October 2006
IMF Country Report No. 06/362

Solomon Islands: 2006 Article IV Consultation—Staff Report and Public Information Notice on the Executive Board Discussion

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2006 Article IV consultation with the Solomon Islands, the following documents have been released and are included in this package:

- the staff report for the 2006 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on June 20, 2006, with the officials of the Solomon Islands on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on August 30, 2006. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- a Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its October 4, 2006 discussion of the staff report that concluded the Article IV consultation.

The document listed below has been or will be separately released.

Statistical Appendix

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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International Monetary Fund
Washington, D.C.

INTERNATIONAL MONETARY FUND

SOLOMON ISLANDS

Staff Report for the 2006 Article IV Consultation

Prepared by the Staff Representatives for
the 2006 Consultation with the Solomon Islands

Approved by Steven Dunaway and Michael Hadjimichael

August 30, 2006

- **Time and place of consultation**: The 2006 Article IV discussions were held in Honiara during June 8–20. The team comprised Ms. Papi (head), Ms. Fernandez, and Mr. Ginting (all APD). Ms. Stone (OED) attended the policy meetings.

- **Counterparts**: The team met with Prime Minister Sogavare, Acting Finance Minister Darcy Lilo, Governor Houenipwela of the Central Bank of the Solomon Islands (CBSI), other ministers, senior government officials, donors, and private sector representatives.

- **Past surveillance**: The outgoing government had started implementing a reform agenda along the lines of Directors' comments at the conclusion of the last Article IV consultation on September 28, 2005 (http://www.imf.org/external/np/sec/np/2005/pn05142.htm), although progress on structural reforms was slow due to difficulties in gathering political support, entrenched interests, and capacity constraints.

- **Exchange system**: The Solomon Islands accepted the obligations of Article VIII, Sections 2(a), 3, and 4 in 1979. Exchange restrictions reintroduced starting in 2000 were removed in 2003 and the exchange system is now free of restrictions on the making of payments and transfers for current international transactions. The currency is de facto pegged to the U.S. dollar.

- **Data**: Despite remedial measures, data quality, coverage, and timeliness remain weak, hampering surveillance.

- **Publication**: As last year, the authorities indicated that they intend to publish the Article IV documents.

Contents Page

Appendixes

EXECUTIVE SUMMARY

Economic Developments and Challenges

- **Since the intervention of the Regional Assistance Mission to the Solomon Islands, growth has rebounded and financial stability has been maintained**. Since 2003, per capita real GDP has increased about 3.5 percent per year. Strong donor-funded and newly started private sector projects, together with high oil prices, have shifted the current account into a wide deficit, but reserve coverage has been boosted by aid and foreign direct investment inflows. Due to rising oil prices, expatriate demand pressures, and brisk private credit growth, inflation is in the high single digits. For the third year running, the budget is projected to record a surplus in 2006 due to investment underspending and revenue overperformance, but low-priority spending is rising.

- **Raising living standards requires addressing pressing challenges**. New private activities to replace logging which is expected to run out in about six years need to be jump-started—a daunting task amidst deep-rooted obstacles to private investment, weak institutions, and rapid population growth. Progress will depend on the vigor of structural reforms, and maintaining macroeconomic and political stability.

Key Policy Issues

- **The 2007–10 national development strategy should translate the government's objectives of "governance plus growth" and the Millennium Development Goals into concrete policies**. The strategy should be country-led, implementable, and incorporate all programs/projects. It should also serve as the key mechanism for aid coordination.

- **Fiscal discipline should be sustained and a medium-term strategy developed taking into account looming pressures**. The expected decline in logging and import duty revenue needs to be offset, while the high wage bill should be strictly controlled to accommodate higher investment spending. Reforms to broaden the tax base and reduce cascading, address state-owned enterprises' (SOEs) inefficiencies, and enhance public finance management should be pursued. As the country remains at high risk of debt distress, ongoing efforts to regularize debt are welcome. Fiscal decentralization should be approached carefully and without weakening public finances.

- **The central bank's current exchange rate policy is appropriate, while the CBSI should remain vigilant on inflation**. With strong foreign inflows, the currency has been stabilized versus the U.S. dollar, but downward pressure on the exchange rate should be accommodated. The CBSI should strengthen its inflation forecasting and take measures if inflation pressures intensify or reserves come under pressure.

- **Financial system soundness should be strengthened mainly by liquidating the development bank and raising the profitability of the National Provident Fund**. Plans to broaden access to financial services should be commercially-oriented.

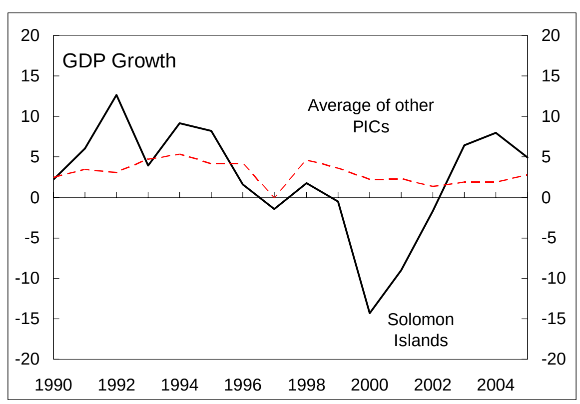
- **Structural reforms to encourage new private sector activities should be vigorously implemented**. Strengthened governance, SOE restructuring, and infrastructure provision should have priority.

I. INTRODUCTION

1. **The economy has performed well in the past three years, although raising living standards remains a formidable challenge**. Since the Regional Assistance Mission to the Solomon Islands' (RAMSI) intervention in 2003, macroeconomic stability has been maintained and activity has recovered. However, fundamental reforms remain essential to raise the prospects of sustainable growth and reduce the economy's vulnerability to shocks. According to the authorities' estimates, logging—accounting for two thirds of exports, 14 percent of tax revenue, and 10 percent of GDP—is expected to run out in about six years at the current rate of cutting and must be replaced by new sources of private sector growth. The task is complicated by political instability, rapid population growth, weak institutions and governance, infrastructure deficiencies, high costs of doing business, limited implementation capacity, entrenched vested interests, and poor social indicators (Figure 1 and Appendix VI).

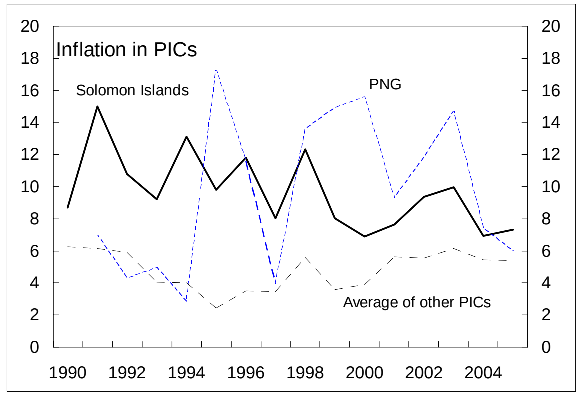
2. **The government is aware of these challenges, and the discussions focused on how to operationalize its *Framework Document*.** The latter aims at "governance plus growth," the Millennium Development Goals (MDGs), rural advancement, effective service delivery, as well as raising Solomon Islanders' skills, which should help achieve all other goals. Having taken office in May 2006, the new government at the time of the mission had not yet articulated concrete policies through which these goals would be pursued. Hence, the discussions dwelled on: (i) how to make the 2007–10 national development strategy a country-led, implementable growth and poverty reduction strategy to achieve these objectives and; (ii) fiscal issues, as these are the main source of risks to macroeconomic stability, and structural fiscal reforms and state-owned enterprise (SOE) restructuring are needed to establish a sound foundation for sustainable growth.

II. RECENT ECONOMIC DEVELOPMENTS AND NEAR-TERM OUTLOOK

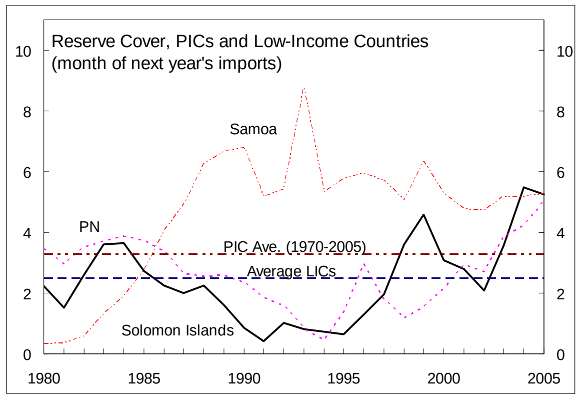


3. **Recent economic developments and the near-term outlook are reasonably positive, with growth above the regional average**. For the fourth year running, real GDP growth is projected to exceed 5 percent in 2006, with logging making no contribution to growth (Table 1 and Figure 2).[1] New investments (mainly an oil palm plantation and a gold mine) and some fiscal stimulus will boost nontimber growth to 6 percent, reflecting the start of palm oil production, and

[1] The short-term economic impact of the April 2006 riots, following the general elections and prior to the formation of the present government, was negligible as it affected mainly small retail businesses in Honiara.



a significant rise in services; nontimber output growth is expected to remain at that level in 2007 (Table 2 and Figure 3). A projected slowdown in total GDP growth to 4¼ percent in 2007 is due to lower logging. Owing to high oil prices, expatriates' demand, and rapid private credit growth, inflation is in the high single digits and above the regional average (Table 3 and Figure 4). With these pressures expected to persist, inflation is unlikely to decline substantially in the near term.



4. **The reserve position continues to be strong, despite the large current account deficit**. With soaring fuel and investment-related imports, the current external account swung into a deficit of 11 percent of GDP in 2005, which is projected to widen to 16 percent in 2006 (Table 4 and Figure 5). Robust official development assistance (ODA) and private foreign direct investment (FDI) inflows are keeping reserves above 5 months of imports. Higher oil prices constitute the most significant risk to the near-term outlook, together with political instability.

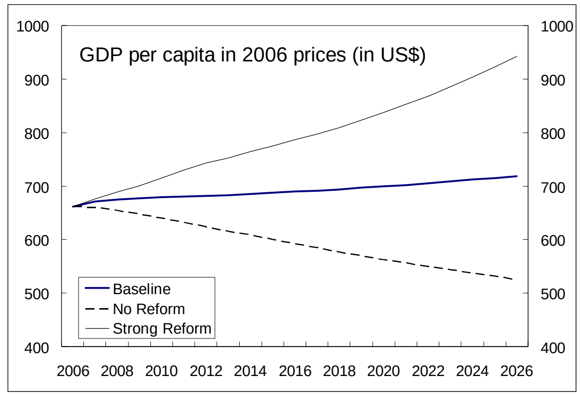
III. Policy Discussions

A. Medium-Term Outlook

5. **There was broad agreement that medium-term prospects depend on the vigor of reforms** (Tables 5–7). If progress on reforms is substantial, macroeconomic stability is maintained, and RAMSI and donors remain fully engaged, real GDP growth could be sustained at 5 percent (2 percent per capita) over the medium term, with nontimber activities—primarily, agriculture and mining where new projects are emerging—more than offsetting timber's decline.

6. **Without reforms, living standards would fall and macroeconomic stability could be compromised**. ODA and FDI would decline substantially, and new nontimber activities would not emerge. Growth could drop to under 2 percent, and per capita income would fall. International reserves and government deposits could be all but exhausted as early as 2009, when import compression and spending cuts would become inevitable and new arrears would start accumulating.

7. **The baseline is an intermediate scenario**. With financial stability and RAMSI and donor engagement, but slow structural reforms, only limited new nontimber activities would emerge and real GDP growth would converge to about 3 percent, barely matching population growth. This represents a downgrading of the baseline compared to the 2005 Article IV consultation, given greater uncertainty concerning the government's reform agenda. Inflation would decline to about 7 percent, less than in the strong reform scenario. With weaker export growth, the current account deficit would moderate to 9 percent of GDP, and reserve coverage would remain above 4 months of imports. Risks to the baseline appear roughly balanced. History weighs on the downside. On the upside, the government may decide to capitalize on the reforms started by the previous administration.



8. **The authorities considered that the baseline scenario could prove to be the most realistic**. They emphasized their commitment to macroeconomic stability, but also the political sensitivities involved in implementing structural reforms. The government's desire to re-orient the development strategy towards rural areas and the search for local solutions might require changing the policies started by the previous government and might slow reforms, but could result in greater ownership and sustainability.

B. The 2007–10 Development Strategy and Aid Flows

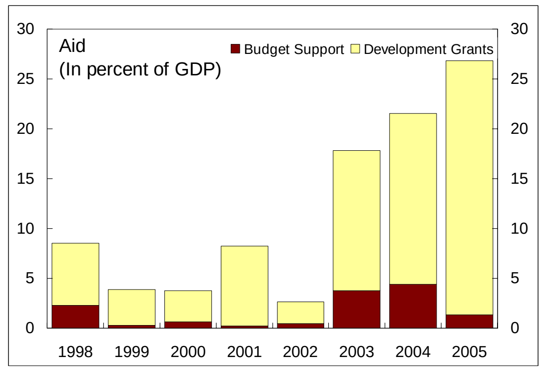
9. **The authorities agreed that preparation of the 2007–10 national development strategy offers an opportunity to translate the *Framework Document*'s goals into concrete policies, but highlighted the challenges**. The strategy—which is currently being prepared to succeed the 2003–06 National Economic Recovery, Reform, and Development Plan—should become the country's poverty reduction strategy, drive the development agenda, determine priorities, and be implementable and monitorable. This requires that it be linked to operational plans and budgets. Such a country-led strategy, together with donor commitments to align their assistance with it, would provide a sound basis for reform.

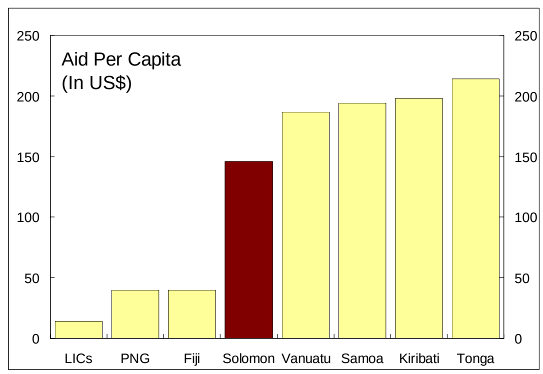
10. **The opportunity afforded by the large aid flows currently available should be exploited by incorporating all programs and projects in the national strategy, and all funding sources in the resource envelope**. Donors have made substantial long-term commitments to the country, estimated at about 25 percent of GDP since RAMSI's intervention, but they have also indicated that these flows will be reduced over time (Box 1). Aid coordination is improving with lead donors identified in most areas and Sector-Wide Approaches (SWAp) under way in some key sectors. Nevertheless, the framework provided by the national development strategy would be better placed to harmonize donors' different approaches and overcome persisting difficulties in coordination between the government and donors. The authorities maintained that greater capacity building efforts as part of donor

Box 1. Aid Flows

Donors support a wide range of projects in the Solomon Islands. The major bilateral donors are: Australia; the European Union; Japan; New Zealand; and Taiwan Province of China.[1] Australia and New Zealand contribute directly and through RAMSI. Donors fund development spending almost entirely, but also provide basic services (health, education, police, and law and order).

Aid flows rose sharply after RAMSI's intervention and are substantial by cross-country comparisons. The staff estimates annual aid disbursements in the order of 25 percent of GDP (including technical assistance) in 2004–05, equivalent to 94 percent of domestic revenue, ten times the low income countries' average, and the largest among large PICs in per capita terms. At present, only New Zealand's assistance to education is implemented through the government's budget. The remaining aid is managed by individual donors and is not centrally recorded. Australia has committed funds to RAMSI until 2009, but information on other donors' multi-year commitments is not available.





The experience of Tanzania and Timor Leste stand out as good examples in managing aid flows.

- **Tanzania**: the *Joint Assistance Strategy* is helping strengthen national ownership; align donors' support with government priorities, systems, structures, and procedures; manage resources to achieve development results with a large part of donor resources integrated in the budget; and ensure mutual accountability with a joint appraisal process.

- **Timor Leste**: the *Road Map for Implementation of National Development Plan* and the *Overview of Sector Investment Programs* integrated in a combined-source budget improved the fit between government priorities and donors' projects, and supported the national development plan monitoring toward measurable objectives.

[1] The AsDB and the World Bank also provide grants.

assistance hold the key to reducing aid dependency over time. The staff commended the authorities' recent efforts toward the adoption of a system that tracks aid delivery and donors' multiyear projections of realistic aid disbursements, as the absence of such a system risks duplication and hampers the assessment of future fiscal pressures, as donors withdraw from projects/programs.

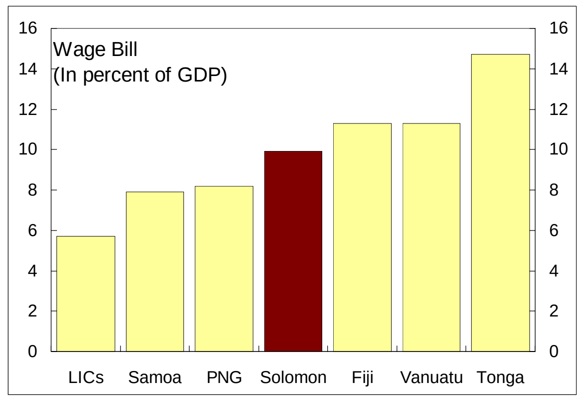
C. Fiscal Policy and Debt

11. **The 2006 fiscal outturn is likely to be better than budgeted, but expenditure quality could be improved**. The budget envisages a shift to a deficit of ¾ percent of GDP from a 2¼ percent surplus in 2005, due to a 21 percent real increase in goods and services purchases and domestically-financed development spending. In the staff's view, the budget outturn is likely to be about 1 percentage point of GDP better than budgeted, with higher spending in low-priority areas (wage bill, tertiary scholarships, and representation) likely to be more than offset by revenue overperformance (due to improved tax compliance and a reduction in logging duty exemptions) and investment underspending. Given that deficiencies in project planning and execution capacity are constraining much needed investment outlays, the government should refrain from spending unused funds. It should also save the revenue overperformance. This fiscal stance would also help contain inflation.

12. **The authorities are committed to remain within budget, but argued for the need to increase wages and fill vacancies across the civil service**. Following a 3 percent increase at the beginning of the year, civil service wages were raised by 6 percent in July, retroactively to January, with much larger increases for departmental heads. The authorities maintained that the degree of budget overperformance will be dictated by the speed of implementation of the new government's policies, which is likely to be slow. The process of filling vacancies is accelerating, but it is still expected that about half of them will remain unfilled by year-end. In these circumstances, the authorities considered that a small budget surplus would be achieved despite these wage increases.

13. **The authorities shared staff's concerns about looming medium-term fiscal pressures, and intend to continue their efforts towards developing a medium-term fiscal strategy**. Albeit difficult to estimate in terms of size and timing, pressures will arise from: (i) declining tax receipts from logging while large agricultural and mining projects just starting have been granted tax holidays/exemptions; (ii) lower import duties because of the Pacific Island Countries Trade Agreement; (iii) lower aid flows; (iv) demands for higher wages and public employment; and (v) social, infrastructure, and operation and maintenance needs. SOEs' and provincial governments' poor financial situation and fiscal decentralization may also contribute. Building on the forward estimates presented for the first time in the 2006 budget, the authorities will continue to work towards a medium-term fiscal framework that takes into account these pressures.

14. **The medium-term budget envelope is constrained by the availability of financing, and the desire to avoid abrupt fiscal retrenchment and to reduce the high public debt**. The debt service requirement and the fact that government deposits are the only source of financing over the next few years (reflecting the government policy of no projected new borrowing in light of the already high debt level and poor credit history) require an overall budget surplus. Assuming that government deposits are used over five years and that aid flows remain directly managed by donors, the budget surplus would need to be about 1 percent of GDP per year over the medium term (a ½ percentage point of GDP adjustment compared to the projected 2006 outturn).



Declining revenue from logging and import tariffs (about 2½ percentage points of GDP over the next five years) should be compensated with higher indirect domestic taxes, although reducing nonproductive expenditure would be the first best. Current spending should be cut by about 1 percentage point of GDP over the next five years, partly to create fiscal space for investment. This could be achieved by strictly limiting the wage bill, which is equivalent to 10 percent of GDP and about 40 percent of current spending. There is also scope to reduce outlays on representation, administration and tertiary scholarships, as suggested by recent audits.

15. **The new government is committed to tax reform, but capacity constraints will likely dictate a staged approach**. Implementing the tax reform outlined in the outgoing government's *Discussion Paper* (November 2005), which has VAT as the linchpin, would relieve two major shortcomings of the present tax system: a narrow base and cascading. Exemptions are estimated to reduce the tax take by over a third and cascading inflates the effective import tax to over 40 percent. While proceeding to work toward this comprehensive reform, the authorities emphasized that it will require extensive legislative and administrative changes. The authorities explained that incremental changes—such as the recent issuance of rules-based and transparent tax exemptions guidelines—would proceed in parallel with the redesign of the system. The staff welcomed these guidelines and the announced revocation of logging duty exemptions, and encouraged the government to refrain from granting any new tax preferences. Also, bringing the reference prices of timber and fish in line with market prices is another step that could be taken immediately.

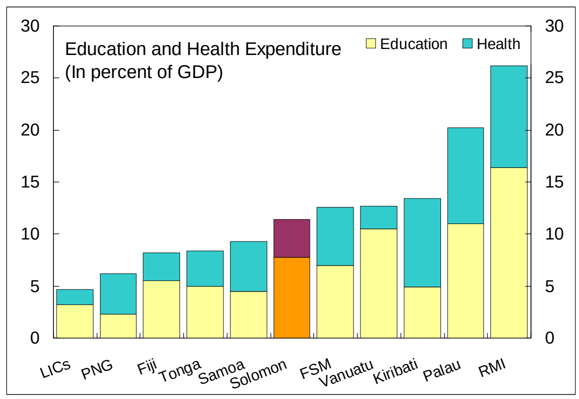
Estimated Costs of Indirect Tax Exemptions in 2004	
Taxes	Taxes forgone
	(in percent of tax revenue)
Import duty	10.4
Export duty	7.0
Goods tax	19.2
Total	36.6

Sources: FIAS and staff estimates.

The Cascading Taxes in the Solomon Islands		
Import duty	Goods tax 1/	Effective tax on imports
	(In percent)	
5	15	25.5
10	15	31.5
15	15	37.4
20	15	43.4

Source: FIAS and staff estimates.
1/ Applied to wholesale price which includes 30 percent margin.

16. **Improvements in the composition of public spending are highly desirable**. Some fiscal space for investment and recurrent costs of donor-funded projects would be created by the current spending cuts proposed by staff. A comprehensive civil service reform that rationalizes employment, while filling critical vacancies, and decompresses the wage scale could free up substantial resources. The overall level of social spending is high by low income country and regional standards,[2] but greater allocations to primary education and health care are warranted. Currently, about 40 percent of the education budget goes to tertiary education (2 percent of students), compared with 30 percent to primary (80 percent of students).



17. **While appreciating the benefits of reorienting spending, the authorities saw a greater need to introduce government subsidies that could promote rural development**. The *Framework Document* mentions subsidies to several sectors and in particular to businesses in rural areas. Staff argued that granting non-targeted subsidies can be costly, whereas implementing the International Finance Corporation Foreign Advisory Service's recommendations on investment incentives would be more effective.

18. **Noting greater compliance with public finance laws/procedures, the authorities agreed that room for improvement in PFM remains considerable**. Local purchase orders are now required for procurement. The ongoing revitalization of the Solomon Islands Accounting Services is enhancing PFM capacity across ministries. Nevertheless, underspending and routine supplementary budgets reflect poor budget planning and

[2] The health spending shown in the chart excludes donor funding to the sector of about 3½ percent of GDP, which is outside the budget.

execution. Recent payroll and tertiary education audits have uncovered irregularities and tender processes need strengthening. The authorities commented that the staff's suggestion to replace the unfunded contingency warrants with a smaller fully-funded contingency reserve would be useful, but politically unpalatable, and that the planned simplification in budget classification should reduce supplementary appropriations.[3] Follow-up on the recent audits and modifications to the Finance Instructions along PFTAC's recommendations should also raise expenditure efficiency and governance.

19. **The authorities agreed that SOEs' poor performance should be urgently addressed**. Although data are scant, risks from SOEs appear substantial and their service delivery poor. The recent financial review of the Solomon Islands Electricity Authority (SIEA), the largest SOE, concluded that it is close to insolvency with accumulated losses of about 10 percent of GDP and debt 15 times its net worth. SIEA suffers from a negative cash flow (partly due to an arrears buildup by the Solomon Islands Water Authority, SIWA) requiring frequent cash injections from the Treasury (estimated at ¼ percent of GDP for 2006) and, the company has recently borrowed commercially. The World Bank's proposed management contract to run SIEA and SIWA jointly should be implemented urgently. Audited accounts of all SOEs should be compiled. The authorities concurred that SOEs should be reformed, but remarked that this would take time, partly because they are currently autonomous statutory bodies and SOEs' accounts have not been audited in years.

20. **While the government believes that power should shift to rural areas, it offered reassurances that it would proceed cautiously with fiscal decentralization**. Greater involvement of the provinces and communities in policy formulation and implementation is welcome, but fiscal decentralization could be costly and ineffective, especially until public finances and capacity strengthen. The devolution of revenue and spending responsibilities also requires good information on local governments' operations, which is currently unavailable. The government is currently focused on improving provincial governments' administrative capacity and efforts are under way to ascertain the debts owed by provincial governments and compile their financial accounts.

21. **The authorities agreed that despite progress, public debt remains at high risk of distress and continued efforts to regularize it are needed** (Appendix I).[4] The Honiara Club initiative led to a short-term moratorium by one creditor and the possibility of debt forgiveness after the planned 2007 review.[5] After successful negotiations with commercial

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[3] Contingency warrants give the government the power to spend a certain amount (1½ percent of GDP in 2006) beyond approved budgetary appropriations.

[4] Due to data availability, public debt data refer only to the central government.

[5] The Honiara Club is a multilateral forum convened by the government in October 2005 to seek debt relief from its official creditors. See Appendix I for details.

creditors and the CBSI and payment of informal arrears, total government debt declined to 80 percent of GDP in 2005, and the NPV of external debt fell to 40 percent of GDP. All debt indicators improve in the baseline scenario with the continuation of the government's policy of no new borrowing. Nevertheless, debt could rise rapidly with lower export and GDP growth. Lower GDP growth and a return of growth and the primary balance to their historical averages causes the NPV of public debt to GDP and revenues to rise dramatically. Other risks include SOEs and the government's proposal to absorb provincial government debt. Staff argued that the latter should not be done without conditionality to enforce strict financial discipline. The authorities added that they would pursue this proposal only if consistent with the Honiara Club agreement. The government's policy not to contract new loans remains necessary at present, while once debt is regularized and has been substantially reduced, modest amounts of domestic borrowing would be appropriate.

Solomon Islands: External Debt as at end-2005
(In millions of US$)

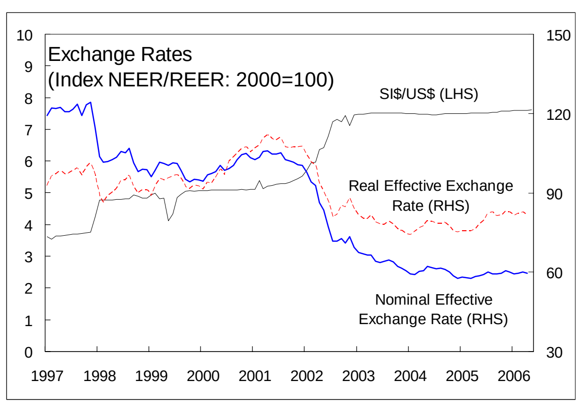
	Outstanding Balance	Share of Total
Total (including arrears)	161.6	100.0
Arrears 1/	22.0	13.6
Total (excluding arrears)	139.6	86.4
Multilateral	98.3	60.8
Of which:		
Asian Development Bank	51.0	31.6
World Bank (IDA)	43.5	26.9
Bilateral	35.2	21.8
Commercial	6.2	3.9

Sources: Solomon Islands' Authorities and Fund staff estimates.
1/ Arrears are principally to bilateral and commercial creditors.

D. Exchange Rate and Monetary Management

22. **The staff supported the current, pragmatic exchange rate policy**. In the face of strong ODA and other inflows, the CBSI has stabilized the value of the Solomon Islands dollar versus the U.S. dollar. The de facto peg has served as nominal anchor and has contributed to a rise in the reserve position to the equivalent of 5½ months of imports (Table 8). As projects financed by these inflows are implemented, reserves will decline, which should be allowed. If downward pressure on the exchange rate were to materialize from other sources, the exchange rate should adjust, since the country cannot appropriately defend a peg and is vulnerable to frequent external shocks. However, domestic policy slippages should be addressed by tightening fiscal and monetary policy rather than by greater exchange rate flexibility.

23. **The current level of competitiveness appears broadly adequate**. The available indicators are relatively comforting. Provided investors' confidences are maintained, with new projects starting, prospects for nontimber exports are fairly positive suggesting profitability in the export sector is satisfactory. The CPI-based REER remains 17 percent below its 1997–2001 average, and



private sector wages appear to be below regional comparators. However, the risk of Dutch disease associated with aid efforts—some pressures on housing and skilled labor have started appearing—and the deterioration in the terms of trade in recent years calls for close monitoring and underscores the need for structural reforms.

24. **As inflation pressures are likely to persist, the CBSI intends to focus on improving its inflation monitoring tool kit**. With rising oil prices, high private credit growth, and a limited supply response of the economy to increased demand for services, inflation pressures are unlikely to ease substantially in the near term. The staff argued that if demand pressures or second-round effects of higher oil prices are likely to intensify—which does not presently appear to be the case—or if reserves came under pressure, the CBSI should reassess the domestic credit expansion and take measures, including raising the liquid asset ratio (LAR) and introducing (possibly tradable) credit ceilings.[6] The CBSI agreed with this strategy and added that once the national CPI becomes available, inflation sources should become clearer and technical assistance on inflation forecasting would be helpful. This would allow the CBSI to adopt a more forward-looking approach to conducting monetary policy. Over time the CBSI plans to expand its instruments by developing the Treasury bill market, but in the short run, issuing more Treasury bills is likely to be hindered by the government's poor credit history.

E. Financial Sector Issues

25. **The CBSI concurred that the financial system should be strengthened by completing the liquidation of the Development Bank of Solomon Islands (DBSI) and raising the National Provident Fund's (NPF) profitability**. Pressures to revive the troubled DBSI should be resisted. All depositors are likely to be repaid by year-end when the CBSI court-appointed management mandate ends. The bank's negative net worth is estimated at ½ percent of GDP, but, if liquidated, its largest creditor indicated its willingness to write off its loans. The CBSI has agreed in principle to let the NPF invest abroad to boost its profitability, but simple and very conservative investment guidelines (currently under preparation) and clear monitoring procedures must be applied. The NPF should also improve asset quality and contain costs. Approval of the draft NPF bill would strengthen the institution's governance.

26. **The authorities are focusing on broadening access to banking services and credit**. Recent and planned initiatives—such as a mobile bank, and an ANZ-post office partnership—underscore how private-public partnerships can help extend banking services on a commercial basis. Enhancing the secured lending transaction framework could also increase access to credit and bank competition. These initiatives have the advantage of being commercially oriented and hence do not weaken commercial banks, which are currently

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[6] Only deposits at the CBSI qualify for the LAR.

adequately capitalized, highly liquid, and profitable. The CBSI viewed these initiatives as a key catalyst for the DBSI's liquidation.

F. Growth-Enhancing Structural Reforms

27. **The government recognizes that its role is to establish the conditions under which the private sector can be the economy's engine of growth and the vital role that structural reforms play in this** (Table 9). Improving governance (including in taxation, PFM, SOEs, and the NPF) is key in attracting investment and using public money and aid more effectively. Upgrading service delivery and the financial position of SOEs is necessary for businesses and for higher social well-being. Better transportation and lower telecommunication costs would improve the business environment, by facilitating access to markets and stimulating new growth areas, such as tourism. Reforms to cut red tape and update commercial laws would also contribute to enhancing the business environment.

28. **The authorities remarked that reforms that support rural development will take center-stage**. Only in this way can economic development benefit the majority of the population: also given that the poor are concentrated in rural areas, this approach should achieve the greatest impact on poverty alleviation. The initiatives mentioned above will contribute to rural advancement, but an agricultural and rural development strategy is also being developed with donors' and World Bank's assistance. The authorities added that land reform is essential and in principle so is better management of forests, but the fact that the majority of the land is under customary ownership limits the government's impact in these areas.

29. **The authorities agreed that, over the next year, tangible progress in key structural reforms would be necessary to signal their reform commitment and boost confidence**. The new government's gazetting of the new foreign investment bill in June provided a positive, first signal. Implementing the SIEA/SIWA management contract would be a further critical step. Progress in streamlining immigration and labor permits would also send positive signals. The government is also considering ways to reduce import duties and other measures to liberalize the trade regime.

G. Statistics

30. **Measures are under way to remedy serious deficiencies in the statistical database**. National accounts, fiscal, and external data are weak (Appendix VII). The Statistics Office is completing a Household Income and Expenditure Survey to produce poverty and MDGs indicators and on which national accounts and a national consumer price index will be based. Surveys to improve external sector data are planned for 2006–07.

IV. Staff Appraisal

31. **The economic recovery and stability prevailing since RAMSI's intervention will likely persist in the near term, but raising living standards on a sustainable basis remains a formidable challenge**. Growth has remained robust and two large projects have started. Budget discipline has been maintained and inflation is under control. However, with the natural forest expected to run out in some six years, diversifying the economy is imperative. This requires jump-starting structural reforms.

32. **The 2007–10 national development strategy should become the key mechanism for policy formulation and aid coordination**. The strategy currently under preparation should be the umbrella framework for all projects and programs, including those run by donors. Setting up a system that tracks aid delivery is a vital first step. Backing the strategy with a sound medium-term macroeconomic framework and linking it to the budget would ensure its realism and that it can be implemented. An evaluation framework will also be needed to monitor progress and strengthen accountability.

33. **With pressures looming, the government should set fiscal policy with a medium-term perspective**. Given limited financing sources and the need to reduce the high public debt, consolidation is required. Declining revenue from logging and import duties need to be replaced with domestic taxes and current spending as a share of GDP reduced by containing the wage bill. The government's commitment to budget discipline is welcome, as is its intention to continue developing a medium-term fiscal framework. In the short run, it should refrain from spending unutilized appropriations for investment projects and revenue overperformance.

34. **Fiscal reforms are critical to support fiscal consolidation and growth**. Reorienting spending from the high wage bill towards investment, especially infrastructure, and implementing a tax reform that widens the base while reducing rates and cascading should be key elements of the fiscal reform agenda. Public financial management reforms would help ensure better governance and allow aid flows to be brought within budget. SOEs' poor performance requires urgent attention. Fiscal decentralization should be approached very carefully and should not involve a weakening of fiscal discipline.

35. **Despite progress, the risk of debt distress remains high**. Public debt is high, and shocks, even temporary ones, could cause it to rise significantly. Contingent liabilities are likely to increase due to the weak finances of SOEs and provincial governments. Moreover, efforts to regularize the debt situation should be sustained, and the policy of no new borrowing enforced for all public entities, including SOEs, until the debt situation improves substantially.

36. **The exchange rate policy is appropriate, and competitiveness appears adequate, but the CBSI should remain vigilant on inflation**. The current stabilization of the S.I. dollar versus the U.S. dollar shields the economy from the effects of strong foreign inflows, but downward pressure on the exchange rate should not be resisted. Good prospects for nontimber exports suggest that competitiveness is reasonable. Efforts under way to upgrade the central bank's

inflation forecasting ability are important to ensure a timely monetary policy response, if inflation pressures intensify or if reserves were to come under pressure.

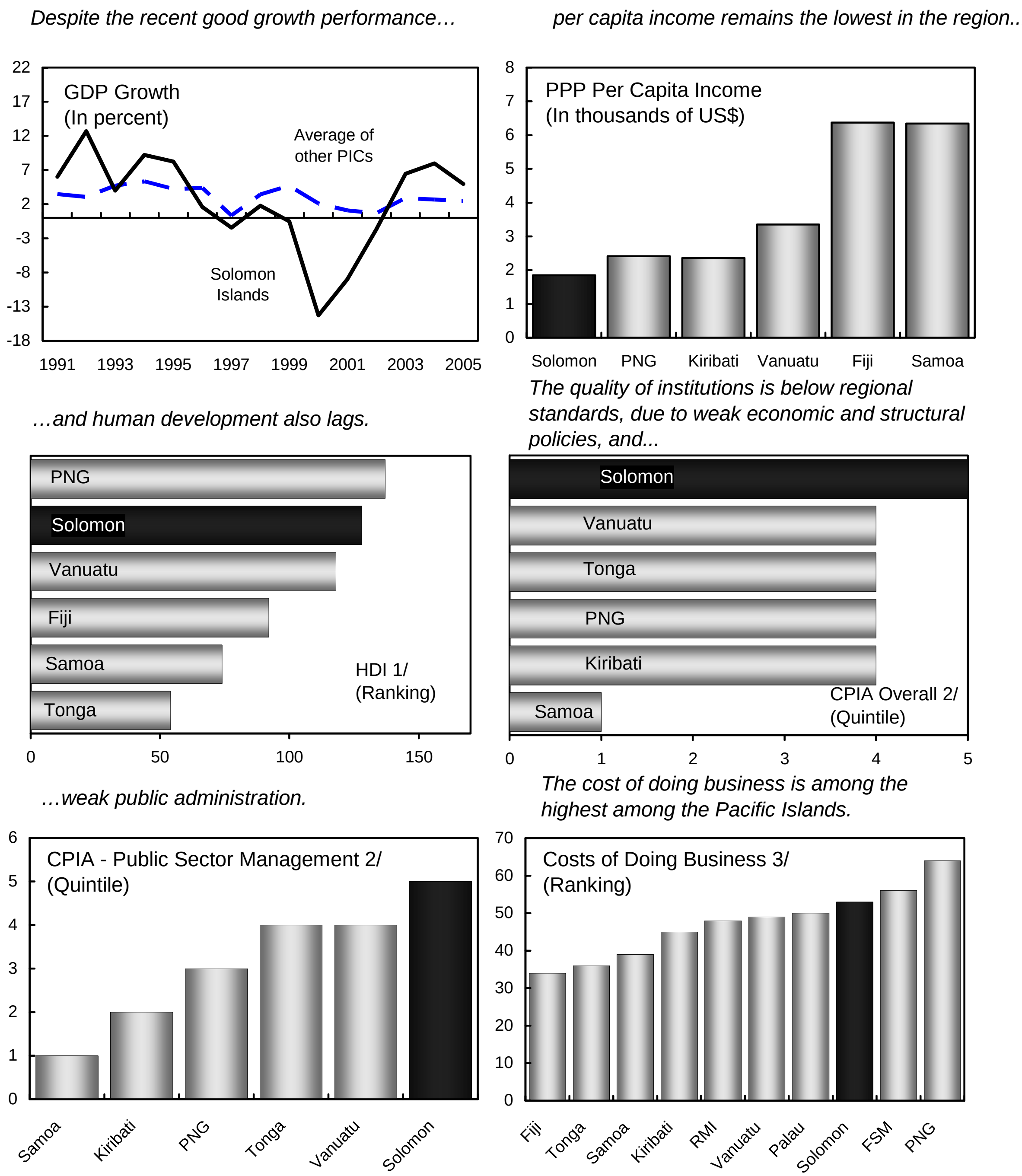
37. **Liquidating the DBSI, strengthening the NPF's profitability, and widening access to banking without compromising financial stability are key financial reforms**. The process of winding up the troubled DBSI is advanced and should be completed. Commercially-based mechanisms should be used to broaden access to banking services and credit to ensure their viability. Allowing the NPF to invest abroad could boost the institution's profitability, but simple and conservative investment guidelines for the Fund need to be developed, and it has to be strictly supervised by the CBSI. The new NPF bill would also improve the institution's governance.

38. **Among structural reforms, priority should be accorded to better governance, SOE restructuring, and improving transportation infrastructure**. The business environment, as well as rural development, will benefit from these reforms. The gazetting of the new foreign investment bill is commendable, but further strong signals of the government's reform orientation are needed to bolster confidence, with the most critical being the restructuring of the utilities.

39. **Improving the statistical database is essential to better ground policymaking and monitor results**. At present, the statistical database is barely adequate for surveillance. Measures under way should improve real and external sector data, but upgrading statistics will be a long-term process.

40. It is proposed that the next Article IV consultation be conducted on the 12-month cycle.

Figure 1. Solomon Islands: Cross Country Comparisons on Economic Developments, Institutions, and the Investment Climate

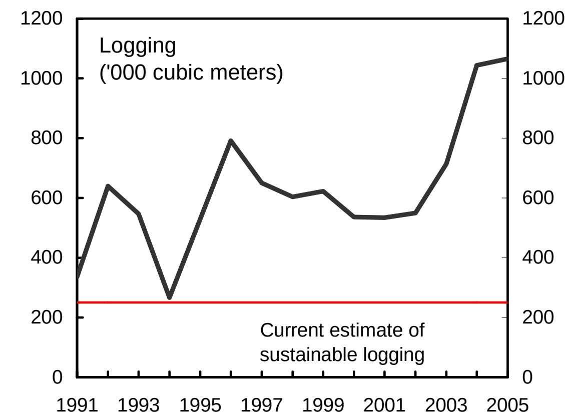


Sources: WEO and IFS databases; UN and the World Bank.

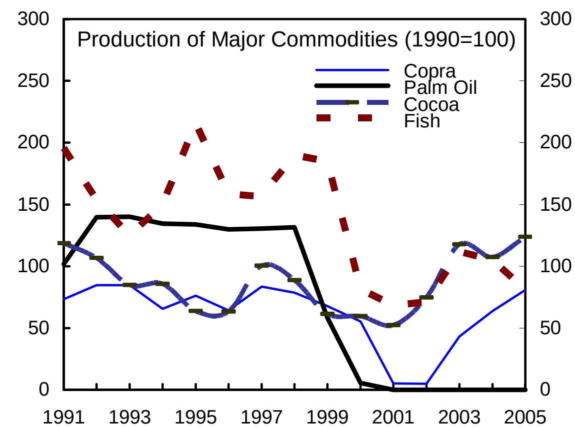
1/ Higher ranking denotes a lower level of development.
2/ Lower quintile indicates a better Country Policy and Institutional Assesment (CPIA) score.
3/ Higher ranking denotes a higher costs of doing business.

Figure 2. Solomon Islands: Production and Price Developments, 1981–2006

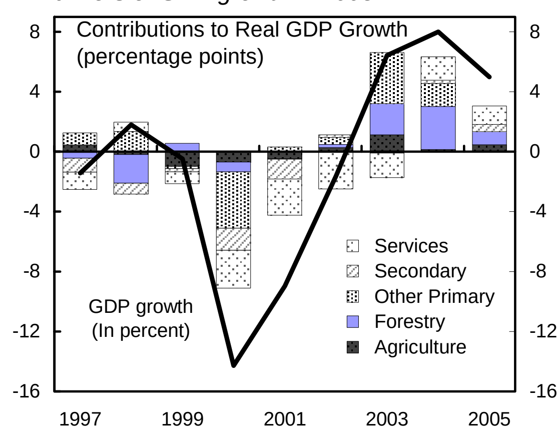
After rising markedly in 2004, logging remained at about four times its sustainable level in 2005.



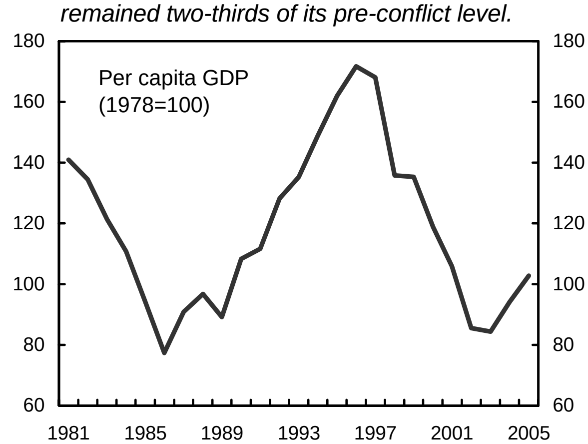
Cocoa and copra production picked up, but fish catch was down.



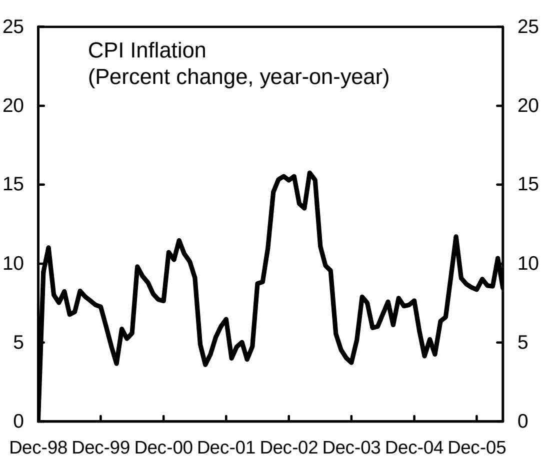
Services and agriculture were the main drivers of GDP growth in 2005.



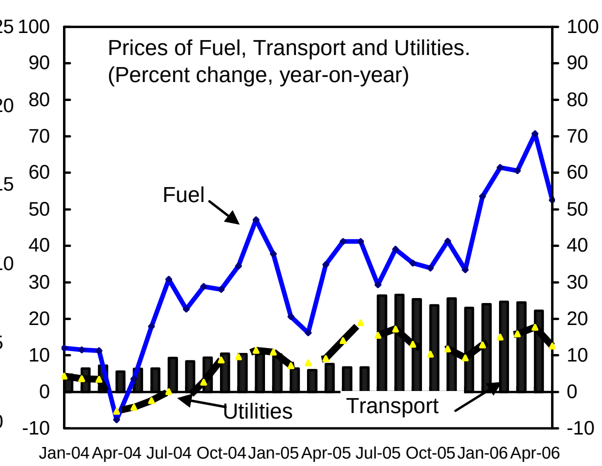
Per capita income continued to recover, but remained two-thirds of its pre-conflict level.



Inflation exceeded the CBSI's 10 percent indicative target in September 2005, but eased in recent months.

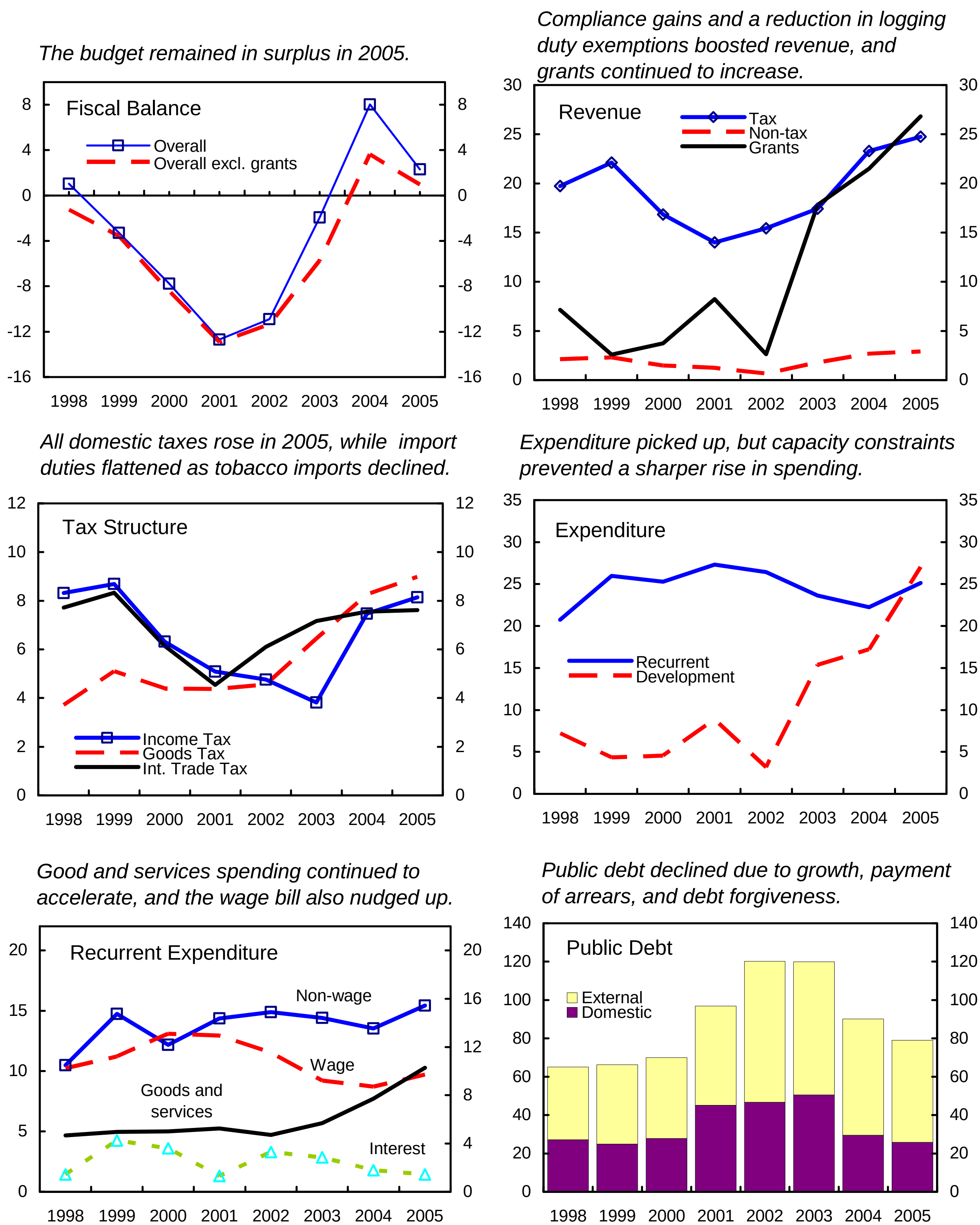


Fuel prices contributed significantly to the rise in inflation, including through transport costs and utility charges.



Sources: Data provided by the authorities, WEO and IFS databases; and Fund staff estimates.

Figure 3. Solomon Islands: Fiscal Developments, 1998–2005 1/
(In percent of GDP)

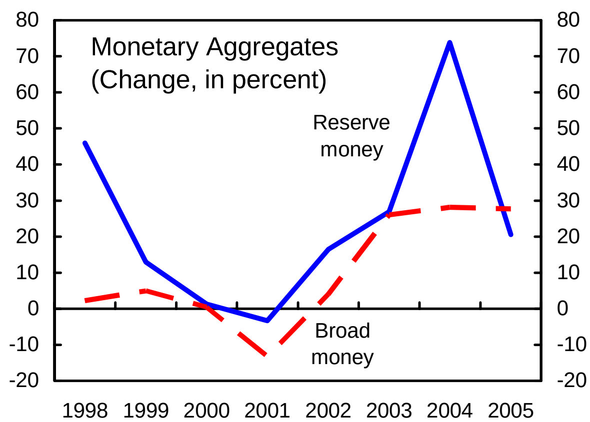


Sources: Data provided by the authorities and Fund staff estimates.

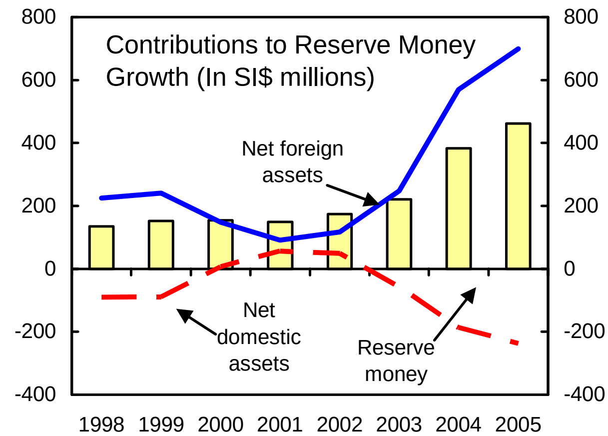
1/ 2005 data are staff estimates.

Figure 4. Solomon Islands: Monetary Sector Developments, 1998–2005

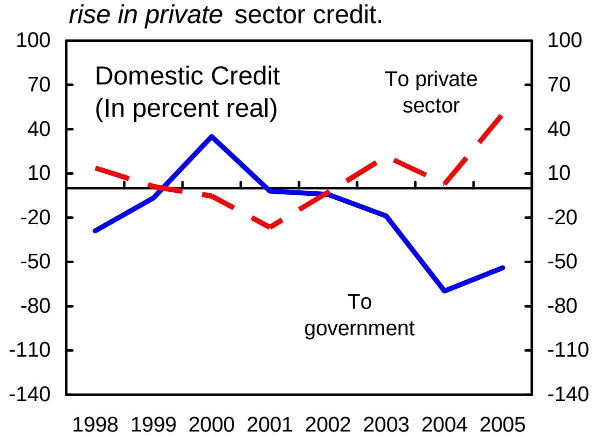
Monetary growth eased in 2005...



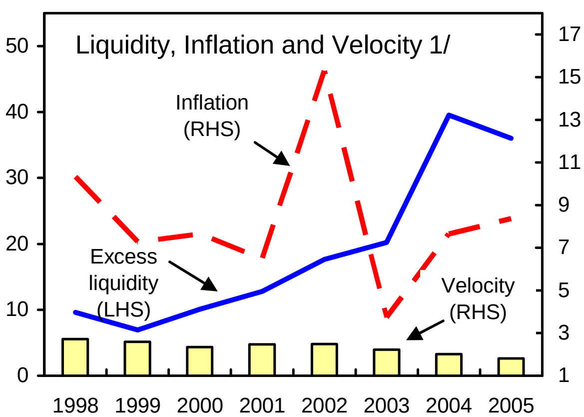
...reflecting a moderation in net foreign assets growth, while NDA continued to decline...



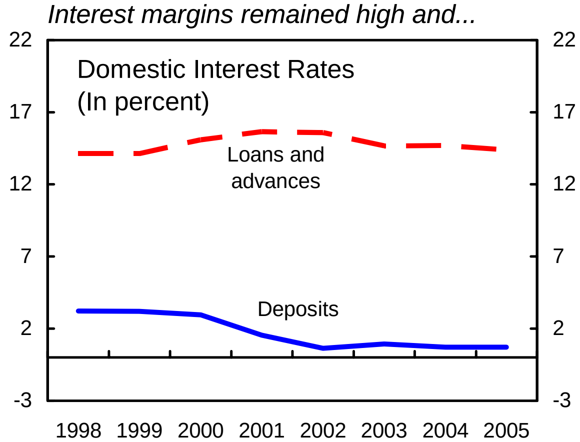
… as the sharp drop in net credit to the government more than compensated the rise in private sector credit.



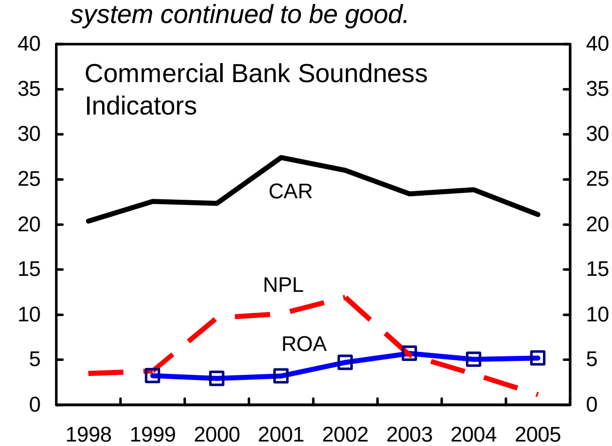
Inflation ended in single digit in 2005 and velocity fell further.



Interest margins remained high and...



...the overall soundness of the banking system continued to be good.

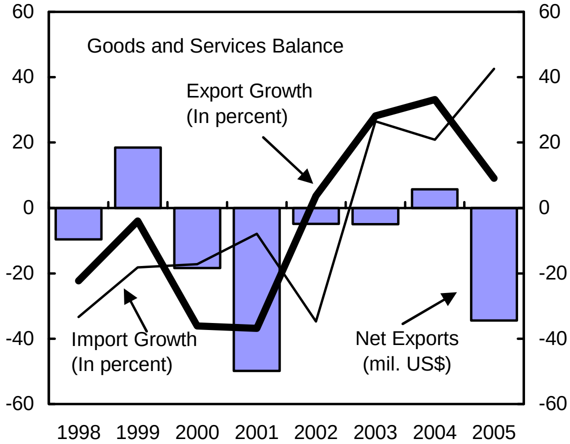


Sources: Data provided by the authorities and Fund staff estimates.

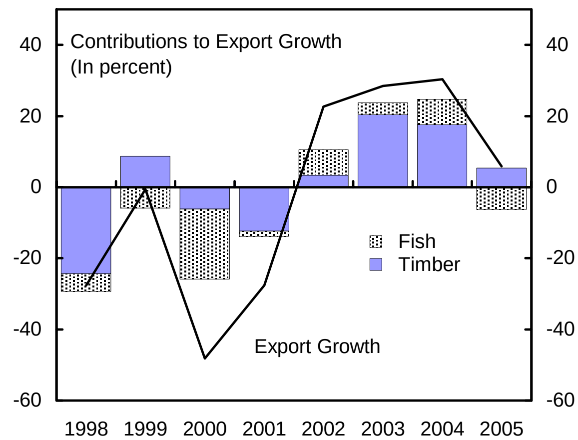
1/ Excess liquidity is in percent of deposits.

Figure 5. Solomon Islands: External Sector Developments, 1997–2005

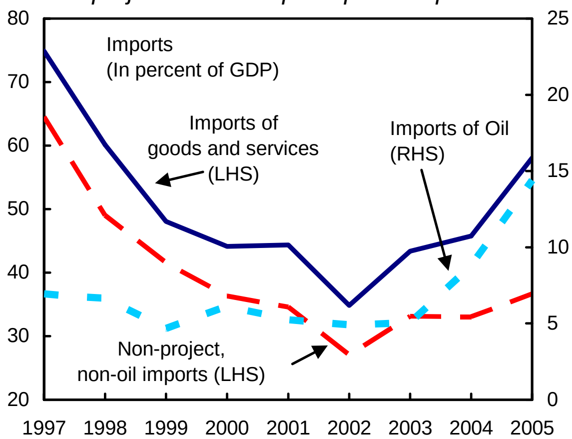
Net exports declined sharply in 2005...



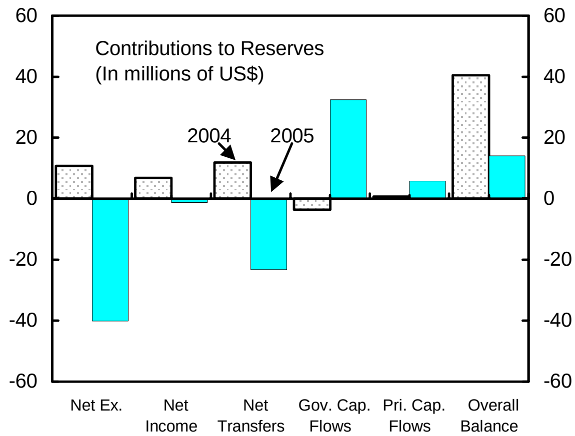
... principally due to weaker fish exports and a smaller contribution from timber...



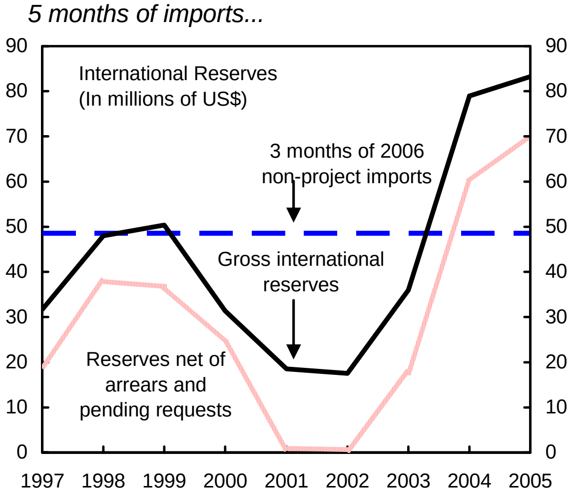
... while imports rebounded strongly as fuel and project-related imports picked up.



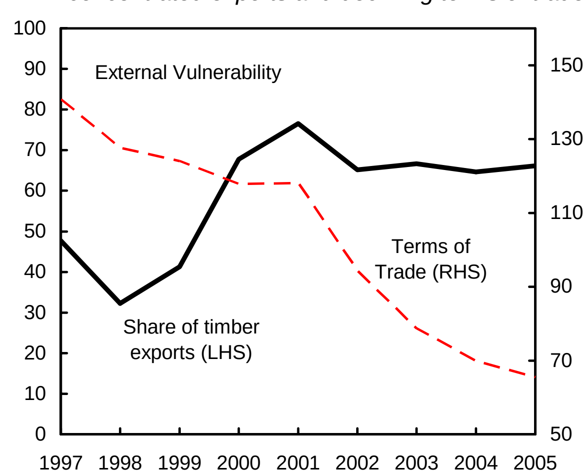
Strong ODA and private FDI flows ...



... have maintained reserve coverage above 5 months of imports...



... which could provide a valuable buffer given concentrated exports and declining terms of trade.



Sources: Data provided by the authorities, WEO and IFS databases; and Fund staff estimates.

Table 1. Solomon Islands: Selected Economic Indicators, 2001–07

Nominal GDP (2005): US$298 million
Population (2005): 482,575
GDP per capita (2005): US$618
Quota: SDR 10.4 million

	2001	2002	2003	2004	2005	2006	2007
						Proj.	
Growth and prices (percentage change)							
Real GDP	-9.0	-1.6	6.4	8.0	5.0	5.3	4.3
Of which : Nontimber	-9.4	-1.9	4.6	5.5	4.5	5.9	5.9
CPI (period average)	7.6	9.3	10.0	6.9	7.3	8.2	8.4
CPI (end of period)	6.5	15.3	3.7	7.6	8.4	9.2	8.5
Per capita GDP (in US$)	637	514	507	565	618	662	682
Central government operations (percent of GDP)							
Total revenue	23.5	18.7	37.0	47.5	54.5	53.7	52.1
Recurrent revenue	15.3	16.1	19.2	26.0	27.7	29.8	29.7
Grants	8.2	2.6	17.8	21.5	26.8	23.9	22.4
Total expenditure 1/	36.2	29.6	39.0	39.5	52.2	53.1	51.1
Recurrent expenditure	27.3	26.4	23.6	22.2	25.1	27.9	27.9
Development expenditure	8.9	3.2	15.4	17.2	27.0	25.2	23.1
Recurrent balance 2/	-11.8	-9.9	-0.6	8.1	3.9	3.1	3.2
Overall balance 3/	-12.7	-10.9	-1.9	8.0	2.3	0.6	1.0
Foreign financing (net)	5.0	3.8	0.2	-0.9	2.0	1.2	-0.8
Domestic financing (net)	-1.4	-2.9	-8.8	-6.5	-2.3	-0.8	-0.3
Other	8.5	8.9	9.8	-2.3	-4.3	-1.0	0.1
Stock of expenditure arrears (in percent of GDP, end of period) 4/	8.9	12.0	14.7	7.8	4.5	2.5	2.4
Central government debt (percent of GDP) 5/	94.1	113.3	120.1	90.1	80.0	69.9	63.6
Domestic	45.1	46.7	50.6	29.6	25.8	20.0	17.1
External	49.0	66.6	69.5	60.6	54.2	50.0	46.5
External debt (in US$ millions, end of period)	134.3	151.6	160.8	160.7	161.6	164.0	161.8
External debt service to exports of GNFS (accrual basis)	8.1	10.3	9.3	5.9	7.2	5.2	5.1
Monetary and credit (percentage change, end-year data)							
Net foreign assets	-31.8	30.2	106.4	111.0	23.7	7.6	2.4
Net domestic assets	-4.4	-4.8	-11.0	-60.4	50.5	65.4	42.7
Net domestic credit	-7.2	11.0	-0.7	-36.1	37.5	30.2	24.5
Credit to private sector	-21.8	12.2	26.1	10.6	62.9	30.2	25.3
Broad money	-13.2	4.0	26.0	28.1	27.7	17.8	12.3
Interest rate (3-month t/bill rate, average) 6/	8.9	8.3	5.8	6.0	3.5	3.5	...
Balance of payments (US$ millions, unless otherwise indicated)							
Exports, f.o.b	47.1	57.8	74.2	96.7	102.5	116.3	116.8
Imports, c.i.f.	-90.6	-62.3	-85.2	-98.7	-143.7	-182.4	-189.0
Current account	-35.1	-16.3	2.9	32.3	-32.3	-51.9	-55.3
(Percent of GDP)	-12.8	-7.1	1.3	12.2	-10.8	-15.8	-15.9
Capital account	17.2	6.3	11.1	8.1	46.3	54.7	51.4
Overall balance (accrual)	-17.9	-10.0	14.0	40.5	14.1	2.8	-3.9
Gross official reserves (US$ millions, end of period)	18.5	17.5	36.0	79.0	94.6	98.2	95.2
(in months of next year's imports of GNFS)	2.8	2.1	3.6	5.5	5.3	5.3	5.0
Exchange rate (SI$/US$, end of period) 6/	5.56	7.46	7.49	7.51	7.58	7.60	...
Real effective exchange rate (period average, 2000=100)	109.2	90.8	78.5	77.3	83.1	83.1	83.1
Nominal effective exchange rate (period average, 2000=100)	103.2	80.1	64.0	59.6	60.6	...	...

Sources: Data provided by the authorities; and Fund staff estimates.

1/ Expenditures are presented on an accrual basis.
2/ Includes recurrent budget grant support.
3/ Calculated from above-the-line data.
4/ Includes interest arrears.
5/ Includes arrears.
6/ 2006 column reflects data for end-June.

Table 2. Solomon Islands: Central Government Operations, 2001–07
(In percent of GDP)

	2001	2002	2003	2004	2005	2006 Budget	2006 Proj.	2007 Proj.
Total revenue and grants	23.5	18.7	37.0	47.5	54.5	45.2	53.7	52.1
Total revenue	15.3	16.1	19.2	26.0	27.7	27.3	29.8	29.7
Tax revenue	14.0	15.4	17.4	23.3	24.7	23.9	26.3	26.0
Income and profits	5.1	4.8	3.8	7.5	8.1	7.5	8.5	8.6
Goods and services	4.4	4.6	6.4	8.3	9.0	9.0	9.4	9.5
International trade and transactions	4.5	6.1	7.2	7.6	7.6	7.3	8.3	7.9
Tax on logging	...	...	3.2	3.2	3.6	3.6	4.2	3.9
Other revenue	1.3	0.7	1.8	2.7	2.9	3.4	3.5	3.7
Stamp duty	0.1	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Licenses and fees	0.1	0.2	0.1	0.3	0.2	0.2	0.2	0.2
Miscellaneous revenue	1.0	0.3	1.4	2.2	2.5	3.0	3.1	3.3
Grants	8.2	2.6	17.8	21.5	26.8	17.8	23.9	22.4
Development grants 1/	8.0	2.2	14.0	17.1	25.5	15.4	22.7	20.9
Recurrent budget grants	0.3	0.5	3.8	4.4	1.3	2.4	1.2	1.5
Expenditure 2/	36.2	29.6	39.0	39.5	52.2	45.9	53.1	51.1
Recurrent expenditure	27.3	26.4	23.6	22.2	25.1	27.7	27.9	27.9
Compensation of employees	13.0	11.5	9.2	8.7	9.7	8.9	9.9	9.8
Goods and services	5.3	4.7	5.7	7.7	10.3	13.9	12.6	12.6
Interest	1.3	3.3	2.9	1.8	1.4	1.4	1.4	1.3
Grants to provinces	2.3	0.9	2.0	2.5	2.5	2.4	2.6	2.6
Employer social benefits	0.0	0.2	0.2	0.2	0.1	0.1	0.1	0.1
Other	5.4	5.8	3.7	1.4	1.1	1.0	1.2	1.5
Development expenditure	8.9	3.2	15.4	17.2	27.0	18.2	25.2	23.1
Grant financed 1/	8.0	2.2	14.0	17.1	25.5	15.4	22.7	20.9
Concessional loan financed	0.9	1.0	1.3	0.1	1.4	1.0	2.1	0.7
Domestically financed	0.0	0.0	0.0	0.0	0.1	1.8	0.4	1.5
Recurrent balance (above the line) 3/	-11.8	-9.9	-0.6	8.1	3.9	2.0	3.1	3.2
Domestic balance (above the line) 4/	-12.9	-11.4	-5.7	3.6	1.0	-3.2	-0.6	-0.5
Overall balance (above the line)	-12.7	-10.9	-1.9	8.0	2.3	-0.8	0.6	1.0
Discrepancy (neg. are net expenditures)	0.6	1.2	0.8	1.7	2.9	0.0	0.0	0.0
Overall balance (below the line)	-12.1	-9.7	-1.2	9.7	5.2	-0.8	0.6	1.0
Financing	12.1	9.7	1.2	-9.7	-5.2	0.8	-0.6	-1.0
Foreign (net)	5.0	3.8	0.2	-0.9	2.0	...	1.2	-0.8
Disbursements	6.1	5.4	1.3	0.1	1.4	...	2.1	0.7
Amortization (accrual)	1.1	1.6	1.6	1.6	2.5	...	1.6	1.5
Debt forgiveness	0.0	0.0	0.4	0.6	3.2	...	0.7	0.0
Domestic bank and nonbank (net)	-1.4	-2.9	-8.8	-6.5	-2.3	...	-0.8	-0.3
Banking system (accrual)	-3.3	-1.0	-8.7	-8.5	-2.0	...	-0.6	-0.1
Central bank	2.9	2.4	-3.8	-5.7	-2.8	...	-0.3	0.2
Commercial banks	-6.2	-3.5	-4.9	-2.7	0.7	...	-0.3	-0.3
Nonbank (accrual)	1.9	-1.9	-0.2	1.9	-0.3	...	-0.2	-0.2
National Provident Fund	0.7	-1.2	0.0	1.6	-0.3	...	-0.2	-0.2
Other	1.2	-0.7	-0.2	0.3	0.0	...	0.0	0.0
Privatization receipts	0.0	0.0	0.0	0.0	0.0	...	0.3	0.0
Increase in expenditure arrears 5/	3.8	3.7	4.1	-5.1	-3.8	...	-1.5	0.1
Principal debt arrears	4.7	5.2	5.7	-9.9	-1.1	...	0.0	0.0
External	0.8	1.9	0.1	0.5	-1.1	...	0.0	0.0
Domestic	3.9	3.4	5.6	-10.4	0.0	...	0.0	0.0
Restructured Bonds	0.0	0.0	0.0	12.7	0.0	...	0.2	0.0
Memorandum item:								
Underlying balance (above the line) 6/	-11.6	-8.1	-2.9	4.5	3.2	-2.0	0.6	0.7

Sources: Data provided by the authorities; and Fund staff estimates.

1/ Estimated by staff as currently only limited data exist. Development grants and grant-financed development spending are currently administered by donors, and hence are not under the direct control of the government. They exclude police and military spending, but include TA.
2/ On an accrual basis.
3/ Includes domestic revenue, recurrent expenditure, and recurrent budget grant support.
4/ Defined as domestic revenue net of recurrent expenditure and nongrant financed development spending.
5/ Includes interest arrears.
6/ Defined as domestic primary balance excluding one-off items.

Table 3. Solomon Islands: Summary Accounts of the Banking System, 2001–07

	2001	2002	2003	2004	2005	2006	2007
						Proj.	
I. Central Bank	(In millions of S.I. dollars, end of period)						
Net foreign assets	91.0	117.5	248.3	570.3	699.7	754.1	772.3
Net domestic assets	56.8	49.8	-26.6	-186.6	-237.1	-260.3	-270.3
Credit to the government (net)	122.3	159.5	94.6	-20.7	-82.5	-89.6	-85.3
Claims	185.2	186.3	186.4	185.4	196.9	181.1	175.8
Deposits	-62.9	-26.8	-91.8	-206.1	-279.4	-270.7	-261.0
Other items (net)	-65.5	-109.8	-121.2	-165.9	-154.6	-170.7	-185.0
Reserve money	147.8	167.3	221.7	383.6	462.6	493.9	502.1
Currency outside DMBs	84.7	91.5	102.7	123.2	153.0	180.2	202.5
II. Monetary survey							
Net foreign assets	101.6	132.2	273.0	575.9	712.5	767.0	785.1
Net domestic assets	301.6	287.1	255.4	101.1	152.1	251.5	358.9
Domestic credit	424.7	471.4	467.9	299.2	411.4	535.6	666.7
Government (net)	270.0	298.3	250.6	81.7	40.6	22.4	19.6
Claims	335.2	336.9	351.3	331.3	342.9	315.9	303.5
Deposits	-65.2	-38.6	-100.8	-249.6	-302.2	-293.5	-283.8
Credit to rest of NFPS	1.9	1.8	1.4	-21.3	-18.3	6.7	12.5
Private sector	152.7	171.3	216.0	238.9	389.1	506.5	634.6
Other items (net)	-123.0	-184.3	-212.5	-198.1	-259.4	-284.0	-307.9
Broad Money (M2)	403.2	419.3	528.4	677.0	864.6	1018.5	1144.0
Narrow money	246.4	247.1	327.9	427.2	538.8	634.7	712.9
Quasi money	156.8	172.2	200.5	249.8	325.8	383.8	431.1
	(Annual percentage change, end of period)						
Reserve money	-3.3	16.5	26.9	73.8	20.6	6.8	1.7
Net foreign assets	-31.8	30.2	106.4	111.0	23.7	7.6	2.4
Net domestic assets	-4.4	-4.8	-11.0	-60.4	50.5	65.4	42.7
Net domestic credit	-7.2	11.0	-0.7	-36.1	37.5	30.2	24.5
Of *which* : Private sector	-21.8	-20.7	26.1	10.6	62.9	30.2	25.3
Broad money (M2)	-13.2	4.0	26.0	28.1	27.7	17.8	12.3
Memorandum items:							
Velocity of broad money (marketed output)	2.5	2.5	2.2	2.0	1.8	1.7	1.7
Money multiplier	2.7	2.4	2.4	1.8	1.9	2.1	2.3
Excess liquidity to deposits ratio	12.8	17.7	20.2	39.5	36.0	29.9	24.3
Net international reserves (in millions of US$)	16.3	15.8	33.1	76.0	92.3	96.0	92.9
Private sector credit growth in real terms	-26.5	-2.7	21.5	2.7	50.3	20.3	15.6
Government credit (net) growth in real terms	-2.0	-4.2	-19.0	-69.7	-54.1	-49.0	-19.2

Sources: Data provided by the Central Bank of Solomon Islands; and Fund staff estimates.

Table 4. Solomon Islands: Balance of Payments, 2000–07
(in millions of U.S. dollars)

	2000	2001	2002	2003	2004	2005 Est.	2006 Proj.	2007 Proj.
Current account balance	-31.7	-35.1	-16.3	2.9	32.3	-32.3	-51.9	-55.3
Current account balance (excl. net pub. sec. transfers)	-32.4	-44.7	-22.9	-6.2	21.3	-31.1	-51.8	-56.5
Trade balance	-32.9	-43.5	-4.5	-11.0	-2.0	-41.3	-66.1	-72.2
Merchandise exports, f.o.b.	65.1	47.1	57.8	74.2	96.7	102.5	116.3	116.8
Of which: Timber	44.1	36.1	37.7	49.5	62.6	67.7	71.5	62.9
Fish	8.1	7.1	10.5	12.4	17.6	11.5	13.5	14.3
Palm Oil	1.3	0.0	0.0	0.0	0.0	0.0	3.9	8.0
Merchandise imports, c.i.f.	98.1	90.6	62.3	85.2	98.7	143.7	182.4	189.0
Of which: Petroleum	18.4	14.4	11.2	11.7	23.3	42.9	56.3	61.3
Services and income (net)	13.8	-6.3	-6.3	0.5	9.1	7.0	10.3	11.4
Nonfactor services (net)	14.6	-6.4	-0.4	6.0	7.7	6.8	7.4	7.8
Exports	48.6	24.7	16.7	21.2	30.4	36.3	40.8	42.9
Imports	34.0	31.1	17.1	15.3	22.7	29.4	33.4	35.1
Net factor income from abroad	-0.8	0.1	-5.9	-5.5	1.4	0.1	2.9	3.6
Credit	7.2	6.2	2.7	3.5	8.5	8.5	10.3	10.8
Of which: Interest	2.7	1.1	0.5	0.7	2.5	3.1	4.9	5.4
Debit	8.0	6.1	8.6	9.0	7.1	8.3	7.4	7.3
Of which: Interest	1.8	2.9	4.4	5.2	3.2	2.5	2.9	2.7
Net current transfers	-12.6	14.7	-5.5	13.4	25.2	2.0	3.9	5.5
Private sector	-13.3	5.0	-12.1	4.2	14.2	3.1	4.1	4.3
Receipts	16.5	24.0	15.9	18.4	37.1	35.0	39.1	41.4
Payments	29.7	19.0	28.1	14.2	22.9	31.8	35.0	37.1
Public sector	0.7	9.6	6.6	9.2	11.1	-1.1	-0.2	1.2
Receipts	2.2	10.0	7.3	14.3	13.0	4.0	3.9	5.3
o/w Unidentified grants	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Payments	1.5	0.4	0.7	5.2	1.9	5.1	4.1	4.1
Capital account balance	8.5	17.2	6.3	11.1	8.1	46.3	54.7	51.4
Government sector	7.3	18.3	5.8	12.2	8.6	41.0	45.2	39.6
Medium and long-term lending	1.7	13.9	2.7	-0.6	-4.0	-3.3	1.8	-2.8
Inflows	4.4	16.8	6.0	3.1	0.3	4.2	7.0	2.6
Amortization	2.7	2.9	3.3	3.6	4.3	7.5	5.2	5.4
Investment flow (projects) 1/	5.5	4.4	3.1	12.7	12.5	44.3	43.4	42.4
Private sector	1.3	-1.1	0.5	-1.1	-0.4	5.3	9.5	11.8
Investment activities (incl. FDI)	2.4	1.0	1.0	-0.1	0.3	7.4	12.0	14.2
Medium and long-term lending	-0.5	-1.2	0.0	-0.7	-0.5	-1.7	-2.1	-2.1
Inflows	0.4	0.0	0.5	0.0	0.0	0.4	0.0	0.0
Amortization	0.9	1.2	0.5	0.8	0.5	2.1	2.1	2.1
Other flows	-0.7	-0.9	-0.5	-0.3	-0.3	-0.4	-0.3	-0.3
Overall balance (accrual)	-23.1	-17.9	-10.0	14.0	40.5	14.1	2.8	-3.9
Commercial bank holdings (increase)	-3.6	3.5	1.4	2.0	2.2	0.1	0.0	0.0
Errors, omissions, and valuation	-2.2	-4.5	7.2	3.4	1.0	0.3	0.0	0.0
Exceptional financing	2.7	13.0	3.1	3.2	3.7	1.3	0.9	0.8
Interest arrears	1.2	2.4	4.1	3.1	2.3	-4.6	0.6	0.6
Amortization arrears	1.5	2.3	3.3	1.5	1.4	-3.3	0.0	0.0
Pending import requests	0.0	8.3	-4.3	-2.4	-1.5	-0.1	0.0	0.0
Debt forgiveness	0.0	0.0	0.0	1.0	1.5	9.4	0.2	0.2
Restructured arrears	0	0	0	0.0	0.0	0.0	0	0
Overall balance (cash)	-19.1	-12.8	-1.0	18.5	43.0	15.6	3.7	-3.1
Memorandum items:								
Gross official reserves	31.3	18.5	17.5	36.0	79.0	94.6	98.2	95.2
(In months of next year's imports of GNFS)	3.1	2.8	2.1	3.6	5.5	5.3	5.3	5.0
(In months of next year's non-project imports)		3.0	2.4	3.9	6.2	5.8	5.8	5.4
Net international reserves (NIR)	29.0	16.3	15.8	33.1	76.0	92.3	96.0	92.9
NIR excl. pending import requests and external arrears	24.4	0.9	0.6	17.7	60.0	70.3	73.4	69.7
(In months of next year's imports of GNFS)	2.4	0.1	0.1	1.7	4.2	3.9	3.9	3.6
External arrears (interest plus principal)	4.6	7.1	11.1	13.8	15.8	22.0	22.6	23.2
Exports GNFS--Value Growth	-36.1	-36.8	3.7	28.1	33.2	9.1	13.2	1.7
Exports GNFS--Volume Growth	-33.6	-25.1	-1.7	52.5	35.6	2.2	7.4	0.8
Timber Exports--Value Growth	-14.9	-18.2	4.4	31.4	26.4	8.3	5.5	-12.0
Non-Timber Exports--Value Growth	-71.5	-47.5	82.5	22.8	38.3	1.5	29.1	20.3
Imports GNFS--Value Growth	-17.2	-7.9	-34.7	26.5	20.9	42.6	24.6	3.9
Imports GNFS--Volume Growth	-19.5	-2.0	-34.3	15.7	8.8	30.1	19.0	4.4
Current account (including transfers)/GDP	-10.6	-12.8	-7.1	1.3	12.2	-10.8	-15.8	-15.9
Current account (excluding transfers)/GDP	-10.8	-16.3	-10.1	-2.7	8.0	-10.4	-15.8	-16.2
Terms of trade (index: 1990=100)	117.8	118.1	94.4	78.7	69.9	66.1	64.6	64.4

Sources: Data provided by the authorities; and Fund staff estimates.
1/ Estimated by staff as currently only limited data exist. The majority of these projects are funded by donors. Only the cash component is included.

Table 5. Solomon Islands: Medium-Term Baseline Scenario, 2004–11

	2004	2005	2006	2007	2008	2009	2010	2011
			Projection					
Growth and prices (percentage change)								
Real GDP	8.0	5.0	5.3	4.3	3.3	3.2	3.0	3.0
Of which : Nontimber	5.5	4.5	5.9	5.9	4.6	4.3	3.9	3.9
CPI (period average)	6.9	7.3	8.2	8.4	8.2	7.7	7.2	7.0
CPI (end of period)	7.6	8.4	9.2	8.5	8.0	7.5	7.0	7.0
Nominal GDP (millions of US$)	265	298	328	348	368	387	407	429
Per capita GDP (in US$)	565	618	662	682	701	718	735	753
Per capita GDP in 2006 prices (in US$)	617	648	662	671	675	678	679	680
Central government operations (percent of GDP)								
Total revenue	47.5	54.5	53.7	52.1	48.7	47.5	46.2	45.0
Recurrent revenue	26.0	27.7	29.8	29.7	29.9	30.0	30.0	30.0
Grants 1/	21.5	26.8	23.9	22.4	18.8	17.4	16.2	15.1
Total expenditure 2/	39.5	52.2	53.1	51.1	47.5	46.2	44.9	43.7
Recurrent expenditure	22.2	25.1	27.9	27.9	27.6	27.2	27.0	26.9
Development expenditure 1/	17.2	27.0	25.2	23.1	19.9	19.1	17.9	16.9
Recurrent balance 3/	8.1	3.9	3.1	3.2	3.8	4.3	4.3	4.3
Domestic balance	3.6	1.0	-0.6	-0.5	-0.2	-0.1	-0.1	0.0
Overall balance 4/	8.0	2.3	0.6	1.0	1.2	1.3	1.2	1.3
Foreign financing (net)	-0.9	2.0	1.2	-0.8	-1.5	-1.9	-1.6	-1.6
Domestic financing (net)	-6.5	-2.3	-0.8	-0.3	0.1	0.5	0.3	0.3
Other	-2.3	-4.3	-1.0	0.1	0.1	0.2	0.1	0.0
Central government debt (percent of GDP) 5/	90.1	80.0	69.9	63.6	57.3	51.5	46.3	41.5
Monetary and credit (percentage change, end-year data)								
Net foreign assets	111.0	23.7	7.6	2.4	15.1	-1.8	-4.7	-7.0
Net domestic assets	-60.4	50.5	65.4	42.7	25.0	34.0	31.1	26.8
Net domestic credit	-36.1	37.5	30.2	24.5	18.8	19.7	17.7	17.3
Credit to private sector	10.6	62.9	30.2	25.3	17.1	17.3	16.7	17.0
Broad money	28.1	27.7	17.8	12.3	18.2	10.0	9.8	9.3
Interest rate (3-month t/bill rate, average) 6/	6.0	3.5	3.5	...	...	...	...	...
Balance of payments								
Exports (GNFS; percentage change)	33.2	9.1	13.2	1.7	14.6	0.9	1.4	1.0
Imports (GNFS; percentage change)	20.9	42.6	24.6	3.9	2.7	1.1	0.7	0.7
Current account	32.3	-32.3	-51.9	-55.3	-38.1	-38.3	-37.5	-37.8
(Percent of GDP)	12.2	-10.8	-15.8	-15.9	-10.4	-9.9	-9.2	-8.8
Capital account	8.1	46.3	54.7	51.4	46.3	31.1	28.5	27.5
Overall balance (accrual)	40.5	14.1	2.8	-3.9	8.2	-7.2	-9.0	-10.3
Gross official reserves (US$ millions, end of period)	79.0	94.6	98.2	95.2	104.1	97.5	89.2	79.7
(in months of next year's imports of GNFS)	5.5	5.3	5.3	5.0	5.4	5.0	4.5	4.0
Exchange rate (SI$/US$, end of period) 6/	7.51	7.58	7.60	...	...	...	...	...
Real effective exchange rate (period average, 2000=100)	77.3	83.1	83.1	83.1	83.1	83.1	83.1	83.1
Nominal effective exchange rate (period average, 2000=100)	59.6	60.6	...	...	...	...	...	...

Sources: Data provided by the authorities; and Fund staff estimates.

1/ Estimated by staff as currently only limited data exist. Development grants and grant-financed development spending are currently administered by donors, and hence are not under the direct control of the government. They exclude police and military spending, but include TA.

2/ Expenditures are presented on an accrual basis.

3/ Includes recurrent budget grant support.

4/ Calculated from above-the-line data.

5/ Includes interest arrears.

6/ 2006 column reflects data for end-June 2006.

Table 6. Solomon Islands: Medium-Term Baseline Scenario--Balance of Payments, 2004–11
(in millions of U.S. dollars)

	2004	2005	2006	2007	2008	2009	2010	2011
		Est.			Proj.			
Current account balance	32.3	-32.3	-51.9	-55.3	-38.1	-38.3	-37.5	-37.8
Current account balance (excl. net pub. sec. transfers)	21.3	-31.1	-51.8	-56.5	-39.3	-39.5	-38.7	-39.0
Trade balance	-2.0	-41.3	-66.1	-72.2	-54.5	-55.2	-54.1	-53.7
Merchandise exports, f.o.b.	96.7	102.5	116.3	116.8	139.1	139.5	140.8	141.2
Of which: Timber	62.6	67.7	71.5	62.9	56.0	48.7	42.3	36.0
Fish	17.6	11.5	13.5	14.3	14.4	14.4	14.9	15.2
Minerals (incl. gold)	0.4	0.2	0.2	0.2	25.6	31.9	37.6	42.5
Palm Oil	0.0	0.0	3.9	8.0	8.0	8.0	8.1	8.1
Merchandise imports, c.i.f.	98.7	143.7	182.4	189.0	193.5	194.7	194.9	194.9
Of which: Petroleum	23.3	42.9	56.3	61.3	61.7	62.2	62.6	63.6
Services and income (net)	9.1	7.0	10.3	11.4	10.6	10.8	10.3	9.4
Nonfactor services (net)	7.7	6.8	7.4	7.8	7.2	7.1	7.0	7.0
Net factor income from abroad	1.4	0.1	2.9	3.6	3.4	3.8	3.3	2.5
Net current transfers	25.2	2.0	3.9	5.5	5.8	6.0	6.3	6.5
Private sector	14.2	3.1	4.1	4.3	4.6	4.8	5.1	5.3
Public sector	11.1	-1.1	-0.2	1.2	1.2	1.2	1.2	1.2
Capital account balance	8.1	46.3	54.7	51.4	46.3	31.1	28.5	27.5
Government sector	8.6	41.0	45.2	39.6	31.8	28.8	28.7	27.7
Medium and long-term lending	-4.0	-3.3	1.8	-2.8	-5.5	-7.4	-6.6	-6.8
Inflows	0.3	4.2	7.0	2.6	0.0	0.0	0.0	0.0
Amortization	4.3	7.5	5.2	5.4	5.5	7.4	6.6	6.8
Investment flow (projects) 1/	12.5	44.3	43.4	42.4	37.3	36.3	35.3	34.6
Private sector	-0.4	5.3	9.5	11.8	14.5	2.3	-0.2	-0.3
Investment activities (incl. FDI)	0.3	7.4	12.0	14.2	10.0	5.7	3.7	3.4
Medium and long-term lending	-0.5	-1.7	-2.1	-2.1	4.8	-3.1	-3.6	-3.3
Inflows	0.0	0.4	0.0	0.0	7.5	0.0	0.0	0.0
Amortization	0.5	2.1	2.1	2.1	2.7	3.1	3.6	3.3
Other flows	-0.3	-0.4	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3
Overall balance (accrual)	40.5	14.1	2.8	-3.9	8.2	-7.2	-9.0	-10.3
Commercial bank holdings (increase)	2.2	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Errors, omissions, and valuation	1.0	0.3	0.0	0.0	0.0	0.0	0.0	0.0
Exceptional financing	3.7	1.3	0.9	0.8	0.7	0.7	0.7	0.7
Interest arrears	2.3	-4.6	0.6	0.6	0.7	0.7	0.7	0.7
Amortization arrears	1.4	-3.3	0.0	0.0	0.0	0.0	0.0	0.0
Pending import requests	-1.5	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
Debt forgiveness	1.5	9.4	0.2	0.2	0	0	0	0
Overall balance (cash)	43.0	15.6	3.7	-3.1	8.9	-6.5	-8.3	-9.6
Memorandum items:								
Gross official reserves	79.0	94.6	98.2	95.2	104.1	97.5	89.2	79.7
(In months of next year's imports of GNFS)	5.5	5.3	5.3	5.0	5.4	5.0	4.5	4.0
(In months of next year's non-project imports)	6.2	5.8	5.8	5.4	5.8	5.4	4.9	4.3
NIR (excl. pending import requests and external arrears)	60.0	70.3	73.4	69.7	77.9	70.7	61.7	51.4
(In months of next year's imports of GNFS)	4.2	3.9	3.9	3.6	4.0	3.6	3.1	2.6
External arrears (interest plus principal)	15.8	22.0	22.6	23.2	23.9	24.6	25.3	26.0
Exports GNFS--Value Growth	33.2	9.1	13.2	1.7	14.6	0.9	1.4	1.0
Exports GNFS--Volume Growth	35.6	2.2	7.4	0.8	15.9	1.5	1.8	1.1
Timber Exports--Value Growth	26.4	8.3	5.5	-12.0	-10.9	-13.1	-13.1	-14.9
Non-Timber Exports--Value Growth	38.3	1.5	29.1	20.3	54.0	9.3	8.4	6.8
Imports GNFS--Value Growth	20.9	42.6	24.6	3.9	2.7	1.1	0.7	0.7
Imports GNFS--Volume Growth	8.8	30.1	19.0	4.4	4.7	3.0	2.1	2.1
Current account (including transfers)/GDP	12.2	-10.8	-15.8	-15.9	-10.4	-9.9	-9.2	-8.8
Current account (excluding transfers)/GDP	8.0	-10.4	-15.8	-16.2	-10.7	-10.2	-9.5	-9.1

Sources: Data provided by the authorities; and Fund staff estimates.
1/ Estimated by staff as currently only limited data exist. The majority of these projects are funded by donors. Only the cash component is included.

Table 7. Solomon Islands: Medium-Term Alternative Scenarios, 2004–11

No-Reform Scenario

	2004	2005	2006	2007	2008	2009	2010	2011
			Projections					
Growth and prices (percentage change)								
Real GDP	8.0	5.0	5.3	2.6	1.9	1.7	1.6	1.6
CPI (end of period)	7.6	8.4	9.2	9.0	9.0	9.0	9.0	9.0
Per capita GDP in 2006 prices (in US$)	617	648	662	661	655	648	640	633
Central government operations (percent of GDP)								
Total revenue	47.5	54.5	53.7	48.8	39.7	32.1	29.5	28.5
Recurrent revenue	26.0	27.7	29.8	28.7	27.6	26.8	25.7	24.8
Grants 1/	21.5	26.8	23.9	20.1	12.0	5.3	3.8	3.7
Total expenditure 2/	39.5	52.2	53.1	49.1	39.1	30.9	29.4	28.3
Recurrent expenditure	22.2	25.1	27.9	28.3	27.1	25.5	25.4	24.4
Development expenditure 1/	17.2	27.0	25.2	20.8	12.0	5.4	3.9	3.8
Overall balance 3/	8.0	2.3	0.6	-0.3	0.5	1.2	0.2	0.2
Central government debt (percent of GDP) 4/	90.1	80.0	69.9	64.1	58.2	52.7	49.6	46.8
Broad money (percentage change, end-year data)	28.1	27.7	17.8	10.0	0.5	-15.8	-9.9	-1.7
Balance of payments								
Exports (GNFS; percentage change)	33.2	9.1	13.2	-0.7	-3.5	-5.0	-9.3	-3.7
Imports (GNFS; percentage change)	20.9	42.6	24.6	0.7	-8.0	-4.2	-14.0	-19.1
Current account (including net transfers; percent of GDP)	12.2	-10.8	-15.8	-15.2	-11.3	-10.8	-7.9	-1.3
Gross official reserves (US$ millions, end of period)	79.0	94.6	98.2	88.1	71.4	32.2	5.6	5.4
(in months of next year's imports of GNFS)	5.5	5.3	5.3	5.3	4.5	2.3	0.5	0.5

Sources: Data provided by the authorities; and Fund staff estimates.

1/ Estimated by staff as currently only limited data exist. Development grants and grant-financed development spending are currently administered by donors, and hence are not under the direct control of the government. They exclude police and military spending, but include TA.

2/ Expenditures are presented on an accrual basis.

3/ Calculated from above-the-line data.

4/ Includes interest arrears.

Strong-Reform Scenario

	2004	2005	2006	2007	2008	2009	2010	2011
			Projections					
Growth and prices (percentage change)								
Real GDP	8.0	5.0	5.3	5.0	4.7	4.6	4.9	5.0
CPI (end of period)	7.6	8.4	9.2	7.5	6.8	6.0	5.0	5.0
Per capita GDP in 2006 prices (in US$)	617	648	662	676	688	700	715	730
Central government operations (percent of GDP)								
Total revenue	47.5	54.5	53.7	53.4	51.0	50.0	48.8	47.7
Recurrent revenue	26.0	27.7	29.8	29.7	30.0	30.2	30.4	30.7
Grants 1/	21.5	26.8	23.9	23.7	21.0	19.8	18.3	17.0
Total expenditure 2/	39.5	52.2	53.1	52.4	49.8	48.8	47.5	46.4
Recurrent expenditure	22.2	25.1	27.9	27.9	27.5	27.0	26.8	26.6
Development expenditure 1/	17.2	27.0	25.2	24.4	22.3	21.8	20.8	19.8
Overall balance 3/	8.0	2.3	0.6	1.0	1.2	1.2	1.2	1.2
Central government debt (percent of GDP) 4/	90.1	80.0	69.9	63.6	57.1	51.1	45.9	41.0
Broad money (percentage change, end-year data)	28.1	27.7	17.8	14.2	25.8	21.0	16.8	14.6
Balance of payments								
Exports (GNFS; percentage change)	33.2	9.1	13.2	2.3	17.5	4.5	7.8	7.3
Imports (GNFS; percentage change)	20.9	42.6	24.6	5.4	4.6	1.4	7.2	5.9
Current account (including net transfers; percent of GDP)	12.2	-10.8	-15.8	-16.5	-10.7	-8.5	-8.3	-7.8
Gross official reserves (US$ millions, end of period)	79.0	94.6	98.2	98.4	116.7	129.3	137.7	145.1
(in months of next year's imports of GNFS)	5.5	5.3	5.3	5.0	5.8	6.0	6.0	6.0

Sources: Data provided by the authorities; and Fund staff estimates.

1/ Estimated by staff as currently only limited data exist. Development grants and grant-financed development spending are currently administered by donors, and hence are not under the direct control of the government. They exclude police and military spending, but include TA.

2/ Expenditures are presented on an accrual basis.

3/ Calculated from above-the-line data.

4/ Includes interest arrears.

Table 8. Solomon Islands: Indicators of External Vulnerability, 2001–07

	2001	2002	2003	2004	2005	2006	2007
						Proj.	
Financial indicators							
Government sector debt (in percent of GDP)	94.1	113.3	120.1	90.1	80.0	69.9	63.6
Broad money (percent change, 12-month basis)	-13.2	4.0	26.0	28.1	27.7	17.8	12.3
Private sector credit (percent change, 12 month basis)	-21.8	12.2	26.1	10.6	62.9	30.2	25.3
3 month T-bill yield (in percent, nominal) 3/	8.9	8.3	5.8	6.0	3.5	3.5	...
3 month T-bill yield (in percent, real) 3/	1.2	-0.9	-3.7	-0.9	-3.6	-4.4	…
External indicators							
Merch. Exports (percent change, 12-month basis in US$)	-27.6	22.6	28.4	30.4	5.9	13.5	0.4
of which : non-timber exports	-47.5	82.5	22.8	38.3	1.5	29.1	20.3
Merch. Imports (percent change, 12-month basis in US$)	-7.6	-31.3	36.9	15.8	45.6	26.9	3.6
Terms of trade (percent change, 12 month basis)	0.3	-20.1	-16.6	-11.2	-6.2	-1.5	-0.3
Current account balance (in percent of GDP)	-12.8	-7.1	1.3	12.2	-10.8	-15.8	-15.9
Capital account balance (in percent of GDP)	6.3	2.8	4.8	3.1	15.5	16.7	14.8
Gross official reserves (in US$ millions)	18.5	17.5	36.0	79.0	94.6	98.2	95.2
Central Bank short-term foreign liabilities (in US$ millions)	2.2	1.7	2.9	3.0	2.3	2.3	2.3
Central Bank foreign currency exposure (in US$)	16.3	15.8	33.1	76.0	92.3	96.0	92.9
Short term foreign assets of the financial sector (in US$)	...	...	...	...	...	...	...
Short term foreign liabilities of the financial sector (in US$)	...	...	...	...	...	...	...
Foreign currency exposure of the financial sector (in US$ millions) 1/	1.9	2.0	3.3	0.8	1.7	1.6	1.5
Official reserves (in months of next year's imports of GNFS)	2.8	2.1	3.6	5.5	5.3	5.3	5.0
Gross international reserves to broad money	0.3	0.3	0.5	0.9	0.8	0.8	0.7
Total external public sector debt (in percent of GDP) 2/	49.0	66.6	69.5	60.6	54.2	50.0	46.5
Total external debt to exports of GNFS	187.0	203.5	168.5	126.4	116.5	104.4	101.3
External interest payments to exports of GNFS	3.1	4.1	2.8	2.0	5.1	1.4	1.3
External amortization payments to exports of GNFS	1.5	0.8	3.6	2.3	7.8	3.3	3.4
Exchange rate (SI$/US$, period average)	5.28	6.75	7.51	7.48	7.53	…	…
Exchange rate (SI$/US$, end of period) 3/	5.56	7.46	7.49	7.51	7.58	7.60	…
REER appreciation (+) (period average)	9.2	-16.8	-13.6	-1.5	7.5	…	…

Sources: Data provided by the authorities; and Fund staff estimates.
1/ Net foreign assets of commercial banks.
2/ Includes arrears.
3/ 2006 column reflects data for end-June.

Table 9. Solomon Islands: Key Structural Reforms Status as of end-June 2006

Area	Specific Reform	Assisting Institution/Donor	Status
Tax reform	Income Tax Amendments (PAYE)	LEG	Passed by Parliament December 2005.
	Exemption guidelines		Issued June 2006
	Value Added Tax Act, Revenue Administration Act, and Customs Act Redrafting	PFTAC/LEG	Draft legislation submitted to authorities.
	Tax Incentives Review	FIAS	Discussion paper submitted to authorities.
Public Sector Financial Management	Review of Public Finance and Audit Act	PFTAC	May 2006 mission in proposed redraft of Finance Instructions.
	Solomon Islands Government Accounting Service (SIGAS)		Being revamped.
	Local Purchase Orders		Introduced 2006.
State Enterprise Reform	SOE Reform and Private Sector Participation	ADB	Ongoing TA to improve SOE ownership, accountability, & performance.
	Electricity Authority (SIEA) Restructuring	World Bank (WB)	Financial restructuring plan (FRP) report finalized and management contract proposed, jointly for SIEA and Solomon Islands Water Authority (SIWA). Implementation requires SIWA's FRP.
	SIWA Restructuring	WB	FRP not started due to authorities' delays (see SIEA).
	Solomon Airlines & civil aviation regulation	ADB/AusAid/ RAMSI	Privatization strategy document submitted to authorities in December

			2005, but not approved.
Business Environment	Foreign Investment Bill Administrative Barriers (licensing; immigration and labor permits) Investment Promotion Strategy Business Law Reform	FIAS FIAS FIAS ADB	Approved by Parliament December 2005, effective July 2006. Report to be integrated with ADB work on business regulation and laws. Planning stage. Ongoing.
Infrastructure	Interisland shipping & National Transport Fund (NTF) Barriers to efficient shipping Roads and Bridges Strengthening of Ministry of Infrastructure Review of the telecommunication monopoly	ADB/AusAid/NZAid ADB/AusAid/NZAid ADB WB	Diagnostic report submitted. Reform to develop private providers and provide subsidies from NTF for nonviable routes being prepared. Reduction in import duties on shipping in June 2005. Repair work 30 percent complete; completion expected by February 2007. Another project to be considered by the ADB board in August 2006. Ongoing TA until end-2006. To be completed in 2006.
Health and Education	Health Sector-Wide Approach (SWAp) Education SWAp	AusAid/WB EU/NZAID/WB	Initial diagnosis and public expenditure review completed. Ongoing.
Financial Sector	DBSI		CBSI court-appointed management mandate to

			end by December 2006, by which time all depositors expected to be repaid. Government decision on next steps pending.
	NPF	WB	New NPF Bill awaits government decision.
	Financial Intelligence Unit	LEG/AusAid	MOU signed to provide funding for three years. FIU officer started work.
	Secured Transactions Reform	ADB	Initial report submitted to authorities.
Rural Development	Agriculture and Rural Development Strategy (ARDS)	AusAid/EU/WB/Japan	Initial draft strategy to be completed by September 2006. New projects to implement the ARDS will be presented to the WB board in June 2007.
Governance	Institutions Strengthening Program	RAMSI	Ongoing.
	Machinery of government	RAMSI	Ongoing.
	Introduction of a single ballot box		Legislation approved in July 2005.
Insurance	Revision of the Insurance Act	MFD	Initial review of the Act to check compliance with international standards completed.
	Resolution of troubled insurance company (SMI)	MFD	SMI under the jurisdiction of the court for liquidation.
Statistics	See Appendix VII	See Appendix VII	See Appendix VII
Trade	Integrated Framework	WTO/WB	Application submitted February 2006.

APPENDIX I: SOLOMON ISLANDS—MEDIUM-TERM BASELINE SCENARIO AND DEBT SUSTAINABILITY ANALYSIS[1]

The staff's medium-term baseline scenario would achieve only small increases in living standards, and leave the Solomon Islands at high risk of debt distress*. Assuming macroeconomic stability and continued donor involvement, but only limited progress in structural reforms, this baseline downgrades macro forecasts, especially growth, compared to the 2005 Article IV due to greater uncertainty regarding the government's reform agenda. Although the debt situation has improved compared to last year, historical scenarios and several stress tests—even some temporary ones—still lead to a significant rise in the debt burden.*

Medium-term Scenario

Under the medium-term baseline scenario, real GDP growth is projected to converge to about 3 percent, only slightly above population growth. This scenario assumes that the two large projects that have recently started (palm oil production and the rehabilitation of a gold mine) will continue, but not many new nontimber activities would commence. Inflation eases but remains around 7 percent. The real effective exchange rate is assumed to be constant. Export growth falls to about 1.0 percent given limited new activities to replace logging which is expected to wind down to about half of its current harvest rate by 2011.[2] The current account deficit gradually improves as import growth declines given lower official development assistance (ODA) and investment inflows, but stays at about 9 percent of GDP. The reserve coverage falls as ODA and exports ease, but remains adequate at above 4 months of imports. The budget position would need to maintain a small surplus due to financing constraints and the desire to avoid abrupt fiscal retrenchment, and to reduce the high public debt. Risks to the baseline appear roughly balanced. The country's history of political instability and volatile growth and export performance pose downside risks. On the other hand, the government may build upon the reforms started by the previous administration which could boost nontimber private sector activity and growth.

Debt

Some progress has been achieved in regularizing the debt situation. The Honiara Club initiative led to a short-term moratorium on principal payments and the forgiveness of interest payments during the moratorium (0.2 percent of GDP) from one creditor, as well as the

[1] Prepared jointly with World Bank staff.

[2] The current logging rate is about four times the sustainable rate.

possibility of debt forgiveness and arrears settlement after a planned review in 2007.[3] The review will focus on the government's commitments to continue to regularize its debts, maintain fiscal discipline, refrain from contracting new loans, and advance on structural reforms. Given uncertainties on the content of the final agreement under the Honiara Club, this analysis does not assume debt forgiveness, but incorporates the impact of the short-term moratorium and related interest forgiveness. Successful negotiations with external commercial creditors achieved debt relief amounting to 2½ percent of GDP. The stock of informal arrears also fell by about 2 percent of GDP to 4½ percent of GDP.[4]

These developments helped reduce total public debt to 80 percent of GDP in 2005—lower than the starting point at the time of the 2005 Article IV consultation of 92 percent of GDP in 2004—despite the calling of a government guarantee on a loan to the state fishing company. In February 2006, agreement was also reached with the Central Bank of the Solomon Islands (CBSI) on outstanding advances and interest arrears.[5]

Debt Sustainability in the Baseline Scenario[6]

Results of the baseline external debt sustainability analysis are mixed (Appendix I, Table I.1).[7] At end-2005, the NPV of external debt to GDP at 40 percent was higher than its Board-endorsed threshold, but is expected to fall below it by 2009.[8] All other indicators, including the ratios of the NPV of debt to exports and revenue, and debt service ratios were below their thresholds, and are expected to decline over time. This assumes that the government's current policy of incurring no new debt will continue.

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[3] The Honiara Club is a multilateral forum convened by the government in October 2005 to seek debt relief from its official creditors. Four creditors participated in the Honiara Club, namely, the Export Finance and Insurance Corporation (EFIC), the European Commission, the European Investment Bank, and the International Fund for Agricultural Development.

[4] Informal arrears are arrears to suppliers.

[5] In February 2006, 25 percent of interest arrears to the CBSI amounting to 0.4 percent of GDP was settled, the rest was forgiven, and outstanding advances were converted into long-term bonds carrying a 2¼ percent interest rate.

[6] Data on private external, state enterprise, and provincial government debt are not available. Therefore, the analysis is limited to central government debt data.

[7] This analysis assumes that the government remains current on all obligations from June 2006, and that all debts in arrears are treated as a current short-term obligation with NPV equal to its face value. Existing external arrears are assumed to continue growing with accrued interest.

[8] The thresholds (see Appendix I, Table I.1) apply to countries with weak policies and institutions, and are discussed in *Operational Framework for Debt Sustainability Analysis in Low Income Countries—Further Considerations*. The Solomon Islands' CPIA at 2.8 is the lowest among the Pacific Island Countries.

Albeit declining, the overall central government debt remains high (Appendix I, Table I.2). At end-2005, public domestic debt including arrears stood at 26 percent of GDP, about half its peak of 51 percent in 2003. In 2006, domestic debt is expected to decline further to 20 percent of GDP, partly reflecting the settlement of the bulk of remaining informal arrears. Nevertheless, total public debt would still be 42 percent of GDP in 2011, and the NPV of public sector debt to revenue ratio stays above 100 percent until 2012.

Risks to the debt dynamics

Historical scenarios and even some *temporary* stress tests demonstrate the country's vulnerable debt position (Appendix I, Tables I.3–I.4).

- *External Debt:* Key variables at their historical averages set the NPV of external debt to exports on a rising path. Even a temporary export growth decline increases the NPV of debt to exports to over twice its threshold. If all recognized contingent liabilities are realized (13.5 percent of GDP), the NPV of external debt to GDP would exceed 30 percent of GDP until 2015.

- *Public Debt:* Lower GDP growth, even temporarily, and a return of growth and the primary balance to their historical averages causes the NPV of public debt to GDP and revenue ratios to rise dramatically.

These tests seem especially relevant given the country's volatile economic and political history, poor credit history, and uncertainties surrounding the government's reform orientation.

These results are indicative given major uncertainties surrounding important variables. Macroeconomic variables (especially GDP) are subject to large measurement errors. ODA plans are uncertain and contingent liabilities are likely to increase as audits of SOEs and provincial governments are under way for the first time in many years.

Appendix I

Table I.1. Solomon Islands: External Debt Sustainability Framework, Baseline Scenario, 2003–26 1/

(In percent of GDP, unless otherwise indicated)

	Actual			Historical Average 5/	Standard Deviation 5/	Estimate	Projections								
	2003	2004	2005			2006	2007	2008	2009	2010	2011	2006-11 Average	2016	2026	Board Endorsed Threshold 6/
External debt (nominal) 1/	69.5	60.6	54.2			50.0	46.5	42.7	38.8	35.4	32.2		20.1	7.5	
Of which: public and publicly guaranteed (PPG)	69.5	60.6	54.2			50.0	46.5	42.7	38.8	35.4	32.2		20.1	7.5	
Change in external debt	2.9	-8.9	-6.3			-4.3	-3.4	-3.8	-3.9	-3.4	-3.2		-2.0	-0.9	
Identified net debt-creating flows	-6.6	-25.6	-12.8			-3.4	-2.1	-3.7	-2.0	-1.2	-0.8		-1.4	-0.5	
Non-interest current account deficit	-2.4	-13.2	10.3	1.8	7.3	15.1	15.3	9.8	9.4	8.7	8.4		4.6	3.3	
Deficit in balance of goods and services	2.2	-2.2	11.5			17.9	18.5	12.9	12.4	11.5	10.9		6.4	4.8	
Exports	41.2	47.9	46.5			47.8	45.9	49.8	47.7	46.0	44.1		35.5	26.7	
Imports	43.4	45.8	58.1			65.7	64.4	62.6	60.1	57.5	55.0		42.0	31.5	
Net current transfers (negative = inflow)	-5.8	-9.5	-0.7	-1.9	4.0	-1.2	-1.6	-1.6	-1.6	-1.5	-1.5		-1.5	-1.4	
Other current account flows (negative = net inflow)	1.2	-1.5	-0.6			-1.6	-1.6	-1.5	-1.5	-1.3	-1.0		-0.4	-0.2	
Net FDI and other non-debt-creating flows (negative = inflow)	-5.3	-4.8	-17.2	-3.6	5.0	-16.8	-16.2	-12.8	-10.8	-9.5	-8.8		-5.7	-3.7	
Endogenous debt dynamics 2/	1.2	-7.6	-5.8			-1.7	-1.2	-0.7	-0.6	-0.5	-0.4		-0.3	-0.1	
Contribution from nominal interest rate	2.2	1.2	0.8			0.9	0.8	0.7	0.7	0.6	0.6		0.3	0.1	
Contribution from real GDP growth	-4.2	-4.8	-2.7			-2.6	-2.0	-1.5	-1.3	-1.1	-1.0		-0.7	-0.3	
Contribution from price and exchange rate changes	3.2	-4.0	-4.0			…	…	…	…	…	…		…	…	
Residual (3-4) 3/	9.5	16.6	6.4			-0.9	-1.3	-0.1	-1.9	-2.2	-2.4		-0.6	-0.3	
Of which: exceptional financing	-1.4	-1.4	-0.4			-0.3	-0.2	-0.2	-0.2	-0.2	-0.2		-0.2	-0.1	
NPV of external debt	...	44.2	39.7			36.6	34.3	31.9	29.3	27.0	24.8		16.2	6.2	
In percent of exports	...	92.2	85.4			76.4	74.7	64.1	61.3	58.6	56.2		45.7	23.3	
NPV of PPG external debt	...	44.2	39.7			36.6	34.3	31.9	29.3	27.0	24.8		16.2	6.2	30
In percent of exports	...	92.2	85.4			76.4	74.7	64.1	61.3	58.6	56.2		45.7	23.3	100
In percent of revenue (excluding grants)	...	170.1	143.6			122.7	115.7	106.7	97.4	89.9	82.7		54.0	21.0	200
Debt service-to-exports ratio (in percent)	6.4	4.3	7.6			4.8	4.8	4.2	5.1	4.6	4.6		3.5	1.8	
PPG debt service-to-exports ratio (in percent)	6.4	4.3	7.6			4.8	4.8	4.2	5.1	4.6	4.6		3.5	1.8	15
PPG debt service-to-revenue ratio (in percent)	13.7	8.0	12.8			7.6	7.3	6.8	8.1	6.9	6.6		4.1	1.6	25
Non-interest current account deficit that stabilizes debt ratio	-5.3	-4.2	16.6			19.4	18.7	13.6	13.3	12.1	11.6		6.6	4.1	
Key macroeconomic assumptions															
Real GDP growth (in percent)	6.4	8.0	5.0	-0.4	6.9	5.3	4.3	3.3	3.2	3.0	3.0	3.7	3.2	3.3	
GDP deflator in US dollar terms (change in percent)	-4.5	6.1	7.0	-0.8	9.3	4.6	1.6	2.3	2.0	2.2	2.2	2.5	2.2	3.6	
Effective interest rate (percent) 4/	3.4	2.0	1.5	2.1	0.9	1.8	1.7	1.7	1.7	1.7	1.7	1.7	1.7	1.9	
Growth of exports of G&NFS (US dollar terms, in percent)	28.1	33.2	9.1	-3.1	27.0	13.2	1.7	14.6	0.9	1.4	1.0	5.5	1.6	4.3	
Growth of imports of G&NFS (US dollar terms, in percent)	26.5	20.9	42.6	-2.7	29.0	24.6	3.9	2.7	1.1	0.7	0.7	5.6	2.3	5.1	
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	49.4	49.9	...	...	...	...	49.7	...	...	
Memorandum item:															
Nominal GDP (billions of U.S. dollars)	0.231	0.265	0.298			0.328	0.348	0.368	0.387	0.407	0.429		0.556	0.950	

Sources: Data provided by the authorities; and Fund staff estimates.

1/ Refers to central government debt only due to data availability. This table assumes the government's current policy of not incurring new debt. The DSA exercise was conducted jointly with the World Bank.
2/ Derived as [r - g - r(1+g)]/(1+g+r+gr) times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, and r = growth rate of GDP deflator in U.S. dollar terms.
3/ Includes exceptional financing (i.e., changes in arrears and debt relief); changes in gross foreign assets; and valuation adjustments. For projections also includes contribution from price and exchange rate changes.
4/ Current-year interest payments divided by previous period debt stock.
5/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.
6/ These thresholds apply to countries with weak policies and institutions and are discussed in *Operational Framework for Debt Sustainability Analysis in Low-Income Countries--Further Considerations*.

Appendix I

Table I.2. Solomon Islands: Public Sector Debt Sustainability Framework, Baseline Scenario, 2003–26 1/

(In percent of GDP, unless otherwise indicated)

	Actual					Estimate	Projections							
	2003	2004	2005	Historical Average 7/	Standard Deviation 7/	2006	2007	2008	2009	2010	2011	2006-11 Average	2016	2026
Public sector debt 2/	120.1	90.1	80.0			69.9	63.6	57.3	51.5	46.3	41.5		24.8	8.1
Of which : foreign-currency denominated	69.5	60.6	54.2			50.0	46.5	42.7	38.8	35.4	32.2		20.1	7.5
Change in public sector debt	6.8	-30.0	-10.3			-10.1	-6.3	-6.3	-5.8	-5.1	-4.8		-2.9	-0.9
Identified debt-creating flows	-11.5	-22.9	-13.9			-8.4	-5.8	-5.5	-4.8	-4.4	-4.1		-2.5	-0.6
Primary deficit	-0.9	-9.8	-3.8	0.6	6.0	-1.9	-2.3	-2.4	-2.3	-2.2	-2.1	-2.2	-1.8	-0.5
Revenue and grants	37.0	47.5	54.5			53.7	52.1	48.7	47.5	46.2	45.0		39.8	36.6
Of which : grants	17.8	21.5	26.8			23.9	22.4	18.8	17.4	16.2	15.1		9.8	7.0
Primary (noninterest) expenditure	36.1	37.7	50.7			51.7	49.8	46.4	45.2	44.0	42.9		38.0	36.1
Automatic debt dynamics	-9.9	-13.1	-8.4			-5.5	-3.5	-3.2	-2.6	-2.2	-1.9		-0.7	-0.1
Contribution from interest rate/growth differential	-7.7	-11.3	-6.4			-5.5	-3.8	-3.0	-2.5	-2.1	-1.8		-0.6	-0.2
Of which : contribution from average real interest rate	-0.9	-2.4	-2.1			-1.5	-0.9	-0.9	-0.7	-0.6	-0.5		0.2	0.1
Of which : contribution from real GDP growth	-6.9	-8.9	-4.3			-4.0	-2.9	-2.0	-1.8	-1.5	-1.3		-0.8	-0.3
Contribution from real exchange rate depreciation	-2.2	-1.8	-2.1			0.0	0.3	-0.2	-0.1	-0.1	-0.1		...	...
Other identified debt-creating flows	-0.6	0.0	-1.7			-1.0	0.0	0.0	0.0	-0.1	-0.1		0.0	0.0
Privatization receipts (negative)	0.0	0.0	0.0			-0.3	0.0	0.0	0.0	0.0	0.0		0.0	0.0
Recognition of implicit or contingent liabilities 3/	0.0	0.0	1.4			0.0	0.0	0.0	0.0	-0.1	-0.1		0.0	0.0
Debt relief (HIPC and other)	-0.6	0.0	-3.2			-0.7	0.0	0.0	0.0	0.0	0.0		0.0	0.0
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0
Residual, including asset changes	18.3	-7.2	3.6			-1.6	-0.5	-0.7	-1.0	-0.7	-0.7		-0.5	-0.3
NPV of public sector debt	101.1	73.7	65.3			56.3	51.2	46.4	41.8	37.8	33.9		21.0	6.8
Of which: Foreign-currency denominated	50.5	44.2	39.7			36.6	34.3	31.9	29.3	27.0	24.8		16.2	6.2
Of which: External	50.5	44.2	39.7			36.6	34.3	31.9	29.3	27.0	24.8		16.2	6.2
NPV of contingent liabilities (not included in public sector debt) 3/	...	...	10.0			13.5	12.1	10.8	9.8	8.9	8.1		5.0	2.0
Gross financing need 4/	1.9	-1.7	1.8			2.9	0.7	0.3	0.0	0.0	-0.1		0.5	-0.1
NPV of public sector debt-to-revenue ratio (in percent) 5/	525.8	283.6	236.0			189.1	172.7	155.1	139.0	125.9	113.1		69.8	23.0
Of which: External	262.6	170.1	143.6			122.7	115.7	106.7	97.4	89.9	82.7		54.0	21.0
Debt service-to-revenue ratio (in percent) 5/ 6/	14.8	25.0	15.5			12.1	6.2	5.5	4.7	4.3	4.2		2.9	0.6
Primary deficit that stabilizes the debt-to-GDP ratio	-7.7	20.2	6.5			8.1	4.0	3.9	3.6	3.0	2.7		1.2	0.4
Key macroeconomic and fiscal assumptions														
Real GDP growth (in percent)	6.4	8.0	5.0	-0.4	6.9	5.3	4.3	3.3	3.2	3.0	3.0	3.7	3.2	3.3
Average nominal interest rate on forex debt (in percent)	3.8	2.0	1.6	2.3	1.1	1.8	1.8	1.8	1.8	1.8	1.8	1.8	0.0	0.0
Average real interest rate on domestic currency debt (in percent)	-4.4	-4.3	-4.9	-1.6	5.3	-4.0	-4.3	-4.9	-4.3	-4.0	-3.8	-4.2	3.6	19.9
Real exchange rate depreciation (in percent, + indicates depreciation)	-3.5	-2.8	-3.6	3.7	12.4	0.1	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	6.2	5.8	7.7	7.0	2.7	6.5	7.3	8.0	7.2	6.9	6.6	7.1	6.7	6.4
Growth of real primary spending (deflated by GDP deflator, in percent)	-2.4	2.9	18.2	1.7	12.0	17.4	9.6	7.4	5.0	4.2	4.1	8.0	4.2	4.2
Grant element of new external borrowing (in percent)	...	...	...	...	...	49.4	49.9	...	...	...	...	49.7	...	...

Sources: Data provided by the authorities; and Fund staff estimates.

1/ The DSA exercise was conducted jointly with the World Bank.

2/ Gross central government debt, including informal arrears. Foreign currency denominated debt converted using end-of-period exchange rate.

3/ Current estimate of recognized contingent liabilities. Remaining contingent liabilities are estimated at 10 percent of GDP.

4/ Gross financing need is defined as the primary deficit plus debt service plus the stock of short-term debt at the end of the last period.

5/ Revenues excluding grants.

6/ Debt service is defined as the sum of interest and amortization of medium and long-term debt.

7/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

Appendix I

Table I.3. Solomon Islands: Sensitivity Analyses for Key Indicators of Public and Publicly Guaranteed External Debt, 2006–26 1/

(In percent)

	Estimate	Projections						
	2006	2007	2008	2009	2010	2011	2016	2026
NPV of debt-to-GDP ratio								
Baseline	37	34	32	29	27	25	16	6
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2007-26 2/	37	36	37	36	35	34	31	27
A2. New public sector loans on less favorable terms in 2007-26 3/	37	34	...	...	...	...	...	...
A3. Realization of all recognized contingent liabilities as external debt in 2007 4/	37	47	45	42	40	38	29	19
A4. Aid flows and FDI 25 percent lower in 2007-2026								
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2007-08 5/	37	38	40	36	33	30	19	9
B2. Export value growth at historical average minus one standard deviation in 2007-08 6/	37	41	53	50	47	45	35	14
B3. US dollar GDP deflator at historical average minus one standard deviation in 2007-08	37	39	41	37	34	31	20	14
B4. Net non-debt creating flows at historical average minus one standard deviation in 2007-08 7/	37	45	52	49	46	44	34	13
B5. Combination of B1-B4 using one-half standard deviation shocks	37	45	63	59	56	52	39	15
B6. One-time 30 percent nominal depreciation relative to the baseline in 2007 8/	37	49	45	41	38	35	22	13
NPV of debt-to-exports ratio								
Baseline	76	75	64	61	59	56	46	23
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2007-26 2/	76	79	74	75	76	77	87	99
A2. New public sector loans on less favorable terms in 2007-26 3/	76	75	...	...	...	...	...	...
A3. Realization of all recognized contingent liabilities as external debt in 2007 4/	76	103	90	89	87	86	83	73
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2007-08 5/	76	84	80	76	73	69	54	35
B2. Export value growth at historical average minus one standard deviation in 2007-08 6/	76	127	240	236	232	229	221	115
B3. US dollar GDP deflator at historical average minus one standard deviation in 2007-08	76	84	82	78	74	71	56	52
B4. Net non-debt creating flows at historical average minus one standard deviation in 2007-08 7/	76	98	104	102	101	99	95	49
B5. Combination of B1-B4 using one-half standard deviation shocks	76	100	148	145	142	139	129	66
B6. One-time 30 percent nominal depreciation relative to the baseline in 2007 8/	76	106	90	86	82	78	62	49
Debt service ratio								
Baseline	4.8	4.8	4.2	5.1	4.6	4.6	3.5	1.8
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2007-26 2/	4.7	5.0	4.7	6.2	5.9	6.3	7.1	7.4
A2. New public sector loans on less favorable terms in 2007-26 3/	4.7	4.7	4.1	...	...	...	...	...
A3. Realization of all recognized contingent liabilities as external debt in 2007 4/	4.7	4.7	5.4	6.4	5.8	5.8	4.9	2.9
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2007-08 5/	4.7	5.3	5.2	6.4	5.7	5.7	4.6	2.2
B2. Export value growth at historical average minus one standard deviation in 2007-08 6/	4.7	6.6	9.9	13.3	12.0	12.0	10.1	11.8
B3. US dollar GDP deflator at historical average minus one standard deviation in 2007-08	4.7	4.7	4.1	5.1	4.5	4.5	3.7	1.4
B4. Net non-debt creating flows at historical average minus one standard deviation in 2007-08 7/	4.7	4.7	4.5	5.8	5.3	5.3	4.4	5.0
B5. Combination of B1-B4 using one-half standard deviation shocks	4.7	5.6	6.8	8.9	8.1	8.0	6.7	6.6
B6. One-time 30 percent nominal depreciation relative to the baseline in 2007 8/	4.7	4.7	4.1	5.1	4.5	4.5	3.7	1.4
Memorandum item:								
Grant element assumed on residual financing (i.e., financing required above baseline) 9/	49	49	49	49	49	49	49	49

Sources: Data provided by the authorities; and Fund staff estimates.

1/ The DSA exercise was conducted jointly with the World Bank.

2/ Variables include real GDP growth, growth of GDP deflator (in U.S. dollar terms), non-interest current account in percent of GDP, and non-debt creating flows.

3/ Assumes that the interest rate on new borrowing is by 2 percentage points higher than in the baseline, while grace and maturity periods are the same as in the baseline.

4/ Liabilities realized and add to arrears from the beginning of 2007, attracting an interest rate equal to 2007 six month libor.

5/ Ratios calculated using baseline export-to-GDP, since GDP and exports are driven by the same primary commodities.

6/ Exports values are assumed to remain permanently at the lower level, but the current account as a share of GDP is assumed to return to its baseline level after the shock (implicitly assuming an offsetting adjustment in import levels).

7/ Includes official and private transfers and FDI.

8/ Depreciation is defined as percentage decline in dollar/local currency rate, such that it never exceeds 100 percent.

9/ Applies to all stress scenarios except for A2 (less favorable financing) in which the terms on all new financing are as specified in footnote 2.

Appendix I

Table I.4. Solomon Islands: Sensitivity Analysis for Key Indicators of Public Debt 2006–26 1/

	Estimate	Projections						
	2006	2007	2008	2009	2010	2011	2016	2026
NPV of Debt-to-GDP Ratio								
Baseline	56	51	46	42	38	34	21	7
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	56	56	56	56	56	56	62	78
A2. Primary balance is unchanged from historical average	56	54	52	50	48	47	44	41
A3. Permanently lower GDP growth 2/	56	52	49	46	44	43	48	107
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviation in 2007-2008	56	61	69	70	72	73	90	132
B2. Primary balance is at historical average minus one standard deviation in 2007-2008	56	59	63	58	54	50	36	19
B3. Combination of B1-B2 using one half standard deviation shocks	56	61	66	58	51	45	22	5
B4. One-time 30 percent real depreciation in 2007	56	68	63	58	54	50	34	13
B5. 10 percent of GDP increase in other debt-creating flows in 2007	56	61	55	51	47	43	29	13
NPV of Debt-to-Revenue Ratio 3/								
Baseline	189	173	155	139	126	113	70	23
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	189	190	188	186	186	186	205	262
A2. Primary balance is unchanged from historical average	189	182	173	165	161	156	147	139
A3. Permanently lower GDP growth 2/	189	177	164	154	148	143	160	359
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviation in 2007-2008	189	206	230	233	239	245	298	444
B2. Primary balance is at historical average minus one standard deviation in 2007-2008	189	200	209	192	178	165	119	63
B3. Combination of B1-B2 using one half standard deviation shocks	189	206	220	193	170	149	73	3
B4. One-time 30 percent real depreciation in 2007	189	230	211	193	179	165	113	44
B5. 10 percent of GDP increase in other debt-creating flows in 2007	189	204	185	169	155	142	97	42
Debt Service-to-Revenue Ratio 3/								
Baseline	12.1	6.2	5.5	4.7	4.3	4.2	2.9	0.6
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	12.1	6.5	6.6	6.4	6.6	7.0	8.5	20.0
A2. Primary balance is unchanged from historical average	12.1	6.2	6.1	5.7	5.7	5.9	6.1	10.4
A3. Permanently lower GDP growth 2/	12.1	6.3	5.8	5.2	5.0	5.3	6.5	19.8
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviation in 2007-2008	12.1	7.0	7.7	7.9	8.4	9.2	12.2	30.9
B2. Primary balance is at historical average minus one standard deviation in 2007-2008	12.1	6.2	7.2	7.6	6.8	6.5	5.0	5.7
B3. Combination of B1-B2 using one half standard deviation shocks	12.1	6.7	7.7	7.6	6.4	5.8	3.1	7.5
B4. One-time 30 percent real depreciation in 2007	12.1	6.8	6.7	5.9	5.4	5.3	3.2	1.2
B5. 10 percent of GDP increase in other debt-creating flows in 2007	12.1	6.2	7.4	6.1	5.6	5.5	4.1	3.4

Sources: Data provided by the authorities; and Fund staff estimates.

1/ The DSA exercise was conducted jointly with the World Bank.

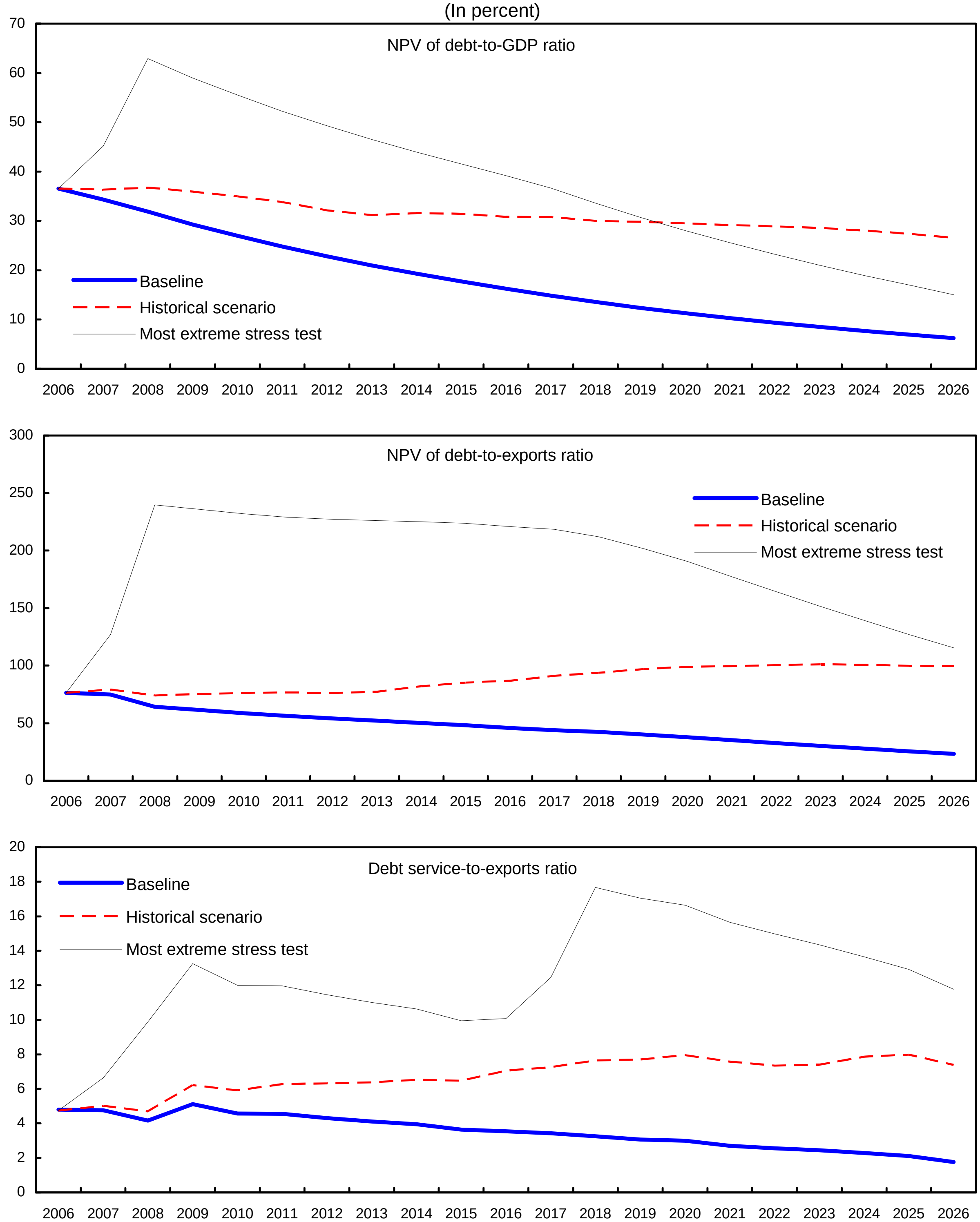
2/ Assumes that real GDP growth is at baseline minus one standard deviation divided by the square root of 20 (i.e., the length of the projection period).

3/ Revenues exclude grants.

Appendix I

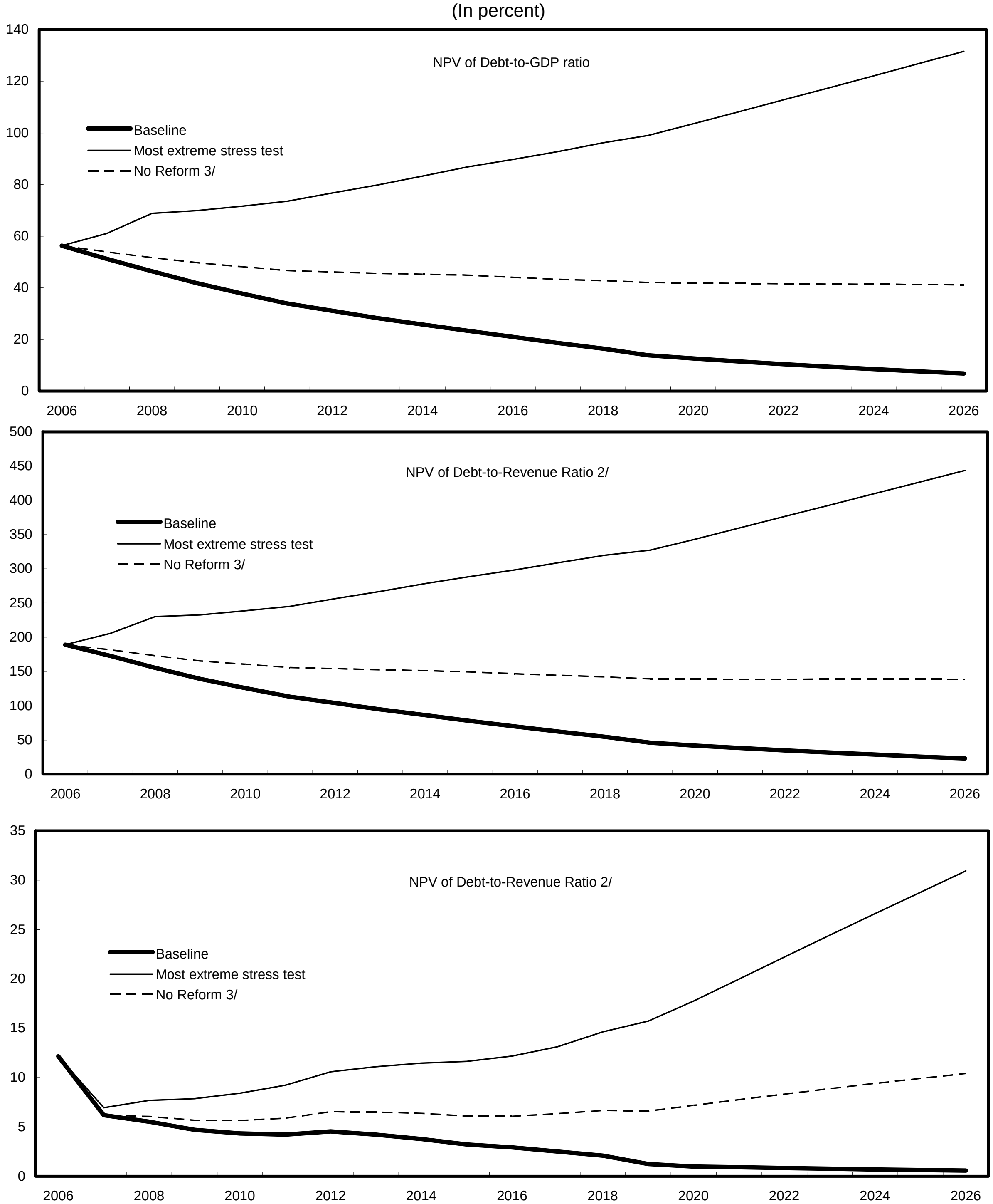
Figure I.1. Solomon Islands: Indicators of Public and Publicly Guaranteed External Debt Under Alternative Scenarios, 2006–26

(In percent)



Source: Staff projections and simulations.

Appendix I
Figure I.2. Solomon Islands: Indicators of Public Debt
Under Alternative Scenarios, 2006–26 1/
(In percent)



Sources: Staff projections and simulations.
1/ Most extreme stress test is teset that yields highest ratio in 2016.
2/ Revenue includes grants.
3/ Primary balance remains at historical average.

APPENDIX II: SOLOMON ISLANDS—FUND RELATIONS
(As of June 30, 2006)

I. **Membership Status**: Joined September 22, 1978; Article VIII.

II. **General Resources Account**:

	SDR Million	Percent Quota
Quota	10.40	100.00
Fund holdings of currency	9.85	94.73
Reserve position in the Fund	0.55	5.29

III. **SDR Department**:

	SDR Million	Percent Allocation
Net cumulative allocation	0.65	100.00
Holdings	0.01	0.94

IV. **Outstanding Purchases and Loans**: None.

V. **Latest Financial Arrangements**:

Type	Approval Date	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
Stand-by	6/22/1983	6/21/1984	2.40	0.96

VI. **Projected Payments to Fund**:
(SDR Million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2006	2007	2008	2009	2010
Charges/Interest	0.01	0.02	0.02	0.02	0.02
Total	0.01	0.02	0.02	0.02	0.02

VII. **Implementation of HIPC Initiative**: Not applicable.

VIII. **Implementation of MDRI Assistance**: Not applicable.

IX. Exchange Rate Arrangements:

Since November 2000, the exchange rate for the Solomon Islands (S.I.) dollar has been based on an undisclosed trade-weighted basket of the currencies of the Solomon Islands' major trading partners, with the U.S. dollar as the intervention currency. During 2002, as pressures on external reserves intensified, the Central Bank of Solomon Islands (CBSI) accelerated the rate of currency depreciation, leading to a gradual real depreciation of the S.I. dollar. Since December 2002, the CBSI has kept the exchange rate broadly stable against the U.S. dollar, although there is no public commitment to continue to do so. The Solomon Islands now maintains an exchange system that is free of restrictions on the making of payments and transfers for current international transactions.

X. Last Article IV Consultation:

The 2005 Article IV Consultation discussions were held in Honiara during June 30–July 12, 2005. The staff report (IMF Country Report No. 05/365, October 13, 2005) was considered by the Executive Board and the consultation concluded on September 28, 2005.

XI. Technical Assistance:

Date	**Department**	**Purpose**	**Duration**
Short-term			
January 14, 1998	PFTAC	Statistics	2 weeks
February 3, 1998	PFTAC	Tax administration	1 week
May 4, 1998	PFTAC	Tax administration	4 weeks
June 7, 1998	PFTAC	Banking supervision	2 weeks
June 30, 1998	PFTAC	Balance of payments statistics	2 weeks
November 28, 1998	PFTAC	Public financial management	1 week
February 9, 1999	PFTAC	Banking supervision	1 week
September, 1999	MAE	Treasury bill auctions and monetary operations	8 weeks
October 3, 2000	MAE	Advisor to CBSI	2 weeks
May, 2001	PFTAC	Banking supervision	1 week
October 2002	PFTAC	Banking Supervision	10 days
January 2003	PFTAC	Statistics	1 week
February 2004	PFTAC	Statistics	2 weeks
May 2004	PFTAC	Tax and customs administration	2 weeks
September 2004	MFD	AML/CFT	1 week
January 2005	PFTAC	Financial reporting system	2 weeks

February 2005	PFTAC	Financial supervision of insurance	2 weeks
April 2005	PFTAC	Financial supervision	2 weeks
May 2005	MFD	Financial supervision of insurance	2 weeks
May 2005	PFTAC	Tax policy and administration	2 weeks
August 2005	MFD	Reserve management	2 weeks
August 2005	MFD	Financial supervision of insurance	4 weeks
August 2005	PFTAC	Statistics	2 weeks
September 2005	PFTAC	AML/CFT	2 weeks
October 2005	LEG	AML/CFT	4 days
November 2005	STA	Monetary and Financial Statistics	3 weeks
January 2006	PFTAC	Tax policy	2 weeks
January 2006	LEG	Tax policy	2 weeks
February 2006	PFTAC	AML/CFT	2 days
February 2006	MFD	Financial supervision of insurance	4 weeks
February 2006	PFTAC	Statistics	2 weeks
April 2006	PFTAC	Statistics	2 weeks
April 2006	MFD	Central Bank Accounting	3 weeks
May 2006	PFTAC	Public Financial Management	2 weeks
Long-term			
June 1995–June 1999;	MAE	Advisor to CBSI Governor	Five years extended in October 1999 through 2000.
January 2001–present	MFD	Peripatetic Advisor to CBSI Governor	Ten six-week missions

XII. Resident Representative: None.

APPENDIX III: SOLOMON ISLANDS—SUPPORT FROM THE PACIFIC FINANCIAL TECHNICAL ASSISTANCE CENTER[1]

(As of July 2006)

Tax Administration and Policy

A mission in May 2004 designed plans to modernize and enhance the efficiency of the Customs and Tax Divisions. A further mission in May 2005 reviewed the current system, outlined a detailed strategy for the implementation of tax reforms over the next few years, and assessed the required technical assistance to support this strategy. The authorities have released a tax reform proposal in conformity with PFTAC's advice. A mission in January 2006 assisted the government with detailed implementation of the reform proposal, including the preparation of draft legislation. It is anticipated that PFTAC and LEG will assist further in this area and a request for assistance is expected shortly.

Public Financial Management

In May 2006, the PFTAC adviser undertook a review of the *Public Finance and Audit Act (1978)*, the *Finance Instructions (1978)* and the *Stores Instructions (1976)* (SIs). The mission agreed with the authorities that the more immediate need was for a process redesign of the key accounting operations, linked to a significant redraft of the Finance Instructions. PFTAC would oversee the provision of two peripatetic experts to undertake this project, tentatively scheduled for August/September 2006.

Financial Sector Regulation and Supervision

In September 2004, an advisor visited the CBSI to advise on the implementation of an anti-money laundering regime. In September 2005, a PFTAC advisor assisted CBSI staff in conducting an AML/CFT on-site examination of a domestic bank. In October 2005, LEG provided technical assistance to the authorities on the establishment of a financial intelligence unit (FIU) and on the strengthening of the anti-money laundering and combating of terrorist financing (AML/CFT) legislation. In February 2006, the advisor participated in an AML/CFT awareness training seminar conducted by the CBSI. A peripatetic advisor visited in January 2005 to assist with streamlining the financial reporting system; and experts visited in February and May 2005 to review the supervision and regulation of the insurance industry. In April 2005, a PFTAC advisor worked with an MFD expert to provide assistance

[1] The Pacific Financial Technical Assistance Centre (PFTAC) in Suva, Fiji, is a regional technical assistance institution operated by the IMF with financial support of the Asian Development Bank, Australia, Japan, Korea and New Zealand. The Center's aim is to build skills and institutional capacity for effective economic and financial management that can be sustained at the national level. Member countries are: Cook Islands, Federated States of Micronesia, Fiji, Kiribati, Marshall Islands, Nauru, Niue, Palau, Papua New Guinea, Samoa, Solomon Islands, Tokelau, Tonga, Tuvalu, and Vanuatu.

on the supervision of an insurance company; provided advice on the oversight of the Solomon Islands National Provident Fund, developed supervisory guidelines on AML/CFT activities in financial institutions, and prepared a project document for the establishment of the FIU. CBSI staff also attended a seminar on monetary policy in shallow markets arranged by PFTAC/MFD in March 2005. In February 2006, a PFTAC advisor participated in an AML awareness raising seminar.

Economic and Financial Statistics

During 2003, the National Statistics Office (NSO) restarted activity, with the production of the Honiara CPI. A PFTAC mission in February 2004 devised a recovery plan, and AusAID and NZAID have committed to provide funding. The CBSI currently compiles balance of payments and national accounts data and CBSI staff attended a regional training course on balance of payments statistics arranged by PFTAC in April 2005. Missions in August 2005 and February 2006 reviewed current methodologies for balance of payments and national accounts statistics and suggested some short-term improvements to their compilation. Assistance has also been provided on a prototype government finance statistics system. The NSO is currently undertaking a Household Income and Expenditure Survey, with assistance from the Secretariat of the Pacific Community, and business surveys.

Contact person: Susan Adams, Project Coordinator, sadams@imf.org.

APPENDIX IV: SOLOMON ISLANDS—RELATIONS WITH THE WORLD BANK GROUP

(As of July 2006)

Since becoming a Bank member in June 1978, the Solomon Islands has received eight IDA credits totaling US$50 million in the infrastructure, education, health, finance, and agriculture sectors. Following the repayment of all outstanding arrears in September 2003, the Solomon Islands came out of non-accrual status, and country relations have normalized. The Solomon Islands is eligible for an IDA 14 allocation of SDR 6.8 million (indicative only) over FY 2006–08. The IDA allocation for FY06 is SDR 1.9 million and this is on a grant-financed basis.

The Bank's assistance to the Solomon Islands is motivated by the need for re-engagement in a low capacity post-conflict country, while recognizing the abundance of donor funds. The assistance program is guided by the government's own development priorities articulated in the *National Economic Reform, Recovery, and Development Plan* (2003–06), and the Bank's broader *Pacific Regional Strategy* which has a focus on (1) strengthening government capabilities, and (2) improving incentives for the private sector. The Bank's involvement in the Solomon Islands is in the following areas:

- **National Planning**. The Bank is assisting the Department of National Planning and Aid Coordination in identifying economic priorities to feed into the successor of the current *National Economic Reform, Recovery, and Development Plan*.

- **Health Sector**. The IDA-funded (US$4.0 million) Health Sector Development Project approved in mid-2000 is helping address some of the challenges in the sector through the strengthening of the reproductive health and malaria programs, the testing of new approaches, and through improved planning, management and monitoring. The Bank is now working on the development of a broader health sector support program together with AusAID, expected to involve joint IDA and AusAID financing.

- **Education Sector**. The government has launched a new education strategy and is developing a sector-wide approach to education planning and financing with support from NZAid and the EU. The Bank is providing selected policy inputs into this process, drawing on the lessons of such approaches elsewhere.

- **Energy Supply**. The Bank is supporting government's efforts to improve the efficiency of the energy sector by providing technical assistance for the financial restructuring of the Solomon Islands Electricity Authority (SIEA), regulatory reform and capacity building, as well as to explore options to improve rural access and service delivery in remote areas. Given the linkages, this work is also addressing the water utility (Solomon Islands Water Authority). Subject to progress on the planned reforms, use of IDA funds may be used to catalyze investment in the energy sector (e.g., PPP options). The Bank has also included the Solomon Islands in a regional renewable energy project.

- **Rural Growth**. The Bank is working with the EC and AusAID to prepare a rural sector strategy to diversify and increase rural income-generating opportunities as the basis for stronger and more inclusive growth. A follow-up IDA operation is envisaged, in cooperation with other donors active in the sector.

- **Telecommunications Sector**. The Bank is providing technical assistance to the government to examine ways to improve the competitiveness of the sector to reduce telecommunication costs and improve the service quality and coverage.

- **Foreign and Domestic Investment**. The Foreign Investment Advisory Service (FIAS) has provided assistance to the government for the preparation of new foreign investment legislation and is assisting with a review of investment incentives and administrative barriers to business.

Solomon Islands: IDA Lending Operations (as of June 2006)		
	Disbursed (USD million)	Undisbursed (USD million)
Health Sector Development Project	3.55	0.85

Contact person: Rajashree Paralkar, Country Program Coordinator, rparalkar@worldbank.org.

APPENDIX V: SOLOMON ISLANDS—RELATIONS WITH THE ASIAN DEVELOPMENT BANK
(As of July 2006)

Since joining AsDB in 1973, Solomon Islands has received 16 loans for a total amount of US$79.3 million, and 58 technical assistance (TA) projects for a total amount of US$13.6 million. The last AsDB loan was approved in 2000 to rehabilitate critical basic infrastructure damaged by the civil strife. This loan, along with other country operations, was temporarily suspended between February 2002 and September 2003, due to security concerns and debt servicing arrears. Country relations have normalized since. However, in agreement with the government, the AsDB will provide no new loans to the country until public finances have stabilized. Current assistance is provided entirely on grant basis. The Solomon Islands is eligible for Asian Development Fund (ADF) grants introduced to effectively promote development in countries that are very poor, heavily indebted, or in a post-conflict situation. The 2005–2006 ADF allocation for the Solomon Islands succeeded in catalyzing substantial bilateral grant cofinancing for the improvement of rural roads.

AsDB's ongoing country strategy—guided by the government's *National Economic Recovery, Reform, and Development Plan*, and AsDB's *Pacific Strategy 2005–2009*—seeks to achieve rapid, pro-poor, private sector-led economic growth, and focuses on improving transportation infrastructure and services and enabling business environment. Capacity development and the promotion of good governance are cross-cutting priorities. AsDB currently has five ongoing TA projects in the areas of institutional strengthening of the Ministry of Infrastructure and Development, inter-island transportation, state-owned enterprise reform and private sector participation, and business law reform. TA for secured transactions reform is being prepared. In early 2006, the scope of the AsDB's ongoing Post-Conflict Emergency Rehabilitation Project (PCERP) was significantly expanded, with support of Australia and New Zealand. The Country Strategy and Program Update (CSPU 2005-2006) can be found at www.adb.org/Documents/CSPs/SOL/2004/default.asp, and a new CSPU 2007–2009 is being prepared.

AsDB's Pacific Liaison and Coordination Office, established in 2005 in Sydney, is responsible for country programming, project implementation and administration, supported by the Pacific Operations Division in Manila.

Loans, Approvals, and Disbursements, 1999–2005

(In millions of U.S. dollars)

	1999	2000	2001	2002	2003	2004	2005
Loan approvals	--	10.00	--	--	--	--	--
Loan disbursements	0.32	0.45	0.01	0.00	0.23	0.86	2.76
Cumulative loan amount approved (as of end-of-year)	69.31	79.31	79.31	79.31	79.31	79.31	79.31
Cumulative net effective loans (as of end-of-year)	64.65	54.30	64.05	64.83	65.87	66.31	79.31
Cumulative disbursements (as of end-of-year)	53.61	54.07	54.07	54.07	54.30	55.16	57.91

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APPENDIX VI: SOLOMON ISLANDS—POVERTY AND HUMAN DEVELOPMENT INDICATORS

Social indicators of poverty and human development remain low in the Solomon Islands. The country ranks 128 out of 177 countries in the United Nations Human Development Index, below all Pacific island countries, except Papua New Guinea. There are few recent poverty statistics, but anecdotal evidence suggests poverty remains high. However, the more extreme forms of poverty, such as malnourishment, have remained limited due to an abundant resource base, assured access to customary land tenure, and resilient social networks. This advantage is under pressure from a population growth rate that, at about 3.0 percent a year, is among the highest in the world.

Nonetheless, the Solomon Islands has achieved some progress in improving living conditions since independence despite falling per capita incomes. Prior to the civil conflict in 1999, sizable health and education expenditures (at 3–5 percent of GDP each) and high per capita aid inflows had helped underpin these improvements. Providing widespread and quality education to the very young population (45 percent under age 15) is a challenge. The primary education enrollment ratio is about 95 percent, although primary education is not compulsory. The enrollment ratio is only 30 percent in secondary education. Concerning health, malaria is rampant, with the highest rate of infection in the world outside of sub-Saharan Africa, and a third of the rural population lacks access to safe water.

The paucity of data makes an assessment of human development trends since 1999 difficult, but anecdotal evidence suggests that pro-poor services delivery is improving. The positive trend was likely either halted or reversed during the civil conflict. While the conflict sharply reduced agricultural production for market (due to the lack of security and transport services), this has recovered since mid-2003 and service delivery has been enhanced.

The aggregate social indicators mask large differences between urban and rural areas. The two main problems in the rural sector are the lack of essential public services such as health and education, and cash income due to difficulties in market access for rural products. While the urban areas have better social services and average incomes are higher, the urban poor face difficulties in securing employment and land for residence.

The government plans to incorporate the Millennium Development Goals (MDGs) in its forthcoming National Development Strategy, and has committed to monitor progress towards them. Achieving the MDGs by 2015 is still possible, but remains a major challenge. Progress in some areas, such as reducing malaria incidence, maternal mortality, and ensuring environmental sustainability, has so far been inadequate.

Appendix VI
Table VI.1. Solomon Islands: Millennium Development Goals Progress

	1990	2000	Latest Data 2001–05	Target 2015
Goal 1: Eradicate Extreme Poverty and Hunger				
Prevalence of child malnutrition (percent of children under 5)	21	21	…	11
Goal 2: Achieve Universal Primary Education				
Net enrollment ratio in primary education	…	74	80	100
Goal 3: Promote Gender Equality				
Ratio of girls to boys in primary school (percent)	86	92	91	100
Ratio of girls to boys in secondary school (percent)	63	78	81	100
Proportion of seats held by women in national parliament (percent)	0	2	0	…
Goal 4: Reduce Child Mortality				
Under 5 mortality rate (per 1,000)	63	60	56	12
Infant mortality rate (per 1,000 live births)	38	36	34	25
Goal 5: Improve Maternal Health				
Maternal mortality ratio (per 100,000 live births)	…	130	142	…
Births attended by skilled health staff (percent of total)	…	85	87	…
Goal 6: Combat HIV/AIDS, Malaria and Other Diseases				
Incidence of tuberculosis (per 100,000 people)	134	73	93	…
Incidence of malaria (per 100,000 people)	45,000	15,172	19,600	less than 8,000
Goal 7: Ensure Environmental Sustainability				
Forest area (percent of total land area)	99	90.6	78	…
Nationally protected areas (percent of total land area)	…	0	0.3	…
CO2 emissions (metric tons per capita)	0.5	0.4	0.4	…
Access to an improved water source (percent of population)	…	71	70	100
Access to improved sanitation (percent of population)	…	30	31	…
Goal 8: Develop a Global Partnership for Development				
Fixed line and mobile telephones (per 1,000 people)	15	21	17	…
Personal computers (per 1,000 people)	…	38	43	…

Sources: World Bank, World Development Indicators and World Bank Human Development Indicators (http://devdata.worldbank.org/data-query/).

Appendix VI

Table VI.2. Solomon Islands: Social Indicators

	Latest Single Year				Same Region/Income Group	
	1970–75	1980–85	1990–95	1996–2004	East Asia & Pacific	Low-Income
POPULATION						
Total population, mid-year (thousands)	193	300	364	466	1,870	2,343
Growth rate (Percent annual average for period)	3.6	3.4	2.6	3.1	0.8	1.8
Urban population (percent of population)	9.1	12.4	15.0	17.0	38.2	30.6
Total fertility rate (births per woman)	7.1	6.2	5.0	4.1	2.0	3.7
INCOME						
GNI per capita (US$)	290	530	880	560	1,416	507
Consumer price index (1995=100)	8	20	64	139	...	...
Food price index (1995=100)	...	33	...	158	...	...
SOCIAL INDICATORS						
Public expenditure						
Health (percent of GDP)	...	...	…	4.5	1.9	1.5
Education (percent of GDP)	5.3	4.5	3.8	3.3	3.0	…
Social security and welfare (percent of GDP)	...	...		...	...	...
Net primary school enrollment rate						
(Percent of age group)						
Total	...	...	83.2	79.6	…	79
Male	...	...	89.1	80.0	…	…
Female	...	...	76.9	79.0	…	…
Access to an improved water source						
(Percent of population)						
Total	...	...	…	70	78	75
Urban	...	...	…	94	92	89
Rural	...	...	…	65	69	69
Immunization rate 1/						
(Percent under 12 months)						
Measles	...	...	68.0	78	82	66
DPT	...	46.0	69.0	71	86	67
Child malnutrition (percent under 5 years)	21	...	…	21	16	44
Life expectancy at birth						
(Years)						
Total	57	62	61	63	69	59
Male	56	61	60	62	68	57
Female	58	63	62	63	71	59
Mortality						
Infant (per 1,000 live births)	71	43	37	34	29	79
Under 5 (per 1,000 live births)	99	56	63	56	37	122
Adult (15-59)						
Male (per 1,000 population)	...	...	...	260	179	317
Female (per 1,000 population)	...	...	...	237	122	266
Maternal (modeled, per 100,000 live births)	...	...	...	142	117.0	681.0
Births attended by skilled health staff (percent)	...	...	85	85	91	...

Sources: World Bank, 2005 World Development Indicators.

1/ Immunization refers to children aged 12-23 months who received vaccinations before one year of age.

APPENDIX VII: SOLOMON ISLANDS—STATISTICAL ISSUES

The economic and financial database is poor, which significantly limits the staff's analysis, particularly for the real, fiscal, and external sectors. Only the monetary statistics are adequate for surveillance purposes. Although the rebuilding of the National Statistics Office (NSO) has commenced, the CBSI continues to publish highly summarized monetary and price data in its *Monthly Economic Bulletin* and data on all sectors in its *Quarterly Review* and *Annual Report*. There is a Solomon Islands page in *IFS,* but significant updating delays occur, particularly for the balance of payments (BOP), government finance, and national accounts statistics.

Real sector statistics

As the NSO has not produced national accounts data since 1994, the task of preparing GDP estimates was taken over by the CBSI. GDP estimates are severely hampered by data availability and quality, and rely on limited sources (primarily commodity exports and employment estimates). No breakdown of GDP by expenditure categories exists. A February 2006 PFTAC mission reviewed the 2005 GDP estimates and 2006 projections and concluded that unless the shortage of source data for GDP estimates is addressed, the quality of estimates would remain poor. The NSO reclaimed the task of producing the CPI (which currently applies only to Honiara) in August 2003, but the weights are outdated. Data on production of major export commodities are reported monthly. Limited data on total employment can be obtained from the National Provident Fund. Wage data are not produced.

Monetary and financial statistics

The CBSI publishes monthly monetary statistics in summary form and provides more detailed data in its quarterly and annual reports. The monetary and financial statistics from the CBSI are used to update the *IFS* country page. After some disruption during the civil conflict, the CBSI recently resumed direct reporting to STA. A November 2005 expert mission, during a PFTAC monetary statistics workshop held in Fiji, reviewed the monetary statistics compilation procedures and provided training and a work plan for the CBSI to comply with the methodology of the *Monetary and Financial Statistics Manual* and to report data using the standardized report forms (SRFs), introduced in October 2004.

Government finance statistics

The Ministry of Finance (MOF) started monthly press releases on budget outturns in August 2003. However, its expenditure and financing data are not consistent with the GFS methodology, and historical data seem unreliable given the breakdown of accounting mechanisms and large expenditure arrears during the crisis. The NSO is developing a prototype GFS system, but problems exist in the coverage of the general government sector. In particular, data for provincial governments are unavailable and data for the state enterprises are currently being compiled. Except for direct budget support, the authorities do not collect disbursements information on grants or grant-financed development spending. The Ministry of Planning held meetings with donors in March and June 2006 to discuss the need for better information and have recently designed reporting forms to obtain data from donors. The installation of the Commonwealth Secretariat Debt Recording and Management System (CS-DRMS) database in the CBSI and MOF in March 2005 has improved the quality of official debt data. The MOF does not report annual GFS data for the *Government Finance Statistics Yearbook* (*GFSY*).

External sector statistics

The CBSI estimates partial quarterly BOP data based on cash foreign exchange transactions (FET) reported through the banking system, which are available with a three-month lag. Such data are deficient in detail and coverage. A February 2006 PFTAC mission noted a significant deterioration in the net errors and omission item. In addition, “other items” in several categories have increased significantly, indicating a deterioration of data quality. Surveys of enterprises on service and financial flows are conducted to collect supplementary information, but the response rates are very low. The Customs Department has recently started to publish merchandise trade data but initial analysis shows that there are still missing records. A mission from New Zealand in February 2006 began to install PCTrade software in the Customs Department to facilitate the NSO’s use of Customs data to prepare trade statistics.

Remedial Measures

The NSO is gradually resuming data collection and publication responsibilities. A PFTAC GDDS mission in February 2004 concluded that rebuilding the statistical system will require extensive technical assistance and external funding. Following its recommendations, a new government statistician was appointed in 2004 and a long-term adviser (18 months)—funded by AusAid and NZAid—took up his post in April 2005.

The NSO is currently conducting a Household Income and Expenditure Survey (HIES), after which it plans to rebase the CPI, and construct national headline and underlying CPIs, national accounts and poverty data by early 2007. The NSO has conducted business surveys on employment and financial data covering 2003 and 2004, the results of which are expected in the second half of September 2006. Preparations for a Demographic and Health Survey started in mid-2006. The Ministry of Tourism, in coordination with NSO, has started a project to measure tourism spending. A population census is planned for late 2009, with preparations expected to commence in 2007. The CBSI has requested PFTAC assistance to improve the quality of their BOP and national accounts. The NSO has requested PFTAC’s assistance to enhance government finance statistics, and the Secretariat of the Pacific Community’s (SPC) assistance to rebase the CPI.

The NSO has prepared, with PFTAC’s assistance, a prototype of government finance statistics tables based on recurrent revenue and expenditure data provided by the Ministry of

Finance. However, this work is still preliminary and hindered by the dearth of aid and development spending information. Audits of state enterprise accounts are currently under way and, once completed, should provide a better picture of public sector finances.

The February 2006 PFTAC mission identified a number of statistical issues that still require attention, including: (i) ensuring that compilation methodologies are applied consistently for GDP and BOP data; and (ii) collecting prices for additional items in the CPI, particularly on diesel fuel and telecommunications products. In the area of the BOP, there is a need to: (i) increase the response rate to enterprise surveys to reduce reliance on FET records; (ii) investigate alternative data to supplement FET data, including the use of official transfers data from the government's financial accounts; and (iii) review the Customs merchandise data for use in the BOP. To address the latter issues, PFTAC plans to send a short-term BOP expert in the second half of June 2006.

The effectiveness of the NSO continues to be hampered by weak technological skills among its staff and low survey response rates, which it is seeking to address through tougher penalties under the Statistics Act.

Solomon Islands: Table of Common Indicators Required for Surveillance
(As of JULY 31, 2006)

	Date of latest observation	Date received[7]	Frequency of Data[8]	Frequency of Reporting[8]	Frequency of publication[8]
Exchange Rates	July 2006	July 2006	D	M	M
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	July 2006	July 2006	W	M	M
Reserve/Base Money	May 2006	June 2006	M	M	M
Broad Money	May 2006	June 2006	M	M	M
Central Bank Balance Sheet	May 2006	June 2006	M	M	M
Consolidated Balance Sheet of the Banking System	May 2006	June 2006	M	M	M
Interest Rates[2]	July 2006	July 2006	W	M	M
Consumer Price Index	May 2006	June 2006	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3] – Central Government	December 2005	April 2006	A	A	A
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government	NA	NA	NA	NA	NA
Stocks of Central Government and Central Government-Guaranteed Debt[4]	December 2005	March 2006	A	A	A
External Current Account Balance[5]	March 2006	June 2006	Q	Q	Q
Exports and Imports of Goods and Services[5]	March 2006	June 2006	Q	Q	Q
GDP[6]	December 2005	May 2006	A	A	A
Gross External Debt[9]	December 2005	March 2006	A	A	Upon Request

[1] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
[2] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
[3] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[4] Including currency and maturity composition.
[5] Detailed BOP data derived from FET through the banking system are available on a quarterly basis with a 3-month lag.
[6] The most recent official data are for 1994, but the central bank has produced real production estimates through 2005.
[7] Including data received following specific requests by Fund staff.
[8] Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A); and Not Available (NA).
[9] Data on private sector debt is not available.

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IMF Executive Board Concludes 2006 Article IV Consultation with the Solomon Islands

On October 4, 2006, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with the Solomon Islands.[1]

Background

The economic recovery and stability prevailing since the 2003 intervention of the Regional Assistance Mission to the Solomon Islands (RAMSI) has continued. Per capita real GDP growth has remained respectable, inflation is under control, and budget discipline has been maintained. Thanks to official development assistance (ODA) and private foreign direct investment (FDI) mainly in two new large projects, international reserves have continued to increase.

Real GDP growth was 5 percent in 2005, about 2¼ percentage points above the Pacific Islands Countries' (PICs) average, driven by agriculture, fishing, and fiscal stimulus, with logging still over four times the sustainable level. In 2006, logging is not anticipated to contribute for the first time since 2001, but real GDP growth is still projected to exceed 5 percent, driven by agriculture, mainly the start of palm oil production, and services. Inflation ended in the high single digits in 2005, reflecting high oil prices, expatriates' demand, and rapid private credit growth. Inflation is expected to be broadly unchanged in 2006, thus remaining about 2 percent above the PICs' average.

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[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities.

The 2006 budget of the central government envisages a shift to a deficit of ¾ percent of GDP from a 2¼ percent surplus in 2005, due to a 21 percent real increase in goods and services purchases and domestically financed development spending. But, the outturn is projected to be about 1 percentage point of GDP better than budgeted, with higher spending in low-priority areas (wage bill, tertiary scholarships, and representation) likely to be more than offset by revenue overperformance and investment underspending.

With soaring fuel and investment-related imports, the current account swung into an 11 percent of GDP deficit in 2005. However, official international reserves climbed to US$95 million (5¼ months of projected 2006 imports) due to robust ODA and FDI flows—mainly by the palm oil company and for the rehabilitation of a gold mine. The current account deficit is projected to widen in 2006, owing to higher oil prices and investment-related imports. But, continued strong ODA and FDI flows are expected to keep reserves above 5 months of imports.

Reserve money growth eased reflecting a moderation in net foreign assets growth in 2005, while broad money increased by 28 percent as the remonetization of the economy continued. Private sector credit rebounded strongly from a low base, growing 50 percent in real terms, reducing banks' excess reserves to 36 percent of deposits from 40 percent at end-2004. The growth of all monetary aggregates is expected to moderate in 2006.

Although the economy has performed well in the past three years, structural reforms remain essential to raise the prospects of sustainable growth, reduce poverty, and lessen the economy's vulnerability to shocks. Progress on this front has been mixed. Logging duty exemptions have been curtailed and tax exemptions guidelines have been issued. The Foreign Investment Bill has been passed and is now in effect. However, further reforms are urgent in the area of governance, state-owned enterprises, infrastructure, and business environment.

Executive Board Assessment

Executive Directors commended the authorities for maintaining macroeconomic stability and noted that near-term growth prospects are reasonably favorable. Looking ahead, Directors underscored the need to promote new sources of growth to raise living standards, particularly in light of the unsustainable pace of logging activities. Given the deep-rooted obstacles to private investment, weak institutions, and rapid population growth, this formidable task will require continued acceleration of the structural reform agenda and the maintenance of financial stability.

Directors encouraged the authorities to craft the 2007–10 national development strategy into the main vehicle for policy formulation and aid coordination, and called on the authorities to incorporate all projects and programs in this strategy, including those run by donors, and to set up a system to track aid delivery. Directors underscored that backing the strategy with a realistic medium-term framework and linking it to the budget will be instrumental for its effective implementation.

Directors welcomed the authorities' commitment to remain within the budget in 2006 and encouraged them to refrain from spending unutilized investment project appropriations and revenue overperformance. Over the medium term, they emphasized that budget consolidation is necessary in light of the limited domestic and external financing sources and the need to reduce the high public debt. Directors stressed the need to replace declining logging and import revenues with domestic taxes, improve expenditure quality, and reorient spending from the wage bill toward infrastructure, especially transport and communications.

Directors welcomed the introduction of tax exemption guidelines and the gazetting of the new foreign investment bill. They urged the authorities to accelerate tax reform to widen the base and reduce cascading, and public financial management reforms to ensure better governance in the use of public funds and aid flows. Directors considered that the poor performance of state-owned enterprises (SOEs), especially in the utilities sector, required urgent attention and recommended a comprehensive restructuring to improve service delivery and their financial position. They also cautioned that fiscal decentralization should be approached very carefully, as it would likely weaken fiscal discipline under present circumstances.

Directors agreed that the risk of debt distress remains high given the sizable public debt level, the country's vulnerability to shocks, and the possible increase in contingent liabilities given the weak finances of SOEs and provincial governments. They welcomed the authorities' progress in regularizing debt and the government's policy of no new borrowing, which should apply to all public entities, including SOEs, until the public debt profile has improved substantially.

Directors endorsed the current exchange rate policy, and agreed that downward pressure on the exchange rate should not be resisted. They were of the view that competitiveness appears adequate, in light of the prospects for nontimber exports, including agricultural and mineral products. Directors supported efforts to develop the central bank's inflation forecasting ability, which they viewed as critical in ensuring a timely monetary policy response should inflation pressures intensify or reserves come under pressure.

Directors agreed that the commercial banks appear sound. To strengthen the overall financial sector, they recommended the liquidation of the troubled Development Bank of Solomon Islands. Directors encouraged the continued use of commercially-based mechanisms to broaden access to banking services and credit, and the development of conservative investment guidelines to enable the National Provident Fund (NPF) to improve its profitability by investing abroad. They added that approving the new NPF bill would enhance the institution's governance.

Directors regretted that the weak statistical database hampers surveillance, but were encouraged by measures underway to improve real and external sector data.

Solomon Islands: Selected Economic Indicators, 2001–06

Nominal GDP (2005): US$298 million
Population (2005): 482,575
GDP per capita (2005): US$618
Quota: SDR 10.4 million

	2001	2002	2003	2004	2005 Est.	2006 Proj.
Growth and prices (percentage change)						
Real GDP	-9.0	-1.6	6.4	8.0	5.0	5.3
Of which: Nontimber	-9.4	-1.9	4.6	5.5	4.5	5.9
CPI (period average)	7.6	9.3	10.0	6.9	7.3	8.2
CPI (end of period)	6.5	15.3	3.7	7.6	8.4	9.2
Per capita GDP (in US$)	637	514	507	565	618	662
Central government operations (percent of GDP)						
Total revenue	23.5	18.7	37.0	47.5	54.5	53.7
Recurrent revenue	15.3	16.1	19.2	26.0	27.7	29.8
Grants	8.2	2.6	17.8	21.5	26.8	23.9
Total expenditure 1/	36.2	29.6	39.0	39.5	52.2	53.1
Recurrent expenditure	27.3	26.4	23.6	22.2	25.1	27.9
Development expenditure	8.9	3.2	15.4	17.2	27.0	25.2
Recurrent balance 2/	-11.8	-9.9	-0.6	8.1	3.9	3.1
Overall balance 3/	-12.7	-10.9	-1.9	8.0	2.3	0.6
Foreign financing (net)	5.0	3.8	0.2	-0.9	2.0	1.2
Domestic financing (net)	-1.4	-2.9	-8.8	-6.5	-2.3	-0.8
Other	8.5	8.9	9.8	-2.3	-4.3	-1.0
Stock of expenditure arrears (in percent of GDP, end of period) 4/	8.9	12.0	14.7	7.8	4.5	2.5
Central government debt (percent of GDP) 5/	94.1	113.3	120.1	90.1	80.0	69.9
Domestic	45.1	46.7	50.6	29.6	25.8	20.0
External	49.0	66.6	69.5	60.6	54.2	50.0
External debt (in US$ millions, end of period)	134.3	151.6	160.8	160.7	161.6	164.0
External debt service to exports of GNFS (accrual basis)	8.1	10.3	9.3	5.9	7.2	5.2
Monetary and credit (percentage change, end-year data)						
Net foreign assets	-31.8	30.2	106.4	111.0	23.7	7.6
Net domestic assets	-4.4	-4.8	-11.0	-60.4	50.5	65.4
Net domestic credit	-7.2	11.0	-0.7	-36.1	37.5	30.2
Credit to private sector	-21.8	12.2	26.1	10.6	62.9	30.2
Broad money	-13.2	4.0	26.0	28.1	27.7	17.8
Interest rate (3-month t/bill rate, average) 6/	8.9	8.3	5.8	6.0	3.5	3.5
Balance of payments (US$ millions, unless otherwise indicated)						
Exports, f.o.b	47.1	57.8	74.2	96.7	102.5	116.3
Imports, c.i.f.	-90.6	-62.3	-85.2	-98.7	-143.7	-182.4
Current account	-35.1	-16.3	2.9	32.3	-32.3	-51.9
(Percent of GDP)	-12.8	-7.1	1.3	12.2	-10.8	-15.8
Capital account	17.2	6.3	11.1	8.1	46.3	54.7
Overall balance (accrual)	-17.9	-10.0	14.0	40.5	14.1	2.8
Gross official reserves (US$ millions, end of period)	18.5	17.5	36.0	79.0	94.6	98.2
(in months of next year's imports of GNFS)	2.8	2.1	3.6	5.5	5.3	5.3
Exchange rate (SI$/US$, end of period) 6/	5.56	7.46	7.49	7.51	7.58	7.60
Real effective exchange rate (period average, 2000=100)	109.2	90.8	78.5	77.3	83.1	83.1
Nominal effective exchange rate (period average, 2000=100)	103.2	80.1	64.0	59.6	60.6	...

Sources: Data provided by the authorities; and IMF staff estimates.

1/ Expenditures are presented on an accrual basis.
2/ Includes recurrent budget grant support.
3/ Calculated from above-the-line data.
4/ Includes interest arrears.
5/ Includes arrears.
6/ 2006 column reflects data for end-June.