Report Number: ICRR14886

IEG ICR Review

Independent Evaluation Group

1. Project Data:			Date Posted: 02/05/2016	
Country:	Solomon Islands			
	Is this Review for a Programmatic Series ?			● Yes ○ No
	How many operations were planned for the series?			2
	How many were approved?			2
Series ID:	S143242			
First Project ID:	P126740		Appraisal	Actual
Project Name:	Solomon Islands Development Policy Operation 1	Project Costs (US$M):	1.3	1.3
L/C Number:		Loan/Credit (US$M):	1.3	1.3
Sector Board:	Economic Policy	Cofinancing (US$M):		
Cofinanciers:		Board Approval Date:		04/26/2012
		Closing Date:	12/31/2013	12/31/2013
Sector(s):	Central government administration (90%); General industry and trade sector (10%)			
Theme(s):	Public expenditure; financial management and procurement (90%); Participation and civic engagement (10%)			
Second Project ID :	P143242		Appraisal	Actual
Project Name:	Solomon Islands Development Policy Operation-2	Project Costs (US$M):	2.0	2.0
L/C Number:		Loan/Credit (US$M):	2.0	2.0
Sector Board:	Economic Policy	Cofinancing (US$M):		
		Board Approval Date:		08/27/2013
Cofinancers:		Closing Date:	12/31/2014	12/31/2014
Sector(s):	Central government administration (71%), Other Mining and Extractive Industries (15%), Transmission and Distribution of Electricity (7%), Water supply (7%)			
Theme(s):	Public expenditure, financial management and procurement (50%), Participation and civic engagement (15%), Tax policy and administration (15%), Other public sector governance (10%), Debt management and fiscal sustainability (10%)			
Evaluator:	Panel Reviewer:	ICR Review Coordinator:	Group:	
Mauricio Carrizosa	Robert Mark Lacey	Lourdes N. Pagaran	IEGPS2	

2. Project Objectives and Components:

a. Objectives:

The Program Documents (PDs) for both Development Policy Operations DPOs) articulated the objective as follows: "The proposed operation would support the following three development objectives: *i*) improve the quality of public financial management; *ii*) improve the financial management of key State Owned Enterprises; and *iii*) improve extractive revenue transparency." ((PD1, pp. I and 18; PD2, pp. 1 and 21).

b. If this is a single DPL operation (not part of a series), were the project objectives/ key associated outcome targets revised during implementation?

No

c. Policy Areas:

1. **Public Financial Management (PFM)**

This area covered actions to broaden community involvement in the budget process, develop the capacity to better track expenditures, improve the quality of budget formation and execution, and improve procurement transparency with initial steps to strengthen procurement.

2. **State Owned Enterprises (SOEs)**

This area covered actions to improve SOEs' financial position. The first grant (DPO1) supported the adoption of a Community Service Obligation policy for State Owned Enterprises in order to reduce the need for internal cross-subsidization of low income clients, with an adequate budgetary allocation to support this policy. The second grant supported an agreement on a mechanism to reduce the Solomon Islands Water Authority (SIWA) debts to the Solomon Islands Electricity Authority (SIEA),

3. **Extractive revenue transparency**

This area included the successful application to the Extractive Industries Transparency Initiative (EITI), an action to build the foundation for future extractive revenue transparency.

d. Comments on Project Cost, Financing, Borrower Contribution, and Dates:

The grants were approved by the Bank on April 26, 2012 (DPO1) and August 27, 2013 (DPO 2), and declared effective on 06/12/2012 and 10/25/2013 respectively. The grants closed, as anticipated, on December 31, 2013 (DPO1) and December 31, 2014 (DPO2) respectively.

3. Relevance of Objectives & Design:

a. Relevance of Objectives:

High. The DPO's objectives address important development challenges, including uneven public financial management (with low scores in most areas of a 2008 Public Expenditure and Financial Accountability - PEFA -- assessment), SOEs that drain budget resources and crowd out private investment, and an inadequate policy, legislative and institutional framework in mining. The objectives are relevant to the World Bank Group's FY2013-2017 Country Partnership Strategy, which envisages strengthened public expenditure and fiscal management; and enhanced regulatory framework, public sector capacity and community benefits in the mining sector as two of its outcomes. The objectives are also relevant to the World Bank Group's 2010 Interim Strategy Note (ISN), notably to its objective to address barriers to growth. The ISN specifically envisaged a DPO "to support select PFM reforms, encourage coordination, selectivity, and sequencing among the overall donor budget support program, and help to move the country away from narrow project aid modalities." DPO outcomes are, moreover, consistent with those sought by the Government, as articulated in its 2011-20 National Development Strategy (NDS) and in its Economic and Financial Reform Program (EFRP), a common matrix for key reforms backed by budget support, and as reflected in its Letter of Development Policy to the Bank. That letter notes the EFRP is built around three NDS issues: budget preparation and planning, quality of budget execution, and the private investment climate

b. Relevance of Design:

Substantial. Broadening public and internal budget consultations, strengthening tools for expenditure tracking, controlling tax and wage expenditures, and strengthening procurement management arrangements can reasonably be expected to improve the quality of public financial management (PFM), as reflected in the size of gaps between planned and realized expenditures. Similarly, settling SOE debts, introducing transparent budget financing of subsidies in utility services can, combined with SOE corporate reporting and governance improvements, achieve progress in SOE financial management. However, the impact of these reforms on SOE financial management could be better assessed by shifts in the overall financial position and performance of SOE, not by the settling of debts and budget financing of subsidies alone. Finally, an EITI arrangement is one of the well-acknowledged foundations of extractive industry transparency. A key additional foundation of the latter is a corpus of clear legislative and regulatory arrangements, which are still lacking under Solomon Islands' mining legislation. A 20-month program is likely to suffice to implement reforms, but would likely be insufficient to fully

achieve PFM quality and SOE Financial Management outcomes.

The macroeconomic framework in the Solomon Islands at the time of the preparation of the DPOs was satisfactory. According to the International Monetary Fund's 2013 Article IV Consultation Report, economic growth was slowly recovering following adverse weather conditions in 2012/13. There was a significant budget surplus in the first half of 2013 (although due mainly to under-execution of development spending). The financial system was sound. Banks were adequately capitalized, highly liquid, and profitable. Although the current account balance deteriorated in 2013, international reserves held up at satisfactory levels.

4. Achievement of Objectives (Efficacy):

Improve the quality of public financial management . Substantial

Broader community engagement in the budget process. Following 2011 pilot budget consultations (for the 2012 budget) that covered civil society and churches in Honiara (Solomon Islands capital city), the Government broadened consultations in Honiara and expanded them to all but one provincial government and to civil society organizations in nine provinces in 2012. The Government increased by 50 the number of civil society organizations, local community representatives, and provincial leaders consulted in 2013 (for the 2014 budget), greatly exceeding the target (5). The Government also expanded dissemination of consultation summaries from a summary in Budget Papers to summaries provided to communities, including to consulted civil society organizations, local community representatives, and provincial leaders.

Develop the capacity to better track expenditures. The Government reformed budget accounts (the Chart of Accounts, CoA) to unify the classifications used in recurrent and development budgets and to achieve a standardized format for all budget ledgers. The changes in classification and coding allow for greater linkages with ministry-level strategies and national development objectives, and for a closer tracking of the resources the government allocates and disburses against its service-delivery goals. As development projects are now required to present costs according to CoA cost headings, rather than simply in terms of the full project, the revised CoA supports better-designed and executed development projects that more fully achieve their goals, thereby requiring less unplanned requests for additional funds. The target of recording and reporting the 2014 budget according to the CoA headings for all development projects was met.

Improve the quality of budget formation and execution. Beginning in 2011 (for the 2012 budget), the Government includes individual ministerial expenditure briefs in budget documents (a DPO-1 prior action). These reflect deeper budget consultations with ministries and are complemented, at the macro level, by a requirement under a Public Financial Management Act that annual budgets and supplementary appropriations be fully funded; by an alignment of budget actions with the Medium Term Fiscal Strategy; and by more explicit public servant responsibilities in relation to public expenditure management and control. However, the DPO target that the number of expenditure heads where expenditures do not deviate by more than 10 percent from approved allocations increase to at least 14 in 2013 (compared to the 2009 baseline of 11) was not met . That number increased to 15 by 2012 before falling to 10 in 2013 and 7 in 2014.

Under the DPO, new legislation (a prior action for DPO-2) requires that a Finance Minister's decision to grant a tax exemption be subject to the recommendations of an Exemptions Committee of officers from the Inland Revenue Division (IRD), the Customs and Excise Division (CED), the Ministry of Development Planning and Aid Coordination (MDPAC) and the Ministry of Commerce. The ICR (p.12) reports that the Exemptions Committee meets regularly and that its recommendations are transparent and authoritative. The requirement reduced the number of tax exemption applications to less than 20% of the number previously received. The total value of actual exemptions also declined. The DPO target that all tax exemptions approved are recommended by the Exemptions Committee was met.

Under DPO-1, the Government started issuing separate authorizations ("warrants") on payroll expenditures (a prior action) and introduced payroll software that captures the full central government labor force and flags expenditures that are not backed by spending warrants. The target that "total actual payroll expenditure (including wages and salaries, allowances and NPF contributions) in 2012 and 2013 shall not deviate by more than 10 percent from the appropriated amount, from a baseline deviation in 2010 of 15 percent" was met. In 2012 and 2013 respectively, payroll expenditures deviated by 7.4 percent and 2.3 percent from original budget allocations.

Take steps towards strengthening procurement. Under DPO-1, the Government started publishing successful procurement tenders controlled by the Central Tender Board (CTB) on the Ministry of Finance and Treasury (MoFT) website (a prior action). In addition, the Government increased controls on information technology (IT) and stationery procurement, following its finding of discrepancies in procurement practices of several ministries in

those areas. Under DPO-2, the Government introduced a dedicated procurement unit in the Accountant General's office (located at the Treasury) that provides tender support, operational procurement, and policy training, and that acts as the Cash Tender Board's secretariat. The ICR's assessment (p. 14) is that this office "has allowed for greater co-ordination and oversight of operations of the CTB and ministerial tender boards across Solomon Islands Government (SIG)"and that "the dedicated tender unit has brought some significant improvements in managing procurement documents, helping annual audits and establishing "preferred supplier" or "framework" contracts". Although errors in procurement compliance remain significant, these are now better documented. The target that "Details of successful tenders awarded by the Central Tender Board in 2011-13, including items procured, contract amount, procurement method, and name of vendor are published on the MoFT website" was met. The ICR could not document achievement of the target that the "Number of procurements filled through unauthorized procurement falls below 3 percent in Q1-2015 from a baseline above 7 percent in Q1-2013" because the Ministry of Finance does not record this data.

Overall, PFM quality appears to have improved as a result of measures supported by the DPOs., These include broader public budget consultations, a better accounting basis for the tracking of expenditures, expenditure briefs at the ministerial level and internal consultations, and greater control of tax and wage expenditures. The extent to which a closer congruence of planned and realized expenditures is, however, unclear, and as to whether procurement measures reduced unauthorized procurements.

Improve the financial management of key State Owned Enterprises (SOEs). Substantial

The Government established a Community Service Obligation (a prior action under DPO 1), a contractual arrangement whereby the Government appropriates funds to finance service-delivery contracts with the SOEs in higher-cost areas in order to ensure service delivery to poor households, as part of the effort to improve SOEs solvency. Furthermore, the Government agreed on a mechanism to reduce Solomon Islands Water Authority debts to the Solomon Islands Electricity Authority (a DPO 2 prior action). The debt reduction of "at least one-third from a September 30, 2011 baseline of SBD 33 million" was surpassed, as the whole amount was settled by end-2013. This was achieved through an initial Government capital injection of SBD5 million to the Water Authority for immediate onward payment to the Electricity Authority, followed by a further SBD15 million transfer from the Government after the approval of the 2013 Budget; and by the Electricity Authority's agreement to convert SBD7.5 million of Water Authority debt into an interest-free loan to be repaid over 8 years, and to write-off SBD9.2 million of the debt. Furthermore, the Government agreed on Community Service Obligations with both institutions that would cover the additional cost of supplying customers in areas (provincial capitals) where operating costs are significantly higher than the nationally uniform tariffs. Other measures included improvements in the SOE regulatory environment (with ADB taking the lead, and on which the ICR did not provide details); a Ministry of Finance agreement to step-wise increases in water tariffs until they covered operating costs (moving thereafter to formula-determined tariff adjustments, now in force, as in the Electricity Authority); and the requirement that SOEs submit annual statements of corporate objectives and report on how well the objectives from the previous year were met, financial statements within 3 months of the closing of each financial year, and audited statements within 6 months of the next financial year.

Build the foundation for future extractive revenue transparency . Substantial

The Government endorsed and publicly committed to an Extractive Industries Transparency Initiative (EITI) policy paper towards implementation of EITI principles (a DPO 1 prior action). The Government applied successfully for EITI candidate status, after meeting the necessary requirements (a DPO 2 prior action). The Government published before December 31, 2014 the Solomon Islands extractive industries revenue report, consistent with the agreed Solomon Islands EITI multi-stakeholder group work plan, thereby achieving a target under the DPO-supported program. These actions constitute an important contribution towards building the foundation for extractive revenue transparency. Work remains to be done on the mining legal framework (which the DPOs did not support);, in particular, the 1990 Mining Act needs to be amended to reduce confusion and conflict between the Government and the private sector. The Act as it stands is a disincentive to mineral exploration investment (PD DPO-2, para. 105).

5. Efficiency (not applicable to DPLs):

6. Outcome:

DPO objectives were highly relevant to Bank and country strategy, and to country development challenges. Relevance of design benefited from a strong link of reforms to objectives, although some outcomes could have

been better articulated. Substantial outcomes were achieved, particularly on public budget consultations, budget accounting for better expenditure tracking, control of tax and wage expenditures, procurement transparency, addressing SOE debts, and laying the foundations for mining sector transparency.

a. Outcome Rating: Satisfactory

7. Rationale for Risk to Development Outcome Rating:

Risks of poor policy decisions in a fragile political environment, together with weak capacity in budget institutions could have significant fiscal costs and/or reverse or retard progress in PFM. SOE management still needs to be tested and risks relapsing to past performance. Progress on mining sector transparency could stall, including progress to develop and clarify mining legislation, which normally involve long processes.

a. Risk to Development Outcome Rating: Significant

8. Assessment of Bank Performance:

a. Quality at entry:

Quality at entry reflected the DPOs' focus on relevant development constraints and objectives that were consistent with Government programs and Bank strategy. Design of the program benefitted from analytical work, including a 2010/11 Public Expenditure Review, a 2008 Public Financial Management Performance Report, a 2012 PEFA, and 2008 and 2012 Procurement Reviews. Other reports underpinned the program for SOEs and EITI. Both DPOs were initiated under a supportive macroeconomic environment with acceptable levels of price stability and of internal and external balances, declining debt stocks, and a build-up of reserves to cushion shocks. The program was expected to help reduce poverty through a better alignment between budgetary allocations and the poverty reduction and inclusive growth objectives of the NDS. Furthermore, the program was envisaged to improve the targeting of social spending to help narrow the priority gender gaps in health and education; and support a more equitable provision of utility services through CSOs. No positive or negative environmental effects were expected. Implementation arrangements were appropriately assigned to the Ministry of Finance and Treasury, which has a vested interest in the PFM and SOE reforms. M&E arrangements were adequate, with some exceptions (see Section 10 below). The PDs provided systematic accounts of risks and their mitigation measures.

Quality-at-Entry Rating: Satisfactory

b. Quality of supervision:

Supervision was conducted primarily in the context of preparation for the DPO-2, the 2013 Joint Review Mission (the annual mission conducted in collaboration with development partners), and two ISRs filed for DPO-2. The ISRs suggest adequate outcome orientation. The ICR reports that the supervision team exercised flexibility in adjusting the program content to the needs of Government, with supervision benefitting from management support and cooperation with the IMF and other development partners.

Quality of Supervision Rating: Satisfactory

Overall Bank Performance Rating: Satisfactory

9. Assessment of Borrower Performance:

a. Government Performance:

The prior actions related to both DPOs suggest strong ownership and commitment to the program.

Government provided an adequate macroeconomic environment (Sections 3b and 8.a). Its budget policies included a particularly strong program of consultation and the EITI program itself is dependent on multi-stakeholder agreements. Implementation readiness appears to have been adequate for the gradual reform program the Government embarked upon. Fiduciary arrangements (Section 11.b) were appropriate as were the joint Government-Donor M&E arrangements. Donor coordination benefited from the Economic and Financial Reform Program and Core Economic Working Group arrangements.

Government Performance Rating : Satisfactory

b. Implementing Agency Performance:

NA

Implementing Agency Performance Rating : Not Applicable

Overall Borrower Performance Rating : Satisfactory

10. M&E Design, Implementation, & Utilization:

a. M&E Design:

M&E design benefited from simplicity and from generally well defined indicators. The ICR notes, however, that one indicator (The number of ministries and government institutions in 2013 that do not deviate more than 10 percent from the original and supplemental allocations approved by Parliament will increase to at least 14 compared to the 2009 baseline of 10) should have excluded supplemental allocations from the calculation, as these may be symptomatic of poor budget planning. Furthermore, indicators for SOEs could have included the financial performance of SOEs in 2014, as initial outcomes from the reforms concluded in 2013. An indicator pointing to how and for what purpose expenditures are being tracked under the new accounting introduced in 2013 could have been devised. The Ministry of Finance and Treasury was to implement M&E jointly with donors. The ICR notes that it is unclear how the baseline for one indicator ("Number of procurements filled through unauthorized procurement falls below 3 percent in Q1-2015 from a baseline above 7 percent in Q1-2013") was established, as the Ministry of Finance and Treasury was unable to provide an update.

b. M&E Implementation:

The ICR reports the Ministry of Finance and Treasury was responsible for producing bi-annual progress reports against implementation of the Government's broader reform program, with a more comprehensive review performed in collaboration with development partners under the annual Joint Review Mission (JRM) process.

c. M&E Utilization:

The M&E framework was used to monitor progress in implementing the Government's program. The ISRs for DPO-2 provided evaluation summaries reflecting the outcome and follow up of the 2013 Joint Review Mission.

M&E Quality Rating: Substantial

11. Other Issues

a. Safeguards:

No safeguards policies were triggered by these operations.

b. Fiduciary Compliance:

The PDs concluded that additional fiduciary arrangements beyond those already included in the Government's EFRP and the Financial and Economic Management Reform Program (FEMSP) would not be considered necessary for this operation".

c. Unintended Impacts (positive or negative):
None reported

d. Other:

12. Ratings:	ICR	IEG Review	Reason for Disagreement/Comments
Outcome:	Satisfactory	Satisfactory	
Risk to Development Outcome:	Significant	Significant	The ICR reports "Substantial"
Bank Performance:	Satisfactory	Satisfactory	
Borrower Performance:	Satisfactory	Satisfactory	
Quality of ICR:		Satisfactory	

NOTES:
- When insufficient information is provided by the Bank for IEG to arrive at a clear rating, IEG will downgrade the relevant ratings as warranted beginning July 1, 2006.
- The "Reason for Disagreement/Comments" column could cross-reference other sections of the ICR Review, as appropriate.

13. Lessons:

The first two lessons are taken from the ICR with some adaptation of language, and the third is drawn by IEG:

- Budget support combined with broad policy dialogue arrangements may help achieve reforms. In the Solomon Islands, the Core Economic Working Group, a coordination mechanism involving key government and donor interlocutors led by the Bank, combined with the Economic and Financial Reform Program (a common Government matrix for key reforms backed by budget support), was instrumental in achieving the DPO reforms.

- Modest reform goals may be appropriate for gradual reformers. Reforms that are uncomplicated and feasible may help build up momentum for additional change. PFM is an example, where the reform path is fairly long and needs to be broken down in steps that a gradual reformer can focus on and achieve.

- Even modest reforms may take time to achieve full development outcomes. The Solomon Islands DPOs achieved progress in PFM but full results, where the value of the reforms for the population at large materializes may take more than the usual time horizon covered by a DPO program.

14. Assessment Recommended? ○ Yes ● No

15. Comments on Quality of ICR:

The ICR is concise and well-written. Its section on achievement of objectives is particularly strong in broadening the discussion beyond the outcome indicators, except that it could have covered the financial performance of SOEs following the Community Service Obligation arrangement and Water Authority bail out, and discussed at more length what comes after EITI candidacy and the issues raised by the unregulated mining law. The context

or relevance sections could have discussed the development challenges addressed by the operation. The ICR did not discuss relevance of design. The “lessons” section could have done a better job articulating the impacts that particular features of the DPO program may have.

a.Quality of ICR Rating: Satisfactory