relatively stable overall budget balance as % of GDP during 1998–2001. Rising sharply in 2001 as deficit turned to surplus. External debt declining. Financing economic activity and fiscal deficit from transfers. Persistent trade deficits and dependent on two major trade partners—United States and Japan. Unemployment rate almost doubled from 7% (1994) to 13% (2000). High youth unemployment. World Bank Ease of Doing Business Index: slipped

Loan	Outputs: Reform Measures	Outcomes: Reform Objectives	Impact: Reform Contributions
	operations. Private sector – investment laws and regulations reviewed. Investment agency established. Foreign investment Act passed in January 1998, with complementary legislation in states. Legislation passed to enable land to be leased for 50 years but made little difference to its use as collateral.		from 121 (2007) to 126 (2007). Relatively very costly (Rank 1–175/181, declining ease of doing business). Improvement on following World Bank governance indicators: government effectiveness, regulatory quality in 2007, modest performance in government effectiveness and anticorruption.
FSM PSDP Program loan of SDR3.912 million ($5 million equivalent) and project loan of SDR6.273million ($8 million equivalent). December 2001	**Outputs at design** Continued economic and legal reforms. Improved public services to support private sector development. New secured transactions system. Strengthened state land administration and management. Strengthened capacity of FSM Development Bank. **Outputs at completion/evaluation** Prior to loan approval, key positive step was establishment in January 2000 of the Public Enterprise Unit within Department of Economic Affairs to coordinate and facilitate formulation of privatization policies and implementation (with ADB-supported TA). Second tranche release: national government and governments of Kosrae and Yap all made resolute efforts to comply with conditions, but only national government and Kosrae met all requirements and release did not include Yap. Maintain economic and public sector reforms—balanced budgets met by all governments; payrolls and wage differentials general awareness; sound management of FSM Trust Fund condition met, but funds unlikely to be enough to match reduced annual payments under later years of Compact; sound management of external debt condition met; progress in public sector reform—each of the governments had to transform at least one Public State Enterprise; national government, Yap and Kosrae complied, although latter's compliance seems weak as major transfer of public utility unlikely	**Outcomes at design** Develop a sound economic and legal environment conducive to private sector development. Improve access to and competitiveness of land, labor, and capital resources to increase business prospects and performance. **Outcomes at completion/evaluation** Not rated at evaluation as under implementation. Current indicators are as follows: foreign Investment Act January 1998; World Bank Ease of Doing Business Index: slipped from 121 (2007) to 126 (2008). Relatively very costly (Rank 1–175/181, declining ease of doing business); S-I gap remains unchanged.	**Impact at design** Increase sustainable economic growth through an increased contribution of the private sector. **Impact at completion/evaluation** Not rated at evaluation as under implementation; Current indicators are as follows: Government still dominant player in the economy (expenditure 64% of 2007 GDP albeit lower than 87% in 1993); services drive GDP growth; and the sector's biggest client is government. Share of agriculture and industry hardly changed. Improvement on following World Bank governance indicators: government effectiveness, regulatory quality in 2007, and modest performance in government effectiveness and anticorruption.

Loan	Outputs: Reform Measures	Outcomes: Reform Objectives	Impact: Reform Contributions
	to happen; Chuuk has not complied; Pohnpei did, but with action being forced in regard to fisheries Public State Enterprise transformation because of inability to inject funds. Improved legal environment for private sector development—laws to improve use of land and property as loan security; improved foreign direct investment laws and regulations. Land leasing largely a state issue. Kosrae complied, but Yap, Chuuk, and Pohnpei have not. Pohnpei's existing act is more likely to deter than attract long-term leasing. National government, Yap, and Kosrae complied with condition on foreign investment reform; Chuuk and Pohnpei have not.		
Cooks ERP $5 million OCR (tranches of $3 million; $1.83 million) September 1996	**Outputs at design** Public sector reform—redefine and rationalize role of government through devolution of selected powers and responsibilities to local communities; sound financial and economic management with increased user charges, reduced subsidies, and cost-cutting measures such as reduction in public servants; and improved public sector management and efficiency. Promotion of private sector-led growth. Protecting and enhancing social equity and sustainability (included Transition Ministry to assist laid off public servants). **Outputs at completion/evaluation** Over 80% of the 124 ERP measures were implemented or substantially completed. Major reforms to downsize government staff by almost 60% and increase civil service productivity and passage of key legislative reform measures were completed shortly before loan approval. Three key pieces of public financial management legislation put in place, which remain the key legislation today: MFEM Act, Public Expenditure Review Committee and	**Outcomes at design** Macroeconomic stability, particularly fiscal and external balance. Reduction in government role and increased private sector activity—agriculture, fisheries, tourism. Mitigation of social costs resulting from downsized public sector and rise in emigration. **Outcomes at completion/evaluation** The reform program, and particularly the downsizing of the public service and sale of government assets to the private sector, enabled the Government to pull back from bankruptcy and move on to a renewed growth path. Cash liquidity was restored within 9 months. Taxes are a major source of government revenue, despite reduced share to 72% in 2002–2007 from 81% in 1993–1996. Grants share increased to 17% (2002–2007) from	**Impact at design** Reform and restructure whole economy, reducing role of public sector. **Impact at completion/evaluation** Sharp swings in GDP growth reaching lowest point in 1997, sharp recovery in 2000 but recent decline due to rising import costs and global economic slowdown. The program played a major role in reducing the severity of the economic downturn in 1996–1998, returning the country to macroeconomic stability, and inducing relatively strong economic growth led by the private sector rather than public sector. Reduced government participation in economic activity—expenditure share of GDP dropped to

Loan	Outputs: Reform Measures	Outcomes: Reform Objectives	Impact: Reform Contributions
	Audit Act, Public Service Act. Significant reduction in government expenditure through downsizing a number of ministries and public servants (60% reduction). Under MFEM Act, improved public expenditure management with specification of outputs with associated performance indicators. The PSC Act was designed to free senior managers from political interference. The performance of individual ministries under these devolved powers varies between ministries with overall public service standards needing enforcement. SOEs are outside the oversight of the PSC Act and PSC role/capabilities needs further review. Lack of attention to regulatory arrangements after sale of privatized government-owned enterprises—a problem where monopolies were created.	13% (1993–1996), likewise non-tax revenue rose to 11% (2002–2007) from 5% (1993–1996). Public service reform is incomplete. Much of devolution to local levels has been reversed, with continued concerns raised about viability and quality of service where devolved. Revised Outer Island Act devolving powers remains in draft. Government seemingly reluctant now to delegate more powers. Major institutional weakness remain in outer islands, some of which are hardly viable as communities given emigration (of the working age population). Limited capacity within government, which was reduced substantially in size under the ERP but now creeping in size. Nevertheless, improved capacity in MFEM, education, health, marine, police, audit but others weak (works, agriculture).	32% in 2007 from peak of 56% in 1994. Trade surpluses and service exports are largely within the tourism sector, which is the main driver of economic growth. Improvements are reflected in a reduction in public ownership of existing tourism services rather than economic diversification. Tourism-dependent services sector share in economic output dropped to 77% in 2007 from 83% in 1995. Share of agriculture increased to 14% in 2007 from 9% in 1995 (agriculture nevertheless at risk of decline due to the disease that hit the pearl farms and reduced access to New Zealand markets). Large external and unsustainable debt as percentage of GDP in 1994–1997, peaked at 141% in 1996. Substantial drop in 1998 (61%), reduced to 19% in 2007. Fiscal situation is fragile, including creeping increase in number of public servants. Inflation kept at 1-digit, but rising faster than economic growth beginning 2005. The private sector has partly filled the growth gap, which cannot yet guarantee sustainable growth as economy highly import dependent. World Bank governance indicators 2007 scored highest in regulatory quality, anticorruption, and government effectiveness.
Samoa FSP $7.5 million (tranches of $4 million; $3.5 million) February 1998	**Outputs at design** Promoting and developing financial markets. Strengthening CBS. Strengthening regulatory framework for transition to market-oriented financial system. Strengthening performance NPF. Privatizing or corporatizing SOEs. **Outputs at completion/evaluation** Interest rates market-determined. Closer alignment to CBS rates, increasing CBS influence on monetary policy. CBS restructured. Prudential and regulatory guidelines developed to underpin transition to market-oriented financial system. Development Bank of Samoa and NPF—	**Outcomes at design** Promotion and establishment of sustainable market-based financial sector policies. Privatization or corporatization of SOEs. **Outcomes at completion/evaluation** Reversal of budget deficit beginning 1995; surplus (government savings) small as % of GDP, 1% in 2007. Current account inflows largely transfer (remittances) and services/income—share hardly changed since 1993; averaged 94% (2002–2007). While transfers dropped, tourism-related services income grew.	**Impact at design** Private sector-led economic growth. **Impact at completion/evaluation** External debt financing of economic activity declined—replaced by tourism and remittances. Public sector not dominant in economy—on average, expenditure accounts for 36% of GDP (1994–2007)—substantially smaller than 80% in 1993. Low unemployment—1% in 2007, down from 4% in 2001.

Loan	Outputs: Reform Measures	Outcomes: Reform Objectives	Impact: Reform Contributions
	capacity building to manage assets better. Privatization or corporatization SOEs slow. Seeming opposition from some ministers on SOE boards.	Taxes major source of revenue; improved to 66% share (2002–2007) from 55% (1993–1996). Prudent fiscal management as government expenditure grew as much as revenues. Very little investment in social infrastructure as most revenues go to government operational expenditure. SOEs employment dropped substantially (35%) from 2,393 (2001) to 1,563 (2006).	No extreme poverty or hunger in Samoa based on 1997 South Pacific Commission and UNDP HIES data. Tourism-related services is a key driver of the economy. Services account for 63% of economic activity (2007)—up from 53% (1997). Agriculture contracted as services expanded by almost half—to12% (2007) from 22% (1997). Estimated food poverty incidence is 7.6% of Samoan households and basic needs poverty incidence is 20% in 2002. 1997 HIES, UNDP estimates that 15% of households fall below the standard poverty line of $1 per day in the 1993 PPP, but figures challenged by government. World Bank Ease of Doing Business Index: improved from 56 in 2007 to 64 in 2008. Still relatively less costly (Rank 1–175/181, declining ease of doing business). World Bank governance indicators 2007 scored well in regulatory quality anticorruption and government effectiveness. Improvement in regulatory quality and anticorruption.
Tonga EPSRP $10 million: SDR8.02 million May 2002	**Outputs at design** Fiscal reform—strengthening public expenditure management; enhancing revenue generation; improving efficiency, and effectiveness of resource use in public enterprise sector. Public service reform—institutional framework for performance-oriented public service; efficient and effective performance management. **Outputs at completion/evaluation** Strengthened public expenditure management—shift from line item to more results-based program budgeting; hiring freeze; civil service pension scheme transformed; Financial Management Act, July 2003. Enhanced revenue generation – Revenue Services Administrative Act, November 2002; increased fees, and consumption tax (VAT). Efficient and effective use of resources by	**Outcomes at design** Fiscal reform. Improved public sector service delivery. **Outcomes at completion/evaluation** Reversal of budget deficit to surplus in 2004. Overall budget surplus as % of GDP small since 2004; just 1% in 2007. Taxes are major source of government revenue. Large improvement in tax revenue—share of total increasing since 1993. Share is 95% in 2002–2007, much higher than previous periods (52% in 1993–1996; 70% in 1997–2001).	**Impact at design** Macroeconomic stability. Private sector-led economic growth. **Impact at completion/evaluation** Public sector not dominant in economy—on average expenditure accounts for 30% of GDP (1993–2007) Services account for more than half of economic output—61% in 2007. Poor economic performance since 2002. Hard hit by inflation—higher than GDP growth. Inflation fuelled by food and oil imports. Structural transformation. Rigid economic structure constrains growth.

Loan	Outputs: Reform Measures	Outcomes: Reform Objectives	Impact: Reform Contributions
	public enterprises—Public Enterprise Act, December 2002. Performance-Based Public Service—Public Service Act effective April 2003. Fiscal reforms were implemented, but little happened in public sector reforms until the public service strike in 2005 and the Government initiated civil service reforms in 2006. Civil strife in 2006 created a greater urgency for reform. Progress is also now being made in the reform of SOEs. Progress evident on revenue generation and expenditure controls, led by the Ministry of Finance. However, progress on the public sector and public enterprise reforms only got under way because of changing social circumstances (civil disturbances and public service strike) demanding political change, which led to pressures for wider reforms. The reform impetus increased from 2006.	Impressive growth in foreign remittances (private transfers) but not translated to GDP growth. Private transfers account for 78% of current account inflows in 2002–2007—up from just half in 1993–1996. PSC established July 2003. Grading and salary and wage exercise completed, but wage demands (civil service strike) interfered with implementation—government agreed to major across-the-board increases. Voluntary retrenchment scheme in 2006—25% reduction. Performance agreement signed by all heads of departments—annual performance agreement against key results areas. However, effectiveness limited by lack of financial devolution. Some limited corporatization of public enterprises, but limited evidence yet of improved performance. Renewed progress in commercialization and privatization of public enterprises since 2008.	Significant improvement in unemployment—5% in 2003 down from 13% in 1996. In 2002, basic needs poverty incidence estimated at 22% (HIES). Persistent trade deficits—worsened beginning 2003. S-I gap widened. Increase in remittances had no impact on savings and economic activity. PCR notes that five outputs did not lead to sustainable fiscal balance and improved public service delivery, the two program objectives, nor were economic growth and inflation targets reached. Fiscal deficit and public service inefficiencies remain. Wage bill remains high, on average 53% of current expenditure in 2002–2007. Complexity and long-term process of economic and public sector reform recognized. The public sector reform process has become intertwined with the political reform agenda, with the latter providing a sense of urgency for progress prior to the elections in 2010. World Bank Ease of Doing Business Index: slipped slightly from 40 (2007) to 43 (2008) and relatively costly (Rank 1–175/181, declining ease of doing business). World Bank governance indicators 2007: improvement in regulatory quality but lower scores in anticorruption and government effectiveness.
Vanuatu CRP $20 million: SDR14.977 million (tranches of $10 million, $5 million; $5 million) July 1998	**Outputs at design** Strengthen legislative and institutional framework: (i) introduce responsible fiscal management, (ii) fiscal balance and stabilization, (iii) restructure public sector institutions and responsibilities, and (iv) perform institutional strengthening of public sector institutions. Improve investment policy environment: (i) reform financial sector policies, (ii) restructure government financial institutions, and (iii) redefine commercial functions of government. Mitigate negative impacts on groups at risk and vulnerable to reform process: enhance social services to disadvantaged groups.	**Outcomes at design** Public sector reforms: redefine role of government and enhance quality and delivery of policy, regulatory, and developments services. Financial and economic reforms: increase productivity and growth of commercial and private sector. Support improvement of social development indicators, particularly for disadvantaged and rural population.	**Impact at design** Enhance and sustain private sector-led economic growth.

Loan	Outputs: Reform Measures	Outcomes: Reform Objectives	Impact: Reform Contributions
	Outputs at completion/evaluation Five key pieces of legislation enacted prior to loan approval and implemented in 1998: Government Act, defining boundaries political leadership and Public Service; Leadership Code Act; Public Service Act to remove political interference in the public service, strengthening independence of PSC (PCR states interference largely removed); Public Finance and Economic Management Act and Expenditure Review and Audit Act, which strengthened accountability of the Executive Branch to Parliament. Expenditure Review and Audit Act allowed for establishment of Expenditure Review Committee to review and report on public expenditure. In parallel, Public Account Committee supported by Auditor General's office, with resources from CRP. Over 700 redundancies following rightsizing. Tax and tariff systems overhauled (reductions in tariffs—30% by 2004—and rationalization) to stimulate economic activity. VAT introduced as planned. Foreign Investment Act passed in June 1999 has improved transparency, but licensing process remains lengthy. Corporate and business plans introduced for each ministry and department, better linked to budgeting process. Financial Institutions Act 1999 empowered Reserve Bank to supervise all domestic financial institutions; December 2002 extended to cover both onshore and offshore banks. National Bank of Vanuatu and Vanuatu NPF rehabilitated and strengthened. Government Business Enterprise Unit set up 1998 to manage divestment government enterprises—successfully corporatized Civil Aviation Authority and Vanuatu Post. Transition Services Unit established to help retrenched public servants.	**Outcomes at completion/evaluation** Fiscal crisis in 1998 as budget deficit ballooned. Inflation almost unchanged while GDP fell. Huge improvement in fiscal position beginning 2001 up to 2007. Reversal from deficit to surplus in 2003–2004. Balanced recurrent budget remains a challenge, with shortfalls in revenue. Taxes are major government revenue source—increased share from 78% (1993–1997) to 83% (2002–2007). Managed to mitigate sharp swings in government expenditures. Last meeting of Public Account Committee in 1999 as incoming coalition governments did not reappoint Public Account Committee. Weak institutional capacity. Parliament required to approve complex legislation with little scrutiny and reflection. Transition between old and new management systems—ministers and public servants found transition difficult, with no close mentoring, resulting in delays. Political interference in sale of SOEs resulted in huge legal damages and loss of investor confidence. Waning commitment of coalition governments. Fall of pro-reform government in November 1999 was major setback in pace and sequencing, although commitments to CRP remained, with good governance firmly established.	**Impact at completion/evaluation** Tourism-related services and investment drive economic growth. Services account for 74% (2007) of economic output—unchanged since 1997. Tourism growth mitigated impact on economy of fiscal crisis, as well as unfavorable trade performance. Public sector not dominant in economy—expenditure hardly changed much as % GDP averaged 26% (1993–2007). Benefits from recent economic growth did not trickle down to disadvantaged groups. Though unemployment rate was 2% in 1999, employment in subsistence activities is high at 68%. Based on 2006 HIES, basic needs poverty incidence is 16%. Tourism-driven economy grew at respectable rates beginning 2003. Inflation kept low though starting to rise but not to alarming levels. No sharp foreign exchange rate fluctuations after 2004. While tourism grew despite local currency appreciation, exports hard hit. FDI plays key role in financing economic activity. Not dependent on external debt, transfers, and grants. World Bank Ease of Doing Business Index: slipped from 67 (2007) to 60 (2008). Still relatively less costly (Rank 1–175/181, declining ease of doing business). World Bank governance indicators 2007—improvement in the following: government effectiveness, regulatory quality, control of corruption. Scored high in anticorruption, moderate in government effectiveness.
Solomon Islands PSRP $25 million: SDR18.8 million	**Outputs at design** Reduce size and operation costs of the civil service.	**Outcomes at design** Reform and reduce size of public sector, partly to adjust to economic contraction.	**Impact at design** Place economy on sustainable track and improve efficiency and performance in public sector.

Loan	Outputs: Reform Measures	Outcomes: Reform Objectives	Impact: Reform Contributions
(tranches of $15 million, $10 million). Approved August 1998, cancelled October 2000	Increase domestic revenue generation. Restructure government operations to improve efficiency and effectiveness; sell or liquidate several major SOEs. Strengthen governance institutions to promote greater transparency and accountability and to reduce opportunities for corruption in the public service. Mitigate negative social or economic impact of adjustment in public expenditure.	Shift balance of economic activity away from the public sector to the private sector.	
	Outputs at completion/evaluation Macroeconomic stabilization—initially, substantial progress—raising revenue, containing expenditure. First phase public service reforms took much longer than expected because of legal challenges and opposition from affected civil servants, and delays in appointing a new head of the public service. Institutional strengthening unit was established within Public Service Division to review organizational strategies, implementing system-wide changes, and carrying out institutional strengthening, and took first steps (2000 budget), but overtaken by unrest. No action taken on plan to strengthen Auditor General's Office, or to increase transparency of public tendering by time of program cancellation. Review of SOEs moved slowly—opposition from political appointees to SOE boards.	**Outcomes at completion/evaluation** Civil unrest 1999–2000 (resulting essentially from ethnic conflict) led to detention and subsequent resignation of the Prime Minister on 5 June 2000. New coalition at end of 2000 aimed at achieving national unity, reconciliation, and peace, with peace as number one priority. New government did not support program objectives. Crisis basically undid most of the achievements. PCR states that without this political change, the program would likely have had the potential to lead to successful outcomes. At the time of formulation and approval, it was widely regarded as a unique opportunity to support a reform-minded government in achieving substantial change. The level of commitment to the reform program was determined not just by the commitment of government, but by its ability to manage vested interests that may wish to maintain the status quo and not reform. Monitoring political environment is important, including all supporting and resisting forces and risks of politically motivated interruption of reform program, as well as assessing the capacity and ability of civil service to continue reforms despite political upheavals.	**Impact at completion/evaluation** Program demonstrates vulnerability of reform programs to political environment, particularly in conflict situations. Huge decline in GDP growth in 2000—negative 14% largely a consequence of the political crisis (coup). Negative growth continued until 2002. Recovery began in 2003 (6%); economy posted 10% growth in 2007 and projected slight decline but still positive growth in 2008 (8%). Persistent budget deficits from 2000, widened to $46 million in 2002. Reduced substantially to $5 million in 2007. Taxes still account for a large proportion of total government revenue—but their share, on average, is lower at 50% during 2002–2007 versus 1995–1997 (79%). Note increase in grants as revenue source—to 22% (2002–2007) from zero (1995–1996). Public sector still not dominant player in the economy, but increasing role—expenditure share of GDP average 38% in 2002–2007, higher than 1993–1997 (30%). Very little government investment in social infrastructure; negligible as most revenues spent on government operations. Wage bill in absolute terms almost unchanged at $33 million in 2006 versus 2001 ($35 million). Substantially reduced though as % of current expenditure—to 26% in 2006 from 51% in 2001. No improvement in unemployment—in fact, worsened. In 1999, 65% of labor force was classified not in paid work. 80% of the population

Loan	Outputs: Reform Measures	Outcomes: Reform Objectives	Impact: Reform Contributions
			depends on subsistence agriculture and fishing. Poverty incidence is 23% based on 2005–2006 HIES. World Bank Ease of Doing Business Index: slipped slightly from 85 (2007) to 89 (2008). Still relatively less costly (Rank 1–175/181, declining ease of doing business). World Bank governance indicators 2007: improvement in the following—government effectiveness, regulatory quality, and anticorruption. Although scored low in government effectiveness, moderate in anticorruption.
PNG PSP $70 million (two tranches of $35 million—note second tranche cancelled) December 2001	**Outputs at design** Building a performance-oriented public service. Reorienting personnel management systems and processes. Strengthening governance probity and oversight agencies. Improve mechanisms to deliver public services. **Outputs at completion/evaluation** Performance-oriented public service built. In 2000, government's policy-making framework was reformed, clarifying the roles of the National Executive Council and its secretariat, central agencies, and line departments. By February 2003, with PSP support, the necessary legislative and regulatory changes were in place, including (i) amending the Constitution to ensure PSC decisions were legally binding; giving the PSC authority over selection, appointment; and discipline of departmental heads, provincial administrators, and heads of regulatory statutory authorities; (ii) passing of legislation—including Public Services (Management, Selection, and Appointment of Departmental Heads and Provincial Administrators) Regulation (2003), the Regulatory Statutory Authorities (Appointment to Certain Offices) Act (2004), and amending the Public Services (Management) Act (1998); (iii) approval of a Code of Ethics, the Business Conduct of the Public Service, and complementary General	**Outcomes at design** Improved public service delivery in key sectors. Increased private sector-led economic growth. **Outcomes at completion/evaluation** Reform implementation has been constrained by weak political commitment, lack of synergy between central and local (province and district) agencies, and in particular poorly developed management competencies (legislation, regulations, and processes are necessary but not sufficient conditions to embed reforms and impact on service delivery). Persistent substantial fiscal deficits, 1993–2001, albeit reversed in 1996–1997—much smaller in 2001 at $105 million versus $279 million in 1993. Deficit in 2001 small as % of GDP at –3%. Fiscal deficit position worsened in 2001–2002. Reversed in 2004–2007—stood at substantial $153 million (2007). Taxes remain the major source of government revenue—75% (2002–07), slightly lower than 77% in 1997–2001. Declining government spending on public and social services over 1993–2002—28% of current expenditure in 2002 versus 52% in	**Impact at design** Improved living standards. **Impact at completion/evaluation** Export industries drive economic growth. Industrial sector share of economic output in 2008 increased to 35% (projected) from 31% (1997). Exports account for very large share of current account inflows. Hardly changed at 83% (2002–2007) from 1993 to 1996 (84%). Public sector not dominant in economy—on average, expenditure accounts for 30% of GDP in 1993–2001 (34% in 2002–2008). Erratic, sharp swings in GDP growth rates, 1994–2000—substantial drop to –2% in 2000 from 6% (1994). High double-digit inflation—more than tripled to 17% in 1995 from 5% (1993); stood at 16% in 2000. Economic growth after languishing in 2001–02—6% in 2007, projected at 8% in 2008 (largely because of high world prices for its major exports—gold, crude petroleum, copper). Inflation much reduced to single digit—1% in 2007, but sharp rise projected in 2008—9%. Trade surpluses since 1993 to 2007. Stood at $1 billion in 2000, highest in 2007 at $7.3 billion (largely because of high world prices for its major exports—gold, crude petroleum, copper).

Loan	Outputs: Reform Measures	Outcomes: Reform Objectives	Impact: Reform Contributions
	Orders; and (iv) approval of a regulatory framework for the public servant performance management system. Personnel management systems and processes reoriented. PSC, Department of Personnel Management, and the PNG Institute of Public Administration strengthened. Personnel management procedures based on fair, transparent, merit-based, selection procedures. Constitution amended in March 2003 and legislation enacted to strengthen the PSC's independence and oversight mandate. Governance probity and oversight agencies strengthened: Ombudsman Commission, Department of Justice and Attorney General, and the Attorney General's Office —corporate and annual action plans to strengthen the offices, ensuring yearly budget allocations. Mechanisms to deliver public services improved. This output addressed (i) functional and expenditure reviews were undertaken in the Department of the Prime Minister and the National Executive Council and the departments of Treasury, Finance, Health, Works, and Transport to identify internal improvements; and (ii) in 2002, government introduced a service improvement program to improve service delivery agriculture, education, health, and transport infrastructure, but not successful.	1994. General public services and education took biggest cut. General public services down to 11% in 2002 after having risen to 27% in 1996. Education spending reduced to 10% in 2002 from high of 22% in 1999.	External debt declined beginning 2003; substantial drop to 17% in 2007, expected to drop further to 13% in 2008. Benefits from trade did not trickle down to disadvantaged groups. Basic needs poverty incidence of 38% There are significant discrepancies between rural (41% below poverty line) and urban (16% below poverty line) areas according to the (1996 Household Income and Expenditure Survey, and ADB MDG data). World Bank Ease of Doing Business Index: slipped to 95 in 2008 from 89 in 2007, relatively costly (Rank 1–175/181, declining ease of doing business). World Bank governance indicators 2007: scored poorly in both government effectiveness and anticorruption. Improvement in regulatory quality but deterioration in anticorruption (1998 versus 2007).

ADB = Asian Development Bank; AMI = Air Marshall Islands; CBS = Central Bank of Samoa; CFA = Compact of Free Association; CIF = cost, insurance, and freight; CRP = Comprehensive Reform Program; EPSRP = Economic and Public Sector Reform Program; ERP = Economic Restructuring Program; FDI = foreign direct investment; FFMP = Fiscal and Financial Management Program; FOB = free on board; FSM = Federated States of Micronesia; FSP = Financial Sector Program; GDP = gross domestic product; HIES = household income and expenditure survey; MDG = Millennium Development Goal; MFEM = Ministry of Finance and Economic Management; MIITF = Marshall Islands Intergenerational Trust Fund; MISSA = Marshall Islands Social Security Administration; NPF = National Provident Fund; OCR = ordinary capital resources; PCR = program completion report; PNG = Papua New Guinea; PPER = program performance evaluation report; PPP = purchasing power parity; PSC = public service commission; PSDP = Private Sector Development Program; PSMIP = Public Sector Management Improvement Program; PSP = private sector participation; PSRP = Public Sector Reform Program; RIF = reduction in force; RMI = Republic of the Marshall Islands; S-I = savings-investment; SDR = special drawing rights; SOE = state-owned enterprise; TA = technical assistance; UNDP = United Nations Development Programme; VAT = value-added tax.

[a] Australian Agency for International Development. 2008. *Pacific Economic Survey*.

Source: Independent Evaluation Mission.

Table A3.2: Estimated Reform Costs in Pacific Developing Member Country Program Loans

Country	Reform Objectives	Reform Costs Identified	Basis For Estimation
Cook Islands: Economic Restructuring Program ($5 million)	Public sector reform Promote private sector growth Social equity and sustainability	Retirement of part of government's short-term liabilities to domestic private sector creditors Establishment of Business Ventures Development Corporation under Cook Islands Development Bank Equity injection in Cook Islands Development Bank Given the outstanding government arrears and other external debt totaling NZ$200 million, the loan size of NZ$7.2 million would not have bridged the gap.[a]	No detailed aggregation documented. The loan size was on the basis of the significance of the policy changes and economic restructuring being pursued and the historical levels of Bank lending to the Cook Islands.[b]
RMI: Public Sector Reform Program ($12 million)	Stabilize government finances in the short run Ensure long-term structural stability of government finances Create an improved environment for the private sector	Reduction-in-force program ($5.5 million) Pay off Air Marshall Islands' commercial debt ($4 million) Seed injection to Financial Reserves Trust Fund ($2.5 million) [a]	Based on salaries paid in the civil service and average length of service, and expected number of retrenchments Two-thirds of Air Marshall Islands' outstanding commercial debt
FSM: Public Sector Reform Program ($18 million)	Reduce size and operating costs of civil service Increase domestic revenue generation Restructure government operations and public enterprises Mitigate social and economic impact Foster development of private sector	Direct costs of early retirement schemes for the national and four state governments ($3.0 million for the national, $5.3 million for Chuuk, $4.2 million for Pohnpei, $3.5 million for Yap, $2.0 million for Kosrae)	No detailed documentation in the RRP but the EMPAT team (advisory TA consultants) did the detailed estimation and developed monitoring schemes for the retirement program
Samoa: Financial Sector Program ($7.5 million)	Deepen financial markets Strengthen Central Bank of Samoa and enhance its operational autonomy Strengthen prudential and regulatory framework Strengthen National Provident Fund and Development Bank of Samoa Privatize and corporatize public enterprises and utilities	Incremental budgetary cost of issuing Central Bank of Samoa bills ($1.9 million over a 3-year period) Temporary compensation for the loss of revenue from elimination of the foreign exchange levies ($1.3 million annually) Temporary compensation for the loss of revenue from the planned corporatization of the Posts and Telecommunications Department ($5.72 million annually)	A loan of $7.5 million is aimed at covering a major share of these costs to the Government, with the remaining part coming from other sources, including revenue from privatization of state-owned enterprises.[c] Short- to medium-term costs of the reform program were estimated in fiscal and balance of payment terms Incremental cost of issuing Central Bank of Samoa bills was calculated as the total incremental interest rate costs associated with interest rate differential
Vanuatu: Comprehensive Reform Program ($20 million)	Redefine the role of government; and enhance the quality and delivery of its policy, regulatory, and development services Increase the productivity and growth of the private sector in both urban and rural areas Support social development of the	Restructure and rightsize the public sector Restructure and rehabilitate government-owned financial institutions Fiscal stabilization (reduce the need for an inflationary domestic financing of budget deficit)	The fiscal outlook covering 1997–2000 and government funding plan 1998–2000 formed the basis of external financing need for the reform program.[d]

Country	Reform Objectives	Reform Costs Identified	Basis For Estimation
	disadvantaged and rural population	The loan amount ($20 million) was to cover a proportion of 35%, 40%, and 25% respectively) of the above three adjustment costs. [a]	
Solomon Islands: Public Sector Reform Program ($25 million)	Macroeconomic stabilization and fiscal reforms Public sector management reforms Public enterprise reforms Strengthen governance institutions	No specification documented in the RRP. the loan amount ($25.0million) permitted clearance of about 63% of government arrears ($23.8 million), the financing of public service retrenchments ($1.0 million), and incremental costs of hiring staff to implement reforms ($0.2 million).[a]	The loan amount is based on the scope and the costs of the policy reforms, the importance and urgency of the reforms and the state of the public finances of the Borrower.[e]

EMPAT = Economic Management Policy Advisory Team, FSM = Federated States of Micronesia, RMI = Republic of the Marshall Islands, RRP = report and recommendation of the President, TA = technical assistance.

[a] Asian Development Bank (ADB). 1999. *Reforms in the Pacific: an Assessment of the Asian Development Bank's Assistance for Reform Programs in the Pacific*. Pacific Studies Series 17. Manila.

[b] ADB. 1996. *Report and Recommendation of the President to the Board of Directors on a Proposed Loan and Technical Assistance Grants to the Cook Islands for the Economic Restructuring Program.* Manila (Loan 1466-COO[SF], for $5 million, approved on 26 September).

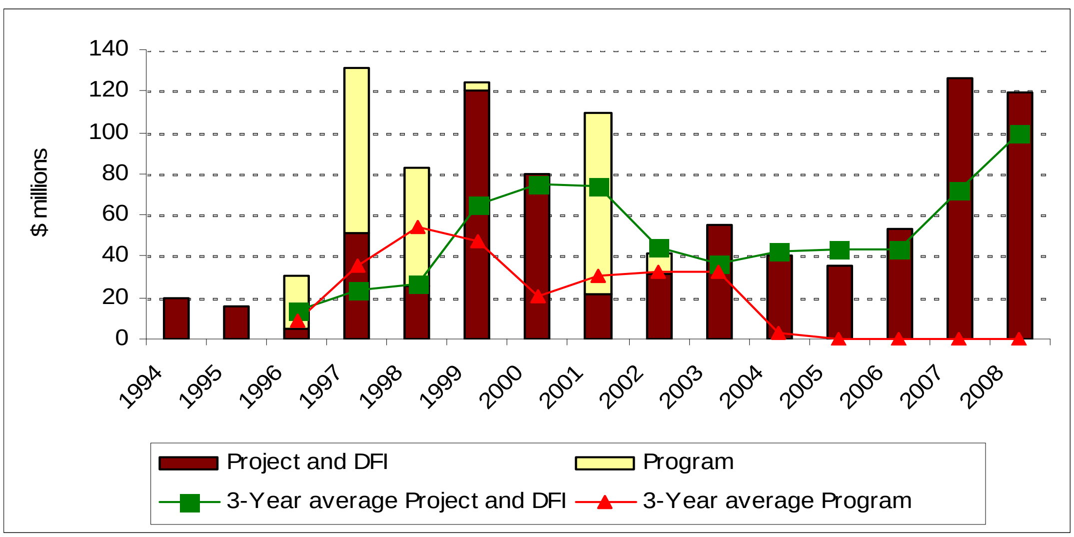
[c] ADB. 1998. *Report and Recommendation of the President to the Board of Directors on a Proposed Loan to Samoa for the Financial Sector Program.* Manila (Loan 1608-SAM[SF], for $7.5 million, approved on 19 February).

[d] ADB. 1998. *Report and Recommendation of the President to the Board of Directors on a Proposed Loan to Vanuatu for the Comprehensive Reform Program.* Manila (Loan 1624-VAN[SF], for $20 million, approved on 16 July).

[e] ADB. 1998. *Report and Recommendation of the President to the Board of Directors on a Proposed Loan and Technical Assistance Grant to Solomon Islands for the Public Sector Reform Program.* Manila (Loan 1627-SOL[SF], for $25 million, approved on 27 August).

Source: Asian Development Bank. 2003. *Economic Analysis of Policy-Based Lending: Key Dimensions*. Manila.

Figure A3: Trends in PDMC Loan Approvals



DFI = development financial institution, PDMC = Pacific developing member country.
Source: Asian Development Bank.

STAKEHOLDERS' VOICE: PERCEPTIONS OF PERFORMANCE

Item	RMI	FSM	VAN	SAM	TON	COO
Getting Reform on the Agenda						
ADB TA work for the dialogue and design of reform programs was useful and relevant.	2	2	2	2	2	3
The proposed reform was seen as a priority need by the Government and consistent with development plans and the reform agenda.	2	2	2	2	2	3
There was sufficient dialogue and consultation during preparation.	1	2	1	2	1	2
Managing Complexity						
The activities planned to achieve outputs and outcomes were relevant.	2	2	2	3	2	2
Policy trade-offs, vested interest, gainer, and loser issues were sufficiently considered.	1	1	1	2	1	1
Scale, sequencing, and complementary reforms and investments were appropriately and adequately considered.	1	2	1	2	1	2
Endorsing Reforms						
Key policy actions were endorsed as planned.	1	2	2	2	1	2
Implementing Reforms						
Planned activities were undertaken.	1	2	2	2	2[a]	3
Loan and counterpart funding resources were sufficient to cover costs arising from reforms.	2	2	2	2	2	2
Related agencies and institutions were ready to provide services and products as planned.	1	1	1	2	1	2
The program and related TA contributed to improving capacity.	0	1	1	2	1	2
The activities planned to achieve outputs and outcomes were feasible.	1	1	1	2	2	2
Activities to improve the environment for private sector development were implemented.	1	1	1	2	1	1

Item	RMI	FSM	VAN	SAM	TON	COO
Sustaining reforms						
Public sector reforms contributed to private sector development where intended.	0	1	1	1	0	0
Reforms to SOEs were undertaken and sustained.	0	0		2	1[b]	2
Oversight and line agencies were able to provide the service or goods after program completed.	1	1	1	2	2	2
Key stakeholders are still in a position to support reforms.	1	1	2	2	2	2
Personnel involved in the program and related institutions or those who received training and advisory support are still with the project or program.	1	1	2	2	2	2
Present personnel have the capacity to provide the service supported by the TA.	1	1	1	2	2	2
Overall, reforms met stakeholder expectations.	1	1	1	2	1	2

ADB = Asian Development Bank, COO = Cook Islands, FSM = Federated States of Micronesia, RMI = Republic of Marshall Islands, SAM = Samoa, SOE = state-owned enterprise, TA = technical assistance, TON = Tonga, VAN = Vanuatu.
Note: Disagree = 0, Somewhat Agree = 1, Agree = 2, Strongly Agree = 3.
[a] Public sector reform activities are now gaining momentum, but initially were slow.
[b] Activities are now gaining momentum with new Asian Development Bank support tailored to individual SOE needs.
Source: Independent Evaluation Mission.

SPECIFIC COUNTRY REFORM PROCESS ISSUES AND SUMMARY POLITICAL ECONOMY MATRIX

1. This appendix provides further country-specific details of the reform processes and issues in the Pacific developing member countries (DMCs) and programs covered by the special evaluation study (SES). Table A5.1 provides an overall summary of the conditions prior to commencement of the Asian Development Bank's (ADB's) support, a summary of key points arising from the reform process, and the post-program current conditions.

A. Getting Reforms on the Agenda

2. **Micronesia.** In the early 1990s, the governments of the Federated States of Micronesia (FSM) and the Republic of the Marshall Islands (RMI) expressed their concern over near-term fiscal sustainability, size of the public sector, and debt obligations (stemming from the bonds that each Government had issued using guaranteed future economic assistance payments under the Compact of Free Association agreements), particularly with the Compact Funding step-down in FY1997 and the possible end to Compact funding in 2001. Both governments requested ADB assistance for policy advisory teams, which helped develop detailed reform programs in consultation with the governments. In Micronesia, analysis confirmed that Compact step-downs had left the governments facing fiscal deficits and that the solution needed to extend beyond the governments' initial idea of expenditure management such as wage cuts, to deeper cuts in public services and a reduction in state-owned enterprises (SOEs), and revenue-side solutions such as tax reforms. The RMI's Public Sector Reform Program (PSRP) was a relevant response at the time but reform ownership wavered from the outset. The Fiscal and Financial Management Program (FFMP) was a relatively focused follow-on to the PSRP that facilitated establishment of the RMI intergenerational (trust) fund and improved financial management, but its design assumed that previous gains were locked in and did not foresee the reversal of public service downsizing and streamlining.

3. The FSM's PSRP and Private Sector Development Program (PSDP) were also a relevant response to deep and unsustainable fiscal deficits following Compact step-downs and, while its approach to expenditure management was thorough, its approach to public service streamlining was less considerate of how to focus essential service delivery. In addition, its assumptions on private sector response were overgeneralized. The PSDP preparation was a timely response, following the commitment at the 1999 Second FSM Economic Summit to accelerate private sector development. However, by delaying approval, momentum to reform was diminished. Macroeconomic diagnostic work, including the preparation of a social accounting matrix and projections, provided the basis for estimating the needs for future transfers and the setting up of a trust fund of sufficient size to allow FSM to self-finance government operations. The subsequent rationale behind reforms was that if key outputs and outcomes were achieved, the public sector would be more efficient and the overall balance of activity would shift toward the private sector.

4. **Melanesia.** Among the Melanesian countries, Vanuatu's economic deterioration since 1989 and the Government's precarious financial situation, as well as weak government service delivery, made Vanuatu's Comprehensive Reform Program (CRP) relevant and timely. The Government of Vanuatu recognized the need for reforms as a result of looming fiscal difficulties and decline in reserves. Vanuatu adopted the CRP developed by ADB, largely as it concluded it had no choice if it wished to obtain ADB support, but the reforms were relevant to its needs. Preparation of the CRP was initiated in February 1997 and the proposed CRP document was presented to a national summit in June 1997, which received bipartisan support. In Papua New

Guinea (PNG), the need for improved public sector performance had been a subject of analysis and discussions between ADB and the Government of PNG since early 1998. However, it was not until a reformist-minded government came to power in 1999 that the impetus to undertake significant public sector reforms was created. ADB provided technical assistance (TA) to help develop a governance and public sector reform agenda, with the new Government recognizing that the country's weak economic performance was the result of poor governance. The Public Service Program was relevant to the Government's reform program providing support in four areas: (i) building a performance-oriented public service, (ii) reorienting personnel management systems and processes, (iii) strengthening probity and oversight agencies, and (iv) improving delivery of basic services by national and provincial governments. Nevertheless, design complexity lowered the level of relevance.

5. **Polynesia.** The Cook Islands was facing a severe fiscal crisis, which had been identified since 1992 through diagnostic work. However, this prospect was not made public until the economic crisis was upon the country. New Zealand, the United Nations Economic and Social Commission for Asia and the Pacific, and ADB provided TA to analyze underlying structural problems in the economy; weaknesses in financial and economic management and the pending crisis; and helping the Government develop a reform program. In 1996, the Government adopted a reform agenda called Pathway to Recovery, on which the reform program was based. The objectives of the reform targeted restructuring the economy as a whole, with expectations of transformation to private sector-led growth as a result of the program. This was a high expectation, given the scale of the reforms and resource constraints. The program response was relevant in terms of the wide range of issues that needed to be addressed, including reducing the size of the public sector by over half, but in particular the need for immediate correction of fiscal and external deficits.

6. The stagnant economy and a deteriorating fiscal and foreign exchange reserve position in the early 2000s encouraged the Government to address needed reforms, notably fiscal concerns. Diagnostic work in Tonga during the 1990s addressed both fiscal concerns and the need to improve the efficiency of the public sector and SOEs, but the Government had not seen the need for any major reforms. Features of the subsequent reform program included revenue-raising measures—including the introduction of value-added tax; and achieving sustainable fiscal balances, strengthened public expenditure management, and improvements in public sector efficiency and resource use. Tonga, however, looked to the programs in the Cook Islands and Vanuatu to learn from their experience and avoid what appeared to be a model approach, focusing initially on fiscal concerns, with public sector downsizing a lower priority and later in the time scale. ADB worked closely with the Ministry of Finance in developing the reform program but there was seemingly limited consultation with officials of other ministries, and limited consultation with the public.

7. Samoa began its process of economic reform in the late 1980s and was revitalized in 1996 (following recovery from the 1990−1991 cyclones) through, first, the Statement of Economic Strategy, which was later renamed the Strategy for the Development of Samoa. The performance of the economy was buoyant in 1995–1997, with medium-term growth coming from reforms that were expected to increase private sector activity through rationalization of the public sector; privatization of the SOEs; and improvement in the economic, financial, and social infrastructure. This reform agenda was expected to result in enhanced private sector capital formation and foreign direct investment. ADB's prior involvement in the financial sector provided the institutional experience and a sound basis for supporting the reforms. Previously, ADB had supported five lines of credit to the Development Bank of Samoa (DBS), which had been rated "partly successful", and the Government and ADB recognized that the effectiveness of this type

of assistance was being adversely affected by an inadequate policy environment. Thus, instead of continuing the proposed sixth line of credit to DBS, assistance was refocused to ensure that better policies were put in place in the financial sector, and as a follow-on to successes in the Government's own efforts in fiscal reforms.

B. Managing Complexity

8. **Micronesia.** Public sector reform, specifically public sector downsizing, was already on the agenda of the RMI political leadership (in particular President Amata Kabua) and ADB's overall country program approach and strategy for the late 1990s through early 2000s (the reform period). The reform scope was broadly aligned with the RMI's priorities, but understanding by a wider set of stakeholders and a more effective approach to community and intergovernmental consultations (between the executive and parliamentary branches) was needed in the RMI during the PSRP. Similarly, more effective consultation could have taken place between the executive and legislative branches, and perhaps also with the private sector prior to commencement of the PSRP. However, the RMI was pressed for time as the fiscal situation required hasty implementation of the reforms.

9. The anticipated short-term gains from the RMI PSRP were relatively clear: (i) stabilization of government finances through reductions in expenditure and increased revenues; (ii) a smooth fiscal adjustment to the dramatic second Compact step-down and other fiscal pressures; and (iii) better positioning for the renegotiation of Compact economic assistance beginning in 2001. It was also clear, however, that these gains would involve short-term adverse socioeconomic costs and impacts. Because the scale and scope of reforms made under the PSRP were significant, most especially the reduction-in-force component, it was recognized that the social and economic impacts could be far-reaching. Thus, TA revised and augmented an existing government reform agenda (focused initially only on public sector downsizing) through ongoing consultations with government officials. These consultations proved to be insufficient, though, particularly between the executive branch and the Nitijela (Parliament of the RMI). The program performance evaluation report (PPER) concluded that the most significant weakness in the program was the failure to get widespread community participation or support, and that the need for reform was seen as being imposed from outside with ADB responsible for the resultant hardships.

10. In the FSM, reform was already on the agenda and design of the reforms and the PSRP and PSDP were relevant, appropriate, and responsive to the needs of the FSM. Public consultations that took place throughout the FSM (particularly with the economic summits) ensured that the ADB-supported reform programs reflected the FSM's concerns and were better understood. Aside from the fast-tracking of a follow-on loan to the PSRP, the Basic Social Services program loan in 2000 (which several stakeholders mentioned was more of an ADB priority than an FSM one, as Compact funding could be used for education and health), most of ADB's work in the FSM during the reform period was in line with the stated priorities and needs of the country.

11. However, in the FSM the structure of government—four state governments and one national government—added complexity to both the analysis and consultation process. Each of the five governments held economic summits, and specific components of the PSRP were customized to reflect the circumstances of each government. The summits, together with pre-reform analytical and consultative work by the advisory team, helped raise general awareness on the issues and prepared the nation for change. However, two state legislatures had not officially endorsed their reform programs before the reforms began, as consensus had not been

reached. Furthermore, some politicians who initially supported reforms campaigned in the next election against some reformist governors, subsequently lost their seats, and were replaced by leaders less supportive of reforms. There was less public dialogue for the follow-on PSDP, but the goal of private sector growth had been consistently articulated since the mid-1990s.

12. **Melanesia.** Vanuatu had a similar experience to the RMI, with recognition of serious fiscal and structural problems making for a compelling need to reform. Issues were discussed publicly, but the view is that there was insufficient time to consider the proposed reform measures. As a result, the public perception later was that the CRP was pre-determined, with a similar package being offered by ADB to several Pacific island countries. However, given the severity of the fiscal and government financial institution problems, the Government found itself in a position where it appeared that there was not much choice but to accept the program.

13. **Polynesia.** In the Cook Islands, the pending crisis was initially kept from the public eye, but by late 1995 the public was informed about the need for far-reaching action, including halving the public service. This was a major shock as there had been no previous warnings. The Pathway to Recovery provided the policy map for addressing the plight of the country through a five-point strategy plan. The plan was formulated via TA and government officials, in consultation with the Cabinet, and explained to the nation through stakeholder meetings as the only option for addressing the country's financial and economic problems. This led to acceptance by the public service, the business community, and the public at large. The program loan was seen to reassure the public and business community that corrective action was forthcoming, which helped to strengthen the Government's resolve and consensus for the reform path. Nevertheless, while the 1996 Reform Agenda was developed with the Cabinet, the reform program was designed largely by consultants following New Zealand public sector management concepts and processes. There was little consultation over the appropriate pace of reform, or of reform alternatives. Furthermore, the coalition governments formed from 1999 onward have demonstrated less commitment to reform as they did during the reform period. Thus, the political value of payments to cover known social costs arising from reforms (adjustment costs) can be short-lived if the intended effects of reforms are not realized as expected.

14. In Tonga, despite the close working relationship between ADB and the Ministry of Finance to develop the reform program, there was seemingly limited consultation with officials of other ministries, and limited consultation with the public. Furthermore, the initial Ministry of Finance agenda broadened during ADB involvement to include elements of public sector reform. Thus, the program was focused on the Ministry of Finance, with other agencies and the public being informed of specific measures once implementation was under way. The lack of broad consultation had implications for reform implementation—with measures under the direct responsibility of the Ministry being effectively implemented, but with less ownership and understanding of other measures by other agencies.

15. As Samoa's reformist government had a defined reform agenda prior to requesting ADB support for advancing reforms, the issues were relatively straightforward. The reform program loan and related TA were also aligned with priorities outlined in the Strategy for the Development of Samoa documents since 1997 when the reform program was designed and implemented. Furthermore, Samoa had a series of reforms under way prior to the FSRP encompassing tax and tariff reforms; introduction of performance budgeting and devolution of financial management; new governance frameworks for public financial management, SOEs and private corporations; a restructuring of government departments and devolution of responsibility for human resource management; strengthening of government departments and SOEs; health sector reforms; and transport, telecommunications, and postal sector reforms.

Much of this was under implementation by 1996, and in 1997 the Government recognized that there were more specific constraints on private sector capital formation and FDI. Direct monetary controls meant that banks rationed loans, private sector credit was constrained, excess bank liquidity existed, and competition between banks and nonbanks was distorted. Furthermore, the Government had identified weaknesses in the prudential and regulatory framework; weaknesses in monetary management; weaknesses in state-owned financial institutions; and inefficiencies in SOEs, few of which were financially sustainable and able to meet debt commitments, straining the government budget.

16. The Samoa FSRP was a sector-focused response to these constraints. Specifically, the FSRP was focused on weaknesses in public financial management, government financial institutions, and SOEs; and the long-range development programs articulated in the political manifesto of the ruling political party that has been in power throughout the period of the reform, and the Government's Statement of Economic Strategy 1996–1998 that presented the framework for an economic and public sector reform program aimed at promoting private sector development and improving public sector efficiency to address constraints to development.

C. Endorsing Reforms

17. ADB's mixed experience with the use of conditionality as a reflection of reform endorsement was fully reflected in the support for reforms in Pacific DMCs. The ADB-wide program lending reviews, carried out in 1996[1] and 1999,[2] found that a large number of policy conditions included in program loans incurred implementation delays vis-à-vis the original schedule. More recent literature[3] and internal and external evaluations support the view that a focus on compliance with conditions can undermine ownership and is not always an effective way to reach intended outcomes. Inflexibility or reluctance to change or waiver of a condition may undermine or delay more important aspects of a reform when a condition is found to be inappropriate. Second tranche releases were delayed in two-thirds of cases where target dates had been set, by an average period of about 1 year. Reference is made to the need to understand the political economy context of policy change, stating that an analysis of the likely impact of the proposed reforms on various interest groups should be carried out. The study indicated that each tranche release should be based on a certain number of specific, time-bound, and objectively monitorable conditions; covenanted conditions should relate to essential policy objectives only; a balanced distribution of conditionalities among program loan tranches should generally be sought, including frontloading of key reform measures.

18. ADB's 1996 study was available at the time of Pacific program loan formulation and was drawn upon but not sufficiently. Table A5.1 shows that, in terms of policy actions and tranche condition numbers, tranches were generally front-loaded but a key feature of the program loans was the large number of conditionalities and policy action requirements used. In any event, the program loan designs, and importance of condition and policy actions as a measure of reform endorsement in countries and compliance from an ADB perspective, meant that much ADB and TA attention was paid to ensuring conditions were met to ensure loan funds were released.

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1 ADB. 1996. *Review of the Bank's Program-Lending Policies*. Manila.

2 ADB. 1999. *Review of ADB's Program Lending Policies*. Manila.

3 See Koeberle, S.G. 2003. *Should Policy-Based Lending Still Involve Conditionality?* The World Bank Research Observer, Vol. 18, No. 2, Washington, DC; Dollar, D. and Svensson, J. 1998. *What Explains the Success or Failure of Structural Adjustment Programs?* Policy Research Working Paper 1998. World Bank. Washington, DC; and Killick, T. 2004. *Politics, Evidence and the New Aid Agenda*. Development Policy Review, Vol. 22, No. 1, pp. 5–29. United Kingdom: Overseas Development Institute.

Table A5.1: Program Loan Policy Actions and Tranche Conditions

Loan No.	Policy Actions No.	Policy Actions Complied	Policy Actions Not/Partly Complied	First[a] No.	First[a] Complied	First[a] Not/Partly Complied	Second No.	Second Complied	Second Not/Partly Complied	Third No.	Third Complied	Third Not/Partly Complied
COO-1466	124	108	16	36	36	0	8	7	1			
FSM-1520	122[c]			10	10	0	8	8[b]	0			
RMI-1513	59	33	26	18	18	0	6	4	2	5	4	1
SAM-1608[d]	62	52	10				6	5	1			
SOL-1627	65	26	29	10	10	0	8	0	8			
VAN-1624	46	44	2	4	4	0	7	5	2			
NAU-1661[e]	72			5	5	0	9	7	2	5	0	5
RMI-1828/29	60	40	20	5	5	0	10	7	3	4	4	0
PNG-1875	34	30	4	4	4	0	7	6	1			
TON-1904[d]	40	32	8				6	6	0			

COO = Cook Islands, FSM = Federates States of Micronesia, NAU = Nauru, PNG = Papua New Guinea, RMI = Republic of the Marshall Islands, SAM = Samoa, SOL = Solomon Islands, TON = Tonga, VAN = Vanuatu.

[a] For COO, FSM, and RMI, documents did not specify the first tranche conditions but loan proceeds were released on loan effectiveness or compliance of the policy actions. Thus, the numbers indicated in the first tranche column of these three countries are the number of policy actions to be complied for the first tranche.

[b] One of the tranche conditions was partly complied, which caused delays and partial release of tranches.

[c] The 122 policy actions indicated in the report and recommendation of the President (RRP) was modified and reclassified as 55 conditions. The 55 figure gives an incorrect impression about the number of distinct condition, as many of them were variations customized to the specific circumstances of each of the five governments.

[d] The number of tranche conditions or policy actions were not specified in the first tranche, but the release was made upon loan effectiveness on the basis of demonstrated improvements.

[e] The program completion report did not provide specific updates on the compliance of the policy actions but instead just indicated updates on tranche conditions, which were parts of the policy actions indicated in the RRP.

Source: Asian Development Bank databases.

19. The Cook Islands' Economic Reform Program had 124 policy actions and 44 tranche conditions, which together with rigid implementation time frames, were not realistic for effective implementation of all measures. Conditions also led to delays in funds release in the FSM and RMI. Although the TA was provided prior to program loans in the FSM and RMI, reasons for delays in the second tranche releases were experienced where laws on foreign investment, taxation, and privatization took much longer to be passed than expected. In addition, geographical spread and multiple subnational legislatures caused further delays in coordinating and realizing compliance, sometimes because of different local government views on reform measures. In the RMI, delays were caused by political transitions and other factors, such as a major drought that resulted in a declaration of emergency. In Samoa, the endorsement of reform measures leading to condition compliance was slower than expected; the main delay related to meeting tranche condition compliance on SOE privatization (this was a common issue in other countries).

D. Implementing Reforms

20. In Micronesia, the FSM's TA to support the PSRP (Economic Management Policy Advisory Team) facilitated the meeting of key policy advice objectives, despite limited capacity development outcomes. The FSM's four counterparts were highly competent and received degree

training as part of the TA, and continue to work in government. However, overall organizational capacity remains limited, particularly given the breadth of issues that needs to be addressed. Major outputs were achieved in the effort to improve the environment for private sector development, but many indicators suggest that little private sector growth is occurring as a result.

21. In Melanesia, Vanuatu's Ministry of Finance implemented improved financial management systems, but expected improvements in public accountability mechanisms at the political level have not yet materialized. Furthermore, an effective performance-based budgeting system that links plans to budgets has yet to be realized. The line agencies developed corporate plans and the role of directors general was realigned to give them more authority over their ministries. In PNG, steps were taken in building a performance-oriented public service. The Government's policymaking framework was reformed in 2000, clarifying the roles of the National Executive Council and its secretariat, central agencies, and line departments. By early 2003, with Public Service Program support, new legislative and regulatory changes were implemented, and the personnel management systems and processes reoriented. The Government introduced a service improvement program with the aim of improving service delivery in four key basic service areas—agriculture, education, health, and transport infrastructure—but has made slow progress. In Solomon Islands, the first public service reform steps took much longer than expected because of legal challenges and opposition from affected civil servants. No action was taken on plans to strengthen the Auditor General's Office, or to increase transparency of public tendering by the time of program cancellation.

22. **Polynesia.** In Samoa, the implementation phase of the financial sector reforms proceeded largely as planned except for the additional resources needed to support the institutional capacity strengthening for the regulatory and supervisory functions of the Central Bank of Samoa. Based on the relative size of total assets of the SOEs, a focus on improving the performance of the top five SOEs would be a more efficient approach than focusing on the privatization of one SOE. The costly and protracted process can divert the attention of the limited pool of skilled personnel away from the more pressing overall priorities of the whole SOE group. In the Cook Islands, over 80% of the 122 Economic Restructuring Program measures were implemented or substantially completed. Major reforms to downsize government staff by almost 60% and increase civil service productivity, and passage of key legislative reform measures were completed shortly before loan approval. In Tonga, progress on revenue generation and expenditure controls was good, led by the Ministry of Finance. However, progress on the public sector and public enterprise reforms only got under way because of changing social circumstances (civil disturbances, public service strike) demanding political change, which led to pressures for wider reforms. The reform implementation accelerated from 2006 with the appointment of a new prime minister, who took a lead role in this process.

E. Sustaining Reforms

23. As indicated in Appendix 4, most respondents in the FSM, RMI, and Vanuatu held the impression that the reform programs and related TA had generally limited impacts in systematically strengthening the capacity of personnel and line agencies. Respondents in Polynesia were more positive. A vast amount of knowledge has been gained in recent years (Box A6) in more effective approaches for building capacity, and future reform efforts should incorporate and follow these recently documented good practices. Box A6 outlines some key capacity development issues, and Appendix 6 provides further discussion on capacity development and TA provided by the reforms. A recent development is the increasing use by ADB's Pacific Department of multiple country, cluster, and rolling thematic designs for TA projects which, at first view, seems a relevant design approach and opens opportunities for

greater cofinancing and lower TA management overheads.[4] Nevertheless, the need exists for expanding demand-driven capacity development and more systematic, longer term capacity development approaches.

24. The FSM continues to face similar constraints to those it faced in the pre-reform days, and its capacity to develop and implement policies for ongoing reform remains limited. In the RMI, there was very limited existing local capacity and either local counterparts were not provided, or they were not able to take full advantage of the consultants' expertise and experience. The PSRP and its related policy advisory TA accomplished little in the way of improving the RMI's internal capacity to develop and implement policies for ongoing economic and public service reform. Although the reform programs in Micronesia have been less successful, it is now clearer that the governments' immediate concerns were over a budget crisis and sustainability rather than wide public sector reform, even though the two are related.

25. In Vanuatu, service delivery improvements, as reflected in social indicator outcomes, are below expectations—especially in rural areas. The PSC has recently begun to take more systemic steps to strengthen institutional capacity and align with clarified line agency mandates, reflecting the fact that the link between the PSC, line agencies, plans, and budgets is a work-in-progress. While the CRP is still on the Government's agenda, including service improvements, the institutional capacity and related assumptions on improvements to service delivery during and after the CRP implementation period have yet to meet expectations. Thus, the core political support has helped to continue the CRP, but the CRP fell far short on improving key public services, making commitments difficult to meet. In PNG, little progress was evident at the time of the PPER, effectiveness having been constrained by weak political commitment, a lack of synergy between central and local agencies, with underdeveloped management competencies. Similarly, while action was taken to strengthen the governance probity and oversight agencies, including the Ombudsman Commission, Department of Justice and Attorney General, and the Attorney General's Office, these actions were insufficient and had little apparent impact.

26. In Polynesia, Samoa's capacity development implementation has met expectations in a better manner. They were focused, and have yielded clearly acknowledged outputs and outcomes in specific institutions. Introduction of the Institute of Directors has also improved the up-skilling of directors in the private sector in terms of corporate governance. Improving corporate and financial management of the National Provident Fund and DBS has also assisted in enhancing the ability of these financial institutions to improve delivery of their financial services to the private sector. Strengthening the supervisory role of the CBS over the banks will assist the private sector in improving the protection of their deposits with the banks. In the Cook Islands, the focus of TA on design and implementation was largely because the severity of the crisis meant that TA necessarily had to focus on helping the government find solutions to the crisis. However, the use of local consultants and some returnees from New Zealand did have beneficial effects on the program, helping ensure that proposed measures took account of local conditions, and there was some spin-off in capacity building, with the local consultants used at that time continuing to provide advice and expertise to the government. A similar development has occurred in Tonga where a limited number of the government officials and local consultants involved in the reform process now provide local expert consultant services.

[4] See PARD's self-assessment in the 2008 midterm review of the Pacific Strategy (2005–2009), footnote 2.

Table A5.2: Prior and Post-Program Conditions and the Reform Process Summary

<table>
<tr><td>Generalized Constraints Prior to Programs</td><td colspan="3">• Slow or declining economic growth
• Low inflation until 2007 when rapidly increased
• Budget deficits prior to reforms
• Trade deficits, low export levels and with low value added, dependence on imported foods
• Large S-I gaps
• High level of external financing of economic activity through foreign loans and grants (particularly Micronesia and Polynesia)
• Government is dominant player in the economy and largest employer (particularly Micronesia); where it is relatively less dominant, intervention is not discounted
• Services drive GDP growth but the sector’s largest client is the government
• Grants as a major source of government revenue, especially Micronesian economies which are grant-driven
• Low government investment in social infrastructure as most revenues spent on government operations
• High formal unemployment
• Mixed and in cases falling social service outcomes and MDG performance
• Public sectors also viewed as having low productivity of civil servants, inefficient administration of taxes, weak enforcement of contracts and policies, and poor quality of public services despite high inputs (health and education)
• Weak budget management, with increasing budget deficits and expansionist fiscal policy
• Limited overall economic, fiscal, and development planning and management capacity
• For both the RMI and FSM, the public sector wage premium was identified as a constraint to private sector growth</td></tr>
<tr><th>Item</th><th>Fiscal Reforms</th><th>Public Service Reforms</th><th>Private Sector Reforms</th></tr>
<tr><td>Primary Goal and Expected Impact</td><td>Expected Outcome: Reform and reduce the size of the public sector to adjust to declining external resource transfers
Components and Outputs:
• Reduced size and operating costs of the public service
• Mitigate the negative social and economic impacts of the adjustment in public expenditure, especially retired civil servants
• Increased domestic revenue generation
• Short-term fiscal stabilization
• Establish sound fiscal policies and systems
• Secure a sustainable longer-term fiscal balance
• Improve policy, planning, and budgeting processes</td><td>Expected Outcome: Improved service delivery
Components and Outputs:
• Improvement of public service quality
• Expand service coverage
• More efficient services
• Reform the public service, including increasing efficiency and productivity of the civil service</td><td>Expected Outcome: Shift balance of economic activity away from the public sector to the private sector
Components and Outputs:
• Transform economies toward private sector driven growth and economic self-sufficiency
• Privatize government operations and public sector enterprises
• Improve enabling environment for private sector development (access to finance, land, labor)
• Facilitate increased foreign investment</td></tr>
<tr><td>Initiating Reform
Factors affecting initiation of the agenda</td><td>• An existing government reform agenda facilitated quicker development of a program
• Addition to the reform agenda by external parties, including ADB, tended to slow preparation
• While to be avoided in the first place, crisis helped to form the agenda</td><td>• Overstaffed and under-qualified services
• In the FSM, wide public consultations (economic summits in 1995 and 1999 seen as a positive factor in initiating reforms</td><td>• Recognized need for private sector to replace public sector-driven economy
• An existing government reform agenda facilitated quicker program development
• Fiscal burden of public sector enterprises</td></tr>
</table>

Item	Fiscal Reforms	Public Service Reforms	Private Sector Reforms
Managing Reform Complexity Factors affecting management of gainers, losers and design manageability	• Focused reform agenda and program with complementary TA to help manage the early stages of the reform • Involvement of relevant agencies, or even two key line agencies • Excessive focus on finance can create a "super agency" that undermines buy-in by political branch and line agencies	• Identification of key services and personnel plus right sequencing of public service rightsizing • PSC has an important role in performance management but often weak • Consultations a factor in managing complexity	• Identification of privatization alternatives and tailored solutions for each SOE individual case • Wide coverage of enabling environment issues appealing but gainers/and/or loser not necessarily understood or apparent initially • Focus on achievable reforms such as financial sector more manageable and likely achievable • Land rights are contentious and often run up against traditions • Focus on all factors of production, but some require far more time and analysis (land, labor) • Addressing highest impact areas (binding constraints) versus across-the-board approach may have been more effective given short time frames of programs • Infrastructure's role in facilitating PSD crucial, but this was beyond the scope of reform programs
Endorsing Reform Factors affecting reform endorsement and acceptance at different levels	• Crisis helped to accelerate endorsement and acceptance by the public • However, fiscal discipline can be easily reversed by political change	• Physical infrastructure, education, health are the most high profile sectors for which sector reform is more likely to be supported • These sectors also most susceptible to political change and use • Development partner focus and division of support more easily achieved at the sector service level	• Lack of understanding at the start of reform can lead to non-endorsement, slow reform momentum, or later policy reversals • Land-related reforms had most resistance—survey, adjudication, title, lease terms seem to be more acceptable
Implementing Reform Factors affecting reform implementation and change	• Needed attitudinal change that usually occurs during implementation • Capacity development needed on how to do reforms • TA that showed how-to was longer-term, with intermittent inputs, to steady cadre of counterparts, providing balanced advice and capacity building • Partnerships and coordinated donor efforts helped to support implementation • One-off, broad-based short-term TA generally not effective on how-to • Contradictory, competing internal ADB TA and development partner efforts confuse and undermine	• Systemic not ad hoc change • Efficiency and timeliness of service reform important, otherwise budget cuts will be seen as the cause of service decline • PSC role crucial for institution-wide capacity development • Capacity development of individuals has limited effectiveness, needing an institution-wide approach and integrated capacity development approach • National, local role, responsibility, and	• Financial sector reforms more manageable to implement and most direct way to address access to capital • However, rural outreach still costly and challenging • Secured transactions easier to implement than long-term land lease and mortgaging • Land survey, adjudication, and titling acceptable way to handle land rights, but has had a limited impact on secured lending

Item	Fiscal Reforms	Public Service Reforms	Private Sector Reforms
	implementation	financing of service delivery important • Political transitions and timing had effects	
Sustaining Reform Factors affecting reform impact and sustainability	• Systemic (backed by legislation and regulations), institutionalized (how-to) changes key to sustaining reforms • Bilateral aid and grants can have a defining influence on reforms and their effect needs to be fully understood (provision, what can and cannot be financed) for ADB support to add value, be complementary, and avoid duplication • Public sector reform a highly relevant objective although benefits can be short-lived without consistent public choice and effective Ministry or Department of Finance capacity to maintain commitment • New funding streams influenced commitment to fiscal restraint	• Investment in systemic, sustained capacity development of service providers through government systems (PSC) crucial • Need to link sector plans and budgets to national plan and budget • Bilateral aid and grants can have a crucial influence on reforms and their effect needs to be fully understood (provision, what can and cannot be financed) for ADB support to add value, be complementary, and avoid duplication • Political changes (e.g., loss of reform champions) affected sustainability	• Expectation of private sector filling void unrealistic; public sector too large and significant player to be replaced • Improved legislative enabling environment necessary but not sufficient condition for private sector growth—next constraints need to be addressed • Favorable environment for FDI and domestic investment in industries with a comparative advantage, especially tourism in South Pacific • Inclusiveness of growth patterns—so far mixed or not evident in some countries
Generalized Post-Program Conditions	• In Micronesia, all major constraints identified prior to reforms still relevant today • Fragile economic recovery undermined by current global financial crisis • Reversal in fiscal position from deficit to surplus but not sustained except for the Cook Islands and Samoa • Persistent trade deficits, still dependent on imported food; terms of trade improvement in PNG not translated to investments and improved public services • Improved remittances (from overseas workers) flow; tourism remains an important foreign exchange earner • No improvement in S-I gap • Reduced but still significant levels of external debt; ADB is major lender • Government is still dominant though reduced in the Cook Islands and Samoa; continued intervention in private sector though not discounted • Economic structure unchanged; services sector still dominant • Improvement in tax effort; Micronesia still grant-dependent • Government investment in social infrastructure still inadequate as most revenues spent on government operations; improvement in PNG, though • Unemployment and more importantly underemployment still a problem • Improved public services expenditure but slow in meeting MDG targets • Low civil servant productivity still exists and translates to inefficient public funds allocation • Limited capacity for fiscal and economic policy, planning, and management still a key constraint		

ADB = Asian Development Bank, FDI = foreign direct investment, FSM = Federated States of Micronesia, GDP = gross domestic product, MDG = Millennium Development Goals, PNG = Papua New Guinea, PSC = public service commission, PSD = private sector development, RMI = Republic of the Marshall Islands, SOE = state-owned enterprise, TA = technical assistance. S-I = savings-investment
Source: Independent Evaluation Mission.

TECHNICAL ASSISTANCE AND CAPACITY DEVELOPMENT SUPPORTING PACIFIC DEVELOPING MEMBER COUNTRY REFORMS

1. There was wide recognition that local capacity would have to be strengthened if the reform efforts were to be effectively carried out and sustained. Capacity development, therefore, formed a critical component of the Asian Development Bank (ADB)-supported reform programs and related technical assistance (TA).

2. **Types of capacity technical assistance.** ADB TA was provided to the Pacific developing member countries (DMCs) to assist in three broad areas: (i) in the provision of direct policy analysis and advice; (ii) to develop the capacity of individual counterparts; and (iii) to develop the capacity of institutions (including organizational restructuring, process design, and across-the-board human resource capacity development). The provision of direct policy analysis and advice was needed and relevant when urgent matters required expert analysis and quick decision making, but this type of TA does not always build capacity to continue analysis and advisory functions (particularly when a crisis exists and/or when existing capacity levels are low to begin with). The direct training of counterparts is often a cost-effective way of building the capacity of an immediate cadre of policy makers and managers, but those who are trained must have sufficient requisite skills and often these individuals may not continue working with the organizations (a common phenomenon in the Pacific). Broader institutional capacity development efforts seek to strengthen overall structural capacity, but this involves deeper and more complex change processes (including processes to shift institutional culture) that require persistence over longer term horizons. The types of TA provided during the reforms covered all of these types of capacity development efforts with mixed results.

3. **One critical capacity shortage.** While all program loans had prior, parallel, and in some cases post-program TA provided to assist with policy analysis and implementation, there remains a critical shortage of local expertise in quality economic analysis and policy advice. These skills are particularly rare in Micronesia and Melanesia. In some instances, this created challenges for ADB and visiting advisers in raising local understanding of the macroeconomic reforms proposed.

4. **The Federated States of Micronesia, Republic of Marshall Islands, and Solomon Islands cases.** In the Federated States of Micronesia (FSM), a shortage of skilled counterparts was seen in both national and state levels of government. The ADB-financed advisory team (Economic Management Policy Advisory Team [EMPAT]) provided policy analysis and advice to five governments, and monitored reform implementation to help fine-tune the reform process. EMPAT spent much of its time outside the national capital Palikir, supporting Chuuk and Pohnpei States (these states, however, cover most of the population). The EMPAT TA was able to train and develop (including through funding of master's degree programs) the skills of four local counterpart economists, three of whom remained in government and one who works in the private sector. Following the EMPAT support, no further cadre was developed or trained. EMPAT also helped build some capacity among leaders and the public to understand economic issues surrounding the reforms through dissemination efforts.[1] In the Republic of the Marshall Islands (RMI), on the other hand, the Policy Advisory Team (PAT) was unable to find suitable counterparts and was therefore unable to build any local capacity. A common concern among RMI leaders was while the PAT and other TA provided sufficient analysis on the problems and

[1] Between 1995 and 1998, ADB provided TA support for the FSM ($3.2 million) and RMI ($2.5 million) for the policy advisory teams to run for 3 years. As indicated above, the teams provided policy advice to both governments in developing and implementing the reform programs, and in the FSM carried out capacity building of local counterparts and other officials.

potential ways forward, insufficient assistance was provided for implementation and on the detailed how-to of reforms, particularly for the more complex reform efforts (such as privatization). In the case of Solomon Islands, respondents noted that assistance was initially late in being provided, but then too much was provided, overwhelming the administration.

5. **The Cook Islands case.** ADB-supported policy advice and capacity efforts in the Cook Islands were provided through a cluster of TA projects spread over 4–5 years. TA projects were provided for policy advice prior to the loan approval, while two TA projects were attached to the loan. Complementary loan assistance was provided by the New Zealand Agency for International Development to assist retrenched public servants during a transition period of 3 months. However, much of this support took on a firefighting role rather than focusing on the original targets of improving policy and planning capacity. The use of both external consultants and local skilled people to facilitate some of the change processes was critical in managing and communicating the reform change process but fell short in building lasting capacity. Nevertheless, in the Cook Islands, legislative reforms did have positive impacts on raising overall structural capacity (largely the result of the enactment of three major pieces of legislation). Altogether, the passage of these laws institutionalized reform principles and gave the reforms more lasting impact.

6. **The Samoa case.** In Samoa, TA for $950,000 was attached to the loan to strengthen the Central Bank of Samoa, National Provident Fund and the Development Bank of Samoa. In addition, four TA projects totaling $2.85 million were funded over 4 years to provide policy advice and to help strengthen the Ministry of Finance. The TA projects were presented as phases of a comprehensive program to strengthen the macroeconomic analysis, planning, and policy formulation capacity of the then Treasury Department. A key difference observed in Samoa was that the Ministry of Finance always had a sufficient cadre of counterparts for TA consultant to work with and train; when respective ADB TA projects were complete, there was substantial complementary support from the Australian Agency for International Development and the European Union; and the Ministry of Finance was clear on its own needs for capacity development, which helped to guide subsequent TA design.

7. **The how-to of reforms.** Some criticisms were made in several countries about TA advisers not being sufficiently knowledgeable of local conditions, even if their experience and skills were recognized. In the case of the Cook Islands, TA funded a combination of expatriate advisers and some Cook Islands returnees as counterparts, with some of the key drivers of the reform process being these and other local Cook Islanders working within government. This combination seemed quite effective. All countries except Samoa expressed the view that more assistance should have been provided in the how-to of implementation, particularly for the more complex reform measures for which little local experience existed.

8. **Demand-side capacity.** The reform programs generally did not give any specific attention to improving the role and effectiveness and capacity of civil society and nongovernment organizations. In the Cook Islands, the reform agenda did not examine civil society and the role of nongovernment organizations in implementing reforms, even though nongovernment organizations had been identified as key stakeholders during the early consultation stage. In Vanuatu, on the other hand, the reform program recognized the need to assist vulnerable sectors of society, with civil society playing a role in providing much needed service.

9. **General conclusions.** A vast amount of knowledge has been gained in recent years (Box A6) into more effective approaches for building capacity. Future reform efforts should incorporate and follow these recently documented good practices. The reform programs (in general) and the TA aimed at capacity building (specifically) were generally more successful in those Pacific DMCs where existing capacity levels were deemed to be stronger, particularly in the areas of economic, financial, and development planning. While some immediate individual-level capacity improvements were seen in most of the countries, structural capacity development efforts (targeting organizational and institutional levels) were less successful. As reflected in Appendix 4, most respondents in the FSM, RMI, and Vanuatu held the impression that the reform programs and related TA had generally limited impacts in strengthening the capacity of personnel and oversight and line agencies. Respondents in Polynesia were slightly more positive.

Box A6: Capacity Development in the Pacific

The Asian Development Bank (ADB) officially adopted capacity development as one of its thematic priorities in 2004, recognizing that capacity issues are a major factor in development and poverty reduction. Capacity constraints (at multiple levels) have long been recognized as a key weakness in the Pacific developing member countries (DMCs) and over the past few decades development partners have invested heavily in strengthening the capacity in the region, with mixed results.

To refocus and sharpen capacity development efforts in the Pacific—and to document what has worked (and why)—ADB and the Australian Agency for International Development recently completed an in-depth analysis of capacity development. The analysis draws on 20 case studies (some covering public sector reforms) from 11 Pacific DMCs.[a]

Some unique characteristics in the Pacific present particular challenges to effective capacity development, including during reform processes. These Pacific-specific factors include significant gaps in capacity in strategically important areas (such as economic policy, planning, and management); regular outflows of human capital (migration); weak and undiversified private sectors; relatively young states with underdeveloped institutional capacities (and ongoing tensions between modern and traditional institutions); and limited capacity for effective demand.

The Pacific capacity development study identified a number of factors that seemed to have influenced success: participation and ownership; leadership and vision; capacity to demand; relevance, readiness and receptivity; investing in understanding; getting the incentives right; an enabling environment; flexibility and adaptivity; effective use of technical advisers; ensuring sufficient time; taking a systems approach; and harmonization of efforts.

Reform efforts in the Pacific must take into account the importance of understanding the context; thinking strategically (considering the dynamics of the capacity system, soft capacities, the relationship between capacity and performance, and the role to be played by the external intervener); and other factors. It is also very important that an integrated approach to capacity development is taken, looking at all levels of capacity and that demand-side capacity issues are also adequately considered.

[a] Asian Development Bank. 2008. *Capacity Development in the Pacific: Learning From Success*. Manila.
Source: Independent Evaluation Mission.

Table A6: List of Advisory Technical Assistance in Public Sector Reform in the Pacific, 1996–2002

TA No.		Country	TA Name	TASF	JSF	Others	Other Sources	Total	Date Approved
1.	2294	FSM	Policy Advisory Team for Economic Management	501,000	1,000,000	999,000	USA	2,500,000	31 Jan 1995
	2294	FSM	Policy Advisory Team for Economic Management	540,000	0	0		540,000	29 Apr 1997
2.	2650	COO	Management of the Cook Islands Development Bank and Business Ventures Development	740,000	0	0		740,000	26 Sep 1996
3.	2651	COO	Institutional Support to the Development Investment Board	251,000	0	0		251,000	26 Sep 1996
4.	2755	RMI	Rationalization Committee for a Program Coordinator	515,000	0	0		515,000	30 Jan 1997
5.	2756	RMI	Institutional Strengthening in the Transport Sector	575,000	0	0		575,000	30 Jan 1997
6.	2757	RMI	Support of the Private Sector Unit	760,000	0	0		760,000	30 Jan 1997
7.	2786	FSM	Investment Promotion and Financial Sector Review	380,000	0	0		380,000	29 Apr 1997
8.	2985	SAM	Strengthening Capacity for Macroeconomic Analysis, Planning and Policy Formulation	0	960,000	0		960,000	2 Feb 1998
9.	3046	VAN	Institutional Support to Central Agencies for the Comprehensive Reform Program (Phase II)	1,200,000	0	0		1,200,000	16 Jul 1998
10.	3061	SOL	Strengthening of Public Sector Management	600,000	0	0		600,000	27 Aug 1998
11.	3125	NAU	Capacity Building for Financial and Economic Management	600,000	0	0		600,000	16 Dec 1998
	3125	NAU	Capacity Building for Financial and Economic Management (Supplementary)	0	0	102,812	Australia	102,812	2 Sep 2005
12.	3668	RMI	Fiscal, Financial, and Economy Advisory Services	950,000	0	0		950,000	7 Jun 2001
13.	3873	TON	Building a Performance-Based Public Service	700,000	0	0		700,000	28 May 2002
			Total	**8,312,000**	**1,960,000**	**1,101,812**		**11,373,812**	

COO = Cook Islands, FSM = Federated States of Micronesia, JSF = Japan Special Fund, NAU = Nauru, RMI = Republic of Marshall Islands, SAM
SOL = Solomon, TA = technical assistance, TASF = Technical Assistance Special Fund, TON = Tonga, USA = United States of America.
Source: Asian Development Bank listing of loan, TA, grant, and equity approvals database.

SUMMARY OF SOURCES OF OTHER DEVELOPMENT PARTNER ASSISTANCE

1. **The Asian Development Bank played a prominent role in providing technical assistance for Pacific developing member country reforms.** Reform efforts in the Pacific received technical assistance (TA) and other forms of support from several bilateral and multilateral development partners. In most of the countries (in particular the Federated States of Micronesia [FSM] and the Republic of the Marshall Islands [RMI]), the Asian Development Bank (ADB) played a prominent role in directly supporting public sector reforms and related advisory TA. ADB contributions to reforms included nearly $212 million in program loans and $11 million in TA projects. From 1995 to 2007, Pacific developing member countries (DMCs) combined received an average of nearly $800 million in total annual official development assistance (ODA) from all sources, including loan and grant assistance from ADB. However, in the latter half of the 1990s, the period during which most reform programs took place, the Pacific DMCs saw a significant and steady decline in total ODA flows. This downward trend occurred despite significant disbursements by ADB into the region via the public sector reform programs and accompanying TA projects. Since 2002, annual aid flows to the Pacific have strongly rebounded and surpassed the $1 billion mark for the first time in 2007.[1]

2. **The United States is the dominant partner in Micronesia and ADB was the key development partner in supporting Micronesian reforms.** The transfers provided through the Compact of Free Association (Appendix 2, Box A2) and the related terms and conditions of the agreement are of a macroeconomic scale. Other significant grant assistance is provided to the Micronesian states by Japan and Taipei,China. Despite the significant grants provided by bilateral partners, ADB played the prominent role in facilitating the Micronesian states' reforms. Major cuts in United States funding support to the FSM and RMI in the late 1990s (as stipulated under the Compact of Free Association with the related terms and conditions of the agreement being of a macroeconomic scale) forced the two nations to look elsewhere for reform support. Having joined ADB in the early 1990s, the FSM and RMI saw ADB as an ideal source of both financial and knowledge resources. In the RMI, some TA projects were provided by the World Bank and the United Nations Development Programme (UNDP) in the lead-up to the reforms, each of which conducted studies on the public sector (including recommendations for downsizing). The World Bank and UNDP studies contributed to what would ultimately become the ADB-supported Policy Reform Program and the Public Sector Reform Program in the RMI. However, no other multilateral partners provided financing for reform implementation.

3. ADB support for reforms in Micronesia and its financing was complementary to assistance provided under the Compact even though the United States was and remains the dominant partner in Micronesia. In particular, payments to retrenched public servants under the downsizing program could not be funded under the Compact, whereas ADB program loan funding could be used for such large-scale reform costs. Nevertheless, the relative roles and effect of other partner finance and programs need careful consideration when determining respective roles, as this can affect initial assumptions and raise risks to commitment. A further complication for coordination arose with new development partners (e.g. Taipei,China in the RMI) providing unconditional development aid.

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[1] For additional information on development assistance flows to the Pacific, see the following internet references for the Organisation for Economic Co-operation and Development, the Australian Agency for International Development, and the European Union: http://www.oecd.org/dataoecd, http://www.ausaid.gov.au/publications/pdf/official_expenditure_00.pdf, http://www.ausaid.gov.au/country/country.cfm?CountryID=27&Region=South Pacific, http://www.ausaid.gov.au/publications/pdf/blue-book/pic.cfm, and http://www.delfji.ec.europa.eu/en/achievements/index.htm

Box A7: Examples of Development Partner Assistance Effects on Reform Commitment

The size and timing of the United States Compact transfers (including direct Compact grant assistance and other federal programs assistance) to the FSM and RMI affected the reform efforts, including the sustaining of reforms upon completion of the FSM and RMI PSRPs in 2000. FSM and RMI experienced sharp declines in transfers from the United States in 1997–1998 (the second step-down) (Appendix 2, Box A.2). The FSM and RMI PSRPs took place from mid-1997 to 1999 (FSM) and 2000 (RMI). By the time the respective PSRPs ended, the FSM and RMI entered what is now referred to as the "bump-up" years. In effect, the FSM and RMI were incentivized to allow the 2001 deadline to pass to trigger these bump-up years.[a] Following the effectiveness of the Amended Compact in 2004, a rise in transfers occurred. The new funding included more stringent monitoring, reporting, and accountability requirements; it did not necessarily induce efforts to sustain the improvements made to public sectors, fiscal performance, and private sector development during the PSRPs. The new funding flows were greater than in the late 1990s and gave room for both countries to ease up on some of the more difficult decisions made during reforms (especially with respect to the size of the civil service).

For the RMI, new and unconditional assistance from Taipei,China (beginning in 1999), the bump-up period (2001–2003), retiring of bond debt (by 2001), and the commencement of new Compact funds in 2003–2004 meant that rehiring and re-expansion of the Government was more affordable. The combined effect was a change in political choices and commitment to the reform path, especially with a new party coming into office in January 2000. A further RMI PSRP measure was to abolish the loss-making Government shipping operation and tendering domestic shipping services to the private sector. The Government agreed in principle to a more efficient, privately-provided service franchise and withdrawal from direct operation of shipping, but this policy direction was later reversed by establishing the Marshall Islands Shipping Corporation in 2005. Funding from Taipei,China in 2001 allowed the Ministry of Transport and Communication to purchase new vessels and re-deploy its fleet, contrary to the reform direction adopted during the PSRP and evidence from around the Pacific that government-operated fleets have suffered from poor operational management, low utilization, donation and acquisition of unsuitable vessels, poor maintenance and safety compliance, and unsustainably high costs.[b]

FSM = Federated States of Micronesia, PSRP = Public Sector Reform Program, RMI = Republic of the Marshall Islands.

[a] In the event that new economic assistance terms were not renewed by the end of the initial economic assistance period in 2001, the Compact allowed for a 2-year transition period for renegotiation—during this period, the FSM and RMI were to receive an average of the prior 15 years worth of Compact assistance, which constituted a bump-up in funds since initial 15-year program was heavily front-loaded

[b] ADB. 2007. *Oceanic Voyages: Aviation and Shipping in the Pacific.* Manila.

Source: Independent Evaluation Mission.

4. **Other assistance.** In Polynesia and Melanesia, the Australian Agency for International Development (AusAID) and New Zealand Overseas Development Agency (NZODA) provided TA specifically targeting reform efforts to be complementary to ADB support beyond their significant ongoing aid programs to the Pacific. The European Union has assisted, for example, with public financial and expenditure management assessments, and it providing support to Samoa for sector-specific (water) plan-budget management. Australia provided an average of A$125 million per annum to the Pacific through its regular aid program from 1995 to 1998. In the Cook Islands, NZODA funded advisers in the Ministry of Finance who worked alongside ADB-funded advisers. In Samoa, ADB advisers provided support to the Ministry of Finance for economic analysis and policy formulation while AusAID support focused on improved budget management and performance. AusAID and NZODA also provided a range of reform support in Tonga and several of the Melanesian countries.

5. **Pacific Department consultative groups.** In addition to in-country consultations and summits, ADB's Pacific Department orchestrated a series of multilateral consultative group meetings. Key development partners participated in the consultative group meetings, including AusAID, European Investment Bank, European Union, the International Monetary Fund (including representation by the Pacific Financial Technical Assistance Center), Japan, NZODA, the World Bank and others. The first consultative group meeting was held in Manila in December 1995 for the first reform program loans in the FSM and RMI. Consultative group

meetings helped different development partners understand the need for reforms, with the respective governments presenting their reform agendas and lobbying for support and for gaining funding support. Consultative group meetings were held in 1996 (for the Cook Islands) and in 1997 (for Vanuatu). The last consultative group meeting took place in 2000.

6. The consultative approach led to a generally coordinated development partner response, but total cofinancing was limited, with most partners self-financing parallel support (Appendix 7 summarizes the development partner roles) even if parallel assistance complementary to ADB's was provided. For example, AusAID and New Zealand Aid provided TA specifically targeting reform efforts in Polynesian and Melanesian countries. However, ADB played the prominent role in facilitating the Micronesian states' reforms, with some prior support from UNDP and the World Bank (Appendix 7). As shown in Table A7, some ADB-financed program loans and TA were cofinanced by Australia, UNDP, the United States, and Pacific DMC governments themselves—although ADB still provided the bulk of financial support for the programs.

Table A7: Cofinancing Distribution

<table>
<tr><th>Source</th><th colspan="2">Loan ($ million)</th><th colspan="2">ADTA ($ million)</th></tr>
<tr><td>ADB</td><td>ADF</td><td>OCR</td><td>TASF</td><td>JSF</td></tr>
<tr><td></td><td>119.51</td><td>104.8</td><td>8.31</td><td>1.96</td></tr>
<tr><td>Australia</td><td colspan="2">11.9</td><td colspan="2">0.10</td></tr>
<tr><td>Government</td><td colspan="2">14.22</td><td colspan="2"></td></tr>
<tr><td>UNDP</td><td colspan="2">0.5</td><td colspan="2"></td></tr>
<tr><td>United States</td><td colspan="2"></td><td colspan="2">0.99</td></tr>
</table>

ADB = Asian Development Bank, ADF = Asian Development Fund, ADTA = advisory technical assistance, JSF = Japan Special Fund, OCR = ordinary capital resources, TASF = technical assistance special fund, UNDP = United Nations Development Programme.
Source: Independent Evaluation Mission estimates.

7. **Region seeing a diversification in assistance.** While major loan-financed reform efforts in the Pacific DMCs subsided since the early 2000s, the Pacific has seen a stable continuation (and in some areas strong growth) in grant and other forms of TA support, both from the region's historic partners as well as from newer entrants. In the recent decade, the Pacific has seen a diversification of development assistance support and sources, including stepped-up assistance from bilateral government partners (the United States, the People's Republic of China, Taipei,China, European Union, etc.); new streams of assistance channeled through regional organizations and multi-country programs; and increasing interest and assistance from other development institutions.

8. **Collaborative intervention approach more important than ever.** The growing number of development partners operating in the Pacific today necessitates a more collaborative approach by ADB in the region. ADB will have to clearly determine and define its role vis-à-vis the other entities now operating in the Pacific to ensure that efforts are congruent, complementary, and value-adding.

PACIFIC TRUST FUNDS, ASIAN DEVELOPMENT BANK, AND REFORMS

1. **Overview.** Trust funds are used by several Pacific developing member countries (DMCs).[1] Beginning with the establishment of the Kiribati Revenue Equalization Reserve Fund more than half a century ago (in 1956), a growing number of Pacific DMCs established national, development-oriented trust funds. While the revenue sources, management structures, and other key aspects of Pacific trust funds vary, most of the funds were established to stabilize current government revenues, to help ensure longer term sustainability, or to provide resources for targeted development objectives (and some have tried to achieve a mix of these aims). As of 2007, the largest national trust funds held just over $1 billion in assets.

2. **Policy issues affecting performance.** Time and experience have shown that where sound fiscal policy and governance structures are in place, both within trust funds themselves and within the national fiscal systems, trust funds can be an effective way to accumulate and mobilize capital for development in the Pacific. Successfully managed trust funds have provided millions of dollars worth of development funding and have filled critical resource gaps in some Pacific DMCs.

3. However, where internal and broader fiscal policies and governance have been weak or (even worse), where rules and laws governing trust funds have been directly breached, Pacific island countries have seen major fund collapses with massive losses incurred. While as of 2007 the largest Pacific trust funds held over $1 billion in assets, over the past 2 decades fund collapses have resulted in over $1 billion in losses.

4. Whereas trust funds are separate stocks of assets that are often held outside of central government budgets, a good policy practice is to manage these funds as part of the larger fiscal system. This means that trust funds should be subject to the same accountability, reporting, and other scrutinizing measures put on the national budget. This also means that national fiscal systems must be transparent and sound—a continuing challenge in Pacific island countries.

5. **Asian Development Bank involvement in trust funds and fiscal reforms.** The Asian Development Bank (ADB) has had direct involvement in establishing or strengthening several trust funds in the Pacific (e.g., the Tuvalu Falekaupule Fund, the Republic of Marshall Islands [RMI] Compact Trust Fund, and the soon to be reestablished Nauru Trust Fund). Through its policy-based lending (including major structural reform programs in the 1990s) and ongoing technical assistance, ADB has also played a prominent role in strengthening broader fiscal management and fiscal systems in the Pacific.

6. While ADB's reform interventions in the region (and in particular its support for structural reforms) have been deemed generally relevant and in line with Pacific DMC priorities, the outcomes have been mixed. Reforms in some Pacific DMCs have yielded tangible positive impacts, particularly in stabilizing fiscal balances over the short to medium term. However, other Pacific DMCs have seen limited overall reform impacts and some have not sustained reform measures over time.

7. The Pacific DMCs struggle to maintain fiscal stability and continue to see some of the lowest and most volatile growth rates in the world. This means longer term fiscal and economic sustainability will remain a major concern.

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[1] This includes funds held by FSM, Kiribati, Nauru, Palau, RMI, Tonga, and Tuvalu; Timor Leste not included.

8. Altogether, this warrants continued development cooperation between Pacific DMCs and their development partners in the areas of fiscal and economic planning and management. This also means that continued (and effective and efficient) technical assistance toward strengthening trust funds (specifically) and broader fiscal systems will remain needed and highly relevant in the Pacific.

MANAGEMENT RESPONSE TO THE SPECIAL EVALUATION STUDY ON ADB SUPPORT FOR PUBLIC SECTOR REFORMS IN THE PACIFIC: ENHANCE RESULTS THROUGH OWNERSHIP, CAPACITY, AND CONTINUITY

On 11 August 2009, the Director General, Independent Evaluation Department, received the following response from the Managing Director General on behalf of Management:

I. General Comments

1. The Special Evaluation Study (SES) assesses the effectiveness of Asian Development Bank (ADB) support for public sector reforms in Pacific developing member countries (DMCs). The SES evaluates 11 loans approved from 1996–2002 to eight Pacific DMCs. The SES considers how reform processes and political economy factors have influenced the reform agenda, design, and results of ADB's support; and recommends ways to improve ADB's future support for Pacific DMC reforms and development. Overall, ADB support for reforms to all Pacific DMCs is rated "partly successful". By region, program loans in Pacific DMCs in the Polynesian countries were rated "successful" overall. Results were overall "partly successful" in the Melanesian and Micronesian countries that received ADB support.

2. We appreciate IED's SES on ADB Support for Public Sector Reforms in the Pacific. We agree with the SES conclusions and lessons identified, and the recommendations will be useful for our future interventions. The SES will be a key input in the preparation of the proposed Pacific Regional Study covering 2010–2015. The SES is timely and relevant as PARD is also embarking on several new program loans, grants and other assistance, to help the Pacific DMCs respond to the global economic crisis.

3. We agree that the broad thrust of ADB support for public sector reforms in the Pacific remains relevant a decade later, even in the context of current global economic conditions. We also agree that effectiveness was limited by overambitious objectives and design that needed to better reflect government ownership—a challenge given the political trade-offs and choices and often unavoidable short-term social costs arising from far-reaching reforms.

II. Comments on Key Strategic Recommendations

4. **Recommendation (i) – Ownership.** We agree. The recommendation to "carry out a stock taking of the current reforms in Pacific DMCs before embarking on further program lending" is being implemented with preparation of a stock-take for new program loans. This stock-take is supported by ADB's annual country performance assessments of policy and institutional settings. The findings of the Knapman and Saldanha review of 1999[1] also remains relevant. Further input is provided by extensive PARD economic, thematic and sector work and other input to Country Partnership Strategy and Country Operations Business Plan preparation.

[1] ADB. 1999. *Reforms in the Pacific: An Assessment of the ADB's Assistance for Reform Programs in the Pacific*. Manila.

5. **Recommendation (ii) – Continuity.** We agree. We add that focus on a longer term programmatic approach is also warranted. This support may be best placed through a series of more modest and focused programs based on *ex ante*/prior conditionalities.

6. **Recommendation (iii) – Focus.** We agree. Reforms need to be tailored to the specific situation of each Pacific DMC. It may be unrealistic to assume that many Pacific DMCs, especially the micro-states, will be able to develop fully-fledged, self-sustained and efficient public sector administrations/sectors. We need to acknowledge the likely limited impact of reforms given the small population and size, remoteness, and lack of resources in many of our Pacific DMCs.

7. **Recommendation (iv) – Capacity.** We agree. ADB is already utilizing demand-driven approaches and pooled, flexible and clustered TA with focus on 'how to' support.

8. **Recommendation (v) – Facilitate Private Sector Development.** We agree. It is important that the report notes that the lack of private sector development was a disappointing outcome. Since this earlier series of program loans was designed and implemented, PARD has adopted a significantly different approach to private sector development in the Pacific. The approach is based on, first, identifying the key binding constraints to private sector development through private sector assessments. Once these constraints have been identified and prioritized, ADB can then provide targeted technical assistance to address them; a bulk of this assistance is now provided through the Private Sector Development Initiative. The framework developed under the private sector assessments can be used to underpin program-type interventions in many Pacific DMCs.

DEVELOPMENT EFFECTIVENESS COMMITTEE

Chair's Summary of the Committee Discussion on 1 September 2009

Special Evaluation Study on ADB Support for Public Sector Reforms in the Pacific: Enhance Results through Ownership, Capacity, and Continuity

1. The special evaluation study (SES) assessed ADB's assistance for public sector reforms in pacific developing member countries (PDMCs) to be partly successful. In general, ADB's lending support to PDMCs has a success rate much lower than that of ADB's overall assistance.

2. ADB's partly satisfactory performance in the PDMCs stems from the unique situation in the pacific where the islands are fragmented and isolated with limited access to world markets, and low capacity to implement necessary reforms. The situation in the pacific is also marked with high reliance on international aid due to limited financial capacity, restricted access to private capital, and limited investments.

Discussion Highlights

3. The Independent Evaluation Department (IED) emphasized the importance of reducing the PDMCs' dependence on foreign aid, although this is beyond the scope of the SES. The SES strongly recommends that any future reform assistance by ADB to PDMCs should be preceded by stocktaking of lessons learned and assessment of the current state of reforms. Further, attention should be given to strengthening government ownership, increasing government capacity, ensuring continuity in ADB support, enhancing focus of operations, and private sector development.

4. DEC members generally endorsed the key recommendations of the SES. There were suggestions for improving the methodology used, like inclusion of a detailed political economy framework and conducting more empirical evaluation research and analysis. DEC Chair pointed out the importance of presenting fiscal deficits exclusive of grants. Both IED and Management representatives emphasized the difficulty faced in gathering such data, though proxy indicators have been made available to determine impacts and outcomes. ADB has made continuous efforts in building statistical capacity of PDMCs to gain more informed basis for policy-making and strategizing about development interventions.

5. One DEC member emphasized the importance of the SES as a tool in designing future country partnership strategies (CPSs) in the Pacific. Another DEC member suggested the need for pre and post reforms evaluation in order to arrive at a better assessment of the assistance. Some DEC members inquired on how the lessons learned fed back into the choice, design and implementation of subsequent programs. Management representatives acknowledged the limited incorporation of lessons in the past. However, attention was given to simplified program designs with government participation and ownership.

6. One DEC member noted that a new political economy or public choice approach with strong emphasis on microeconomic foundations could provide better explanation and guidance for future reform programs on private sector development and state-owned enterprises reforms. It was also acknowledged that there may be trade-offs in achieving sound fiscal and financial management, improved public service delivery, and enhancing environment for private sector

development. Management mentioned that there have been technical assistance programs designed to create enabling environment for private sector development.

7. DEC recognized the uniqueness of the situation in PDMCs and the importance of gaining a better understanding of the historical, social and cultural traditions and context of these countries. The uniqueness of the situation should be considered not only in the design and implementation of programs, but also in the measurement of the results of the programs. A one-size-fits-all approach would not be appropriate.

8. Management generally agreed to the recommendations of the SES, as the recommendations are consistent with the broad dimension of ADB's policy on weakly performing countries, which includes keeping program designs and business processes simple. Management emphasized the challenges of narrow economic base, vulnerability to external economic shocks and natural disasters, and limited and weak capacity in PDMCs.

Conclusions

9. DEC welcomed the SES, which is an in-depth study of 11 reform loans between 1996 and 2002. DEC noted the challenges faced by these countries given their dependence on external grants and limited capacity.

10. DEC pointed out the urgent need to develop better system of national accounts and focusing on income balance inclusive and net of foreign grants.

11. DEC encouraged staff and IED to have a very careful look at the evaluation and rating of programs in these countries to improve ADB support to such DMCs.

12. DEC emphasized the importance of reducing the dependence of PDMCs on the public sector, improving governance in general, and education and training in particular, and property rights.

13. DEC underscored the importance of particular cultural factors deep-rooted in these countries and promoting ownership of programs.

Ashok K. Lahiri
Chair, Development Effectiveness Committee