Program Information Document (PID)

Appraisal Stage | Date Prepared/Updated: 22-Oct-2019 | Report No: PIDA27767
### BASIC INFORMATION

#### A. Basic Project Data

<table>
<thead>
<tr>
<th>Country</th>
<th>Project ID</th>
<th>Project Name</th>
<th>Parent Project ID (if any)</th>
</tr>
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<tbody>
<tr>
<td>Solomon Islands</td>
<td>P167465</td>
<td>The First Solomon Islands Transition to Sustainable Growth Development Policy Operation (P167465)</td>
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<thead>
<tr>
<th>Region</th>
<th>Estimated Board Date</th>
<th>Practice Area (Lead)</th>
<th>Financing Instrument</th>
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</thead>
<tbody>
<tr>
<td>EAST ASIA AND PACIFIC</td>
<td>27-Feb-2020</td>
<td>Macroeconomics, Trade and Investment</td>
<td>Development Policy Financing</td>
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<tr>
<th>Borrower(s)</th>
<th>Implementing Agency</th>
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<tr>
<td>Solomon Islands</td>
<td>Ministry of Finance and Treasury</td>
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#### Proposed Development Objective(s)

The proposed operation focuses on two Program Development Objectives, namely i) strengthening fiscal management in the areas of debt management, cash management and budget management; and ii) strengthening the business environment through simplifying tax processes, fighting corruption and supporting more efficient payments systems.

#### Financing (in US$, Millions)

**SUMMARY**

<table>
<thead>
<tr>
<th>Total Financing</th>
<th>9.90</th>
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**DETAILS**

<table>
<thead>
<tr>
<th>Total World Bank Group Financing</th>
<th>9.90</th>
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<tbody>
<tr>
<td>World Bank Lending</td>
<td>9.90</td>
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#### Decision

The review did authorize the team to appraise and negotiate
B. Introduction and Context

Country Context

Solomon Islands is a fragile small island state. A low-level conflict between 1998 and 2003, known as ‘the tensions’, brought the formal economy and many state functions to a halt, causing growth to contract throughout four consecutive years between 1999 and 2002. Overall, the conflict resulted in an estimated 40 percent contraction in GDP. Peace was rapidly restored through an Australian-led Regional Assistance Mission to Solomon Islands (RAMSI), and key state functions were rebuilt and strengthened over the years. The country has subsequently enjoyed a relatively stable security situation which supported economic growth. The post-conflict period saw a strong rebound in economic growth from a low base, which was briefly interrupted by the Global Financial Crisis (GFC) in 2009. Economic growth has moderated over the past five years, driven by softening international commodity prices from 2011 onwards, the impact of a natural disaster in 2014 (which brought about the closure of the country’s only operating gold mine), and limited diversification of the economic base. The economy remains highly dependent on grossly unsustainable log production, estimated to have accounted for 60 percent of exports, 20 percent of domestic revenues, and 32 percent of foreign exchange receipts in 2018. Critically, despite sustained economic growth in the post-conflict period, real per capita GDP remains below its pre-conflict level. While this can primarily be attributed to the rapid rate of population growth experienced over the past decades, effectively it means that on average, Solomon Islanders are relatively worse off today than they were over 20 years ago. In the context of low economic growth, lack of essential services and infrastructure, marked inequities between formal settlements and informal and rural areas, conflicts over land tenure, poor links between the indigenous and imported political system, and a high level of youth unemployment, the risk of conflict recurrence remains relevant.

Economic growth in Solomon Islands is estimated to have increased to 3.9 percent in 2018 from 3.7 percent in 2017, driven by stronger-than-expected log output. The forestry sector remains the single most important contributor to economic growth, government revenues and foreign exchange receipts, with the sector registering 10 percent growth in 2018 and with export volumes reaching a record high 2.7 million cubic meters, well above sustainable levels (last estimated in 2011 at 250,000 cubic meters a year). Growth in the economy was also supported by strong fish and palm oil production, as well as sustained growth in the construction, manufacturing and wholesale sectors. Overall, forestry made up 13 percent of GDP in 2018 and was more significant than the construction, manufacturing, mining and utilities sectors combined. To promote longer-term sustainability in the forestry sector, the Solomon Islands Government (SIG) adopted a Logging Sustainability Policy (LSP) in 2018, which targets phased reductions in log export volumes from 2019 through to 2023.

Solomon Islands’ macroeconomic policy framework is adequate for the purposes of the proposed operation. The return to fiscal prudence in 2018 through curtailing expenditure growth enabled the government to significantly narrow the deficit and supported the much-needed stabilization of cash reserves. The 2019 budget demonstrates a continued commitment to fiscal consolidation efforts through the passage of a balanced budget and restraint on discretionary expenditures, although a deficit (SI$258 million, or 2.2 percent of GDP) is now expected on the back of a negative revenue shock in the first half of 2019 and an additional SI$47 million in expenditures authorized through a supplementary budget (around half of which represent payments arrears). It will be critical for SIG to adequately manage existing and emerging expenditure pressures going forward, and in a constrained fiscal environment, place a heightened focus on improving the transparency, efficiency and effectiveness of public spending to support poverty reduction and promote inclusive growth. The macroeconomic risks associated with the cessation of the correspondent banking relationship of a key domestic bank were successfully mitigated in 2018, and SIG has since adopted new measures to address governance and environmental concerns in the forestry sector and set the industry on a more sustainable footing. The adoption of a new
The tax administration framework will be key not only to foster private sector growth and increase compliance but lays the foundation for future tax reforms aimed at modernizing the tax system and broadening the revenue base.

**Relationship to CPF**

The proposed operation is aligned with the priorities laid out under the Country Partnership Framework (CPF). The World Bank Group’s Country Partnership Framework for Solomon Islands is structured around three focus areas, namely i) strengthening the foundations of well-being; ii) promoting inclusive and sustainable growth; and iii) managing uneven development. Both program development objectives (PDO) – strengthening fiscal management; and strengthening the business environment – are aligned with focus area (ii) of the CPF. Similarly, both PDOs are aligned with the twin goals of ending extreme poverty and promoting shared prosperity in a sustainable manner, by focusing on lifting constraints to the broad-based economic growth that is needed to support Solomon Islands’ transition away from reliance on the logging sector. The proposed operation aligns closely with broader World Bank Group engagements in contributing to achieve the objectives of the CPF. These include the World Bank-International Finance Corporation (IFC) Pacific Payments, Remittances and Securities Settlement Initiative (PAPRI), and ongoing engagements on the macroeconomic policy dialogue supported through analytical work focused on public expenditure management and economic growth. Policy actions supported by this operation are also closely aligned with the International Development Association (IDA) 18 special theme “Governance and Institutions”. Strengthening good governance and building capable institutions is critical to poverty reduction and development effectiveness in Solomon Islands. The operation is closely aligned with the IDA18 special theme, in particular through the operation’s focus on strengthening fiscal management (prior actions 1 and 2), improving tax administration and ensuring equitable enforcement of tax policies (prior action 3), increasing transparency and accountability in the use of public funds (prior action 4), and supporting more efficient payments systems (prior action 5). The reforms supported by the operation are expected to contribute to Solomon Islands’ broader state-building goals needed for poverty reduction and development effectiveness.

**C. Proposed Development Objective(s)**

The proposed operation focuses on two Program Development Objectives, namely i) strengthening fiscal management in the areas of debt management, cash management and budget management; and ii) strengthening the business environment through simplifying tax processes, fighting corruption and supporting more efficient payments systems.

**Key Results**

Actions to strengthen fiscal management are expected to contribute to: i) public debt sustainability, through compliance with the provisions of Solomon Islands Government’s (SIG) Debt Management Framework; ii) the elimination of expenditure arrears and improved liquidity, through measures to improve cash management and oversight of payment requests; and iii) enhanced integrity of the annual budget process, through regulations to reduce reliance on within-year adjustments to appropriations and mandate comprehensive forward estimates in the published Budget Strategy. Actions to strengthen the business environment are expected to result in: i) more efficient tax administration processes; ii) the establishment of more effective anti-corruption institutions; iii) and the introduction of electronic payments systems to improve financial sector efficiency.

**D. Project Description**

The first pillar of the proposed operation – to strengthen fiscal management – is closely aligned to
the inclusive economic growth and governance objectives of the National Development Strategy (NDS) and aims to support SIG’s public financial management (PFM) reform priorities. Specifically, this pillar supports i) implementing regulations under the PFM Act to improve debt management in line with the PFM Roadmap; ii) efforts to prevent payment arrears through improved cash management and stronger controls over payment processing; and iii) regulations for the effective management of the budget process to strengthen fiscal discipline and improve medium-term planning. Over time and complemented through other reform measures currently underway, this pillar should contribute to improved fiscal resilience – an important foundation for poverty reduction and shared prosperity.

Similarly, the second pillar of the proposed operation – to strengthen the business environment – is also closely aligned with the inclusive economic growth objective of the NDS. This pillar supports i) an overhaul of tax administration to simplify processes for taxpayers; ii) the adoption of new anti-corruption legislation, including the establishment of the Solomon Islands Independent Commission Against Corruption (SIICAC); and iii) improved financial sector efficiency through the adoption of a national payments system under oversight of the Central Bank of Solomon Islands. Over time, and complemented through related reform measures, this pillar is expected to promote a level playing field for business and foster private sector development – again, supporting poverty reduction and shared prosperity.

The proposed operation builds on lessons learned from a previous programmatic series of two Development Policy Operations (DPOs), and a stand-alone DPO in Solomon Islands, as well as other DPOs completed in small Pacific Island Countries. The Solomon Islands experience has shown that sharply focusing on a small number of strategic reforms is the most effective approach in leveraging policy reforms. The team has emphasized government ownership and consultation in preparing the operation, selecting policy actions that are strategic and ambitious but also realistic within a difficult post-conflict political economy context. The operation builds on broader regional lessons regarding the importance of close donor coordination and shared policy matrices for budget support to minimize duplication of efforts that risk overstretching government capacity. Heeding this lesson, this DPO was prepared through the Core Economic Working Group (CEWG) donor coordination mechanism.

E. Implementation

Institutional and Implementation Arrangements

Monitoring of the operation will be conducted jointly between the Ministry of Finance and Treasury (MoFT) and development partners, under SIG’s CEWG forum. The MoFT Financial and Economic Development Unit (FEDU) has adequate capacity and is the main office responsible for monitoring the program and all associated outcome indicators. FEDU will provide half-yearly reports to the World Bank and other CEWG budget support partners on implementation progress against established timetables and agreed performance indicators. This will be done as part of the established reporting process under the CEWG. The overall reform effort will be reviewed by the Government in close coordination with the World Bank’s in-country office and regular joint-donor missions to ensure continued implementation of the program within an adequate macroeconomic policy framework.

F. Poverty and Social Impacts and Environmental Aspects

Poverty and Social Impacts

Actions under the first pillar on strengthening fiscal management are not expected to have negative poverty or social impacts. Improved cash management should have a positive social impact, by helping to reduce the risk of interruptions to the provision of critical public services as a result of poor cash management. Strengthened budget management
should indirectly support poverty reduction and positive social impacts, by helping to support sustainable fiscal outcomes and, in the longer run, contributing to higher-quality public spending.

Other reforms under the second pillar are not expected to have significant poverty or social impacts and should benefit poor people and vulnerable groups. Given that the poor are less likely to hold bank accounts and rely more on non-conventional payment methods (e.g. mobile phone-based transfers), Central Bank of Solomon Islands’ (CBSI) expanded consumer protection mandate under the payments systems reform may particularly benefit the poor and vulnerable. Reforms to introduce an Anti-Corruption Commission should benefit vulnerable groups to the extent that it provides an avenue for ordinary citizens (especially the rural poor living outside of Honiara) to raise corruption complaints, and to the extent that it contributes to reduced incidence of corruption in local-level service delivery that is critical for the poor.

Environmental Aspects

The policy reforms supported by this operation are unlikely to have any negative effects on Solomon Islands’ environment. Reforms to strengthen fiscal management through the areas of debt management, cash management, and budget management are not likely to have any significant environmental impacts. Similarly, reforms to strengthen the foundations for inclusive and sustainable growth through simplifying tax processes, fighting corruption, and supporting more efficient payments systems are equally not likely to have any significant environmental impacts.

G. Risks and Mitigation

The overall risk rating for the proposed operation is substantial, with the most significant risks stemming from thin institutional capacity within central government ministries, and an uncertain macroeconomic environment. Thin capacity in the public sector presents a risk that could impede the implementation of the proposed reforms. This is being mitigated by selectivity in the design of the program, clear communication on requirements of each policy action and, where gaps arise, by mapping technical assistance from development partners. Secondly, macroeconomic risks stemming from a decline in log output and slippages in fiscal management could place a strain on Solomon Islands’ fiscal situation. The DPO engagement aims to address these risks through the macroeconomic policy dialogue and the DPO-supported reforms to strengthen PFM. Finally, Solomon Islands’ vulnerability to external shocks, including from natural disasters, poses a risk to the operation. The DPO-supported reforms to strengthen fiscal management mitigate against this risk through the rebuilding of the government’s cash buffers and measures to strengthen budget management. The Bank will continue to engage in dialogue with the authorities and the International Monetary Fund (IMF) to monitor macroeconomic risks and provide policy advice as needed.

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