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SOCIAL ECONOMICS, POLICY AND DEVELOPMENT

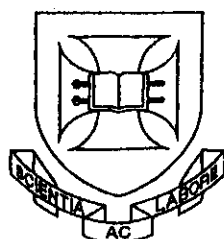
Working Paper No. 9

**The Development of the Solomon Islands:
An Analysis of Trends, Issues and Policies**

by

Clem Tisdell

May 2000



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Clem Tisdell[†]

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* This is a background paper used by the author as an input in preparing a report for the UN on the least developed Pacific island nations in relation to the UN "Final Review of the Implementation of the Programme of Action for the Least Developed Countries for the 1990s". The views expressed in this paper are those of the author and do not necessarily reflect the views of the United Nations.

† I sincerely wish to thank all those interviewed in the Solomon Islands (see appendix) for their assistance as well as many outside of the Solomon Islands who gave assistance. The usual *caveat* applies.

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Abstract

The Solomon Islands is one of the five least developed Pacific island nations according to the classification of the United Nations. This article reviews the situation of the Solomon Islands in relation to its development generally but paying particular attention to

- public and private finance;
- social issues such as education and health;
- its trade and external balance and
- economic infrastructure.

Policy suggestions are made in relation to each of these matters and an assessment given of the development status of the Solomon Islands.

1 BACKGROUND

The Solomon Islands is located about 1800 km off the Australian east coast and adjoins PNG and Vanuatu. It has a population in excess of 426,000 of which most are Melanesian (94.2%), 4% Polynesian, 1.4% Micronesian, and 0.4% European and 0.1% Chinese. In 1893, it became a British Protectorate and did not become independent until July, 1978, after which it remained in the British Commonwealth. So like most of the least developed countries in this group in the Pacific Islands, it did not shed its colonial status until relatively late in the 20th century.

It is relatively rich in natural resources and has a landmass of 30,000 km² much of which consists of relatively rich volcanic soil. But situations do differ between islands, of which there are more than 900. Some are coral islands and poor in soil quality as in Ontong Java. Possibly up to 100 different tribal languages or dialects are spoken in the Solomon Islands but education is conducted in English, a factor which may contribute to the low literacy rates in the Solomon Islands. Pijin is commonly used for communication by islanders from different areas.

The annual rate of growth of population is very rapid at about 3.5% per year. A dual economy exists. Just under 75% of the workforce is engaged in subsistence activity (non-monetary basically), about 12.5% are a mixture of wage-earning and subsistence farming with a further 12.5% entirely dependent on cash income. Around 86% of the population live in rural villages. The nature of the economy suggests that the economics applicable to Western-style market economics must be significantly modified for policy application in the Solomon Islands.

By any standards, the Solomon Islands has a comparatively low standard of living. The Human Poverty Index (HPI) for the Solomon Islands is below that of Bangladesh and it has a very low Human Development Index (HDI). This is so despite significant social and economic improvement compared to the 1980s. The situation of the Solomon Islands is such that it can ill afford to squander its economic opportunities through failures in governance of various kinds, in particular, past failures to collect natural resource rents

especially in relation to timber exports. This, coupled with excessive borrowing by the Government created financial difficulties for the Government in the second half of the 1990s which forced economic reforms on it and necessitated further foreign borrowing for the purposes of economic restructuring.

2 FINANCE FOR DEVELOPMENT

The Solomon Islands experienced a series of financial difficulties in the 1990s which impacted on its path for development. These included falling real aid per capita, rising Government debt and a crisis precipitated by the inability of the Solomon Islands Government to meet its debt obligations in August 1995. Subsequently a policy and structural reform programme was commenced with the aim of eliminating the deficit in the government's budget. The Policy and Structural Reform Programme (PSRP) represents a structural change in fiscal policy and involves the imposition of increased economic discipline.

2.1 The Long-term Overseas Development Assistance of Solomon Islands

In part the need for extra economic discipline in SI stems from a substantial decline in the real overseas development assistance given SI in the 1990s. While (see Table 1) this assistance fluctuated between 1990 and 1997, it almost halved in this period (see Pasifiki Services Ltd., 1998, p.10). Allowing for the considerable degree of price inflation in SI it will have more than halved by 1999 given that ODA is expected to be 164.3 (SBD \$m) in nominal terms (Department of Finance, SI, 1999), that is much the same as in 1997. Between 1990 and 1997, development assistance per capita to SI declined from SBD \$433 to \$397, and in real terms from SBD \$453 to \$190, that is by more than half. This trend appears to be continuing.

INSERT TABLE 1

Table 1

Nominal and Real Levels of Development Assistance for SI 1990 to 1997
(Aggregate in SBD\$m and Per Capita Figures in SBD\$)

Year	1990	1991	1992	1993	1994	1995	1996	1997
Nominal assistance	138	81	104	164	165	152	183	163
Real assistance	138	70	82	118	105	88	94	78

Nominal per Capita assistance	433	245	304	462	448	398	460	397
Real per capita assistance	433	213	238	332	284	230	238	190

Source: Based on Pasifiki Services Ltd (1998) pp.9 and 10

In the period 1990-1997, overseas assistance financed between 37-56% of total government expenditure and covered between 22-38% of SI's value of imports. Thus overseas assistance was and is a significant factor in the finances of SI.

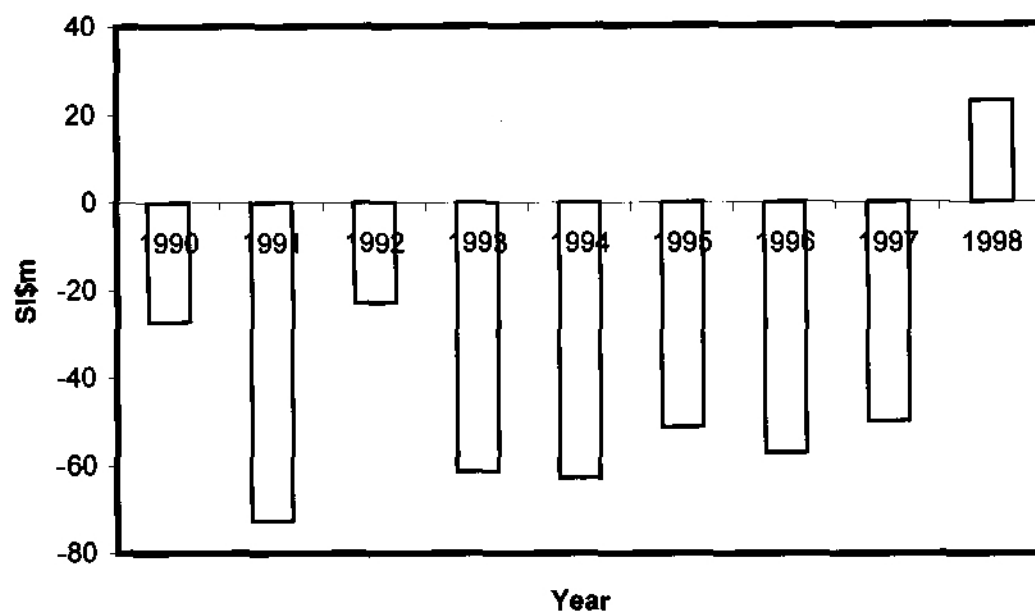
During the 1990s, ODA has been relatively volatile on a yearly basis. This makes long-term economic planning for SI, more difficult than otherwise. The greatest volatility has occurred in multilateral assistance. While the major proportion of aid to the SI is from bilateral sources, in recent years the proportions from bilateral and multilateral sources have started to converge.

'Soft' loans as opposed to grants are making up an increasing proportion of the external development assistance to SI. Whereas loans only accounted for 7% of development assistance in the period 1990-97, in 1998, SI accepted a large loan from the Asian Development Bank to assist it with restructuring. It is expected that in the period 1999-2001 loans will constitute about 19% of the external assistance for SI (Pacifiki Services, p.37). While such loans are at concessional rates, they place extra financial pressures on SI to ensure that investments financed by those loans give a rate of return in excess of the rate of interest charged and to ensure that it can meet its debt obligations. So not only is reduced foreign aid in real terms heightening financial constraints on SI but so also is the fact that an increasing proportion of this aid is in the form of loans rather than grants. This means in effect a higher "gearing" ratio for the SI government and so tends to raise the economic vulnerability of the loan recipient.

2.2 Government Financing

SI experienced difficulties with public finance in the 1990s for a number of reasons. These resulted in a financial crisis in August 1995 when the Government could no longer meet its debt service obligations. The crisis had its roots in deficits in the Government Budget. Deficits occurred in every year in the period 1990-1997 with the first surplus being recorded in 1998. Deficits were especially large in 1991, 1993 and 1994 (See Figure 1).

Figure 1: Government Fiscal Balances, 1990-1998



Note: Surplus for 1998 is for the recurrent budget.

Source: CBSI (1996), CBSI (1999) and IMF (1999) and Solomon Islands Government (1999, p.13)

INSERT FIGURE 1

The following comment on the fiscal balance of the Solomon Islands is worth noting:

“The outcome of government budget operations in 1998 was a surplus of \$24 million on the recurrent budget. This is the first time in the 1990s for the government to generate a budget surplus. This came mainly from tight controls on the expenditures, underspending of budgeted amounts and increase in domestic revenues. It should be noted that government has arrears amounting to about \$100 million at the end of 1998,” (Solomon Islands Government, 1999, p.12).

Factors contributing to the SI Government’s budget deficits included the following:

- (i) Weak accounting systems (Asian Development Bank, 1998, p.xviii)
- (ii) Failure to collect taxes due; partly a governance and discipline problem. Undercollection of government revenues has occurred on a massive scale (Ministry of National Planning and Development of Solomon Islands, 1998, p.6).
- (iii) The Minister of Finance was able to grant various tax remissions and exemptions. In particular the granting of these to logging companies resulted in a huge loss of revenue. The Central Bank estimated a loss of as much as SBD \$53 million from this source in 1996 (Ministry of National Planning and Development, 1998, p.6). This combined with failure to record all the log exports accurately [the problem indicated in (iii)] reduced the revenue due to the Government.
- (iv) On the outlays side, the proportionate cost of servicing the government debt rose in relation to the budget (Solomon Islands Government, 1999, p.21).
- (v) Considerable growth occurred in the size of the public sector e.g. outlays on the payroll of public servants.
- (vi) To some extent state-enterprises placed a net drain on government revenues due to their economic losses and capital requirements.

The election of the Solomon Islands Alliance for Change (SIAC) Government in August 1997 heralded a change in economic policy. As reported by the Deputy Governor

of the Reserve Bank, the Solomon Islands Government implemented a Policy and Structural Reform Program aimed at achieving macroeconomic stability. "Key policy measures introduced since 1997 include:

- Adjustments to the exchange rate (20% devaluation in December 1997 and 6% in August 1998);
 - Pursuance of tight fiscal and monetary policies;
 - Pursuance of a wage moderation policy;
 - Public service reform;
 - Privatization and reform of state-owned enterprises and joint venture companies; and
 - More consultation between the government and other stakeholders in the economy"
- (Deputy Governor Reserve Bank of SI, 1999)

The government was successful in recording a surplus on its current account for 1998 due to tighter fiscal policy, the freezing of the salaries of public servants, retrenchment to reduce the size of the public service and other reform measures within the public service. These include greater contracting out by government. Also, the employment of the user pays principle is being followed up by government. Privatisation of state-owned enterprises has progressed slower than previously anticipated. It was hoped that sale of the Government's remaining share of Telekom (58%) and its sale of Solomon Island Plantations Ltd. (SIPML) would have enabled the government to reduce its debt. While a bid was received from Cable and Wireless for Telekom, it was not considered satisfactory. Similarly an offer made for SIPAL was unacceptable. It is understood that taxation and other concessions were requested by prospective private purchasers.

2.3 Sources of Finance to Cover the Government's Debt

The Government's debt involved both internal and external borrowing. As at the end of 1998, the Government's external debt was SI \$574 m and its domestically financed debt was covered by \$293.7 million in securities plus loans and advances from the Central Bank of \$75.2million, making an internally financed debt of \$368.0 m. In addition, \$41 m. was owed to trade creditors. Excluding the last item, the total government debt was

\$942.9 m. Given an estimated population of 425,000 in 1998, this amounted to a debt of SI\$2,218.6 per position. This is a considerable debt for a country with a low level of per capita income and with around 85% of its population earning only subsistence or semi-subsistence income.

Table 2 provides information about the distribution of internal holdings of the Government's debt. The principal holders of the debt were the commercial banks, followed by the National Provident Fund, then (if loans and advances are included) the Central Bank, with the public only holding a relatively small percentage of this debt. Virtually all the Government debt internally financed is owed to institutions.

INSERT TABLE 2

A financial/monetary type economy is relatively underdeveloped in the Solomon Islands. It is at its highest stage of development in the Honiara area. The capital market is thin.

The domestic capital market was thrown into disarray in mid-1995 when the Government was unable to meet its debt obligations, particularly since the major financial institutions had a high exposure to this debt. To restore confidence in the capital market is not easy, even though there are some signs that confidence in the capital market is being restored. Debt obligations have been renegotiated and the government budget is now in surplus. Nevertheless, the government will need to exert continuing fiscal discipline in order to restore a stable financial situation. It is only by this means that the availability of domestic financial resources to the government can be restored.

As pointed out earlier, the external debt of the Government in 1998 was \$574.5 million, and exceeded the debt held internally. Table 3 indicates that the Government's external debt grew at a faster rate than that of the private sector external debt of the Solomon Islands in the period 1994-1998. In this period official external debt increased by around 80 per cent whereas in fact private sector external debt decreased somewhat.

Table 2
Domestic holders and Distribution of the Public Debt
within the Solomon Islands, 1998

Holder		\$'000	%	\$'000
		Securities only		Securities plus loan advances
National Provident Fund	109,579	37.3	109,579	29.7
Commercial Banks	165,527	56.35	165,527	44.87
Public	12,217	4.09	12,217	3.31
Central Bank ^(a)	6,437	2.19		
Total Securities	293,760	100.00 ^(b)		
Central Bank ^(a) plus loans and advances to Govt.			81,620	22.12
Total debt held internally			368,943	100.00 ^(b)

Note b: May not add exactly due to rounding

Source: Based on Central Bank of Solomon Islands (1999) pp.66,91

Table 3
External Debt of the Solomon Islands

	1994	1995	1996	1997	1998
Private Sector	269.8	233.3	212.8	248.5	253.7
Official	320.6	339.9	370.3	507.5	574.0
of which: arrears			24.3	52.3	40.5
Total	585.5	519.3	583.1	756.0	827.7
Debt Service	64.6	81.7	75.4	91.4	186.9
Principal	48.1	69.5	70.8	79.6	138.7
Interest	16.5	12.2	4.6	11.8	48.2

Source: Central Bank of Solomon Islands (1998) p.30

INSERT TABLE 3

Long-term capital inflows according to Balance of Payments data (Central Bank of Solomon Islands, 1999, p.29) are mostly in the form of loans. As can be seen from Table 4, in recent years (1996, 1997 and 1998) the Balance of Payments of SI has been in surplus. The Central Bank of SI (1999, p.29) reported:

“In the Solomon Islands, the surplus in the capital account is also a common feature of the balance of payments. This reflects to a great degree, lack of adequate domestic savings to finance the desired volume of capital expenses. As a result, the country has become a net borrower and recipient of direct investments from abroad. In 1998, the capital account registered a surplus of \$122.1 million less than the surplus in 1997. The reduction resulted mainly from the decline in private sector net inflows”.

There was a significant decline in foreign direct investment in 1998 but this investment is relatively volatile. For example, it is likely to have been influenced by an Asian financial crisis.

INSERT TABLE 4

Policies designed to encourage private investment including foreign direct investments are mostly those concerned with economic reform of the public sector to restore macroeconomic stability and economic confidence in the government. However, tax holidays, taxation reductions and exemptions are available to foreign investors at the discretion of the relevant minister. These appear to have been administered in a relatively ad hoc fashion and have been the source of considerable loss of public revenue e.g. from logging. These concessions have helped contribute to past government budget deficits. Even now new investors are seeking such concessions, e.g. private bidders for SI public enterprises.

Table 4
Summary of Balance of Payments of the Solomon Islands,
1994-1998 in SI \$m

Year	1994	1995	1996	1997 ⁽¹⁾	1998 ⁽²⁾
Current A/c					
Balance	-46.8	-6.3	14.8	-142.4	24.3
Capital A/c					
Balance	-7.5	-13.6	-16.5	182.9	108.4
Balance of Payments after errors and omissions	-6.5	-2.7	64.1	33.8	83.3

Notes: ⁽¹⁾ Revised figures

⁽²⁾ Provisional figures

Source: Extracted from CBSI (1999, p.85, Table 1.9)

2.4 Availability of Private Finance in Solomon Islands

In common with the other least developed Pacific Island nations, financial markets in the Solomon Islands are underdeveloped and exhibit major gaps compared to those in more developed countries. Constraints include the absence in most of the country of private ownership of land which limits its possible use as collateral for loans, the limited size of the potential market for equity capital which means that a stock exchange is absent and the difficulties of providing micro-finance for indigeneous entrepreneurs.

SI has a Central Bank and three commercial trading banks. The commercial banks are required to maintain liquid asset deposits with the Central Bank partly as a prudential measure. Commercial bank deposits with the Central Bank earn interest. Foreign investment by the commercial banks appears to be restricted. The commercial banks are relatively centralised in their locations and generally extend loans to established businesses able to provide adequate collateral. Thus, they concentrate on the lower risk segment of the loans market. Also they usually find any small loans to be financially unattractive. The paucity of their branches and agencies is the subject of criticism. CBSI (1999, p.47) commented that their representation is well below the demand for their services and continues to be of great concern to government, businesses and individuals directly affected because of difficulties in accessing formal banking services in their respective localities.

The Development Bank of the Solomon Islands (DBSI) provides loans for riskier projects than the commercial banks and with less collateral. New entrepreneurs, rural projects and businesses of Solomon Islanders may be more likely to obtain finance from DBSI than the commercial banks. Nevertheless, DBSI may be reluctant to provide micro-finance. Furthermore, ADB (1998, p.15) found in 1997 that most of DBSI's recent loans have been for commercial and service-type projects around Honiara. So regional development has not been pursued by DBSI. In 1995 and 1996 DBSI made a small profit. Its debt arrears (17%) were moderate especially when compared with those of the Development Bank of Kiribati.

However in 1998 the financial situation of the DBSI had deteriorated. Its arrears on loans had risen to 20% but more significantly the European Investment Bank suspended its \$6 million credit line to the DBSI mainly because of the inability of the SI government to service its debts. DBSI is being brought under the supervision of the CBSI. The structural change in the nature of DBSI loans in favour of Honiara and other urban centres and away from agriculture continued. The CBSI (1999, pp.48-49) commented:

“This reflects a structural shift in DBSI’s asset portfolio towards more lucrative business activities and clients with good repayment track records. This positive discrimination stems from the need to ensure that the banks resources are channeled to activities yielding a greater rate of return and involving lower risks. This shift is essential to allow for the sustainability of DBSI activities in the face of dwindling financial support from government and the increasing trend to finance lending from internally generated resources, and improving the quality of its loan portfolios.”

It was not possible during my visit to ascertain the extent to which the DBSI provides business advice and education. However, the Ministry of Commerce and Tourism provides some such services for small businesses through a UNDP-sponsored scheme.

An important component of the SI financial system as far as micro-finance is concerned is the existence of credit unions. These operate in many communities throughout the country providing finance to villagers and deposit schemes for their savings. Being to a large extent community-based, they are likely to have reasonable knowledge of the credit worthiness of their potential borrowers.

Credit unions are of growing importance in the financial system of the Solomon Islands and are registered under an umbrella organization, the Solomon Islands Credit Union League. They tend to be-community based and are more likely to provide micro-financing than other financial institutions partly because of their superior knowledge of the credit worthiness of their potential borrowers. It is pertinent to note that the Solomon Islands Credit Union League had been to a considerable extent funded by the International Fund for Agricultural Development (IFAD) which has provided significant

support globally for micro-financing to assist rural development. However, IFAD funding was withdrawn in 1998. Suspension of IFAD Loan disbursements occurred because the SI Government was unable to service its arrears on the IFAD loan.

In 1998, there were in fact 163 registered credit unions in SI with a membership of 17,871. The CBSI (1999, p.51) points out that the quality of the management of credit unions varies considerably and that they are often lax in reporting statistical information and financial data (required by the credit union act) to the Solomon Islands Credit Unions League and the CBSI. Nevertheless, they appear to be filling an important niche in the financial system of the Solomon Islands.

Apart from the commercial banks, the National Provident Fund (NPF) is a major financial institution in SI. It owns 49% of the shares of the National Bank of the Solomon Islands (the remainder being held by the Bank of Hawaii). Despite the fact that the NPF is funded by compulsory levies on employees and employers in the cash economy, contributors appear to have little control over its policies. The Government has strongly influenced its policies and has made it an important source of finance for Government enterprises. As a result, it seems to have failed to promote the interest of NPF members (ADB, 1998, p.4) and has not adopted best financial practices. Prudential supervision of the NPF is being transferred in 1999 to CBSI. The position of national provident funds in all of these least developed countries has been clouded to some extent by political intervention in their policies.

Restrictions on foreign investment by major financial institutions in SI have limited their potential to maximize returns on available funds. Given the limited opportunities for high yielding private investment in the Solomon Islands this probably increased their willingness to purchase Government securities thereby exposing them to the risk of default on Government loans.

The housing loan scheme of the NPF was suspended in 1998 due of arrears. In addition the Housing Finance Corporation is in financial difficulties because of arrears and its bad debts constitute a serious problem.

It was reported that the SI financial system is unable to finance major projects internally and that gaps in micro-financing still exist.

2.5 Recommendations

- It is important that the Government continues to take steps which will keep its budget in balance, and do so as efficiently and equitably as possible. Lack of confidence in the financial reliability of the SI Government can only serve to reduce financial resources available to it and slow the long-term economic development of SI. It needs to become a speedier and more reliable payer of its trade creditors. In a country where the Government is a major purchaser of goods and services, business confidence and willingness to accept Government business will be seriously reduced by slow payment or lack of payment by the Government. This is especially important if greater contracting out of public works and services is to occur.
- Possibly SI financial institutions should be given easier access to foreign capital markets than at present so as to increase their return on capital, diversify their investment portfolio and reduce their risks. At the same time, no substantial evidence appears to exist to support the claim that public borrowing in SI crowded out private investment, even though unwise public borrowing in the end did eventually shake business confidence. The position is clearly complex.
- Without much doubt, ethnic conflict will further erode private investment in SI. Considerable effort should be made to restore social harmony and make sure that ethnic violence, such as occurred in 1997, ends.
- One must also wonder for how long SI will be able to continue with a managed exchange rate (cf. ADB, 1998, p.18).
- The Development Bank of the Solomon Islands has experienced financial difficulties which has resulted in a change in its financial activities. Most development banks in the region have had similar difficulties. A review of development banking is needed.

- Credit unions are playing an important role in financing small projects in SI. Their role is worth in-depth study. The potential for transferring the experience of SI in that respect to countries such as Kiribati and Tuvalu is worthy of consideration given the lack of comparable institutions in these countries.

3 SOCIAL ISSUES

3.1 An Overview

The social issues of SI can best be appreciated against the background of its demographic features. The Solomon Islands has the highest rate of population growth for the Pacific island nations belonging to the SPC. This rapid rate of population growth has placed considerable strain on the ability of SI to supply educational and medical facilities to keep pace with this growth. According to the Secretary to the Minister of Education and Human Development, the provision of facilities for education has been unable to keep up with population growth in SI. The position in relation to health is less clear but undoubtedly the rising population has increased the demand for health facilities and medical services.

Both the provision of education and health are funded from the recurrent budget as well from overseas aid. Health typically accounts for 13% of the recurrent budget. Expenditure on education accounts for 17.2% of the recurrent budget. Therefore, together health and education account for around 30% of the recurrent budget.

Social targets do not seem to be well articulated, and are at present undergoing review. In education, relative support for primary education in the recurrent budget has increased but overseas aid money has been focussed more on higher levels of education. Both literacy rates and school enrolments as a percentage of school age children appear to have increased in the 1990s compared of the 1980s. However, a considerable gap remains to be filled, even though it may be that the method of measuring literacy (with its emphasis on English) understates literacy. The Secretary of Education and Human Development reported that a balanced educational system is needed. Balance is required in relation to levels of educational attainment, type of programmes offered and regional delivery.

The least developed status of SI is confirmed by its very low HDI. UNDP (1999, p.13) estimates that in 1998 it was 0.371 making it the second lowest HDI in the Pacific – only that for PNG was lower. GDP per capita for SI was also low at US\$920 per annum with only that of Kiribati being lower. Nevertheless, between the 1980s and 1998 the HDI for SI considerably improved rising from the extremely low figure of 0.179 to 0.371.

In terms of the Human Poverty Index (HPI), the situation of SI was one of the poorest in the world being comparable to that for Guinea and worse than for Bangladesh or Pakistan. HPI for the Solomon Islands was estimated to be 49.1 with only PNG in the Pacific islands having a higher HPI. Vietnam, Myanmar and Cambodia had lower HPIs. By world standards, the poverty of SI and PNG (and up to a point Vanuatu) is clearly oppressing (cf. UNDP, 1999, p.19).

The situation of the Solomon Islands is made more difficult by its rapid rate of population growth which increased on average by 3.3% per annum in the period 1990-98 – one of the fastest growth rates in the world. Unfortunately, low incomes and poverty are often associated with rapid rates of population growth.

Such growth places considerable economic pressure on a nation as it tries to provide for education and expand its health and infrastructure facilities.

Consider now some specific aspects of education, health and other issues in SI in turn.

3.2 Education

School enrolments in SI are amongst the lowest in the Pacific islands. The gross school enrolment for males is only 38% and for females 31% (UNDP, 1999). Only PNG has a lower school enrolment in the Pacific islands.

Males are favoured in comparison to females for education. This disparity exists both at primary and secondary levels with the relative disparity in favour of males widening at the secondary level.

It is estimated that 80% of females are illiterate and that 61% of males are illiterate – very high levels of illiteracy indeed. However, the Secretary of the Ministry of Education and Human Resource Development, SI, raised doubts, in private conversation about the accuracy of these estimate and suggested that they are over estimates. Nevertheless, available resources for education in SI have clearly resulted in a low level of educational attainment. This is so despite the fact that over 15% of the national budge is allocated to education, a percentage not markedly less than that of Kiribati.

ADB suggests that SI may not spend its allocation for education efficiently. It suggests, for example, that relatively speaking that there is too much emphasis on higher secondary education relative to primary education, and higher secondary education is expensive, particularly since many of the students involved have to board due to the scattered nature of the population and shortcomings in transport. Like Vanuatu, the Solomon Islands also has to cope with significant cultural diversity and diversity of local languages.

ADB (1998) favours greater attention to primary education. However, given limited resources a balanced system is needed to meet SI's trained labour requirements. It seems that at present that SI cannot offer basic education for all, and education is not compulsory. It may be that too much emphasis is being placed on higher education but if at the other extreme, all emphasis was to be placed on basic education only, this would be unsatisfactory from a economic and social viewpoint as well. Given limited resources an appropriate balance must be struck.

Responsibility for administering schools in SI is mixed. In 1997-98, 89.5% of primary school enrolments were administered by the Provinces, 9.29% by church authorities and 1.2% by secular authorities (Ministry of Education, SI, 1999, p.3). Church involvement at secondary school is relatively greater. The Provinces administered 72.48% of secondary enrolments, the churches 20.6% and 6.92% of enrolments were directly administered by the Ministry of Education and Human Resource Development (1999, p.4).

It is possible that his mixed system adds to administration costs, and it is unclear from data supplied whether non-government suppliers of education are supplying it at lower cost than in government administered schools. The government normally provides the salaries of teachers and other school expenses are met by the schools themselves from school fees.

Not only is education far from universal but doubts have been raised about the quality of education provided. Many teachers themselves have little education (ADB, 1998). In 1992, for example, UNESCO found that 20% of primary teaching staff had not been educated beyond grade 9.

In recent years, the relative allocation of funds from the budget for education have declined slightly. Furthermore, it appears that population growth is outstripping the availability of school places at primary level. UNDP (1999) estimates that the population of SI's youth is increasing at about 4% per year. But in 1996 and 1997 primary school enrolments only increased by 2.88% and 1.31% respectively, down from just over 5% in 1994 and in 1995 (Ministry of Health and Human Resource Development, 1999, p.6). In addition, available statistics indicate that growth in secondary school enrolments was at a relatively constant absolute rate between 1995 and 1998, which implies a declining geometric rate, but the rate of this increase was faster than the rate of increase in SI's youth population (cf. Ministry of Education and Human Resource Development, 1999, p.6). Comparatively speaking most emphasis still seems to be on expanding the secondary sector of education. This suggests that policy-makers need to give more attention to determining the appropriate balance between different levels of education in SI.

At the tertiary education level, SI has the Solomon Islands College of Higher Education (SICHE) which according to the Solomon Islands Trade Directory, "provides courses designed for the lower and middle level manpower needs of the country". Courses are available in education, business, trades and technical education generally. The University of the South Pacific has an Extension Centre in Honiara with satellite back-up to its main

campus in Suva. It is important that tertiary education facilities and offerings not be duplicated in the South Pacific given the limited available resources for education unless there are very good reasons for doing so. SICHE, in fact, probably only involves very limited duplication of offerings with USP.

3.3 Health

The health situation in Solomon Islands remains a cause for concern even though life expectancy at birth increased from 54 in the 1980s to around 65 years by 1998. As in Vanuatu, malaria continues to be a problem as do various parasitic infections associated with the tropical conditions of SI. Some progress has been made in controlling morbidity due to malaria. In 1992, 440 cases per 1000 of the population were reported but by 1998 this had fallen to 200 per 1000, which of course is still a high figure. Malnutrition amongst children continues to be a problem. Over 20% of children under 5 were reported by UNDP (1999, p.112) to be under-weight.

Furthermore access to health services in SI is one of the lowest in the Pacific Islands. According to UNDP (1999, p.112), one in five persons in the Solomon Islands does not have access to health services.

Infant mortality is still relatively high at 38 per 1000 births, and 50 children per 1000 live births die before 5 years of age. Maternal mortality is one of the highest in the Pacific at 550 per 100,000 live births.

The leading causes of death in SI in 1998 in decreasing order of importance were respiratory diseases, diarrhoea and malaria. The leading causes of morbidity are the same, but the incidence of malaria is greater than that of diarrhoea.

The Solomon Islands allocates about 11.6% of its national budget to health, a percentage comparable to Samoa, actually slightly higher. But the Solomon Islands may have conditions that are very environmentally unfavourable to health. Samoa, for example, is free of malaria.

The Solomon Islands has the Central Hospital in Honiara and eight provincial hospitals. There are Church hospitals in Munda and Malaita. In addition, SI has several health centres and many clinics some of which are administered by the churches and subsidised by the state. It is reported that such subsidisation raises many problems for accountability.

Health services are free, except for those who use private doctors, mostly expatriates. Financial support is provided to church administered hospitals, health centres and clinics. ADB (1998) suggests that greater use be made of fees and that insurance schemes be introduced in urban areas. This had not happened as at mid-1999. The issues and problems are similar to those reviewed in relation to Samoa. Active consideration was being given to greater contracting out of some services to increase efficiency.

In 1999, the Ministry of Health intended

- To explore scope for contracting out some services.
- Arrange formal agreements with church hospitals, medical centres/clinics which are being subsidised.
- Review the balance of funding between curative and preventative medicine, possibly to increase emphasis in the latter
- Review the balance between central provision of health services in Honiara and regional provision

It is not intended to institute charges for immunization, treatment of communicable diseases and for natal care for women. It is recognised that charging for medical services is likely to raise serious political concerns.

Concerning decentralisation of provision of health services, ADB (1998, p.127) argued that they were too centralised. However, in relation to its report on Vanuatu, ADB (1998) argued that health services in Vanuatu were too decentralised and that economies could be achieved by greater centralisation. So it is clear what is the 'optimal' model.

The Solomon Islands is experiencing a shortage of doctors. There were 12 vacancies for doctors with the Health Department in mid-1999. Medical equipment is in short-supply.

3.4 Other Social Issues

As in many Melanesian countries, the status of women is of concern. Women have a lower level of literacy than men in SI, and females have less access to schooling than males. They have little political representation. They may suffer on the whole other disadvantages as well. There is a relatively high rate of teenage pregnancies and a low contraception prevalence rate.

Ethnic disharmony is another serious problem as indicated by ethnic violence in 1999 on Guadalcanal in relation to settlers from Malaita, many of whom were small entrepreneurs. Tribal loyalties and communal land ownership impede internal migration in response to economic opportunities.

SI is an archipelagic country covering a large area with a diversity of local cultures. Presently the prime loyalty of individuals is to their own village or tribal group rather than to the nation. The process of nation-building still has a considerable way to go and it has been said that the country consists of hundreds of nations with loyalties centred on local groupings. This lack of solidarity adds to the costs of governing the country and requires special attention to be given to provincial and local concerns.

3.4 Recommendations

- The Solomon Islands needs to plan carefully the appropriate structure of its educational system, particularly the appropriate balance between primary and secondary school enrolments. Analysis may not indicate a reduction on senior school places is desirable compared to primary enrolments but the balance should be determined rationally.

- SI does not appear to be in an economic position to introduce 10 years of compulsory universal education without seriously undermining the quality of its current educational efforts, the quality of which needs to be improved according to ADB and other international bodies.
- SI needs continuing aid to support its educational effort.
- It is not clear to what extent the payment of fees prevents the children of low income households and subsistence/semi-subsistence Solomon Islanders from attending school or continuing schooling.
- A selective scheme for higher senior school places seems fair given the limited number of places, if it is based on academic merit.
- There is a need for provision of some tertiary education courses in SI but this should be done in a way which avoids duplication, unless a strong case can be made out in each particular case for duplication.
- SI still has serious health problems which arise partly out of its underdeveloped status which makes it difficult to supply primary health needs. It has problems arising from its tropical environment such as the presence of malaria. Ill health is a drag on economic productivity in SI.
- Many rural dwellers are without access to health services, although several provincial hospitals exist. ADB suggests that the health system should be more decentralized. Arguments have been put forward both for centralisation and decentralisation. The case is not clear-cut either way. However, for the 20% of the population which has no access to health services, provision of basic health services may be desirable.
- The present policies being explored by the Ministry of Health for improving efficiency in supply of health services seem appropriate. Furthermore, the broad guidelines for services to be excluded from user-pays seem appropriate because of the externalities involved.
- Tardiness in introducing health user-fees and compulsory health insurance schemes is appropriate in view of political considerations, and in the case of insurance systems their possible distributional shortcomings in subsistence economies. The option for private insurance through private doctors exists. In-depth study is required to devise

an equitable and economical user-pays scheme for health services if user-pays is adopted as a political option for the provision of health services.

- The status of females in SI is not satisfactory from a Western perspective. Improving the status of females is a long-term process. More aid should be given to NGOs aiming to improve the status of women in SI.
- Ethnic tensions which erupted in violence in 1999 undermine the economic development of SI by reducing mobility of human resources and deterring foreign investment and tourists. A high priority needs to be given to measures to promote national harmony and solidarity. Local loyalties appear to prevail over national loyalties. This is not surprising seeing that SI, like many other nations, is a colonial legacy. Care must be taken to ensure that structural adjustment policies do not undermine the process of nation-building which is still in its early stages.

4 TRADE AND THE EXTERNAL BALANCE OF THE SOLOMON ISLANDS

4.1 An Overview

Unlike Kiribati and Tuvalu, and to some extent Samoa, and to a greater extent than Vanuatu, SI relies on its merchandise exports heavily to contribute towards its international receipts. It does not receive the significant contributions from inbound tourism which Vanuatu does.

The major contributors to SI's exports in recent years have been timber (logs and sawn), fish (tinned, frozen and smoked), palm oil and kernel, copra and coconut oil, cocoa, marine shells and gold. By value timber has been the main item (about 55% of value of exports) followed by fish (25%) then palm oil followed by copra. But prices and demand for most of these products can be volatile. The Asian financial crisis, for example, led to a collapse in the demand for the timber from the Solomon Islands with serious repercussions for SI's balance of payments and for fiscal stability.

As far as timber is concerned, there is also the problem that it is being logged at an unsustainable rate. As mentioned earlier, much revenue from logging was lost to the

Government due to duty exemptions and remissions by the relevant Minister and especially through under-invoicing. Just how much economic benefit flows permanently to the local communities where logging occurs is difficult to say. SI needs a strategy to free itself from unsustainable economic dependence on logging.

Not all exports are equally beneficial to semi-subsistence farmers in SI. Banstead (1999) points out that about 86% of Solomon Islanders engage in subsistence agriculture and states (p.39):

“Subsistence agriculture among the villages consists mainly of cassava and sweet potatoes, but in terms of cash crops, 57% of household produce copra; and cocoa, betel nut, taro, sweet potato, cassava, yams, tomatoes and sugar cane are produced by up to 40% of households for local income. Other cash crops include vanilla, English potatoes, cardemon, mango, avocado, pawpaw (papaya) and various nuts, including ngali nuts, which are packaged and exported, and coffee”.

Table 5 provides a relatively detailed account of the balance of payments of SI for the years 1994-1998. It confirms the importance of exports in the accounts. On average and in the long-period, the value of exports of SI almost covers the value of its imports, even though a significant gap still exists as a rule. Overall, however, the current account of SI is usually but not always in deficit mostly because of its large deficit on account of services. Transfers make a positive contribution and official transfers in particular are important as a contribution to the current account. However, these are at most stationary in absolute terms and appear to be declining. There is a small net contribution from private transfers, possibly mainly because of employment of some Solomon Islanders on foreign vessels.

The balance of SI's capital account has varied. It was negative in the period 1994-96 and positive in the period 1997-1998 mainly because of large long-term loans accepted by the SI government and a substantial rise in direct investment.

Table 5
Balance of Payments of Solomon islands, 1994-1998 in SI\$millions

	1994	1995	1996	1997 /1	1998 /2
CURRENT ACCOUNT	-46.8	-6.1	14.0	-142.4	24.3
Merchandise trade (net)	-0.2	46.9	39.8	-104.3	-87.0
Exports, fob	467.9	573.2	576.6	581.5	683.0
Imports, cif	468.1	526.3	536.9	685.9	770.0
Services (net)	-193.9	-142.5	-155.6	-145.6	-38.2
a) Travel (net)	12.6	-1.0	-9.1	-19.0	-29.5
Credit	64.0	58.2	56.7	35.9	39.6
Debit	51.4	59.2	65.8	54.9	69.1
b) Investment Income (net)	-9.7	-22.9	-25.2	-31.4	-38.0
Credit	4.9	4.1	8.4	10.1	10.2
Debit /3	14.6	27.0	33.6	41.5	48.2
c) Other Services (net)	-196.9	-118.6	-121.3	-95.2	29.3
Credit	100.4	84.2	109.2	202.8	207.8
Debit /4	297.3	202.8	230.5	298.0	178.5
Transfers (net)	147.3	89.5	129.8	107.5	149.6
a) Official	143.8	88.3	139.0	96.2	137.5
Cash	4.1	3.3	5.6	9.4	14.1
Goods and Services	139.7	85.0	119.4	86.8	123.4
b) Private (net)	3.5	1.2	4.9	11.3	12.1
Credit	40.3	61.1	66.0	79.6	123.8
Debit	36.8	59.9	61.2	68.3	111.6
CAPITAL ACCOUNT	-7.5	-13.6	-16.5	182.9	108.4
Private (net)	2.5	-39.8	-33.7	162.6	34.3
a) Long term (net)	-4.4	-46.7	-21.0	36.8	5.2
Loans	34.8	16.7	45.2	87.8	109.7
Repayments	39.2	63.4	66.2	51.0	104.5
b) Direct Investment (net) /5	1.7	4.6	1.6	128.4	35.0
c) Other (net)	5.2	2.3	13.7	-2.6	-5.9

Table 5 continued on next page

Table 5 continued

SI Government (net)	-4.4	11.8	-7.5	20.3	74.1
a) Investment grants	9.4	5.1	1.8	1.1	33.3
b) Long term (net)	-4.4	11.8	-7.5	-18.9	58.6
Loans	4.5	24.7	9.2	9.7	92.8
Repayments /6	8.9	12.9	16.7	28.6	34.2
b) Short term capital (net) /7	0.0	9.3	27.9	38.1	-17.8
Net Errors and Omissions	32.0	17.0	33.5	-6.7	-49.8
Overall Balance	-6.5	-2.7	64.1	33.8	83.3

1/ Revised figures.

2/ Provisional Estimates.

3/ Figures for 1995-97 include interest arrears.

4/ 1997 figure includes non-debt arrears.

5/ 1997 figure includes \$11.3m in debt equity swaps

6/ 1995-97 figures include principal arrears.

7/ Principal, interest and other external arrears.

Source: Central Bank of Solomon Islands. 1998, p.85

The foreign reserves position of SI is not very strong. As at the end of the fourth quarter of 1998, its gross external reserves stood at SI\$233.7m whereas its imports for this quarter were SI\$146m. This meant that it had less than 5 months cover for its imports, a figure which has sometimes been lower in recent years.

It seems that SI has failed to collect much of the natural resources rent from foreigners due to it (partly due to poor governance), has failed to use rents collected to build up its foreign reserves e.g. by investing some of these funds abroad, and also may not have invested these rents wisely or to the extent desirable to accumulate man-made capital (particularly by additions to infrastructure) in the country. In fact, its Gross Domestic Investment as a percentage of its GDP was lower in the 1990s than in the 1980s (see ADB, 1998, p.7). Although its resource gap fell in the 1990s this was mainly due to a falling GDI as a percentage of GDP.

SI's failure to collect adequate resource rents is especially regrettable in relation to timber harvests because the recent rate of harvest is unsustainable. The Solomon Islands must look more towards the sustainability of its long-term economic development. It is a country rich in natural resources but at the same time it is extremely poor country which cannot afford to squander its economic opportunities.

Even though SI has a broader resource-base than Kiribati and Tuvalu, its balance of trade and payments is volatile as is its public revenues as recent experience shows. This experience has forced SI to engage in significant structural adjustment and accept substantial foreign loans in an attempt to regain its economic equilibrium. Therefore, there may also be a case for it to use some of its natural resource rents to build up a stabilisation fund managed in a similar way to that of Kiribati and Tuvalu. Furthermore, it would seem important to use a significant proportion of these rents for considered capital accumulation in SI.

4.2 Recommendations

- Not all export industries are equally beneficial to domestic semi-subsistence producers. A review of the export industries of SI may be desirable from a distributional point of view.
- The major export of SI (timber) cannot be sustained at current rates. SI needs to consider measures to reduce its dependence on such exports. It should not wait until the virtual exhaustion stage before taking appropriate political action.
- It must make sure that it collects natural resource rents due and uses these in a wise manner for the sustainable development of SI.
- It might consider using some of its natural resource rents to build up a stabilization/foreign investment funds. This could help with public finance as well as improve the external reserve situation of SI.
- The infrastructure needs of SI are considerable and some rents should be used for adding wisely to SI's infrastructure.
- At this stage overseas assistance continues to be essential to SI to prevent a major deficit in its balance of payments. In the long-term the type of fund mentioned above would reduce this dependence.

5 INFRASTRUCTURE

5.1 An Overview

Infrastructure is in a poor state in SI. Banstead (1999, p.47) reports:

“Economic growth has been inhibited to date by lack of infrastructure. Projects such as fishing or cannery development has been abandoned due to lack of storage and ports (although a Japanese-funded port project in Guadalcanal is now underway). A World Bank study has indicated that expenditure on roads and civil aviation is currently about 47% of what is required, and on marine transport about 53%”.

Proposed improvements in infrastructure are mostly focused on Guadalcanal, particularly Honiara and rural areas are relatively neglected.

Roads: There are only 110 km of roads on Guadalcanal but most are in very poor condition including the main thoroughfare in Honiara which is heavily pot-holed. Traffic congestion at various times of the day is a problem in this thoroughfare. A Kuwaiti-funded road improvement scheme will help rectify this problem providing an improved carriage-way from the airport to the other side of the CBD of Honiara.

Only 11% of rural areas are accessible by road. These are mainly located on Guadalcanal and Malaita which means that other provinces are lagging in terms of provision of infrastructure.

Air: The International Henderson Airport near Honiara is an all-weather sealed airport which was upgraded in 1998 with Japanese assistance. It provides regular international services. During the period of ethnic violence in and around Honiara airlines cancelled night landings for security reasons. Solomon Airlines is the national carrier serving both internal and external routes.

There are 20 airfields in SI and about 50,000 internal passengers are carried annually. (Banstead, 1999, p.49). However, there are many significant islands without airfields and flight schedules are often irregular, as in much of the Pacific. Ambitious plans exist to increase the number of airfields in SI but problems have been encountered because of the number requiring construction to obtain contractors able to supply the works.

Sea Transport: Many ports of the Solomon Islands are only served by sea transport, most of which is provided by the Government. Almost 400,000 passengers annually are transported by sea. Shipping is considered to be unreliable, though fares are low. There are few wharves and storage facilities for freight are often inadequate. In many areas, passengers must disembark by canoe or small boat and small boats are used for the transfer of freight.

Government shipping services have operated at a loss, and under proposals for economic reform, SI's inter-island fleets are to be privatised, subsidies being provided for

uneconomical routes. This follows a pattern similar to that recommended by external agencies for many other Pacific Island nations. It is hoped that this will result in a more economical service. There are, however, some concerns about the possible impact of these changes on the availability of sea transport to remote islands and areas expressed. This is especially important because good transport and communications with SI can help with its process of nation-building.

Energy, Telecommunication and Water: Electricity (generated from oil) is available on the larger islands only and is not very reliable in supply, and considered to be quite expensive. The Solomon Islands Electricity Authority (SIEA), a public body, is responsible for the supply and has been provided with government assistance especially for capital works. Increasing the efficiency of SIEA is a high priority.

Water supply in urban areas is under the control of the Solomon Islands Water Authority, a public body which is in the process of upgrading water and sanitation supplies in Honiara. The high incidence of diarrhoea in SI indicates that there is considerable need to upgrade water supplies and sanitation throughout the country.

Telecommunication are operated as a joint venture. Solomon Telekom is partly owned by Cable and Wireless (C&W). Under restructuring, the Government proposed to reduce its share in Solomon Telekom from its 58% holding in accordance with restructuring. However, as at mid-1999, it had been unable to reach an acceptable agreement with C&W. It is unclear how well SI as a whole is served by telecommunications, but Honiara seems to be well served with internet services available.

Some Additional Policy Issues: The SI Ministry of Public Works intends to make greater use of contracting out. Concerns were, however, expressed that this could give scope for dishonest practices, and reduce the level of in-house skills. Furthermore, in several areas there is likely to be only one or a few contractors available. This can result in excessive charges and inability to have construction programmes completed. The failure of the Government to pay or to pay trade creditors and suppliers in a reasonable

time during the recent financial crises of the SI government has reduced the number of corporations willing to tender and in general the number interested in doing business in the Solomon Islands. Prompt and reliable payment to suppliers is essential in any system of contracting out. Problems in this regard are likely to result in a rise in tender prices, lack of interest in tendering or below standard supply in view of the problem involved in payment. Contracting out is not a panacea for economic efficiency.

5.2 Recommendations

- The infrastructure of SI is inadequate. Serious deficiencies exist in relation to roads and in many areas, in marine facilities such as wharves and stores. In addition, more airports are required but it is difficult to find contractors to carry out the required work given its nature and the extent of the work needed, as well as the previous credit record of the SI Government.
- The situation both in relation to electricity supplies and other utilities such as water and sewerage is far from adequate. Improvements call for continuing foreign aid.
- SI needs to make concrete plans to use part of its natural resource rents for investment in the improvement of its infrastructure.
- Privatisation of utilities and increased contracting out of public works are unlikely to be sufficient to overcome its deficiency in infrastructure and these can bring new economic problems. For this reason care and further analysis of the issues involved are needed.

6 CONCLUDING COMMENTS

The Solomon Islands experienced serious problems with its development in the 1990s; some of which were similar to those of least developed countries in sub-Saharan Africa. In August 1995, its Government was unable to service its public debt and to pay its trade creditors. Thus it experienced an economic crisis. A 'rescue package' and rescheduling of its debt followed.

The crisis had several origins. These included lack of restraint on public expenditure and significant failure in collecting taxation and revenue due to the government such as

timber royalties. Governance problems played a role and the Asia financial crisis added to the economic difficulties of the Solomon Islands.

As part of the rescue package, the Solomon Island's Government was obligated to introduce economic reforms. A substantial reduction in employment in the public sector followed. In 1999, steps were also being taken to introduce performance budgeting in the public service and increasing emphasis was being placed on contracting out of public works and activities to increase economic efficiency. However, divestiture of public corporations was proving to be difficult and little headway had been made with that process.

Of all the least developed nations in the Pacific island, the Solomon Islands is most dependent on merchandise exports to earn it foreign exchange, but other components of foreign receipts are also important e.g. foreign aid, income from offshore employment. In 1999, the foreign reserves of the Solomon Islands were relatively low in relation to its import bill. The Solomon Islands as a member of the WTO has reduced its tariff levels in recent years.

School enrolment rates are extremely low in the Solomon Islands and the rate of illiteracy is high. While there was some improvement in enrolment rates in the early 1980s, the situation has now begun to deteriorate. Recently, the growth in primary school places has been at a slower rate than the rate of population growth. Females are greatly under represented in school enrolments. The situation as far as health services are concerned is far from adequate in the Solomon Islands – at least 20% of its population is believed to have no access to health services. Rates of morbidity, and mortality rates of infants are high. Civil unrest and rioting has also occurred in recent times creating further economic disadvantages for the Solomon Islands.

In addition, to the above problems, the Solomon Islands suffers from extremely inadequate infrastructure which further adds to its development difficulties.

In the 1990s, the Solomon Islands experienced a substantial decline in foreign aid. Furthermore, loans rose in proportion to grants as a part of overseas aid thereby increasing the relative obligations of the Solomon Islands.

Thus the development situation of the Solomon Islands is far from satisfactory and this nation showed retrogression in several respects in the second half of the 1990s. According to the estimates of UNDP, the Solomon Islands has a lower Human Development Index (HDI) than Bangladesh and a higher Human Poverty Index (HPI) than Bangladesh. Australia has on its doorstep some of the least developed countries in the world, of which the Solomon Islands is one.

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APPENDIX

Interviews in Solomon Islands Conducted 15-18 June

1. Mr Donald Kudu, Secretary, Department of Development Planning
2. Mr Rick Houenipwela, Governor, Central Bank of Solomon Islands
3. Mr Vinod K. Dhall, International Business Advisor, Ministry of Commerce and Tourism
4. Mr C.J. Alfred Helm, Financial Advisor, Ministry of Finance and Development Planning
5. Mr Anthony Makabo, Head, State Owned Enterprises, Monitoring and Privatization Unit, Ministry of Finance
6. Mr Lucian Kii, Secretary, Department of Education and Human Resources Development
7. Dr Lester G. Ross, Secretary to Ministry of Health and Medical Services
8. Martin Wale, Secretary, Department of Works

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