Does Size Matter?

Tuvalu and Nauru Compared

Tuvalu and Nauru are both small Pacific states, but Nauru has been badly misgoverned, argue **Helen Hughes*** and **Steven Gosarevski**

For the majority of people in the Pacific living standards have stagnated since independence. For some islanders they have even declined. Pacific leaders have come to believe a litany of excuses for this lack of progress. They claim that their countries are too small, scattered over a vast ocean, mountainous, barely above high tide, get too much or too little rain, are distant from markets and lack resources. The multilateral agencies that make a living out of giving aid to the Pacific endorse this culture of excuses, arguing that aid will be needed for a long time or forever. This has reinforced aid dependency to the point where understanding of, and belief in, the economic (and hence political) viability of the Pacific has been destroyed.

Yet the Pacific is so rich in natural resources—gardens, orchards and fish—that early sailors deserted for lifestyles of plenty and leisure unimaginable in the Europe or America of that era. In modern times, the Pacific's 'rim of fire' minerals

Helen Hughes is an Emeritus Professor at The Australian National University and a Senior Fellow at The Centre for Independent Studies (CIS). **Steven Gosarevski** worked on the economy of Nauru as a researcher at CIS.

* Professor Hughes, then a Fellow at the Australian National University, on a *pro bono* basis negotiated the world price for Nauru's phosphate in 1963 and helped to mount the constitutional team that enabled Nauru to become an independent republic in 1968 and to nationalise its phosphate mine. She assisted in early financial and business planning (including the building of Nauru House) and in finding Philip Shrapnel & Co, leading Sydney consultants, to take over financial and business planning for Nauru on a commercial basis.

and hardwood timbers have become valuable and the fall in freight costs has opened up large and growing markets for coffee, tea, cocoa, palm oil, spices, fruits, vegetables and flowers. With access to the internet and open skies policies for low airfares, even the smallest islands can translate palms soughing in soft breezes on pristine beaches into tourist attractions.

All countries that now have high per capita income have had to establish modern open societies with transparent legal structures, secure policing and honest governments appropriate in size to their needs. Pacific islanders want the education, health, longevity, high income and consumer goods that modern life offers. Instead of facing up to the policy reforms that would deliver these benefits, however, Pacific leaders hide behind tradition to avoid changes that would threaten their privileges and ignore the lessons from countries that have adopted policies that led to positive growth and development.

Botswana in sub-Saharan Africa has shown that traditional tribal societies can grow strongly. In 1970 it had half of Papua New Guinea's per capita income; now it is three times higher.[1] Mauritius, a sugar producer with a similar ethnic heritage to Fiji, used clothing exports and tourism to grow from half of Fiji's per capita income in 1970 to three times its level by 2001. Small size did not prevent Norfolk Island, with a population of 1,800 compared to Tuvalu's 11,000 and Nauru's 13,000 (of whom some 2,000 are foreign phosphate workers), from enjoying a higher per capita income than Australia.[2]

Within the Pacific, states of similar size have considerable differences as well as similarities. Tuvalu and Nauru have roughly the same populations, but Tuvalu consists of eight small island-villages scattered over a considerable ocean area, whereas Nauru is one island, 21 square kilometers in area. Both these island states have been saddled with swollen political establishments. Tuvalu has a Governor-General representing Queen Elizabeth, a Prime Minister, a Cabinet of five members and 15 members of Parliament. Nauru has a President, a cabinet of seven members and 18 members of Parliament. With almost half the population under the respective voting ages of 18 and 20 years, this makes for about 350 voters per parliamentary member in Tuvalu and 300 in Nauru. The costs of parliaments and cabinets for such small states are thus ridiculously high.

These two states are the smallest members of the United Nations, each with a vote equal to that of giants like the United States or China. Each belongs to some 30 UN and other international agencies and multilateral banks, and each has a representative office in New York. But there the similarity ends. Tuvalu is arguably the best governed territory in the Pacific. It has appreciably raised living standards and at the same time become fairly independent of ongoing aid. By contrast, Nauru's marine phosphate gave it the highest resource wealth per capita in the Pacific, but it now claims to be bankrupt and is asking Australia and other donors for more aid.

Tuvalu

Tuvalu's small islands are densely populated. It is more seriously constrained geographically than other Pacific islands. Its coral atoll villages flood when high tides peak so that that their very existence would be threatened if predictions about global warming were to eventuate. Tuvalu's leaders have made a major issue of this possible danger, seeking drier territory, possibly in Australia or New Zealand but also on relatively thinly populated Niue (population 2,000).

With almost half the population under the respective voting ages of 18 and 20 years, this makes for about 350 voters per parliamentary member in Tuvalu and 300 in Nauru. The costs of parliaments and cabinets for such small states are thus ridiculously high.

Historically Tuvalu was part of the British Gilbert and Ellice group, but opted first for separation and then for independence in 1978. Ellice Islanders had mined phosphate on Ocean Island (now worked out) and on Nauru, where they continue to do so. They have also become deep water sailors. Tuvalu has turned its education toward making its young men employable and has a work culture. Those who find life constraining on a small, distant Pacific atoll emigrate so that the island has remittances to supplement its income. Emigrants visit, making inputs into political and social life. Population growth is a modest 1.4% per annum.

In 1987 Tuvalu persuaded Australia, New Zealand, the United Kingdom (and later Japan and the Republic of Korea) to put their aid into a Trust Fund of US$17 million. With sensible investment, this had become $US35 million by 1997. Income from the Trust Fund was reduced as stock markets suffered in the early 2000s but is now recovering. The United States, Taiwan and Japan pay considerable sums for fishing rights. Tuvalu has leased its telephone line and in 1998 it sold the rights to the 'tv' internet domain name to a Californian company for US$48 million, but retained a 20% share in tv Corporation International so that it has a continuing income.[3] Tuvalu also has an extensive postage stamp business. It has not, however, made any attempt to sell passports or to start an off-shore banking laundry.

Egregiously wasteful public expenditures on the island and high external representation and official overseas travel (that included golf in the Bahamas) blew out budgets year after year so that the Government began to borrow to supplement its huge income.

Past aid paid for the principal infrastructure that is well maintained out of current income. Tuvalu's own income has also paid for recent road construction in the capital, Fongafale. During the 1990s its administration was slimmed down. It uses the Australian dollar for currency. Provided Tuvalu can maintain its modest and pragmatic approach to government, it deserves the title of the most successful government in the Pacific.

Nauru

Initially a German colony, Nauru became a United Kingdom, New Zealand and Australian Trust Territory administered by Australia in 1918. Farmers in these three countries benefited from cheap phosphate until World War II when the Japanese used the island as an aircraft carrier, shipping most of its 5,000 people to Truk in the Marianas, where all but 500 starved to death. In 1945, Trust status was resumed and in 1963 Nauru obtained the world price for its phosphate. By independence in 1968, it had accumulated half a million Australian dollars (the currency used by the island) for each man, woman and child in Trust and personal accounts. In 1975, when phosphate prices peaked at $52 per ton, Nauru's annual earnings rose to nearly US$50,000 a head (in 1998 dollars), the second highest per capita income in the world after Saudi Arabia.

Since 1968, Nauru has exported 43 million tons of phosphate. This brought it a total income of US$3.3 billion (in 1998 dollars). Assuming generously that the cost of production was 30% of export income and that another 20% was spent on private and public consumption, this would have left an income of US$1.6 billion (in 1998 dollars) for investment. At a conservative 7% a year in long-term financial instruments, this would have amounted to another US$8 billion or (assuming five persons per family) nearly US$4 million per family.

Nauru's economic and business policies, encouraged by the carpetbaggers that plague the Pacific, quickly moved from the conservative advice of Sydney consultants, Philip Shrapnel & Co, to grandiose real estate investment in Australia, the Pacific and the United States. A shipping business and an airline ran at a loss, with the airline alone reputedly losing A$40 million a year. Nauru's leaders spent millions on a musical about Leonardo da Vinci in London and chartered an airplane for the premiere. There were problems with the flight and by the time the official party reached London the musical had closed. Egregiously wasteful public expenditures on the island and high external representation and official overseas travel (that included golf in the Bahamas) blew out budgets year after year so that the Government began to borrow to supplement its huge income. The public service had 1,600 employees at the end of the 1990s when budget deficits were running at over A$10 million. The use of the Australian dollar as currency did not prevent real estate and other investments running off the rails.

Off-shore banking was introduced to replace income from phosphate. Nauru has registered some 450 foreign bank 'shells'. In 1998 alone it was said to have laundered US$70 billion of Russian Mafioso funds. In 2002, the United States forbade its banks to have any contact with Nauru, thus defining it as the first rogue state under the 2001 Patriot Act. The sale of some 1,000 passports for US$15,000 each was also seen as being of assistance to money launderers and terrorists. Secretary of State Colin Powell wrote to Nauru condemning 'the indiscriminate sale of Nauru's passports' in 2002. Nevertheless, an internet website specialising in tax havens still states: 'Nauru is absolutely the easiest jurisdiction in the world to get a bank license'.[4] This banking 'industry' is so weak, however, that the Bank of Nauru (sic) from time to time limits withdrawals to $100. Few businesses accept its cheques. Nauru has become a pariah because of its money laundering and passport sales, but it continues to play global politics. It is claimed China gave Nauru US$135 million for ceasing to recognise Taiwan. Australia paid Nauru $30 million for the 'Pacific solution'.

In 1991, communal property assets were valued at A$1.26 billion, then peaked at A$1.7 billion. By 1996 finances were in a 'critical state'. *The Visionary*, a publication produced by a group of young Nauruans, claimed losses could have amounted to A$2.1 billion by September 2001.[5] By late 2003 Nauru could not afford to have its telecommunications repaired and in March 2004 satellite communications were to be shut down for non-payment of subscription fees. A month later it was reported that Nauru House in Melbourne could receive incoming telephone calls but could not dial out, because its bills had not been paid.[6]

With these strains Nauru become so sharply divided that parliament and government came to a standstill, with deep resentment against those who have wasted public money while enriching themselves. Nauru's President, Renee Harris, visited Australia in mid-April 2004 to seek assistance in the repayment of a loan of A$236 million to GE Capital Corporation that was to fall due in early May,[7] but he lacked the support of a majority in the Legislative Council even though receivers were moving in on Nauru's remaining properties in Australia, including Nauru House.

Australia responded to Nauru's woes early in 2004 with a package of $22.5 million over two years to sort itself out. An Australian official was to head up Nauru's Finance Department to account for Nauru's true financial situation. An Australian police commissioner was to strengthen law and order.[8] The Australian government was clearly concerned that Nauru might fall into the hands of international criminals. But it is hard to see why Australian taxpayers should foot the bill for more aid to a country that has wasted billions of dollars and lacks the political resolve to change its ways.

The last 30 years' waste of Nauru's good fortune demonstrates the strength of the theory of economic rents that suggests that windfall returns from natural resources will result in the waste of public funds and corruption.

Nauru's problems have arisen from the denial of property rights in the colonial period and the 1960s phosphate settlements when the then prevalent welfare statism thought communal trust funds to be superior to individual income and property rights. The last 30 years' waste of Nauru's good fortune demonstrates the strength of the theory of economic rents that suggests that windfall returns from natural resources will result in the waste of public funds and corruption. Had the income from phosphate been distributed to individual families instead of being paid into trust funds, some would have been wasted, but some would have been saved and invested, rewarding prudent behaviour.

Instead of pursuing further uneconomic schemes, such as mining the remaining deep phosphate or building a deep water harbour at a cost of billions, Nauru's true financial situation has to be established. The funds remaining after debts are paid off should be distributed to Nauru's families.

The task of sorting out Nauru's financial situation will be formidable. Public expenditures on Nauru have for years been far above the levels needed for a population of some 12,000, which will shrink further as phosphate mining becomes completely uneconomic in 2006 or earlier. A significant proportion of Nauru's so-called debts are to predators who do not deserve a cent in the dollar on funds they have helped to waste and could not claim them in a court of law. Another considerable proportion of the money lost by the Trust Funds has been appropriated by Nauruans who are very rich indeed with large bank accounts and investments abroad.

Nauruans have worked in the public service over the years and they have earned income as their land was mined for phosphate. Some have used these earnings to establish households abroad, mostly around Melbourne. Many Nauruans have been educated in Australia and could emigrate on their own initiative under current Australian immigration laws. Experiencing racial discrimination, Nauru rejected the offer of moving the entire population to Queensland's Fraser Island in the 1950s, and new prospects for the movement of the entire population to an Australian location still seem fraught with difficulties.

Instead of pursuing further uneconomic schemes, such as mining the remaining deep phosphate (unprofitable at foreseeable phosphate prices) or building a deep water harbour at a cost of billions, Nauru's true financial situation, including fortunes accumulated in private hands, has to be established. The funds remaining after debts are paid off should be distributed to Nauru's families. Nauruans typically live in compounds of two to four related families, so that although there may be some 2,000 nuclear families, the effective number of family groups among whom resources have to be divided is likely to be smaller.

Nauruans could even opt to sell their island for a considerable sum for its fishing and other marine rights and reserves and its (limited) tourism potential. They could use the proceeds to live out their lives modestly on the island or emigrate. Emigrants would lose in terms of their old identity, but they and their children would gain immeasurably from greater employment, social and cultural opportunities.

Endnotes

1. Papua New Guinea's per capita income stagnated so that in 2001 it was US$2,450, Botswana's was US$7,410 (purchasing power parity). Botswana's per capita exports (US$3,160) were ten times those of Papua New Guinea's (US$350). Fiji's per capita income is US$4,920 while that of Mauritius is US$9,860 (purchasing power parity). Fiji's per capita exports are US$640 per capita compared to Mauritius' US$1,030 per capita. See World Bank, *World Bank Atlas, 2003* (Washington D.C.: World Bank, 2003).
2. M. L.Treadgold, *Bounteous Bestowal: The Economic History of Norfolk Island*, Pacific Research Monograph (Canberra: Australian National University, National Centre for Development Studies, 1988).
3. Department of Foreign Affairs and Trade, *Tuvalu Country Brief* (November 2003), www.dfat.gov.au/geo/Tuvalu/Tuvalu/_brief.html
4. www.taxhavenco.com/osm/BankCharter.html (accessed 23 April 2004).
5. The last report of the Nauru Insurance Corporation was dated 1994-95, of the Bank of Nauru 1995-96, of the Nauru Phosphate Corporation 1995-96, Nauru Air Corporation 1995-96, Public Service Report 1995-96 and the Director of Audit's Report 1998-99. Pacific Islands Development Program/East-West Center, *Pacific Islands Report* (Honolulu: University of Hawaii, 25 September 2001).
6. ABC Radio National (20 April 2004).
7. M. Bachelard, 'Receivers Move on Nauru Property', *The Australian* (20 April 2004).
8. Graeme Dobell, 'Made on the Run: Australia's Pacific Policy', ABC Radio National (21 April 2004).