

SOLOMON ISLANDS

ECONOMIC REPORT • SEPTEMBER 1998



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Cover Photos: *Sigana Village in Ysabel Province, Solomon Islands*, Richard Majchrzak. **Inset Photo:** *Spear fisherman in the West Solomon Islands*, Robert C. Kiste, PhD, Center for Pacific Island Studies, University of Hawaii at Manoa.

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TO OUR FRIENDS AND ASSOCIATES:



Lawrence M. Johnson



Richard J. Dahl

It is with pleasure that we present this economic report on the Solomon Islands, Bank of Hawaii's second report on the economy of this South Pacific nation and the latest in our ongoing series of studies on the economic conditions and factors shaping the economies of the West and South Pacific region.

Our presence in the Solomons dates back to 1994 when Bank of Hawaii International, Inc. acquired a majority interest in the National Bank of the Solomon Islands (NBSI). The Solomon Islands holds great promise, and Bank of Hawaii is pleased to play a part in the economic growth and development of this youthful nation.

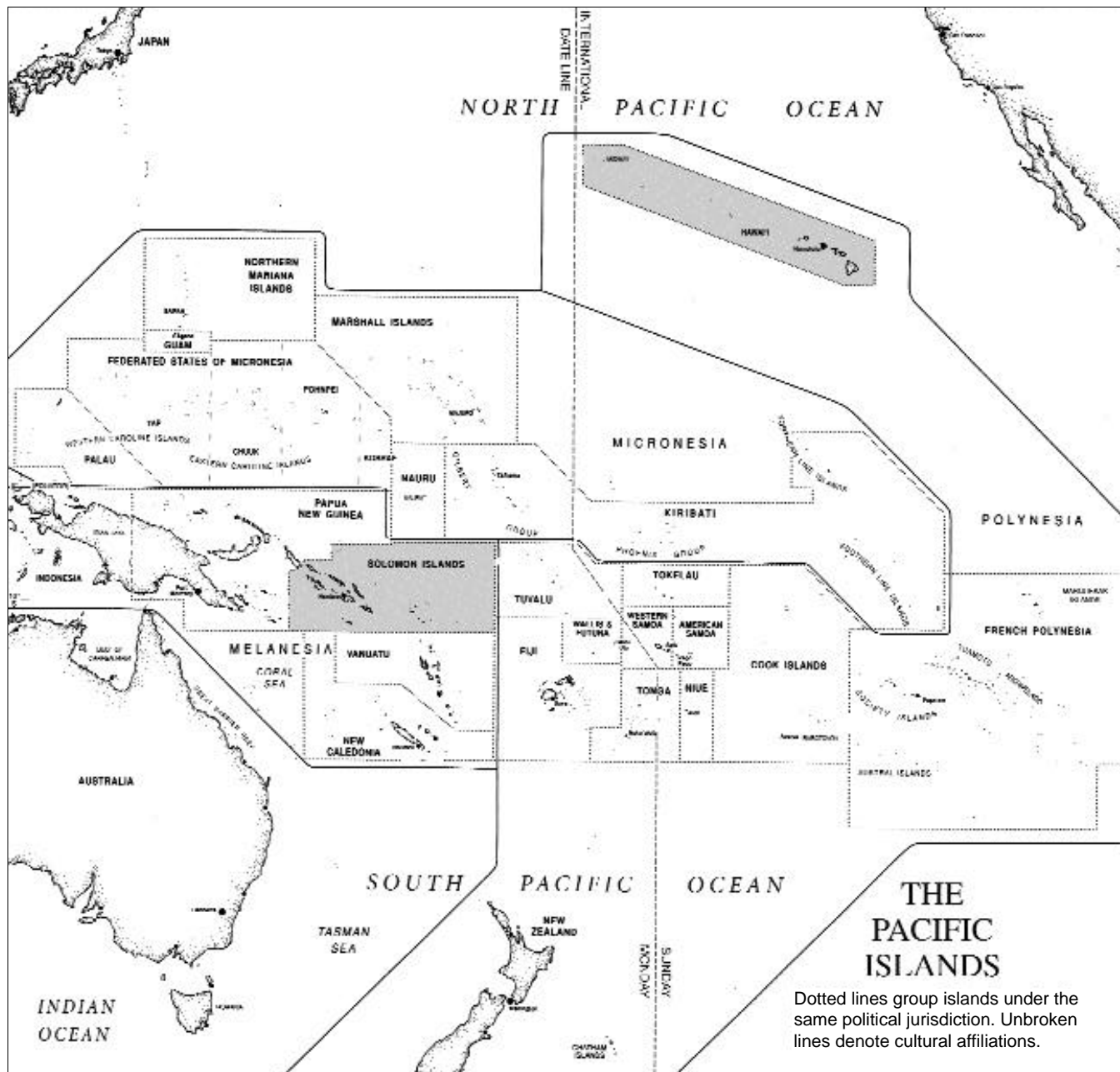
NBSI, the largest commercial bank in the Solomon Islands is an important link in Bank of Hawaii's Pacific regional network. Our presence in the Solomons together with our branches and subsidiaries elsewhere throughout the greater Pacific region enable us to offer a full range of quality financial products and services to customers in all of the region's major economies.

We offer this report as a resource to those who share our interest in and commitment to the Pacific region. We invite you to visit the Bank of Hawaii web site at <www.boh.com> to view reports on other Pacific economies or to visit any NBSI branch to learn about the banking services NBSI offers or about other financial services offered by Bank of Hawaii and its sister companies throughout the Pacific, East Asia and the U.S. Mainland.

Sincerely,

Lawrence M. Johnson
Chairman and CEO

Richard J. Dahl
President and COO



Adapted from *The Pacific Islands*, 1992, courtesy of the East-West Center's Pacific Islands Development Center and the Hawai'i Geographic Society.

SOLOMON ISLANDS

DISTANCE FROM

Australia: 1,200 miles
 Honolulu: 4,100 miles
 Los Angeles: 6,600 miles

LAND AREA

Total islands: over 900
 Inhabited islands: 347
 Total land area: 11,947 square miles
 Largest island: Guadalcanal
 Capital: Honiara (Guadalcanal)

POPULATION

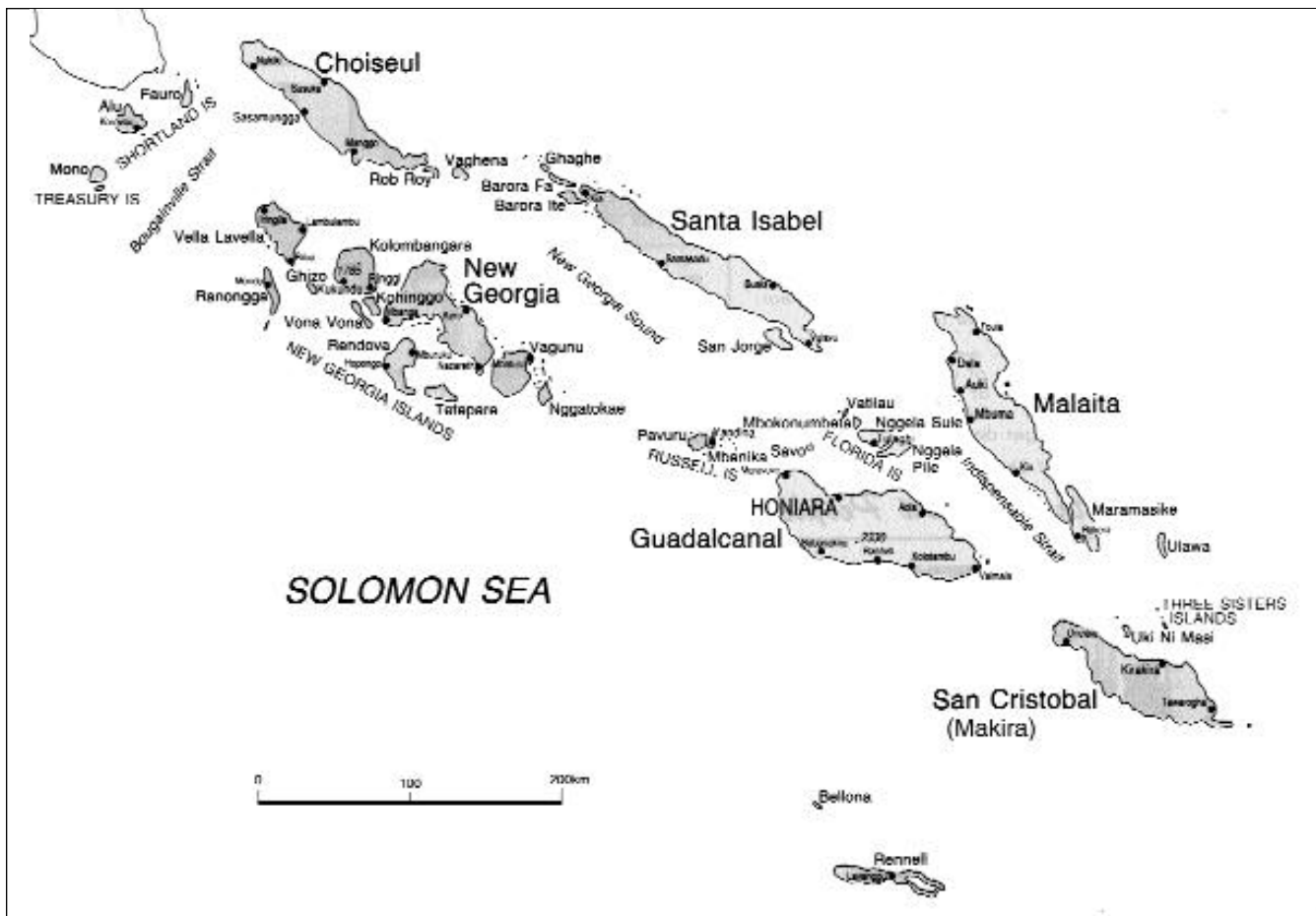
1997: 407,000
 Annual growth rate: 3.5 percent
 Estimated life expectancy: 65 years
 Most populated island: Malaita
 Population by groups: 95 percent Melanesian
 4 percent Polynesian
 1 percent Micronesian

POLITICAL STATUS

Parliamentary Democracy
 Member of the British Commonwealth
 Independent state since 1978

ECONOMY

Currency: Solomon Island dollar
 SI dollars per \$1US: 3.73
 Income sources: subsistence agriculture, forest products,
 fishing, services, tourism, mining (gold)
 Gross Domestic Product (GDP) in 1997: \$US 362.7 million
 Per capita GDP in 1997: \$US 890.9
 Labor force by U.S. standards (15 years and older): 191,697
 Employment in the money economy: 26,408



PACIFIC ISLANDS FACT SHEET

US DOLLAR-DENOMINATED ECONOMIES

	Population	Land Area (square miles)	Notable Geographic Characteristics	Capital/ Distance from (miles)	Currency
GUAM	153,700	212	One island. Major US naval base and regional trans-shipment center at Apra Harbor. In hurricane path.	Agana/ Honolulu 3,800 Tokyo 1,600	US dollar
COMMONWEALTH OF THE NORTHERN MARIANA ISLANDS (CNMI)	63,000	177	Saipan the largest island, Tinian and Rota next, 14 others in the chain. 125 miles north of Guam. US territory closest to Asia.	Garapan, Saipan/ Honolulu 3,700 Tokyo 1,500	US dollar
FEDERATED STATES OF MICRONESIA (FSM)	105,506	270	607 islands and atolls, Pohnpei 130 square miles, other major islands Kosrae, Yap and Chuuk. The 4 FSM states span 1,700 miles from east to west.	Kolonia, Pohnpei/ Honolulu 3,100 Hong Kong 3,100	US dollar
REPUBLIC OF PALAU	18,146	170	343 islands, the main group encircled by a hundred mile reef. Babeldaob 136 square miles. 8 other inhabited islands. Rock Islands.	Koror/ Honolulu 4,600 Tokyo 2,000 Hong Kong 1,700	US dollar
REPUBLIC OF THE MARSHALL ISLANDS (RMI)	62,924	70	34 coral islands, 870 reefs, highest elevation 33 feet above sea level, average elevation 7 feet.	Majuro/ Honolulu 2,300 Guam 1,800	US dollar
AMERICAN SAMOA	58,900	76	5 islands, 2 atolls. Pago Pago Harbor. Home of newest US national park. In hurricane path.	Pago Pago, Tutuila/ Honolulu 2,600 Los Angeles 4,800	US dollar
TOTAL/AVERAGE	462,176	975			

NON-DOLLAR ECONOMIES

FRENCH POLYNESIA	220,524	1,609	130 islands, mostly atolls in 5 archipelagoes. Tahiti the largest island, 400 miles square, maximum elevation 7,464 feet.	Papeete, Tahiti/ Honolulu 2,700 Los Angeles 4,100 Paris 10,400 Tokyo 5,900	French Pacific franc (F CFP)
NEW CALEDONIA	196,836	7,376	Main island, Grande Terre 250 miles by 30 miles (larger than the Hawaiian Islands together), mostly mountainous. Several small islands.	Noumea/ Honolulu 3,900 Paris 10,400 Brisbane 900	French Pacific franc
WALLIS AND FUTUNA	14,800	106	2 main islands, highest elevation 2,493 feet.	Wallis Island/ Honolulu 2,700 Paris 10,000	French Pacific franc
PAPUA NEW GUINEA (PNG)	4,150,000	179,490	Eastern half of the island of New Guinea. Largest by far Pacific island-state land mass. Other main islands New Ireland, New Britain and Bougainville.	Port Moresby/ Honolulu 4,300 Cape York, Australia 300 Tokyo 3,100 Hong Kong 3,100	Kina

Major Languages	GDP (US\$ million current)	Per Capita GDP (US\$)	Major Income Sources	Political Status	Major Sources of External Investment	Major Sources of Future Income
English, Chamorro, also Tagalog, Japanese	3,109.0	20,228	Tourism, military, trade and services	US territory since 1898. Guam Organic Act of 1950 conferred US citizenship. Some push for commonwealth status.	US, Japan, Korea	Tourism, services
English, Chamorro, Carolinian	650.6	10,327	Tourism, garment manufacturing, trade and services	After WWI under Japanese mandate. In 1947 became part of US Trust Territory of the Pacific. Since 1978 a Commonwealth of the US. Islanders are US citizens.	Japan, Korea, Hong Kong, US	Tourism, services
English, 8 major local languages	215.8	2,045	US payments, government services, fisheries, tourism	After WWI under Japanese mandate. In 1947 became part of US Trust Territory. Became sovereign in 1979. In compact of free association with US as of 1986.	US, Japan	Compact status uncertain as of 2001. Fisheries development, tourism
English, Palauan, Sonsorolese-Tobian	159.8	8,806	US Compact payments, tourism	After WWI under Japanese mandate. In 1947 became part of US Trust Territory. Became sovereign in 1994, in compact of free association as of 1994. Compact ends 2044.	Japan, US	Compact money, tourism
English, Marshallese dialects	102.1	1,623	US payments, Kwajalein Missile Range, government services, copra, fisheries	After WWI under Japanese mandate. In 1947 became part of US Trust Territory. Became sovereign in 1979. In compact of free association since 1986.	US, Japan	US military. Compact status uncertain as of 2001. Fisheries.
English, Samoan	253.0	4,295	Tuna canneries, government services, remittances from Samoans overseas	US territory since 1899. Samoans are US nationals.	US	Canneries, remittances, US entitlements
	4,490.3	9,716				
French, Tahitian	3,655.8	16,578	Payments from Metropolitan France, tourism, Tahitian pearls	French controlled from the 19th century. Overseas territory of France since 1957. Active independence movement.	Metropolitan France	French transfers, tourism, pearls
French, 30 Kanak dialects	3,717.5	18,886	Payments from Metropolitan France, nickel, agriculture and ranching, tourism, aquaculture	1853 became a French possession. Overseas territory of France since 1946. Relation to France under review.	Metropolitan France	French transfers, nickel, tourism, agriculture, aquaculture
French, East Uvean, East Futunan	25.0	1,689	French transfer payments, trochus shells	French controlled from the 19th century. Overseas territory of France since 1961.	Metropolitan France	French transfers
English, Tok Pigin, Hiri Motu, hundreds of vernaculars	4,957.0	1,194	Minerals, oil and gas, forestry, agriculture, tourism	Under Australian & German control before WWI. Administered by Australia after WWII. Independent within the British Commonwealth since 1975. The Bougainville secessionist movement ended by a formal treaty in April 1998.	Australia, UK	Minerals, oil, timber, fisheries, tourism

PACIFIC ISLANDS FACT SHEET (continued)

	Population	Land Area (square miles)	Notable Geographic Characteristics	Capital/ Distance from (miles)	Currency
COOK ISLANDS	19,600	92	15 widely dispersed islands including volcanic peaks and atolls. Rarotonga the largest island 26 miles square. In hurricane path.	Rarotonga/ Honolulu 3,000 Wellington 2,000	New Zealand dollar
SAMOA	170,000	1,158	4 inhabited islands, 5 uninhabited. Highest point 6,100 feet, Mt. Silisili on Savai'i. In hurricane path.	Apia/ Honolulu 2,600 Suva 700 Brisbane 2,500	Tala
FIJI	815,045	7,055	320 islands. Viti Levu 4,000 miles square, Vanua Levu 2,100 miles square. Major islands are mountainous and forested to windward.	Suva/ Honolulu 3,100 Sydney 2,000 Tokyo 4,500	Fiji dollar
KIRIBATI	82,400	266	33 islands scattered 2,400 miles east to west, 1,300 miles north to south. Almost entirely low-lying atolls, Christmas Island the largest.	Tarawa/ Honolulu 1,300 Tokyo 3,900	Australian dollar
SOLOMON ISLANDS	393,000	11,197	850 mile long double island chain. 6 mountainous main islands, Guadalcanal 2,080 miles square.	Honiara, Guadalcanal/ Honolulu 3,960 Port Moresby 900	Solomon Island dollar
TONGA	99,000	386	Main islands volcanic, some 150 coral atolls, 36 permanently inhabited.	Nukualofa/ Honolulu 3,100 Brisbane 2,000	Pa'anga
VANUATU	185,000	4,707	80 scattered islands, several active volcanoes. Largest island Espiritu Santo 1,500 miles square, highest point 6,158 feet.	Port Vila, Efate/ Honolulu 3,500 Tokyo 4,100	Vatu
NAURU	11,200	8	A single island with a 100 foot high central plateau of now nearly exhausted phosphate-bearing rock.	Nauru/ Honolulu 2,800 Banaba, Kiribati 200	Australian dollar
NIUE	2,500	101	Coral island rising 65 feet from the ocean and another 130 feet to a central plateau.	Alofi/ Wellington 1,800 Suva 800	New Zealand dollar
TOKELAU	1,800	4	3 atolls with islets 10 to 16 feet above sea level. In hurricane path.	Nukunonu/ Honolulu 2,300 Wellington 3,800	New Zealand dollar
TUVALU	10,200	10	5 atolls, 4 coral islands, maximum elevation 16 feet above sea level.	Funafuti/ Suva 700 Sydney 2,500	Australian dollar
TOTAL/AVERAGE	6,371,905	213,565			
GRAND TOTAL/AVERAGE	6,834,081	214,540			
HAWAII	1,205,126	6,423	4 main islands. Island of Hawaii 4,028 miles square, highest point of Mauna Kea 13,796 feet. Mauna Loa and Kilauea on Hawaii both active volcanoes. Maui 727 miles square, Oahu 597 (Waikiki), Kauai 552. In hurricane path.	Honolulu/ San Francisco 2,400 Los Angeles 2,600 Washington 4,800 Tokyo 2,500	US dollar

SOURCES: Central Intelligence Agency, *The World Factbook*, 1994; Norman and Ngaire Douglas, editors, *Pacific Islands Yearbook*, 17th edition, Suva, 1994; Europa, *The Far East and Australasia*, 1994; Gary L. Fitzpatrick and Marilyn J. Medlin, *Direct-line Distances, International Edition*, New Jersey, 1986; International Monetary Fund, *International Financial Statistics*, June 1996; David Stanley, *Micronesia Handbook*, Chico, California, 1989; David Stanley, *South Pacific Handbook*, 5th Edition, Chico, California, 1993; State of Hawaii Department of Business and

Major Languages	GDP (US\$ million current)	Per Capita GDP (US\$)	Major Income Sources	Political Status	Major Sources of External Investment	Major Sources of Future Income
English, Cook Islands Maori	50.9	2,596	Government aid, services, tourism	Self-governing since 1965 in association with New Zealand. Cook Islanders are citizens of both Cook Islands and New Zealand.	New Zealand	Tourism
English, Samoan	170.0	1,000	Agriculture, remittances from abroad, tourism, manufacturing	Under German control before WWI, New Zealand after. New Zealand trusteeship after WWII. Independent since 1962.	New Zealand, Japan	Agriculture, tourism, light manufacturing
English, Fijian, Hindi	2,148.9	2,637	Sugar and other agriculture, tourism, forestry, fishing, mining, garment industry	Annexed by Great Britain in 1874. Became independent within the Commonwealth in 1970, rejoined the Commonwealth in 1997.	Australia, New Zealand, EU, Japan	Agriculture, tourism, mining, light manufacturing
English, Micronesian	54.6	662	Agriculture (copra), remittances, aid	Annexed by Britain in 1919. A republic within the British Commonwealth since 1979.	NA	Fisheries development
English, Solomon Islands Pijin, more than 80 vernaculars	343.7	875	Agriculture, timber sales, fishing and fish canneries, aid	British protectorate as of 1874. Politically independent within the Commonwealth since 1978.	Australia, Japan	Agriculture, fisheries, tourism
Tongan	124.9	1,262	Agriculture, tourism	British protectorate as of 1900. Independent monarchy within the Commonwealth.	NA	Tourism, agriculture
French, English, Bislama	247.0	1,335	Agriculture and ranching, tourism, Offshore Finance Center, services	Anglo-French New Hebrides Condominium in 1906. Republic of Vanuatu within the British Commonwealth established in 1980.	Australia, Japan	Tourism, agriculture
English, Nauruan	80.7	7,205	Phosphates and investments from phosphates	From 1919 administered by Australia. Became an independent republic in 1968.	NA	Investments from phosphate
English, Niuean	7.1	2,825	Subsistence activity, government aid	Self-governing since 1974 in free association with New Zealand.	NA	Tourism
English, Tokelauan	1.2	667	Subsistence activity, government aid	Non-self-governing territory administered by New Zealand beginning 1925.	NA	Subsistence activities, government aid
English, Tuvaluan	3.8	373	Subsistence activity, government aid	Independent state within British Commonwealth since 1978.	NA	Subsistence activities, government aid
	15,588.0	2,446				
	20,078.3	2,938				
English	35,146.4	29,164	Tourism, services, trade, government	Annexed in 1898, became a US territory in 1900, became a state in 1959.	US, Japan, Australia	Tourism, defense, services, trade, government

Economic Development, *Data Book 1995*, Honolulu, 1996; Peter W. Thomson, *Trade and Investment in the South Pacific Islands*, Honolulu, 1989; World Bank, *World Development Report*, 1996; various Bank of Hawaii economic reports, 1992–97, and other sources. (Rev. 4/22/98)

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I. GENERAL CHARACTERISTICS

1.1 INTRODUCTION

The Solomon Islands archipelago lies in the Southwestern Pacific 1,000 miles northeast of Australia and stretches 1,050 miles southeast from Papua New Guinea (PNG) across the Coral Sea to Vanuatu. The insular landmass of the Solomon Islands is the second largest among Pacific Island economies after PNG, and nearly 78 percent larger than Hawaii's. The Solomon Islands population is the third largest after PNG and Fiji, and its economy ranks fifth in gross domestic product (GDP) among South Pacific (non-US dollar denominated) Island economies.

The Solomon Islands is among the Pacific's most mountainous and scenic island chains. However, because of its comparative isolation, the country has remained relatively untouched. Many of the economic and technological changes occurring in the Pacific since the end of World War II have bypassed the Solomon Islands. In this relatively unspoiled environment lies the potential for economic growth and change that can generate long-term income.

The country's forests, minerals (especially gold), ocean resources, tropical climate and relatively abundant labor force provide the means for sustainable, relatively high-income growth and increased standards of living.

Modern transport and communication technologies will make the transition from traditional subsistence production and distribution to contemporary methods much easier now than 10 or 20 years ago. Despite long-standing economic problems, the conditions for economic change are better now than at any time since independence. Fully aware that change will not come without cost, the government actively encourages domestic and foreign exploration of new opportunities.

The Solomon Islands is comprised of six large and 20 small islands and hundreds of small islets and coral reefs. The national capital, Honiara, is located on the northern edge of the Island of Guadalcanal, the largest, though not the most populated, island. With 60,000 inhabitants, Guadalcanal makes up 15 percent of the total population while Malaita to the east accounts for a quarter of the total with 100,000 people. The six main islands support 80 percent of the population. Like Guadalcanal and Malaita, the other four main islands of Choiseul, New Georgia, Santa Isabel and Makira (San Cristobal) have thickly forested mountain ranges of mainly volcanic origin, deep narrow valleys and coastal belts dotted with coconut plantations. Eighty percent of the Solomon Islands land area is forested.



Sigana Village, Ysabel Province

The smaller islands are mostly atolls and raised coral reefs that offer hundreds of miles of shallow water, deep-water channels and lagoons for snorkeling, diving and sport fishing. These resources offer good potential for tourism development (especially adventure tourism) and other new sources of income in the years ahead.

The estimated 1997 population of 407,000 Solomon Islanders lives on 347 of the 922 islands and is comprised of 300 cultural and linguistic groups. About 95 percent of Solomon Islanders are Melanesian, four percent Polynesian and one percent Micronesian. There is a community (2,000-3,000 including dependents) of Australian, New Zealander, European, Chinese and other expatriates in Honiara, most of whom provide technical, professional and business services. American presence in Solomon Islands is minimal.

Only about 10 percent of Solomon Islanders live in urban and semi-urban areas, mainly in Honiara. All others live in small, widely dispersed villages along the coasts, with 60 percent living in villages of fewer than 200 people. The vast majority of rural people are principally engaged in a subsistence economy, which has changed little over the decades.

Long settled by Melanesians, the Solomon Islands was given its name by the Spanish navigator Alvaro de Mendana in 1568. European missionaries, traders and whalers did not reach the islands until the 19th century. The northern Solomon Islands became a German protectorate in 1885 and the southern Solomon Islands a British protectorate in 1893. Germany ceded most of the Solomon Islands to the United Kingdom around 1900 in exchange for freedom to acquire Samoa, and the entire archipelago was then named the British Solomon Islands Protectorate.

In 1942, Japan invaded the Solomon Islands and nearly destroyed Tulagi, then the capital. After US forces reclaimed the Solomon Islands in 1943, the returning British administration chose to establish a new capital at Honiara to take advantage of the infrastructure that American forces had built during the war. Consequently, much of the existing road and airport infrastructure in the Solomon Islands' capital was built during World War II. Abandoned equipment and scattered war wreckage can still be found around Henderson Airport and other parts of Honiara. With the opening of the new airport terminal in March this year, Solomon Islands took the first critical step in upgrading its access to the rest of the world.

Solomon Islands is a parliamentary democracy and has been an independent nation within the British Commonwealth since July 7, 1978, having begun internal

self-rule in 1976. Under this structure, the head of state is the British monarch represented by the Governor-General who must be a Solomon Islands citizen. The head of government is the Prime Minister, who is leader of the parliamentary majority or coalition parties. Parliamentary elections are held every four years, and a majority may dissolve parliament in the event of a no-confidence vote.

The last parliamentary elections were held on August 6, 1997 which produced the new ruling coalition, Solomon Islands Alliance for Change (SIAC). At the time Solomon Islanders were preparing to vote for a new parliament last year, the economy was still growing, but signs of distress were evident in many areas, especially in the public sector. The most critical was government's inability to pay vendors, creditors, regional organizations and government employees on time.

In November, SIAC issued a "Statement of Policies" which outlined economic and financial objectives for the country as well as policy directions to achieve them. SIAC's economic revitalization program was aimed at achieving two main objectives: restoring stability and confidence in the country's public and financial sectors, and putting in place an economic change program based mainly on private sector growth and sustainable rates of use of the country's natural resources.

The program's key policy elements were: redirection of the country's resources to markets and the private sector, macroeconomic and financial stability, restoring confidence in the Solomon Islands securities market, overhauling the existing tax system with the goal of reducing tax rates, encouraging private investment, reorganization of public finances and establishing financial accountability, and emphasizing sustainable harvest of the country's forests, marine and mineral resources.

The coalition is to rule for four years. Thus far, there has been one no-confidence motion that was later withdrawn. If the SIAC can restore stability and confidence in the Solomon Islands' economy, the coalition may successfully complete its term.

1.2 ABRIEFREVIEW OF CURRENT CONDITIONS

The economy was headed toward turbulence by mid-1997 because of two principal factors: inefficient management of public resources and the fall of commodity prices (especially log prices), precipitated by the first signs of turmoil in the Asian financial and asset markets. The Solomon Islands dollar was devalued in early December last year, in the midst of an economic downturn already caused by external factors. Since the desired impact of

devaluation (reducing export prices) takes some time to work, while the undesirable effect (import price inflation) occurs much more rapidly, devaluation exacerbated the ongoing economic slowdown.

As regional economic conditions continued to worsen, government's ability to respond effectively by means of the usual monetary and fiscal stimulation was limited. Turning the economy around became a more difficult challenge than ever. At the same time, parliamentary opposition demanded economic recovery and threatened no-confidence motions as early as late last year shortly after the new government took over.

The coalition appears to have restored some confidence in the country's financial market by resuming debt service payments. This is the first major step taken within the one-year time period specified by the SIAC in its public policy statement. Substantial foreign aid will also be required to restore stability to the whole economy, and the country's development partners, the World Bank, International Monetary Fund (IMF), the Asian Development Bank (ADB), Australian Agency for International Development (AusAid) and Commonwealth Development Corporation (CDC) have indicated their willingness to help.

With no other alternative, it became clear in the first half of 1998 that an external financial aid package needed to be secured in the next 12-18 months. This package may take the form of funding a restructuring plan that would help the government revitalize the economy by expanding the private sector. Informal estimates place the adjustment loan package needed to remedy most of the immediate financial challenges in the range of US \$50-75 million. If used properly, it would also pave the way for long-term economic reconstruction and expansion of productive capacity.

But the Solomon Islands is in the midst of a difficult transition, both politically and economically. Politically, the coalition needs broader public support for its proposed reforms which will reduce the public sector's role and make the economy more open, competitive and efficient. The main economic challenge lies in increasing the economy's productive capacity to create work and consumption goods for a rapidly growing population.

Among new enterprises to help kick the economy into higher gear is the completion of the infrastructure for a new gold mine this summer, which began extracting gold in August. At the cost of SI \$270 million, the project, according to the Central Bank, is being financed entirely from external sources in the form of loan and equity capital. A mining firm from Queensland is to work the mine for 10-15 years. Because much richer deposits lie nearby, the area will more

than likely produce enough to keep its crew for perhaps twice that length of time.

Another important new addition to the country's infrastructure is the new airport terminal that opened in March. At the cost of SI \$74 million, the new terminal will help the country's infant tourism industry get off the ground. Other efforts to expand the economy's productive capacity and income sources are being made in commercial agriculture, especially oil palms, cocoa and specialty forest products for export.

II. MACROECONOMIC ANALYSIS

2.1 INTRODUCTION

Macroeconomic fluctuations in the Solomon Islands arise from two sources: (a) economic structure (the economy's makeup and productive capacity), and (b) external shocks (such as sudden changes in commodity prices and other variables, fish migration in the Pacific caused by changes in climatic conditions, and drought attributed to El Niño). In addition to fish migration and drought in some areas of the Solomon Islands, the latest external event to cause widespread economic and financial dislocation has been the decline in the market value of timber exports (caused mainly by price drops). Timber products (primarily logs) produced up to 55 percent of total export earnings in recent years.

With the financial crisis in Asia, the main market for Solomon Islands and other South Pacific logs, prices have dropped sharply over the last year. The average price per cubic meter fell from US \$150 in the first quarter of 1997 to US \$115 by the end of the third quarter, and was US \$70 in January 1998. At the end of the first quarter of this year, dealers reportedly offered US \$28-30 per cubic meter, but the offers were rejected. Meanwhile, logs waiting for shipment absorb moisture, altering their quality, and possibly rendering them valueless.

The convergence of economic and political uncertainties is among the dilemmas faced by the Solomon Islands. Exacerbated by external shocks such as falling prices, investor confidence in the country's financial and economic prospects is impaired. While foreign aid may be effective in dealing with short-term crisis, long-term solutions lie in putting in place an institutional structure that makes the economy more open, competitive and efficient. These reforms, combined with effective use of the country's resources (including mineral deposits found in land or

seabed), can certainly pave the way for more predictable and sustainable economic growth.

2.2 AMACROECONOMIC APPRAISAL

The Solomon Islands government has yet to put in place its own macroeconomic accounting routine. The Solomon Islands Central Bank's quarterly reports and annual report normally issued 6-9 months after the close of the year, are about the only sources of current information and commentary on macroeconomic matters. There are no consistent economic data on components of GDP by industry, employment, wages and other payments and receipts. Other data such as tourist arrivals and spending are usually dated and incomplete. The most widely used source of economic and financial statistics on IMF member countries, International Financial Statistics, carries virtually no current numbers on the Solomon Islands macroeconomic accounts.

The only macroeconomic data sets on the country are those developed by regional and global aid organizations such as the World Bank, ADB and AusAid, whose domains include the Pacific Islands. Even the most recent reports, however, often lack detailed GDP accounts.

As serious a constraint as this information vacuum can be for Solomon Islands analysts and overseas observers, enough evidence of the Solomon Islands' economic structure and performance exists to make a reasonable assessment of both current and long-term potentials. Data collected during a recent visit, an ADB/AusAid draft report, Bank of Hawaii's first economic report (1994) along with its data sources, and other information gathered from government and business are the main sources of information for this report.

The Solomon Islands is in a difficult economic and financial transition at the end of an unstable yet rapid growth cycle. In 1990-97, real GDP growth rate averaged 3.5 percent, but prior to the 1997-98 recession (which was caused by commodity price declines and devaluation), real GDP growth rate averaged 6.0 percent from 1992 to 1996. It was the longest period that real GDP growth exceeded 5.0 percent. Economic growth in the 1990s, though erratic, has been fueled mostly by exports of logs, with fish and palm oil contributing to macroeconomic vitality. Meanwhile, a steady flow of overseas financial aid offset the economic instability arising from commodity price fluctuations.

The economy grew erratically in the early 1990s, mainly because of unpredictable fluctuations in both production and prices of commodities such as logs, copra, palm oil and fish. The 1990s started with anemic real GDP

growth of 0.8 percent in 1990, followed by a 2.1 percent gain in 1991. In 1992, real GDP grew 10.7 percent, mainly on the strength of log exports, whose prices rose sharply, doubling their export value. Although log prices rose even more to nearly double the export value yet again in 1993, the rest of the economy did not generate that kind of growth. As a result, real GDP grew only 2.4 percent in 1993.

While the roller-coaster-style growth pattern of log exports was generating anxiety, the rest of the economy began to surge into a higher growth mode. With all main income sources raising production and benefiting from the momentum generated by log exports, growth stabilized in the subsequent three years (1994-96), ranging from 5.0 percent to 6.7 percent, and averaged a healthy 5.6 percent annually. This period of consistent growth resulted mainly from stable commodity prices and production, especially in logs.

In 1992-97, fees from log exports made up as much as 20 percent of total government revenues. Timber export receipts rose from 36.4 percent of total exports in 1992 to 56.3 percent in 1993-94 and dropped only slightly to 49.4 percent in 1995. In 1996, timber sales (over 95 percent of which were logs) rose back up to 55.8 percent of total commodity exports.

Timber exports assumed a critical role in the Solomon Islands' economy by not only providing revenues to the government directly in the form of export fees, but also indirectly by means of import duties and other ways. Anecdotal evidence indicates that surging log revenues were used, for example, to purchase second-hand vehicles in Asia, which were imported at low duty levels. While these import duties contributed to government revenues, the total economic impact (benefits and costs) of an increased fleet of vehicles may not be known precisely, though it is not negligible. Apart from providing a more convenient means of transport for a larger proportion of the population, heavier vehicular traffic on narrow, mostly unpaved streets in the capital city has been used as a case to attract foreign aid for road improvements.

In the first three quarters of 1997, timber exports were down only 1.9 percent from the same period in 1996. Log prices collapsed by the end of the fourth quarter of last year, however, and caused a virtual shutdown of log exports by the beginning of this year.

Fish exports, the country's second largest foreign exchange source, averaged about 21.9 percent of total exports in 1992-95, ranging from 20.1 to 25.4 percent. In 1996, fish exports rose 7.9 percent over 1995, but dropped as a share of total export receipts to 23.9 percent, as logs became a larger part once again. In the first nine months of 1997, fish export receipts were ahead by 26.0 percent over

the same period a year earlier.

Palm oil export receipts, Solomon Islands third largest source of foreign earnings, averaged 10.3 percent of the total in 1990-96, ranging from 8.4 to 12.6 percent. In the first three quarters of 1997, palm oil and kernel export value was down 22.1 percent from the same period in 1996. Since production of palm oil in the first nine months of 1997 was about the same as in the first nine months of 1996, the drop in value is attributed to price drops.

Other exports such as copra rose in value in 1995, but it was such a small share of the total (5.7 percent) that it made little difference in the country's merchandise trade balance. The total market value of copra fell 28.4 percent in 1996, back to the 4.0 percent share of total as before.

The combined impact on the Solomon Islands economy of the log price collapse late last year and other price weaknesses, all continuing into 1998, has been a general drop in the total national output. It is highly likely that real GDP fell at least 4-5 percent in 1997, and will drop even more in 1998. Since log prices are unlikely to recover soon, and no other export commodity can make up for the loss in export value, the impact on the economy will be large and of some duration.

Export of gold will not be enough to make up for the loss of log revenues. Overseas transfers of capital and aid will be among the critical sources of funds, but these will not be large enough to make up for the loss of revenues from the country's own resources. Meanwhile, some debt and debt service restructuring may also be required in light of the liquidity woes brought upon the country by these changes.

There have been no significant shifts in GDP components during the 1990s. As a share of GDP, commercial agriculture, forestry and fisheries remained unusually stable in 1990-95, ranging from a low of 32.3 percent to a high of 35.4 percent for an average of 33.9 percent. Subsistence food production, on the other hand, dropped from 17.9 percent of GDP in 1990-91 to 15.6 percent in 1995, perhaps indicating that some subsistence producers shifted to the money economy. This movement in the Solomon Islands is consistent with that of other countries in the region.

Manufacturing, construction and power use ranged from 7.2 percent of GDP to 10.0 percent, averaging 8.0 percent in 1990-95. This rise in share of GDP was largely the result of increases in power use, which generally signals an improvement in the economy. Trade, transport and financial services as a share of GDP was among the most stable in 1990-95, ranging from 18.6 percent to 19.6 percent for an average of 19.2 percent. Also stable as a

share of GDP in 1990-95 was the category of other services, which averaged 22.4 percent, ranging from 20.1 percent to 23.5 percent.

The stability of GDP shares in the Solomon Islands is typical of developing economies in the early stages of change. Production and sale of primary goods are the main sources of sustenance and income and, therefore, become main sources of instability as global prices fluctuate.

2.3 FISCAL MANAGEMENT

Since 1980, the Solomon Islands government has had only one fiscal surplus of SI \$1.6 million in 1984, when revenues amounted to \$47.7 million with spending at \$46.1 million. Every other year since 1980 has been marked by a deficit, ranging from \$0.9 million in 1980 to \$62 million in 1991.

Deficits became both large and persistent in the 1990s, when the government assumed a more activist posture, using fiscal policy to stimulate economic change, mainly through redistribution of income from timber products and other exports. According to ADB, spending increased from \$151.2 million to \$378.0 million in 1990-97, averaging an annual gain of 14.0 percent. During the same time, revenues rose from \$135.3 million to \$327.8 million, averaging an annual gain of 13.5 percent.

As a percent of GDP, the budget deficit ranged from a large 11.5 percent to a small 1.4 percent in 1990-97. The 4.7 percent average deficit for the period is considered large. The 2.5 percent and 2.4 percent shares of GDP in 1995-96 were the smallest consecutive budget deficits. Had it not been for the Asian financial crisis, this trend might have continued. In 1997, budget deficit as a share of GDP was up to 3.7 percent, based on preliminary numbers. The actual ratio may turn out to be larger since the government's revenue picture deteriorated when timber prices fell.

Budget deficits in excess of 2.5-3.0 percent of GDP are considered high, especially in developing economies that rely on commodities for exports and have inconsistent growth records. The government's need to meet social objectives as well as provide basic services and infrastructure compels it to resort to expansionary fiscal policies.

In 1990-95, according to the Central Bank, total wages and salaries of public employees and contractors consumed 39.6 percent of the total budget. Other government purchases accounted for 42.0 percent of the total budget, while debt service represented the remaining 18.4 percent. Since government payroll has been a large part of the budget for years, cutting back on public

SOLOMON ISLANDS ECONOMIC AND FINANCIAL INDICATORS

	1990	1991	1992	1993	1994	1995	1996	1997
Nominal GDP (\$US million)	187.8	198.3	230.6	237.5	267.2	311.0	345.3	362.7
Nominal GDP Per Capita (\$US)	587.0	600.9	678.1	678.6	722.0	818.5	877.9	890.9
Nominal GDP (\$SI mill)	475.0	539.4	675.1	755.3	879.3	1,059.3	1,225.8	1,352.7
Nominal GDP Growth Rate (%)	11.1	13.6	25.2	11.9	16.4	20.5	15.7	10.4
Nominal GDP Per Capita (\$SI)	1,484.4	1,634.5	1,985.6	2,158.0	2,376.5	2,787.6	3,116.7	3,323.1
Real GDP (1984 Prices, \$SI)	232.4	237.4	262.6	268.8	282.8	301.7	316.8	300.9
Real GDP Growth (%)	0.8	2.1	10.7	2.4	5.2	6.7	5.0	(5.0)
Real GDP Per Capita (\$SI)	726.3	718.8	772.4	768.0	764.3	793.9	805.5	739.3
Merchandise Exports (\$SI)	178.1	228.7	301.2	411.4	467.9	573.2	576.6	629.2
Merchandise Imports (\$SI)	231.0	305.7	326.6	436.3	468.1	526.3	536.9	736.1
GDP by Industry (\$SI mill)	232.4	237.2	262.6	267.9	282.6	301.7	—	—
Agriculture, Forestry & Fisheries	77.1	76.7	91.2	88.9	97.0	106.7	—	—
Food (Subsistence Production)	41.5	42.5	43.6	44.8	45.9	47.1	—	—
Mining & Exploration	(1.7)	(1.1)	(0.8)	(0.8)	(0.4)	(0.4)	—	—
Manufacturing, Construction & Power	18.9	17.7	18.8	20.0	21.8	30.3	—	—
Trade, Transport, Commerce & Fin. Services	43.2	45.6	49.5	53.8	55.3	57.5	—	—
Other Services	53.4	55.8	60.3	61.2	63.0	60.5	—	—
Ratios, GDP by Industry (%)	100.0	100.0	100.0	100.0	100.0	100.0	—	—
Agriculture, Forestry & Fisheries	33.2	32.3	34.7	33.2	34.3	35.4	—	—
Food (Subsistence Production)	17.9	17.9	16.6	16.7	16.2	15.6	—	—
Mining & Exploration	(0.7)	(0.5)	(0.3)	(0.3)	(0.1)	(0.1)	—	—
Manufacturing, Construction & Power	8.1	7.5	7.2	7.5	7.7	10.0	—	—
Trade, Transport, Commerce & Fin. Services	18.6	19.2	18.8	20.1	19.6	19.1	—	—
Other Services	23.0	23.5	23.0	22.8	22.3	20.1	—	—
Fiscal Indicators								
Government Revenues (\$SI mill)	135.3	145.9	201.8	221.8	278.7	322.9	340.5	327.8
Government Spending (\$SI mill)	151.2	207.9	211.1	277.7	324.7	349.0	369.9	378.0
Budget Balance (\$SI mill)	(15.9)	(62.0)	(9.3)	(55.9)	(46.0)	(26.1)	(29.4)	(50.2)
Government Revenues/GDP (%)	28.5	27.0	29.9	29.4	31.7	30.5	27.8	24.2
Government Spending/GDP (%)	31.8	38.5	31.3	36.8	36.9	32.9	30.2	27.9
Budget Balance/GDP (%)	(3.3)	(11.5)	(1.4)	(7.4)	(5.2)	(2.5)	(2.4)	(3.7)
Money, Rates, Prices & Exchange Rates								
Narrow Money, M1, (\$SI mill)	66.1	78.7	106.8	124.0	160.4	169.6	198.2	211.4
Broad Money, M3, (\$SI mill)	141.4	172.6	217.5	249.2	309.4	340.1	393.5	418.3
Change in Broad Money (%)	11.5	22.1	26.0	14.5	24.1	9.9	15.7	6.3
Lending Rate (%)		19.5	19.8	17.8	15.7	16.6	17.8	15.7
Consumer Price Index (1985=100)	183.8	211.8	234.5	256.0	290.1	317.9	355.3	384.0
Consumer Price Inflation (%)	8.6	15.2	10.7	9.2	13.3	9.6	11.8	8.1
Official Exchange Rate: \$SI/\$US	2.53	2.72	2.93	3.18	3.29	3.41	3.55	3.73
Population & Employment								
Population (000)	320	330	340	350	370	380	393	407
Population Growth (% per year)	3.2	3.1	3.0	2.9	5.7	2.7	3.5	3.5
Employment (000)	26,122	26,631	26,842	29,577	32,519	33,103	34,207	—
Employment Growth (%)	2.7	1.9	0.8	10.2	9.9	1.8	3.3	—
Balance of Payments								
Current Account Balance (\$SI mill)	(69.2)	(99.1)	(23.7)	(22.5)	(11.7)	23.1	43.3	(99.8)
Merchandise Trade Balance (\$SI mill)	(52.9)	(77.0)	(25.4)	(23.8)	(0.2)	46.9	39.8	(106.9)
Services Balance (\$SI mill)	(112.2)	(125.6)	(110.9)	(133.4)	(193.9)	(145.0)	(140.3)	(120.0)
Transfers (\$SI mill)	95.9	103.5	112.6	134.7	182.4	121.2	143.8	127.1
Capital Account Balance (\$SI mill)	74.8	70.0	43.2	21.9	(1.9)	(28.0)	(41.2)	90.2
Errors & Omissions (\$SI)	(18.6)	8.0	25.9	(3.9)	7.1	9.6	(6.7)	13.9
Overall Balance (\$SI)	(13.0)	(21.1)	45.4	(4.5)	(6.5)	4.7	(4.6)	4.3
International Reserves Minus Gold (\$US m)	17.6	8.5	23.5	20.1	17.4	15.9	32.6	36.3
Import Cover	3.0	1.2	2.7	1.9	1.5	1.1	2.4	2.6
Ratios (%)								
Current Account Balance/GDP	(14.6)	(18.4)	(3.5)	(3.0)	(1.3)	2.2	3.5	(7.4)
Overall BOP Balance/GDP	(2.7)	(3.9)	6.7	(0.6)	(0.7)	0.4	(0.4)	0.3
Foreign Debt Stock & Servicing	18.8	26.1	11.1	17.2	16.0	7.8	6.0	9.2
Total Public Debt Outstanding (\$SI mill)	334.7	422.1	469.0	549.7	637.8	687.7	728.8	795.9
Total Domestic Debt (\$SI mill)	98.6	171.4	196.6	250.8	317.9	333.1	339.7	347.1
Total Foreign (External) Debt (\$SI mill)	236.1	250.7	272.4	298.9	319.9	341.8	352.9	355.0
Total Debt Service (\$SI mill)								
Total Debt as Share of GDP (%)	70.5	78.3	69.5	72.8	72.5	64.9	59.5	58.8

Sources: International Monetary Fund, *International Financial Statistics* (yearbook), Asian Development Bank, "Solomon Islands 1997 Economic Report," Draft, January 1998; Central Bank of Solomon Islands, *Annual Report 1997*; Bank of Hawaii.

spending has always been among the most challenging tasks faced by the government, including the new coalition. While it is too soon to predict, its proposal to cut public spending and, therefore, cause possible layoffs of public workers may potentially endanger the coalition's survival.

Government's reluctance in the past to cut back public spending, especially payroll, has been among the major causes of default. Debt service arrears to both external and internal creditors amounted to \$80 million in the third quarter of 1997. Some \$36 million of this was for external debt and \$44 million for domestic debt, including short-term government securities. Although the coalition government resumed making partial payments earlier this year, it does not yet have a concrete and consistent fiscal management policy in place.

On the other hand, if the coalition builds a national consensus for cutting public spending in the context of a larger structural adjustment program which the country's development partners will support, the likelihood of a sound fiscal policy rises substantially. Considering all factors, the Solomon Islands has taken a good first step by gaining support of the country's development partners to rebuild the country's financial basis and the economy.

2.4 MONETARY POLICY

Monetary policy appears to have been accommodative throughout the 1990s, which may have contributed to high inflation. The rate of growth of so-called narrow money, or M1 (money in circulation and demand deposits), averaged 18.5 percent a year in 1990-97, ranging from 35.8 percent in 1992 to 5.7 percent in 1995. M1 grew at a single-digit rate of 6.6 percent in 1997 when money supply contraction was necessary to combat inflation fueled by devaluation of the SI dollar.

It is not clear whether rapid growth in M1 was influenced by the national government's need to finance debt, or the Central Bank's desire to meet credit market and other liquidity demands. However, erratic and relatively rapid growth in the basic money supply appears consistent with rapid growth in both nominal GDP and retail price inflation.

In itself, movement in M1 is not a definitive indicator of price inflation. However, if movement in the so-called broad money, M3, which is M1 plus other monetary instruments in circulation, correlates with M1 and price inflation systematically, it may be a case of "too much money chasing too few goods." In the Solomon Islands, M3 growth averaged 16.3 percent in 1990-97, indicating some correlation to M1. At the same time, nominal GDP



Solomon Islander holding shell money

growth averaged 15.6 percent, also suggesting a link to growth in money supply. Although real (adjusted for inflation) GDP growth averaged a healthy 3.5 percent in 1990-97, GDP growth arising entirely from price inflation of 12.1 percent reflects persistent inflation.

Retail price inflation, as measured by the Honiara Retail Price Index, averaged 10.8 percent a year in 1990-97. This is high, especially when compared to much lower price inflation in other large and small economies in the region. It is possible that the high inflation (more than five percent a year) of the Solomon Islands in a generally low-inflation (sometimes even deflationary) environment is linked to some inherent cost peculiarity such as that for transport arising from shipping monopolies which are common in the Pacific. (Republic of the Marshall Islands and Vanuatu present other examples.) Further, if such a

peculiarity exists while the Central Bank attempts monetary restraint to combat inflation, it may cause credit problems. Ensuring stable prices while supplying adequate liquidity to the banking system and the government may make monetary controls more challenging and, therefore, reaching an optimal monetary policy difficult.

Meanwhile, the high inflation of the last few years is also evident in the high commercial bank lending rate. It averaged 17.5 percent in 1990-97, ranging from 19.8 percent in 1992 to 15.7 percent in 1997. According to the Central Bank, the lending rate did not change much over the last few years, although regional and global inflationary pressures have subsided. Whether this pattern is the result of structural rigidities, accommodative monetary policy or both cannot be concluded with certainty. What may be concluded on a tentative basis, is that high inflation and, therefore, high rates appear to have been built into the system. Further study is required to establish its causes and recommend the proper remedial actions.

2.5 BALANCE OF PAYMENTS

Following five years (1990-94) of current account deficits, the Solomon Islands registered two consecutive years of surpluses in 1995-96, only to be followed by another large deficit in 1997.

Although short-lived, the 1995-96 improvement was

seen as an important turnaround. The increase in the current account resulted from the decade's first merchandise trade surpluses attributable to revenue gains in logs, fish, palm oil and other commodities whose quantities and prices rose. During the same period, the capital account (overseas capital flows) saw deficits for the first time in the 1990s, but these were offset by continued surpluses in transfer payments (official and private overseas transfer payments which include aid). The overall balance of payments also reflected fluctuations in the component accounts by registering small balances averaging a negative 0.1 percent a year in 1990-97.

The current account balance in 1997 fell mainly as a result of an economic decline caused by export price drops and import price increases. Current account surpluses could have been sustained had it not been for large service deficits. The Solomon Islands will continue to have these deficits in the near future because it imports services. In the aftermath of the 1997 commodity price drop, the Solomon Islands external accounts will see further deterioration in the months ahead before improvements occur. The only question at this stage is that of magnitude, not direction.

International reserves rose through most of the 1990-97 period, reflecting gains in external accounts. In 1990-97, international reserves ranged from US \$8.5 million (1991) to US \$36.3 million (1997), averaging US \$21.5 million. Import cover for merchandise alone

averaged 2.1 months in 1990-97, which is a relatively short period. Import cover of six months or more is often considered optimal. However, the impacts of external shocks on small open economies such as the Solomon Islands make application of large economy standards impractical.

Based on this brief review of the Solomon Islands balance of payments, external account performance was mixed. It is reasonable to say it will remain this way in the near term. The Solomon Islands has suffered from the typical developing country syndrome of consuming more domestic and overseas resources while investing less in expanding the economy's productive capacity. Without putting in place some basic



A produce market

structural changes, these trends will continue. There will probably never be totally adequate insurance against external shocks, especially in the Pacific where isolation is a permanent challenge. However, steps can be taken to minimize fluctuations and their impact, such as expanding the economy's total productive capacity and meeting more domestic consumption demands from within.

2.6 DEBT AND PAYMENTS

The Solomon Islands public debt situation offers a puzzling picture. Total outstanding public debt dropped as a share of GDP toward the end of the 1990s, indicating that the economy grew more rapidly than public debt. Yet the government defaulted by ceasing to pay interest on certain debt (Treasury Bills) in late 1995. This debt service problem arose at a peculiar time when the economy was growing and public debt was declining as a share of GDP, just the reverse of the trend one would normally expect in developing economies of the Pacific, where declining public debt is often a welcome change.

In 1990-97, nominal GDP growth averaged 15.6 percent a year while total public debt growth averaged 13.4 percent. This growth was still high for public debt, but as long as it remained below GDP growth, it was considered a positive change. As a share of GDP, total public debt dropped from a high of 78.3 percent in 1991 to 58.8 percent in 1997, the lowest ratio of the 1990s.

It appears that the government prior to the current coalition stopped servicing debt and paying other creditors rather than cutting spending as a way to deal with the financial dilemma it faced. In 1996, the last full year when the previous government was in office, government payroll increased 2.4 percent, other spending increased 12.7 percent and debt service rose 20.0 percent. Also in 1996, nominal GDP increased 15.7 percent while total public debt rose only 6.0 percent, the smallest gain of the decade.

The new coalition government resumed payment on certain obligations in early 1997, but debt service arrears to external creditors and domestic holders of government securities rose to SI \$192 million at the end of 1997, up SI \$110 million from the previous year. These arrears also contributed to a much larger than expected government deficit in 1997, even though actual spending for the year was down from 1996.

ADB's earlier estimate of arrears for 1997 was SI \$93.8 million, up 159.1 percent from 1996's SI \$36.2 million which, in turn, was up 182.8 percent from 1995's SI \$12.8 million. No estimates of arrears are available for periods

earlier than 1995, which may mean that public debt service obligations were either met on time or were insignificant.

In a macroeconomic context, the Solomon Islands public debt is not out of line with other developing economies. As a percent of GDP, it is even lower than some developed economies. The important task facing the new coalition government is to bring changes in public debt in line with the government's capacity to service debt and the economy's capacity to generate revenues. The new government is confronted with numerous challenges, but restoring confidence to government's fiscal management is among the most critical.

2.7 LABOR FORCE AND EMPLOYMENT

As indicated earlier, Solomon Islands has one of the Pacific's, and indeed one of the world's, highest population growth rates, averaging 3.5 percent annually in 1990-97. Given this growth rate, the labor force has also risen by roughly the same rate. There are no up-to-date data on the country's demographic makeup, labor force and employment components outside the money economy. However, assuming the demographic profile of the country has not changed drastically, the 1986 census data set is still useful and supplies valuable parameters.

In 1986, total population was 283,505 with 55.1 percent over the age of 14. In some economies, this is considered to be the labor force. The so-called economically active population (able people actively seeking work) and the equivalent of the US labor force, was 47.1 percent. Applying the 1986 census ratios to 1997's estimated

EMPLOYMENT BY SECTORS

Sector	1994	1995	1996	1997
Agriculture	4,343	4,157	4,093	3,809
Forestry	4,040	3,964	3,313	2,709
Fishing	2,623	2,844	2,937	2,579
Mining & Exploration	28	32	38	62
Manufacturing	1,284	1,471	1,612	1,665
Electricity & Water	531	631	703	650
Construction	1,221	1,474	1,925	1,638
Retail & Wholesale	3,890	3,921	4,066	3,844
Transport & Telecom	1,335	1,427	1,972	1,777
Finance	1,124	1,291	1,422	1,602
Public Administration	3,909	6,244	6,198	1,016
Other	3,861	4,080	8,567	5,057
Total	31,189	31,536	36,846	26,408

Source: Central Bank of Solomon Islands, *Annual Report 1997*, p. 18

population of 407,000, 224,257 persons would have been over the age of 14, and 191,697 economically active (the effective labor force). As was the case in 1986, the majority of that labor force in 1997 was engaged in the village subsistence economy. The market value of such an economy is subject to considerable variation, as well as levels and degrees of unemployment and underemployment.

Data gathered by the Solomon Islands National Provident Fund (NPF) which is the equivalent of the US Social Security Administration, showed that only a small 12.5 percent of the labor force held jobs in the money economy in 1997. In neighboring PNG, the figure is around 10 percent, suggesting similarity to Solomon Islands. In the context of comparative economic development, the Solomon Islands and PNG are at similar stages of change and, therefore, the similarities of their labor forces in the money economies roughly confirm what is evident from anecdotal evidence in the two economies.

According to the Central Bank, the NPF data showed that 26,408 persons were employed in the money economy (and contributing to the Fund) last year, down 28 percent from 1996. However, the NPF data are collected for purposes not necessarily connected to employment statistics and, therefore, the number reported making contribution is not the same as those actually employed and on payroll. The NPF numbers are, however, the only periodic employment figures available for the money economy.

With the money economy employing only 12.5 percent of the labor force, the Solomon Islands has a large pool of idle labor that may be employed if the money economy expands to create more work. This is not to suggest that other sources of work and livelihood do not already exist. Based on the 1986 census, 33.6 percent of the economically active labor force worked in villages without money wages, 6.8 percent worked in the village plus the money economy, and only 6.6 percent worked in the money economy alone. By these accounts, the money economy's share of employment has increased over the last 12 years, but remains substantially below the economy's full-employment potential.

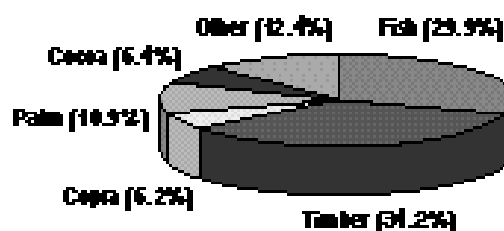
These numbers also confirm that unemployment and underemployment remain serious problems in Solomon Islands, especially in rural areas where alternatives for work outside the subsistence economy do not exist. With both Solomon Islands business and government focusing on a national economic development strategy, attention should be concentrated on the most labor-intensive areas offering the largest possible geographic coverage. Given the

country's relatively large land mass and other resources, potential exists for creating more work for a larger portion of the labor force.

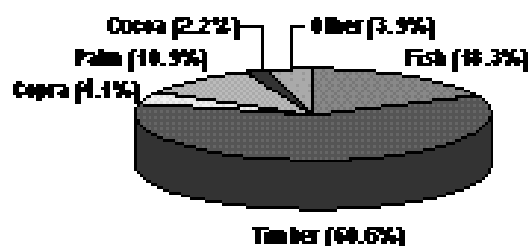
III. ECONOMY BY SECTORS & MAJOR INDUSTRIES

The most important economic sector in the Solomon Islands is agriculture, forestry and fishing (AFF) which remained relatively stable as a share of GDP in 1990-95. (GDP components by sector are not available for periods more recent than 1995.) Based on market price valuation, which excludes the market value of subsistence production, AFF ranged from 32.3 percent of GDP in 1991 to 35.4 percent in 1995, averaging 33.9 percent. With log prices down and forestry products on hold before they can return to playing a more critical role in economic growth again, the rest of AFF, especially agriculture, offers good potential for growth. Agriculture presents more labor-intensive opportunities, and is also the most widely available source of income and work, especially in rural areas.

Solomon Islands Exports By Commodity Type: 1990



Solomon Islands Exports By Commodity Type: 1996



Mechanized commercial agriculture now offers greater potential in the Solomon Islands, where individuals and families have traditionally met their own basic needs by growing crops. While it has been of limited use in most Pacific Island economies because areas of flat land are small, it offers better potential in the Solomon Islands where both land and labor are available. Growing and processing tree crops such as oil palms, which have only recently been adapted to the Solomon Islands tropical climate, presents an especially promising potential in the near and medium terms.

3.1 COMMERCIAL PRODUCTION OF OIL PALMS

Exploring crop potential on the Guadalcanal plains in the early 1960s, CDC was asked to study the feasibility of commercial agriculture. Early focus was apparently on crops such as rice and soybeans to supplement other domestic food sources. Results of experiments showed that large-scale arable farming was not the optimal use of resources. Meanwhile, a trial plot of oil palms had produced yields promising enough to take the next step and establish a commercial plantation.

Solomon Islands Plantation Limited (SIPL) was established in 1971, jointly owned by the Solomon Islands government, local landowners and CDC as shareholders. The oil extraction mill was built in 1976. In the 27 years since SIPL was incorporated, it has established a viable new industry with great potential, especially for the plains of Guadalcanal and other main islands with large tracts of flat lands.

In 1997, SIPL had 6,350 hectares under cultivation in five estates, each with its own road system totaling 450 kilometers. It takes about 6,000 hectares to establish a commercially viable plantation. Oil palms begin bearing fruit at about five years and have an average life span of about 20-25 years. Informal estimates place land suitable for oil palms on Guadalcanal to be about 20,000-25,000 hectares. Other areas with commercial viability are Malaita, New Georgia, North Choiseul and Isabel.

In 1987-97, palm oil production ranged from 11,999 to 28,863 metric tons, having been as high as nearly 31,000 tons in 1992-93. Palm kernel output ranged from a low of 2,432 metric tons in 1987 to 7,183 tons in 1994, with a 1997 output of 7,005 tons. Total export value of palm oil in 1997 was an estimated SI \$61.1 million and that of palm kernel was roughly \$6.5 million. With a total export value

of SI \$67.6 million in 1997, oil palms contributed about nine percent of total export value.

SIPL's work force of about 1,800 and their families are housed in villages on the various estates, which have their own water, power and other infrastructure, including 24-hour clinics, something rare in most of the Pacific Island economies. Company-run schools provide education to all employees' children. Employees run cooperative shops on the plantation and most management level positions are filled by Solomon Islanders committed to making oil palms a larger industry.

The main reason why tree crops such as oil palms are so promising is that they generate various levels of work and many different products, most of which are labor-intensive. Between the two main export products of kernels and oil are a few stages of harvesting and processing that require considerable labor. Thus, they are ideally suited for labor-surplus economies such as the Solomon Islands.

Palm oil is among the world's most versatile natural products. It has uses ranging from plain cooking oil to detergents and plastics, cosmetics and pharmaceutical products. Byproducts include glycerol, which is used in making explosives, and the residue, which is used as livestock feed. After oil is extracted from the kernel, the fiber and shells are used as boiler fuel to make steam for the turbo-electrical generating plant which powers the processing factory. The empty fruit bunches are returned to the ground as mulch. The many attributes of oil palms as a means of generating income and work while preserving the natural environment make them ideal tree crops for the flat lands of the Solomon Islands.

Apart from being among the largest employers in the country and providing many direct and indirect economic benefits as well as a modern plantation lifestyle, SIPL also contributes directly to the Solomon Islands government. Informal estimates show a total contribution of SI \$11.3 million was made in 1997, which included taxes, import duties, export fees, contribution to the National Provident Fund and dividends to the government as a shareholder.

An SIPL sister firm, also funded by CDC, grows high-value hard wood for local assembly as well as for export. It is still a small operation, but holds good future potential, especially on the outer islands where the preferred types of forests for such woods are more plentiful than on Guadalcanal.

3.2 FORESTRY AND FOREST PRODUCTS

As noted before, logs produced up to 55 percent of the country's export earnings in 1992-97. But with current log prices reportedly down to \$30 per ton, the Solomon Islands' 300,000 cubic meters of logs in storage continue to await shipment. Demand for logs will remain at current levels until Asia, the major market for South Pacific hard wood, returns to normal. In the meantime, Solomon Islands has an opportunity to reconsider its optimal harvesting and processing policy. Forests are a finite resource, and cutting forests without a vigorous replanting program can lead to serious problems arising from soil erosion.

Given the country's limited forest resources, it may also be time to consider options for maximizing other valued-added areas accruing to the Solomon Islands before forest products leave the country. Thus far, logs have been the main export item of forest products. Log production rose from an average of 350,000 cubic meters (CM) in the 1980s to 640,000 CM in 1992 and a record 686,000 CM in 1993, of which 590,000 CM (86 percent) were exported as round logs. In 1997, log shipment totaled 650,000 CM.

Other processing activities such as those for specialty furniture and other products would generate more direct and indirect benefits for the economy. The



Logging at Guadalcanal, Solomon Islands

immediate problem in processing forest products is the lack of capital and skills to make this a viable industry.

Just as with oil palms, forest products generate more work at various stages of processing and marketing, which the Solomon Islands' rapidly growing labor force needs. If making forest products a viable industry requires government subsidy at the beginning, it should be considered an investment in both the nation's human resources and its forest products. Again, optimal use of the Solomon Islands' resources requires new policies and methods of implementation that are consistent with both labor market needs and environmental concerns.

The total national forest inventory is approximately 13 million CM with a maximum cutting quota allowable by

TIMBER HARVEST AND EXPORTS

		1990	1991	1992	1993	1994	1995	1996	1997
Volume of natural forest log exports	('000 m ³)	399	292	543	591	650	716	730	554
Value of natural forest log exports	(\$m)	56.53	49.46	104.02	221.72	265.04	261.41	308.88	237.83
Volume of plantation log exports	('000 m ³)	na	na	na	na	9.5	32.4	55.2	102.4
Value of plantation log exports	(\$m)	na	na	na	na	2.03	8.21	16.07	24.68
Volume of sawn timber exports	('000 m ³)	8	6.2	8.5	10.9	12.4	12.4	9	8.1
Value of sawn timber exports	(\$m)	4.28	4.1	6.43	9.99	9.48	13.34	9.89	10.97
Total harvest from natural forest	('000 m ³)	457	352	617	675	744	811	811	637

Source: Asian Development Bank, *Solomon Islands 1997 Economic Report*, Second draft January 1, 1998, p. 31.

VALUE OF EXPORTS BY COMMODITY

(SIS '000)	1990	1991	1992	1993	1994	1995	1996
Fish	53,185	106,417	87,950	82,687	99,068	145,711	105,319
Timber	60,811	53,557	110,448	231,715	276,856	282,952	349,363
Copra	10,936	10,369	21,294	18,533	19,770	32,852	23,510
Palm Oil	17,933	19,345	32,900	35,808	39,911	66,544	55,808
Palm Kernel	1,387	1,523	2,861	2,272	4,304	5,493	7,147
Cocoa	11,375	13,728	14,368	16,804	12,549	13,424	12,855
Coconut Oil	2,467	1,886	5,519	4,653	2,013	4,122	5,689
Marine Shells	6,305	2,719	1,476	905	1,282	5,568	330
Gold	1,198	1,252	843	947	311	631	181
Other Exports	6,718	14,515	22,421	13,172	14,585	8,426	10,374
Re-exports	5,320	4,577	3,772	3,945	2,668	7,429	6,072
Total	177,635	229,888	303,852	411,441	473,317	573,152	576,648

Source: Central Bank of Solomon Islands, *Annual Report 1997*, p. 91

law of 1.4 million CM annually. However, the licensing arrangement currently in effect limits annual cutting to 800,000 CM per year. It is calculated that the Solomon Islands forest resource would be exhausted within 10-15 years if the maximum allowable harvest were to be cut. At the present licensed level of 800,000 CM a year, the total national inventory will be exhausted in 16 years. Adopting a policy to explore alternative uses for logs such as processed products may also reduce annual harvest to a sustainable level.

According to a survey conducted for the National Forest Resources Inventory, annual cutting of an estimated 325,000 CM would be roughly the maximum for a sustainable yield. Although there is widespread agreement, especially among forestry managers, that the 325,000 CM annual allowable cut is the safest level for a renewable rate of harvest, it has not yet been adopted as a formal national policy. This appears to be an optimal time to adopt such a policy, while the country waits for its forest resources to resume their critical role in economic growth.

3.3 FISHING AND FISHERIES

Fish output of 40,653 tons was down one percent from 1996, mainly because of adverse fishing conditions, according to the Central Bank. Anecdotal evidence suggests that somewhat unusual fish migration patterns occurred in the Pacific over the last couple of years because of El Niño.

Of the total commercial catch, Solomon Taiyo Ltd. (STL), the nation's largest commercial fishery and the only one with a cannery in the Solomon Islands, accounted for about 25,000 tons or 61.5 percent. STL's forecast for 1998

called for 26,600 tons of total production, as compared to the 1996 total of 27,400 tons. STL, a joint venture between the government of the Solomon Islands (51 percent) and a major Japanese fishing concern (49 percent), employs 1,500-2,000 workers, including boat operators. Under pressure from other low-cost, high-volume producers such as Thailand and the Philippines, STL has had to become more efficient.

After the Solomon Islands government, STL is the largest employer in the country and the only large-scale industrial producer. Other than a few Japanese nationals and other expatriates at the managerial level, the vast majority of the workers are Solomon Islanders. At present, STL is the only



Spear fisherman in the West Solomon Islands

major employer in the western region of the country.

According to STL's 1998 forecast, 6,159 tons of fish would be exported frozen, 15,194 tons canned, and 4,537 tons smoked, while 444 tons would be sold to local markets and 329 tons committed to other uses. Canned product would amount to 1.134 million cases, of which 815,550 cases would be exported and some 302,000 cases sold in the domestic market. Fishmeal would amount to about 1,300 tons and bone meal to about 224 tons in 1998.

Efforts are underway to increase fish production by developing small fishing enterprises in the villages. If these prove to be successful, they can be replicated elsewhere and add further to the industry's viability.

Aquaculture is presently limited to experiments on Guadalcanal raising prawns for domestic consumption. Aquaculture has some growth potential in the islands, and the experimental station plans to enlarge operations as the demand for its products increases. However, the future of aquaculture and fishing appears to depend on long-term government subsidies, which may involve heavy costs. As with national airlines in the various Pacific island states, if the Solomon Islands domestic fishing industry requires continued government subsidy, it should consider seeking cooperation with other island governments in the region to spread costs and increase efficiency while gaining access to expanded markets.

3.4 TOURISM

Visitor arrivals to the Solomon Islands increased from nearly 12,000 in 1980 to a record high of 21,000 in 1983. Thereafter, arrivals declined nearly every year until they were back down to 12,000 in 1990. Total arrivals again rebounded, reaching 17,200 in 1992 and 19,000 in 1993. According to the Central Bank, total arrivals since then have stagnated in the 11,000-12,000 range, showing little change. The average length of stay of 12-14 days for all tourists has remained nearly unchanged over the last decade, reflecting the isolation that characterizes a visit to the islands.

Dominating arrivals are divers and those accompanying them from Australia and New Zealand. Most are males in the 25-45-age range. The Solomon



Villagers perform a traditional dance

Islands will have to depend on tourists primarily from Australia and New Zealand until more markets in Japan, other Asian countries and North America can be tapped.

The current tourism plant consists mainly of small hotels and motels, diving operations and transport facilities. As with most Pacific Island destinations, the Solomon Islands is not suited for mass market tourism, because of its size and the fragility of the environment. Inconvenience in transport, rudimentary infrastructure, and the high cost of getting to and staying in these islands are also obstacles. These high costs result partly from isolation and partly because economies of scale, typically applicable in mass markets, cannot be realized to reduce per unit production and distribution cost. The country appears instead to be an excellent candidate for developing niche markets such as adventure tourism. These markets can be large enough to sustain a reasonable level of activity in the Solomon Islands without threatening its ecosystem.

VISITOR ARRIVALS IN SOLOMON ISLANDS

YEAR	VISITORS
1984	11,177
1985	11,974
1986	11,630
1987	12,555
1988	10,679
1989	9,860
1990	9,195
1991	11,105
1992	12,446
1993	11,570
1994	11,919
1995	11,209
1996	11,217

Source: Asian Development Bank, *Solomon Islands 1997 Economic Report*, Second Draft, January 1, 1998, p. 90

The Solomon Islands appears capable of becoming a prime destination for those who seek to explore unique places in the world and to enjoy specific marine leisure activities such as sport fishing and diving in tropical settings. However, developing a consistent niche market will require the investment of considerable capital as well as promotional efforts. Construction of the basic infrastructure will be necessary to prevent a visit from becoming a chore, even for the most willing traveler.

Eco-tourism has nearly become a buzzword in Pacific tourist destinations, but its potential commercial benefits are being debated. Eco-tourism that entails unobtrusive visits to remote parts of the islands for backpacking, camping and visiting villages may be environmentally friendly, but will not generate much in the way of job and income benefits that can raise island living standards.

If Solomon Islanders are able to develop the infrastructure in an environmentally sensitive manner and combine it effectively with traditional island hospitality, there is great potential for specialty tourism to become a large income source within the next 10-20 years. As in other emerging destinations, community ambivalence about the level to which tourism should be raised as a source of national income and economic change has prevented more rapid development of this industry.

Most tourist facilities are considered under-developed and in need of upgrade or expansion. There are a total of about 500-600 hotel and motel rooms and other accommodations in the islands, of which about 450-500 are located in Honiara. There is a reasonable assortment of restaurants in the capital, but the potential exists to increase its higher quality facilities.

Facilities outside Honiara are limited to small motels adequate for the current small number of tourists. Gizo, a major center in the western Province of New Georgia and a short distance from Noro (location of the cannery), has large potential as a regional hub, but the existing infrastructure needs to be expanded to accommodate more tourists. Inter-island transport is infrequent but adequate. Increased arrivals will require more air transport capacity, expanded airport facilities and more workers.

As with Gizo and Noro, other coastal locations in New Georgia and elsewhere throughout the country offer spectacular lagoons and shallow-water coral reefs for sport fishing and snorkeling. However, pollution, including the disposal of sewage in the oceans, is a concern in some

areas, and there is need for better quality facilities and management of waterways. Some of the outer island channels offer unequaled beauty and water sport opportunities that can be turned into tourist attractions, provided pollution is controlled.

Looking at the experience of other destinations in the Pacific, one of the single most effective means for attracting tourists and tourist-related capital is the presence of world-class, regionally competitive hotel chains. Brand, product and service marks that have global and regional identities are more effective in establishing tourism than any amount of individual promotional efforts. If a world-class hotel by a recognized chain existed in Honiara or elsewhere, the country could establish tourism as a legitimate income source and new occupation for its citizens. The new airport terminal makes attracting a world-class hotel chain easier than in the past.

3.5 MINING

Gold Ridge Mining Limited, the first gold mining firm in the Solomon Islands, began building infrastructure in June 1997, and its first gold pour occurred in mid-August 1998. Ross Mining NL, an Australian firm from central Queensland, started the project at the invitation of the Solomon Islands government at a location 26 kilometers from Honiara. Three gold reserves have been identified at Gold Ridge, which will be mined by means of open-cut pits and excavation with the ore to be processed at the location. Using the carbon-in-pulp method, roughly 22 tons of ore will be processed to produce one ounce of gold.

Initial estimates called for 100,000 ounces of gold production a year for at least 10 years. Since other reserves, perhaps with higher concentrations, lie nearby, the mining activity may go on far longer. As gold mining is capital-intensive, the labor impact of the new mine, which will employ no more than 200-300 people, will be small.

Other explorations in other parts of the country may be undertaken later, depending on where mines exist. Whether or not other mining firms will also enter the country for exploration is dependent on the results of the first gold mine. It is too early to predict what the impact of Gold Ridge may be on the economy. But the fact that mining has finally begun after more than a decade of exploration is an important step forward. At its optimum, the gold mine should make a notable contribution to the Solomon Islands' export earnings.

IV. LOOKING AHEAD

4.1 THE NEED FOR MARKETABLE LAND USE AND EXCHANGE RIGHTS

Among the changes that would help expand output and employment is a reformed communal land use system. About 95 percent of land in the Solomon Islands is communally owned. This land, seen as a perpetual source of sustenance rather than a tradable commodity or resource, has been held by the villages and clans without title for generations. The other five percent is divided between government and the few private owners who have acquired land for urban use. Communal land may not be sold for any purpose, especially to non-native persons and institutions.

Private interests can obtain access but not title to land through leases which, in current practice, can best be obtained through the government, acting as agent. The government has acted as the agent in all cases involving land use for activities other than traditional subsistence. It was through the government that foreign interests obtained access to harvest forests and construct the new gold mine.

Because of the need to determine ownership in the absence of land titles or maps, there may be lengthy and costly delays in obtaining land leases or financing for development. Conflicting claims to the same parcel of land, which arise often, can lead to disputes, slowing the process and adding to the costs. Only the government can acquire land for public facilities such as roads without lengthy and costly delays. The normal channel for obtaining land leases of up to 75 years for private commercial use is through the Commission of Lands.

Land preservation is an understandable and legitimate concern in the Solomon Islands. There is land along the coasts that is highly desirable for higher and better uses such as tourist and manufacturing facilities. Access and title to these lands should play a critical role in the development of alternative sources of income. A more flexible land use exchange system should be a part of the new government's reform package.

What may work as a means for originating a system of more flexible land exchange is the establishment of marketable land use rights. This would allow exchanges to be made in the open market without permanent alienation (sale) of land. It is essential that a practical solution to the problem of uncertain land titles be determined, as nearly anything that could generate new income requires secure

and certain access to land in the Solomon Islands. The main advantage of a market-like land system will be the efficiency that certainty brings into market economies. Also, a predictable system of land use rights and exchanges limited to specific uses should also help preserve the integrity of the communal system.

The US-affiliated Commonwealth of the Northern Mariana Islands and the Republic of Palau in the Western Pacific have put in place land use exchange systems that preserve the traditional communal ownership while making provisions for long-term leases that businesses need. This middle ground arrangement, half-communal and half-market, is less than ideal, but it has been shown to work. Those doing business in these markets have come to understand it and learned to work with it.

4.2 THE CHALLENGE AHEAD

The most critical challenge the Solomon Islands' leaders and development partners face is to put in place policies and programs that will expand the country's productive capacity, optimizing its human and natural resources. Rapid population growth in an economy with one of the Pacific's lowest standards of living leads to the question of what level of work the economy must create to absorb new entrants to the labor market.

Although current and accurate numbers are unavailable, it can be estimated that the Solomon Islands labor force grows by 7,500-10,000 persons a year, given a 3.5 percent annual gain. Also using informal figures from sources such as the National Provident Fund, actual payroll employment has declined, and will do so even more when government adopts its ambitious plan to reduce the role of the public sector. The question then becomes: where do these new labor force entrants go and what do they do?

Stabilizing population growth is a long-term proposition. Rural-urban migration is not a serious problem now, but it is certain to become one if there is no work in either market. By Solomon Islands custom, migrants from villages, in search of work or other aid, may not be turned away by city residents, even by prominent political leaders. Creating work for the country's rapidly growing labor force requires far more labor-intensive economic activities. The country's relatively large landmass, scattered islands and even larger exclusive economic zone make it practical to raise the levels of production, distribution, and standards of living.

Eventually, the institutional structure supporting a more open market system will evolve, as is the case in the

rest of the developing world. However, with better management of all of its resources, Solomon Islands can achieve a sustainable growth rate more easily. Life outside the capital is rural, and rural-urban links are not yet well established. Traditional leaders rule villages and exert considerable influence. The links between villages and the capital will eventually get stronger with education, communication and better transport facilities. In the immediate future and medium terms, creating work for the country's labor force in both urban and rural areas, is the most urgent and difficult task.

With its development partners providing the aid it needs, the Solomon Islands should be back on track to growth and prosperity in the next 12 to 18 months. GDP growth may reach close to five percent in real (adjusted for price inflation) terms in the next couple of years.

Provided that the financial turmoil in Asia comes to an end in the next 12 months, the Solomon Islands should be in a position to attract more capital. This will allow the country to embark on a new path to a stronger economy through private sector growth, and to create better work opportunities for a growing labor force. To participate in the emerging regional economy, the Solomon Islands needs not only a more efficient and competitive economy, but also one that is more open and linked to the region's other economies. In the long run, the Solomon Islands will benefit more from market dynamism than the smaller island economies in the Pacific, which lack the resources and labor force of Solomon Islands. A return to financial and economic stability from the current recession with constructive structural changes will pave the way for long-term economic growth and development.



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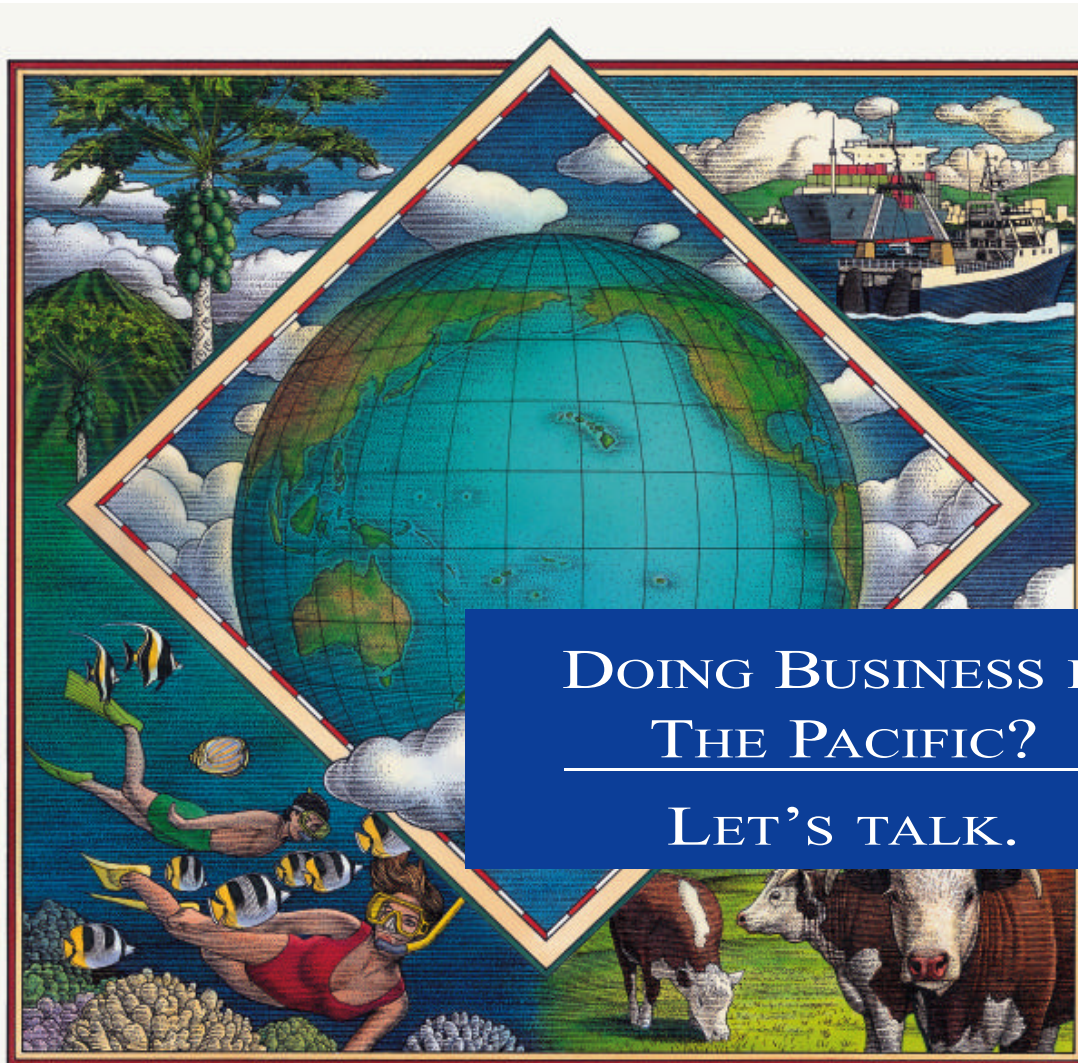
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