

Note for AusAID, Canberra

Neighbours: the Australian aid programme in Solomon Islands

Aim. This note describes aspects of the Australian aid programme and of the economic and social condition of Solomon Islands, that could usefully influence AusAID's strategy for the next three years. It is written at AusAID's request after a workshop discussion of its SI aid strategy on 28/29 March 2001, but presents an independent view of issues and policy options.

The Australian aid programme.

1. *Defining characteristics.* Solomon Islands, like the rest of the Indonesian-Melanesian 'arc of instability', is close to Australia and will not go away. Most of SI's communication and transport links lie to and through Australia, and have done so for two hundred years. Solomon Islands people, whose forebears provided labour for Queensland canefields, now attend school and university in Australia, travel regularly to and from Australia, and when they are able to they acquire property and residence rights in Australia.
2. These long-standing and complex links pervade the aid programme from the strategic level down to interpersonal relationships in the field. The Australian aid programme is unavoidably high-profile, relatively large, diverse and loaded with two-way political messages. The Australian diplomatic and aid post in Honiara is the largest, and its TA personnel the most numerous of all SI's aid donors. Solomon Islands people do not object to this. They regard it as natural. Australia is SI's wealthy neighbour—usually understanding and helpful, sometimes clumsy and overbearing.
3. The diversity of the programme makes management more complicated, and is sometimes regarded as a weakness needing correction. But it can equally well be seen as an aspect of strength. Australia has—or should have—an immediacy and depth of knowledge of SI in official, academic and commercial fields, and a capacity to locate and rapidly mobilise a range of technical and practical skills in sufficient numbers to make a difference, far surpassing any other donor. To be the 'donor of last resort' may not sound very dignified, but in many fields it is no different from being the donor most capable of a timely and effective response.
4. Having said that, the Australian response to SI requests has sometimes been ponderous and bureaucratic, failing to draw on available academic and commercial resources, and gripped more by Canberra's procedural requirements, or the need to make a political point in Australia, than by the need to engage the SI authorities intellectually at several levels. The Australian public service is justifiably proud of its professionalism, but aid delivery will be more effective if AusAID and its collocutors in Australia can be more confident, more innovative, think 'outside the box' more often, and challenge Solomon Islands to do likewise.

5. *Recent developments.* The tragedy unfolding in SI since late 1998 has only highlighted these characteristics. Australia was shocked by the eruption of violence on Guadalcanal, as were many people in Solomon Islands. The build-up of pressure—traditional inter-island friction, aggravated into bloody vengeance by uncontrolled post-war migration, land dealings, increasing unemployment and a history of unattended grievances—was missed by most observers.
6. As the violence escalated and the deep fault-lines in SI's security services were exposed, the SI Government asked Australia for help with restoring law and order. The negative response was a blow to SIG and many ordinary people, including most resident Australians. Official statements explained that Australia was afraid of being sucked into open-ended internal strife with no clear prospect of success in ending it and thus no sure way out. Once it was clear that there would be no preventive intervention from outside the Ulufa'alu government's fate was sealed.
7. The 5 June 2000 armed coup by the MEF, PFF and their political allies precipitated the evacuation of most Australian personnel from Honiara. Key diplomatic and aid management people remained to witness the small-scale but intensely traumatic civil war, political deal-making and gangster-like wave of urban and rural crime that followed. The eventual cease-fire and the Townsville Peace Agreement—both achieved with strong logistical and psychological support from Australia—opened the way for a small, unarmed Australian peace-monitoring team to be provided as support to the peace process.
8. These events threw the aid programme into turmoil. Projects, mostly in Honiara and using TA project personnel, that had been set up to support a process of policy and structural reform by the now-overthrown SIAC government were suspended. Projects designed in 1999 to help with the impact of the forcible expulsion of Malaita people from North Guadalcanal were kept going with great difficulty. For several months it became impossible to hold useful aid-planning talks with SIG officials and politicians. Australian efforts—aid, diplomatic, defence—concentrated on helping to bring about a cease-fire, and after that a peace agreement.
9. As a kind of peace returned to Honiara after the Townsville Peace Agreement (TPA), the aid administrators reassembled projects that looked as if they would still be needed, and set about strengthening and redirecting them in the light of new priorities. The speed with which AusAID got its existing activities back into order and devised new ones is a tribute to the resilience and skill of the aid personnel concerned. There have been signs of increasing flexibility and willingness to innovate, a need referred to earlier in this note, and of being prepared to go where angels and aid donors fear to tread.
10. At the same time, the attachment of SIG, or at least the Finance Minister and his supporters, to fiscal policies that reward 'former' militants and enrich its political cronies (apparently depending on continued monetisation of the deficit and/or massive transfers from Taiwan) is deterring AusAID and other donors and IFIs from putting in place increased budget support. They argue, with good reason, that without policy changes the additional funds would be diverted into counter-productive uses, and many people in SI are of the same view.

The current plight of Solomon Islands

11. *Economic issues.* The central macro-economic problem is the continuing fall in the external reserves, caused by the simultaneous and linked collapse of export earnings and government revenues. The private sector as a whole has ceased to run a surplus with the rest of the world, and has run a deficit to the extent that domestic credit has allowed, while the government has been financing its growing fiscal deficit—after external grants and loans—by borrowing from the central bank (eg, by not repaying the central bank for debts settled on its behalf). SIG has been injecting spending power directly into the economy by paying out large amounts as ‘compensation’ and payroll expenditures, unbacked by domestic taxation, savings or foreign exchange receipts on private or government account.¹ Reserves have been falling at around \$10m a week, and at that rate have only about ten weeks to go before they are exhausted.
12. Neither the fiscal deficit nor the balance of payments deficit are short-term phenomena suitable for financing from the diminished reserves or by commercial borrowing. It will be several years before either can be re-balanced on an orthodox sustainable² basis. There is a strong case for aid-based financing of both deficits to avoid a socially and economically crippling cut-back in levels of consumption and development expenditure in the public and private sectors. SIG apparently thinks it can do this³ with grants and loans from Taiwan and by drawing down funds already committed by EU and other donors, but this seems highly problematic. Taiwan is said to be exacting a price for its support⁴, eg by obtaining favourable terms for access to SI’s tuna fishery, that will reduce future SIG revenues, while the bulk of EU funds are only available on policy conditions through a lengthy process.
13. At the macro and micro-economic level, the absence of an explicit and credible statement of SIG economic strategy is handicapping AusAID and other donors/IFIs in developing more effective aid. Such a statement does not need to be elaborate or long, but it needs to reflect economic, social and political realities, and address issues of resource availability and allocation.⁵ SIG probably has the intellectual resources in the Central Bank, Finance and

¹ Some importing business are experiencing a mini-boom as these payments are re-spent on consumer imports and hardware. A number of enterprises that have been favoured by the Finance Minister with massive import duty and goods tax remissions are earning extraordinary margins.

² Sustainability here does not require that there be no borrowing at all, but that the costs of any borrowing, along with all other costs, can be met from income growth that can be confidently foreseen.

³ Foreign grants and soft loans directed to the Budget deficit also support the BoP, but they are applied to SIG’s expenditures. There is also a need for BoP support in a form (and on a scale) that eases investor concern about the currency and the external reserves, and makes foreign exchange available through the financial system to re-start and re-grow private enterprise.

⁴ The form of this support is somewhat opaque. RoC’s ambassador to SI won praise recently from other donors for joining them in requiring better SI fiscal management as a condition for more assistance. But he also alluded to RoC ‘facilitating’ commercial borrowing by SIG in Taiwan. If that means RoC guaranteeing bank loans that there is little prospect of SIG repaying, there is no practical difference between that and untied grants. SIG has not revealed any details of the Finance Minister’s negotiations in Taipei.

⁵ The imminent 2001 Budget Speech might conceivably do this, but the circumstances of its preparation make it unlikely. Existing development policy statements are out of date because of recent events or are political manifestos on a weak technical base. A credible economic strategy would have a 2-3 year perspective, addressing fiscal and balance of payments issues, micro-economic policies to revitalise the productive private sector at all levels in a fair and

Planning, and the new MERSA to articulate a credible strategy with a minimum of external involvement, but political will is another matter—the strategy would have to explicitly address distributional and other issues that powerful people apparently prefer to avoid. AusAID and other donors/IFIs should be raising this need in their contacts with SIG and civil society. Even if it cannot be produced before the scheduled general election, work should be technically advanced so that it can come out very early in the life of the next government, and be the main influence shaping the 2002 Budget and mobilising external support.

14. *Government failure.* In terms of a government-market analysis, Solomon Islands is a case of government failure writ large. A variety of ‘markets’, some benign and others deeply harmful to development, have developed to fill the gap left by the collapse of government capacity in law enforcement, social and economic services and infrastructure.
15. That capacity was full of holes even before the Guadalcanal insurgency. The SIAC government elected late in 1997 confronted a bankrupt and dysfunctional public sector⁶. It embarked on a ‘policy and structural reform programme’ (PSRP) based on plans drafted by CBSI and like-minded officials during, but rejected by, the outgoing Mamaloni administration. The PSRP made good headway in 1998 with restoring fiscal respectability, but progress with the more complex reform of the public service and state-owned enterprises was much slower—in the latter case almost nil—and efforts during 1999 to review and strengthen provincial/island-level government bogged down.
16. As 1999 advanced, economic activity, government services and infrastructure on North Guadalcanal were disrupted and destroyed, concerns mounted about the social impact on Malaita, and political energy was diverted from the PSRP. In the months leading up to the 5 June coup Ulufa’alu seemed to be politically alone in continued pursuit of the PSRP, a stance for which he was criticised then and later by Sogavare (for paying too much attention to reform and not enough to the insurgency, a criticism with some basis in fact). After 5 June, services and infrastructure disintegrated further, leaving a few ‘islands’ of continued, even intensified, activity under effective leaders who could improvise means and inspire others⁷, surrounded by a sea of non-functioning institutions and staff on indefinite unpaid leave—*de jure* or *de facto*.
17. *Non-government responses.* The response of civil society and people at large to pervasive government failure has been remarkable. After conspicuous hesitation in several of its member churches⁸ about where their duty lay, the Solomon Islands Christian Association

transparent manner, and the financing of rehabilitation and strengthening of social services and economic infrastructure.

⁶ Despite this, and the poor state of economic infrastructure, the private sector at that time seemed reasonably robust and capable of continued growth, built around tree-crop agriculture, tuna fisheries, forest logging (albeit mostly on a scale unsustainable beyond the short term), a newly-opened gold mine, and a range of light industry and secondary manufacturing activities almost all located in Honiara and North Guadalcanal. The banks and NPF were heavily exposed to government risk, and were closely involved in the restructuring of public debt that took place in 1998.

⁷ Fortunately including the national referral and provincial hospitals. Hospital staff in Honiara were caught up in the armed conflict and responded with great courage and steadiness.

⁸ All the main churches except the United Church had members in Guadalcanal and Malaita, and saw their adherents engaging in bloodshed and mayhem, often in leadership roles. For much of 1999 only the Roman Catholic Church was

(SICA) has become an active force in mobilising people and opinions for the restoration of a lawful peace, openly putting pressure on SIG to clean up its act, enforce the TPA and hold the general election on schedule. Australia provides some funding for the SICA Peace Office, enabling it to engage the help of SI professional and technical persons in its activities.

18. Non-church NGOs have also responded, individually and through Development Services Exchange (DSE), by stepping up their work efforts in the community and adding their voices to calls for SIG transparency and implementation of the TPA, and liaising with SICA. Recently SICA called on the PM to resign, 'to break the chain of violence and corruption stretching from 5 June 2000'. It is not clear that this move will be productive. There is a risk that it may drive Sogavare further into the arms of the power-brokers behind the present government—persons deeply involved in the 5 June coup, whose continuing control over all important government decisions Sogavare has admitted in several interviews.
19. At the practical levels of service delivery, churches and NGOs have stepped up their activities in health and education. AusAID and other donors/IFIs have sought ways to deliver assistance directly to them, without going through SIG channels. These developments are understood and welcomed by people in SI, and a pragmatic, no-objection response is looked for from SIG.
20. *Flexible federalism*. What to do about island identity and aspirations for autonomy has been a theme of political debate in SI since long before independence. Events in Guadalcanal in 1998-2001, and reactions to them throughout SI (with echoes from Bougainville's continuing efforts to secede from PNG), have highlighted the depth and permanence of inter-island feelings of different-ness. The importance attaching to sub-national identity has not been eroded by colonial or post-colonial experiences, despite all efforts to diminish it, and it is evidently not lessened by recent events. At the same time there is a wide understanding that for some social and economic purposes it makes sense to collaborate with other islands, that different islands have different resource endowments, capacities and needs, and that both the efficiency dimension and the ownership dimension need to be taken into account in designing service delivery structures.
21. In these circumstances a kind of 'flexible federalism' appears to command support. This would accommodate separateness for some purposes and togetherness for others, and allow various degrees of autonomy to co-exist within a single federal structure. After restoration of internal security and accountable government, achieving a workable form of flexible federalism is the most important challenge ahead of Solomon Islands. This will require brains, energy and money to be applied at national/federal and at island/state level, and it should engage the attention and active participation of AusAID—and other donors/IFIs—just as soon as SIG itself can make a coherent statement of its intentions.

openly engaged in trying to mediate in the growing conflict, and it attracted both praise and blame for its active role. Now it seems content to act within a SICA framework. Among church workers on the ground, the Melanesian Brothers repeatedly went into danger areas to seek a cessation of hostilities, and have recently been helping the Peace Monitoring Council with investigations into breaches of the TPA.

22. This is now expected from the Minister responsible, Nathaniel Waena, at the next meeting of Parliament. It will be helpful if AusAID can signal Australian ‘in principle’ readiness to be actively involved in supporting the move to flexible federalism—not to be afraid of engagement in this vitally important area. There will be a huge amount to do, intellectually and practically, to design it and make it work, and several aid donors will need to collaborate to mobilise all the help that will be needed. The existing national-provincial government structure manifestly has not worked, except in scattered instances and for short periods, and its ineffectiveness⁹ has been a major factor in the current, wider failure of government as a whole. The cost of not moving successfully to flexible federalism would most likely be continued political and constitutional instability, and further outbreaks of violence as assertion of island-level identity coincides with economic frustration.

Implications for AusAID

23. *Unorthodox assistance.* Faced by intractable problems, AusAID has shown increasing flexibility and willingness to innovate in the SI programme. This spirit will need to be sustained in the face of inevitable setbacks, and possibly resistance from SI official and political quarters. The growing constituency of support in civil society for more flexibility in aid programmes will be a useful ally, provided it is skilfully used.

In SI’s present circumstances three areas of innovation appear particularly worth pursuing:

- *balance of payments support:* this would involve Australian collaboration with IMF¹⁰ to provide a substantial injection into SI official external reserves, in return for a few simple but crucially important reforms to fiscal policy—substantially the same as those now on the table with World Bank and ADB, with the addition of undertakings on central bank credit to SIG (to ensure that BoP support does not leak into monetisation of the Budget deficit), and possibly on private sector credit and exchange rate policy.

A balance of payments loan¹¹ of SI\$100m (A\$40m) in 2001, and similar amounts available if needed in 2002 and 2003, would provide the underpinning to the external reserves necessary (though not sufficient by itself—a credible peace also has to be restored) to rebuild investor confidence and enable the private sector to shift back to growth mode. IMF has held back from offering assistance so far on the grounds that its funds are too expensive for SI, and no doubt also because it does not see evidence of sound policy intent by SIG. To reduce the cost to SI, Australia could meet the interest charges on the IMF loan from a specific increase in the aid programme to SI. It could also top up

⁹ The causes of the failure of the present system and its predecessors need to be understood. Useful work on this has been done by SI officials in the current Ministry of Provincial Government in reports to the Buala Conference of Provincial Premiers late last year.

¹⁰ SI is a member of the ‘Australian constituency’ at IMF, but normally gets little practical benefit from this. The Australian Executive Director represents SI as well as Australia, and if so briefed by Canberra, is well placed to argue the case for more flexibility and innovation by the Fund in relation to SI, with the participation of the Australian Treasury and Reserve Bank.

¹¹ A fixed-term reversible purchase of SI dollars by IMF.

whatever amount is available to SI under current IMF formulas by supplying funds from its own reserves through the IMF, to make an agreed total sum, eg SI\$100m, available.

- *budget support*: in parallel with the BoP support—which is aimed at restoring private sector confidence—AusAID would increase its tied support for the recurrent budget by extending help to specific costs of the ‘flexible federalism’ programme. These would be additional costs not presently budgeted, some at national/federal level but mostly at island/state level, and funds would go to staffing costs (including TA), other operating costs, buildings¹² and equipment. The prospective costs of moving to a federal system—probably a net SI\$50m a year more than the pre-coup ‘overhead’ costs of government—are unnerving those who need to be bold and resolute about this change. The offer of solid financial support, extending over a number of years until economic activity has revived and revenues are restored (and shared equitably), would be the best thing Australia could do to help SI into a federal future on a sound basis.
 - *direct assistance to civil society*: AusAID is already doing this, so it is less a question of innovation and more one of building on an important and welcome development in aid strategy and management. There is a risk that SIG will see this as derogating from its control over aid allocations. The civil society constituency should be articulate enough and the evidence of government failure clear enough, to deal with that, but AusAID and the High Commission will have to be diplomatically robust also to protect these arrangements, and indeed to progressively channel additional aid through them. The competence and accountability of the receiving institutions will have to be built up in step with their increasing access to aid resources.
24. *Australia’s manifest self interest*. Australia has a clear interest in SI being a stable and well-run country whose government and people feel good about themselves and about Australia. That is not the case at present, and the aid programme, broadly defined, is the main tool Australia has for trying to improve matters. Advances are needed on several fronts at the same time—restoration of peace and security, a credible economic strategy, a timely general election, financial support for the balance of payments and the move to a federal structure of government, and extension of support to civil society and non-formal institutions. A more complex engagement by AusAID and other Australian agencies places a greater load on scarce management resources to ensure internal and external coordination.
25. Finally there is a development policy risk, not at the top of the list right now in SI, but potentially troublesome. It is that out of a soundly-based concern for social and distributional issues, AusAID and other donors/IFIs may lose sight of the need for the formal SI economy to grow, and to grow faster than the population is growing. A sustained increase in direct investment in job-creating, export-earning, tax-paying commercial enterprises is critically important to returning SI to reasonable social and economic stability. The SI authorities know intuitively and from experience that formal-sector growth cannot provide a reasonable life for everyone in SI. Small-scale village and urban settlement-based, informal-sector growth is also

¹² A substantial amount of housing, offices and other buildings will be required at island/state level.

necessary. But people in government and civil society may need to be reminded that restoration and growth of foreign exchange earnings and government revenues, derived from steadily growing formal-sector activity, are essential if SI is not to be a permanent basket case, increasingly dependent on Australian aid.

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