Aid dependent and vulnerable: Vanuatu's status, agency and opportunities to emerge

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Contents

Abstract

Aid dependence occurs when a country relies on significant donor funding for at least a decade. The original development economists, and neo-structuralists since then, have seen this as one of the risks posed by overseas development assistance (ODA), one which should be avoided. Neoliberals see it as a necessary stage of development which can be managed in a good policy environment. These debates about transactional effects are relevant, but it is the politics of international governments which drive the ODA agenda.

Vanuatu is a small island developing state in the South Pacific. Vanuatu is not inherently or historically vulnerable, but has become so as a result of interacting with the colonial and globalised international system. Following a long and unique dual colonial administration, Vanuatu emerged as a politically independent, but weakened nation in 1980. Initially dependent on ODA, Vanuatu experienced the economic volatility typical of Pacific Island Countries with exposure to natural disasters, structural economic and policy vulnerabilities and fractious politics. Dependent on a narrow set of donors, such as Australia, who use ODA in pursuit of their own interests, Vanuatu's vulnerability was exacerbated. Notwithstanding, macroeconomic indicators were gradually improving, showing reduced aid dependence and aid saturation.

However, in 2002, in response to the combination of international terrorist events, refugee arrivals and the emerging role of China, Australia implemented a sustained expansion of ODA to Vanuatu to protect its own national interests. In order to increase its sovereign agency, Vanuatu's vulnerable position of entrenched aid dependence must be leveraged with a suite of economic, trade and foreign policies.

The contribution of this thesis is two-fold. Firstly, it argues that Vanuatu is similar to other SIDS in that it is indebted within an international ODA system which preserves subservience to donors. Through an analysis of the rationale and motivations behind ODA, it will demonstrate that while there are real domestic political and human needs to meet, Vanuatu's dependent posture towards the agenda of donor countries, is not always entirely beneficial. Secondly, this thesis shows that this dependence does not need to be permanent and that a greater degree of autonomy is possible through relationally engaging the electorate and bilateral partners on a mix of economic and foreign policies.

Declaration

I certify that this thesis does not incorporate without acknowledgment any material previously submitted for a degree or diploma in any university; and that to the best of my knowledge and belief it does not contain any material previously published or written by another person except where due reference is made in the text.

Signed...

Date.........................16/10/17.............................

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Acronyms

ADB	Asian Development Bank
ANZUS	Australia, New Zealand, United States Security Treaty
AUD	Australian Dollars
AusAID	Australian Agency for International Development
BOPA	Barbados Plan of Action
DAC	Development Assistance Committee
DFAT	Department of Foreign Affairs and Trade
DFID	Department for International Development
EIB	European Investment Bank
FCAS	fragile and conflict affected states
FDI	foreign direct investment
GDP	Gross Domestic Product
GfG	Governance for Growth
GNI	Gross National Income
GNP	Gross National Product
GNP	Gross National Product
HDI	Human Development Index
HFA	Hyogo Framework of Action
IMF	International Monetary Fund
LDC	Least Developed Countries
MDC	Medium Developed Countries
MDG	Millennium Development Goals
MSI	Mauritius Strategy for the Further Implementation of the Barbados Programme of Action
NAB	National Advisory Board
NDMO	National Disaster Management Office
ODA	Overseas Development Assistance
OECD	Organisation for Economic Co-operation and Development
PFTAC	Pacific Financial and Technical Assistance Centre
PIAC	Pacific Infrastructure Advisory Centre
PICs	Pacific Island Countries
PIFS	Pacific Islands Forum Secretariat
PRIF	Pacific Region Infrastructure Facility
RAMSI	Regional Assistance Mission to the Solomon Islands

SDG	Sustainable Development Goals
SIDS	Small Island Developing States
UK	United Kingdom
UN	United Nations
UNCTAD	UN Conference on Trade and Development
UNDP	United Nations Development Programme
UNFCCC	UN Framework Convention on Climate Change
UN-OHRLLS	UN Office of the High Representative for the Least Developed Countries, Landlocked Developing Countries and Small Island Developing States
UNRISD	United Nations Research Institute for Social Development
US	United States of America
VAT	Value Added Tax
VMGD	Vanuatu Meteorological Services and Geo-hazards Department

Introduction

Overseas Development Assistance (ODA) is a flow of finance from the donors of the global North to the South, allocated under the rubric of promoting economic development and poverty alleviation. The rationale for ODA is based on the economic theories of the North: first, John Maynard Keynes, then the Chicago School, and latterly the World Bank. Starting in the post-war period, ODA was typically designed and executed by donors as bilateral or multilateral 'aid'. Its effectiveness in achieving development outcomes is a matter of debate, as in many cases, ODA has also induced or exacerbated the economic and financial dependence of recipients (Brown, in Haslam *et al* (Eds.), 2012; Moyo, 2009). Moves to address this include integrating social development and economic development to include considerations of human rights, basic needs and poverty alleviation, alongside econometrics. The Human Development Index, Millennium Development Goals and the 2005 Paris Declaration on Aid Effectiveness are examples of these efforts, with varying degrees of effectiveness for recipients. However, the effectiveness of ODA in achieving donor interests, has been substantial (Grant and Nijman, 1997; Hawksley, 2009; Meizels and Nissanke, 1984). Donors have marshalled these multilateral structures in pursuit of geopolitical positioning, strategic influence and economic advantage. The perspective of ODA recipients is driven by domestic political considerations and sometimes regional standing, rather than the geopolitics of rich nations. The attraction of ODA for recipients is that it often provides funds to balance a recurrent budget, and that projects and programs which are otherwise unaffordable, are generally well received by the electorate (Boone, 1996). Also, often implicit, is that the more powerful donor nations offer security against other foreign and domestic threats (Hay, 2012). Thus, there is a mutual interest in ODA from both donors and recipients, which has propagated ODA and generated recipient dependence.

There is no universally agreed threshold or measurement for aid dependence. However, aid intensity is used as a proxy, where ODA is expressed as a percentage of gross national product (GNP). High aid intensity is assumed where this figure is greater than 10 per cent for more than a decade (Bräutigam, 2000:16). A survey of the literature reveals two main theoretical perspectives on aid dependence, though there are variants within these. Broadly, structuralists consider aid dependence to be part of the wider machinations of the international financial and political system, established by and operated in favour of the North (Bräutigam, 2000; Glennie, 2010; Castel-Branco, 2008; Tandon, 2009; Nissanke, 2000). Neoliberals tend to portray aid dependence as an undesirable but sometimes necessary stage in the process of the emergence of developing countries, which can be overcome by delivering ODA into 'good' policy environments (Knack 2001, 2004; Combes *et al*, 2016; Collier, 1999; Alesina and Dollar, 2000; Burnside and Dollar, 1997, 2000).

Aid dependence can be compounded by a country's vulnerability. Various factors play a role in making a country vulnerable, including small geographical size and population, remoteness, limited resources, susceptibility to natural disasters and exposure to external price shocks and international trade (ADB, 2016). These factors apply – often in combination – to many small island developing states (SIDS). ODA is frequently sought as an answer to the causes or symptoms of SIDS' economic vulnerability, as if the problems were caused merely by technocratic transactions. But ODA can also be part of the problem, as long-term impacts of ODA, such as governance risks, ODA volatility and perpetual ODA, stifle economic growth and the development of human capital, and contribute to the inability of aid dependent countries to become resilient (Boone, 1996; Bräutigam and Knack, 2004; Altincekic and Bearce, 2014; Hailu and Shiferaw, 2016).

The purpose, operation and effects of the ODA system will be considered in the context of Pacific Island Countries (PICs)[1] in general, and for the case of Vanuatu in particular. The contribution of this thesis is two-fold. Firstly, it argues that Vanuatu is similar to other SIDS in that it is indebted within an international ODA system which preserves subservience to donors. Through an analysis of the rationale and motivations behind ODA, it will demonstrate that while there are real domestic political and human needs to meet, Vanuatu's dependent posture towards the agenda of donor countries, is not always entirely beneficial. Secondly, this thesis shows that this dependence does not need to be permanent and that a greater degree of autonomy is possible through relationally engaging the electorate and bilateral partners on a combination of economic and foreign policies.

The thesis is comprised of five chapters. Chapter 1 traces the historical rationale for ODA and the current landscape, to contextualise the trajectory of ODA and appreciate the implications of possible alternatives. Chapter 2 explores the literature on aid dependence from different theoretical perspectives, as a means of assessing its root causes and therefore, possible substitutes. Chapter 3 examines the relationship of ODA to a country's vulnerability and what influence ODA has in increasing or decreasing vulnerability and dependence. This is then further discussed in Chapter 4, with Vanuatu analysed as a case study, to examine its unique experience of ODA, which aspects of that experience are typical and atypical of PICs and the impact of donor interests, particularly Australia's national interests. Based on the theories, literature and realisms, some of the implications for Vanuatu's future and possible exit strategies from aid dependence are surveyed in Chapter 5.

[1] The Pacific Island Countries are: Fiji, Federated States of Micronesia, Kiribati, Marshall Islands, Nauru, Palau, Papua New Guinea, Solomon Islands, Tonga, Tuvalu, Vanuatu, Samoa. (Niue and Cook Islands are excluded from this analysis)

Chapter 1. ODA – What and Why?

This chapter defines ODA, its historical rationale and why it still exists today. It explains what practical needs ODA is said to be responding to and analyses whose interests it serves. The structures and mechanisms of ODA are described, its challenges and successes, as well as its general trajectory in the PICs and Vanuatu. The current status of ODA in the era of 'retroliberalism' (Murray and Overton 2016) illustrates the characteristics that are pertinent in evaluating alternatives.

ODA is concessional financing and technical assistance provided by developed countries to developing countries, through bilateral and multilateral agencies. The Development Assistance Committee (DAC)[2] of the Organisation for Economic Co-operation and Development (OECD) defines that ODA must hold the "promotion of the economic development and welfare of developing countries as the main objective" (stats.oecd.org). Leading multilateral organisations such as the World Bank, Asian Development Bank (ADB), United Nations Agencies and the European Investment Bank (EIB) channelled approximately 16 per cent of the ODA to PICs since 1980 (stats.oecd.org). Bilateral ODA accounts for the remainder. But the sources of ODA are no longer just OECD countries, with China, India and Russia as key players in Africa, Asia and the Pacific (Mawsdley, 2012). Chinese aid data is characteristically obscure and it is not always clear if non-DAC reporting on aid volumes excludes military spending, as required by the DAC definition (Brant, 2013; Kaikai, 2015; Hameiri, 2015; Bräutigam, 2000). This may distort reported volumes and impacts. However, given the overall ODA volumes to PICs, the disparity is likely to be negligible. The discussion that follows focusses primarily on DAC ODA, with later commentary on China's emerging role in geostrategic considerations.

Another important definition is the 'Aid dependence' of a nation. Aid dependence depicts a situation where a country is unable to provide for the physical needs of its people and requires external assistance to do so. Bräutigam (2000:2) defined it as "a situation in which a country cannot perform many of the core functions of government, such as operations and maintenance, or the delivery of basic public services, without foreign aid funding and expertise." By effectively boosting or substituting government revenue, ODA enables a developing country to enjoy a higher standard of living (from better public services and infrastructure) than they would otherwise enjoy. For the purposes of this thesis, the most common proxy for measuring aid dependence will be used, known as 'aid intensity,' and calculated using ODA as a percentage of GNP, or more recently, gross national income (GNI). This definition spans many of the parameters considered in both aid dependence and economic vulnerability. High aid intensity is delineated where this ratio is greater than 10 per cent (Bräutigam, 2000:16, Bräutigam and Knack, 2004:257) and dependence is reached when these levels are

[2] Current DAC Members are Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Japan, Luxembourg, the Netherlands, New Zealand, Norway, Portugal, Spain, Sweden, Switzerland, United Kingdom, the United States and the Commission of the European Communities (OECD, stats.oecd.org)

sustained for 10 years or more. A literature review on aid dependence is presented in Chapter 2, which identifies the differing theoretical perspectives on how it forms and persists, as well as the impacts of long-term ODA.

Economic rationale for ODA

At its most basic, the justification for ODA is that it is essential assistance from donors to meet recipient's needs. Economic needs, humanitarian needs and social needs have been defined and organised in various ways over the seven decades of the 'aid project', to form plausible explanations for these financial flows from rich nations to poor nations.

In the late 1950s and 1960s, Rostow and Rosenstein-Rodan provided a simplified economic growth model that outlined five stages of linear development, where 'less developed' countries move to 'more developed' status; from traditional society, to preconditions, through take-off, maturity and ultimately to high mass-consumption (Willis, 2011). Although Rostow is not noted for encouraging the use of foreign aid as an accelerant to economic growth, he was the first to write about economic growth as a means to development, and his ideas were influential in US policy in the 1960s. Prior to Rostow, Keynes' theory of supply side economics supported the initial post-war aid project, the 1947 Marshall Plan. Largely formulated in response to the economic consequences of the Great Depression, Keynes' theory emphasised government expenditure to create a 'supply' or surplus, of infrastructure, school facilities or services (Peet and Hartwick, 2015). Keynes' focus on the role of government to generate the conditions for economies to emerge from crises aligned well with Rostow. Thus, the same logic was applied to the provision of ODA, where it was believed that temporal but sustained injections of government finance could generate the conditions for Rostow's 'take-off' (Peet and Hartwick, 2015).

Drawing on these ideas, Chenery and Strout (1966) provided the defining justification of foreign aid for that era, by describing three non-linear, but interrelated phases, through which they saw developing economies must prevail: investment limited growth, trade limited growth and self-sustaining growth. They prescribed policy settings for donors and recipients, including the limits and sector targets of foreign assistance, which must be provided through each phase of growth and transition. To transition an economy, they reasoned, ODA financing could be provided to meet investment and trade limitations, by the supply of imports and foreign exchange, as well as supporting the transfer of skills and strengthening of domestic savings (Chenery and Strout, 1966). With a prescient view of aid effectiveness and the dangers of inducing aid dependence, they observed empirically that a rise in GNP stoked initially by large amounts of external capital, should be followed by a steady decline in dependence on external finance (Chenery and Strout, 1996:680, 725). Thus, Chenery and Strout particularised the government-led modernisation-industrialisation reasoning for foreign aid that Keynes, Rostow and Rosenstein-Rodan had formulated. The attraction of Chenery and Strout's economic model was that it connected one of the most important objectives of development – speeding up economic growth – to what was often assumed to be the major constraint on the rate of economic growth, investment (Lockwood, 1990:19-20; Maizels and Nissanke, 1984; Chenery and Strout, 1966; Nissanke, 2000). Based on this investment rationale, ODA flows to PICs increased during the 1960s, as this logic was applied to stabilise newly decolonised nations (World Bank, 2017).

During the 1970s and 1980s, neoclassical economic theories first expounded by Ludwig von Mises (1881-1973) and Friedrich von Hayek (1899-1992) were revived to challenge this 'state interventionist' orthodoxy, as part of a broader pendulum swing back towards renewed liberal economics – neoliberalism. The term neoliberalism captures the hypothesis that "markets are almost always the best decision-makers in terms of efficient resource allocation and that trade and investment flows across borders are optimised when there are as few restrictions [on markets] as possible" (Haslam *et al*, 2012:544). Due to the declining 1970s world economy, much of which was (inaccurately) blamed on Keynesianism, the neoliberal philosophy transformed the policy and practice of Western governments, bilateral donors and development agencies, particularly manifest in the adoption of a minimalist role for the state. However, the underlying rationale for ODA under neoliberal economic theory remained similar – to instigate less-developed countries to follow a pathway of economic growth and modernisation, to become developed countries. But neoliberalism changed the pathway design for this to occur. Instead of government-sponsored industrialisation producing domestic self-sufficiency, this new roadmap was delineated by a set of policy instruments (principles of operation) implemented by the World Bank and International Monetary Fund (IMF). These were targeted at producing macroeconomic reorientation to introduce market operations into each component of the economy, including government outsourcing, tax reform, deregulated interest rates, floated currency exchange, trade liberalisation, privatisation of state enterprises, deregulation and property rights (Peet and Hartwick, 2015:98-99; Willis, 2011). John Williamson coined the term 'Washington Consensus' for these principles in 1989, reflecting their origins amongst the US policy makers and agencies (Babeiya, 2012) and it soon became generally accepted DAC policy.

Bilateral donors thus made their ODA conditional on (amongst other things) recipient countries having World Bank and IMF programs, including binding debt repayments (Peet and Hartwick, 2015:103). The terms of the lending included strict conditionalities which forced recipient countries to adopt an export-orientation, at the expense of cultivating industries that primarily served domestic markets (Hanlon, in Haslam *et al* (Eds.), 2012:264; Szymanski, 1981, cited in Lockwood, 1990). What followed was the 1980s debt crisis, as developing countries could not meet the loan repayment terms, nor could they default.[3] Failure to repay resulted in structural adjustment packages

[3] In the 1930s, countries simply defaulted on debts. But in the globalised financial system established by the 1944 Bretton Woods agreement institutions, and later reinforced by neoliberal economics, by the 1980s, defaulting on debts was not permitted

being implemented, to impose austere fiscal management conditions, supervised by the IMF, to guarantee repayments (Peet and Hartwick, 2015:103). As this crisis was worsening, many PICs were still emerging from colonial rule. The structural weaknesses in their economies meant that they were characteristically unqualified to accept loans and relied on ODA grants even for basic government expenditures. This meant that PICs were generally insulated from this crisis, although they were indirectly affected by the global downturn. It was through heavy initial reliance on conditional *grant* ODA, that some of the seeds of PICs' future long term aid dependence were sown at this time. Despite these crises, the ascendency of the neoliberal economic rationale saw DAC ODA flows to PICs from 1970 to 1990, increase by 305 per cent (World Bank, 2017).

ODA was framed as a temporary measure, but the possibility of aid dependence was soon recognised, as questions also emerged about aid effectiveness (Griffin, 1970, cited in Lockwood, 1990; Papanek, 1972). However, within the development economics community, contemporary critiques were not weighing the underlying premise or the rising levels of ODA *per se*, rather the volume that should be delivered into different policy environments. Peter Bauer's (1982, cited in Collier, 1999) position was that ODA in fact *prevents* governments from making good policy decisions. Kanbur *et al* (1999, cited in Collier, 1999) agree that gross ODA payments overwhelm the capacity of government. Collier (1999) argues that this is not universally true, but admits that ODA higher than 30 per cent of GDP has only a diminishing benefit, even in good policy environments. This absorptive capacity for ODA (known as aid saturation) can significantly reduce the effectiveness of ODA as aid-saturated economies cannot grow. Specifically, aid saturation constrains the ability of the economy to convert ODA into GDP, caused by the limited capacity and integrity of institutions, productivity factors and the lack of any surplus to absorb economic shocks. For PICs, Feeny and McGillivray (2008) found that the optimum level for ODA to contribute to growth is where ODA is 20.2 per cent of the recipient's GDP. Bhaskara Rao *et al* (2008) surveyed others' work in this area, and cite Pavlov and Sugden's (2006) finding that the significant and positive effect of ODA on growth starts to decline when the aid ratio reaches about 50 per cent of GDP.

Thus, it seems that when ODA levels are beyond about 20 per cent of GDP, ODA's contribution to growth has a diminishing benefit, as saturation increases. It fact, ODA may begin to retard growth and induce or perpetuate dependence, thus rendering it ineffective. As the 1990s progressed, ODA-induced debt levels became unsustainable, and the enthusiasm for neoliberal economics as a justification for ODA started to wane. At the same time, the rise of human rights based approaches to development, evident since the 1970s, was waxing into a neostructuralist phase (Murray and Overton, 2016).

Social development rationale for ODA

At that point, many in the development discourse realised that, despite its convenience, measuring economic growth alone does not serve policy formulation in a way that results in appropriately nuanced, culturally appropriate social support or intervention. Development sociologists persuasively argued that development was about more than growing an economy – it was also about deep societal changes affecting well-being and culture. In 1963, the United Nations Research Institute for Social Development (UNRISD) was established to respond to this expansion of the dominant economics approach. By the mid-1970s, development was no longer seen exclusively in economic terms or even in terms of generic social change, but also in terms of what it would deliver for individuals, households and communities. This became known as the 'basic needs' approach to development and later, social development. Put simply, social development theory is when actors and policies are "used to intervene in people's social relations and in the process…lead to the creation of new 'objects' and generate new collective representations" (Arce, 2003:847). Social development has often been seen as a soft policy option or as 'social infrastructure' (health, education, skills programs) to accompany economic development (Arce, 2003). This simplification fails to "capture the middle ground between people, ideas and objects," because social development theory is not simply a 'toolkit' to combine economic and social policies (Arce, 2003: 853). Rather, it engages with the social drivers and emergent properties from bringing people and policies together towards development, as a rebuke to "abstract notions of freedom linked to neo-liberal discourses" and econometric approaches (Arce, 2003: 846 & 851).

This hypothesis was used to underpin the Human Development Index (HDI), developed by Ul Haq of the United Nations Development Programme (UNDP) in the 1980s. The HDI showed that social outcomes can be measured independently of economic indicators and also that economic theory can be adapted to measure and drive improvement in social outcomes (Power, 2006). During the 1990's, a similar shift was detected in World Bank policy, whom by that stage had become pre-eminent in setting global development policy (Peet and Hartwick, 2015:105). Simultaneous with the collapse of the Soviet Union and Berlin Wall (1989-1991), the rise of the East Asian 'tigers' and the apparent ascendency of liberal democratic economies, there was this paradoxically coincident broadening of development rationale to permit market-friendly state intervention, encourage good governance and deal directly with poverty (Peet and Hartwick, 2015:104; World Bank, 2000; Feeny and McGillivray, 2008:169). By the late 1990's the social development rational for ODA had gained firm traction. A 1996 DAC paper listed four social development goals – education, gender, mortality, health and one quasi-economic goal (halving poverty) – as being the major forward targets for DAC ODA (OECD, 1996:1-2). The British Government's 1997 White Paper on International Development was further reinforcement of this rationale. It was followed by the UK's Department for International Development (DFID) adoption of the Sustainable Livelihoods approach (2001), where the concept of 'capital' was assigned to human, natural, financial, social and physical dimensions. This new consensus accelerated a global movement to end poverty, culminating in the Millennium Development Goals (MDGs) and the push for debt relief (Peet and Hartwick, 2015:105-108). In 2015, the MDGs expired and were replaced with an expanded version of the MDGs – the Sustainable Development Goals (SDGs).

These structures and mechanisms were established to better respond to human needs. Historically, the multilateral agencies such as the World Bank, ADB, and United Nations agencies have demonstrated a greater propensity to respond to recipient need than bilateral ODA has. Multilateral aid is "largely a function of income level, population and policy" (Burnside and Dollar, 2000:848) and is thus more responsive to recipient need and performance (Maizels and Nissanke, 1984). The recipient need model assumes that aid is proportional to the recipient's economic and welfare needs (Meizels and Nissanke, 1984). Many issues could be identified as 'needs' of recipients. A summary of these needs from the literature would include, economic growth (GDP per capita) and foreign exchange shortages as the key economic needs, and quality of life, infant mortality, and illiteracy as social needs, all of which are affected by geographical and population size and economic and meteorological vulnerability (Bräutigam and Knack, 2004:273; Bräutigam, 2000; Gani, 2009). Building on the recipient need model, and following their dissatisfaction with traditional aid conditionality of the 1970s and 1980s, the multilaterals and the World Bank in particular, further developed a justification for aid allocations which seized upon this idea of the quality of policy environments (Collier, 1999; Burnside and Dollar, 2000). Mosley *et al* (2004) constructed a more sophisticated model measuring how donor objectives may be "sought through three alternative methods: selectivity; traditional 'ultimatum' conditionality; or the new conditionality", which seeks to marry aid disbursements to reward for pro-poor policies (Mosley *et al*, 2004:F219). With a primary focus on poverty reduction, Mosley *et al* advocated for conditionality of aid, based on a 'pro-poor expenditure index', rather than arbitrary selectivity. Models developed by Mosely *et al*, Collier and Dollar (2001) and Cogneau and Nordet (2007) theorise the 'fairness' of ODA distribution.

But to justify ongoing ODA, something more that fairness was required. Thus, in the 1990s, in concert with the DAC and multilateral agencies' diversifying focus on poverty reduction and the social dimensions of development, the enquiry into aid effectiveness also gained momentum. The question of the policy environment into which ODA is sent, was rebranded, when it was concluded that aid effectiveness is policy dependent (Burnside and Dollar, 2000). Striking a similar chord, Collier and Gunning (1999) found that ODA allocation should be selective and dependent on the policy environment of recipients, rather than tying it to reform performance. Under an economic rationale for ODA, national monetary and fiscal policy is crucial to economic growth and its positive and negative interactions with ODA need to be understood to determine effectiveness (Combes *et al*, 2016). But Nissanke (2000:171-172, citing Hansen and Tarp, 2000), contended that there is a lot more to aid effectiveness than the policy environment, including "weak management capacity of recipients; poor aid coordination among the donors, resulting in proliferation of parallel aid projects or problems in allocation of domestic resources; lack of recipient ownership of the development agenda, and design problems of aid conditionality". Boone (1996) generally agreed, pointing out that liberal regimes do not significantly positively affect the effectiveness of ODA against economic or social indicators, other than an outlier positive result for infant mortality. However, it became multilateral orthodoxy that 'good' governance and 'good' economic policies in the recipient country are the key to achieving maximum economic growth from aid finance (Burnside and Dollar, 2000; Gani, 2009; Mosley *et al*, 2004). Likewise, inequality and corruption are particularly strongly negatively associated with aid effectiveness because they exercise a downward influence on investment and productivity (Mosley *et al*, 2004:F224, 236). Agreeing with Nissanke (2000), Collier and Dollar (2001) encouraged alignment with 'local priorities' as part of creating an environment conducive to effective ODA.

Against this backdrop, in 2005, the Paris Declaration on Aid Effectiveness, and the subsequent Accra Agenda for Action (2008) outlined five principles for making aid more effective: Ownership, Alignment, Harmonisation, Managing for Results and Mutual Accountability (OECD, 2005). The Paris Declaration requires developing countries to play a lead role in designing and implementing its development strategies and donors are required to align with them (Brown, 2012). Given the paternal overtones of the document, its near-silence on the purpose of ODA and the fact that many developing countries require assistance to even produce and monitor the national planning instruments with which donors must align, the Paris Declaration does not resolve whose interests (donor's) or needs (recipients') are being served. Indeed, the Paris Declaration did little to quell the debate over whether an increase in aid effectiveness can even be demonstrated. Cleary, any evaluation of aid effectiveness must examine firstly what purposes the ODA is designed to achieve. External indicators such as the MDGs or project targets for gender inclusivity (for example) are often used to measure the level of achievement of ODA by showing the success of particular ODA programs. But these indicators are usually target at a micro (outputs) level. For example, targeting increased primary school attendance (MDG 2.A), says nothing about the quality of the curriculum or teaching methods, which would also determine the impact and effectiveness of that increase in attendance. To address this, design methods such as 'Logframe' are used, to logically connect direct program outputs to broader socioeconomic impacts. However, while the indicators are often worthy of pursuit, particularly for the realisation of social development outcomes, whether their achievement positively disrupts national macroeconomic or socioeconomic trends is unclear (Nissanke, 2000; Moyo, 2009; Glennie, 2010). Given the centrality of this concept to the evaluation of the effectiveness of ODA, it is surprising that the Paris Declaration includes only a scant and passing definition of the purpose of ODA – to increase ODA's impact in "reducing poverty and inequality, increasing growth, building capacity and accelerating achievement of the MDGs" (OECD, 2005:1). While "ODA per capita" is a common proxy for measuring and comparing aid effectiveness (Gani, 2006), this lack of a tangible pathway from implementation indicators to the achievement of national targets is obscured by the plethora of such indicators. The Paris Declaration's indicators and the broad range of insights into what does and does not improve aid effectiveness, offer some sophistication to the allocation prescription for any ODA.

Neostructuralism was typified by ODA being used to support the state to tackle social justice and poverty, but in the context of an open, globalised economy which marketised ODA spending (Murray and Overton, 2016). By the 2000s, donors were deeply wedded to the integrative narrative of economic and social development, as well as the powerful instruments of aid effectiveness and governance, as evidenced by their inclusion in the essential architecture of donor-funded development program design. Since 2010, this hybrid of economics and social rationales for ODA has undergone further change. Labelled by Murray and Overton (2016) as 'retroliberalism', it is an adjustment back towards the political right, characterised by allowing state stimulation of economic growth, but with more oxygen for the private sector, a renewed focus on investment for trade growth, including infrastructure, as one example of the blurring of the lines between donor's national interest and developmentism.

Political rationale for ODA

After considering the above, the question remains, why did the North engage, and continue to engage, in what is ostensibly a sustained and unprecedented demonstration of humanitarian largesse? Beyond mere human goodwill, or the development of self-serving markets, even the social development rationale does not answer this central question of 'why?'. The rationales demonstrate the needs and the opportunity to assist, but it is politics which explains the motivations and ultimately answers the question as to why the opportunity was taken (Boone, 1996).

Firstly, the politics of recipients. ODA usually results in delivery of an asset or service that can be shown to benefit people. While the outcomes of ODA are sometimes esoteric and the people can resent the exporting of profits through multinational firms, hard infrastructure, locally-won contracts and skills programs generally deliver enough positive effects to influence domestic politics. Funding to improve the recipient country's productivity, health service, education system, institutions or other noble aims is lauded by locals (Meizels and Nissanke, 1984:880). ODA is still used in most PICs as some form of budget support, thus boosting the standard of government services to be beyond what would otherwise be available. Using ODA in this way delays the need for politicians to impose unpopular taxes to balance the budget. Another benefit for domestic politicians is the derived esteem from showing that they hold court with more powerful nations, in a bilateral relationship, that can be leveraged for further allocations (Grant and Nijman, 1997). There are so many constituent parts in an economy, that the negative effects of ODA can usually be successfully deflected by focussing on achievement of selected development outcomes. Conversely, Knack (2004) attributes small country size as being a strong predictor of high ODA levels as a result of "donors' desire to 'show the flag' widely" (Knack, 2004:259) As long as the politicians of both donors and recipients can demonstrate value in the continuance of the bilateral relationship involving ODA, it will continue. As we will see from the following discussion on donor interests, the derived value may be different for the two, but mutual benefitting is the key that connects the political rationale of donors and recipients. It is political considerations that propels ODA, and being able to demonstrate its effectiveness which sustains it (Grant and Nijman, 1997; Glennie, 2010).

Even at the early stages of development theory, laid out by US President Truman as an 'obligation' for developed states (Gulrajani, 2017), the purpose of foreign assistance was linked to foreign policy. The Marshall Plan enacted US funds to assist the reconstruction of European infrastructure and economies after World War II. Above humanitarian impulse, US national interests – economic and geopolitical – can be detected in the Plan. The practical function of the Plan's funds was to provide markets for US products, to create an international trading system and to reduce the likelihood of Western Europe adopting socialist economies and communist governments (Willis, 2011).

Many other examples of the foreign policy motivations of the use of ODA can be cited, such as extension of trade advantages, geostrategic presence and as rewards for progressive liberal democracies in Cold War calculations (Muller, 1985). Bilateral ODA is a direct expression of donor's foreign policy objectives, as a "multidimensional instrument of a donor's diplomatic, economic, developmental, and environmental policies" (Grant and Nijman, 1997). Bilateral ODA is much more useful to donors than multilateral ODA is, due to the donor's control and leverage over it (Grant and Nijman, 1997; Burnside and Dollar, 2000). In addition, bilateral ODA is comparatively more flexible in its uses. Meizels and Nissanke (1984) summarise donor interests into three overlapping categories: political and security, investment and trade interests, interpreted from the method and volume of their ODA allocations (Meizels and Nissanke, 1984:883, Barthel *et al*, 2014). It serves its primary purpose of indebting the recipient to the donor (financial and non-financial debts), both implicitly and through the conditionality of tied ODA. Historically in the Pacific, donor's interests were most notably Cold War and post-Cold War consolidation of geographic dominance by US-allied countries and access to resources, including use and conservation of forests and fisheries. More recently, these have turned to terrorism, migration and stability concerns, as well as re-positioning to contain the increasing influence of China (Hawksley, 2009).

While donor governments will seek to influence the policy and allocation of multilateral ODA through their shares in them, that influence is tempered by the balanced governance model and allocation formulae of the multilaterals. The real value of multilateral agencies to bilateral donors, is their perpetual development of vast and sophisticated frameworks and modalities for delivering ODA, to meet ever-more nuanced needs. These can then be selectively and legitimately erected as scaffolding around bilateral ODA, to normalise it and to suit the target and scope of the foreign policy objective. The standout example over the past 20 years is the MDGs – several other examples of this type of 'scaffolding' follow.

Following the United Nations' lead, the multilateral agencies have adopted a categorisation of nations, according to their income and development status. There are nine categories, including Least Developed Countries (LDC), Developing Economies and Developed Economies, typically separated on the basis of GNI per capita (UN, 2014). This status dictates the rate of concessional lending that a country can apply for under each agency's operational lending policy. This sets up incentives for countries to remain in lower categories, in order to maintain access to cheap finance. It also validates a range of useful spending options for bilateral ODA.

Another example is the aid effectiveness and governance agenda described above. Frameworks, indicators, monitoring and evaluation of outputs, outcomes and impacts have become ubiquitous amongst bilateral and multilateral donor programs. Allied with these are typically institutional strengthening and capacity building programs. To provide technical assistance and relieve capacity constraints within development partner governments in the Pacific, regional fora have proliferated in recent decades. Those sponsored by bilateral and multilateral donors include the Pacific Financial and Technical Assistance Centre (PFTAC), Pacific Infrastructure Advisory Centre (PIAC), Pacific Islands Forum Secretariat (PIFS), Pacific Region Infrastructure Facility (PRIF). The sponsorship, ostensibly for the purpose of supplementing capacity, also provides useful avenues for influencing policy discussions. Other examples of the propagation are the voluminous social and environmental safeguards evaluations, gender action plans, poverty assessments, financial sustainability and climate change, vulnerability and disaster risk management assessments – all of which have their origins in worthwhile development considerations, but which also represent the donor's value system.

A recent substitution in the ODA lexicon is the term 'development partnerships' in lieu of 'donors', 'foreign aid', or 'development assistance'. The change appears to have been designed to recast the negative perceptions of post-colonial North-South relationships. Words and concepts such as ownership and harmonisation (OECD, 2005), responsible agents (Abrahamsen, 2006), partnerships for progress (OECD oecd.org) and 'participation', proliferated. In the Paris Declaration on Aid Effectiveness (2005), donors committed to aligning their ODA with recipient's national development plans as partners, rather than as leaders of development. It is argued whether the change in language has changed the underlying power imbalance or paternal attitudes in donor-recipient relationships. The 'partnerships' nomenclature itself is attractive due to its slipperiness and its ability to derive authenticity and legitimacy for donor programs (Harrison 2002:591). According to Mawsdley (2012), while the rhetoric has changed, the use of aid as an instrument for hard and soft foreign policy implementation remain largely the same, if not more-so in favour of the North (Amin, 2009:68). Arce also notes that the shifting of rhetoric and even practice, from a discourse of experts to a participatory model, may indeed simply be a way of engineering flexibility into the implementation of the same neoliberal ideological framework (Arce, 2003:853).

This discussion reveals that it is politically important for donors to be seen to be offering effective ODA in pursuit of their broader interests. Similarly, recipients rely on the elasticity of their electorate's demand for new infrastructure and projects, to overcome the fact that macroeconomic indicators are often only imperceptibly changed by ODA and that in some cases their economy has reached aid saturation and the ODA may be encouraging aid dependence. Bilateral donors co-operate with multilateral agencies to develop 'scaffolding' to erect their own ODA programs. Vanuatu is a small, vulnerable nation, but exhibits responsiveness to donors and 'development partners' who offer financing for programs which will facilitate local politicians' political prowess before a domestic audience. Holding the tension between recipient need and donor interest, what emerges is that ODA is primarily as a result of an interactive relationship between the different priorities of international governments and that the impacts and effects of aid on human need are less important than political outcomes. This ductile relationship provides the key opportunity for Vanuatu to exercise agency.

Chapter 2 – Aid Dependence

The intercourse of economic, political and social justifications for ODA give pretext for a country's dependence on ODA. The phenomenon of aid dependence is often blamed on a lack of aid effectiveness. Yet political economy more adequately explains its rise and persistence than technocratic rationalisations. Through the lens of different theoretical perspectives on development, the literature on dependence is surveyed below, to understand why countries become dependent on ODA and why it endures.

In its simplest form, the term 'dependent' implies a reliance upon external assistance for basic functioning. A nation state can be defined as dependent on ODA, if it "will not achieve objective X in the absence of aid for the foreseeable future" (Lensink and White, 1999, cited in Bräutigam, 2000:9). Thus aid dependence defines the condition of receiving a large and essential amount of ODA for an extended duration. While a short period or spike in receiving significant ODA is categorised simply as 'aid intensity', this may turn into aid dependence when such an intensity is maintained over the longer term (Bräutigam, 2000; Bräutigam and Knack, 2004). There is no universally agreed threshold or even agreed measurement for classifying aid dependence (Bräutigam, 2000). Subject to the dimension of dependence they are considering, researchers use other denominators such as GDP, government expenditures, tax revenue, imports or per capita (e.g., Chenery and Strout, 1966; Glennie, 2010; Combes *et al*, 2016; Knack, 2001; Brown, in Haslam *et al* (Eds.), 2012; OECD, oecd.org; Action Aid, 2011; McKinlay and Little, 1977, 1978a, 1978b, 1979 cited in Meizels and Nissanke, 1984). Notwithstanding, high aid intensity (ODA/GNI) at greater than 10 per cent, sustained for about a decade or more, is loosely considered to constitute aid dependence (Bräutigam, 2000). Aid saturation is described in the previous chapter, defined in relation to the overall size of what the economy produces (GDP). It is a lead indicator for aid dependence, because of ODA's characteristic retarding effect on production (Knack, 2001; 2004). If aid saturation persists, it will reduce the competiveness of exports and thus, income. This in turn reduces GNI, which shapes the level of aid intensity and dependence.

From the perspective of the fundamental economic rationale, ODA is ineffective when it has not achieved the level of savings and productive investment required to enable self-reliant economic growth. Thus, aid dependence manifests when the costs of the "core functions of government, …operations and maintenance, or delivery of basic public services" for which a government is responsible cannot be covered without ODA funding and expertise (Bräutigam 2000:9). The provision of such essential services reflects the original vision for ODA to the 'Third World', "to relieve shortages of skills, saving, and imported commodities", with the intent that the resultant increased output would be effectively invested in reducing the savings and trade gaps (Chenery and Strout, 1966:724). Chenery and Strout saw this secondary investment strategy as even more critically important to achieving self-sufficiency, than the initial uses of the ODA itself. With less specificity, Lensink and White (1999, cited in Bräutigam, 2000:10) make a similar argument, that high levels of ODA are not necessarily problematic, as long as it is assisting progress towards self-sustaining development objectives. The economic theorists of the Keynesian school foresaw aid dependence as a risk to be avoided (Chenery and Strout, 1966:680-681).

The neoliberal approach to development also recognised aid dependence as a problem. The need to manage the second phase investment implementation in such a way as to avoid aid dependence, was addressed by the idea of injecting ODA into sound policy environments.[4] This idea progressed the impersonal target of Chenery and Strout's concerns, to recognise that *all* secondary effects of ODA were a function of regime and active policy. Burnside and Dollar (1997, 2000) showed that under sound policy, independent of political conditions, ODA had a positive effect on growth, which was statistically significant beyond the functioning of the policies themselves. Hansen and Tarp (2000), concluded that ODA works even in poor policy environments. However, Bräutigam (2000) linked institutional weakness, corruption and governance to aid proliferation – the very symbols of aid *in*effectiveness. Knack (2001) took this further, to indicate that policy environments are not inert and that ODA itself has a distorting influence on the quality of governance. He found evidence that, amongst other factors (e.g., religious or legal traditions, colonial heritage), higher aid levels (i.e., aid dependence) causes the quality of governance to worsen over time. He also consistently found that ODA hurts market liberalising reform, one of the key principles of the neoliberal development consensus (Knack, 2001; 2004; Heckleman and Knack, 2008).

While it appears almost self-evident that the politics and policies of ODA recipients affect the economic and social outcomes for ODA (and other sources of income), Collier (1999) takes a pro-aid stance in challenging what he sees as superficial criticisms. He argues that the critique that ODA itself is the cause of ongoing problems in aid dependent countries, is simply populist. He is forthright in promoting the soon-coming success of macroeconomic reform in Africa, paving the way for 'big aid' to make its most vital contribution over the following decade (Collier, 1999:544). Others accept aid dependence as a reality and engage with various prescriptions of the cause of dependence within a neoliberal framework. For example, Combes *et al* (2016) found that aid dependency *increases* when recipients accept an IMF intervention and that it *decreases* when they reduce diplomatic ties with US and Russia. Dambisa Moyo's 2009 book, *Dead Aid*, presents as an aid liberation manifesto. She believes that stimulating the effective operation of national markets, local lending and trade will generate wealth at all levels of society and that ODA is the prime hindrance to this process (Moyo, 2009). However, Hilary (2010) criticises Moyo's Washington Consensus-like proposals to end aid dependence. Hilary contends that it was World Bank and IMF policies that induced much aid dependence in the 1980's and 1990's,

[4] In keeping with neoliberal doctrine, "sound" policy comprises trade openness, avoidance of high inflation (as a measure of monetary policy), and the fiscal disciplines of budget surplus and reduced government consumption (Burnside and Dollar, 1997:4; 2000:849).

inferring that neoliberal ODA failed and therefore *all* liberal economic approaches will fail. Thus, while aid dependence is universally seen as negative, what induces it and the neoliberal policy prescription to address it, does not clearly emerge – is it a good policy environment, more ODA, or less ODA?

It was sociologists working from the dependency and world-system perspectives who pointed out that while ODA is a flow of funds, ostensibly for the purposes of increasing investment and achieving economic growth in recipient countries, the flow is often reversed from South to North in the form of debt repayments, essentially propping up the economies of the North (Hanlon, in Haslam *et al* (Eds), 2012:270). Latin American scholars led this school, such as Dos Santos (1973), who defined this economic dependence as, "a situation in which the economy of certain countries is conditioned by the development and expansion of another economy to which the former is subjected" (Dos Santos, 1973, cited in Ismail, 1986). Johan Galtung (1971) developed and then applied dependency theory to analyse a form of economic dependence that resulted from in-built inequities of the international system, and a continuation of colonial imperialism, rather than being the simple economics of the balance of trade or payments (for example). The process by which colonialisation and then neo-colonialism replaced traditional societal structures with Western ones in the Pacific is explained by understanding the relationship between aid dependence and dependency theory (Chappell, 2005). As nations gained political independence, neo-colonial structures endured, such as the public service and parliament, bureaucracies of local advisory councils, imposition of aid programs based on Western economics, and the extraction methodology of multinational corporations. These have produced "aid dependency, debt crises, austerity budgets, social disruption, and political instability as client elites cling to power" (Chappell, 2005:298). Thus, structuralists broadened the econometric understanding of aid dependence, by associating the geopolitical and market forces – the donor's interests – which have compelled the structural features of the state and society to be dependent on ODA.

Sobhan (1996) argues that aid dependence is a "state of mind, where aid recipients lose their capacity to think for themselves and thereby relinquish control" (Sobhan, 1996:122). This is perhaps an overstatement, but it depicts the essential posture of aid dependent countries. They are often conflict affected, small islands or landlocked countries with few natural resources – a situation which produces a range of barriers to development and which exacerbates their sense of victimhood (Action Aid, 2011). They are engaged in deep, historical, "multidimensional, structural and dynamic" bilateral and multilateral relationships involving ODA, which serve multiple simultaneous political and practical purposes (Castel-Branco, 2008; Glennie, 2010; Hilary, 2010). As a result, aid dependence cannot easily be discontinued or reversed.

Several researchers have looked into the effects and implications of receiving high levels of ODA for a long period of time (beyond 10 years). Hailu and Shiferaw (2016) take a generally econocratic perspective, in observing that the impacts of long-term aid dependence are easier to correlate than are the initial causes of it. These impacts range from investment rate and manufacturing intensity being negatively correlated with aid dependence, while a growing investment-savings gap and inflation is contributable to its persistence. They also recognise that the quality of political institutions suffers under continued ODA, for acutely high aid dependence, but don't find this to be typical. These impacts are largely explained by the political stimuli created by ODA. Bräutigam (2000) observed that "large amounts of aid delivered over long periods, create incentives for governments and donors that have the potential to undermine good governance and the quality of state institutions… long-term dependence on aid creates disincentives for both donors and governments to change the rules of their engagement" (Bräutigam, 2000:1). Bräutigam and Knack (2004) agree that "large amounts of aid over long periods of time can weaken institutions and establish incentives for aid agencies and aid recipients alike that undermine the ability of each to change" (Bräutigam and Knack, 2004:276). Although these incentives are not always acted upon, they are present within the bilateral system in particular. Several other studies pick up on this perception, that aid dependence firstly has its own inertia and secondly has ill effects on governance and accountability (Boone, 1996; Altincekic and Bearce, 2014). Easterly (2006) and Moyo (2009) expound the conventional and popular wisdom that long-term ODA is eventually marshalled by local elites to prop up corrupt, autocratic regimes and therefore achieves little of what it set out to do. Others also cite the fungibility of ODA as its Achilles heel and that that's why higher aid levels negatively affect institutions, governance and tax effort (Bräutigam and Knack, 2004; Action Aid, 2011). Svensson (2000) points out that even the sociological focus of ODA dis-incentivises recipients – if ODA allocation is guided by the needs of the poor, recipients have little incentive to improve the welfare of the poor. However, whilst everyone recognises the appeal for donors and recipients to maintain the ODA *status quo*, even if that means continued aid dependence, the effects of aid dependence are insidious: recipient's loss of policy autonomy, undermined accountability and service delivery, and inconsistent government expenditure hindering long-term planning (Action Aid, 2011; Bulir and Hamann, 2008:2049, cited in Altincekic and Bearce, 2014; Lensink and Morrissey, 2001). These are issues which render a nation vulnerable and intractably dependent.

At least two conclusions about the nature of aid dependence can be drawn from this discussion. Firstly, aid dependence does not develop as a result of simple financial transactions alone (such as trade, investment and debt), but also emanates from political impulses and policies, which cannot be reversed or terminated quickly, or by applying more ODA. Secondly, the complexion of donor interests and recipient politics shows that the key to reducing aid dependence is ultimately relational, not transactional. However, the gravity of relationship required to engage in such perspicacity, can only develop where there is a perceived measure of power balance. To achieve this, a reduction in donor leverage must transpire, alongside a recipient focus on autonomy. Recipients must build economic strength and capable government institutions and leadership, to generate the oxygen and agency required for dialogue. Thus, transactional and policy efforts are what will produce the preconditions for relational discourse, to help turn the perpetual tide of bilateral ODA. Structural economic weaknesses and frequent shocks create a vulnerability that can hamper and deter the transactional efforts described.

Chapter 3 – Vulnerability of small island developing states

There is a convincing body of evidence to show that small states in general, and small *island* states in particular, are subject to a range of constraints and vulnerabilities that do not affect larger states. These small island developing states (SIDS) experience a unique vulnerability, due to a combination of small population and geographical size, remoteness and susceptibility to natural disasters. SIDS are vulnerable to natural (environmental) and external shocks, such as export demand and exchange rate fluctuations. This situation is recognised by the UN and other international agencies, which has resulted in targeted ODA to SIDS. The effect of ODA on SIDS is positive for environmental protection and significant but variable for economic growth. Donor's interests in SIDS reflect broader trends which exacerbate vulnerability and aid dependence. This is considered in the context of PICs in general and Vanuatu in particular.

The vulnerability of SIDS

In 2015, the UN Office of the High Representative for the Least Developed Countries, Landlocked Developing Countries and Small Island Developing States (UN-OHRLLS) defined SIDS as, "a distinct group of 38 UN Member States and 20 Non-UN Members/Associate Members of regional commissions facing unique social, economic and environmental vulnerabilities", including Vanuatu (UN-OHRLLS, 2015). They quote SIDS' inherent vulnerabilities as "small size, remoteness, climate change impacts, biodiversity loss and narrow resource base" (UN-OHRLLS, 2015). The International Panel on Climate Change defines vulnerability as, "The propensity or predisposition to be adversely affected…Vulnerability encompasses a variety of concepts and elements, including sensitivity or susceptibility to harm and lack of capacity to cope and adapt" (IPCC, 2014 in OECD/World Bank, 2016). This resonates with ADB's vulnerability assessment for fragile and conflict affected states (FCAS) in the Pacific. Their 2016 report recognised that many fragile states are also SIDS, who are also aid dependent. The common features of SIDS in ADB's study, are "small but growing populations, limited resources, remoteness, great susceptibility to natural disasters, vulnerability to external shocks, excessive dependence on international trade, and fragile environments" (ADB, 2016:4). ADB further identified high costs of communication, energy, and transportation, irregular international transport volumes, disproportionately expensive public administration and infrastructure and little opportunity to create economies of scale, as limitations on SIDS' growth and development (ADB, 2016:4).

The concept of the particular vulnerability of small nations emerged at least as early as 1960. At that time, Tibor Scitovsky (1960, cited in Easterly and Kraay, 2000), noted that it was the trade openness of small states with small economies that increased their vulnerability to trade shocks. International agencies (UNCTAD, World Bank and IMF) began to devote time to studying small countries, firstly relating to trade difficulties in the early 1980s (Srinivasan, 1986:207). Efforts to distil and define a single, representative, apolitical cause for small states' anecdotally apparent slow development, were problematic, as the data showed that smallness was neither necessary nor sufficient to explain it (Srinivasan, 1986). Indeed, small states typically have higher per capita GDP than large states (Easterly and Kraay, 2000). Seemingly regardless of these findings, and perhaps because of other evidence which showed greater volatility of annual GDP growth rates (Easterly and Kraay, 2000; Gani, 2006) and higher aid intensity (Burnside and Dollar, 2000), many explored the issue further, deriving common traits, from which all other issues are said to emanate. These are summarised as: small population, remoteness and susceptibility to natural disasters (Easterly and Kraay, 2000; Ahmed, 2004; Boone, 1996). Stemming from these common traits, the academic literature voluminously identifies the *symptoms* typical of SIDS which operate as limitations or hindrances to their economic growth. SIDS' smallness requires them to rely heavily on factors beyond their borders, for exports, ODA and remittances, to drive economic growth (McGillivray *et al*, 2010; Knack, 2004). The dynamics of small populations help explain slow economic growth in the Pacific, resulting from poor domestic policy, exposure to international terms of trade and political instability (Gani, 2006). Borgatti (2008) distinguished that it is distance-to-markets rather than remoteness *per se*, which affects firstly SIDS' import absorption and consequently, the elasticity of bilateral trade. She finds Pacific countries being heavily affected by their distance from markets, as they are remote from each other and from larger trading partners (compared to the better performance of Caribbean countries close to the US). Many other measures usually targeted by development programs and ODA, such as developing export capabilities and transportation, encouraging foreign direct investment (FDI), labour mobility and migration are all hindered by the lack of demand for SIDS' remoteness and small populations (McGillivray *et al,* 2008).

Susceptibility to natural disasters is a common trait characteristic of both economic and non-economic views of vulnerability. Guillaumont (2010) maintains a distinction between economic vulnerability and ecological fragility.[5] This is helpful in separating the ecological issues (biodiversity loss, soil fragility, etc.) from the structural and policy features which form economic vulnerability. The structural component is comprised of factors which are independent of a country's current political will, such as the environmental (natural disasters) or external shocks it faces (Guillaumont, 2010:829-830). 'External' economic instability is caused by variations in the terms of trade, agricultural production and global political instability. Secondary instabilities (the rate of investment and relative prices) are also structural vulnerabilities which negatively affect economic growth (Guillaumont, 2010; Burnside and Dollar, 2000). An example of structural vulnerability is small population – small populations have a higher trade to GDP ratio (*ceteris paribus*), due to small domestic markets, and thus the more trade dependent the economy (Easterly and Kraay, 2000; Burnside and Dollar, 2000). This is exacerbated by distance to other markets reducing the competiveness of any

[5] Ecology, land and human resources are captured under the rubric of "sustainable development" (UN, 1994).

exports. Structural vulnerabilities are essentially fixed, but they can be either exacerbated or improved by policies, including the use of ODA. Policy vulnerability derives from choices (Guillaumont, 2010:829-830), and often involves matters of governance, culture and society, making it difficult to overcome.

Vanuatu – vulnerability and the climate change era

Vanuatu's customary land arrangements thwart a land market, deny opportunities for land taxes and prevent the means of production being privately owned – a key feature of developed economies (Howes and Soni, 2009; Hughes, 2003), Duncan and Chard, 2002; Peet and Hartwick, 2015:93). The sense of identity, belonging and ownership, as well as the practical benefits of local subsistence need not be displaced by changes to such policy. Culturally derived policies can be so powerful that they operate as a structural element within the economy. The preserved colonial structures, such as dependence on external finance, trade and investment relationships, form of government and the lack of human capital are essentially inherited vulnerabilities which perpetuated the condition of external dependence (structural), but which can now be influenced by policy (Premdas, 1985). Domestic shocks such as political unrest or instability also influence vulnerability, and are considered here to the extent to which they affect policy choices (Guillaumont, 2010). The Anglophone-Francophone divide in Vanuatu's party political system is understandable, but the influence of identity politics formed by island and tribal allegiances, fractured the original two-party system into an enduring state of multiparty coalition government (van Trease (Ed), 1995). Diversity can produce strength, and certainly affects policy calculations.

A current high-profile example of the interplay between the structural and policy controlled components of economic vulnerability is climate change. Many PICs are vulnerable to both climate-induced risks and disaster risks from geo-hazards. In fact, the island formation of Vanuatu is considered to be the world's most vulnerable country to natural hazards (Mucke, 2012). Vanuatu's exposure to geo-hazards is affected by its geographic location in the 'Pacific Ring of Fire' seismic zone. This results in earthquakes, tsunamis and volcanic eruptions. Typical impacts of these geo-hazards are coastal inundation and slope instability and landslide (Temakon, 2014). Vanuatu is also at the centre of the Pacific Cyclone Belt where there is considered to be a high likelihood of at least one of either a storm surge, coastal and river flooding or strong wind force, occurring frequently. Vanuatu's structural vulnerability to climate change is induced primarily by its low-lying and coastal habitable land, which supports subsistence for a significant majority of the population, yet is also the most susceptible to higher rainfall intensity, drought frequency, sea level rise, ocean acidification (loss of coral habitat) and wind-wave action. These increasing hazards have been well known for several decades and the policy of the Vanuatu government has been to actively participate in the global efforts to address climate change. The Republic of Vanuatu ratified the UN Framework Convention on Climate Change (UNFCCC) on 9 March 1993, ratified the Kyoto Protocol on 17 July 2001 and subscribes to the Hyogo

Framework of Action (HFA), linking climate change and disaster risk reduction, the UNFCCC Bali Action Plan (2007) and the Cancun Adaptation Framework (2010).

The Vanuatu government is working to ensure that management of climate change and disasters are integrated, primarily through a combined institutional arrangement, the National Advisory Board (NAB). The integration agenda was driven by the NAB co-chair agencies, that is the Vanuatu Meteorological Services and Geo-Hazards Department (VMGD) and the National Disaster Management Office (NDMO), and was implemented in 2014. NAB considers project proposals and seeks to maintain coordination of the different initiatives across the country. In addition, a number of climate policy and natural disaster management policies and plans have been promoted. The government's Vanuatu Climate Change and Disaster Risk Reduction Policy (2016-2030), prescribes that community stakeholders and vulnerable groups are included in climate change adaptation and risk reduction initiatives and have an institutional role and voice at the various levels of decision making. Despite these commendable policy measures to increase resilience, more can be done. The hazards and intrinsic geophysical characteristics remain as structural vulnerabilities, but treating vulnerability to climate change as a semi-integrated policy issue is still inadequate. It is the lack of resilient capacity and human capital, land use planning, design standards and enforcement, disaster response resources and scarce logistical support that has a greater effect on the security of human life. When disaster strikes, Vanuatu's heavy dependence on external assistance is magnified.

In parallel with the transition to a more human-centred approach in development thinking, the issue of small island states reached prominence during the United Nations Conference on Environment and Development, Rio, 1992, where the participating nations adopted 'Agenda 21'.[6] One of the action items was the agreement to hold a special conference on the needs of SIDS for the achievement of sustainable development. Consequently, the *Global Conference on the Sustainable Development of Small Island Developing States* was held in Barbados, 1994, which produced the Barbados Plan of Action (BOPA). BOPA identified the unique resources as well as the "particularly severe and complex" challenges that are peculiar to SIDS, as distinct to those faced by developing countries in general (UN, 1994). It was followed in 2005 with the Mauritius Strategy for the Further Implementation of the Barbados Programme of Action (MSI), "with a view to addressing the implementation gap that still confronted SIDS" (Hay, 2012:310) and again in 2010, where the MSI 5-year review found that "significant efforts" were required to meet the agreed MSI goals and the Millennium Development Goals" (Hay, 2012:310; Sem, 2010). A third conference was held in Samoa in 2014 to "forge a new pathway for the sustainable development" of SIDS (UN-OHRLLS, 2015). In 2002, UN-OHRLLS was established, again reflecting the expanding inclusion of niche issues, by the 'international community'.

[6] "Agenda 21 reflects a global consensus and political commitment at the highest level on development and environment cooperation" (UN, 1994)

Vulnerability, ODA, and resilience

With international recognition of SIDS' predicament has come increased international engagement with SIDS to address their vulnerability. This has primarily been in the form of ODA, delivered through multilateral and bilateral relationships. Small countries, who sense and experience their economic vulnerability, are attractors of ODA for several pragmatic reasons (Boone, 1996). Firstly, small countries require only small amounts of ODA to meet their needs – this is attractive to donors, as it draws less management and political attention to their transfers. Secondly, the costs of commencing engagements are low, regardless of the size of transfers. Thirdly, the "sale of votes at the United Nations" is a disproportionate generator of ODA flows to small countries (Boone, 1996:307-8). The utter weakness of post-colonial small states was a factor in bilateral ODA allocation, particularly in the Cold War context (Christopher, 2003). Therefore, bilateral ODA allocations tend to show a bias towards smallness (Burnside and Dollar (2000:848). But vulnerability is not part of the multilateral ODA allocation formula, which does not weight small, fragile or vulnerable economies favourably, focussing instead on aid effectiveness formulae (Guillaumont *et al*, 2017). While small countries do receive higher per capita ODA (Collier and Dollar, 2001b), the unbalanced benefits of ODA (if there are any) for small, vulnerable states such as Vanuatu are primarily available from bilateral donors.

Reliance on a narrow group of donors, for climate change or other purposes, exacerbates SIDS' financial fragility (OECD/World Bank, 2016). Some research found that the effects of ODA are beneficial for SIDS. Economically, ODA for SIDS can "dampen the negative impact of exogenous shocks on growth and development", acting as a stabilising factor on economies (Guillaumont *et al*, 2017:29, Guillaumont, 2010:847). Easterly and Kraay (2000) found that trade openness has a net positive for growth despite volatility from increased trade exposure. In small countries, and particularly aid dependent ones, Boone (1996) found that ODA leads to higher investment. He attributes this to the paradoxical lack of fungibility of ODA in SIDS, rather than as a result of ODA promoting growth. For example, in a small country one dam or large public infrastructure project can represent a sizable portion of GNP and the project is therefore unlikely to be fungible (Boone, 1996). But these positive effects are qualified. Guillaumont (2010, 2017) doesn't address the much higher likelihood of ODA inducing aid dependence. Similarly, Boone (1996) only suggests that short-term ODA is desirable. Even where ODA is meeting social needs, its negative long-term effects on governance erode even those advantages. Certainly, the implications from the literature are that in small economies, ODA has a more pronounced effect – both when it is provided and when it is withdrawn (Feeny and McGillivray, 2008). The volatility of ODA, which is much greater than that of domestically-generated budget revenue (Bulir and Hamann, 2006) can make it impossible for recipient governments and businesses to engage in long-term planning and sustainable spending (Action Aid, 2011). ODA volatility derives from two sources. Firstly, the budgetary decisions of donor governments. While ODA is an important tool of foreign policy, it is also a budget cost and the benefits gained from the expenditure are weighed differently over time.

Secondly, Lensink and Morrissey (2001, in Guillaumont, 2010) suggest, in a circular way, that the fluctuations in ODA are due to SIDS' economic vulnerability, as structural and policy weakness produce an instability that can significantly reduce the effectiveness of aid (by between 15 and 20 per cent according to Kharas, 2008). Because it is such a powerful lever within SIDS' small economic apparatus, the likelihood of ODA inducing aid dependence is amplified.

Interestingly, SIDS and their inhabitants, are not essentially or inherently vulnerable people. Whilst they have always been exposed to environmental shocks, many countries which are now classified as SIDS, were traditionally sites of resilience. John Hay (2012) names colonialism, development and globalisation as having instigated processes by which resilience has been reduced and exposure increased. Hau'ofa (1994, cited in Johnson, 2014) extended this to include the colonially-influenced paradigm of SIDS, whereby historically strong inter-island relationships have been replaced with the notion and nomenclature of remoteness, vulnerability, weakness and 'least developed countries' (LDCs). This dependency perspective places all vulnerability as a structural feature outside of policy control. The IMF lists LDCs as countries that need to 'graduate' to be 'medium developed countries' (MDCs), by meeting a range of complex criteria and performance standards, qualifying them for non-concessional finance, amongst other privileges (Guillaumont, 2010). This counterintuitively incentivises countries to remain as LDCs, further controlling any policy impulses to the contrary. The terminology dismisses the value of SIDS' culture, their natural wealth, their resilience as a people, or other such respected characteristics. The labels send the message that LDCs are not doing as well as others and need help to rise to the standard. Illogically, by exacerbating the economic vulnerability of SIDS, the international finance system entrenches the dominance of the global North.

The well-recognised unique vulnerability of SIDS presents a complex task for achieving development (McGillivray *et al*, 2010). As well as typical ecological fragility, SIDS' economic vulnerability is set up by structural and policy formulations such as smallness, distance effects on trade and a narrow reliance on bilateral donors. Their vulnerability is now codified in international nomenclature, as 'SIDS' and 'LDC' – labels which also represent an entrenched international system that minimises or ignores cultural and traditional practices of resilience which do not interact with the global economy. The interaction of ODA, dependence, vulnerability and the politics of recipient need and donor interest are now discussed in the context of Vanuatu's current and future positioning within this dynamic.

Chapter 4 – Vanuatu's vulnerability-dependency nexus

The intersectionality of aid dependence and vulnerability can be usefully considered by looking at the case of Vanuatu in greater depth. Its experience of the use and impacts of ODA are similar in some ways to other PICs, and is unique in other ways, regarding its colonial administration, vulnerability and politics. Vanuatu's dependent position in relation to donor countries' agenda is not always beneficial to Vanuatu, but how did it come to be so and remain so? Vanuatu's geology, geography and topography include cascades, rainforest, coral reefs, volcanos, and small, accessible islands, making it a very popular tourist destination from Australia, New Zealand and increasingly from China. This rich natural beauty generates tourism, making up about a third of GDP (Reserve Bank of Vanuatu, 2016). Yet it is these same characteristics which make Vanuatu susceptible to geo-hazards and natural disasters – a key feature of economic vulnerability. Vanuatu's colonial history and smallness significantly shaped its domestic politics and relationships with donors, fashioned around an initial reliance on ODA. When Australia initiated a sustained escalation of ODA in the early 2000s, Vanuatu's progressively diminishing reliance on ODA was reversed, cementing aid dependence and exacerbating economic political vulnerabilities.

Vanuatu's distinctive colonial experience

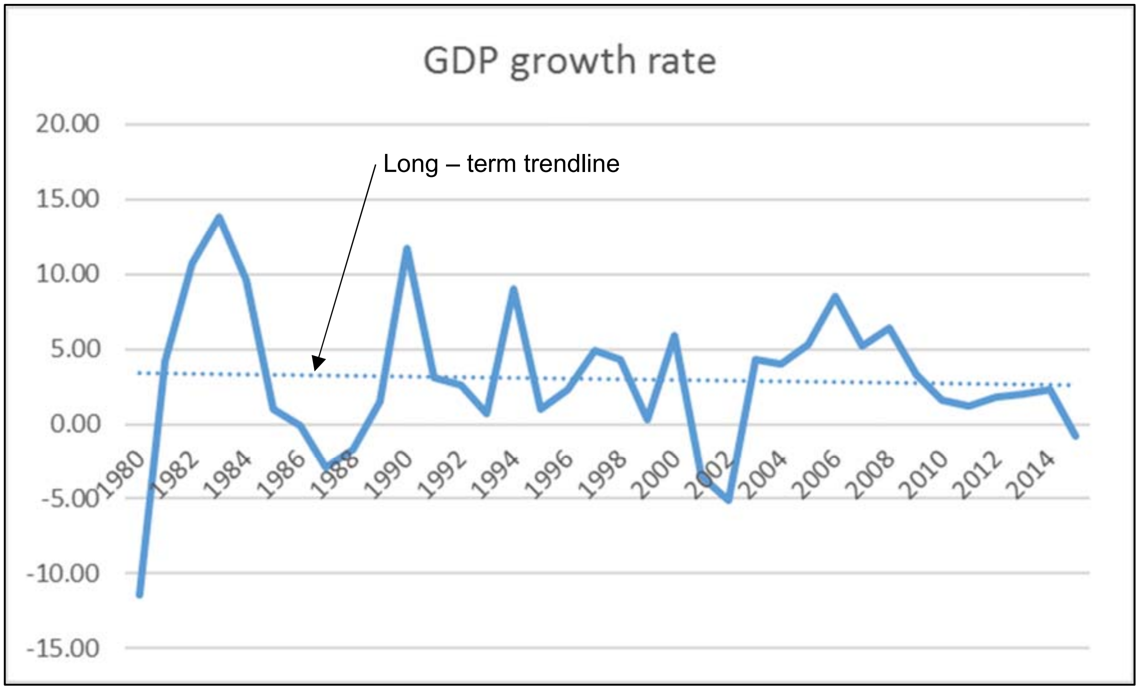
European explorers, traders and Christian missionaries began visiting the South Pacific as early as 1521 when Spanish explorer Magellan made his westward passage, in search of direct trading routes between Spain and the 'spice islands' of Indonesia (van Trease (Ed), 1995; Fitzpatrick and Callaghan, 2008). By the mid-nineteenth century, all of the island peoples of the South Pacific were either colonised, 'protected' or annexed by Great Britain, France and Germany, with pioneers Holland and Spain by then largely absent (Stillman, 2004). Vanuatu's colonial experience was distinctive in several aspects. Vanuatu was formally colonised in 1907 under a unique joint administration, comprised of a French Resident Commissioner and a British Resident Commissioner, in a condominium arrangement (Woodward, 2014). The economy of the New Hebrides (as Vanuatu was then known) was overwhelmingly based on agriculture (copra and later cacao and coffee). As such, it was an extraction colony, rather than for settlement, with several French and British settlers managing the plantations, which employed mostly local Ni-Vanuatu staff (Woodward, 2014). Also unlike some neighbouring nations such as the Solomon Islands, for a long time, Vanuatu did not nurture internal political pressure, even for a representative council, let alone self-governance. The move to initiate 'constitutional advance' came from London and Paris, starting in the 1950s. In the lead up to independence in 1980, there were nationalist uprisings in Santo and violence in Tanna, which had their ideological roots in earlier land alienation protests. These were quashed, with the assistance of Papua New Guinea's military (Woodward, 2014). However, the resulting political instability was emboldened by a complex and terse diplomatic standoff between France and Britain over contradictory political aims of the condominium (Gardner and Waters, 2013). Independence was achieved on 30 July 1980 and a period of national unity followed, founded on bi-partisan support for the political and economic autonomy of Vanuatu (National Planning Office, 1981).

Along with many other PICs, Vanuatu's post-colonial independence was accompanied by continuing economic dependence on the former colonial powers. With the exception of Papua New Guinea and Fiji, PICs are still typically aid dependent, decades after gaining political independence, and the pathway to reducing that reliance is not clear (World Bank, 2017). For Vanuatu, the condominium powers of Britain and France financially supported post-independence national stability by funding the public service (budgetary aid), capital works (grant aid) and technical assistance (National Planning Office, 1981:72). Other DAC members also contributed aid, notably Australia, New Zealand, Canada and the European Economic Community.[7] In this sense, decolonisation was not a significant rupture to the economy or business and social fabric (Gardner and Waters, 2013). ODA was originally designed to be phased out over 15 years, with economic self-reliance nominated as one of the six key objectives of the First National Development Plan (National Planning Office, 1981). This was to be achieved through "the creation of an expanded economic base" to reduce reliance on imports in particular (National Planning Office, 1981:10).

However, this goal turned out to be elusive. Vanuatu's macroeconomic indicators are volatile. The GDP growth rate has fluctuated between 13.8 per cent at its highest point in 1983, to as low as -5.1 per cent in 2002, with the long term average easing slightly from about 4 per cent in the early 1980s to 3 per cent in 2014 (see **Figure 4.1**). Inflation was unstable and mostly too high for the first dozen years after independence, but has stabilised since then at below the Reserve Bank's upper target of four per cent, since the early 1990s (World Bank, 2017). Vanuatu's balance of payments has been negative each year since 1982, with the exception of four years (World Bank, 2017). Vanuatu's Reserve Bank monetary policy sets interest rates based on a range of international and domestic economic factors (Reserve Bank of Vanuatu, 2017). Development statistics related to unemployment, income and wages growth are not available in significant volumes to interpret. The contribution to GDP from the services, industry and agriculture sectors has remained almost static for the past 25 years, at 60 per cent, 10 per cent and 25 per cent respectively (VNSO, 2011). It is worth noting that the economy transitioned from an export economy to a service economy in the post-independence decade. While the values, extent and reasons for macroeconomic fluctuation contrasts across PICs, the instability seen in Vanuatu is commonplace (World Bank, 2017).

[7] The UK's aid budget to Vanuatu was absorbed into the European Union and European Investment Bank in 1995

Figure 4.1 Vanuatu's GDP – annual growth rate



Source – GDP growth (annual %) (World Bank, 2017)

Post-independence politics was initially segregated along Anglophone-Francophone lines and the pre-independence political polarisation was carried over into the proportionally representative party system of government (Woodward, 2014). This binary arrangement was ruptured in 1991, when the ruling *Vanu'aku Pati* (Anglophone) fractured, resulting in no one party being able to govern in their own right (van Trease (Ed), 1995). A series of unstable governments followed. According to some observers, this splintering was inevitable, as it revealed the strong, individual island identity consciousness and its religious denominationality (van Trease (Ed), 1995; Woodward, 2014:85). There are other examples of fractious politics in the Pacific, notably in Fiji and Solomon Islands, which have at times led to armed conflict. While Vanuatu never descended into violence, the decades-long political volatility has affected decision-making priorities, reduced resilience to disasters and increased the reliance on default aid quick fixes, and all this has stalled the country's overall development (Johnson, 2014).

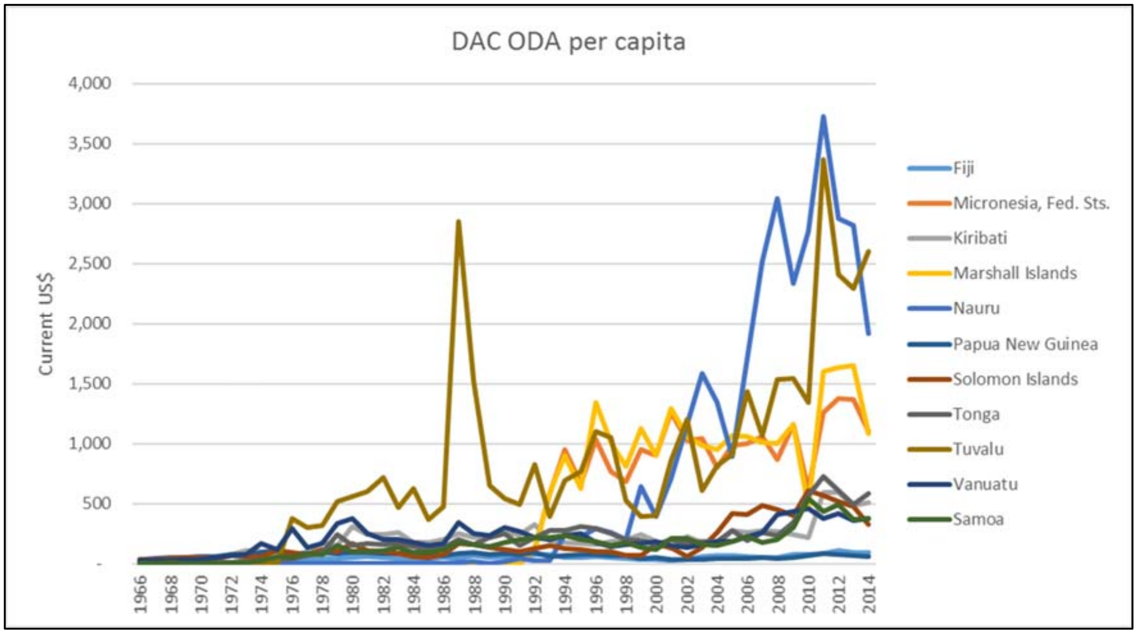
Post-colonial reliance on development assistance

Government performance on aid planning is poor. The national planning document has been updated and reviewed less than every five years since independence. The latest iteration, *Vanuatu 2030* was launched in 2016 with another 15-year vision. The vision is admirable and appears to be primarily built on public consultations. It is strong on a posture of victimhood for two reasons – to offer a ready-made rationale for donor ODA and to erect plausible defences as to why its aspirations for stable, sustainable, prosperous, integrated, holistic, inclusive development will not be achieved. Yet, it is devoid of rigorous analysis that would define problems and guide policy formulation. Perhaps as a result of trying to represent many divergent views, it lacks an underlying, coherent rationale or plan to tackle the inevitable difficulties its implementation will face. At the behest of donors, and to enable them to align with national planning priorities, every PIC has one of these documents, often produced with donor-funded technical assistance.

The original post-independence reasoning for Vanuatu's apparent need for donors was based on the Keynesian economic argument that ODA fills the savings gap, the trade gap and the fiscal gap with investments that will generate future savings and substitute for imports, thereby creating a supply-side economic structure (National Planning Office, 1981, Chenery and Strout, 1966; Peet and Hartwick, 2015). Echoing the Marshall Plan, the first 15 years of development planning was titled the "Transition and Reconstruction Phase" (National Planning Office, 1981:11). In view of the fact that development economics by then had given way to neoliberalism, it is surprising that such an approach was adopted at that time. Typical of the PICs, spikes occurred in bilateral ODA from the colonial powers-come-donors, around the time of the country's independence period. Over time, these gave way to increased multilateral aid – up from 3.0 per cent of all DAC ODA in the decade pre-independence, to average almost 25 per cent in the decade to 2000 and peaking several times at over 50 per cent (World Bank, 2017). These trends follow a pattern consistent with the donor's strategic withdrawal from responsibilities, indicated primarily by the move to decolonisation itself. Vanuatu's decision to accept ODA to fund the projected expenditure on "basic needs" and "social infrastructure" was justified on the basis of "politically expedient" stabilisation and the "rapid build-up of the nation's economic base" (National Planning Office, 1981:11).

However, the plan also included unrealistic assumptions such as government wage and hiring freezes, increasing public service efficiencies, long-term expectations of introducing an income tax (which still has not been imposed) and optimism for growth in the industrial sector (National Planning Office, 1981). As these expectations unravelled, the real cost of expenditure growth exceeded inflation, and led to the enduring 'need' for ODA. Vanuatu's experience of enduring ODA is shown as a subset of PIC trends in **Figure 4.2**. In the 1966-1985 period, ODA was delivered to PICs at an average per capita rate of less than US$ 100 (current US$), compared to almost US$ 500 (current US$), for the 1986-2005 period, a trend which has continued (**Figure 4.2**). By 2014, per capita DAC ODA to PICs had reached US$ 846 (current US$, World Bank, 2017). The proportion of multilateral ODA to Vanuatu has been considerably tempered by the ascendency of Australia's bilateral ODA contributions since 2002; it is down to an average of 4.5 per cent of DAC ODA for the decade to 2014. The rising trajectory and bilateral domination of ODA volumes exhibits at-risk characteristics for Vanuatu, for high aid intensity (dependence) and saturation.

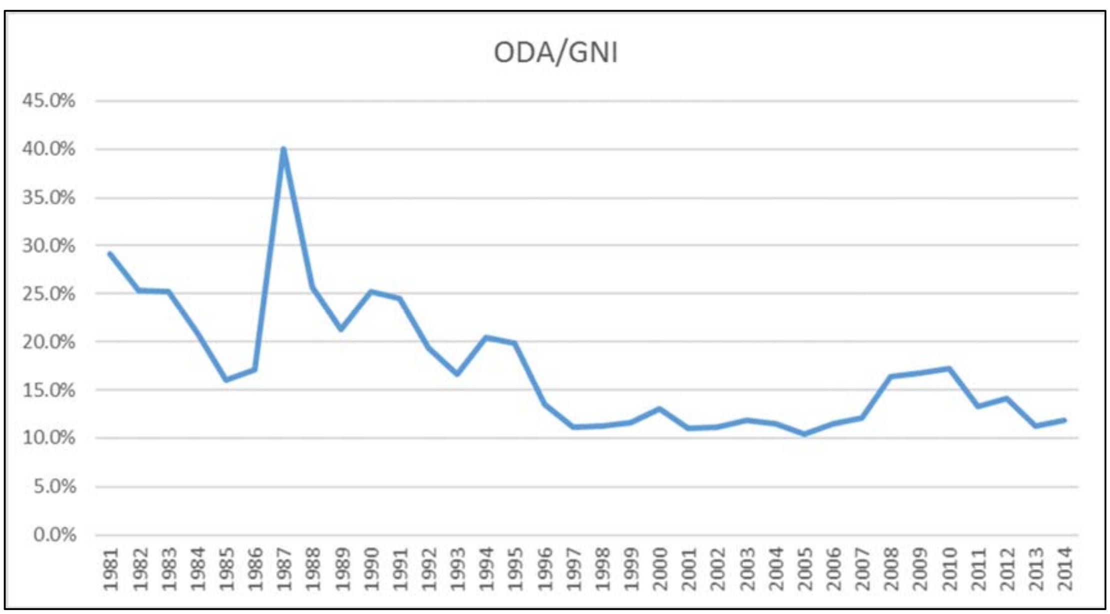
Figure 4.2 Per capita DAC ODA to PICs (1966-2014)



Source – (Net bilateral aid flows from DAC donors, Total (current US$)) / (Population, total) (World Bank, 2017). Excludes Palau, as its volatility obscures other results

With the exception of Fiji and Papua New Guinea, the PICs are on a persistently fixed trend of aid dependence (World Bank, 2017). World Bank data shows Vanuatu's aid intensity (the proxy for aid dependence) trending downward from a spike of 40 per cent in 1987, to 11.9 per cent in 2014. While the trend is encouraging, it still identifies Vanuatu as aid dependent by Bräutigam's (2000) measure – above 10 per cent for more than a decade. This is trend is very similar for Tonga and Kiribati.

Figure 4.3 Vanuatu's aid intensity



Source – (Net bilateral aid flows from DAC donors, Total (current US$)) / (Population, total) (World Bank, 2017)

However, while Vanuatu's aid dependence has been trending downward, another development can be inferred from the data – aid intensity had dropped to just over 10 per cent by 1997, but has plateaued at that level (with a short-term increase to 16-17 per cent from 2008-2010, most likely due to the global financial crisis). This plateau shows that as GNI has increased steadily, from US$ 100 million in 1981 to US$ 819 million in 2014, so has ODA funding (both in current US$; World Bank, 2017). This inability of GNI growth to continue to outpace ODA growth, is reflected in other indicators. Consider ODA as a proportion of government expenditure. In 1981, budgetary aid was 40 per cent of the budget. Over the 1981-2014 period, this figure more than halved, but remains at 13.5 per cent of the total budget, typical across the last three years (Reserve Bank of Vanuatu, 2016:17), showing that its decline has slowed. It is spent on a combination of technical assistance, goods and services and projects. Recent Quarterly Economic Reviews reveal routine reference to donor grants as "revenue" (Reserve Bank of Vanuatu, 2016:16; cf. Hughes, 2003).

Next, consider ODA per capita. As Vanuatu's population more than doubled from 118,000 in 1981 to almost 260,000 in 2014, aid effectiveness (using ODA per capita) increased from 248 to 377,[8] with a low of 137 achieved in 2002, the lowest since 1973 (World Bank, 2017). Lastly, Collier's (1999) definition of aid saturation (ODA/GDP) shows Vanuatu again trending downwards from 29.8 per cent in 1981, to 10 per cent in 1997, where it has also plateaued (12.0 per cent in 2014). This suggests that there are structural issues within Vanuatu's economy that are preventing the conversion of ODA into income-producing assets – specifically, the limited capacity and integrity of institutions, productivity factors and the lack of any surplus human and financial capacity to absorb economic shocks. Therefore, the proportional volume of ODA increases. The reasons why such structural issues are not being eased by policy are complex and include optimistic evaluations of fiscal capacity to repay loans, physical and non-physical constraints on productivity including infrastructure capacity, governance, cultural norms and social issues. This combination of factors results in stagnation of growth rates, disproportionate increases in ODA or both.

Aid dependence and donor interests

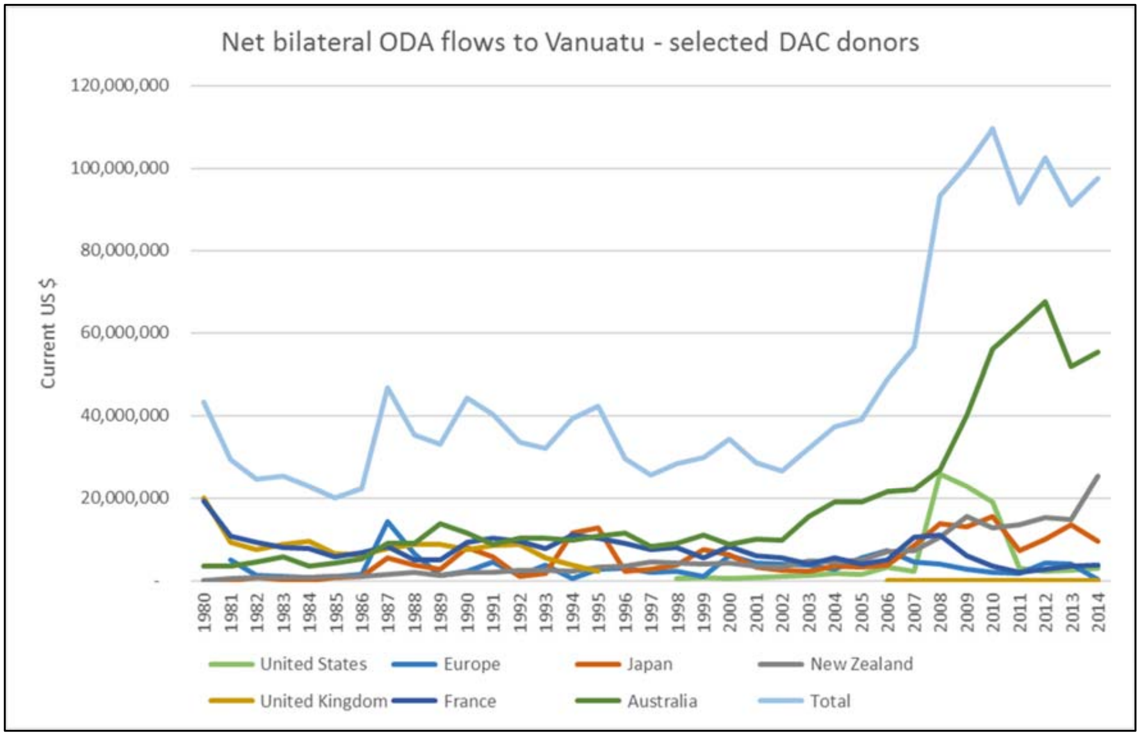
The question then is whether these ODA trends are more reflective of recipient need or donor interests. Vanuatu's 'needs' are described in general in Chapter 3 on vulnerability. Vanuatu experiences regular humanitarian crises, brought about during natural disasters. In 2017 thus far, the country experienced the effects of two categorised tropical cyclones, one severe rainfall event, numerous small earthquakes and the temporary relocation of all 11,000 people from the island of Ambae in response to a heightened likelihood of the volcanic eruption of Mt. Manaro; the largest evacuation of its type in the nation's history (McGarry, 2017). Vanuatu's economy is slowly recovering from negative GDP growth following Cyclone Pam (Reserve Bank of Vanuatu, 2016) and GNI per capita is just below the PIC average (World Bank, 2017). Health indicators are median for PICs and primary school enrolment is very

[8] 2014 figure

strong, driven by MDG grant-enabled fee-free education (Regional Commissions, 2013; World Bank, 2017). Poverty is viewed as hardship and lack of opportunity and progress on changing this during the MDG period remained constrained by low economic growth, rising prices and a lack of job opportunities (Regional Commissions, 2013). Therefore, despite Vanuatu showing some level of developmental progress as revealed by rising per capita incomes and human development achievements, absolute and proportional ODA receipts have continued to climb appreciably (Gani, 2006).

Historically, French, British, US and Japanese contributions of ODA to the Pacific were significant, including to Vanuatu. Post World War II, the US had become a significant donor to the Pacific, to support its nuclear testing and naval dominance, and as a result of the perceived threats to US interests from the Cold War and disintegrating European empires (Grant and Nijman, 1997). In the period after independence, Vanuatu's former colonial powers provided large components of the ODA bursary to Vanuatu, reflecting a retained but declining responsibility for the stability of the fledgling nation. Other large ODA contributors were the so-called 'metropolitan powers', Australia and New Zealand (O'Keefe, 2015). Globally, Australia would be ranked as a middle power. However, in the context of the Pacific Islands, both Australia and New Zealand have demonstrated ability to project foreign policy through military, trade and aid influence, as a proxy for US interests (Hawksley, 2009; O'Keefe, 2015). Together with Japan, they have provided almost 68 per cent of Vanuatu's ODA since 1980 (O'Keefe, 2015; World Bank, 2017). As early as 1988, Australia was the leading donor to Vanuatu and has now contributed more than twice as much as any other donor (**Figure 4.4**). Non-DAC countries have provided only 0.09 per cent of ODA to Vanuatu since 1980 (World Bank, 2017). The donor interests in the Pacific are clear – PICs hold a geographically strategic global position, possess useful resources and present as potential political allies. Donors recognise the weakness, vulnerability and general openness of PICs as an opportunity to suitably organise them in the pursuit of their own political and security, investment and trade interests.

Figure 4.4 Net bilateral ODA to Vanuatu, by donor (1980-2014)



Source – Net bilateral aid flows from DAC donors, country (current US$) (World Bank, 2017)

Australian ODA to Vanuatu

The prominent turning point in the trend lines in **Figure 4-4**, is the rapid and sustained rise of Australia's ODA funding to Vanuatu from about 2002. Up to that point, Australia's disbursement was indistinguishable from the other key donors. What happened in 2002 to drive it up so suddenly and significantly? A survey of economic, social and humanitarian recipient needs reveals no particular crisis to which ODA would traditionally be applied.

Vanuatu's GDP growth in 2002 was in a two-year negative slump, but that was not particularly unusual, as part of the volatile, cyclical trends, and certainly not cause for concern for Australia's policy makers. There were tropical cyclones of average frequency and strength (seven category 4 or 5 cyclones from 2000-2017; Bureau of Meteorology, 2017) and one 5.7 magnitude earthquake in 2009, which caused 10 deaths. But there appears to be no particularly acute or extended humanitarian crisis or disaster in Vanuatu which would have initiated a sustained ODA escalation. Another possible explanation is the funding requirements for achieving the MDGs. The MDG's commenced in 2000, with the human need in Vanuatu presenting notable challenges to achieving them. Globally, the UNDP estimated that between US$ 40 billion and US$ 70 billion per annum would be needed to reach the 15 year targets, not accounting for the retarding effects of aid saturation – figures which represented considerable recipient need (Devarajan *et al*, 2002). Vanuatu proved receptive to MDG funding, including the injection of approximately US$ 63 million between 2008-2010 from the

US under the Millennium Challenge Account (QCPP, 2011) and overall, Australia contributed over US$ 485 million during the 15 year MDG period (World Bank 2017). The funding enabled useful infrastructure, improved outcomes for health and education and the service industry, particularly tourism. In part, the ODA increases can simply be attributed to MDG8.C, which asks developed countries to provide more financing to enable the achievement of these goals, particularly to small island countries. Yet, despite this injection of funding, Vanuatu's performance against the MDGs was mixed. Vanuatu's government attributed this to population growth outstripping employment growth, malnutrition and a lack of awareness leading to the onset of non-communicable diseases (Kilman, 2014). Some sector indicators were improved upon but overall, if achieving the MDGs was the purpose of Australian ODA, its success was subdued (Regional Commissions, 2013).

Vanuatu's economic vulnerability and human needs did not change significantly into the new millennium. But Australia's ODA response was in part due to the greater awareness and obligation conveyed through the MDG apparatus and the Paris Declaration (Commonwealth of Australia, 2011). However, if this was the sole explanation for Australia's exponential increase in ODA to Vanuatu, why then wasn't there a corresponding rise in the spending of other DAC nations, who had also subscribed to the MDGs and Paris? Was the Australian spending anomaly due to noble and sophisticated donor co-ordination, to prioritise the sources of ODA in pursuit of the MDGs? Was it as a result of selective rejection by Vanuatu of non-Australian ODA, driven by concerns of aid saturation? Considering the turbulent Australian national and international affairs of 2001-2003, the most plausible explanation is that Australia increased their ODA to Vanuatu to secure their own national interests.

In August 2001, refugee arrivals to Australia by boat became politicised, spawning the so-called 'Pacific solution', which didn't directly involve Vanuatu, but was not generally well received in the Pacific (Beeson, 2002). As this crisis was still unfolding, the September 11th terrorist attacks on the United States occurred, triggering the ANZUS treaty and delivering a shock to the international world order (Beeson, 2002; Downer, 2002). In 2002, Australian tourists were the target of overseas bombing incidents. Then, against the backdrop of the military intervention in East Timor in 1999 (INTER-FET), Australia was again called upon to lead a regional peacekeeping mission (RAMSI) to the Solomon Islands in 2003. Owing to this series of events, Australia secured the political will to spend heavily and engage in the Asia-Pacific region, to unashamedly, in the words of the Foreign Minister, "ensure that Australia's national interest is advanced in an ambitious yet pragmatic and clear-minded fashion" (Downer, 2002). As a result, spending on military, intelligence, law enforcement, counter-terrorism, customs, economic development, 'secure borders' and focused interests (e.g., biosecurity and preventing illegal flows of people, drug, arms) increased. As sponsorship for this quest, ODA spending to PICs also increased from US$ 225 million in 2001 to US$ 769 million in 2014, peaking at just over US$ 1 billion in 2012 (World Bank, 2017). This included portions of the large expenditure on RAMSI (Solomon

Islands) and refugee facilities (Papua New Guinea), as well as the range of labour mobility programs, tourism development, 'aid for trade' and from 2013, the transposing of ODA spending from Africa to PICs. Vanuatu was one of beneficiaries of the ODA expansion, including reparation of bilateral relations that were damaged by the patently self-serving 'Pacific Solution' (Beeson, 2002).

While these salient events help explain the exponential increase of Australian ODA to PICs, Australia's propensity to deal self-confidently with PICs can be seen in the broader sweep of their bilateral relations. As Pacific observers pointed out as early as 1986, the sovereignty of newly independent countries was being "compromised by the imperatives and meddling of the former colonial powers" (Gardner and Waters, 2013). The example at that time was the deployment of the 'good governance agenda' as part of the bilateral relationships with several Melanesian countries. From 1998 to 2001, Australian spending on governance programs doubled to AUD 291 million (Downer, 2002). This focus has continued, with the Australian Government's 'Governance for Growth' (GfG) program in Vanuatu as another iteration, lasting 10 years. The program was reviewed upon completion in 2017, claiming it as "a powerful example of the importance of brokering relationships", supporting government to implement a number of "important reforms" in economic governance and public financial management, by working politically rather than superficially, as critiqued in the past (Hadley and Tilley, 2017). The report comments on the fact that "perceptions of Australian support among some partners have changed [since AusAID/DFAT reform in 2013], as the rhetoric about aid as a tool of diplomacy and Australia's national interest has become more explicit", though the GfG team were able to circumvent this by being co-located in the Prime Minister's Office, rather than at the Australian High Commission in Port Vila (Hadley and Tilley, 2017). The GfG was designed as a value-for-money approach to increase bilateral trust, thereby increasing leverage to encourage reforms, i.e., obtaining the dividend with the least investment. Specific reforms targeted were increased pressure against corruption, as well as the regulation of Vanuatu's financial system, to greatly reduce the likelihood of it being used as a 'tax haven' for terrorism funding ('Sweeping anti-tax haven bill Introduced in Senate', 2007).

However, while programs such as the GfG wheel away in the corridors of power, it is important to recognise the political capital that donor politicians extract from foreign aid programs. They use them to demonstrate their international citizenry and fulfil their delegated moral responsibilities to their own domestic audience by offering bilateral ODA for a multiplicity of physical and social infrastructure (Downer, 2002). These projects absorb the bulk ODA expenditure, through capital expenditure and technical assistance (Commonwealth of Australia, 2011). This might at least partially explain the attention paid by donors to multilateral initiatives, programs and frameworks such as the MDGs, SIDS and more recently, climate change and disaster risk management, as these provide new and useful avenues for a variety of program opportunities. As seen with Vanuatu's MDG results, the outcomes of the programs are less important to donors than achieving their strategic objectives, regardless of the “rhetorical camouflage” employed to justify them (Meizels and Nissanke, 1984; Premdas and Howard, 1985). Indeed, politicians of both donors and recipient countries need something tangible to demonstrate the value of the bilateral relationship to audiences at home (Hughes, 2003).

Vanuatu’s interests in the ODA system

It is tempting to portray Vanuatu as the victim of colonialism and multiple vulnerabilities, doing their best to provide for their people in the midst of the live crossfire of a geopolitical struggle between great powers. However, Vanuatu is implicated in encouraging the increases in ODA to their country over the past 15 years. Firstly, domestic politics generates some of the demand for programs and projects, as politicians attempt to demonstrate their diplomatic skills to their domestic audience by extracting a well-received grant-funded hospital, bridge, skills program or emergency relief from donors. Secondly, Vanuatu’s purpose in the bilateral relationship must also be considered. As a recipient aware of their needs, Vanuatu’s politicians exercise agency in order to secure and attempt to direct ODA toward national priorities, such as those expounded in *Vanuatu 2030*. Early on in the post-independence period, Vanuatu demonstrated a desire for independent foreign policy, opening diplomatic relations with Cuba before having done so with the United States (Premdas and Howard, 1985). They continue to show some of this spirit by internationally championing the cause of West Papuan independence, citing human rights violations, much to the chagrin of Indonesia (and therefore, no doubt, Australia) (Cullwick, 2017). Yet it is important to recognise that their agency is profoundly constrained and their actions generally calculated to optimise income and shelter from great powers. What is also clear is that bilateral and multilateral donors’ ODA allocations are not directly proportional to Vanuatu’s national interest, vulnerability or needs. The trends in ODA to Vanuatu are best explained by discernment of donor’s strategic interests, and those of Australia in particular (Grant and Nijman, 1997; Burnside and Dollar, 2000). The more recent levelling off of Australia’s ODA bursary to Vanuatu since 2013 reflects two changes. Firstly, the coming to power of a neoconservative government, who, in the name of efficiency, restructured AusAID into DFAT and reset bilateral ODA levels. Secondly, it reflects a maturing of the relationship, where both Australia and Vanuatu appreciate the levels of ODA required in order to secure common interests, without jeopardising the sustainability of those interests (O’Keefe, 2015).

Part of Vanuatu’s survival strategy therefore, which is traditional for small states, is to take advantage of the great powers’ use of small states as buffers between themselves and the great powers (Wivel, 2016). They can do this by adopting either of two strategic options: hiding or sheltering. ‘Hiding’ is essentially opting out of international relations and military engagements in order to reduce perceived threats and hence, one’s vulnerability (Wivel, 2016). Vanuatu has in the past adopted strategies that would amount to ‘hiding,’ by conscious policy objection and the pursuit of economic self-sufficiency. In the post-colonial environment, the space afforded them by the metropolitan powers to practise this non-alignment, was checked through preserved colonial structures (O'Keefe, 2015; Premdas and Howard, 1985). A sheltering strategy is more relevant to Vanuatu's current context. Sheltering is to seek military and/or economic protection from one of the great powers by either adapting to the policies of a threatening power, or by joining an opposing bilateral or multilateral alliance (Wivel, 2016:98). In Vanuatu's case, Australia and New Zealand (and to a much lesser extent, France) are regional metropolitan power proxies for the US, with long-term, meaningful, favourable relations with Vanuatu. Vanuatu has allowed them to use targeted ODA and other foreign policy instruments as a "broader framework of strategic denial of [access to] the region to other great and middle powers" (Hawksley, 2009). The other great power in the Pacific region is the People's Republic of China. China's attraction to Vanuatu has been firm and fast. What started as a part of a regional competition with Taiwan for diplomatic recognition by means of 'chequebook diplomacy' (which reached equilibrium under a tacit truce in 2008), China's key entry point to Vanuatu was building the Secretariat for the Melanesian Spearhead Group in Port Vila in 2007 (Hameiri, 2015; Hawksley, 2009). Chinese businesses are now dominating aid-funded infrastructure construction in Vanuatu, not to mention the proliferation of the now-ubiquitous Chinese 'junk shops'. Vanuatu's capacity to orchestrate this contention between great powers to its own advantage is not well-developed, but the reality of the contest is a complimentary explanation of the prolonged expansion of Australian ODA to Vanuatu over the past decade or more (Wivel, 2016; Hawksley, 2009).

Thus, China's aid program, as an instrument of foreign policy, is worthy of special consideration. Although Chinese aid can be traced back to 1950, since 2000, China has become a significant donor to PICs. The Chinese Government released a White Paper on foreign aid in 2011, which outlined the scale and direction of Chinese economic cooperation and development assistance (Brant, 2013). However, the scale of China's actual aid expenditure (using the OECD-DAC definition) is still not well known (Kitano and Harada, 2014; Hameiri, 2015; Brant, 2013). Disentangling Chinese aid from investment and trade can be difficult and "most of what is on offer is not official development assistance, as this is defined by the traditional donors" (Hameiri, 2015:638; Bräutigam, 2009:165). It is this opacity of China's aid program and the frequent (and at times overt) involvement of Chinese government officials in securing resource deals, that fuels a perception of undue influence (Brant 2013). This view is contested, as some see the increase in Chinese aid to the Pacific being driven more by the commercial interests of Chinese companies and State Owned Enterprises, than by resource security (Hameiri, 2015). Brant cites as evidence, a fairly even distribution of grants and zero-interest loans across resource and non-resource rich countries (Brant, 2013). She notes in particular that for the South Pacific, the resource deals are not explicitly aid- related, but also that China's interest in the region is not adequately explained by resource interests alone (i.e., economics). Brant recognises that the West's dominant narrative in objecting to Chinese aid alludes to resource exploitation. Yet in reality, the objection is directed at the displacement of Western interests (Brant, 2013:166). The no-interference Chinese approach to governance, democracy and systems of recipient countries is an attractive aspect of their packages for recipients and a direct challenge to the traditional appeal of DAC ODA (Brant, 2013; Kaikai, 2015): “Traditional donors are concerned that their influence in the region is diminishing in the face of a new, generous competitor” (Brant, 2015).

This concern is not without basis, as there is a recent example of power transitions within the Pacific. Beyond the attractions of easier up-front money for recipient countries, China has shown itself to be opportunistic in acquiring influence. Fiji’s “Look North” policy began in the early 2000s, as a way of disrupting the *status quo* to get a better deal for Fiji in diplomatic partnerships and modes of cooperation. Following Fiji’s coup in 2006, Australia and New Zealand imposed a range of sanctions. With China already firming as Fiji’s new partner, the too-rigid, long-term sanctions amounted to a diplomatic overreach by Australia and resulted in Fiji forging a new regional architecture, one which is insulated from Australian and New Zealand interests (O’Keefe, 2015). Eclipsing Australia, China was the largest donor to Fiji over the past decade (O’Keefe, 2015). Australia’s recent responses to Chinese activities elsewhere in the PICs, including Vanuatu, have manifested some understanding from the Fijian rebuff. The sustained expansion of Australia’s ODA to Vanuatu over the past decade is part of this strategy of being a reliable, helpful and indispensable development partner (O’Keefe, 2015).

Besides programmatic outcomes, the interpretive result of the expansion of Australian ODA has been a prolonging of Vanuatu’s aid dependence – it has now been held at just over 10 per cent for 20 years. It is doubtful that economic rationales or the effect of ODA within the economy or on aid dependence were considered by Australia (or China), as the ODA escalation was planned. Indeed, Vanuatu’s continued aid dependence provides essential leverage for Australia in their bilateral relationship. Australia also provides the majority of Vanuatu’s tourists (70-75 per cent) and FDI (Net Balance Management Group, 2014; DFAT, 2015). The value of the ODA itself in addressing its stated intentions is questionable. ODA, and notably Australian aid to the Pacific, has been found to be generally ineffective, especially as it is channelled through multilaterals, as well as being fragmented and lacking direction (Hughes, 2003; Duncan, 2008; Commonwealth of Australia, 2011). Since the Paris Declaration (2005), there has been no discernible improvement in aid effectiveness to Vanuatu. ODA per capita, (i.e., aid effectiveness), was promisingly and consistently trending down until 2002, when it was reversed by Australia’s ODA upsurge. Despite much ODA, provided in the name of meeting targets, reducing poverty and increasing resilience, Vanuatu remains deeply vulnerable to the effects of natural disasters. When Severe Tropical Cyclone Pam struck Vanuatu on 13 March 2015,[9] the ensuing

[9] Severe Tropical Cyclone Pam was a category 5 storm. Passing just east of the island of Efate, the ensuing impact from extreme winds and rainfall resulted in damage to infrastructure including roads, bridges, housing, telecommunications, and sewerage and water supply systems. This disaster caused Vanuatu’s Gross Domestic Product (GDP) growth to contract to 0.9 per cent in 2015, down from 2.3 per cent in 2014. TC Pam had a notable

damage resulted in 11 lives lost, 17,000 houses destroyed, 65,000 people displaced, widespread crop destruction and estimated economic losses of US$ 450 million (Esler, 2015). Aid dependence and ineffectiveness is not unique to DAC ODA. As Brant points out, “recipients of China’s largesse are beginning to worry about their growing indebtedness to Beijing” (Brant, 2015); also signalling an ever-changing landscape for ODA as a device of foreign policy and interests.

Conclusion

In summary, Vanuatu’s experience of ODA is a part of broader regional and global machinations. Vanuatu’s fractious politics are unique, as is the popularity of their cruise ship tourism. However, in most aspects, Vanuatu is similar to other PICs, most notably in Papua New Guinea, Solomon Islands and Fiji, who underwent decolonisation without significant rupture, observing the handing of the regional leadership baton to Australia and New Zealand (Hawksley, 2009; Gardner and Waters, 2013). In this sense, PICs’ dependence was simply transferred from colonial funding to the ODA of metropolitan powers. Fiji and Papua New Guinea have emerged from post-colonial tutelage to some extent, owing to higher GDP growth rates. But all PICs experienced the progressive surge of ODA from Australia from 2002, which accompanied an intensification of diplomacy, aimed at securing Australia’s interests. The essential purpose of ODA is to secure those interests with an “integrated set of foreign, trade, security and development policies”, yet it is presented in the ‘rhetorical camouflage’ of “economic growth, stability and poverty reduction” (DFAT, 2015). Threats to these interests include terrorism, fears of civil instability creating a vacuum for migration, narcotics, arms, radicalisation and the Chinese challenge to regional leadership. It follows therefore that ODA will continue to be deployed as long as it remains a useful tool of foreign policy. Even if Vanuatu’s macroeconomic strength or social and basic needs improved, it is likely that new camouflage will be found. Given Vanuatu’s vulnerabilities to climate change, disasters and economic shocks and the range of other scaffolding available (aid effectiveness, LDC status, etc.), this will not be difficult and Vanuatu’s status as a ‘beneficiary’ of ODA will likely continue to deliver the net result of an entrenchment of aid dependence.

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effect on tourism, with immediate and future bookings affected for up to 12 months (data.worldbank.org). “Vanuatu is expected to incur, on average, 48 million USD per year in losses due to earthquakes and tropical cyclones. In the next 50 years, Vanuatu has a 50% chance of experiencing a loss exceeding 330 million USD and casualties larger than 725 people, and a 10% chance of experiencing a loss exceeding 540 million USD and casualties larger than 2,150 people” (SOPAC, 2011).

Chapter 5 – Are there alternatives?

The economic conditions which traditionally justified ODA to Vanuatu are still present – the fiscal gap and the savings gap. The structural vulnerabilities in the economy, including heavy ODA input, overpower the healthy growth in GNI, thereby prolonging aid dependence. Against social dimensions, while progress was certainly made against many of these during the MDG era, poverty stubbornly persists. And while ever Vanuatu allows donor's interests to be accommodated, ODA to Vanuatu is inevitable and indefinite. Considering these realities in connection with the vast expansion of ODA to Vanuatu over the past 15 years, in what sense can it exercise its independence? If aid dependence, vulnerability constraints and the strategic interests of great powers are so durable, the question for Vanuatu is whether they want their position to remain or whether there are any practical and realistic alternatives. The objective would be to reduce dependence on ODA, which will in turn reduce the leverage that donors can apply to Vanuatu with the offer of said ODA, thereby increasing their agency and autonomy. The possible strategies to reduce aid dependence are divided into economic and political strategies, or more broadly, transactional and relational strategies, where the former creates the environment for the latter. That enquiry occupies the remainder of this thesis.

In order for Vanuatu to reduce reliance on ODA to fulfil government expenditure obligations, government either needs to reduce its disbursements or increase its revenue. Reduction of government expenditure is unlikely, for a range of practical reasons including an existing low base for government services and the political costs. But some short and long-term possibilities to increase income do exist. The first economic strategy focusses on growing the economy to increase government revenues through the value added tax (VAT) on consumption (there is no income or company tax), and to divest some future expansion of expenditures into a more affluent populace. PICs have a comparative advantage in the resource, tourism and agriculture sectors, but not in manufacturing and services (Chen *et al*, 2014). Strategies to enhance all three advantageous sectors to drive economic growth could be employed, including improving infrastructure and tourism infrastructure in particular and well as encouraging private sector investment and FDI (ABD, 2016). Work is underway on several such initiatives in Vanuatu (all donor funded), such as new passenger and container terminals in Port Vila, a new container wharf in Santo, Port Vila's urban road and drainage project, the recently completed waterfront and seawall development in Port Vila, as well as much rebuilding from Cyclone Pam under the rubric of 'building back better' (ADB, 2015b). The theory behind attracting FDI is that it will create a capital formation effect in the local economy, even if the profits are exported – in fact, if the profits cannot be exported, FDI is unattractive to investors (Sowell, 2015). FDI is also sought after to build national industrial capability and human capital, as growth in manufacturing contributes to exiting aid dependence (ADB, 2016; Hailu and Shiferaw, 2016). Kimura and Todo (2010) use an empirical model to try to link Japanese ODA to downstream increases in FDI, but the link is tenuous; given that it finds that ODA from Japan *alone* has such a "vanguard effect" on FDI. Lensink and White (1998) found that the reasons behind the overall increase in international private capital flows since the mid-1980s was occurring primarily as a result of the attractiveness of a macro policy environment and stability of government – a situation not yet consistently occurring in Vanuatu. Fundamentally, FDI is hindered by the lack of demand for SIDS' remoteness and small populations (McGillivray *et al,* 2008). Greater private sector investment by wealthy locals and long-term expatriates is a more realistic objective for Vanuatu than expansive FDI, especially if this effort was directed by a well-defined industrial policy, which also encouraged exports (Hailu and Shiferaw, 2016).

The second economic strategy for increasing revenue relates to tax policy. Vanuatu's tax revenue is currently provided primarily by VAT and import duties. Unfortunately, this has the effect of incentivising government to increase imports, even if this is in the guise of a trade liberalisation agenda. Vanuatu's advantages as an offshore financial centre were forced to be abandoned, as concerns over terrorism funding through tax havens manifested amongst the US and metropolitan powers ('Sweeping anti-tax haven bill Introduced in Senate', 2007). There has recently been a polarising debate in Vanuatu about the imposition of an income tax, with rationales ranging from unfairness, to its being a Christian duty in a Christian nation, to a rejection of it as neo-colonialism. First presented by the government in 2016, the proposal was reportedly developed by Australian-funded 'technical assistance', with functional support from the Tax Policy Unit of the Australian Department of Finance (Dwyer, 2016). It is facing a tough political journey. Alternatives need to be considered. Rather than taxing labour or capital, substantially increasing land tax on alienated and leased land (not customary land) would offer a non-distortionary revenue stream, which, unlike income or corporate tax, cannot be avoided. While customary land is the great, hidden economic asset of the Pacific, if land tax reform was combined with a long-term policy for privatisation of customary land, this would unlock one of the keys to economic prosperity (Hughes, 2003; Peet and Hartwick, 2015:93; Sowell, 2015; Duncan and Chard, 2002). The emerging land markets for long-term leases of customary land may provide the vehicle (Howes and Soni, 2009).

These transactional methods could help reduce dependence on ODA. Taiwan and Botswana, two previously aid dependent countries, have adopted many such measures – reliance on the private sector as the engine of growth and earning foreign exchange by investing in exports (Bräutigam, 2000). They also developed human capital, including strengthening government institutions and leadership, which are critical for ODA reduction, by gathering the domestic political support for the structural changes to the economy and for managing the donor relationships through transition and beyond (Bräutigam, 2000). Mature leadership skills are the critical element required to generate the political support within domestic and bilateral relationships to initiate and sustain a journey towards reducing aid dependence. Pragmatic approaches must be adopted, incorporating economic, industrial, trade and foreign policy.

To reduce the leverage of ODA, better international positioning could be found by adopting so-called ‘smart state strategies’ (Wivel, 2016). Given their limited resources, Vanuatu must focus on where they are most likely to get an autonomy dividend from their effort. Thus, “Rather than attempting to hide from, or seek shelter from the great powers, ‘smart’ states… tap into great power discourses by providing (part of) a solution to problems defined by the great powers as important and by taking on the role as mediators or norm entrepreneurs providing a benchmark for future developments” (Wivel, 2016:101). This is a trade-off between influence and autonomy. For example, to reduce Australia’s influence and thereby increase Vanuatu’s autonomy, Australian ODA must be reduced. Vanuatu could request this, in return for a calculated partial freeze on targeted aspects of Chinese FDI such as retail and construction. At the same time, they could modify their non-tax haven status to allow multi criteria-tested Chinese and Australian investors to invest in selected sectors, directed by policy, to increase savings, which will then be reinvested in productive ways. At the same time, the subsequent reductions in Australian ODA might placate the Chinese reaction to the targeted FDI freeze. In this way, this smart state strategy posits Vanuatu as both mediators and as provocateurs of economic and fiscal policy.

Conclusion

ODA is a flow of funds from donors to countries with recipient needs, such as the PICs and Vanuatu. The original rationale offered for ODA was from economics. Over time, the specific economic element being addressed, and the pathway to achieve modernisation, changed to suit Keynes, then neoliberalism, neo-structuralism and most recently, retroliberalism. The latter two incorporate components of the social development rationale for ODA. This was born out of dissatisfaction with the econometric focus on development, and gave attention to poverty, basic human needs and the deep societal changes affecting well-being and culture. The political rationale for ODA explains the donor's interests in providing ODA at all and why recipients accept it. Donor's political, security, investment and trade interests, aligned with the recipient's needs (and interests) create the mutually beneficial engine that keeps ODA flowing.

Aid dependency is defined where the proportion of ODA compared to GNI is more than 10 per cent and this lasts for 10 years or more. Often when this occurs, ODA is entrenched as a structural feature of an economy, and ODA is counted as government revenue (Hughes, 2003). The reasons why aid dependence forms and persists were debated within the economics schools. Structuralists saw it as a problem and that long-term ODA was an impediment to growth (Chenery and Strout, 1966). Neoliberals saw it as a necessary stage, but one which was less likely to persist in a good policy environment (Collier, 1999). But the risk for national political economy are that once ODA is established, there are incentives for it to endure, (Bräutigam and Knack, 2004). ODA exists because of politics, despite the negative effects on the economy and the loss of recipient's policy autonomy.

Vulnerability status provides many apparent reasons for ODA. Small island developing states like Vanuatu have structural and policy vulnerabilities which are access points for donors' ODA, such as their small population, remoteness and susceptibility to natural disasters. International frameworks such as the MDGs, and nomenclature such as 'SIDS' and 'LDC', provide necessary focus for ODA. But narrow reliance on bilateral ODA (in particular) exacerbates economic fragility and vulnerability. Despite exposure to natural events, Vanuatu is not inherently or historically vulnerable, but has become so as a result of interacting with the colonial and globalised international system. Within this system, there are limited incentives for Vanuatu to strive for growth, given the concessional lending policies of the multilateral banks. Rising through vulnerability and out of aid dependence is complex.

Vanuatu is at the nexus of this complexity. As a country emerging from a condominium colonial administration, with its legacy of economic, structural and political inefficiencies, Vanuatu was already aid dependent at its point of political independence in 1980. Despite economic volatility and ongoing structural and policy vulnerabilities, Vanuatu was showing positive progress, until the key indicators of aid dependence, efficiency and saturation stopped improving in about 2002. Vanuatu's needs did not radically alter at that time, but ODA surged. This could have been in response to meeting the MDGs. However, as it was only ODA from Australia which multiplied, the most likely explanation is that it was as a result of Australia securing their national and US proxy interests. It occurred in the wake of international terrorism, national refugee policy, regional instability and increasing Chinese engagement. The result of the sustained increase of Australian bilateral ODA was a prolonging of Vanuatu's aid dependence, now held at 10 per cent-plus for 20 years.

International development and the ODA that funds it, are a subset of a larger group of foreign policy issues. Vanuatu is a small country, with limited human capacity, economic engines and agency. Therefore, its autonomy is truncated; leveraged by the great and metropolitan powers to their own ends, using the offer and functions of ODA as a key tool. While ODA purports to deliver great benefits to the people, these are inadvertent and not central to the purposes for which ODA is provided (Meizels and Nissanke, 1984). Vanuatu is a sovereign state and retains a range of policy options which could delineate the pathway through this set of scenarios. As a small state between two great powers (or their proxies), Vanuatu's smart foreign policy move will be to use one of these powers for shelter from the other. While the Chinese are certainly being accommodated by Vanuatu, the leverage created by Australian ODA is leading to Australia being favoured. A proposed 'smart state' strategy to achieve ongoing shelter involves careful consideration of the benefits which Vanuatu affords the great powers and to promote those as a prototype for other bilateral relations in the Pacific. Such a strategy does not alter the international ODA architecture but repositions Vanuatu within it. The unequal power relations between Vanuatu and its donors do not lend themselves to an address of aid dependence on its own. Thus, a posture of usefulness to the great powers in achieving their aims creates an opportunity to exercise a higher level of autonomy for the benefit of Vanuatu.

Simultaneously, to exert greater agency, Vanuatu must reduce incoming ODA by lowering spending or finding alternate income sources. In the short term, these income sources are limited to tax reform and FDI. If allied with prudent economic management and the development of human capital, reduction of aid dependence will solve a range of issues within Vanuatu's economy, but also, more importantly, this will reduce Australia's influence. Implementing this combination of transactional and relational strategies will require Vanuatu to strengthen government institutions and demonstrate the political leadership to firstly transition the domestic electorate through the implications of this strategy; and secondly, to manage the bilateral relationships. A range of economic, industrial, trade and foreign policies must be integrated by an overarching narrative.

The appetite for this course of action to be explored by Vanuatu's policy makers is unclear. Further research into the political economy of Vanuatu, the strength of their political coalitions, business outlook and investment opportunities is required. The role of regionalism and the impact of Fiji's recent 'defection' should also be considered in any broader investigation into the impact of Vanuatu's position in changing the regional order. Understanding the forward foreign policy objectives of China and Australia and their implications for multilateral regional co-operation would give clearer shape to Vanuatu's foreign policy options.

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