Economic Transition in Solomon Islands

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IN BRIEF 2013/16

The Regional Assistance Mission to Solomon Islands (RAMSI) recently completed an important 'transition'. After a decade of post-conflict stabilisation and recovery efforts — during which RAMSI played a key role in peacekeeping, policing, justice and economic management — responsibility for international assistance is being handed to bilateral and multilateral donor agencies delivering regular aid and development support. The Australian Government has been clear that this 'transition' reflects the success of intervention efforts in supporting 'recovery' across several fronts (Coppell 2012, 11). But has Solomon Islands' economy yet 'recovered' from the disruptions of the tensions? And what do recent patterns of growth mean for Solomon Islands' future economic development?

Since 2003, Solomon Islands' per capita ouput has grown at an average rate of 3.6 per cent per annum, compared to 0.6 per cent for other small Pacific Island economies. Recent growth reflects and has supported broader development progress. Security and justice interventions have re-established conditions conducive to basic economic activity, following the pervasive disruption of the tensions. Support to economic governance has allowed macroeconomic stabilisation, including significant reductions of external debt, and impressive improvements in revenue collection to support basic services.

But the extent, durability, and quality of recent growth should not be overstated. Only now, 10 years after the tensions, are per capita incomes returning to pre-conflict levels. Solomon Islands remains the poorest Pacific island country. Growth has been substantially driven by aid and logging. Aid inflows (equal to 38 per cent of GDP on average since 2003) and the accompanying expansion of the public sector have bolstered the Honiara service economy, providing additional employment opportunities, within the public sector and in businesses supplying goods and services to government, public servants, and international officials and consultants (Haque and Greig 2011).[1] Beyond Honiara, logging has proceeded at an unprecedented pace, contributing 16 per cent of GDP in 2012, but does not always translate into improved living standards, given very limited domestic processing, continued weaknesses in taxation arrangements, and associated land conflicts and environmental degradation (Kabutaulaka 2008), and output is highly variable in response to global prices.

The World Bank has highlighted the extent to which Solomon Islands' development trajectory has been and will continue to be shaped by immutable geographic factors. A small, dispersed population precludes the economies of scale and thickness of markets that drive productivity in a globally integrated economy (World Bank 2009; Winters and Martin 2008). Consequently, its economic development is likely to continue to rely on subsistence agriculture and the successful management and exploitation of various rent-generating opportunities, including aid, forestry, mineral resources, and, potentially, tourism (World Bank 2010). The experience of most small island developing states suggests that such reliance in no way precludes sustainable improvements in incomes and living standards (Bertram 2006).

Amid this continuity, however, important changes should be managed. The Honiara-centric nature of public sector-led growth is fuelling accelerated urbanisation. While Solomon Islanders overwhelmingly live in rural areas, the urban population expands by more than five per cent per year, placing pressure on services, infrastructure, and urban employment opportunities. Natural forest stocks are nearing exhaustion and logging output is expected to decline precipitously over coming years. Many expect new mining activities in Choiseul and Isabel to eventually replace the revenue and foreign exchange lost from logging. But the transition to a mining economy is risky and dependent on adequate legislative and regulatory frameworks, strong capacity within government to monitor and regulate mining activities, systems to ensure fair treatment and benefit-sharing with landowners, and sound public finance systems to capture, allocate, and utilise royalty and tax revenues.

Despite recent high rates of growth, the Solomon Islands economy will continue to rely on international assistance for fiscal support and economic management capacity. Recent growth reflects the benefits of such assistance rather than demonstrates its redundancy. Given projected declines in logging over coming years, disappointing returns from the Gold Ridge mine, and long lead-times for any further mining developments, Solomon Islands is ill-placed to withstand significant reductions in donor support if deterioration in basic services and slowed progress towards the achievement of Millenium Development Goals is to be avoided.

Alongside continued capacity support for macro-economic management, revenue collection, and budgeting, the international community should concentrate on pressures and risks that will inevitably accompany resource-based, Honiara-centric development.

Technical support to the mining sector is vital. This should include expert assistance for the establishment of a legal and regulatory regime to protect against environmental damage, safeguard the rights of landowners, and ensure adequate revenue returns. *De jure* measures are unlikely to translate into *de facto* outcomes, however, unless accompanied by ongoing in-line technical assistance in relevant ministries during the negotiation of access and taxation and royalty agreements, and for ongoing compliance and monitoring. Advisors in the Ministry of Finance face an important challenge in developing and building political support for revenue smoothing and management options. Given likely ongoing weaknesses in the Solomon Islands' regulatory regime, options should also be explored for constraining potentially socially and economically destructive actions of mining investors through regulatory controls in mining firms' home countries. Solomon Islands' experience with logging suggests there may be a brief window of opportunity before rent flows generate entrenched vested interests.

The inability of employment growth to keep pace with the expanding youth population presents risks to social cohesion in Honiara. Over the short-term, donors might increase the employment intensity of their expenditure — for example, through increased use of domestic procurement and continued support for workfare schemes. Over the medium-term, Honiara's potential as an economic hub could be harnessed by addressing administrative constraints to land transactions and ensuring reliable connective infrastructure between Honiara and other provincial capitals. Improving basic services outside Honiara can also help prevent the congesting impacts of urbanisation motivated by inadequate rural services.

Solomon Islands' economy, geography, and recent economic development points to a continuing mismatch between the demand for employment and the number of jobs that the domestic economy will be able to generate. Experience across the Pacific demonstrates labour mobility would be the most effective means of increasing productivity and incomes of Solomon Islanders, while delivering benefits to home populations through remittances, economic linkages, and access to education. Improving Solomon Islanders' access to larger nearby labour markets, including Australia and New Zealand, should be a priority given Solomon Islands' low levels of development, demographic challenges, and minimal access to permanent and temporary migration schemes relative to other Pacific Island countries.

Despite recent transitions, economic development in Solomon Islands is likely to remain a shared responsibility of its government and the international community. The sovereignty and moral hazard issues that accompany this reality should be the subject of robust discussion; they cannot be avoided.

Endnote

1 Public sector spending has increased 180 per cent in real terms since 2003, while the number of public servants has increased by 80 per cent.

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We acknowledge the Australian Government's support for the production of *In Brief*.