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Mr. Jim Kim
President
The World Bank
Washington, DC. 20433
USA

Dear President Kim,

Re: Letter of Development Policy

Solomon Islands is currently experiencing significantly improved economic conditions compared with late last decade. Much of this improvement can be attributed to the Government’s implementation of its Economic and Financial Reform Program (EFRP) in our pursuit of Solomon Islands’ growth and development. The EFRP outlines core policies supported by our budget support partners and draws from our National Development Strategy (NDS), which sets out our vision for the period 2011-20.

The economic reforms implemented by the government in recent years have been rewarding for the Solomon Islands. After the strong rebound from the global financial crisis in 2010 and 2011, growth returned to more sustainable rates in 2012, around 4 percent. Growth is expected to slow slightly from these rates through the next several years, as output of the Gold Ridge plateaus and logging activity slowly but steadily declines, offset by strength in agricultural production, improvements in the service sector and the potential for significant new investments in fisheries and, in the longer-term, mining. We remain well-aware of our vulnerability to global conditions and the impact these can have on our economy. Recently, Solomon Islands’ trade performance has been particularly notable, with merchandise trade in surplus in 2012, reflecting stronger exports and a moderation in growth of imports. This, along with ongoing support from our development partners and other capital flows, has allowed us to build our buffer of foreign exchange reserves to US$ 460 million in late 2012.

These improved economic conditions, and disciplined economic management, have placed the government’s finances on a surer footing. We have continued to reduce the Government’s debt, to 14 percent of GDP at the end of 2012, and the improvement in our financial health is reflected in the IMF/World Bank assessment of Solomon Islands facing a moderate risk of debt distress. With the decline in risks, we have introduced a medium-term debt strategy and renegotiated the Honiara Club Agreement, allowing for prudent levels of concessional borrowing, and we entered our first borrowing agreement under this arrangement in 2012.

The government has effectively managed the recent strong growth in revenues, maintaining budget surpluses while investing in our National Development Strategy’s priorities. For 2012, we estimate that we achieved a budget surplus approaching SBD 300 million or 4 percent of GDP (after accounting for financing transactions). This was achieved despite slowing revenue growth, and more ambitious spending, including in support for the Festival of Pacific Arts held in Honiara in July 2012,
a nationally significant event. These surpluses have allowed the government to maintain the cash buffers it accumulated during 2010 and 2011, over 2 months’ recurrent spending.

Our 2013 Budget maintains the gains in our macroeconomic framework. We again project a modest surplus, while maintaining prudent revenue expectations. Of the new spending measures, fifty-nine percent are directed towards Rural Development and other Economic Affairs. This commitment is supported by additional funding to education, public order and safety, and health. Also budgeted are significant investments in the capacity of the public sector to implement our program, including funding for 25 new permanent positions in core parts of the Ministry of Finance and a number of additional positions elsewhere across government. We continue to set aside funds, to prudently cover inevitable but unexpected expenditures. Our presentation of the budget also continues to strengthen, with the recently-introduced Budget Paper Volume 1 providing an increasingly thorough analysis of economic conditions, policy initiatives, and ministries’ spending.

Monetary conditions have remained stable, as growth in the broad money supply slowed from over 25 percent in 2011 to 17 percent in 2012, with most of this growth attributable to the accumulation of foreign exchange reserves. Consumer prices accelerated in 2012 and early 2013, reflecting rising prices of various imported items and some tariff increases. Year-on-year inflation declined from 8.2 percent in March 2012 to 4.2 percent by October, before rising again to 5.9 percent for the year to March 2013, due to weather-related supply disruptions. Inflation is projected to remain around 6 percent over the medium-term.

Mr. President, budget support from our development partners is critical to our continued progress. Budget support in 2013 is expected to reach approximately SBD 566 million, including US$ 2 million equivalent from the World Bank and support from AusAID and NZAP specifically for the health and education sectors. This follows budget support of SBD 343 million in 2012. All of these funds are firmly anchored by the EFRP which we regularly update and monitor jointly with our development partners through the Core Economic Working Group (CEWG). The EFRP is built around three central themes drawn from the NDS: i) strengthening SIG’s budget preparation and planning systems to ensure resources are applied to sustainably and effectively support better quality public services for Solomon Islands; ii) improving the quality of budget execution so that resources for public services reach their intended purpose; and iii) a better environment for private sector investment. Within these themes, and building on the success of the first budget support grant in our current program with the World Bank, the second grant includes actions aimed at improving revenue transparency, strengthening public financial management, and placing key state-owned enterprises on a firmer financial footing, so they can focus on improving their service delivery.

**Improving Revenue Transparency:** With the restoration of the Gold Ridge Mine, the Government believes that revenue transparency is a prerequisite to ensure that the country receives an appropriate share of the revenues generated and mining receipts are distributed equitably. The Government has therefore successfully applied for candidacy of the Extractive Industries Transparency Initiative (EITI) — we are proud to be the first EITI candidate country in Oceania. As part of our candidature, we have committed to working with all stakeholders. We have established a national Multi-stakeholder Steering Committee, and have published a work plan. We are now preparing the first EITI Report and a request for financial support from the EITI Multi-donor Trust Fund.

**Strengthening Public Financial Management:** Through our EFRP, and with technical support from regional and bilateral partners, we are implementing a multi-year program of continued reforms aimed at a more consultative budget formation with tighter links to intended results, better expenditure controls, and improved procurement practices. Annual consultations with civil society organizations, including women’s groups, and provincial governments are becoming an important component of the budget process, and we are working to make these exchanges more effective. We are working more closely with the Ministry of Development Planning and Aid Coordination (MDPAC), the Ministry of Public Service (MPS) and other line ministries through the budget preparation process. Our new chart of accounts is supporting better budget preparation, especially of the development budget, and will
strengthen analysis of spending. Our new procurement unit is developing procurement processes and guidelines which are already raising the quality of government purchasing. Further, we are creating a more transparent and coordinated process for determining eligibility for exemptions from taxes and duties. These efforts are core components of a wider reform program, described in the various editions of the EFRP and supported by our CEWG partners and by an IMF Extended Credit Facility (ECF).

We are currently finalizing a new Public Financial Management Act. We are also working to ensure more resources reach all members of the community, while improving the administration and transparency of funding mechanisms. For example, the Government is planning to strengthen the newly passed Constituency Development Fund (CDF) Act through developing regulations that will promote transparency and accountability of CDFs, including auditing all CDFs. The effectiveness of all our efforts was recognized in the general improvement in ratings in the 2012 Public Expenditure and Financial Accountability (PEFA) assessment relative to the 2008 assessment.

Better Finances for Key State-Owned Enterprises: Government realizes that improved public service delivery by our power and water utilities requires improved financial management. Key to this is resolving the Solomon Islands Water Authority’s debts to the Solomon Islands Electric Authority in a way that is sustainable and less likely to lead to future reversals. I entered a comprehensive agreement with both agencies in May 2012, which includes not only capital injections and debt write-offs and rescheduling, but also a scheme to bring tariffs into line with operating costs, and broader improvements in both organizations’ management. As this agreement continues to be implemented, it is most heartening to see these organizations shift their focus to long-term investments in their operations, and towards raising the quality, coverage and affordability of their services.

Mr. President, the Government is firmly committed to implementing its Economic and Financial Reform Program. As we develop the next general budget support program with the World Bank, we will aim to broaden the policy dialogue to support improvements in the delivery of key public services, including in health and education, and to improve the environment for private sector development in Solomon Islands. The Government looks forward to continuing our partnership with the World Bank in this important program.

Yours sincerely,

Hon. Rick Houenipwela, MP
Minister of Finance and Treasury