Policy dialogue

Conflict to crisis in Solomon Islands

Satish Chand

The Australian National University

The Solomon Islands economy contracted by 15 per cent in 2000 and is estimated to have recorded another contraction in 2001. These contractions follow ethnic tensions, much of which had been present for the last decade but escalated into fighting from 1999. This paper presents a simple model to understand the mechanics of the conflict so as to facilitate more effective policy interventions.

Solomon Islands is not only facing a political crisis but also an economic crisis, the effects of which may linger well into the future. In 2000, the economy recorded a contraction in gross domestic product (GDP) of 15 per cent (Hou 2001),[1] a very sharp contraction given that similar declines for five consecutive years could see per capita income halve from the current level of approximately US$712. By developing economy standards, Solomon Islands is not desperately poor. An adult literacy rate of 62 per cent, an infant mortality of 22 for every 1,000 live births, and life expectancy of 71 years are reasonably favourable and reflect a rich resource base—fertile land in particular. While the level of income and other indicators of development do not suggest mass poverty, trends in income and population do not suggest future economic prosperity. Compounding these factors are the recent social problems and the failure of the state to contain the deteriorating law and order problems.

Recent fighting has seriously eroded investor confidence in the economy. Several companies have closed and a number of foreign investors have departed. This has affected production adversely, but the problems of social unrest and have been long-standing. The state and its disciplinary forces were unable to contain, and some would claim exacerbated, the civil unrest. The challenge for the leaders elected in December 2001 is to return the state to normalcy, a difficult task given the extent of damage already done to institutions of civil society. In ensuring that resources are conserved and mistakes minimised, a good understanding of the 'mechanics of the conflict' has to be gained. This article presents a highly stylised model of the source and dynamics of the conflict in Solomon Islands, and puts forward some policy recommendations.

The economic setting

The performance of the economy has been both volatile and poor over the decade commencing 1990. With the exception of 1992, 1994 and 1995, GDP growth had been less than the 3.14 per cent annual growth rate of the population. Even prior to the sharp decline in economic activity following the fighting, per capita GDP had been stagnant for most of the decade. The fighting since

Pacific Economic Bulletin Volume 17 Number 1 May 2002 © Asia Pacific Press

1999 has had a serious impact on investor confidence and on the budget—both of these effects have been largely responsible for the rapid slowdown in economic activity.

Closure of Solomon Islands Plantation Limited (SIPL), the only palm oil producer, saw the decimation of an industry that accounted for nearly 30,000 tons of palm oil produced annually until 1998. Fish production fell sharply from a peak of 49,000 tons in 1998 to less than 21,000 tons by 2000. Logging fell sharply in the aftermath of the East Asian financial crisis of 1998, resulting in sharp falls in exports and government revenues.

But by far the largest impact of the recent crisis has been on the financial sector. First, the country risk premium increased sharply, contributing to high interest rates on borrowing. This increased pressure on the interest rate was further compounded by the need to fund growing budget deficits caused by rising outlays (largely to fund compensation payments to aggrieved groups), coupled with falling revenues. As a consequence, investment fell even more sharply than the decline in production, suggesting that recovery in output will be slow in the short to medium term.

Government debt now accounts for close to a third of the total assets of the domestic financial sector. The inability of the government to service its debt commitments makes domestic financial institutions, including the National Provident Fund, over exposed to this risk, and contrary to experience elsewhere, treasury bills in Solomon Islands constitute a serious financial risk to their holders. In such a climate, cash-flow management by the treasury becomes extremely difficult.

Recently, the objective of the Solomon Islands Treasury has been to ensure sufficient revenues for the payment of salaries of public servants—a necessity to ensure delivery of the most basic public services. Part of the blow-out in the budget has been due to compensation payments to a growing number of claimants. A shortage in budgetary revenues in 2001 has forced the public sector to issue duty remissions as an alternate form of compensation payment.

A grant of SI$30 million by Taiwan, in the first quarter of 2001 provided some respite, but this will by no means alleviate the long-term need for a sustainable source of revenue for the state. As there is no flexibility in the form of raising taxes, production would need to rise.

In a climate of extreme fiscal stress including increasing demands to monetise rising budget deficits, maintaining responsible monetary policy becomes impossible. When restructured bonds fail—as in the case of Solomon Islands following the World Bank sponsored structural adjustment program of 1999—the credibility of the state, and reforms in general, suffer enormously. The Central Bank of Solomon Islands has been preoccupied on a daily basis with protecting foreign reserves and has done so with capital controls, including on current transactions. Transfers from donors and non-government organisations have assisted in the process.

Lending rates as of the first quarter of 2001 of 15.5 per cent with deposit rates at 0.5 per cent imply an interest rate margin of 15 percentage points—high both by international standards and in the context of the severe domestic recession. Two of the major financial institutions, the Development Bank of Solomon Islands and the National Provident Fund, are in severe financial trouble. Their collapse will send further shock waves throughout the economy and adversely affect the confidence of those who hold any monetary assets. It is clear that both the fiscal and the monetary positions of Solomon Islands are being sustained on ‘borrowed time’. Reversing the slide to a crisis is turning out to be an increasingly difficult task for the new administration.

The longer-term challenges of raising production to build the revenue base have been overwhelmed by the urgency to keep the economy stable in the short term. Given that the prevailing situation is not sustainable, it is only a matter of time before an economic crisis is reached. At that point some painful measures will have to be taken. International assistance, particularly from bilateral and multilateral donors, will be necessary but will only defer the impending crisis without also addressing the causes of the current impasse. We turn to one highly stylised representation of the dynamics in Solomon Islands to gain a better grasp of the drivers of the current social and economic paralysis.

A simple model

Some features of Solomon Islands' current situation include increasing law and order problems, rising incidences of disregard for rights to property and personal security, increasing abuse of public office including misappropriation of public funds, and widespread allegations of nepotism in the public service. Investment and output have been spiralling down, social service delivery is suffering, and many of the basic services such as health and education are increasingly relying on donor support for their delivery.

One simple means of capturing these characteristics in a coherent framework is through a model through which we can consider the mechanics driving stability, peace and prosperity, and the feedback between each of these, in an ideal setting. A healthy society has its rules in the form of regulations, norms, customs and traditions, together with structures such as the courts, churches and media—the institutions of society—to ensure a fluid exchange of goods, services and ideas within the community. These institutions in turn provide the ground rules for transformation and exchange, both across commodities and over time. Such exchanges under well understood and observed rules provide the stability and basis for exchange that together drive the process of value-adding and wealth creation. In this ideal environment, the machine that ensures prosperity is kept oiled by the feedback mechanisms where taxes are used to resource and enrich the institutions that constitute the foundations of stability. This machine is self-reinforcing in that prosperity funds peace and stability via better institutions. Unfortunately, this same machine works just as efficiently in reverse.

We now consider the dynamics of the mechanical caricature sketched above. The workings of the prosperous, stable and peaceful society is robust to small perturbations in that the system self repairs after limited damage is done to any component of the system. Once the institutions underscoring the stability of society are damaged beyond its ability to self-repair, the system begins to unravel. For example, blatant and prolonged disregard of social norms such as principles of justice and fair play lead to social instability and consequent erosion of peace; this, in turn, lowers investment and wealth creation. Should those having a 'monopoly on violence', for example via sole access to arms through the disciplinary forces, begin to plunder the wealth of society, the incentives for value-adding quickly dissipate, as does entrepreneurial activity. In such a climate, a low and perhaps subsistence level of output is realised where, with the exception of the monopoly group, society is worse off than otherwise.

It is instructive to ask how such an unravelling process could begin. This would differ between contexts but one possibility, with some anecdotal support from Solomon Islands, is as follows. A genuine grievance seeds the process of revolt that the authorities fail to resolve. An opportunist capitalises on the state's oversight to muster support and widen the grievance, often for personal gain.

It is important to note that the opportunist is motivated principally by greed but has strong incentives to couch this in terms of the grievance of the instigating group. The dynamic takes its own path from here on; the number and seriousness of the grievances multiply with the support base.[2]

It is equally instructive to note that it is not in the interest of the opportunist to see total chaos since this may not allow any resources to be siphoned off. At the other extreme, it is not in the interests of the greedy opportunist to see a return to a healthy, stable, prosperous economy since such an economy would be able to grow and resource institutions that will expose and punish socially unproductive behaviour. The metaphor of the relationship between a parasite and the host serves well in this context since it is in the interest of the parasite to ensure that the host lives but does not become so healthy that it is able to shake the parasite off.

This highly stylised representation provides a coherent framework within which to place features of the Solomon Islands economy in recent times. It would be naïve to assume that the above is a complete characterisation of the mechanics responsible for the observed impasse in Solomon Islands. The model could be enriched by including further elements of reality to better explain the observed regularities. But for the purposes of this discussion, we will assume the model captures the salient features so as to facilitate a discussion of policy interventions.

Policy implications

The first and most obvious policy implication arising from the preceeding discussion is to diffuse the potential for revolt by attending to the original grievance. Only those grievances that are overlooked become the seeds of discontent and revolt; a minor fraction of these may survive and grow into full-blown crises of the order witnessed in the Solomon Islands. Hindsight in this case offers guidance on policy interventions after the opportunity for diffusing the crisis at its birth has been missed.

Second, genuine grievances need to be distinguished from those manufactured for purposes of furthering greed. These distinctions expose any misinformation and allow resolution of the conflict with minimal resources. Given that greed-driven grievances can multiply rapidly, the process of disentanglement could be both difficult and time consuming. Separation of genuine grievances saves resources; but, perhaps more importantly, also diffuses the snowballing process of such conflicts.

Third, a clear understanding of the dynamics of grievance creation has to be in place before policy interventions can be effective in bringing this process to a halt. For example, if the grievances are addressed through payment of compensation without a clear understanding of the process driving the conflict, then such a process could actually reward grievance creation.[3] This risk is particularly large when external parties who want to see a quick resolution volunteer to meet the costs of compensation and, in doing so, raise the stakes for those manufacturing the grievances. To keep the stakes realistic, compensation for grievance, as a general rule, has to be met by the original offenders. This ensures that transfers between groups amounts to a zero-sum game. Such agreed compensation, when arrived at through a competitively negotiated process, guarantees that the price paid for the compensation is commensurate with the magnitude of the infringement.[4]

Following on from the last point, negotiations should be encouraged together with a thorough examination of the sources of the grievance. Insofar as coordination failure prohibits this process, outside intervention may assist by reducing 'transaction costs' of information exchange between the parties in conflict. For example, two warring parties may not be able to negotiate on their own and therefore may require an intermediary to facilitate such a process. The Townsville Peace Accord may have served this purpose, but only to a degree given the time pressures placed on arriving at an agreement.

Detailed research into the source of the Solomon Islands conflict and exposition of the grievance that led to the current conflict is long overdue. The issues raised here provide a beginning and cover some ground on this front. Australia and New Zealand as the two external parties trying to resolve this impasse have a role only in bringing the warring parties to the negotiation table. Extreme caution needs to be exercised in the funding of any compensation claims since such action could exacerbate rather than resolve the current problems. The presence of 'rents', either from aid or natural resources, that often constitute the motive for greed have to be quarantined away from the negotiating process in order to minimise incentives for continued creation of grievances.

Conclusion

This article has considered a simple mechanism via which an initial grievance is taken hold of by opportunists to 'manufacture' further grievances driven by greed. This very simple representation of the greed–grievance dynamics generates several symptoms that closely resemble observed realities of the past four years in Solomon Islands. The downturn in economic activity has been severe and will have consequences for development and economic prosperity. The immediate effect of a contraction in GDP of 15 per cent in 1999 is in all probability overshadowed by the decline in investment as a result of a fall in investor confidence. The departure of foreign investors and rising interest rates, partly due to domestic financing of a growing budget deficit, imply that investment will return slowly even after the political situation stabilises following the election of a democratic government in December 2001. Clearly the downward spiral of the economy cannot continue, hence urgent and extreme action will be necessary soon.

Some of the policy implications arrived at from this analysis include the following. First, a clear distinction has to be made between genuine and manufactured grievances before any remedial action is taken. Second, any compensation paid has to be commensurate with the grievance so as not to provide an incentive for further creation of grievances. Third, donor communities should, in so far as possible, refrain from providing resources for compensation payments since such action has the potential to exacerbate the conflict by rewarding grievance creation.

This article has noted that a conflict arises from a genuine grievance that is overlooked by the authorities initially and taken advantage of and cultivated by opportunists to create further grievances as a means of furthering their own personal agenda. This is the 'greed hypothesis' and one that has support from analysis in the region (Chand 2001). In such a situation, compensation payments for the grievance have the potential to exacerbate rather than resolve the conflict. While attending to a genuine grievance is necessary to resolve the problem, once this fails to happen and for whatever reason, the process gains its own dynamic often driven by considerations around greed. In such a situation, attending to the 'manufactured' grievances will only reward and therefore encourage more conflict. This is particularly true when resources from abroad are used to 'resolve' the crisis. Solomon Islanders and the donor community have much to draw from this simple analysis in the design of policy interventions to bring the current political and economic crisis to a close.

References

Chand, S., 2001. The Fijian coups: outcome of grievance or greed, The Australian National University (unpublished).

Hou, Rick N., 2001. 'An overview of Solomon Islands economy: the effects of the ethnic tensions and policy implications', paper presented at the State, Society and Governance in Melanesia Workshop, The Australian National University, Canberra, 24–26 October.

Notes

1 Current economic statistics on Solomon Islands is both limited and of poor quality, hence care has to be taken in interpreting these figures..

2 It is quite possible for the original grievance to be overshadowed in this process.

3 According to *Pacnews* of 8 November 2001, a demonstration had been staged in Honiara in protest over compensation payments totalling around US$13 million to Malaita Eagle Force members from the US$17 million loan from Taiwan.

4 Third party intervention runs the risk of distorting the price and hence accruing both the static and, more importantly, the dynamic costs.

Acknowledgments

Helpful comments from Ron Duncan and Vivek Suri are gratefully acknowledged with the usual caveat.