Summary Points

Economic growth in Solomon Islands since the end of civil conflict in 2003 has been driven by rapid expansion of the forestry sector and large increases in international aid flows. Stocks of natural forest logs are nearing exhaustion and, as the security situation improves, aid flows are likely to flatten off. The Solomon Islands Government asked the World Bank to investigate future growth prospects. This note summarizes the findings and presents a strategic vision for future growth, equity and stability. Efforts have been made to align this work with the policy commitments of the new government. Once these findings and proposals have been considered by the new Government, along with donor partners, specific aspects of these proposals could be further elaborated in subsequent work.

Sources of Growth

Most countries have improved living standards by moving from a reliance on agricultural production towards manufacturing and services, with accompanying urbanization. Geographical disadvantages, combined with weak governance and limited capacity for regulatory and economic policy reform suggest that Solomon Islands’ progress along this trajectory is likely to be highly constrained over the medium term. Rather, Solomon Islands’ best prospects lie in realizing opportunities in areas where it has an existing advantage, and improving flows of people, resources, and ideas within the country and regionally. Future economic growth in Solomon Islands will come from four primary sources:

1. **A vibrant smallholder agriculture sector.** Most Solomon Islanders will continue to rely on smallholder agriculture for incomes and livelihoods. Improving productivity of smallholder agriculture is vital for food security and livelihoods. But even with the best policies, this growth will not be sufficient to provide economic opportunities for all, nor sufficient revenues to enable the Government to meet commitments for service delivery. Alternative sources of growth and revenue are needed.

2. **Natural resource industries that benefit Solomon Islands.** Solomon Islands is well endowed with natural resources, including world class tourism potential, forests and fisheries, gold and nickel. But good outcomes from exploiting these advantages are far from assured. The chances of good outcomes will improve if the right policy and regulatory arrangements are in place to ensure that resource owners gain a fair share of benefits, and that Government is able to capture revenues and spend them equitably on public services. If natural resource industries are well integrated into local supply chains, they will also provide a major source of demand for local businesses.

3. **An internationally mobile workforce.** Growth in the local private sector will not be sufficient to provide jobs for the rapidly growing labor force. For many Solomon Islanders the best prospects for well-paid, productive employment may lie overseas. Closer integration of the Solomon Islands labor market with regional partners is a key objective. Short-term regional labor schemes can lead to remittances and the acquisition of skills that benefit the local economy. In the longer-run, integration would allow Solomon Island workers to make the best use of their skills and partner countries to address growing labor shortages in key sectors.
4. **International partnerships.** Growth from smallholder agriculture, natural resource development and an increasingly international workforce is unlikely to be sufficient to deliver economic opportunities and Government revenues required to meet public expectations on income and service delivery. Aid will continue to play a vital role in addressing shortfalls in fiscal resources and capacity across public administration, security, infrastructure, and social services. Aid in these areas will be necessary for the foreseeable future to realize the potential benefits from other sources of growth. Recognizing the central and long-term role of aid, along with further innovations in approaches, will make it possible to more predictably and effectively promote better public administration and political accountability, and provide an added stimulus to the local private sector.

**Enabling Requirements**

**Growth from the identified sources will not be distributed equally across the country.** Economic activity and population will tend to concentrate in some areas. This is already occurring. Efforts to evenly distribute economic growth, by state sponsorship of particular projects and sectors in lagging areas are not likely to be successful. Limited resources and political and administrative talent can be better used in other ways. Solomon Islands faces two challenges. The first is to maximize the advantages of economic concentration by planning for integration, both externally and within the country. The second challenge is to make development inclusive, by ensuring the benefits of growth are more evenly felt in access to public facilities and services. These two challenges can be addressed by:

**Building efficient connections between centers of economic activity and to surrounding populations.** Benefits from sources of growth will be maximized if the cost of movement of people, goods and services are reduced. This will enable people to take up employment opportunities, or to set up businesses supplying ancillary goods and services to growth industries. If goods and people can flow freely, growth in urban areas can benefit rural areas through increasing demand for agricultural and other rural produce. Good communication links can provide people with information on opportunities and demand in other parts of the country.

**Facilitating concentration of population and production in urban centers.** Urbanization is synonymous with economic growth and it is inevitable that urbanization will gain pace in Solomon Islands. If well managed, urbanization could provide major benefits in terms of improved business productivity and reduced costs of expanding the quality and coverage of services and infrastructure. Growth in urban areas can also enable Government to generate revenue to finance services and thereby help to correct disparities in services across the country. Presently, urban areas are not well managed, and this is both a constraint on business and a source of continuing social discontent. Improvements in urban land administration will enable real estate to be allocated to its most efficient use. Improved power and water supply will both reduce the cost of business and better cope with growing populations.
**Recommendations**

The following table outlines recommendations to maximize benefits from sources of growth:

<table>
<thead>
<tr>
<th>Outcome</th>
<th>Short-Term</th>
<th>Medium-Term</th>
</tr>
</thead>
</table>
| **A vibrant smallholder agriculture sector.**                          | • Strengthen existing extension services  
• Review options for improving access to finance                                          | • Provide information on production techniques, market conditions and post-harvest handling  
• Improve transport links between centers of high agricultural productivity and urban economic centers |
| **Natural resource industries that benefit Solomon Islands.**           | • Develop mining sector policy and regulation  
• Review regulatory and other barriers to improved domestic air services                       | • Broad-ranging institutional, legislative and regulatory reform in relevant natural resource ministries and the Ministry of Finance and Treasury, supported as necessary by international technical assistance |
| **An internationally mobile workforce.**                              | • Strengthen institutional capacity to facilitate selection, certification and international transfer of migrant labor  
• Improve access to foreign markets on short and long-term basis  
• Invest in education to support an internationally mobile workforce                          |                                                                                                                                              |
| **Innovations in international partnerships.**                         | • Maintain current close dialogue between the Government of Solomon Islands and donors around Government efforts to improve fiscal management  
• Complete the new multi-year development and financing strategy and include greater clarity on Government and donor responsibilities  
• Improve clarity in assignment of responsibilities and resources between central and provincial Governments | • Make progressively greater use of programmatic approaches and budget support, as improvements in Government systems allow, with the eventual goal of predictable fiscal and capacity transfers to support the Government in delivering its own policies  
• Increase integration of development objectives in other areas of international engagement, including trade agreements |
| **Efficient connections between economic centers and to surrounding populations.** | • Ensure updated Transport Plan allocates adequate priority to key centers of economic activity, and linkages between population centers and centers of production | • Invest more in strategically located transport infrastructure, linking populations and areas of economic concentration  
• Fund associated developments in inter-island sea transport, including temporary shipping subsidies |
| **Remove barriers to concentration of population and production in economic centers.** | • Review current administration of alienated land in Honiara to identify current obstacles to efficient use  
• Prioritize investment in services to areas of concentration. Expand access to affordable and reliable sources of energy through removing unnecessary constraints on private sector power providers  
• Remove artificial constraints to urban land use, including improved systems to allocate urban alienated land, regulating licensing of customary land around town centers, and managing Government assets and housing policy |                                                                                                                                              |
1. Introduction

**Solomon Islands needs new sources of growth.** Economic growth was slow even before a civil conflict between 1998 and 2003 led to a sharp drop in activity. General economic recovery, an influx of aid, and a logging boom drove economic growth at an average annual rate of 7 percent between 2003 and 2008. Rapid growth has not been enough to make good on lost ground, especially as the population was growing at an estimated 2.6 percent. GDP declined by 2.25 percent in 2009, with falling international demand for logs, softening agricultural commodity prices and reduced growth in Government expenditure. While growth is expected to recover to 4 percent in 2010, overall, incomes per head remain below 1998 levels, and the geographical disparities that contributed to the conflict remain pronounced. Broader macro-economic imbalances are becoming increasingly severe. Government expenditure has increased at an unsustainable rate of 20-30 percent a year from around 25 percent of GDP in 2003 to 50 percent of GDP in 2009. The country relies heavily on natural forest log exports for Government revenue, exports and employment. But commercially exploitable stocks will be virtually exhausted by 2014 and aid flows are expected to flatten off over coming years.

*Figure 1: GDP, Population and GDP per capita*
The loss of exports, jobs and Government revenue due to the decline in natural forest logging is unlikely to be replaced by other big projects. Planned new projects in fisheries, mining, forestry and agriculture, even if implemented successfully, would be unlikely to provide broad benefits or enough jobs for the growing labor force. Bigger projects would also carry higher risks, both because of global volatility and by adding to domestic tensions if the benefits and costs are not fairly distributed.

Box 1: Can Planned Investments be Relied Upon?

Many hoped that already-planned major investments in selected sectors would offset the loss in exports, jobs and Government revenue from natural forest logging. In March 2009 a World Bank team analyzed near-term growth prospects in these specific projects within the agriculture, fisheries, mining, tourism and plantation forestry sectors, and identified the specific policy measures needed to realize major projects.

If big projects in these sectors were implemented promptly, and in particular the Gold Ridge mine came on stream by late-2010, exports from these sectors might make up for the fall in logging exports. However, these gains would be offset largely by higher imports and payments to foreign investors and lenders. Tax and royalty receipts from the projects would not make up for the loss of Government revenues from logging. The projects might generate enough employment to offset the loss of jobs in logging, but they would not provide sufficient additional jobs for the roughly 10,000 people entering the labor force each year.

Big projects would be subject to fluctuations in global demand and prices. Without appropriate regulations, the benefits of such projects would tend to accrue to foreign investors, with the Solomon Islands Government, resource owners, and citizens receiving a modest share. There was also a concern that the uneven distribution of domestic benefits and costs of such developments would, in the absence of much improved public expenditure systems, potentially add to underlying tensions that gave rise to the recent conflict in the country. In the event, with the exception of Gold Ridge, progress with these big projects has been slow since early-2009.

<table>
<thead>
<tr>
<th>Sector</th>
<th>Project</th>
<th>Potential exports (US$ million per annum)</th>
<th>Potential Government revenue (US$ million per annum)</th>
<th>Potential employment (Permanent full-time equivalent jobs created)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Minerals</td>
<td>Gold Ridge Mine</td>
<td>&lt; 100</td>
<td>&lt; 5</td>
<td>&lt; 500</td>
</tr>
<tr>
<td>Tuna Fisheries</td>
<td>Soltai</td>
<td>&lt; 50</td>
<td>5-10</td>
<td>&lt; 1000</td>
</tr>
<tr>
<td>Plantation Forestry</td>
<td>KFPL and EPPL</td>
<td>~15</td>
<td>Negligible</td>
<td>Negligible</td>
</tr>
<tr>
<td>Tourism</td>
<td>Increased visitor numbers</td>
<td>~15</td>
<td>Negligible</td>
<td>&lt; 1000</td>
</tr>
<tr>
<td>Plantation Agriculture</td>
<td>RIPEL and smallholders</td>
<td>~ 15</td>
<td>Negligible</td>
<td>&lt; 2000</td>
</tr>
<tr>
<td>Palm Oil</td>
<td>GPPOL and Aluta</td>
<td>&lt; 50</td>
<td>Negligible</td>
<td>&lt; 2500</td>
</tr>
</tbody>
</table>

To respond to this outlook, the Solomon Islands Government sought World Bank assistance in identifying policy options for inclusive economic growth. The aim is to support ongoing efforts by the Government and donors to create a vision of a successful Solomon Islands economy, and build support for a small number of actions that may have the greatest impact in making this vision a reality. Section 2 summarizes key points from extensive analysis of potential barriers to growth in Solomon Islands, drawing on international growth experiences, cross-country quantitative comparisons, and Solomon Islands recent experience of conflict. This analysis shows that geographical and other constraints limit the options for economic development. Similarly, the country’s capacity to agree on and implement economic reforms over time is limited by available administrative resources and weak political incentives. Together, these factors will limit the pace, extent and impact of policy and regulatory reforms. Section 3 summarizes findings on sources of growth that could be exploited despite these constraints.
This section summarizes conclusions from extensive quantitative and qualitative analysis undertaken during the course of this work. It suggests an appropriate direction of economic reform efforts in Solomon Islands from analysis of: 1) international evidence regarding the dynamics of economic growth, 2) specific constraints to growth within the Solomon Island economy, and 3) the Solomon Islands post-conflict context.

2. Lessons from the Evidence

Analysis of the growth experience of other countries and the specific growth experiences of small states suggest the following three lessons for Solomon Islands:

2.1 Lessons from international experience

2.1.1 Growth is uncertain

The sustained growth required for Solomon Islands to converge to the living standards of an average lower-middle income country, even over the longer-term, has seldom been achieved and is difficult to spur. Periods of significantly accelerated growth are relatively common internationally. Such growth episodes, however, are highly unpredictable, unstable, and depend on a combination of both internal and external factors that are largely idiosyncratic (see Box 2 and 3 on the growth experiences of Vanuatu and Mauritius). While political and economic reforms have been important where economic growth has occurred, such reforms do not consistently result in sustained periods of growth. Very few countries have experienced consistently high growth rates over periods of several decades. More typically, countries experience periods of growth, stagnation, or decline of varying length. The recent report of the Growth Commission identifies only 13 economies that have ever sustained growth of at least 7 percent per annum for 25 years or more.
Small states do not necessarily grow slower. International evidence shows that small states are no poorer or slower growing than larger states. This is especially the case where they are close to large markets, and have relatively high population densities. Small states have overcome obstacles of scale by increasing trade and specializing in a small number of exports to a small number of market countries. But this reliance on specialization has been shown to increase their vulnerability to rapid shifts in the terms of trade and changes in economic conditions in market countries. As a result, small states experience greater volatility in growth.

**Box 2: Sources of Growth in Vanuatu**

The take-off in Vanuatu’s tourism sector reflects the importance of enabling reforms, geography, and idiosyncratic factors in determining economic performance.

After a long period of low growth and falling per capita incomes, Vanuatu’s economy has improved in recent years. Between 2004 and 2008, Vanuatu achieved average economic growth of 6.5 percent per annum. Income per capita is now more than twice that of Solomon Islands. Growth in Vanuatu has been driven by a rapidly expanding tourism sector, which now accounts for more than 45 percent of GDP.

Growth has been attributed to active land markets, deregulation of the airlines and telecoms sectors, liberal tax provisions, maintenance of macro-fiscal stability, and foreign policy focusing on strengthening relationships with larger economies in the region. These reforms reduced the costs of tourism and made tourism investment attractive at a time when the Australian market was looking for alternative travel destinations, following the 2002 Bali bombings, political instability in Fiji from 2006, and more recently the 2008-09 economic crisis which led travelers to choose closer, cheaper holidays in what were perceived to be safer destinations.

**Tourism as a proportion of GDP, Vanuatu and Solomon Islands**
2.1.2 Growth tends to be concentrated and geographically uneven
Internationally, urbanization and growth in manufacturing have accompanied development. Rapid development in large and small countries has typically been driven by movement from agriculture in rural areas to manufacturing and services in urban areas. No country has ever achieved sustained economic growth without urbanization.

Economic growth in Solomon Islands is likely to become increasingly concentrated in Honiara or around natural resource enclaves. Production is unevenly spread globally and within countries. Half of the world’s production occurs on just 1.5 percent of its land, and most of the world’s population now lives in cities. In larger and richer countries, growth occurs as production becomes concentrated in certain areas. In these countries, the concentration of population and production enables firms to: i) more easily access markets, enabling economies of scale, ii) specialize, with the ability to outsource easily upwards and downwards through the supply-chain, and iii) innovate faster, by observing the practice of other firms and having access to a pool of workers with experience in different firms and industries. Similarly, the concentration of population also reduces the costs of infrastructure and delivering services. Urbanization, in Solomon Islands as elsewhere, also presents particular challenges. Where land, urban services and security are not dealt with in ways acceptable to new and existing urban residents, urbanization can be a source of social discord.

2.1.3 Natural resources are a key source of growth for small states
Natural resource industries, including tourism, are likely to be a key part of Solomon Islands’ economic future. There are strong similarities in the means by which high growth rates have been achieved in small countries. Tourism, natural resource exploitation, and economic liberalization, or recovery, are common factors across small countries that have achieved either short periods of sustained and very rapid growth, and also high growth sustained over the longer-term. Tourism and natural resources play a part in the growth experience of most strongly-performing small countries.
But good outcomes from natural resource industry investment are not assured. The presence of natural resource wealth can be an opportunity for rapid growth, but many studies show that reliance on large natural resource industries is typically accompanied by lower rates of economic growth. The exact causal links between natural resources and lower growth remain subject to debate. But it is clear that reliance on natural resource extraction for government revenues can distort incentives for good fiscal management and crowd out growth in other sectors. Contests over ownership and access to natural resources can lead to conflict and corruption.

Box 3: Sources of Growth in Mauritius

The experience of Mauritius illustrates the potential for rapid growth in small states. But it also shows that it would be difficult for Solomon Islands to successfully implement a similar growth strategy.

The experience of Mauritius is commonly cited as evidence that low-income, small island states can achieve convergence to middle-income country living standards. From an early stage, the Government of Mauritius certainly took important steps to encourage robust development of the pivotal textile sector. The country enacted the Export Processing Zone (EPZ) Act in 1970, providing incentives and concessions to export enterprises, liberalized the economy, and devalued the rupee to make Mauritian exports internationally competitive.

But external, largely idiosyncratic factors also played a key role in the development of the Mauritius economy:

- The Multi-Fibre Agreement signed in 1982, constrained textile exports from Hong Kong, and encouraged investors to set up their firms in Mauritius
- An appreciation of the Taiwanese Dollar, and reduced Taiwanese competitiveness on the world market, led to Taiwanese investment in the Mauritius textiles sector
- The 1984 appreciation of the European currencies improved Mauritian competitiveness at a key point of the development of the industry
- During the 1990s, political uncertainty over the future of Hong Kong’s reintegration into China encouraged investors to relocate operations to the perceived safety of Mauritius. This brought capital, marketing networks, and technical know-how
- Rents from preferential arrangements for sugar exports to the European Union (EU) provided a source of capital for local investment in the sector. EU sugar purchases occurred at a price that was, on average, about 90 percent above the market price between 1977 and 2000—a subsidy worth 5.4 percent of GDP, on average, each year.

Relatively high population density and infrastructure coverage also provided an enabling environment for the development of manufacturing.

External, idiosyncratic factors can be of paramount importance. But the Mauritius experience also shows that Government can take steps to create an enabling environment: for instance, in the provision of power and other services to service expanding urban areas and improve internal mobility.

<table>
<thead>
<tr>
<th>Metric</th>
<th>Mauritius (earliest)</th>
<th>Solomon Islands (latest)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Electrification rate</td>
<td>73% (1981)</td>
<td>17% (1999)</td>
</tr>
<tr>
<td>Km roads per sq km</td>
<td>0.90 (1990)</td>
<td>0.05</td>
</tr>
<tr>
<td>Phone subscribers per 100</td>
<td>2.45 (1980)</td>
<td>3.02 (2007)</td>
</tr>
<tr>
<td>Pop/sq. km</td>
<td>475 (1980)</td>
<td>18 (2009)</td>
</tr>
<tr>
<td>Literacy (% 15 and above)</td>
<td>80% (1990)</td>
<td>Possibly as low as 17%</td>
</tr>
<tr>
<td>Urban population %</td>
<td>42.4 (2005)</td>
<td>17 (2005)</td>
</tr>
</tbody>
</table>
2.2 Lessons from the analysis of constraints

Detailed cross-country analysis has been used to assess Solomon Islands’ performance against a number of factors that are vital to economic growth and private sector development. The following three lessons have been drawn from this analysis.

2.2.1 Solomon Islands is unlikely to follow standard trajectories of development

The geography of Solomon Islands is a major constraint on growth. Solomon Islands is on average 8500 kilometers from its three main international markets – China, the European Union and Thailand – compared to other, non-Pacific small states’ average of 4960 kilometers distance from their main markets. Solomon Islands is close only to the relatively small markets of Australia and New Zealand. The population is scattered: only 18 people live on each square kilometer, compared to more than 70 for the median small country. People in Solomon Islands on average also live more than 200 kilometers from the capital, considerably further than those in most small states. Only 17 percent of the Solomon Islands population lives in towns – fewer than any other major Pacific Island country. The dispersion of the population and the low level of urbanization add to domestic transport costs and limit the development of local markets and businesses. Internal transport costs are a major burden on local exporters. Dispersal increases the costs of providing infrastructure and private and public services, and contributes to some of the poorest infrastructure coverage and quality across small states. High costs of providing transport connections prevent people moving easily to where the best employment opportunities exist. The scattered population erodes links between local communities and public institutions and policy-makers. Few small countries face similar disadvantages from geography.

Solomon Islands is unlikely to be able to follow the standard trajectory of development, at least over the medium-term. As well as geographical barriers, there are fifteen other areas in which Solomon Islands’ business environment compares poorly to other small countries’ (see Attachment A). Some constraints – such as long distances to large export markets – are not amenable to policy action. Other constraints might be addressed through sustained reform effort. But this will be challenging because of weak governance and uneven administrative
capacity. Consequently, Solomon Islands is unlikely to be able to provide a competitive business environment for manufacturing or service exports. Export competitiveness and growth are likely to be concentrated in sectors where Solomon Islands can offer other advantages.

2.2.2 Reform strategy must reflect capacity
Solomon Islands must avoid strategies that over-reach its administrative and political capacity. Reform policies will be more effective if they reflect capacity constraints, and work with, rather than against, the forces driving economic concentration. Solomon Islands faces many constraints, including some that are not amenable to policy influence. Broad and generalized ‘enabling environment’ reform agendas are unlikely to be successful and will dissipate effort across a long list of recommended reforms. Many reforms will not be implemented or will not achieve high impact. On the other hand, international experience also shows that targeting development efforts towards specific sectors, geographical regions, or trying to spread economic activity evenly across the country is capacity-intensive, and often ineffective. A ‘middle way’ is needed that allows the targeting of effort on high-priority actions and areas of existing advantage, while also working with – rather than against – forces driving economic concentration.

2.3 Lessons from the experience of conflict
Solomon Islands remains vulnerable to conflict. The pattern of growth since 2003, including a large increase in Government and aid expenditure, has further concentrated formal sector employment in Honiara and a few other towns. Urban residents have significantly better access to services – despite important gains in coverage and quality across the country in education and health services. Unresolved grievances about the distribution of powers, responsibilities and public resources between provinces and central Government, combined with a growing gap between public expectations and perceptions of Government performance, foster continuing challenges to the legitimacy and authority of Government. Public opinion surveys show that people appreciate the improvements in social services. But they also show that people feel their communities are less safe than two years ago, they continue to lack confidence in Government, and believe that violence would recur if the international security guarantee was withdrawn.

Distributional impacts of economic development need to be carefully managed. Government is augmenting community reconciliation efforts and, with donor support, is expanding access to basic services. But the enduring difficulties of dealing effectively with the inequalities and disputes that led to the Tensions will mean that any strategy must address the geographical and distributional impacts of economic change. It is vital that a credible security guarantee is provided for as long as it is required. But these realities also require national leaders to manage public expectations while holding out the reasonable prospect that living standards will improve for the majority of the population.
3. Applying the Lessons

We have translated these lessons to offer a vision of a possible future Solomon Islands economy. Future growth is likely to be concentrated around four key areas. These are discussed in turn. Two key steps for improving the business environment are also identified to enable growth in these areas, and to ensure that this growth benefits the greatest possible number of Solomon Islanders.

3.1 Sources of growth

This section identifies four key areas that are likely to represent the main sources of growth for the future Solomon Islands economy.

3.1.1 A vibrant smallholder agriculture sector

Subsistence smallholder cash agriculture will remain the primary source of livelihoods for the majority of Solomon Islanders. Many Solomon Islanders will remain in areas with few employment prospects, and some in areas where population growth is already putting stress on subsistence agricultural systems. There is ample evidence of Melanesian farmers responding positively to improved prices and market opportunities if affordable finance can be accessed and transport connections are reliable and reasonably priced. As growth in production and population occurs in urban areas or natural resource enclaves, there will be new opportunities for rural people to meet expanding urban demand. The smallholder cash economy has been, and will remain, a buffer against the external economic shocks that Solomon Islands, as a small state reliant on natural resource exports, will remain vulnerable to. Smallholder agriculture will also provide social insurance against natural disasters.

Policy actions to improve smallholder agricultural productivity are a priority. Improving performance of the smallholder agriculture sector represents an opportunity to improve livelihoods of a large number of Solomon Islanders, mitigate existing risks arising from increased population pressure and food insecurity in some areas, and safeguard livelihoods against ongoing volatility in economic performance. The Government has given priority to improving domestic and export marketing infrastructure, reviving agricultural research and extension capacity, and promoting ‘agriculture opportunity’ areas. To facilitate growth from this source, the following short and longer-term actions are important priorities:
3.1.2 Natural resource industries that benefit Solomon Islands

Natural resource industries are likely to become an increasingly important part of the Solomon Islands economy. Solomon Islands is well endowed with natural resources, including world class tourism potential, forests and fisheries, and minerals. These endowments have provided a key basis for growth in many small countries. As reflected in the Government’s policy manifesto, with the right policy and regulatory frameworks in place, large-scale natural resource investments have the potential to create substantial incomes for employees and landowners and generate significant revenues for local and central Government. Natural resource industries that are well integrated into local supply chains will provide a vital source of demand for local businesses.

Good outcomes from natural resource industries are far from assured. Despite good prospects, foreign natural resource and tourism companies are unlikely to invest if: 1) mineral prices or international tourism demand falls too low, 2) investors see an unfriendly investment environment or risks of changes in the policy and regulatory environment that may harm their interests, or 3) there is further political instability or conflict. Even if investment does occur, if poorly managed, natural resource industries can often bring few benefits, create environmental harm and social distress, and fuel corruption and conflict. Accordingly, the Government intends, in relation to mining, to update information on deposits and potential, upgrade management capacity in the sector, and adopt the requirements of the Extractive Industry Transparency Initiative.

Policy actions to improve the regulatory and policy environment for natural resource and tourism are vital to attracting investment, ensuring domestic economic benefits and avoiding conflict. To facilitate growth from this source, the following short and longer-term actions are important priorities:

<table>
<thead>
<tr>
<th>Short-Term</th>
<th>Medium-Term</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Maintain and strengthen existing donor assistance to Ministry of Agriculture and Livestock Development to promote national research and extension services</td>
<td>• Strengthen provision of information on production techniques, market conditions and postharvest handling and processing of produce through: i) broadcasting services, ii) expansion of telecoms coverage and iii) engagement of rural training centers, churches and NGOs in agricultural extension</td>
</tr>
<tr>
<td>• Donor assistance to Government or the Central Bank of Solomon Islands in reviewing options for improving access to finance</td>
<td>• Improve transport links between centers of high agricultural productivity and urban economic centers</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Short-Term</th>
<th>Medium-Term</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Government and donors support rapid progress with planned technical assistance to: i) develop mining sector policy, and ii) achieve equitable and durable regulation of investor and resource owner relationships</td>
<td>• Broad-ranging institutional, legislative and regulatory reform in relevant natural resource ministries and the Ministry of Finance and Treasury, supported as necessary by international technical assistance</td>
</tr>
<tr>
<td>• Donors support the Government in implementing a review of regulatory and other barriers to improved domestic air services for tourism</td>
<td></td>
</tr>
</tbody>
</table>
3.1.3 An internationally mobile workforce

**Increasing integration of regional labor markets will bring positive benefits for Solomon Islands and development partners.** Growth in the local private sector is unlikely to provide jobs for the 10,000 Solomon Islanders entering the workforce each year. Opportunities for well-paid, productive employment will need to be found overseas. Short-term regional labor schemes can lead to remittances and skills acquisition that benefit the local economy. The Government intends to enhance the ‘Temporary Movement of National Persons’ program. In the longer-run, closer integration of the Solomon Islands labor market with regional partners is a key objective. Integration would allow Solomon Island workers to make the best use of their skills and partner countries to address growing labor shortages in key sectors. Increasing labor market integration may be the most cost-effective way for donor partners to improve the standards of living of Solomon Islanders.

**To make the most of this source of growth, policy action is needed** to increase Solomon Islanders’ access to international labor markets, especially major Pacific neighbors but also other countries. The following short and longer-term actions are important priorities:

<table>
<thead>
<tr>
<th>Short-Term</th>
<th>Medium-Term</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Government and donors accelerate progress with ongoing work to strengthen institutional capacity within the Ministry of Foreign Affairs and Trade to facilitate selection, certification and international transfer of migrant labor</td>
<td>• Remove inefficient legal barriers to temporary and long-term migration that are restricting access of Solomon Islanders to foreign labor markets, and improve match between skills provision and foreign market demands</td>
</tr>
<tr>
<td></td>
<td>• Consider options for integrating labor market access arrangements within regional trade agreements, allowing Solomon Islands to access greater benefits</td>
</tr>
<tr>
<td></td>
<td>• Improve education and skills of people in poorer provinces in order to improve prospects for participation in international labor schemes</td>
</tr>
</tbody>
</table>

3.1.4 Innovations in international partnerships

**International support will continue to be needed.** Growth from smallholder agriculture, tourism and natural resources, and an increasingly international workforce is unlikely to be sufficient to deliver the economic opportunities and Government revenues required to achieve the level and distribution of incomes and services needed for long-term harmony and security. Aid will continue to play a vital role in addressing shortfalls in fiscal resources and capacity across public administration, security, infrastructure, and social services. Assistance in these areas will be necessary to realize the potential benefits from other sources of growth. With innovation in approaches, and acknowledgement of the central role that aid will play in the Solomon Islands economy over the long-term, international assistance can more predictably and effectively augment governance and improve accountability of leaders for the performance of the public sector. Such innovation could also provide an added stimulus to the local private sector.
International assistance will underpin outcomes from other sources of growth. Without ongoing donor assistance, Solomon Islands will not be able to maximize benefits from potential sources of growth. Programmatic assistance – where donors contribute to a common strategic framework of Government priorities, and work through national systems and procedures – could play a vital role in realizing potential growth in smallholder agriculture. Similarly, international capacity will be vital in designing and implementing policy, regulatory and tax frameworks in natural resource industries. The active engagement and policy action of donor countries will be required for increased regional labor market access.

The way aid is delivered needs to change. Government and donors are committed to partnership arrangements that involve closer alignment with Government priorities and increased use of Government systems. These partnerships would benefit by more explicitly recognizing the country’s constrained economic outlook, and the fiscal realities that future Governments will face. This would encourage donors and the Government to make less use of short-term project modalities that work in parallel to Government. These modalities are based on assumptions that sustainability is achievable within short timeframes. Long-term systems that encourage predictability in aid transfers to assist Government in meeting its own service-delivery and development priorities may be more appropriate. More dialogue between the Government and donors will be needed to achieve mutually agreeable arrangements to improve and strengthen Government investment planning capacity, financial and administrative systems, and greater clarity on the roles of central and province authorities and civil society. A more proactive use of Government systems and a focus on agreed results will improve accountability of elected leaders for outcomes. It would also increase the local economic impact of aid by providing an enduring source of demand for the local private-sector.

International assistance will increasingly emphasize other mechanisms for improving living standards. While aid will remain vital, donor countries may also increasingly broaden the mechanisms of assistance to include 1) sustained capacity transfer to key roles requiring specialist expertise, 2) enhanced or preferential Solomon Islands access to donor-country labor markets, and 3) taking greater responsibility for ensuring regulatory, tax, and antitrust law compliance of businesses based in donor countries but operating in the Solomon Islands.

Progress in improving international partnerships will require policy action from the Government and donors. The following short and longer-term actions are important priorities:

<table>
<thead>
<tr>
<th>Short-Term</th>
<th>Medium-Term</th>
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</thead>
<tbody>
<tr>
<td>• Maintain current close dialogue between Government and donors to:  1)</td>
<td>• Progressively greater use of programmatic approaches and budget support,</td>
</tr>
<tr>
<td>ensure progress in strengthening alignment and coordination of aid</td>
<td>as improvements in Government systems allow, with the eventual goal of</td>
</tr>
<tr>
<td>programs  2) support ongoing Government efforts to improve fiscal</td>
<td>sustained fiscal and capacity transfers supporting the Government in</td>
</tr>
<tr>
<td>management</td>
<td>delivering its own policies</td>
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<tr>
<td>• Complete the new multi-year development and financing strategy and</td>
<td>• Increased integration of development objectives in trade agreements,</td>
</tr>
<tr>
<td>include greater clarity on Government and donor responsibilities</td>
<td>including considerations of labor mobility options</td>
</tr>
<tr>
<td>• Additional support to the Government in improving clarity or roles,</td>
<td></td>
</tr>
<tr>
<td>accountability and appropriate resourcing for service delivery between</td>
<td></td>
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<tr>
<td>central and local Government</td>
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3.2 Enabling requirements

There are two overarching policy priorities that would both: 1) increase the economic benefits from identified sources of growth, and 2) ensure that the largest possible number of Solomon Islanders are able to access these benefits.

3.2.1 Geography and sources of growth

The economic impacts of each of the identified sources of growth will be to varying extents geographically unbalanced. Benefits and opportunities will not be evenly distributed across areas or provinces, but will occur where agricultural productivity is highest, where natural resource potential exists, where the families of relatively highly educated migrant workers live, or where administrative centers – where aid money is disproportionately spent – are located. A key challenge for Solomon Islands is to maximize the benefits of inevitable and already-occurring concentration of population and production, while mitigating the potential social and economic costs. This can be achieved by improving connection between key economic areas, and facilitating concentration of population and production within these areas, through better administration and services. Each of these cross cutting priorities is central to the Government’s policy commitments.

3.2.2 Improving connection

A key priority is to improve flows of people, goods, and information across the country. Benefits from sources of growth will be maximized if people are able to move to where they the best prospects for jobs and services exist, or to set up businesses supplying ancillary goods and services to growth industries. If goods can flow freely, the growth in urban areas will benefit rural areas by increasing demand for agricultural and other rural produce. Good communication links can provide people with better information on opportunities and demand in other parts of the country. Existing Government policy recognizes the need for improved connections between producers and growth centers.

Geographical constraints mean that investments must be prioritized. Under any conceivable pace of economic growth, reliable and regular transport links between every village in Solomon Islands will remain unaffordable. Transport and communications infrastructure investments need to be strategically targeted to provide linkages between centers of production, and to link production centers to surrounding population centers. Such linkages will help suppliers in certain areas to meet demand created in others, and allow people to take advantage of changing employment and economic opportunities.

A key priority is to improve internal connections to reduce transport and other costs. Government policy is to urgently review transport infrastructure – roads, wharves, air and telecommunications – in light of the strategic need to enhance connections between areas of greatest productive potential and population centers. This could be advanced through the following measures:
3.2.3 Facilitating concentration

A further priority is to improve administration, services, and infrastructure in areas where populations and economic opportunities will be concentrated. The inevitable increase in urbanization can provide major benefits in terms of improved business productivity and reduced costs of expanding quality and coverage of services and infrastructure. Growth prospects will be enhanced, and the social costs of urbanization will be mitigated, if: 1) economic infrastructure is sufficient to allow expansion in economic opportunities through the development of businesses supplying ancillary goods and services, 2) high quality public services are ensured for growing urban populations through adequate human and financial resources, and 3) land administration is improved to ensure that housing is available to migrant populations, and that real estate is allocated to its most efficient use under inevitable urban scarcity.

A key priority is to maximize the potential benefits of concentration and mitigate the possible costs through the following measures:

<table>
<thead>
<tr>
<th>Short-Term</th>
<th>Medium-Term</th>
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<tbody>
<tr>
<td>- Ensure that the updated Transport Plan allocates adequate priority to key economic linkages, and linkages between population centers and centers of production</td>
<td>- Invest in more strategically located transport infrastructure, linking populations and areas of economic concentration</td>
</tr>
<tr>
<td>- Funding associated developments in inter-island sea transport, including temporary shipping subsidies, where absence of transport prevents the development of otherwise viable production, the absence of which undermines the viability of shipping services</td>
<td>- Review administration of alienated land in Honiara to identify current obstacles to efficient use</td>
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<tr>
<td>- Prioritizing investment in services – in particular, water and electricity – to areas of concentration. Existing levels of geographic coverage of primary social services would be maintained. New investments in higher level services would be concentrated in areas of growth and where connections with rural areas can be facilitated so as to more affordably deliver services and enable better access</td>
<td></td>
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<tr>
<td>- Expanding access to affordable and reliable sources of energy through removing unnecessary constraints on private sector power providers</td>
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<tr>
<td>- Removing artificial constraints to urban land use, including improved systems to allocate urban alienated land, regulating licensing of customary land around town centers, and managing Government assets and housing policy</td>
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### Attachment A: Factors Hindering Growth

#### Geography
1. Relatively high cost to exporters of accessing international markets and importers of shipping goods due to distance.

2. Relatively low population density, dispersion, low urbanization and high average distance to capital increase costs for exporters and import competing producers.

#### Infrastructure
3. Low coverage and relatively high cost of electricity reduces profitability of any business requiring manufacturing, processing or refrigeration.

4. Relatively low density of roads and high cost and infrequency of inter-island shipping imposes high costs and reduces economic productivity.

5. Relatively high cost, low frequency and coverage of inter-island air services reduce profitability of tourism investments.

#### Human Capital
6. Shortage of particular specialized skills imposes relatively high costs on business.

7. Relatively high rates of total fertility, result in high proportion of dependent population, imposes costs on working population (tax, absence/care), and forces more intensive land use, reducing the return to agricultural activity.

#### Cost and Access to Finance
8. Relatively high cost and lack of access to loan finance deprives SMEs of working capital and deters investment.

#### Macroeconomic
9. Low investment rate is insufficient to replace depreciation of existing capital stock, let alone increase stock to support employment of growing labor force.

10. Low share of exports in GDP and concentration in few sectors, logs and copra, leaves Solomon Islands unable to sustain import growth and vulnerable to swings in global demand and prices. Reliance on imported oil and increasingly on imported food adds to this vulnerability.

11. Misallocation of public resources leads to inefficiency.

#### Business conditions
12. Lack of appropriate regulation and administration of existing registered land limits availability of land and raises costs for urban business.

13. Contestability of rights and agreements involving customary property increases risks and costs for large scale investors and dissuades international investment.


#### Labor Mobility
15. Barriers to internal mobility lead to unnecessary mismatches between supply and demand in various labor markets and preclude the scale and agglomeration benefits of labor concentration.

16. Regulatory and institutional barriers to external labor migration reduce incomes and opportunities for Solomon Islanders while precluding potential income streams from remittances.

#### Aid
17. Lack of a prioritized and costed Government development strategy, which could be supported consistently by donors, means that the needs of private business are not addressed coherently, e.g. in infrastructure or regulatory reform.

18. Modalities of aid flows weaken governance and Government accountability, lead to fragmentation in Government administrative structures and competition for scarce administrative capacity, and make allocation to strategic priorities difficult.