Conflict to crisis in recent Solomon Islands

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Abstract
The recent crisis in Solomon Islands is as much political as economic. The economy contracted by 15 percent in 2000 and is estimated to have recorded another contraction in 2001. These contractions follow the ethnic tensions, much of which had been present for the last decade but escalated into fighting since 1999. This paper presents a simple model to better understand the mechanics of the conflict so as to enable design of more effective policy interventions.

Introduction
Solomon Island is not only facing a political crisis but also an economic crisis, the effects of the latter may linger well beyond the resolution of the former following the elections of December 2001. The economy recorded a contraction in gross domestic product (GDP) of 15 percent in 2000 (Hou 2001). This is indeed a very sharp contraction given that similar declines for five consecutive years could see per capita income halve from the current level of approximately $US712. By developing country standards, Solomon Islands is not a desperately poor country. An adult literacy rate of 62 percent, an infant mortality at 22 for every 1,000 live births, and life expectancy of 71 years are reasonably favourable and reflect the rich resource base, the fertile land in particular. While the level of income and other indicators of development do not suggest mass poverty, the trends in income and population do not suggest future economic prosperity. Compounding the above are the recent social problems and the failure of the state to contain the deteriorating law and order problems.

The recent fighting has seriously eroded investor confidence in the economy. Several companies have closed and a number of foreign investors have departed. This no doubt has adversely affected production, but the problems of social unrest have been longstanding. Its eruption into a full-blown crisis took some by surprise, but in hindsight this should not have been the case. Unfortunately, the state and its disciplinary forces were unable to contain, and some would claim exacerbated, the civil unrest. The challenge for the newly elected leaders 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 is the primary objective of the paper. Following the presentation of a highly stylised model of the source and dynamics of the conflict in Solomon Islands, some policy recommendations are made.

The rest of the paper is organised as follows. First the state of the economy is presented to set the scene for subsequent analysis. Second, a highly stylised model of the economy is presented. This static model is then ‘cranked’ to generate the dynamics; many of which reflect the current observed realities in the Solomon Islands. Third,

1 Helpful comments from Ron Duncan and Vivek Suri are gratefully acknowledged with the usual caveat.
2 Current economic statistics on Solomon Islands is both limited and of poor quality, hence care has to be taken in interpreting these figures.
policy choices are presented given the climate of limited resources and limited domestic capacity to take on any major reforms.

The economic settings
The performance of the economy has been both volatile and poor over the decade commencing 1990. With the exception of 1992, 1994, and 1995, the GDP growth had been less than the 3.14 percent 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 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 SIPL, the only palm oil producer, saw the decimation of the palm oil industry that accounted for nearly 30,000 tons of palm oil produced each year until 1998. Fish production fell sharply from a peak of 49,000 tons in 1998 to less than 21,000 tons by 2000. Logging that was undertaken at 2.5 time the sustainable rates in the mid-90s fell sharply in the aftermath of the Asian 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 the high interest rate on borrowing. This increased pressure on the interest rate was further compounded by the need to fund growing budget deficits from rising outlays coupled with falling revenues. The last is the textbook case of the crowding-out of private sector investment by public sector consumption since much of the increased budgetary outlays were to fund compensation pay out to aggrieved-groups. As a consequence, investments fell even more sharply than the decline in production. This suggests that recovery in output will be slow in the short to medium term.

Government debt now accounts for close to a third of 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. Contrary to experiences elsewhere, treasury bills in Solomon Islands constitute a serious financial risk to the holder of this asset. In such a climate, cash-flow management by the treasury becomes a very difficult if not an impossible task. The prime objective of the treasury of late 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 pay-outs to a growing number of claimants. A grant of $SI30 million by Taiwan, ROC, 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. There is no flexibility in the form of raising taxes, hence production would need to rise to achieve the above.

In a climate of extreme fiscal stress including increasing demands to monetise rising budget deficits, maintaining responsible monetary policy becomes impossible. When restructured bonds – as in the case of Solomon Islands following the World Bank sponsored structural adjustment program of 1999 – fail, the credibility of the state and

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3 Shortage of budgetary revenues in 2001 has forced the public sector to issue duty remissions as an alternate form of compensation payment.
that of reforms in general suffer enormously. The Central Bank 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 NGOs have assisted in the
process.

Lending rates as of the first quarter of 2001 of 15.5 percent with deposit rates at 0.5
percent imply an interest rate margin of 15 percentage points, which is 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 so as to grow the revenue base have
been ‘gazumped’ by the urgency to keep the ‘head above water’ for the moment. Given
that the prevailing situation is not sustainable, it is only a matter of time before a crisis
is reached. At that point some painful measures will have to be taken. International
help, and particularly from bilateral and multilateral donors, will be necessary but such
help without due consideration to addressing the causes as against the symptoms of the
current impasse may only defer the impending crisis. 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 of the stylised facts about the recent Solomon Islands 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, albeit, highly stylised means of capturing the above in a coherent
framework is through a model. 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 to ensure fluid exchange of goods,
services, and ideas within the community. Call these the institutions of society. The
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 drives the
process of value-add and wealth creation. In this ideal environment, the machine that
enures 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”, as perhaps 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. It is not hard to imagine that in such a climate, a low and perhaps subsistence level of output is realised where with the exception of the monopoly engaged in the plunder, 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 and that 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 such oversight by the state 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 dynamics takes its own path from here on; the number and seriousness of the grievances multiply with the support base.  

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 interest 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.

The above highly stylised representation provides a coherent framework within which to place the various stylised facts about the recent Solomon Island economy. 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 perhaps most obvious policy implication from the discussion above is to diffuse the potential for revolt by attending to the original grievance. Such action, in all likelihood, takes place with few exceptions. It is only those grievances that are overlooked which become the seeds of discontent and revolt and then only a minor fraction of these survive and grow into full-blown crises of the order witnessed in the Solomon Islands. Hindsight can be a source of much wisdom and in this case offers  

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4 It is quite possible for the original grievance to be overshadowed in this process.
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. The pay-offs from such investments in separating out the grievances and exposing such findings is in the form of resources saved in attending only to the true grievance; but perhaps the major savings is in diffusing the snowballing process of such conflicts; the last is elaborated upon next.

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. This risk is particularly large when external parties who want to see a quick resolution volunteer to foot the bill for compensation. Doing so raises the stakes for those manufacturing the grievances in order to feed their greed. To keep the stakes at the right magnitude, 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 competively negotiated process, guarantees that the price paid for the compensation is commensurate with the magnitude of the infringement.

Following on from the last point, negotiations should be encouraged together with thorough research into the seeding of the grievance. In so far as coordination failure prohibits this process, outside intervention may assist by reducing ‘transaction costs’ of exchanging information between 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 the above purpose, but only to a degree given the time pressures placed on arriving at an agreement.

The above discussion has relevance to the current Solomon Islands situation in that detailed research into the source of the 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. Second, 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 help resolve the current problems. The presence of “rents”, either from aid or natural resources, that

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5 According to Pacnews of 8 November 2001, a demonstration had been staged in Honiara in protest over pay-outs totalling around $US13 to Malatila Eagle Force (MEF) members from the $US17m loan from Taiwan, ROC.

6 Third party intervention runs the risk of distorting the price and hence accruing both the static and more importantly the dynamic costs.
often constitutes 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 paper has considered a simple mechanism via which an initial grievance is taken hold of by opportunists to ‘manufacture’ further grievances that are driven by considerations of 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 percent 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 that are 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.

The thesis of this paper has been 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 has been the greed hypothesis and one that has support from analysis in the region (Chand 2001). In such a situation, compensation pay-out for the grievance has 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