



Report and Recommendation of the President to the Board of Directors

INTERNAL

Project Number: 55011-001
November 2022

Proposed Programmatic Approach and Policy- Based Loan and Grant for Subprogram 1 Solomon Islands: Supporting Fiscal and Economic Recovery Program

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Asian Development Bank

CURRENCY EQUIVALENTS

(as of 25 October 2022)

Currency unit	–	Solomon Islands dollar/s (SI\$)
SI\$1.00	=	\$0.12
\$1.00	=	SI\$8.19

ABBREVIATIONS

ADB	–	Asian Development Bank
CBSI	–	Central Bank of Solomon Islands
COVID-19	–	coronavirus disease
GDP	–	gross domestic product
IMF	–	International Monetary Fund
IRD	–	Inland Revenue Division
JPRG	–	Joint Policy Reform Group
JPRM	–	joint policy reform matrix
LTO	–	Large Taxpayer Office
MOFT	–	Ministry of Finance and Treasury
MTDMS	–	medium-term debt management strategy
PFM	–	public financial management
SIICAC	–	Solomon Islands Independent Commission Against Corruption
SOE	–	state-owned enterprise
TA	–	technical assistance
VAT	–	value-added tax
WHO	–	World Health Organization

NOTE

In this report, “\$” refers to United States dollars, unless otherwise stated.

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PROGRAM AT A GLANCE

1. Basic Data		Project Number: 55011-001	
Project Name	Supporting Fiscal and Economic Recovery Program (Subprogram 1)	Department/Division	PARD/PLCO
Country	Solomon Islands	Executing Agency	Ministry of Finance and Treasury
Borrower	Solomon Islands		
Country Economic Indicators	https://www.adb.org/Documents/LinkedDocs/?id=55011-001-CEI		
Portfolio at a Glance	https://www.adb.org/Documents/LinkedDocs/?id=55011-001-PortAtaGlance		
2. Sector		ADB Financing (\$ million)	
✓ Public sector management	Economic affairs management		4.000
	Public expenditure and fiscal management		4.000
Finance	Finance sector development		2.000
		Total	10.000
3. Operational Priorities		Climate Change Information	
✓ OP1: Addressing remaining poverty and reducing inequalities		GHG reductions (tons per annum)	0
✓ OP2: Accelerating progress in gender equality		Climate Change impact on the Project	Low
✓ OP6: Strengthening governance and institutional capacity			
		ADB Financing	
		Adaptation (\$ million)	0.000
		Mitigation (\$ million)	0.000
		Cofinancing	
		Adaptation (\$ million)	0.000
		Mitigation (\$ million)	0.000
Sustainable Development Goals		Gender Equity and Mainstreaming	
SDG 1.4, 1.a		Some gender elements (SGE)	✓
SDG 5.5, 5.a			
SDG 8.10			
SDG 16.6			
SDG 17.1, 17.17			
		Poverty Targeting	
		General Intervention on Poverty	✓
4. Risk Categorization:		Low	
5. Safeguard Categorization		Environment: C Involuntary Resettlement: C Indigenous Peoples: C	
6. Financing			
Modality and Sources		Amount (\$ million)	
ADB		10.000	
Sovereign Programmatic Approach Policy-Based Lending (Grant): Asian Development Fund		5.000	
Sovereign Programmatic Approach Policy-Based Lending (Concessional Loan): Ordinary capital resources		5.000	
Cofinancing		32.955	
Government of Australia - Programmatic Approach Policy-Based Lending (Grant) (Not ADB Administered)		1.254	
Government of New Zealand - Programmatic Approach Policy-Based Lending (Grant) (Not ADB Administered)		1.701	
World Bank - Programmatic Approach Policy-Based Lending (Grant) (Not ADB Administered)		26.500	
World Bank - Programmatic Approach Policy-Based Lending (Loan) (Not ADB Administered)		3.500	
Counterpart		0.000	
None		0.000	
Total		42.955	
Currency of ADB Financing: US Dollar			

I. THE PROPOSAL

1. I submit for your approval the following report and recommendation on (i) a proposed programmatic approach for the Supporting Fiscal and Economic Recovery Program, (ii) a proposed policy-based loan, and (iii) a proposed grant to Solomon Islands for subprogram 1 of the Supporting Fiscal and Economic Recovery Program.

2. The program will help Solomon Islands implement reforms to support a resilient economic and fiscal recovery following the impact of the coronavirus disease (COVID-19) pandemic. The program comprises two subprograms that will support the government's ongoing actions to (i) promote tax reform for domestic revenue mobilization, (ii) strengthen public financial management (PFM) for fiscal resilience, and (iii) improve the enabling environment for private sector recovery. Program financing of \$20 million consists of a policy-based loan and grant of \$5 million each for subprogram 1 in 2022, and a policy-based loan and grant of \$5 million each for subprogram 2 indicatively in 2024. The program builds on reforms supported by previous Asian Development Bank (ADB) programs and complements financial support provided for COVID-19 response.¹ The program was developed in collaboration with the World Bank; the governments of Australia, Japan, and New Zealand; and the European Union; and in close and regular consultation with the International Monetary Fund (IMF). The World Bank and the governments of Australia and New Zealand have provided parallel cofinancing not administered by ADB (para. 30).

II. PROGRAM AND RATIONALE

A. Background and Development Constraints

3. **Development context.** ADB recognizes Solomon Islands as a small island developing state in a fragile and conflict-affected situation.² Its narrow economy is based on exporting natural resources. The forestry industry, which supplies about 22% of tax revenue, faces decline as resources are being depleted.³ The country is geographically scattered, consisting of many islands, with large infrastructure gaps. Remoteness from markets, human capital shortages, and vulnerability to external shocks constrain economic development. Solomon Islands had the lowest income per capita among Pacific developing member countries in 2021.⁴

4. **Sound macroeconomic management.** Despite the challenges, annual gross domestic product (GDP) growth averaged 3.3% during 2016–2019. Before the pandemic, Solomon Islands made a concerted effort to improve its macroeconomic resilience. In 2018, the government initiated a fiscal consolidation program comprising expenditure reductions, more conservative revenue estimates, revenue measures including an extension of the withholding tax regime and an increase in excise taxes on tobacco and alcohol, and provisions to clear accumulated domestic

¹ ADB. 2018. [Solomon Islands: Improved Fiscal Sustainability Reform Program](#). Manila; ADB. 2016. [Solomon Islands: Economic Growth and Fiscal Reform Program](#). Manila; ADB. 2013. [Solomon Islands: Economic and Financial Reform Program](#). Manila; ADB. 2011. [Solomon Islands: Economic Recovery Support Program \(Subprogram 2\)](#). Manila; and ADB. 2010. [Solomon Islands: Economic Recovery Support Program \(Subprogram 1\)](#). Manila. ADB provided \$5 million under the Pacific Disaster Resilience Program during the COVID-19 outbreak in 2022, and \$20 million under the COVID-19 Rapid Response Program in 2020. ADB. 2020. [Pacific Disaster Resilience Program](#). Manila; and ADB. 2020. [Solomon Islands: COVID-19 Rapid Response Program](#). Manila.

² ADB. 2021. [Fragile and Conflict-Affected Situations and Small Islands Developing States Approach](#). Manila.

³ Government of Solomon Islands. 2022. *2022 Financial Policy Objectives and Strategies Budget Paper: Volume 1*. Honiara. Logs and timber accounted for about 70% of goods exports from 2015–2020 and fell to 59% in 2021.

⁴ Gross national income per capita using both the Atlas and purchasing power parity methods. World Bank. [World Development Indicators](#) (accessed 15 September 2022).

payment arrears to private sector contractors.⁵ The budget was close to balance (averaging a surplus of 0.1% of GDP) in 2018–2019, compared with an average deficit of more than 3.0% of GDP in 2016–2017.⁶

5. **Economic shocks.** The government's public health response to the COVID-19 pandemic, including closing the borders, prevented an outbreak of the disease until 2022.⁷ However, the economy was hit hard by trade and travel disruptions and the effects of Cyclone Harold in 2020, leading to a 3.4% decline of GDP in 2020 (Table 1). The social unrest in the capital, Honiara, in 2021, contributed to a further 0.5% decline of GDP in 2021.⁸ The government implemented a fiscal stimulus package aimed at protecting jobs and stabilizing the economy. It also reprioritized expenditures to reduce nonessential spending. Revenue and grants fell to 31.5% of GDP in 2021 from 39.4% in 2018, while expenditure was contained at 35.2% of GDP in 2021, down from 38.5% in 2018. The fiscal deficit averaged 3.6% of GDP in 2020–2021 reflecting the decline in tax revenue and higher nonwage recurrent spending to support the economy. The Central Bank of Solomon Islands (CBSI) pursued an accommodative monetary policy stance. The IMF noted that the supportive fiscal and monetary policy measures to respond to COVID-19 were appropriate.⁹

Table 1: Selected Economic and Fiscal Indicators
(% of GDP, unless otherwise indicated)

Item	2018	2019	2020e	2021e	2022p	2023p	2024p
Real GDP growth (% change)	2.7	1.7	(3.4)	(0.5)	(4.2)	3.0	2.2
Inflation (% change in CPI)	3.5	1.6	3.0	(0.2)	4.0	4.0	3.2
Total revenue and grants	39.4	31.8	32.4	31.5	32.3	32.6	32.5
Domestic revenue	29.7	25.6	23.5	24.1	22.4	25.1	26.0
of which: tax revenue	25.5	21.7	19.9	20.6	19.1	22.1	23.3
of which: log export duties	6.1	4.4	3.8	3.2	2.8	2.8	2.6
Grants	9.7	6.2	8.8	7.3	9.9	7.5	6.5
Total expenditure	38.5	32.6	35.9	35.2	39.1	36.9	36.5
Recurrent expenditure	28.8	24.8	29.5	28.5	30.9	27.0	27.3
Development expenditure	9.8	7.8	6.4	6.7	8.2	10.0	9.2
Overall balance	0.9	(0.8)	(3.5)	(3.8)	(6.8)	(4.3)	(4.0)
Public debt	7.9	7.9	11.7	14.8	22.3	25.8	28.5
GDP (\$ million, current prices)	1,615.5	1,619.8	1,536.8	1,608.6	1,549.7	1,645.3	1,713.0

() = negative, CPI = consumer price index, e = estimate, GDP = gross domestic product, p = projection.

Sources: Government of Solomon Island budget documents, and International Monetary Fund and Asian Development Bank estimates.

6. **Macroeconomic outlook.** GDP is projected to fall by 4.2% in 2022 because of COVID-19 community transmission, containment restrictions, and damage from the social unrest in 2021. Economic recovery is expected from the second half of 2022 as restrictions ease and the border reopens. GDP growth is projected at 3.0% in 2023.¹⁰ ADB assesses the general direction of macroeconomic policies to be satisfactory. The fiscal deficit is projected to widen to 6.8% of GDP in 2022 due to revenue shortfalls as spending rises to mitigate the impact of the negative shocks.¹¹

⁵ ADB supported these measures under ADB. [Solomon Islands: Improved Fiscal Sustainability Reform Program](#).

⁶ Sector Assessment (Summary): Public Sector Management (accessible from the list of linked documents in Appendix 2).

⁷ Solomon Islands had 21,544 confirmed cases and 153 deaths as of 6 October 2022. [World Health Organization COVID-19 dashboard](#) (accessed 31 October 2022). Of those aged 12 years and older, 40% were vaccinated with two doses and 60% with just one dose, according to the [PacificDataHub](#) (accessed 31 October 2022).

⁸ The protests and riots in Honiara caused economic damage equivalent to about 5.4% of GDP.

⁹ IMF. 2022. *Solomon Islands 2021 Article IV Consultation-Press Release; Staff Report; and Statement by the Executive Director for Solomon Islands*. Washington, DC.

¹⁰ ADB. 2022. *Asian Development Outlook 2022 Update: Entrepreneurship in the Digital Age*. Manila.

¹¹ Fiscal measures to cut the duty and sales tax on fuel to help mitigate inflationary pressures are planned to be temporary and conclude in December 2022.

But it is projected to narrow to 4.0% in 2024 with increased revenue effort and recurrent expenditure controls (footnote 6). Although public debt is projected to rise from 14.8% of GDP in 2021 to 28.5% in 2024 to finance infrastructure investment and fiscal deficits, this is below the government's debt limit of 35.0% of GDP, which the IMF assesses as appropriate. Solomon Islands is at *moderate* risk of debt distress (footnote 9). The CBSI is expected to continue accommodative monetary policy in the near term as economic activity regains momentum. The outlook is subject to downside risks from external shocks and disasters.¹² Solomon Islands faces constraints that can undermine fiscally sustainable, private sector-led recovery (paras. 7–11).

7. **Inefficiencies in revenue mobilization.** The current tax system of Solomon Islands is complex and expensive to administer. It relies on high rates applied to a narrow base, which discourages compliance. There is no overarching tax administration legislation, and individual taxes are subject to different procedures, time frames, and penalties for taxpayers, contributing to cumbersome processes for taxpayers and an unnecessary administrative burden for the Inland Revenue Division (IRD) of the Ministry of Finance and Treasury (MOFT).¹³ High tax arrears indicate problems with taxpayers' compliance, and significant revenue is foregone in tax exemptions (footnote 9). Prior to COVID-19, tax revenue had not kept pace with nominal GDP growth.¹⁴ As revenues from logging decline, broadening the tax base and modernizing tax administration could help achieve a more sustainable revenue base to fund public services on which individuals and the private sector can rely. Getting the tax system right is important to support job creation and productive investment to underpin a resilient economic recovery.

8. The government embarked on a comprehensive three-stage review of the tax system in 2017. The first stage covers the broader tax administration framework and consumption taxes, the second covers income tax, and the third covers other types of tax. The rationale for starting with tax administration is to ensure a strong foundation on which to build the other tax reforms and to help ensure effective compliance once the other reforms are implemented. The IMF has noted that modernizing tax administration and introducing value-added tax (VAT) are important first steps toward comprehensive tax reforms (footnote 9). Modernizing and simplifying tax administration could enhance the business environment. Reforms to broaden the tax base provide an opportunity to lower the high tax rates, while maintaining revenue collections.

9. **Weaknesses in public financial management.** Economic shocks have increased the government's liquidity pressures and exposed PFM challenges. The low capacity and high turnover of financial controllers has spillover effects throughout the PFM system given their integral role leading the preparation of annual budget submissions for government agencies, midyear budget revisions, and annual financial statements.¹⁵ Weak budget planning and commitment controls result in regular budget virements (transfers) to manage unplanned expenditure. This shifts the MOFT's resources toward low-level process-oriented tasks and away from more strategic tasks such as providing fiscal policy advice to government. Poor targeting of government expenditure can undermine the economic and fiscal recovery and undercut improvements in gender equality. Procurement planning, transparency, and efficiency remain a challenge and weak oversight of procurement processes poses a risk for corruption. Although the PFM Act 2013 provides a solid legislative framework, there are incomplete regulations and institutions to guide budget planning and procurement. The IMF noted that finalizing regulations under the act and improving expenditure control were immediate priorities (footnote 9). The lack

¹² Inflation is projected at 4.0% in 2022 and 2023 mainly because of high global oil prices.

¹³ The IRD is responsible for administering tax legislation and collecting tax revenue.

¹⁴ The ratio of tax revenue to GDP declined from 24.9% in 2016–2017 to 23.6% in 2018–2019.

¹⁵ Financial controllers are public accounting officers located across central and line ministries.

of an up-to-date medium-term debt management strategy (MTDMS) means that debt financing strategies are unclear, creating debt sustainability risks.

10. **Barriers to private sector recovery.** Limitations in the regulatory and legal framework governing the finance sector, state-owned enterprises (SOEs), and the Solomon Islands Independent Commission Against Corruption (SIICAC) can undermine a resilient private sector recovery.¹⁶ The absence of an electronic funds transfer system among banks means that transactions among businesses and government rely on inefficient manual payment methods. This limits the CBSI's oversight and adds to finance sector risks. An inefficient financial and payments system can have negative spillovers on the economy. Financial inclusion remains low, particularly for women.¹⁷ The laws supporting the supervision and regulation of financial institutions need to be updated to reflect international best standards, new technology, and the expansion of nonbank institutions. In response to the IMF's recommendation to strengthen the supervisory and regulatory framework for the financial system, the CBSI commenced a review of the Financial Institutions Act 1998. Solomon Islands also launched its third National Financial Inclusion Strategy, 2021–2025, which calls for policy and legal reforms to establish an inclusive national payments system, extend the reach and quality of digital financial services, and strengthen supervisory functions in financial services, among other objectives.¹⁸

11. Although SOEs are responsible for delivering essential infrastructure services that the private sector relies on, the legislative framework for SOEs has not been updated to align with the SOE Ownership Policy, approved by cabinet in 2018.¹⁹ Women are underrepresented in many areas of business leadership.²⁰ Weak accountability and integrity institutions, combined with governance challenges in natural resource management, and limited income-earning opportunities, pose risks to corruption. In 2018, Parliament passed landmark legislation to establish the SIICAC as an independent body for preventing, investigating, and prosecuting corruption offenses.²¹ Commissioners were appointed (including two women) to lead the SIICAC in 2019 and staff recruitment has commenced. However, to tackle corruption effectively, the SIICAC requires reliable funding and a sound regulatory framework to support its operations. In a 2021 Transparency International study, 90.0% of respondents reported that corruption in the business sector was a big problem in Solomon Islands.²² This was higher than the Pacific regional average of 56.0% and the highest in the 10-economy study, indicating the vital role that an integrity institution such as the SIICAC can play, once it is fully operationalized.

12. **Strategic alignment.** The program supports the National Development Strategy, 2016–2035, which targets sustained and inclusive economic growth and an improvement in the

¹⁶ The World Bank Worldwide Governance Indicators ranks Solomon Islands' regulatory quality at the 18.8th percentile in 2020, where 0 corresponds to the lowest rank and 100 corresponds to the highest rank among all economies. World Bank. [Worldwide Governance Indicators](#) (accessed 24 June 2022).

¹⁷ Active bank account users reached 149,917 in 2020, of whom 38.2% were women. Central Bank of Solomon Islands. 2021. [Solomon Islands National Financial Inclusion Strategy 3 \(2021–2025\)](#). Honiara.

¹⁸ Central Bank of Solomon Islands. 2021. [Solomon Islands National Financial Inclusion Strategy 3 \(2021–2025\)](#). Honiara.

¹⁹ Government of Solomon Islands. 2019. [Solomon Islands SOE Ownership Policy](#). Honiara.

²⁰ In a 2021 study of business leadership in 14 Pacific countries, Solomon Islands had the lowest level of women's representation on boards at 11.0%, well below the regional average of 21.0%. The Solomon Islands sample included SOEs, industry associations, and private sector organizations. Pacific Private Sector Development Initiative. 2021. *Leadership Matters Benchmarking Women in Business Leadership in the Pacific*. Australia: ADB.

²¹ Parliamentary approval of the Anti-Corruption Act (2018) was supported by ADB. [Solomon Islands: Improved Fiscal Sustainability Reform Program](#).

²² Further, 63.0% of respondents in Solomon Islands reported that corruption in the business sector had increased in the past 12 months. Transparency International. 2021. [Global Corruption Barometer Pacific 2021: Citizens' View and Experiences of Corruption](#). Berlin.

environment for private sector development.²³ The government seeks to implement reforms for more sustainable revenues to fund critical public services and legislative and institutional changes to enhance the business environment. The program is aligned with the 2022 budget theme, “Building Our Resilience,” with a focus on building a resilient economy that withstands the impacts of COVID-19 (footnote 3). The program aligns with three operational priorities of ADB’s Strategy 2030: strengthening governance and institutional capacity, accelerating progress in gender equality, and addressing remaining poverty and reducing inequalities.²⁴ It is aligned with ADB’s Pacific Approach, 2021–2025, which supports inclusive growth and helps prepare for and respond to shocks.²⁵

B. Policy Reform, ADB’s Value Addition, and Sustainability

13. **Program description.** The program will help the government transition its priority from immediate crisis response to resilient economic and fiscal recovery by delivering three reform areas (paras. 15–24) that broadly align with the Joint Policy Reform Group (JPRG) reform areas.²⁶ Policy actions address the government’s priorities to respond to policy challenges intensified by COVID-19 and restore long-term growth.

14. Policy-based sovereign budget support is a suitable modality to support the government’s broad-ranging reform agenda (para. 12). The programmatic approach is appropriate because it (i) provides much-needed budget support, (ii) allows sequencing of policy actions in line with the government’s implementation capacity and medium-term reform agenda, and (iii) provides flexibility to respond to unforeseen constraints or opportunities while sustaining reform momentum. Subprogram 1 supports reforms to develop and introduce new policies, regulations, and legislation to strengthen tax collection and administration, debt management, PFM and procurement, supervision and regulation of financial institutions, SOE governance, and anticorruption efforts; and to establish and begin operationalizing new organizational units to promote economic and fiscal recovery (Appendix 1). Subprogram 2 will build on this by implementing, embedding, and expanding the policy and legislative decisions approved in subprogram 1 to help realize and sustain the development impacts. Subprogram 1 comprises ten prior actions, all of which have been completed. Ten policy actions have been identified for subprogram 2.

15. **Reform area 1: Tax reform for domestic revenue mobilization.** Under subprogram 1, in August 2022, Parliament passed the Tax Administration Act, which provides the legal basis to simplify the tax system and introduce a unified set of rules and penalties for all tax types. This act also provides the legal basis for tax authorities to improve their administrative systems. The act introduces a framework to replace the commissioner-imposed assessment system with taxpayer self-assessment, which will enable IRD resources to shift from low-level tax assessment tasks to compliance and risk-based audit. Under subprogram 2, the cabinet will approve and submit to Parliament for enactment an income tax bill that will build on and complement the frameworks and procedures established under the Tax Administration Act approved in subprogram 1.

²³ Government of Solomon Islands. 2016. [National Development Strategy, 2016–2035](#). Honiara.

²⁴ ADB. 2018. [Strategy 2030: Achieving a Prosperous, Inclusive, Resilient, and Sustainable Asia and the Pacific](#). Manila.

²⁵ ADB. 2021. [Pacific Approach, 2021–2025](#). Manila.

²⁶ The JPRG involves development partners and central government agencies collaborating to identify and monitor reforms, and coordinate technical assistance (TA) and budget support. The 2022 JPRG reform areas are as follows: (i) support domestic resource mobilization, (ii) strengthen PFM and promote sound fiscal policy, and (iii) promote good governance and economic growth.

16. Also under subprogram 1, the cabinet approved in March 2022 a policy that provides a solid basis for legislative reform to replace various taxes (including goods tax, sales tax, stamp duty, accommodation levy, and most customs duties) that have different rules and procedures with a unified, broad-based VAT. Based on the policy, the cabinet approved the drafting instructions in September 2022 that were submitted to the Attorney General's Chambers for a VAT bill to be prepared. Under subprogram 2, the cabinet will approve and submit to Parliament for enactment a VAT bill that is in line with the policy and drafting instructions approved in subprogram 1. Following its enactment, the MOFT will operationalize new systems in the IRD, including a new VAT module in the broader tax administration information system, to establish the foundations for effective implementation and rollout of the VAT.

17. Institutional reforms complement the legislative tax reforms. To improve tax collections and compliance, the minister of finance and treasury approved in August 2021, under subprogram 1, the establishment of the Large Taxpayer Office (LTO) as an integral component of the IRD restructure.²⁷ The LTO has commenced operations and had eight staff in September 2022, equivalent to 21.0% of the approved positions, of whom four are female. Under subprogram 2, MOFT will further operationalize the LTO by appointing the assistant deputy commissioner and recruiting additional staff to fill at least 80% of the approved positions. The LTO will continue to implement tax collections from large taxpayers.

18. Under subprogram 1, the minister of finance and treasury made the Customs and Excise (Import Duties) (Amendment) Order 2021 and the Customs and Excise (Import Duties) (Amendment) (No. 2) Order 2021 in December 2021, approving (i) a new tax on sugar and sugary drinks; and (ii) a new tax on single-use plastics and other plastics with toxic components, which were implemented by the MOFT. Discouraging sugar consumption can reduce conditions such as obesity and diabetes that are more prevalent in women.²⁸ Given Solomon Islands' limited plastic disposal facilities, discouraging imports of single-use plastics and other plastics with toxic components will help preserve public health and the environment. Under subprogram 2, the MOFT plans to expand its health taxes.

19. **Reform area 2: Public financial management for fiscal resilience.** Under subprogram 1, the cabinet approved, effective July 2021, the MTDMS to help ensure that public debt reflects the government's cost-risk preferences. The MTDMS covers all public debt and the preferred strategy aims to develop the domestic debt market, with the balance of finance from concessional external borrowing.²⁹ Under subprogram 2, the government will implement the MTDMS through budgets underpinned by its provisions.

20. To improve public spending governance, the minister of finance and treasury issued under subprogram 1 the Public Financial Management (Procurement) Regulations, effective October 2021, to promote fair and transparent public procurement, in line with international best practice.³⁰ The regulations establish value for money, competitive purchasing, financial

²⁷ The IRD restructure involves moving to a functional structure where staff are grouped by type of work rather than the type of tax, business, product, or customer. This is intended to improve tax administration and IRD's customer focus.

²⁸ According to the World Health Organization (WHO), the rate of obesity stood at 30.5% for women and 19.6% for men in 2016. The rate of diabetes stood at 11.8% for women and 9.8% for men in 2016. WHO. 2016. [Diabetes Solomon Islands Country Profile](#) (accessed 19 July 2022); and WHO. 2019. [Global Health Estimates: Life Expectancy and Leading Causes of Death and Disability](#) (accessed 19 July 2022).

²⁹ The preferred strategy is based on an analysis of four alternative financing strategies, relying on standard market risk indicators to assess the different strategies.

³⁰ The regulations (i) require tender advertisements and award notices to be published on the MOFT website; (ii) specify the role of the Central Tender Board and the ministerial tender boards; (iii) specify situations where a bid waiver may

sustainability, and equity (including providing economic opportunities for women) as principles for public procurement. Also under subprogram 1, the permanent secretary of the MOFT approved, effective April 2022, a comprehensive financial controllers' operations manual that specifies financial controllers' responsibilities, including the legal framework and annual budget cycle that they must comply with. The manual consolidates PFM guidance and provides templates on budget submissions and task schedules. Under subprogram 2, the MOFT will deepen reforms by (i) approving with immediate effect new budget regulations under the PFM Act (2013), which will expand the coverage of the financial controllers' operations manual by incorporating requirements to guide budget virements; and (ii) implementing selected recommendations from the upcoming World Bank public expenditure review, which is expected to be completed by the end of 2022.

21. Reform area 3: Enabling environment for private sector recovery. Under subprogram 1, Parliament passed a Payment Systems Act in August 2022, with commencement date on 1 October 2022, which provides the legal basis for secure and efficient introduction of an electronic payments and settlement system. The act provides the CBSI with statutory authority to oversee the payment and settlement system, and regulate potential payments and service providers. This strengthens the CBSI's capacity to monitor financial system risks and protect consumers. Under subprogram 2, the CBSI will begin to operationalize the electronic rollout of the payment systems to facilitate a more efficient settlement of payments across commercial banks and the MOFT.

22. Under subprogram 1, the Financial Inclusion Taskforce, chaired by the governor of CBSI, approved in August 2022 the National Women's Financial Inclusion Policy 2022–2026, which identifies barriers faced by women in accessing financial services and sets clear targets to accelerate women's access to affordable financial services. The policy identifies reforms across four areas: (i) increased access to and sustainable use of financial services, (ii) financial literacy and consumer protection, (iii) savings clubs, and (iv) collection of sex-disaggregated data to assess the status of financial inclusion between men and women. Also under subprogram 1, the cabinet approved in October 2022 a new Financial Institutions Act policy paper to guide the consultation and preparation of a revised financial institutions bill. The policy paper recommends that a revised bill should align with international standards, strengthen depositor protection, and allow the expansion of the CBSI's supervision over banks and nonbank financial institutions. This includes microfinance institutions, which are important for extending financial inclusion, especially to women, but fall outside the current act. Under subprogram 2, the cabinet will approve and submit to Parliament for enactment a revised, comprehensive financial institutions bill in line with the policy paper approved under subprogram 1. The CBSI will also begin implementing collection and analysis of sex-disaggregated financial inclusion data based on a manual to be prepared and approved, as specified in the National Women's Financial Inclusion Policy 2022–2026.

23. The cabinet approved in October 2022, under subprogram 1, a policy paper to guide the development of an SOE Act amendment bill that (i) aligns with the SOE Ownership Policy (para. 11), (ii) consolidates ministerial oversight of SOEs under the minister of finance and treasury, (iii) strengthens SOEs' publication and transparency requirements, and (iv) promotes gender diversity among SOE boards and staff. This will be carried through to subprogram 2 with the cabinet approval for submission to Parliament for enactment of an SOE Act amendment bill, in line with the policy paper approved in subprogram 1. To support diversity on SOE boards, the MOFT will also establish and operationalize under subprogram 2 a database of current and qualified prospective board members disaggregated by sex, qualifications, and experience.

be used and require bid waiver requests be submitted to the Central Tender Board; and (iv) establish a treasury procurement unit within the MOFT to provide procurement advice, and conduct compliance reviews and audits.

24. Under subprogram 1, to support the SIICAC to operationalize and begin to tackle corruption, the 2021 government budget established a new budget allocation for the SIICAC (to be continued in future budgets), and funds were appropriated for 2021 and 2022 under the Office of the Prime Minister and Cabinet budget head. The government, through its Prime Minister, also issued the Solomon Islands Independent Commission Against Corruption (Remuneration and Other Conditions) Regulations 2020, effective October 2020, to regulate the remuneration of SIICAC commissioners. Under subprogram 2, the Prime Minister will issue regulations to govern the SIICAC's investigation of corruption complaints, which requires the collection and reporting of sex-disaggregated data.

25. **ADB's value addition.** The program progresses achievements in fiscal sustainability, PFM, and private investment climate supported by ADB's previous program.³¹ The program also complements and reinforces reforms supported by ADB's Domestic Resource Mobilization Project, including to restructure IRD and train its staff, and implement gender-responsive taxpayer education and outreach support.³² ADB technical assistance (TA) supported policy formulation, consultations, and legislative drafting to underpin the tax reforms, and the drafting of the financial controllers' operations manual.³³ ADB provided TA for analysis, consultation, and policy development to underpin the Financial Institutions Act policy paper, and the development of the policy paper to guide the preparation of an SOE Act amendment bill.³⁴ This built on earlier ADB TA supporting the development of the SOE Ownership Policy (para. 11).³⁵ ADB contributed to other prior actions through staff advice, policy dialogue, and joint review missions under the JPRG (para. 26). Prior actions are aligned with advice from ADB and development partners, as relevant.

26. **Partner coordination.** ADB coordinated program design, policy dialogue, and TA with development partners, particularly the governments of Australia, Japan, and New Zealand; the European Union; and the World Bank through the JPRG.³⁶ This coordination included joint missions to identify actions in the rolling joint policy reform matrix (JPRM), which provided the basis for ADB's program design, and to review progress. The Government of Australia's TA supported the development of the procurement regulations, which is part of the JPRM. The World Bank, the IMF, and the Australian Office of Financial Management provided TA to support the development of the MTDMS, which is part of the JPRM and was a policy action supported by ADB and the World Bank under the Sustainable Development Finance Policy.³⁷ The World Bank supported the policy development of the payment systems bill, which is also part of the JPRM. The United Nations Development Programme provided TA to support the SIICAC and the World Bank plans to support its work plan. IMF TA provided support for capacity development in revenue administration, PFM, and banking regulation and supervision, among other areas (footnote 9). ADB staff regularly consulted with the IMF on policy reform issues and macroeconomic projections during program design. The IMF has provided an assessment letter in support of the program.³⁸

27. **Sustainability.** Policy dialogue through the JPRG helped build on government-led reforms. The operation is structured around current government priorities for which strong reform

³¹ ADB. 2020. [Solomon Islands: Improved Fiscal Sustainability Reform Program](#). Manila.

³² ADB. [Solomon Islands: Domestic Resource Mobilization Project](#). Manila.

³³ ADB. [Regional: Improving Pacific Public Financial Management Facility](#). Manila.

³⁴ ADB. 2019. [Technical Assistance for Pacific Private Sector Development Initiative, Phase IV](#). Manila.

³⁵ ADB. 2019. [Technical Assistance for the Pacific Private Sector Development Initiative, Phase III](#). Manila.

³⁶ Development Coordination (accessible from the list of linked documents in Appendix 2). JPRG development partners align their own policy-based budget support programs with the JPRG policy reform matrix, with each partner disbursing against completion of selected reforms and other actions, as agreed bilaterally.

³⁷ International Development Association. [Sustainable Development Finance Policy](#). Washington, DC.

³⁸ International Monetary Fund Assessment Letter (accessible from the list of linked documents in Appendix 2).

momentum exists. ADB will continue to provide TA for policy formulation and implementation in coordination with development partners (para. 26). ADB and the government will develop a post-program partnership framework during the processing of subprogram 2 to support reform progression.

28. **Lessons.** The program builds on ADB's long-standing support for economic and fiscal management.³⁹ Based on lessons, the program builds on regular dialogue through the JPRG to coordinate TA from development partners and limits actions to key reforms that are prioritized by the government to avoid overloading limited capacity.⁴⁰ The programmatic approach adopts implementation periods of about 2 years for each subprogram to allow adequate time for preparation, implementation, and completion of actions that are time- and resource-intensive (footnote 40). By supporting the collection of sex-disaggregated data, the program will build implementing agencies' capacity to monitor progress on gender equality (paras. 22 and 24).⁴¹

C. Expected Outcome of the Reforms

29. The program is aligned with the country's development objective of sustained and inclusive economic growth and an improved environment for private sector development and increased investment opportunities for all Solomon Islanders (footnote 23). Its outcome will be resilient economic and fiscal recovery in Solomon Islands. Both subprograms will contribute to this outcome through sequenced policy actions that support the government reform program (paras. 15–24). The program reforms will (i) strengthen domestic revenue mobilization by broadening the tax base and modernizing tax administration; (ii) improve fiscal resiliency through better planning and regulations for public finance, debt, and procurement; and (iii) enhance the private sector environment through an improved policy, regulatory, and legislative framework for financial institutions and SOEs, and operationalization of the SIICAC.⁴²

D. Development Financing Needs and Budget Support

30. ADB's proposed budget support financing is based on the government's development financing needs. The policy-based lending adopting the programmatic approach is estimated to cost \$20.0 million: \$10.0 million for subprogram 1 in 2022 and \$10.0 million for subprogram 2 in 2024. Each subprogram comprises a \$5.0 million Asian Development Fund grant and a \$5.0 million concessional ordinary capital resources loan. The program will help the government meet estimated financing gaps of \$258.4 million in 2022 and \$179.4 million in 2024, based on projected fiscal deficits (exclusive of grants) (Table 2). The government expects to finance the remaining financing gap in 2022 through external support, domestic borrowing, and drawdown of cash reserves. Other JPRG development partners have provided parallel cofinancing not administered by ADB as budget support in 2022: the World Bank committed \$15.0 million (comprising a \$11.5 million grant and a \$3.5 million concessional loan) in July 2022; and the Government of New Zealand disbursed a grant of \$1.7 million equivalent in May 2022. In addition, the World Bank

³⁹ Independent Evaluation Department. 2020. [Validation Report: Improved Fiscal Sustainability Reform Program in Solomon Islands](#). Manila: ADB; Independent Evaluation Department. 2019. [Validation Report: Economic Growth and Fiscal Reform Program in Solomon Islands](#). Manila: ADB; Independent Evaluation Department 2015. [Validation Reports: Economic and Financial Reform Program in Solomon Islands](#). Manila: ADB; and ADB. 2013. [Completion Report: Economic Recovery Support Program in Solomon Islands—Subprograms 1 and 2](#). Manila.

⁴⁰ Independent Evaluation Department. 2020. [Validation Report: Improved Fiscal Sustainability Reform Program in Solomon Islands](#). Manila: ADB.

⁴¹ A key lesson from the previous program was to have proactive engagement on gender. The program completion report recommended future programs build government partners' capacity to understand the importance of gender-related actions and monitor their progress, such as through the collection and analysis of sex-disaggregated data.

⁴² Program Impact Assessment (accessible from the list of linked documents in Appendix 2).

provided \$15 million and the Government of Australia \$1.3 million as parallel cofinancing, accounted in 2021.⁴³ ADB has assessed that debt distress risk will remain *moderate* and debt will remain sustainable, inclusive of program financing.

Table 2: Development Financing Needs, 2022–2024

Item	2022p		2023p		2024p	
	(\$ million)	(% of GDP)	(\$ million)	(% of GDP)	(\$ million)	(% of GDP)
Total revenue (tax and nontax)	347.2	22.4	412.2	25.1	441.6	26.0
Total expenditure	605.5	39.1	606.5	37.0	621.0	36.5
Fiscal deficit (excluding grants)	(258.4)	(16.7)	(194.3)	(11.8)	(179.4)	(10.5)
External grants	153.7	9.9	123.8	7.5	111.3	6.5
of which ADB policy-based grant	5.0	0.3	0	0	5.0	0.3
Net lending (borrowing) requirement ^a	(104.7)	(6.8)	(70.5)	(4.3)	(68.1)	(4.0)
External financing (net)	38.7	2.5	46.6	2.8	50.0	2.9
of which ADB policy-based loan	5.0	0.3	0	0	5.0	0.3
Domestic financing (net)	66.0	4.3	23.9	1.5	18.1	1.1

() = negative, ADB = Asian Development Bank, GDP = gross domestic product, p = projection.

Note: Numbers may not sum precisely because of rounding.

^a Net lending (borrowing) requirement corresponds to the overall balance (deficit) in Table 1.

Sources: Government of Solomon Islands budget documents and Asian Development Bank estimates.

31. The government has requested (i) a grant not exceeding \$5 million from ADB's Special Funds resources (Asian Development Fund), and (ii) a concessional loan of \$5 million from ADB's ordinary capital resources to help finance the program. The loan will have a 24-year term, including a grace period of 8 years; an interest rate of 1.0% per year during the grace period and 1.5% per year thereafter; and such other terms and conditions set forth in the draft loan agreement.

E. Implementation Arrangements

32. The MOFT leads the JPRG process and will oversee the program as the executing agency. The IRD, the CBSI, and the SIICAC are the other implementing agencies. The JPRG will facilitate reform consultations. The implementation period is October 2020–October 2022 for subprogram 1 and November 2022–October 2024 for subprogram 2. The proceeds of the policy-based loan and grant will be withdrawn in a single tranche for subprogram 1, upon effectiveness, following ADB's *Loan Disbursement Handbook* (2017, as amended from time to time).

III. DUE DILIGENCE

33. **Poverty and social.** COVID-19 compounded vulnerabilities and exacerbated poverty and insecurity.⁴⁴ Women were more likely than men to lose jobs and income because of COVID-19, with women heads of household more likely to report stopping work to care for an ill relative.⁴⁵

⁴³ The World Bank committed \$15 million in June 2022 as supplemental financing for the Second Solomon Islands Transition to Sustainable Growth Development Policy Operation that was the parent Development Policy Operation, approved in November 2021, which committed \$15 (grant) million in 2021. World Bank. 2022. *Solomon Islands FY22 Supplemental Development Policy Operation (P178608) Report No: PGD4936*. Washington, DC; and World Bank. 2021. *The Second Solomon Islands Transition to Sustainable Growth Development Policy Operation (P172454) Report No: PGDD241*. Washington, DC. In November 2021, the Government of Australia provided \$1.3 million equivalent (grant) as parallel budget support cofinancing not administered by ADB. A\$ and NZ\$ amounts are converted to dollar equivalent using 20 October 2022 exchange rates.

⁴⁴ An estimated 44,589 people were at risk of being pushed into poverty in 2020–2021 because of the pandemic. United Nations Economic and Social Commission for Asia and the Pacific. 2021. [Estimating the Short-term Impact of the COVID-19 Pandemic on Poverty in Asia-Pacific LDCs](#) [Least-Developed Countries]. Bangkok.

⁴⁵ World Bank. 2020. *Solomon Islands High Frequency Phone Survey on COVID-19: Results from Round 1*. Washington, DC.

Many households used medium-term coping strategies, such as drawing down savings, with limited assistance from informal safety nets.⁴⁶ In Solomon Islands, noncommunicable diseases account for an estimated 69% of all deaths. Females are more likely to be obese (footnote 28). Although the program is not expected to have direct poverty impacts, positive impacts on taxation, PFM, and debt management can safeguard funding of essential public services, minimize risks to service disruption, improve health outcomes, and enhance public investments that benefit the poor and vulnerable. Together with reforms to strengthen the business environment and develop the finance sector, this can also promote productive investment to support a resilient recovery.

34. **Gender.** The program's proposed gender mainstreaming category is *some gender elements*. The program supports employment of women in the LTO and is intended to complement ADB's Domestic Revenue Mobilization Project for Solomon Islands, which is categorized *effective gender mainstreaming* and supports gender equality actions within the IRD and gender-responsive outreach of tax education on the changes to the tax system (footnote 32). To accelerate women's financial inclusion, the program supports (i) the National Women's Financial Inclusion Policy 2022–2026, (ii) the inclusion of gender analysis in the Financial Institutions Act policy paper to guide legislative reform on financial institutions, and (iii) the improved collection and analysis of sex-disaggregated financial inclusion data to guide further reform. To promote the increased representation of women in the economy, the program supports (i) amendments to SOE legislation to incorporate gender diversity provisions, and (ii) establishment of a database of current and prospective boards of directors disaggregated by sex. The program also supports regulation to ensure data on corruption complaints to the SIICAC are disaggregated by sex to better track and respond to gender impacts of corruption.

35. **Safeguards.** Following ADB's Safeguard Policy Statement (2009), the program is classified category C for environment, involuntary resettlement, and indigenous peoples. Program activities will be confined to policy and institutional reforms. The prior policy actions were assessed and are not expected to result in or lead to involuntary resettlement, or negatively affect indigenous peoples or the environment.

36. **Governance.** The World Bank Worldwide Governance Indicators ranked Solomon Islands in the 16.4th percentile for government effectiveness in 2021, representing a small reduction from the previous year (footnote 16). Solomon Islands was ranked 73rd of 180 economies in the 2021 Corruption Perceptions Index.⁴⁷ In a 2021 survey, 21% of respondents had recently paid a bribe to receive public services (para. 11). Solomon Islands has made progress with strengthening its PFM and procurement systems although challenges remain.⁴⁸ Policy reforms and TA support from JPRG development partners will help address the remaining fiduciary risks. Reform area 1 of this program will address weaknesses in procurement and budget formulation, execution, and reporting. Reform area 3 of this program will strengthen the capacity of the SIICAC to operationalize and tackle corruption.

37. Major risks and mitigation measures are summarized in Table 3 and described in detail in the risk assessment and risk management plan.⁴⁹

⁴⁶ United Nations Children's Fund and World Bank Group. 2021. *Solomon Islands High Frequency Survey on COVID-19: Results from Round Two*. Honiara.

⁴⁷ Transparency International. 2021. [Corruption Perceptions Index](#) (accessed 23 September 2022).

⁴⁸ The latest public expenditure and financial accountability assessment, completed in 2012, showed improvements in most PFM areas compared with the 2008 assessment. Government of Solomon Islands and European Commission. 2012. *Public Expenditure and Financial Accountability (PEFA) Assessment: Final Report*. Brussels.

⁴⁹ Risk Assessment and Risk Management Plan (accessible from the list of linked documents in Appendix 2).

38. ADB's Anticorruption Policy (1998, as amended to date) was explained to and discussed with the government and the MOFT, the IRD, the CBSI, and the SIICAC.

Table 3: Summary of Risks and Mitigating Measures

Risks	Mitigation Measures
Further economic shocks, including those to commodity markets and from disasters, exacerbate the current economic downturn.	Regular policy dialogue on the economic and fiscal outlook with the government through the JPRG enables development partners to monitor and respond to economic shocks, including through additional budget support. ADB is seeking to renew its contingent disaster financing to Solomon Islands by early 2023, which will enable Solomon Islands to access funds if a major disaster strikes.
Continuing COVID-19 impacts, or a reinstatement of containment measures, expose fragilities in public sector capacities and weaken reform implementation.	Vaccination was relatively low as of 26 September 2022 with 39% of those eligible vaccinated with two doses. The government is building health system capacity, in coordination with development partners, to increase vaccination coverage and respond to potential outbreaks.
Decline in capacity or high staff turnover hinder internal coordination and weaken reform implementation.	Through the JPRG process, the government and development partners identify capacity weaknesses and provide TA to bridge critical gaps. ADB TA is funding a consultant in the Ministry of Finance and Treasury to support JPRG coordination and policy reform formulation.

ADB = Asian Development Bank, COVID-19 = coronavirus disease, JPRG = Joint Policy Reform Group, TA = technical assistance.

Sources: Asian Development Bank and [Pacific Data Hub](#) (accessed 26 September 2022).

IV. ASSURANCES

39. The government has assured ADB that implementation of the program shall conform to all applicable ADB policies, including those concerning anticorruption measures, safeguards, gender, procurement, consulting services, and disbursement, as described in detail in the draft loan and grant agreements.

V. RECOMMENDATION

40. I am satisfied that the proposed programmatic approach and policy-based loan and grant would comply with the Articles of Agreement of the Asian Development Bank (ADB) and recommend that the Board approve

- (i) the programmatic approach for the Supporting Fiscal and Economic Recovery Program;
- (ii) the loan of \$5,000,000 to Solomon Islands for subprogram 1 of the Supporting Fiscal and Economic Recovery Program, from ADB's ordinary capital resources, in concessional terms, with an interest charge at the rate of 1.0% per year during the grace period and 1.5% per year thereafter; for a term of 24 years, including a grace period of 8 years; and such other terms and conditions as are substantially in accordance with those set forth in the draft loan agreement presented to the Board; and
- (iii) the grant not exceeding \$5,000,000 to Solomon Islands from ADB's Special Funds resources (Asian Development Fund) for subprogram 1 of the Supporting Fiscal and Economic Recovery Program, on terms and conditions that are substantially in accordance with those set forth in the draft grant agreement presented to the Board.

Masatsugu Asakawa
President

15 November 2022

POLICY DESIGN AND MONITORING FRAMEWORK

Country's Overarching Development Objectives Sustained and inclusive economic growth Environment for private sector development improved and investment opportunities for all Solomon Islanders increased (National Development Strategy, 2016–2035) ^a		
Outcome A resilient economic and fiscal recovery in Solomon Islands	Risks and Critical Assumptions R1: Economic shocks, including those to commodity markets and from disasters, exacerbate the current economic downturn. R2: Continuing COVID-19 impacts expose fragilities in public sector capacities and undermine reform progress. R3: Decline in capacity or high staff turnover hinder internal coordination and weaken reform implementation.	
Prior Actions: Subprogram 1 Completed October 2020–October 2022	Policy Actions: Subprogram 2 November 2022–October 2024	Outcome Indicators By October 2025:
Reform Area 1: Tax reform for domestic revenue mobilization		
1.1. To modernize tax administration and unify the framework for different taxes, the Parliament passed a new Tax Administration Act 2022. ^b 1.2. To remove distortions and raise revenue in a more efficient manner, the cabinet approved 1.2.1. a policy to provide the basis for the preparation of a broad-based value-added tax bill; and 1.2.2. drafting instructions for the Attorney General's Chambers to prepare a value-added tax bill. 1.3. To ensure there are sufficient resources to administer collections from the largest taxpayers,	2.1 To enable taxpayers to meet their tax payment obligations in a timelier manner, the cabinet will approve and submit to Parliament for enactment an income tax bill that replaces the commissioner-imposed assessment system with self-assessment by taxpayers, consistent with the Tax Administration Framework passed in subprogram 1; and is informed by gender analysis and consultations with women's business organizations. 2.2 To improve the efficiency of revenue collection 2.2.1 the cabinet will approve and submit to Parliament for enactment a value-added tax bill (based on the policy and drafting instructions approved in subprogram 1) that replaces various goods taxes, sales tax, stamp duties, and customs duties which have multiple rates of tax, and different rules and procedures with a unified, broad-based value-added tax; and 2.2.2 MOFT will operationalize new systems to implement the value-added tax. ^f 2.3 To improve administration of collections from the largest taxpayers	a. Ratio of tax (excluding logging taxes) to GDP exceeds the 2019 level (2019 baseline: 17.9% estimated tax–GDP ratio). Source: IMF Article IV Consultation and Staff Visit reports (annual). b. On-time filing rate for large taxpayers increases above pre-pandemic levels (2019 baseline: 74%). ^j Source: IRD reporting.

Prior Actions: Subprogram 1 Completed October 2020–October 2022	Policy Actions: Subprogram 2 November 2022–October 2024	Outcome Indicators By October 2025:
<p>1.3.1. the Minister of Finance and Treasury approved the establishment of a new Large Taxpayer Office (LTO), as an integral part of the new functional-based IRD restructure; and</p> <p>1.3.2. MOFT began to operationalize the LTO by appointing staff to at least 20% of the approved positions, of whom at least 40% are female.^c</p> <p>1.4. To raise revenue and improve development outcomes, the Minister for Finance and Treasury made the Customs and Excise (Import Duties) (Amendment) Order 2021 and the Customs and Excise (Import Duties) (Amendment) (No. 2) Order 2021 and MOFT implemented</p> <p>1.4.1. a new tax on sugar and sugary drinks to improve health outcomes by discouraging sugar consumption, and raise revenue;^d and</p> <p>1.4.2. a new tax on single-use plastics and other plastics with toxic components to reduce plastic pollution.^e</p>	<p>2.3.1 MOFT will further support IRD's restructure and the operationalization of the LTO by appointing the Assistant Deputy Commissioner and staff to at least 80% of the approved positions, of whom at least 40% are female;^g and</p> <p>2.3.2 the LTO will continue to implement tax collections from large taxpayers.^h</p> <p>2.4 To raise revenue and help prevent disease, the MOFT will expand its health taxes on at least one product that has a negative public health impact to reduce its consumption.ⁱ</p>	
Reform Area 2: Public financial management for fiscal resilience		
<p>1.5. To improve debt management arrangements, the cabinet approved effective July 2021 and MOFT published on its website an MTDMS 2021–2024, which includes financing strategies and debt service requirements.</p> <p>1.6. To improve the governance of public spending, the</p> <p>1.6.1 Minister for Finance and Treasury issued effective October 2021, the Public Financial Management (Procurement) Regulations 2021, which include a principle that procurement activities support equality of opportunity and provide economic opportunities for women, youth and people with disabilities;^k and</p> <p>1.6.2 Permanent Secretary of MOFT approved effective April 2022 a new comprehensive Financial Controllers' Operations Manual that specifies the responsibilities of Financial Controllers across line ministries to enable more effective management of public financial</p>	<p>2.5 To support debt sustainability, the MOFT will operationalize the MTDMS through the implementation of the 2022 and 2023 budgets which are underpinned by the MTDMS provisions for sustainability and affordability.^l</p> <p>2.6 To improve budget planning and the quality of expenditure, the MOFT will</p> <p>2.6.1 approve with immediate effect and publish in the official gazette new budget regulations under the PFM Act (2013) that strengthen budget controls;</p> <p>2.6.2 approve with immediate effect an Annex to the Financial Controllers' Operations Manual that clarifies the requirements and processes for budget virements; and</p> <p>2.6.3 implement selected recommendations from the forthcoming World Bank Public Expenditure Review.^m</p>	<p>c. Public debt sustainability assessment rating of sustainable is maintained based on IMF debt sustainability analysis (December 2021 baseline: Rated sustainable). Source: IMF Article IV Consultation and Staff Visit reports (annual).</p> <p>d. Public debt remains below the government's nominal debt threshold of 35% of GDP (December 2021 baseline: public debt estimated equivalent to 16.2% of GDP).ⁿ Source: IMF Article IV Consultation and Staff Visit reports (annual).</p> <p>e. Value of recurrent budget transfers (virements) in the first half of 2025 falls below pre-pandemic level (January–June)</p>

Prior Actions: Subprogram 1 Completed October 2020–October 2022	Policy Actions: Subprogram 2 November 2022–October 2024	Outcome Indicators By October 2025:
operations as required by the PFM Act (2013).		2019 baseline: recurrent budget virements equal SI\$21.5 million) Source: Government of Solomon Islands Mid-Year Budget Review reports.
Reform Area 3: Enabling environment for private sector recovery		
<p>1.7. To establish the legal framework to introduce a modern payments infrastructure and regulatory system, the Parliament passed a Payment Systems Act 2022.^o</p> <p>1.8. To understand the opportunities and risks related to financial sector development and increase women's financial inclusion, the</p> <p>1.8.1. Solomon Islands Financial Inclusion Taskforce, chaired by the Governor of the CBSI, approved effective August 2022 the National Women's Financial Inclusion Policy 2022–2026 which sets clear targets, measures and actions to guide reforms;^p and</p> <p>1.8.2. cabinet approved a new Financial Institutions Act policy paper that (i) will guide further consultation; (ii) includes specific recommendations based on a gender gap analysis; and (iii) provides a strong basis for new legislation that will strengthen the regulation and prudential supervision of financial institutions.</p> <p>1.9. To improve the governance of SOEs, the cabinet approved a policy paper that provides a strong basis for the preparation of an SOE act amendment bill to (i) align with the SOE Ownership Policy (2018),^q (ii) consolidate responsibility and oversight of SOEs to the Minister for Finance and Treasury, (iii) strengthen SOEs' publication and transparency requirements, and (iv) provide for promotion of gender diversity among SOE staff and board members.^r</p>	<p>2.7 To support implementation of the Payment Systems Act, approved in subprogram 1, the CBSI will begin to operationalize the electronic payments system to ensure more efficient settlement of payments between commercial banks and MOFT.^t</p> <p>2.8 To support effective supervision and regulation of financial institutions and women's financial inclusion, the</p> <p>2.8.1 CBSI will implement collection and analysis of sex-disaggregated financial inclusion data (based on a new manual to be approved) as specified in the National Women's Financial Inclusion Policy approved under subprogram 1;^u and</p> <p>2.8.2 cabinet will approve and submit to Parliament for enactment an updated financial institutions bill, based on the policy paper approved in subprogram 1.</p> <p>2.9 To improve the legal framework governing SOEs and promote gender diversity the</p> <p>2.9.1 cabinet will approve and submit to Parliament for enactment a SOE Act amendment bill, based on its policy paper approved in subprogram 1; and</p> <p>2.9.2 MOFT will establish and operationalize a database of current and qualified, prospective board members disaggregated by sex, qualification, and sectoral experience.^v</p>	<p>f. Number of active companies registered increases by 300 (September 2020 baseline: 2,389 active registered companies). Source: Solomon Islands Registry of Companies (Company Haus).</p> <p>g. Share of company shareholders who are women reaches 28% (September 2020 baseline: 26% of company shareholders were women). Source: Solomon Islands Registry of Companies (Company Haus).</p> <p>h. Number of active users of a financial account increases by 80,000 (March 2020 baseline: 283,954 active users of a financial account). Source: Central Bank of Solomon Islands reporting on the National Financial Inclusion Strategy 2021–2025.</p> <p>i. Share of active users of financial accounts who are women reaches 50% (March 2020 baseline: 47% of active users of a financial account were women). Source: Central Bank of Solomon Islands reporting on the National Financial Inclusion Strategy 2021–2025.</p>

Prior Actions: Subprogram 1 Completed October 2020–October 2022	Policy Actions: Subprogram 2 November 2022–October 2024	Outcome Indicators By October 2025:
<p>1.10. To fight corruption and improve the business environment, the government operationalized the Solomon Islands Independent Commission Against Corruption (SIICAC), through</p> <p>1.10.1. establishment of an annual budget allocation for SIICAC starting with the 2021 government budget, and appropriation of funds in 2021 and 2022;^a and</p> <p>1.10.2. approval by the Prime Minister of the Solomon Islands the Solomon Islands Independent Commission Against Corruption (Remuneration and Other conditions) Regulations 2020 effective October 2020 outlining the remuneration of the SIICAC Commissioners.</p>	<p>2.10 To support SIICAC's operation and the investigation of corruption cases, the Prime Minister will approve with immediate effect new regulations, that are published in the official gazette, governing the process for corruption complaints which requires the collection and reporting of sex disaggregated data.</p>	

Budget SupportSubprogram 1:

ADB: \$5.0 million grant and \$5.0 million loan

Government of Australia: \$1.3 million equivalent grant not administered by ADB

Government of New Zealand: \$1.7 million equivalent grant not administered by ADB

World Bank: \$26.5 million grant and \$3.5 million loan not administered by ADB

Subprogram 2:

ADB: \$5.0 million grant and \$5.0 million loan

ADB = Asian Development Bank, COVID-19 = coronavirus disease, GDP = gross domestic product, IMF = International Monetary Fund, IRD = Inland Revenue Division, LTO = Large Taxpayer Office, MOFT = Ministry of Finance and Treasury, MTDMS = medium-term debt management strategy, PFM = public financial management, SIICAC = Solomon Islands Independent Commission Against Corruption, SOE = state-owned enterprises.

^a Government of Solomon Islands. 2016. *National Development Strategy, 2016–2035*. Honiara.

^b The government embarked on a comprehensive three-stage review of the tax system in 2017. The first stage covers the broader tax administration framework and consumption taxes. The second stage covers income tax, and the third stage covers other types of tax. The rationale for starting with tax administration is to ensure a strong foundation on which to build the other tax reforms and to help ensure effective compliance once the other reforms are implemented. The Tax Administration Act 2022 provides a framework for taxpayer self-assessment, which will allow IRD resources to be shifted away from low-level tax assessment tasks and towards compliance and risk-based audit. By introducing a common set of rules, offenses and penalties across all tax types, the act will simplify taxpayer obligations and reduce scope for administrative discretion. In their Article IV Staff Report, the International Monetary Fund noted that modernizing tax administration and introducing a value-added tax are important first steps towards comprehensive tax reforms. These steps, which are supported under subprogram 1, are intended to lay the foundation for legislative reform to income tax in subprogram 2. IMF. 2022. *Solomon Islands 2021 Article IV Consultation-Press Release; Staff Report; And Statement by the Executive Director for Solomon Islands*. Washington DC.

^c The IRD restructure involves moving to a functional structure where staff are grouped by type of work rather than the type of tax, business, product, or customer. This is intended to improve tax administration and IRD's customer focus. The former organizational structure of the IRD was a mix between a tax type and functional structure, which did not allow taxpayer data to be applied across the various taxes, creating a significant burden for taxpayers.

^d Discouraging sugar consumption may help reduce conditions such as obesity and diabetes, identified as a priority in the Multi-Sectoral National Non-Communicable Disease Strategic Plan 2019-2023. According to the World Health Organization (WHO), the rate of obesity stood at 30.5% for women and 19.6% for men in 2016.

The rate of diabetes stood at 11.8% for women and 9.8% for men in 2016. WHO. 2016. Diabetes Country Profiles: Solomon Islands. Accessed 19 July 2022. Diabetes is the third leading cause of disability-adjusted life year (DALYS) (i.e., lost years of life due to premature mortality and lost years of healthy life due to disability) and the third leading cause of death among women in Solomon Islands. WHO. 2019. Global Health Estimates. <https://www.who.int/data/gho/data/themes/mortality-and-global-health-estimates>. Accessed 19 July 2022. <https://www.who.int/publications/m/item/diabetes-slb-country-profile-solomon-islands-2016> Accessed 19 July 2022.

- ^e The new levy is SI\$1.0 per kilogram for sugary products, and \$2.0 per litre for sugary drinks. For plastic products, the new levy is SI\$1.40 per kilogram.
- ^f Following enactment of the value added tax bill, MOFT will establish conditions for its successful implementation. This includes operationalizing a new value-added tax administration module in the broader tax administration information system that is being upgraded with support under ADB. [Solomon Islands: Domestic Resource Mobilization Project](#).
- ^g The target that 80% of LTO positions are filled allows for a small share of positions to be vacant in 2024, given the environment of human capital and skills shortages. This is estimated to be sufficient to carry out the LTO's primary functions.
- ^h The IRD has defined 'large taxpayers' as taxpayers with turnover above SI\$50m and companies that are under a group structure or which have overseas assets.
- ⁱ The targeting of the government's health taxes is under discussion and the product(s) that the new tax will be levied on will be confirmed during processing of subprogram 2
- ^j On-time filing relates to returns that are filed before or on a statutory due date for a certain period whether it be monthly, yearly or the financial year.
- ^k The procurement regulations provide that procurement should be conducted in a manner which supports equality of opportunity in general; and in particular advances community equality by providing economic opportunities for all Solomon Islanders, including women, youth and people with disabilities. For example, temporary special measures may be adopted to ensure women owned and led businesses can access procurement opportunities. To promote value for money, transparency, and reduce opportunities for corruption, the regulations also require (i) waiver requests to be submitted to the Central Tender Board, and (ii) tender advertisements and tender award notices to be published on the MOFT website. The regulations also formally establish a Procurement Unit within MOFT to undertake training in line ministries, check compliance and to maintain the regulatory framework over time.
- ^l The implementation of the MTDMS is institutionalized through to 2024 by the cabinet approval of the strategy. Full year estimates on the implementation of the 2022 and 2023 budgets will become available for verification during the subprogram 2 implementation period. MTDMS targets include maintaining public debt below 35% of GDP; maintaining short-term debt (maturing within 1 year) below 12% of total-debt; and maintaining 100% of debt at fixed rates.
- ^m The PER, supported by the World Bank, is expected to be finalized by the end of 2022. The selected recommendations for implementation under the program will be identified based on government priorities and an action plan that is developed during subprogram 2. The selected recommendations for implementation will be discussed with the government and other JPRG partners in the context of identifying the next iteration of the JPRG joint policy reform matrix for 2023-2024.
- ⁿ The government may review the nominal debt threshold during the subprogram 2 implementation period.
- ^o The Payment Systems Act provides the CBSI with the statutory authority to oversee and administer the safe and efficient introduction of an electronic payment and securities settlement system. The act brings the legal framework in line with international standards for the conduct of payments to mitigate risks to the finance sector. The act also supports the expansion of digital instruments that have potential to improve business efficiency and increase financial inclusion.
- ^p The National Women's Financial Inclusion Policy 2022-2026 identifies policy measures across four key areas: (i) increased access to and sustainable use of financial services, (ii) financial literacy and consumer protection, (iii) savings clubs, and (iv) sex-disaggregated data. The policy builds on the broader National Financial Inclusion Strategy 2021–2025.
- ^q The SOE Ownership policy, endorsed by the cabinet in November 2018, outlines the rationale for SOE ownership, performance expectations, privatization principles, and dividend requirements. The policy is intended to guide government investment, oversight, and divestment of SOEs. ADB TA supported the drafting, consultation, and finalization of the policy. ADB. 2013. *Technical Assistance for [Regional–Policy Advisory and Technical Assistance for the Pacific Private Sector Development Initiative, Phase III](#)*. Manila
- ^r The policy paper proposes amendments to the SOE Act (2007) to require that at least one female candidate meeting the requisite qualifications be shortlisted for each board director vacancy.
- ^s The budget allocation for SIICAC was established under the Office of the Prime Minister and Cabinet budget head and budget appropriations are intended to continue in future years.
- ^t The introduction of the electronic payment system, in line with the legislative framework established by the Payment Systems Act approved in subprogram 1, will enable the government, businesses, and individuals to benefit from more efficient transactions with reduced scope for corruption and errors. Operationalization of the

system with MOFT, expected to go live during the subprogram 2 implementation period, will eventually enable automation of transactions for customs and tax which may otherwise require physical travel to customs and tax offices.

- ^u While the Central Bank of Solomon Islands collects some sex-disaggregated data from financial service providers, the data lacks completeness in terms of reporting entities and coverage of newly established non-bank clients. This limits the information on the status of financial inclusion (including men and women's access to and usage of financial services) that could inform policy, regulatory and legislative reforms. To address this gap, the manual will (i) outline methodology and templates to periodically collect, analyze and share financial inclusion data, and (ii) specify the data reporting channels and entities.
- ^v The database is intended to complement the legislative reforms that strengthen the director selection and appointment process for SOE boards. By compiling potential applicants' qualifications and sectoral/technical experience, the database can help facilitate better matching of qualified candidates with director positions.

Contribution to Strategy 2030 Operational Priorities: Operational priority indicators to which this operation will contribute results are detailed in Contribution to Strategy 2030 Operational Priorities (accessible from the list of linked documents in Appendix 2).

Source: Asian Development Bank.

LIST OF LINKED DOCUMENTS

<http://www.adb.org/Documents/RRPs/?id=55011-001>

1. Loan Agreement
2. Grant Agreement
3. Sector Assessment (Summary): Public Sector Management
4. Contribution to Strategy 2030 Operational Priorities
5. Development Coordination
6. International Monetary Fund Assessment Letter
7. Summary Poverty Reduction and Social Strategy
8. Program Impact Assessment
9. Risk Assessment and Risk Management Plan
10. List of Ineligible Items

DEVELOPMENT POLICY LETTER

**MINISTER OF FINANCE AND
TREASURY**



**MINISTRY OF FINANCE AND TREASURY
P.O BOX 26, HONIARA
SOLOMON ISLANDS**

SOLOMON ISLANDS GOVERNMENT

Ref: RF 459/11/49

Date: 20th October, 2022

DEVELOPMENT POLICY LETTER

Mr. Masatsugu Asakawa
President
Asian Development Bank
6 ADB Avenue Mandaluyong City
1550 Metro Manila
Philippines

Dear Mr. Asakawa,

Subject: Solomon Islands Supporting Fiscal and Economic Recovery Program

The Government of Solomon Islands is committed to putting the country on the path to fiscal and economic recovery. Our National Development Strategy 2016-2030 recognizes that inclusive economic growth and an improved private sector environment are key to the sustainable development of all Solomon Islanders. The Asian Development Bank (ADB) continues to play a pivotal role in supporting Solomon Islands to undertake critical reforms and mitigate the impact of COVID-19. We welcome the multi-year support provided by the ADB and value our long-standing working relationship.

Fiscal and Economic Outlook

The COVID-19 pandemic, coupled with the riot in Honiara in November 2021, has made 2022 a challenging year for the country. The Central Bank of Solomon Islands (CBSI) initially projected an economic contraction of 7.3% in 2022 due to sluggish economic activity and containment measures enacted to reduce the spread of COVID-19. However, with containment measures fully eased as of 1 July this year and the international border restrictions lifted, CBSI revised its projection and now expects the economy to contract by 4.3% in 2022. This would be the third consecutive year of economic contraction. However, CBSI expects recovery in all sectors except for logging in 2023. Risks remain, though, including a resurgence in COVID-19 cases that could prompt a reinstatement of containment measures, natural disasters, and uncertainty in the global outlook. CBSI also expects that inflation will rise to around 3-4% by the end of the year, driven by the surge in global fuel prices.

The fiscal deficit is expected to increase this year due to revenue declines caused by the economic contraction – especially in the critical export sector of logging in the first half of this year – and increased spending pressures on the pandemic response, rehabilitation

of damage caused by the November 2021 riots, and counter-cyclical fiscal support measures. Recognizing these challenges, the Government's 2022 budget theme is 'Building Our Resilience' with a focus on building a resilient economy that can withstand the impacts of COVID-19 and other shocks. Fiscal pressures are expected to remain elevated over the medium term owing to weak revenue from declining logging activities while pressure on recurrent and development spending remains high.

Development Partner Coordination

Despite the fiscal and economic challenges, the Government remains committed to engage with development partners on fiscal and economic reforms through the Joint Policy Reform Group (JPRG). The JPRG links development partner budget support to an established set of processes, including discussions on the joint policy reform matrix, coordinated technical assistance (TA) to bridge capacity constraints, and Joint Review Missions to assess the progress being made to implement reforms. The Permanent Secretary of MoFT chaired a JPRG Technical Working Group meeting in Honiara on 16 September 2022, which concluded the latest joint review mission, and I confirm again now that the government remains committed to these processes.

ADB's Supporting Fiscal and Economic Recovery Program

ADB's Supporting Fiscal and Economic Recovery Program focuses on reforms initiatives in which ADB is engaged alongside Solomon Islands and JPRG development partners through TA and policy dialogue. The Government has made significant progress in the three reform areas under this program.

Tax reform for domestic revenue mobilization: The Government remains committed to reforming the tax system having commenced a comprehensive review of the tax system in 2017. In August 2022, Parliament passed a Tax Administration Act, which provides the legal basis to introduce a unified set of rules and penalties for all tax types and modernize tax administration. Cabinet also approved a policy and drafting instructions to provide a solid basis to prepare a Value-Added Tax (VAT) bill that will replace various other taxes with a broad-based VAT. The introduction of a tax on sugar and sugary drinks and a tax on single-use plastics and other plastics with toxic components, which were effective from January 2022, are intended to reduce consumption of sugar and single use and toxic plastics products to help tackle non-communicable diseases and plastic pollution.

To facilitate a more modern approach to tax administration, I approved the new organizational structure for the Inland Revenue Division (IRD) that provides a clear distinction between operations and support services. As part of its transition to a function-based organizational structure, the IRD has established a large taxpayer office to improve compliance among the largest taxpayers. Staff have been appointed to 21% of the approved positions in the large taxpayer office, of whom half are female. Under the second stage of the program, the government plans to further operationalize the large

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taxpayer office, introduce new legislation for a VAT and income tax, and expand its health taxes.

Public financial management for fiscal resilience: Although we have a solid legislative framework under the Public Financial Management Act (2013), the Government has prioritized strengthening the regulations, strategies, and working-level guidelines under this legislation to improve the efficiency, transparency, and integrity of public spending. Towards this end, Public Financial Management Procurement Regulations have entered into force which improve MoFT's oversight of procurement activities and contractual commitments. The Permanent Secretary of MoFT has endorsed a Financial Controllers' Operations Manual that consolidates public financial management guidelines and provides budget submission templates and timetables. The manual will support Financial Controllers across ministries to better manage the Government's financial operations as required by the Public Financial Management Act (2013).

Maintaining debt sustainability continues to be a key priority for the Government. The Medium-Term Debt Management Strategy (MTDMS) for 2021–2024 assesses various financing options and sets debt management goals consistent with macroeconomic stability. Under the second stage of the program, the Government plans to continue implementing the MTDMS, approve new Budget Regulations under the Public Financial Management Act (2013), expand the coverage of the Financial Controllers' Operations Manual, and implement selected recommendations from the World Bank public expenditure review.

Enabling environment for private sector recovery: The Government and CBSI are committed to ensuring that Solomon Islands' payments system and infrastructure is modernized, efficient and meets international standards. Earlier this year, Parliament passed the Payment Systems Act which expands CBSI's authority and responsibility to regulate and monitor payments and securities settlements. This will help mitigate risks as the finance sector develops and provides the legal basis for Solomon Islands to move away from outdated and cumbersome manual payments methods. Complementing this, the National Women's Financial Inclusion Policy 2022-2026 aims to build an inclusive and sustainable financial system in Solomon Islands. The Cabinet has approved a Financial Institutions Act policy paper to guide consultation and legislative reform that strengthens the CBSI's prudential supervision and supports the development of the finance sector.

The Government is committed to ensuring that its public investments, including in state-owned enterprises (SOEs), remain efficient and contribute to public welfare. The Cabinet approved a policy paper to provide a sound basis to develop an SOE Act amendment bill for tabling to Parliament under the second stage of the program. Having passed legislation in 2018 to establish the Solomon Islands Independent Commission Against Corruption (SIICAC), the Government is committed to support the commission to operationalize and tackle corruption. This commitment is demonstrated by Cabinet

approving a new budget allocation to support SIICAC's operations in the 2021 government budget. The Prime Minister has issued regulations governing the remuneration of SIICAC commissioners. Under the second stage of the program, the Government plans to (i) introduce legislation governing financial institutions, (ii) operationalize and roll-out the national payments system (iii) introduce a further regulation to govern SIICAC's investigation of corruption cases, and (iv) operationalize a database of SOE board members.

Request from Government of Solomon Islands

The Government is firmly committed to implementing this program to support Solomon Islands' recovery efforts. This is demonstrated by our efforts to push forward with much-needed reform despite the current challenging fiscal and economic situation. As the recovery gets underway, I am confident that the reforms targeted under the second stage of the program can be achieved with TA from the ADB and other JPRG development partners. Relevant policies, strategies and bills have been approved and commenced implementation, in line with the first stage of the agreed program. We therefore seek the ADB's consideration of our request for a policy-based grant of \$5.0 million and a policy-based concessional loan of \$5.0 million based on the satisfactory completion of the agreed policy actions under subprogram 1. The program will help finance the anticipated fiscal deficit in 2022 and our development financing needs.

We look forward to continuing our close collaboration with the ADB through the program.

Yours sincerely,


Hon Harry D Kuma, MP
Minister for Finance and Treasury

