Abbreviations

ADB	–	Asian Development Bank
ADF	–	Asian Development Fund
AMI	–	Air Marshall Islands
AMU	–	Asset Management Unit
AusAID	–	Australian Agency for International Development
BVDC	–	Business Ventures Development Corporation
CBS	–	Central Bank of Samoa
CIDB	–	Cook Islands Development Bank
CRP	–	Comprehensive Reform Program
DBV	–	Development Bank of Vanuatu
EMPAT	–	Economic Management and Policy Advisory Team
ERP	–	Economic Reform Program
ESCAP	–	Economic and Social Commission for Asia and the Pacific
FSM	–	Federated States of Micronesia
FSP	–	Financial Sector Program
FY	–	Fiscal Year
GDP	–	Gross Domestic Product
GNP	–	Gross National Product
ICSI	–	Investment Corporation of Solomon Islands
IMF	–	International Monetary Fund
MFEM	–	Ministry of Finance and Economic Management
MOU	–	Memorandum of Understanding
MTBF	–	Medium-Term Budget Framework
NBV	–	National Bank of Vanuatu
NDC	–	National Development Council
NPF	–	National Provident Fund
NZODA	–	New Zealand Overseas Development Authority
OECD	–	Organization for Economic Cooperation and Development
OPO	–	Office of Pacific Operations
PAT	–	Policy Advisory Team
PDMC	–	Pacific Developing Member Country
PERCA	–	Public Expenditure Review Committee and Audit Act
PFTAC	–	Pacific Financial Technical Assistance Centre
PSC	–	Public Service Commission

PSIP	–	Public Sector Investment Program
PSRP	–	Public Sector Reform Program
PSU	–	Private Sector Unit
RIF	–	Reduction in Force Program
RMI	–	Republic of the Marshall Islands
RRP	–	Report and Recommendation of the President (ADB)
SIPEU	–	Solomon Islands Public Employees' Union
SOEs	–	State-Owned Enterprises
SOEMU	–	State-Owned Enterprises Monitoring Unit
TA	–	Technical Assistance
UNDO	–	United Nations Development Organization
UNDP	–	United Nations Development Programme
UNICEF	–	United Nations Children's Fund
US	–	United States
VAT	–	Value-Added Tax
VNPF	–	Vanuatu National Provident Fund

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FOREWORD

The 1990s has been a decade of major change for the Asian Development Bank and its Pacific Developing Member Countries (PDMCs). As the Bank has transformed itself from being primarily a project lender to being a broad-based development institution, a wave of economic, public sector and governance reform has broken on most PDMC shores. The Bank has assisted the reform process through provision of program loans and technical assistance.

This book presents the results of an assessment of Bank assistance to reform efforts in six PDMCs. The assessment was undertaken at the request of the Board of Directors of the Bank by an interdepartmental task force consisting of Cedric Saldanha (Chairperson, Office of Pacific Operations), Louis de Jonghe (Office of Pacific Operations), David Edwards (Economics and Development Resource Center), Manabu Fujimura (Economics and Development Resource Center), Michael Heppell (staff consultant, Strategy and Policy Office), Bruce Knapman (staff consultant, Office of Pacific Operations), and Salvatore Schiavo-Campo (Senior Advisor for Governance and Public Management). A summary report was prepared on the basis of individual country reports, which involved missions to the Cook Islands (October 1998), the Republic of Vanuatu (October-November 1998), the Federated States of Micronesia (January-February 1999), the Republic of the Marshall islands (February 1999), Solomon Islands (February 1999), and Samoa (March 1999). These reports are published in order to make the findings available to the Pacific community, external funding agencies, and the public at large.

Special acknowledgment is made of contributions to the individual country reports by Manabu Fujimura (Samoa, Vanuatu), Michael Heppell (Cook Islands, Federated States of Micronesia), and Salvatore Schiavo-Campo (Samoa, Vanuatu).

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4 REPUBLIC OF THE MARSHALL ISLANDS

4.1 Introduction

The Public Sector Reform Program (PSRP) Loan of $12 million to the Republic of the Marshall Islands was approved in December 1996, to be released in three tranches. Adjunct technical assistance was provided that aimed at supporting PSRP implementation in three specific areas: (a) program coordination ($515,000); (b) institutional strengthening of the transport sector ($575,000); and (c) establishment of a private sector unit ($760,000). The loan amount compared with external grant assistance, mostly under the Compact of Free Association with the United States, of $40 million in the fiscal year ending 30 September 1997.

4.2 The Macroeconomic and Governance Context

Marshall Islands 1996 Economic Report (ADB 1997b) provides a comprehensive analysis of economic development performance, problems and policy issues up to 1996. The central challenge identified in the report was for a heavily aid-dependent, public sector-dominated economy to adjust to reductions in external grants under the Compact of Free Association with the United States. These reductions occurred in 1992 and 1997; and, subject to the outcome of re-negotiation of Compact funding in 1999, further reduction could be anticipated in 2001. The magnitude of the adjustment required is indicated by the fact that in the period FY1991-FY1995, US grants accounted for an average 71 percent of total government revenue and 59 percent of total expenditure. The budget deficit before grants averaged 65 percent of GDP, and after grants a still unsustainably high 16.5 percent.

The budget deficits of the early 1990s resulted from a failure to adjust to the 1992 Compact stepdown. Instead, capital expenditure increased, high subsidies to public enterprises (especially Air Marshall Islands) remained, and the public sector payroll grew. The number of public sector employees increased by 53 percent between 1991 and 1995 - from 2,671 to 4,086, compared with private sector figures of 4,168 and 4,724, respectively. By the end of September 1995, with government's financial reserves run down to $3 million (from $47 million in 1991) and external debt at $141 million (134 percent of GDP), the incumbent President recognized the need for urgent fiscal adjustment. A Policy Reform Program that focussed on fiscal stabilization was developed with assistance from a Bank-funded Policy Advisory Team and presented to external funding agencies in December 1995 (see sections 4.3 and 4.4).

Given that public administration (including health and education services) accounted for 27 percent of GDP in 1995, and that public enterprises were prominent in transport and communications, finance, manufacturing and electricity and water, fiscal adjustment was bound to have a significant, negative impact on the level of economic activity. Following annual growth of 3-4 percent during the early 1990s, RMI's real gross domestic product (GDP) fell sharply by 7.8 per cent in 1996 and by 5.0 percent in 1997, according to the Office of Planning and Statistics. In 1998, it is estimated to have fallen by a further 5.0 percent, to about $57.5 million in 1991 prices. With population growing at 3.5 percent per annum, real GDP per capita has fallen 41 percent in the 1990s - to an estimated $913 in 1998 (Figure 4.1). There are no recent data on GNP, but in 1990-96 net factor income receivable from overseas averaged 6.4 percent of GDP (World Development Indicators 1998). Income distribution was, in the words of the 1996 Economic Report (ADB 1997b, p.47), "highly skewed". In 1991, average income in the outer islands was 47 percent of that in Majuro and 32 percent of that in the island of Ebeye, Kwajalein atoll. The richest 20 percent of the Majuro population received average incomes of over $3,000, whereas the poorest 20 percent received $840.

Declines in output during 1995-98 reflected not only the cuts in government expenditure and employment made under the Policy Reform Program, but also the poor performance of agriculture and fishing. Agriculture and fishing output contracted by 20 percent in FY1996-FY1997, and fell again in FY1998 because of the effects of typhoon Paka (December 1997) and El Nino. Copra production continued to be adversely affected by low producer prices, inter-island transport problems, and an aging tree stock. Food and livestock production fell. Fishing production contracted when unprofitable government-owned long-line and purse-seiner vessels ceased operations in FY1996. In line with the economic recession, the inflation rate fell from almost 10 percent in FY1996 to 5 percent in FY1997, and an estimated 4 percent in FY1998.

In 1999, economic activity has recovered as a result of aid-funded roadworks employing about 300 people and, more importantly, growth in the fisheries sector. A reduction in domestic fuel prices was the catalyst for a substantial increase in the foreign purse seiner fleet. Fishing license fees are expected to rise to over $4 million, compared with $1.8 million in 1998; and on-shore spending by crews has stimulated the services sector. A loining factory that will provide 300 jobs is to be built. Bank technical assistance to the fisheries sector has been instrumental in the process leading to these developments.

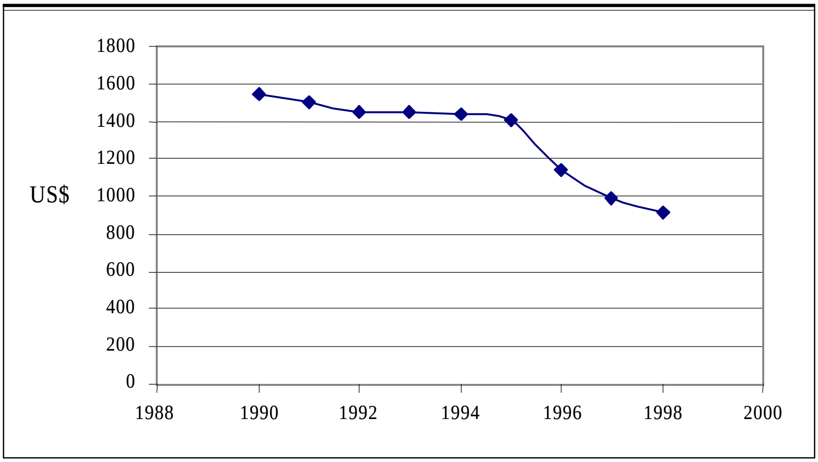
Substantial progress toward fiscal stabilization was made in FY1996 and FY1997, as public service downsizing, the reduction or elimination of subsidies to state-owned enterprises, and a major drop in capital spending combined to generate overall budget surpluses equivalent to 20 and 4 percent of GDP, according to IMF estimates. These surpluses were used to make loan repayments and, in FY1997, to reduce arrears. The budget for FY1998 aimed at continuing the fiscal adjustment, estimating a surplus equivalent to 11 percent of GDP would be achieved through a 17 percent cut in expenditure. A 5 percent drop in revenue and grants was expected, given the deferment of revenue-raising actions that originally were to have been incorporated in the budget. However, in March 1998 a supplementary budget provided for a 13 percent increase in expenditure on the estimated level, $6.5 million from general funds and $2.2 million from anticipated assets sales that have not eventuated. In addition, revenue receipts were running below the estimated level. Data on the actual outcome in FY1998 are not yet available, but it is likely that an overall deficit was realized, rather than the large surplus needed to cover net amortization of external debt, which stood at $125 million at the end of FY1997.

The absence of timely, reliable and comprehensive statistics on government finances is one aspect of a lack of transparency in government decision-making, which is also on occasion notable for its unpredictability.[24] However, government is ultimately accountable at the ballot box. Elections to the Nitijela (parliament) are due in November 1999, and a government that holds a slender majority is now in election mode. In early March, it announced a substantial rise in the copra subsidy, a cut in the general tariff rate from 12 to 5 percent, and large cuts in the tariff rates on alcohol, tobacco and soft drinks. (The general rate had been increased from 10 to 12 percent in 1996 as a revenue-raising measure). There seems to be considerable confidence amongst politicians and government officials that the need for further fiscal adjustment shall be forestalled by increased external aid from Taipei,China, which RMI recognized in late 1998, and by a successful re-negotiation of Compact funding. Belief in the latter outcome has been encouraged by a US Department of Defense assessment of the US Army Kwajalein Atoll (USAKA)/Kwajalein Missile Range (KMR) as a "national asset" because of its unique suitability for full-scale testing of long-range missiles and intelligence gathering, and its importance for space programs.[25] The Compact provides for automatic renewal rights of the lease on Kwajalein for 15 years after expiration of the current lease in 2001.

[24] Audits of General Purpose Financial Statements for the fiscal years of 1995 and 1996 conducted by Deloitte and Touche note a lack of comprehensiveness in accounts, inadequacies in accounting records, and inadequacies in internal control structures. G. Vaughan-Jones, Review of Progress in Implementation of Budget Reforms, Republic of Marshall Islands, (TA2755-RMI, n.d.), notes "improvement of all elements of financial management [is] an important necessary initiative for the Marshall Islands". The Minister of Finance observes: "Our financial records are in terrible condition (17 major exceptions in the audit opinion)" (Tony A. de Brum, Minister of Finance to Peter Sullivan, Vice President (East), 5 January 1999). Up to the end of 1997, no executing agency for Bank loans had ever submitted the required audited annual project accounts.

[25] Testimony of Stanley O. Roth, Assistant Secretary of State for East Asian and Pacific Affairs, Asia Pacific Subcommittee of the House International Relations Committee, 1 October 1998.

Figure 4.1: Real GDP per capita (1991 prices)



Sources: Office of Planning and Statistics, *Marshall Islands Statistical Abstract 1997*; staff estimates.

Funds permitting, government is supportive of a sympathetic interpretation of section 11 of the Constitution of the Marshall Islands (1983), which refers to the functions of the Public Service Commission:

> *[The Commission] shall take account of the need to recruit and train an efficient staff, to afford reasonable opportunities of employment for Marshallese and to act consistently with government economic and social policy bearing in mind that conditions of employment in the public service are a major element in the general well-being of the Marshall Islands.*

4.3 The Process of Program Design

4.3.1 Ownership and appropriate participation in the design process

During late 1995, the government of RMI developed a Policy Reform Program with assistance from a Bank advisory team that arrived in Majuro in July.[26] The program focussed on fiscal stabilization and tax reform, privatization of public sector enterprises, public service reform, and stimulation of private sector development. The public service reform component was based largely on a UNDP study – the Boag study - that was begun in January 1994 and adopted by Cabinet and the Nitijela in December 1995.[27] In the latter month, the program was presented to, and endorsed by, the first RMI Consultative Group Meeting in Manila. Subsequently, it formed the basis of the Public Sector Reform Program (PSRP), which reportedly included those reforms that the RMI government was ready to implement and that were adjudged to have a chance of actually being implemented over the next two to three years, with technical assistance.

The Program Matrix was presented by the RMI President to his Cabinet and approved prior to signing of the MOU on 31 May 1996. Beyond this, a one-day workshop, and some radio broadcasts, there seems to have been little concerted effort to communicate reform objectives and strategies to the legislature or the public at large. With the death of President Kabua in late 1996, impetus for reform was lost. The first National Economic and Social Summit in Majuro was not held until January 1998, and then was at the request of the funding agencies' 1997 Core Group meeting in Fukuoka. Summit papers were translated into Marshallese and circulated amongst summit participants, and proceedings were broadcast on the radio. This was the first major step taken to address communication gaps identified within the Government and between Government and the general public. There have been no summits since the first, and none is planned.

[26] TA 2295-RMI: Policy Advisory Team, approved for $2.5 million on 31 January 1995.

[27] Peter Boag, Public Sector Management Improvement Program, November 1995 (2 volumes). This study followed earlier studies of public service rationalization – the 1988 Aries Report and a 1994 World Bank study.

It remains the case that the reform process is seen essentially as a public service downsizing instigated by the President of the day, implemented through a Presidential Committee on Rationalization of the Public Service established in October 1992, chaired by the Chief Secretary of the Office of the President, and informed by the UNDP study and PAT advisers. The Committee, later renamed the National Steering Committee, presented targets to Cabinet and the Nitijela for approval, and then informed Secretaries of Ministries of the required, across-the-board cuts in numbers. Secretaries were expected simply to comply. They still complain that there was inadequate attention paid to organizational structure and function, and to individual ministeries' staffing needs, let alone to effective service delivery. It is telling in this regard that the Boag study notes with reference to its downsizing estimates that "Obviously no discussions have been held with the Ministries concerned".

4.3.2 Partnership and consultation with other external funding agencies

The Bank has been holding Consultative Group meetings for RMI since the December 1995 meeting mentioned above. The third meeting was held on 30 January 1998 in Tokyo and, like previous meetings, served to inform external funding agencies on design and implementation issues and to identify priority areas for assistance. During the process of formulation of the PSRP, the Bank consulted with, and sought feedback from, the IMF and the World Bank.

4.3.3 Effectiveness of internal processing procedures

Processing procedures were completed relatively quickly. Fact finding was completed from 18 to 31 May 1996, loan appraisal from 9 to 18 September, and loan negotiations were completed on 18 November, 1996. Disbursement of the first tranche occurred on 6 February 1997.

4.4 The Content of the Program

4.4.1 The Public Sector Reform Program

The overall, long-term goal of the PSRP is to stimulate private sector-led economic growth. This is to be done through the achievement of three primary objectives: short-run stabilization of government finances; ensuring long-term structural stability in government finances; and creation of an enabling environment for the private sector. The first two primary objectives have related secondary objectives of increasing revenue, reducing recurrent expenditure by 20 percent during the Program period, and improving management of funds under government control. The third primary objective has the two related secondary objectives of reducing government involvement in the economy and improving the regulatory environment. Fifty-nine reform actions to attain the objectives are specified in a policy matrix: 38 relate to the first two primary objectives; and 21 to the third.

The first tranche of the $12 million loan was released upon loan effectiveness, reflecting the fact that 15 policy actions in the policy matrix were already completed. Thus, according to the RRP (para 5 of Appendix 1), "The goal of stabilization of Government finances was achieved by the beginning of FY1997, on 1 October 1996...by increasing revenues, and reducing expenditures". The active part of PSRP is therefore made up of 44 policy actions, 40 of which explicitly address the second and third primary objectives. Six actions are second tranche conditions and three are third tranche conditions (Appendix 1).

The first three second tranche conditions – to downsize the public service, end subsidies to Air Marshall Islands, and continue the three-year wage freeze – are the key actions to reduce government's recurrent expenditure. The Reduction in Force (RIF) program provides retrenched public servants with a lump-sum payment of 3-9 months' pay, depending on length of service, and monthly maintenance payments over a three-year period, calculated according to the benefit rules of the Marshall Islands Social Security Administration. Other key, non-tranche actions contributing to strengthening public finances from the revenue side include improving tax and customs administration; reducing tax arrears; simplifying the import duty schedule, with a basic duty of 12 percent and eight other rates between 5 and 150 percent; reducing exemptions from import duties and the Gross Revenue Tax; and doubling the petrol tax.

The fourth second tranche condition concerning the establishment of a Financial Reserves Trust Fund as a long-term source of recurrent revenue is worthy of special mention. It drew its inspiration from the Tuvalu Trust Fund that began in 1987 and has operated successfully since, providing around 20 percent of government's annual recurrent revenue. The introduction of the Fund concept into the RMI PSRP represents an acknowledgement of the severe development constraints confronting this ultra-small atoll economy, and the consequent limitations to private sector activity and bankable development projects.

Compared with the first four second tranche conditions, the condition requiring a reduction in the numbers on the Air Marshall Islands Board, and the third tranche condition requiring a tax on rental income from commercial building, seem trivial.

The original and plausible expectation was that, with reform and the Bank's program loan, there would be an economic recession in 1996-98, the depth of which would be reduced in comparison with the reform-but-no-loan scenario as a result of the RIF payouts. Thereafter, economic recovery would depend on the strength of the private sector's response. Both the Boag report and the RRP acknowledge that the private sector would not be able to quickly absorb many, if any, retrenched public servants.[28] The RIF program, including a counselling and training component, was expected to mitigate the impact of retrenchment.

Three risks are identified as potentially preventing successful implementation and effectiveness of the reform program: (1) insufficient capacity in government; (2) a loss of government commitment to the pace of reform as opposition grew with the retrenchment of public servants; and (3) a failure of the private sector to respond to reforms as expected. The first risk was to be minimized through the use of Bank technical assistance. A Program Coordinator was to be assigned to the Rationalization Committee. TA

[28] Projections in Marshall Islands 1996 Economic Report (p.45) were that real GDP would fall almost 50 percent in 1996-2001, before modest recovery on the back of increased government expenditure made possible by completion of debt repayments and continuation of Compact funding into 2002 and 2003.

in institutional strengthening of the transport sector was to be provided. And a Private Sector Unit was to be supported. The second risk was to be reduced through a 1997 public information campaign, and through the provision of a safety net for retrenched public servants (the RIF program). With regard to the third risk, separate TAs were to design strategies expected to improve the policy environment in the fisheries and tourism sectors.

Although both the Boag report and the RRP refer to the need to produce a quality public service, the design of the PSRP reflects an overriding concern with the achievement of a more affordable public service through reductions in the number of ministries, outsourcing of some services, and cuts in staff and operating budgets. There is no discussion of the basic framework of a post-reform government that can more efficiently and effectively deliver the services required by a rapidly growing population. From the outset, therefore, the PSRP ran the risk of cutting staff too far in some areas and not far enough in others, potentially creating hierarchical imbalance (removing too many managers, key personnel and key classes of personnel) and diminishing the capacity of an organization to deliver core services at an appropriate quality level. With the focus on downsizing, the likelihood was that the target number of 1,484 would become an end in itself, rather than a signpost on the way to achieving the goals of public service reform.

Public service downsizing alone was considered hard enough. As the RRP notes:

> *The issue of what is affordable is difficult to address, in the light of the considerable uncertainties in RMI's future.*
>
> *The decision on the extent of downsizing was made more difficult in the absence of any reliable data on the actual size of the civil service (Appendix 1, paras 28,29).*

The numbers given in the Boag report are shown in Table 4.1. Following an immediate cut in government employees through termination of the school-feeding program and privatization of services in Public Works and the Ministry of Transport and Communications, the report recommended a further cut in "Core Government" numbers to 1,484, a 5 percent annual decrease in the average wage rate, and a 3 percent annual decrease in operations budgets. Roughly 38 percent was thus to be cut from the public service budget over a five-year period. The Rationalization Committee endorsed the target number of 1,484; and the March 1996 interim budget cut wages by 5 percent for the 22 percent of employees receiving over $10,400 per annum, and reduced appropriations for ministries' operating expenditures by 3 percent. The PSRP reduced the timeframe for downsizing to one year.

It should be acknowledged that the Bank sought to provide a stand-alone, small-scale advisory TA to assist with implementation of civil service reform.[29] This was to provide an analysis of the current civil service organization and prepare a detailed, timebound action plan which would, amongst other things, identify required parliamentary approvals and legislative action and training and counselling needs of retrenched public servants. However, there was an 11 month delay in the start of the TA (from July 1996 to mid-1997), largely because of sluggishness in Bank processing attributed to staff changes; and the chosen consultant was in country for under two months.

4.4.2 Rationale and appropriateness of loan amount

The background diagnosis presented in the RRP is as comprehensive as data limitations permit. Government was unable to continue to pay the existing public service workforce, subsidize public enterprises, service the external debt, and still deliver the current level of services. Fiscal projections for FY1996-FY2003 presented in the 1996 Economic Report and revised in the RRP are the best available demonstration of the quantitative dimensions of the required fiscal adjustment and its negative impact on income. If anything, the bleakness of the medium-term economic outlook is understated because the impossible demands placed on private sector growth are not spelled out. It has been estimated that, in the absence of growth in public sector employment, the private sector in RMI would have to grow at a sustained 10.6 percent per annum just to absorb new entrants into the workforce (ADB 1998a, p.75). The PSRP is presented as a means of providing "at least some longer

[29] TA No.2599-RMI: Civil Service Reform Implementation, approved 2 July 1996 for $100,000.

term hope" and, through provision of loan funds, softening the impact of reform-induced recession (RRP, para 32).

Table 4.1: Public Service Downsizing

	Oct. 1995	Oct. 1995	Oct. 2000	% Reduction (total to new core)
	Total Govt.	Core Govt.	New Core	
Employees	2,125	1,739	1,484	30.2
Total wages	21.7	15.21	10.77	50.4
Operations	10.6	10.55	9.09	14.2
Total recurrent	32.3	25.76	19.86	38.5

Source: Peter Boag, Public Sector Management Improvement Program, November 1995 (2 volumes).

The loan amount of $12 million is "based on the scope and the costs of the policy reforms, the importance and urgency of the reforms, and the critical state of public finances" (RRP, para 84). The amount is divided as follows: $5.5 million for the RIF program; $4.0 million for paying off Air Marshall Islands' commercial debt; and $2.5 million for the Financial Reserves Trust Fund. The first number was estimated on the basis of expected retrenchments. The second represented two-thirds of AMI's outstanding commercial debt. The third number likely seemed an appropriate amount for seed-funding the Trust. With regard to the allocation of $4 million to pay off commercial debt of the ailing AMI, there was presumably some confidence that professional management, a change in the constitution of the board of directors, and assistance in developing an aviation policy would turn the enterprise around.

4.4.3 Consistency with country and Pacific strategy

Both the rationale for the program loan and the content of the PSRP are consistent with the Bank's Pacific and country strategies:

Policy reform and improved economic management are the overall strategic objectives of Bank operations in RMI...During the 1996-99 period, a first priority is stabilizing public finances. The Bank will also support investments in public sector reform and private sector development (Country Strategy, p.50).

4.4.4 Relevance and focus

The PSRP's general relevance has been acknowledged above. It has an explicitly limited focus, as explained in the RRP (Appendix 1, paras 3, 4):

While [the] three primary objectives are necessary to address the short-term fiscal constraints and create an environment for sustainable growth, these objectives alone are not sufficient to achieve that growth. The PSRP therefore is a program with a limited focus designed to create a stable macroeconomic framework which will contribute to the overriding objective of the creation of an improved enabling environment for private sector-led economic growth.

To attain these objectives, reforms are included in three areas: the public service, fiscal policies and the transport sector. The main rationale for the inclusion of these three areas...is that all three have a large impact on public sector finances, and reforms in all three are necessary to achieve private sector-led economic growth.

Reform actions extended to improving the regulatory environment, but did not address all of the issues raised in a Bank review of private sector operations in the Marshall Islands.[30] This review concluded that "the private sector environment is constrained by lack of long-term funding for project finance, a deficient legal environment, a lack of respect for the court, and a lack of enforcement of laws, rules and regulations, in particular [those] related to duties and taxes".

[30] RMI: Country Programming Mission – Review of Private Sector Operations, 5 February 1996.

4.4.5 Appropriateness and Sustainability

The PSRP design covers what was accepted by the President and some officials, on advice from the PAT team, as a necessary public service downsizing. As noted above, it does not address the more difficult task of identifying what services government should provide in the future, deciding how government operations could be restructured to deliver these services, and formulating an action plan with a timetable. Nor does it provide a mechanism ensuring that the reform program is marketed to the public and private sectors, the legislature and the public at large. The absence of such a mechanism, combined with an initial weakness in participation and ownership, plus the Constitutional recognition of the public service as an employer (section 4.2), raises doubts about the durability of any downsizing. In these circumstances, the Bank and its advisory team are readily cast in the dual role of enforcer of undesired reforms and scapegoat.

4.4.6 Likely impact on governance

Governance is dealt with in the PSRP insofar as it involves the regulatory environment, which is described in the RRP as "currently nontransparent with many discretionary powers vested with the executive branch of the Government" (Appendix 1, para 16). Specific actions to improve transparency and predictability of decision-making include the third tranche condition to remove company registration from Cabinet hands and make it the sole responsibility of the Registrar of Corporations; a review of policy and procedures concerning hiring of foreign workers; improving procedures for issuing of business licenses to foreign investors and passing new legislation to provide standard international protection for such investors; establishing an Ombudsman's office; and creating legislation and procedures to ensure security of land leases (Appendix 1, C2).

More generally, it should be noted that legislation has not been codified or published in the past three years and that departmental regulations have never been codified or published. This basic requirement of good governance is not mentioned in the PSRP.

4.5 Implementation

4.5.1 Actions to date

At the time of loan effectiveness, three revenue-raising actions and 11 expenditure-reducing actions had already been satisfied. Conditions for second tranche release were not fully met on schedule (September 1997), because of Government's sudden removal of Air Marshall Islands' chief executive officer and a failure to downsize the public service to 1,484 employees. In the event, release occurred one year later, after a new CEO had been recruited for AMI, and on the basis that the Bank (1) effectively waived the tranche condition requiring an AMI board of five (there were seven members), and (2) granted a waiver that transferred two second tranche conditions into the third tranche box. One of these was the 1,484 target, which government undertook to meet in 1999. The other was the establishment of the Financial Reserves Trust Fund: government had set aside $300,000 as its contribution, but had not passed the required legislation.

In early March 1999, 30 of the 59 policy matrix actions were completed and remained in place, three had been completed but subsequently reversed, and 26 remained incomplete. The reversals concerned rationalization and raising of import duties, the reduction of copra subsidies, and the number of AMI board members. Included in the incomplete category are all of the revised third tranche conditions. Five pieces of legislation are yet to be passed, and the public service downsizing target has not been met (though the number had dropped from 2,303 in October 1995 to 1,607 at the end of 1998). The condition requiring imposition of a tax on rental incomes from commercial buildings will have to be waived if the third tranche is to be released, since it was to be met through introduction of value-added tax legislation, which has been withdrawn from the Nitijela.[31]

[31] By the end of March 1999, all legislation except for that concerning company registration had been passed; and Bank staff were confident that third tranche conditions would be met on schedule.

4.5.2 Use of loan and counterpart funds

Paragraph 104 of the RRP states that: "The Borrower will ensure that the Counterpart Funds withdrawn from the Special Account to be established for the purpose of the loan, will be used for (i) financial support for civil servants retrenched from the public service under the RIF program, (ii) supporting retirement of AMI's accumulated commercial debts, and (iii) supporting the establishment of the Financial Reserves Trust Fund". This requirement has been complied with, but actual allocations to the three categories have not corresponded exactly to the program loan tranching schedule. Air Marshall Islands has received $4.37 million instead of the scheduled $4.0 million because of an apparent oversight by the executing agency (the Ministry of Finance). This has provided a windfall to the management of a cash-strapped AMI and, together with the strengthening of the SDR exchange rate, has left the RIF program $0.5 million short of its intended allocation.

4.5.3 Effectiveness of monitoring

The RRP (para 105) noted that the Bank "will monitor closely the implementation and impact of the Program, including future policy, institutional and financial developments, and any other changes likely to have an effect on the Program. The Office of Planning and Statistics will be charged with the design and implementation of a monitoring program". The Bank has undertaken the monitoring task as planned, and this has been facilitated by the appointment of a PSRP Coordinator from mid-1997 (though the contract surprisingly contains no requirement for regular reporting to the Bank). In addition, under the Loan Agreement, the RMI Government is required to submit semi-annual reports on progress to the Bank. This has been done. However, there is no evidence that the Office of Planning and Statistics has designed and implemented a monitoring program, or that it has effectively pursued the task of tracking retrenched public servants. As in the FSM reform program, anecdotal evidence is the only basis for establishing what has happened to these people. Nor has the RMI government forwarded operational and financial statements of AMI to the Bank on a monthly basis.

4.6 Results

4.6.1 Participation and ownership

From the beginning of the PSRP, it is doubtful that participation and ownership have been strong enough to underpin a sustained reform effort. The public service downsizing was very much a top-down initiative of the late President's, supported by external advice. After the President's death the Bank's Policy Advisory Team became marginalized, at least in part because of a reported failure to gain the trust and respect of the new leadership.

In 1999, the prospect of aid from Taipei,China and a belief that Compact funding will be re-negotiated mean that a government in election mode is unlikely to revitalize the reform process. Enough may be done to ensure release of third tranche funds, and thus to retain credibility with external funding agencies (including Taipei, China).

4.6.2 Public service downsizing and government finances

Strengthening of government finances is the core of the PSRP, with public service downsizing the primary means. The Nitijela's Interim Budget (Appropriation Act FY1996) imposed staff ceilings and cancelled 178 existing vacancies. Then, under the first phase of the RIF program, the Ministry of Social Services was disbanded, with 53 staff being transferred to other ministries, and 179 cooks and 33 administrative staff receiving three months' notice. Under the second phase, a further 103 public servants were given notice. Thus 315 personnel within the jurisdiction of the Public Service Commission (which does not include police and education) were "RIFFED" by 31 August 1997 - all of them funded out of General Funds, not Federal Program funds earmarked for special projects. In addition, there was a 5 percent across-the-board pay reduction for salary brackets over $10,400 p.a.; and Public Works was merged with the Ministry of Resources and Development, thereby reducing the number of ministries from 10 to 8. 1998 updates on downsizing have been made painstakingly from the Ministry of Finance payroll by the PSRP Coordinator, and show that there were 1,607 government employees at 4 December 1998, compared with 2,303 on 27 October 1995. This represents a 30 percent reduction.

The impact of staff cuts on service delivery is unknown, although efficiency gains in Health have enabled the maintenance of the pre-reform level, according to the Secretary. Generally, no measures have been taken to improve staff productivity.

The annualized savings in recurrent expenditure from the downsizing are estimated to be in excess of $4.2 million; and if the 1,484 target is hit will rise to $5.1 million. Expenditure on personnel out of General Funds has fallen from $15.0 million in FY1996 to $11.1 million in FY1998, or 26 percent, according to Ministry of Finance data, coming in below original budget estimates. During the same period, total recurrent expenditure out of General Funds has fallen from $29.2 million to $22.7 million, or 22 percent, so that the share of personnel expenditure has fallen from 51.4 percent to 48.9 percent. Personnel expenditure in FY1998 absorbed 47.8 percent of domestic revenue.

The public service downsizing has thus contributed significantly to a strengthening of public finances. This does not mean, however, that fiscal worries are over, and some cautionary observations are in order. As noted above, the RRP asserts that "The goal of stabilization of Government finances was achieved by the beginning of FY1997, on 1 October 1996...by increasing revenues, and reducing expenditures". The aide memoire of a review mission 25 September - 10 October 1997 repeated the claim: "the overall fiscal position of the Government seems to have stabilized". But less than a year later deferred liabilities of between $3 and $8 million surfaced, and a Bank consultation mission was referring to a present crisis of Government finances that threatened to derail the ongoing economic and financial reforms. The 12.5 percent pay reduction approved by Cabinet as an emergency measure in 1998 was abandoned following a public outcry.

Appropriations to subsidize government agencies actually have increased from $1.34 million in FY1997 to $1.63 million in FY1999: although appropriations for the Majuro Water and Sewer Company, government shipping operations and AMI have been eliminated, subsidies to the Ebeye Power Plant and Tobolar have been maintained, and those to the Marshall Islands Visitors Authority and the government-owned Outrigger Hotel increased. Government has also announced an intention to buy two new aircraft for Air Marshall Islands, though AMI's poor financial position would probably prevent its realization. The 1999 budget was passed by the

Nitijela one month after the start of the fiscal year, without estimates of the outcomes in FY1998. It reportedly includes only one line appropriations by ministry and, for the first time, an unexplained $1.2 million contingency provision.[32] The March 1999 announcement that the general import duty will be lowered from 12 to 5 percent and that the copra subsidy will be increased has been made without apparent consideration of the budget implications; and represents a reversal of earlier PSRP policy actions.

4.6.3 Public enterprise restructuring

The Private Sector Unit is charged with the task of reviewing public enterprises and identifying privatization options, with the assistance of a team of consultants. This work is in process. Following Bank TA in the transport sector, the privatization of domestic shipping services is proceeding. Generally though, there is some doubt that there will be further effective action, given the expiration of the PSU Coordinator's contract in April 1999, and some reluctance on government's part. Attempts to make AMI profitable are ongoing, but its financial position is fragile. Potential commercial lenders would not expect to be paid off by the Bank a second time.

4.6.4 The Reduction in Force program

The precise number of public servants RIFFED by the end of 1998 has not been reported, but the number is in the vicinity of 350. In the absence of the planned monitoring by the Office of Planning and Statistics, it is not known what has happened to these people. The anecdotal evidence is that none has returned to the outer islands as expected, perhaps partly because there is no way in which they could receive their monthly maintenance payments if they were to return. The retrenched have either stayed in Majuro or joined family in the United States, where Marshallese can find unskilled jobs, such as those available in Tyson's chicken processing plant in Arkansas. The planned training and counselling component of the PSRP never eventuated.

[32] A copy of the budget was not available for the mission to examine.

4.6.5 Private sector development

The third objective of the PSRP is creation of an improved enabling environment for the private sector. Actions in pursuit of this objective are pending or indefinitely postponed. In the meantime, contraction of the public service has caused a contraction in the private sector because so much private sector activity depends on sales to the public sector. Particularly in the retail trade sector, businesses extended credit to public servants against future wage payments.

One positive development noted in section 4.2 has been the growth in the fisheries sector, in which a stand-alone Bank TA has played a crucial initiating role. Though not directly linked to the PSRP, this TA benefited in its early days from the Policy Advisory Team's efforts in changing government thinking about the role of the private sector in economic development. Another positive development, which is the outcome of TA linked to the PSRP, is the privatization of domestic shipping referred to above.

4.7 Looking to the Future

Although progress has been made in the Marshall Islands, the reforms have been slower in coming than originally expected, and the reform process has now lost momentum. Key lessons that emerge from the RMI reform experience are not diminished in importance because they are familiar:

- There needs to be strong government ownership of the reform program if it is to succeed. Governments and economies cannot be reformed by external agents; they must reform themselves.

- There needs to be strong community-wide participation in the reform process that is informed and encouraged by an effective public relations program that markets the reforms.

- A public service retrenchment program should be based on a clear specification of the desired future form of government.

- The design of a reform program should pay careful attention to the identification of key performance indicators that are relevant to the aims of the program, and to the information demands that such indicators make. For example, where an objective is the strengthening of public finances through reducing the absorption of resources by the public service, personnel expenditure is an indicator that is both more relevant and more easily measured than the number of civil servants.

Reform Programs in PDMCs: Design

PDMC	Coverage	Tranche Conditions	Prioritization/ Sequencing	Scheduling Pacing	Monitoring Mechanisms	Technical Assistance
Cook Islands (loan approval Sept. 1996)	• Public sector reform • Promotion of private sector growth • Social equity and sustainability • Governance • 110 policy matrix actions	Eight 2nd tranche: • comply with Finance & Economic Management Act • draft Public Sector Investment Program acceptable to ADB • enact amendments to Income Tax and Turnover Tax Acts • enact Act establishing the Development Investment Board • complete agriculture policy & strategy statement • complete marine resources policy & strategy statement • complete tourism policy & strategy statement • legally decentralize a large measure of political and economic power to Vaka & Island Councils & where appropriate village-level bodies	• Priority to public service down-sizing • Simultaneous undertaking of most policy actions	• 55-60% cut in public service employees between May & Sept. 1996 • Tranche conditions to be met between end Sept. 1996 & end July 1997	• Quarterly reports from Govt. to ADB; Program Monitoring Committee chaired by Govt., including ADB & NZODA reps., meeting every 6 months; Bank missions	• $740,000 for Cook Islands Development Bank; $251,000 for the Development Investment Board.

Reform Programs in PDMCs: Design *(con'td.)*

PDMC	Coverage	Tranche Conditions	Prioritization/ Sequencing	Scheduling Pacing	Monitoring Mechanisms	Technical Assistance
FSM (loan approval April 1997)	• Size & operating costs of public service • Domestic revenue generation • Public enterprise reform • Mitigation of social & economic impact of reforms • Private sector development • 122 actions in 5 policy matrices	Four 2nd tranche: • Sufficient progress achieved & maintained in carrying out reform programs as set out in policy matrices • Reduction in number of public servants as specified in policy matrices • Passage of foreign investment laws • Enactment of Customs Act and amendments to Gross Revenue Act	• Priority to reducing costs of public service & implem-entation of early retire-ment schemes • Simultaneous undertaking of most policy actions	• Tranche conditions to be met by March 1998 • All actions to be completed by March 1999	• Monitoring by State Public Sector Reform Committee; quarterly reports to ADB by Bank-funded advisory team; joint Bank-Govt. reviews; Bank missions	• $540,000 to supplement Policy Advisory Team for Economic Management; $380,000 for development of investment promotion plan and review of financial sector.
RMI (loan approval Jan. 1997)	• Stabilization of Government finances in short run • Long-term structural stability of	Six 2nd tranche: • Reduce Government employees from 1,650 to 1,484 & provide compen-sation as per agreed formula • End all subsidies to Air Marshall Islands except for	• Priority to public service down-sizing	• 2nd tranche conditions to be met by Oct. 1997	• Monitoring program to be designed by Office of Planning & Statistics; Govt. to provide semi-annual	• $515,000 for program coordination; $575,000 for institutional strengthening of the transport

Reform Programs in PDMCs: Design *(cont'd.)*

PDMC	Coverage	Tranche Conditions	Prioritization/ Sequencing	Scheduling Pacing	Monitoring Mechanisms	Technical Assistance
	Government finances • The private sector enabling environment • 59 actions in policy matrix	interest payments on 2 Dorniers • Continue 3 year wage freeze for civil servants introduced in March 1996, excluding normal promotions • Establish a Financial Reserves Trust Fund… • Reduce the Board of Directors of Air Marshall Islands from 9 to 5 members, ensuring at least 2 are from the private sector • Establish a Private Sector Unit in the Office of the President for a period of no longer than 2 years Five 3rd tranche: • Impose a tax on all rental incomes on commercial buildings • Establish a Road Users Trust Fund… • Establish a Marshall Islands Airport Authority… • Transfer all airport management functions to the new Authority	• Simultaneous undertaking of most policy actions	• 3rd tranche conditions to be met by April 1998 • All actions completed by Oct. 1998	reports; Bank missions.	sector; $760,000 for establishment of private sector unit.

Reform Programs in PDMCs: Design *(cont'd.)*

PDMC	Coverage	Tranche Conditions	Prioritization/ Sequencing	Scheduling Pacing	Monitoring Mechanisms	Technical Assistance
Samoa (loan approval Feb. 1998)	• Financial sector liberalization • Strengthening of Central Bank, National Provident Fund, Development Bank and prudential and regulatory framework • Privatization/ corporatization of state-owned enterprises (SOEs) • 62 actions in policy matrix	Six 2nd tranche: • Remove foreign exchange levy • Secure agreement, satisfactory to ADB, between Central Bank and Treasury on providing a more secure income stream to the Central Bank • Amend the Financial Institutions Act 1996 so as to include prudential guidelines for the National Provident Fund and the Development Bank… • Ensure that external audits of all SOEs in which the government holds a majority share are carried out on an annual basis… • Divest all government equity in 8 specified SOEs • Corporatize Post and Telecommunications Dept. under a commercially oriented Board of Directors	• Financial sector reform & phased public enterprise reform imple-mented as components of a sequenced economic reform strategy	• 4 tranche conditions to be met by end 1998, & 2 by end 1999 • All actions to be completed by end 1999	• Financial Sector Program Coordination Committee to prepare semi-annual reports to ADB; Bank review missions	• $950,000 for institutional strengthening of Central Bank, National Provident Fund, and Development Bank.

Reform Programs in PDMCs: Design *(cont'd.)*

PDMC	Coverage	Tranche Conditions	Prioritization/ Sequencing	Scheduling Pacing	Monitoring Mechanisms	Technical Assistance
Solomon Islands (loan approval Aug. 1998)	• Macroeco-nomic stabilization • Public service reform (including mitigation of social impact of downsizing) • Public enterprise reform • Public sector governance • 65 actions in policy matrix	Eight 2nd tranche: • Reduce payroll costs to SI$130m. or less on an annualized basis, subject to an adjustment for 1998 inflation acceptable to ADB • Obtain Cabinet approval of budget limits for annual expenditures of each Ministry in accordance with Medium Term Budget Framework; & ensure that MTDS, PSIP & MTBF are consistent • Apply competitive & transparent recruitment, selection & appointment procedures in recruitment of all public service staff… • 1999 budget submissions for at least 4 selected ministries to include verifiable performance targets • For all SOEs, Cabinet to approve action plans for liquidation, restructuring, corporatization, divestment &/or privatization	• Priority to restoration of macro-economic stability through a sequence of actions, followed by public service restructuring & privatization of SOEs, & actions to improve fiscal governance	• Tranche conditions to be met by June 1999 • All actions to be completed by Dec. 1999	• Progress reports of Govt's four reform task forces; minutes of the Policy and Structural Reform Committee and the Monthly Monetary Management Meeting; quarterly reports from Govt. to ADB; Bank missions	• $1m. loan to assist in implementa-tion of privatization policy; $600,000 grant to strengthen public sector management.

Reform Programs in PDMCs: Design *(cont'd.)*

PDMC	Coverage	Tranche Conditions	Prioritization/ Sequencing	Scheduling Pacing	Monitoring Mechanisms	Technical Assistance
		• Invite market offers for at least 6 SOEs, finalizing sale or liquidation of at least 3 • Issue guidelines for SOEs that establish a corporate governance framework in order to enhance management & promote accountability • Prepare an action plan to improve the effectiveness of the Auditor General's Office				
Vanuatu (loan approval July 1998)	• Governance • Fiscal management • Public service reform • Reform of public financial institutions • Private sector development • Mitigation of social impact of reforms	Five 2nd tranche: • Enact and implement new VAT law • Reduce total number employed in public sector by between 10 & 15 percent • Establish & operationalize a Development Committee of Officials consisting of all director-generals to coordinate Government-wide policy & technical	• Priority to improving governance through establishing the required legislative framework, & to improving financial and economic management	• 2nd tranche conditions to be met by Sep. 1998 • 3rd tranche conditions to be met by June 1999 • All program outputs to be produced by	• Dept. of Strategic Management & National Task Force; quarterly reports to ADB; six-monthly reviews by Bank, other external funding agencies, & Govt. reps.;	• $1.2m. in support of Dept. of Strategic Management and Ministry of Finance and Economic Management.

Reform Programs in PDMCs: Design *(cont'd.)*

PDMC	Coverage	Tranche Conditions	Prioritization/ Sequencing	Scheduling Pacing	Monitoring Mechanisms	Technical Assistance
	• 46 program outputs in policy matrix	advice to the Council of Ministers • Enact legislation for & establish an asset management unit • Externally recruit & appoint a new general manager, operations manager, human resource manager, & senior credit officer (for the National Bank) Seven 3rd tranche: • Establish with adequate staffing & resources & operationalize the Expenditure Review Committee to scrutinize public expenditures • PSC & DSM to develop & start implementing a management improvement plan for all government agencies… • Establish under legislation a government remuneration tribunal…	• Simultaneous actions on a broad front	June 1999 (except for 3 expected between Jan. 2000 & Dec. 2002)	monitoring by ADB's Regional Mission office in Port Vila	

Reform Programs in PDMCs: Design *(cont'd.)*

PDMC	Coverage	Tranche Conditions	Prioritization/ Sequencing	Scheduling Pacing	Monitoring Mechanisms	Technical Assistance
		• Establish a Master Plan for national infrastructure development • Amalgamate into the National Bank of Vanuatu the good loans of the Development Bank… • Complete a comprehensive review of health and education policies and services, & require ministers to develop 5 year action plans.. • Establish a decentralization commission to develop policy & implementation for decentralized governance				

Reform Programs in PDMCs: Results

PDMC	Implementation Progress	Achievements	Concerns/ Challenges
Cook Islands – loan approved Sept. 1996; funds used to retire Govt.'s short-term liabilities & for general budget support	• Loan closed on timely basis. • 86% of policy matrix actions completed Dec. 1998.	• Strong local ownership and participation from the outset • A move toward fiscal balance by reducing the number of public servants by about 60 percent over the period 1996-98. • The passage of key legislation establishing principles of fiscal responsibility, improved accountability, and transparency to be followed by heads of departments and Government. • The establishment of the Public Expenditure Review Committee to review all aspects of public finance. • Introduction of the concept of performance orientation in public expenditure management. • Progress in creating an environment conducive to private sector growth. • Avoidance of a threatened period of serious macroeconomic instability.	• A still fragile fiscal situation • Passage of a 1998-99 budget that was not in compliance with legislative requirements and that relied on unspecified asset sales to fund current expenditure. • Incomplete public service reform, with the number of ministries (22) and public servants (1,340) still too high for a population of 16,500. • A lack of transparency and contestability in government's handling of a key asset sale. • The lack of attention to regulatory arrangements in the sale of government-owned natural monopolies. • Doubts about the durability of output-based budgeting and accrual accounting systems, and the capacity to deliver effective performance monitoring. • The failure to reduce the size and cost of Parliament, and the associated public concern over politicians' real commitment to improved governance.
FSM (national & 4 state govts.) – loan approved April 1997; funds used for early retirement payouts	• Loan closed after 1 year delay in full release of 2nd tranche.	• Establishment of general participation in, and ownership of, the reform process through a series of national and state summits.	• The failure to gain the commitment of some state legislatures to reform, and to develop a mechanism that institutionalized participation in the reform process.

Reform Programs in PDMCs: Results *(cont'd.)*

PDMC	Implementation Progress	Achievements	Concerns/ Challenges
	• 78% of consolidated policy matrix actions completed March 1999.	• Substantial public service downsizing and pay cuts in the four states during 1996-98, with Bank-funded early retirement schemes operative from late 1997. • A strengthening of state government finances as a result of the downsizing and some revenue-raising measures. • Downsizing of that part of the national public service funded from FSM Unrestricted Funds. • Privatization and contracting out of some departmental activities, and the transfer of power, water and sanitation to public utility authorities. • Some liberalization of the financial sector and the passage of new foreign investment legislation that potentially will improve the investment climate.	• A loss of momentum in the reform process as the political and personal costs have mounted. • The lack of attention at the design stage to governance, the basic framework of government post-reform, and the effective long-term delivery of public services (now being addressed). • The lack of attention at the design stage to the fundamental issue of revenue-sharing between the national and state governments (currently under review). • Deficient monitoring of, and reporting on, the reform program. • Inadequate attention paid to preparing people to manage large voluntary retirement payouts of two years' salary. • The impact of wage cuts and increased workloads on public service morale. • Anomalies in the implementation of the early retirement scheme at the national level. • The need to develop a comprehensive policy framework and an associated action plan for public enterprise reform and private sector development (now being addressed).

Reform Programs in PDMCs: Results *(cont'd.)*

PDMC	Implementation Progress	Achievements	Concerns/ Challenges
RMI – loan approved Jan. 1997; funds used for early retirement payouts, retirement of AMI debt, & support of Trust Fund	• One year delay in 2nd tranche release. 3rd tranche yet to be released. • 56% of policy matrix actions completed March 1999.	• A 30 percent downsizing of the public service and a reduction in the number of ministries from 10 to 8. • A three-year public service wage freeze. • Annualized savings in recurrent expenditure from the downsizing and freeze in excess of $4.2 million. • Elimination of direct subsidies to some public enterprises, most notably to Air Marshall Islands. • A rationalization of the tariff structure and some improvement in taxation compliance. • A start to the establishment of a trust fund as a means of durable revenue generation for government. • The establishment of a Private Sector Unit in government that is reviewing public enterprises and identifying privatization options. • Effective action to privatize domestic shipping services. • Regular reporting to the Bank on implementation of the PSRP. • Facilitation of the Bank's successful technical assistance to the fisheries sector.	• A lack of participation and ownership beyond the Presidential level at the outset of the PSRP, and a failure to develop these subsequently to ensure a sustained reform effort. • A consequent slowness in implementing PSRP following the death in late 1996 of President Kabua. • A loss of momentum in the reform process ahead of the November 1999 elections and in an atmosphere of confidence that (1) Compact re-negotiation will be successful and (2) substantial new external assistance will be provided by Taipei,China. • Worrying fiscal developments, including a crisis in government finances in 1998, a rise in appropriations to subsidize government agencies in the last two years, and the inattention to the budgetary implications of the March 1999 announcements to reduce the general import duty and raise the copra subsidy. • The lack of attention at the program design stage to governance, the basic framework of government post-reform, and the effective long-term delivery of public services.

Reform Programs in PDMCs: Results *(cont'd.)*

PDMC	Implementation Progress	Achievements	Concerns/ Challenges
			• The limited action to date on corporatization/privatization. • The failure to design and implement the counselling, training and monitoring of retrenched public servants as planned. • The impact of public service downsizing on staff morale and service delivery. • The failure to take actions in pursuit of the objective of creating an improved enabling environment for the private sector.
Samoa – loan approved Feb. 1998; funds used to cover fiscal costs of reforms	• Generally proceeding smoothly. • 65% of policy matrix actions completed March 1999.	• Strong local ownership of a clearly focused and sequenced reform program, especially in respect of financial sector reforms. • A well-designed financial sector program encompassing governance-improving measures, formulated through a generally effective consultative process, and promoted through a public information campaign. • Significant progress in the development of financial markets. • Progress in strengthening the prudential and regulatory framework of the financial sector. • Privatization of one state-owned enterprise (SOE) and the imminent corporatization of another; the undertaking of considerable preparatory work by the newly-established State Enterprise Monitoring Unit; and an	• Insufficient attention in program design to the implications for financial development of small size, and a consequent overstatement of the potential benefits from financial sector reform. • Implementation of some reform actions, especially those affecting privatization/ corporatization of SOEs, at a pace slower than planned. • Inadequate and ambiguous division of responsibility in corporate governance of public enterprises. • The possible placement of all public employees on fixed-term contracts, and effective removal of central control and monitoring of Government personnel, without a cautious assessment of the

Reform Programs in PDMCs: Results *(cont'd.)*

PDMC	Implementation Progress	Achievements	Concerns/ Challenges
		improvement in the accountability and transparency of most SOEs. • Effective use of the technical assistance provided for strengthening of Government financial institutions.	consequences that is informed by varied international experience and appropriate advice.
Solomon Islands – loan approved Aug. 1998; funds used to clear debt & other payments arrears	• Proceeding. • 59% of policy matrix actions completed Feb. 1999.	• Passage of a new Financial Institutions Act. • Cancellation of tax/duty exemptions and remissions, except those that are legally binding. • A substantial reduction in arrears on public debt. • Confinement of recurrent expenditure within the recurrent revenue level. • Considerable progress in restoring a functioning accounting and auditing system. • Improved co-ordination in the preparation of recurrent and development budgets. • Public service downsized by 7 percent and a saving of 8 percent on payroll expenditure made in the context of a longer-term re-engineering of the public service. • Progress in privatization of two state-owned enterprises. • A shift toward a performance orientation in the public service. • A notable improvement in the governance environment.	• The effort required to hold on to power in a situation where the coalition government has a slender majority, and the consequent risk that efforts to improve governance will be compromised. • A loss of impetus to reform in the face of (1) sustained opposition from politicians and public servants adversely affected by the changes, and (2) a lack of enthusiastic support from a sufficient number of those senior and middle level public servants who remain in employment. • The related threat to gains made so far in macroeconomic stabilization (particularly through a failure to contain the public service payroll to the desired level). • The difficulty of implementing the policy on state-owned enterprises because of opposition from the boards of those enterprises.

Reform Programs in PDMCs: Results *(cont'd.)*

PDMC	Implementation Progress	Achievements	Concerns/ Challenges
Vanuatu – loan approved July 1998; funds used to cover adjustment costs of public service reform, rehabilitation of Govt.-owned financial institutions, & fiscal stabilization	• Second tranche released on timely basis. • 57% of policy matrix actions completed Dec. 1998.	• Strong public participation and a convergence of local ownership around the key theme of improved governance. • A reduction in the number of ministries from 34 to 9 and of public servants by 289. • An improvement in public servants' autonomy and efficiency through the selection of Directors-General on the basis of merit, the independent functioning of the Public Service Commission, and the introduction of a performance orientation. • The establishment of the legislative framework for improved governance (Leadership Code Act, Public Finance and Economic Management Act, Expenditure Review and Audit Act, Ombudsman Act). • The beginning of the process of preparing a public investment program, including aid-financed projects. • The introduction of a value added tax, and simplification and reduction of import duties and business license fees. • Progress in financial reform through restructuring of the National Bank and Development Bank, and amendment of the Vanuatu National Provident Fund Act.	• The difficulty of maintaining political consensus in coalition government and the associated threat to political stability. • Limited Parliamentary scrutiny of legislative change and restricted explanation of such change to the public • most concerning is the last-minute addition of schedules to the Foreign Investment Act that are contrary to the letter and spirit of CRP and that will discourage foreign investment (though government is reviewing the legislation). • Weaknesses in law enforcement. • The severity of the human resource constraint; the heavy reliance on external advisers and some consequent resentments and feelings of loss of ownership; and the absence of a human resource development strategy. • The delay in completing the public service downsizing and the need to ensure there are credible mechanisms in place that will prevent later rehiring. • The need for institutional strengthening of the Reserve Bank, for improvement of banking legislation and supervision, and for an assessment of the National Bank's capital adequacy.

Reform Programs in PDMCs: Results *(cont'd.)*

PDMC	Implementation Progress	Achievements	Concerns/ Challenges
			• The apparent exclusion of the Credit Union League from the financial sector reform process. • The inadequacy of macroeconomic data bases, the difficulty of conducting standard fiscal analyses, and a poor economic outlook.