



## Concept Paper

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**PUBLIC**

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# 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 6 October 2022)

|               |   |                               |
|---------------|---|-------------------------------|
| Currency unit | – | Solomon Islands dollar (SI\$) |
| SI\$1.00      | = | \$0.12                        |
| \$1.00        | = | SI\$8.15                      |

## ABBREVIATIONS

|          |   |   |
|----------|---|---|
| ADB      | – | Asian Development Bank                                    |
| COVID-19 | – | coronavirus disease                                       |
| GDP      | – | gross domestic product                                    |
| IMF      | – | International Monetary Fund                               |
| IRD      | – | Inland Revenue Division                                   |
| JPRG     | – | Joint Policy Reform Group                                 |
| 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                                      |

## 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  | <a href="https://www.adb.org/Documents/LinkedDocs/?id=55011-001-CEI">https://www.adb.org/Documents/LinkedDocs/?id=55011-001-CEI</a>                     |  |                                  |
| Portfolio at a Glance  | <a href="https://www.adb.org/Documents/LinkedDocs/?id=55011-001-PortAtaGlance">https://www.adb.org/Documents/LinkedDocs/?id=55011-001-PortAtaGlance</a> |  |                                  |
| 2. Sector  | Subsector(s)  | 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  |   | 0.000  |                                  |
| None   |   | 0.000  |                                  |
| Counterpart  |   | 0.000  |                                  |
| None   |   | 0.000  |                                  |
| Total  |   | 10.000   |                                  |
| Currency of ADB Financing: US Dollar   |   |  |                                  |

## I. THE PROPOSAL

1. The Supporting Fiscal and Economic Recovery Program will help the Government of Solomon Islands implement reforms to support a resilient economic and fiscal recovery from the contraction caused by the coronavirus disease (COVID-19) pandemic. The proposed program comprises two subprograms to promote (i) tax reform for domestic revenue mobilization, (ii) public financial management (PFM) for fiscal resilience, and (iii) an enabling environment for private sector recovery.<sup>1</sup> It aligns with the Asian Development Bank (ADB) Strategy 2030 operational priorities of addressing remaining poverty and reducing inequality, strengthening governance and institutional capacity, and accelerating progress in gender equality.<sup>2</sup> The program is consistent with the priorities of the Pacific Approach, 2021–2025.<sup>3</sup>

2. The program will be financed through (i) a grant and a loan of \$5 million each for subprogram 1 in 2022, and (ii) a grant and loan of \$5 million each for subprogram 2 to be approved in 2024. A policy-based 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. Subprogram 1 supports reforms to develop and introduce new policies and legislation and to establish new organizational units to promote economic and fiscal recovery. Subprogram 2 will focus on implementing, embedding, and expanding the policy and legislative decisions approved in subprogram 1 to help realize and sustain the development impacts (paras. 13–15).

## II. PROGRAM AND RATIONALE

### A. Background and Development Constraints

3. **Development context.** Solomon Islands is a small island developing state whose narrow economy is based on exports of natural resources. The forestry industry, which accounts for about two-thirds of exports and 22% of tax revenue, faces a decline as resources are being depleted.<sup>4</sup> The country is geographically scattered and consists of many islands, which contributes to large infrastructure gaps. Its fragile institutional capacity is vulnerable to corruption. Remoteness from markets, human capital shortages, and vulnerability to external shocks constrain economic development. Real per capita gross domestic product (GDP) is one of the lowest in the Pacific.

4. **Sound macroeconomic management.** Despite the challenges, annual 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 extending the withholding tax regime and increasing excise taxes on tobacco and alcohol; and provisions to clear accumulated domestic payment arrears to private sector contractors.<sup>5</sup> 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% of GDP in 2016–2017.<sup>6</sup>

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<sup>1</sup> A preliminary draft of the policy design and monitoring framework is in Appendix 1.

<sup>2</sup> ADB. [Strategy 2030: Achieving a Prosperous, Inclusive, Resilient, and Sustainable Asia and the Pacific](#).

<sup>3</sup> ADB. [Pacific Approach, 2021–2025](#). It supports preparing for and responding to shocks and inclusive growth.

<sup>4</sup> Government of Solomon Islands. 2022. *2022 Financial Policy Objectives and Strategies Budget Paper: Volume 1*. Honiara. The contribution of logging to exports and fiscal revenue has fallen since 2018.

<sup>5</sup> These measures were supported by ADB. [Solomon Islands: Improved Fiscal Sustainability Reform Program](#).

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

5. **Economic shocks.** The government's public health response to the pandemic, including closing the borders, prevented an outbreak of the disease until 2022. However, the economy was hit hard by trade and travel disruptions and the effects of Cyclone Harold in 2020, leading to a 3.4% GDP decline in 2020. Social unrest in the capital, Honiara, contributed to a further 0.5% GDP decline in 2021.<sup>7</sup> The government implemented a fiscal stimulus package to protect jobs and stabilize the economy.<sup>8</sup> It also reprioritized expenditures to reduce nonessential spending. Revenue and grants fell from 39.4% in 2018 to 31.5% of GDP in 2021; expenditure dropped from 38.5% in 2018 to 35.2% of GDP in 2021. Fiscal deficit averaged 3.7% of GDP in 2020–2021. The International Monetary Fund (IMF) noted that the supportive fiscal and monetary policy measures to respond to COVID-19 were appropriate.<sup>9</sup>

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.<sup>10</sup> Economic recovery is expected from the second half of 2022 as restrictions ease and the border reopens, and GDP is projected to grow by 3.0% in 2023.<sup>11</sup> ADB assessed the general direction of macroeconomic policies to be satisfactory. While fiscal deficit is projected to widen to 6.8% of GDP in 2022 because of revenue shortfalls as spending rises to mitigate the impact of the negative shocks, it is projected to narrow to 4.0% in 2024 with increased revenue effort and recurrent expenditure controls (footnote 6). Public debt is projected to rise from 14.8% of GDP in 2021 to 28.6% 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 assessed as appropriate. Solomon Islands is at moderate risk of debt distress (footnote 9). The outlook is subject to downside risks from external shocks and disasters.<sup>12</sup>

7. **Binding constraints.** Solomon Islands faces constraints that, without concerted reforms, can undermine a resilient economic and fiscal recovery (paras. 8–10).

8. **Inefficient revenue mobilization.** Solomon Islands' tax system is complex, expensive to administer, and relies on high rates applied to a narrow base, discouraging compliance. No overarching tax administration legislation exists. 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). No online tax return facility exists, high tax arrears indicate problems with taxpayers' compliance, and significant revenue is foregone through in tax exemptions (footnote 9). Before COVID-19, tax revenue had not kept pace with nominal GDP growth.<sup>13</sup>

9. **Weak public financial management.** Economic shocks have increased liquidity pressures and exposed PFM challenges, as indicated by the reemergence of payment arrears. The Public Financial Management Act 2013 provides a solid legislative framework but regulations and institutions to guide budget planning and public procurement are incomplete. Turnover is high among financial controllers, who generally have low capacity, undermining the quality and timely

<sup>7</sup> Protests and riots in Honiara caused economic damage equivalent to about 6.7% of GDP.

<sup>8</sup> The fiscal stimulus package was equivalent to about 2.6% of GDP, spread over 2020–2021.

<sup>9</sup> IMF. 2022. Solomon Islands: 2021 Article IV Consultation-Press Release; Staff Report; and Statement by the Executive Director for Solomon Islands. *IMF Staff Country Report*. No. 2022/014. Washington, DC.

<sup>10</sup> After avoiding COVID-19 outbreaks until January 2022, Solomon Islands confirmed 21,544 cases and 153 deaths as of 11 August 2022. World Health Organization. [WHO Coronavirus \(COVID-19\) Dashboard: Solomon Islands](#) (accessed 12 August 2022).

<sup>11</sup> ADB. 2022. [Asian Development Outlook 2022 Update: Entrepreneurship in the Digital Age](#). Manila.

<sup>12</sup> Inflation is projected at 4.0% in 2022 and 2023, mainly because of high global oil prices.

<sup>13</sup> The ratio of tax revenue to GDP declined from 24.9% in 2016–2017 to 23.6% in 2018–2019.

submission of budget reporting to the Ministry of Finance and Treasury (MOFT). Budget planning weaknesses have led to regular budget transfers to manage unplanned expenditure. Poor targeting of government expenditure can undermine fiscal recovery and gender equality improvements. The lack of a medium-term debt management strategy (MTDMS) means debt financing strategies are unclear, creating debt sustainability risks.

10. **Barriers to private sector activity.** Limitations in the regulatory and legal framework can constrain the recovery of the private sector. Because banks lack an electronic funds transfer system, business and government transactions rely on inefficient manual payment methods. Along with limitations in the legislation for central bank prudential supervision, this adds to finance sector risks and may undermine greater financial inclusion. Laws on supervising and regulating financial institutions need to be updated to reflect new technology. Weak debt enforcement can induce lenders to demand highly liquid collateral that is difficult for borrowers to provide, limiting credit to the private sector. Although state-owned enterprises (SOEs) deliver 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 (2019). Women are underrepresented in many areas of business leadership.<sup>14</sup> Corruption poses obstacles to doing business,<sup>15</sup> and despite landmark legislation to establish the Solomon Islands Independent Commission Against Corruption (SIICAC) in 2018, an inadequate funding allocation and regulatory framework pose risks to SIICAC's capacity to tackle corruption.<sup>16</sup>

11. **Government strategy.** Under the National Development Strategy, 2016–2035, the government targets increased inclusive economic growth and an improved environment for private sector development.<sup>17</sup> 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 2022 budget theme, Building Our Resilience, focuses on building a resilient economy that withstands the impacts of COVID-19 (footnote 4).

## **B. Policy Reform, ADB's Value Addition, and Sustainability**

12. **Program description.** The program will help the government transition from immediate crisis response to resilient economic and fiscal recovery by delivering three reform areas (paras. 13–15) that broadly align with the joint government–development partner Joint Policy Reform Group (JPRG) (para. 16).<sup>18</sup> Subprogram 2 policy actions will deepen the foundational reforms introduced under subprogram 1, focusing on implementation. Subprogram 2 reforms are directional and will be further refined with monitorable actions during processing.

<sup>14</sup> The proportion of women in board director positions was 11.0%, below the regional average of 21.0%, in a study that included SOEs, industry associations, and private sector organizations. The Pacific Private Sector Development Initiative. 2021. *Leadership Matters: Benchmarking Women in Business Leadership in the Pacific*. Sydney.

<sup>15</sup> In a 2021 study, 90% of respondents said that corruption in the business sector was a big problem in Solomon Islands, higher than the Pacific regional average of 56% and the highest in the 10-country study. Transparency International. 2021. *Global Corruption Barometer Pacific 2021: Citizens' View and Experiences of Corruption*. Berlin.

<sup>16</sup> The Anti-Corruption Act 2018 established SIICAC to prevent, investigate, and prosecute corruption offences.

<sup>17</sup> Government of Solomon Islands. 2016. *National Development Strategy, 2016–2035*. Honiara.

<sup>18</sup> The JPRG is a collaborative process to identify reforms and coordinate technical assistance and budget support between the government and its development partners. The 2022–2023 JPRG reform areas are (i) support domestic resource mobilization, (ii) strengthen PFM and promote sound fiscal policy, and (iii) promote good governance and economic growth. The program reform areas also build on achievements in PFM, fiscal sustainability, and the private investment climate supported by ADB's Improved Fiscal Sustainability Reform Program. ADB. 2020. [Completion Report: Improved Fiscal Sustainability Reform Program in Solomon Islands](#). Manila.

13. **Reform area 1: Tax reform for domestic revenue mobilization.** Under subprogram 1, the cabinet will approve for tabling to Parliament (i) a tax administration bill that provides the legal basis to introduce a unified set of rules and penalties for all tax types and modernize IRD systems, laying the foundation for further tax reform; and (ii) a value-added tax bill that replaces various other taxes with a broad-based value-added tax. The cabinet will also approve and MOFT will implement (i) a new tax on sugar and sugary drinks to improve health outcomes and raise revenue, and (ii) a new tax on single-use plastics and other plastics with toxic components. MOFT will approve and begin operationalizing a new large taxpayer office to improve compliance of the largest taxpayers by ensuring sufficient resources to administer collections. Under subprogram 2, the government will continue to implement the value-added tax, introduce legislation for income tax, further operationalize the large taxpayer office, and expand its health taxes.

14. **Reform area 2: Public financial management for fiscal resilience.** Under subprogram 1, the cabinet will approve an MTDMS for 2022–2024 to provide clear financing strategies and debt service requirements. MOFT will approve (i) procurement regulations that promote transparency and efficiency, and (ii) a Financial Controllers' Operations Manual that consolidates PFM guidance and provides templates on budget submissions and task schedules. Under subprogram 2, the government will implement the MTDMS, approve new budget regulations, expand the coverage of the Financial Controllers' Operations Manual, and implement selected recommendations from the upcoming World Bank public expenditure review.

15. **Reform area 3: Enabling environment for private sector recovery.** Under subprogram 1, to enable introducing secure, reliable electronic payments by businesses, the government, and individuals, the cabinet will approve for tabling to Parliament a national payments system bill and MOFT will operationalize the central bank-administered Automated Transfer System. The cabinet will approve a new financial institutions policy paper to guide legislative reform that strengthens the central bank's prudential supervision and supports finance sector development. The cabinet will approve for tabling to Parliament amendments to the State-Owned Enterprises Act 2007 and State Owned Enterprises Regulations 2010 that align with the SOE Ownership Policy and promote gender diversity. A new budget allocation will be established for SIICAC to support its operations, and regulations governing the remuneration of its commissioners will be approved. Under subprogram 2, the government will (i) introduce overarching legislation for financial institutions, (ii) introduce regulation to govern the national payments system, (iii) introduce regulation to govern SIICAC's investigation of corruption cases, and (iv) operationalize a database of SOE board members and introduce SOE reporting on gender diversity.

16. **Partner coordination.** ADB coordinated program design and technical assistance (TA) with development partners, particularly the governments of Australia, New Zealand, and Japan; the European Union; and the World Bank through the JPRG. Cofinancing will be confirmed during fact-finding. ADB coordinated with the IMF on policy reform issues during program design.

17. **ADB's value addition.** ADB provided TA and the Domestic Resource Mobilization Project to support analysis to underpin tax reforms and continues to support IRD to implement reforms.<sup>19</sup> ADB provided TA to support (i) consultation and drafting of the Financial Controllers' Operations Manual (footnote 19), and (ii) drafting of amendments to the SOE act and regulations and the

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<sup>19</sup> ADB. [Regional: Improving Pacific Public Financial Management Facility](#); and ADB. [Solomon Islands: Domestic Resource Mobilization Project](#).



financial institutions policy paper.<sup>20</sup> ADB also supported the government to mitigate COVID-19 impacts.<sup>21</sup>

18. **Sustainability and lessons.** The program builds on ADB's long-standing support for economic and fiscal management.<sup>22</sup> Based on lessons, the program builds on regular dialogue through the JPRG to coordinate the TA with the development partners. It also limits actions to key reforms that are prioritized by the government to avoid overloading limited capacity.<sup>23</sup> By supporting the collection of sex-disaggregated data, the program will build implementing agencies' capacity to monitor progress on gender equality (para. 23). ADB and the government will develop a post-program partnership framework during the processing of subprogram 2 to support reform progression.

### C. Expected Outcome of the Reform

19. The program is aligned with the country's development objective of increasing inclusive economic growth and improving the environment for private sector development (footnote 1717). Its outcome will be resilient economic and fiscal recovery in Solomon Islands. 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, including oversight of financial institutions and SOEs.

### D. Development Financing Needs and Budget Support

20. ADB's proposed budget support financing is based on reform sequencing and the government's development financing needs. The proposed 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 an estimated financing gap of \$99.7 million in 2022 and \$63.1 million in 2024, based on projected fiscal deficits (exclusive of ADB support). ADB has assessed that debt distress risk will remain moderate and debt will remain sustainable, inclusive of program financing. Budget support from the JPRG's other partners is also planned for 2022.

### E. Implementation Arrangements

21. MOFT leads the JPRG process and will oversee the program as the executing agency. IRD, the Central Bank of Solomon Islands, and SIICAC are the other implementing agencies. The JPRG will continue facilitating consultations on reform priorities. The indicative implementation period is October 2020–September 2022 for subprogram 1 and October 2022–September 2024 for subprogram 2. The proceeds of the policy-based grant and loan will be withdrawn in a single

<sup>20</sup> ADB. [Regional: Pacific Private Sector Development Initiative, Phase IV](#).

<sup>21</sup> 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. [Pacific Disaster Resilience Program](#); and ADB. [Solomon Islands: COVID-19 Rapid Response Program](#).

<sup>22</sup> ADB. 2020. [Completion Report: Improved Fiscal Sustainability Reform Program in Solomon Islands](#). Manila; ADB. 2018. [Completion Report: Economic Growth and Fiscal Reform Program in Solomon Islands](#). Manila; ADB. 2015. [Completion Report: Economic and Financial Reform Program in Solomon Islands](#). Manila; and ADB. 2013. [Completion Report: Economic Recovery Support Program in Solomon Islands—Subprograms 1 and 2](#). Manila.

<sup>23</sup> ADB. 2020. [Completion Report: Improved Fiscal Sustainability Reform Program in Solomon Islands](#). Manila.

tranche for subprogram 1, upon effectiveness, following ADB's *Loan Disbursement Handbook* (2017, as amended from time to time).

### III. DUE DILIGENCE REQUIRED

22. ADB will request an assessment letter from the IMF, and program due diligence will include a risk assessment and mitigation plan, program impact assessment, and public sector management assessment. Program risks relating to weak PFM and procurement, and corruption are expected to be partially mitigated by program reforms. The proposed safeguards classification is *category C* for the environment, involuntary settlement, and indigenous peoples. The program will not modify or weaken any environmental safeguard policy or regulation in Solomon Islands.

23. The program's proposed gender mainstreaming category is *some gender elements*. The program supports regulation to ensure data on corruption complaints to SIICAC is disaggregated by sex to better track and respond to the gender impacts of corruption. To promote the increased representation of women in the economy, the program supports (i) amending SOE legislation and regulation to incorporate gender diversity provisions, (ii) establishing a database of current and prospective board directors disaggregated by sex, and (iii) SOE reporting on gender diversity. Further gender elements will be explored during due diligence.

### IV. PROCESSING PLAN

#### A. Risk Categorization

24. The program is categorized *low risk* because (i) the aggregate loan and grant amount for each subprogram does not exceed \$50 million, (ii) ADB has a strong track record of engaging in Solomon Islands' public sector, (iii) the executing agency has reasonable capacity and experience administering policy-based programs (footnote 23), and (iv) the operation is not expected to be classified as *category A* for any safeguards category.

#### B. Resource Requirements

25. ADB estimates that 18 person-months of staff time will be required to process the program.

#### C. Processing Schedule

26. The milestones and their expected completion date are summarized in the table.

**Proposed Processing Schedule**

| Milestones                   | Expected Completion Date |
|------------------------------|--------------------------|
| Concept approval             | September 2022           |
| Fact-finding                 | September 2022           |
| Staff review meeting         | October 2022             |
| Loan and grant negotiations  | October 2022             |
| Board consideration          | December 2022            |
| Loan and grant effectiveness | December 2022            |

Source: Asian Development Bank.

### V. KEY ISSUES

27. ADB will monitor potential shifts in the economic and political context, including after the 2024 general election, to ensure subprogram 2 reinforces the government's reform agenda.

## PRELIMINARY POLICY DESIGN AND MONITORING FRAMEWORK

|  |   |   |
|--|---|---|
| <b>Country's Overarching Development Objectives</b><br>Rate of inclusive economic growth reinvigorated and increased<br>Environment for private sector development improved and investment opportunities for all Solomon Islanders increased<br>(National Development Strategy, 2016–2035) <sup>a</sup>  |   |   |
| <b>Outcome</b><br>A resilient economic and fiscal recovery in Solomon Islands  | <b>Risks and Critical Assumptions</b><br>R1: Economic shocks, including those to commodity markets and from disasters, exacerbate the current economic downturn.<br>R2: Continuing COVID-19 impacts expose fragilities in public sector capacities and undermine reform progress.<br>R3: Increased socio-economic instability weakens pace of reforms and fiscal discipline.  |   |
| <b>Indicative Policy Actions: Subprogram 1<sup>b</sup></b><br>(October 2020–September 2022)  | <b>Indicative Policy Actions: Subprogram 2<sup>b</sup></b><br>(October 2022–September 2024)   | <b>Outcome Indicators<sup>b</sup></b><br>By September 2025:   |
| <b>Reform Area 1: Tax reform for domestic revenue mobilization</b>   |   |   |
| 1.1. To modernize tax administration and unify the framework for different taxes, the cabinet will approve and table to Parliament for enactment a tax administration bill. <sup>c</sup><br><br>1.2. To raise revenue in a more efficient manner, the cabinet will approve and table to Parliament for enactment a value added tax bill 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.<br><br>1.3. To ensure there are sufficient resources to administer collections from the largest taxpayers, the MOFT will<br>1.3.1. approve the establishment of a new LTO, in line with IRD restructure; and<br>1.3.2. begin to operationalize the LTO by appointing staff to at least 20% of the approved positions, of whom at least 40% are female. <sup>d</sup> | 2.1 To enable taxpayers to meet their tax payment obligations in a timelier manner, the cabinet will approve and table 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 approved in subprogram 1; and is informed by gender analysis and consultations with women's business organizations.<br><br>2.2 To improve the efficiency of revenue collection, the MOFT will begin implementing the value added tax, approved under subprogram 1, by operationalizing new systems and processes in IRD.<br><br>2.3 To improve administration of collections from the largest taxpayers<br>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 <sup>f</sup> ; and | a. Ratio of tax (excluding logging taxes) to GDP exceeds the 2021 level (2021 baseline: 16.4% estimated tax–GDP ratio). Source: IMF Article IV reports.<br><br>b. On-time filing rate for large taxpayers is increased above pre-pandemic levels (2019 baseline: TBC). <sup>h</sup> Source: IRD reporting.<br><br>c. Tax debt for large taxpayers is reduced below the pre-pandemic level (2019 baseline: TBC) Source: IRD reporting. |

| Indicative Policy Actions: Subprogram 1 <sup>b</sup><br>(October 2020–September 2022)  | Indicative Policy Actions: Subprogram 2 <sup>b</sup><br>(October 2022–September 2024)   | Outcome Indicators <sup>b</sup><br>By September 2025:   |
|--|---|---|
| <p>1.4. To raise revenue and improve development outcomes, the cabinet will approve and the MOFT will implement</p> <p>1.4.1. a new tax on sugar and sugary drinks to improve health outcomes particularly for women who have higher levels of obesity and diabetes than men, by discouraging sugar consumption, and raise revenue<sup>e</sup>; and</p> <p>1.4.2. a new tax on single-use plastics and other plastics with toxic components to reduce plastic pollution.</p>   | <p>2.3.2 the LTO will implement tax collections from large taxpayers.</p> <p>2.4 To raise revenue and help prevent disease, the government will implement a new health tax on at least one product that has a negative public health impact.<sup>g</sup></p>  |   |
| <b>Reform Area 2: Public financial management for fiscal resilience</b>  |   |   |
| <p>1.5. To improve debt management arrangements, the cabinet will approve with immediate effect and MOFT will publish on its website a MTDMS for 2022–2024, which includes financing strategies and debt service requirements.</p> <p>1.6. To improve the governance of public spending, the MOFT will</p> <p>1.6.1 approve with immediate effect and publish in the official gazette new procurement regulations as required under the PFM Act (2013) which include a principle that procurement activities support equality of opportunity and provide economic opportunities for women, youth and people with disabilities<sup>i</sup>; and</p> <p>1.6.2 approve with immediate effect a new comprehensive Financial Controllers' Operations Manual that clarifies the roles and responsibilities of Financial Controllers across line ministries to enable more effective management of public financial operations as required by the PFM Act (2013).</p> | <p>2.5 To support debt sustainability, the MOFT will implement the MTDMS for 2022–2024 through the 2023 and 2024 budgets which are underpinned by the MTDMS provisions for sustainability and affordability.<sup>j</sup></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 as required 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.</p> | <p>d. Public debt sustainability assessment rating of sustainable is maintained based on IMF debt sustainability analysis and public debt remains below the government's nominal debt threshold of 35% of GDP (December 2021 baseline: Rated sustainable, and public debt estimated equivalent to 16.2% of GDP). Source: IMF Article IV Consultation and Staff Visit reports</p> <p>e. Value of recurrent budget transfers (virements) in the first half of 2025 falls below pre-pandemic level (January–June 2019 baseline: recurrent budget virements equal SI\$21.5 million) Source: Government of Solomon Islands Mid-Year Budget Review reports.</p> |
| <b>Reform Area 3: Enabling environment for private sector recovery</b>   |   |   |
| <p>1.7. To transition to a modern payments infrastructure and regulatory system which supports the expansion of digital payment instruments that have</p>  | <p>2.7 To support implementation of a modern electronic national payments system, the government will approve with immediate effect</p>   | <p>f. Number of active companies registered increases by 350 (September 2020)</p>   |

| Indicative Policy Actions: Subprogram 1 <sup>b</sup><br>(October 2020–September 2022)   | Indicative Policy Actions: Subprogram 2 <sup>b</sup><br>(October 2022–September 2024)   | Outcome Indicators <sup>b</sup><br>By September 2025:  |
|---|---|--|
| <p>potential to improve business efficiency and increase financial inclusion, the</p> <p>1.7.1. Cabinet will approve and table to Parliament for enactment a national payments system bill to provide a legal framework to introduce an electronic payment and settlement system; and</p> <p>1.7.2. MOFT will join and operationalize the Automated Transfer System administered by the Central Bank of Solomon Islands to enable more secure, and reliable payments between government, businesses, and individuals.<sup>k</sup></p> <p>1.8. To understand the opportunities and risks related to financial sector development, the cabinet will approve with immediate effect a new Financial Institutions Act Policy paper that will (i) guide further consultation; (ii) include gender gap analysis; and (iii) provide 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 will approve and table to Parliament for enactment amendments to the SOE Act (2007) and Regulations (2010) which (i) align with the SOE Ownership Policy (2019),<sup>l</sup> (ii) consolidate the ministerial oversight of SOEs, and (iii) provide for promotion of gender diversity among SOE staff and board members.<sup>m</sup></p> <p>1.10. To fight corruption and improve the business environment, the government will operationalize the SIICAC, through</p> <p>1.10.1. establishment of a budget allocation for SIICAC starting with the 2021 government budget, and appropriation of funds in 2021 and 2022;<sup>n</sup> and</p> | <p>and publish in the official gazette new regulations as required under the national payments system bill.</p> <p>2.8 To support financial sector development and effective supervision and regulation of financial institutions, the cabinet will approve and table to Parliament for enactment an updated financial institutions bill, based on the Financial Institutions Policy paper approved in subprogram 1.</p> <p>2.9 To support the implementation of the amended SOE Act and Regulations, approved under subprogram 1</p> <p>2.9.1 MOFT will establish and operationalize a database of current and qualified, prospective board members disaggregated by sex, qualification, and sectoral experience; and</p> <p>2.9.2 90% of the SOE portfolio by value will publicly release their 2023 Annual Report which incorporates reporting on gender diversity.<sup>o</sup></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> | <p>baseline: 2,389 active registered companies).<br/>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).<br/>Source: Solomon Islands Registry of Companies (Company Haus).</p> <p>h. Number of active users of a financial account increases by 116,000 (March 2020 baseline: 283,954 active users of a financial account).<br/>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).<br/>Source: Central Bank of Solomon Islands reporting on the National Financial Inclusion Strategy 2021–2025.</p> |

| Indicative Policy Actions: Subprogram 1 <sup>b</sup><br>(October 2020–September 2022)  | Indicative Policy Actions: Subprogram 2 <sup>b</sup><br>(October 2022–September 2024) | Outcome Indicators <sup>b</sup><br>By September 2025: |
|--|---|---|
| 1.10.2. approval by the Prime Minister with immediate effect regulations outlining the remuneration of the SIICAC Commissioners. |   |   |

**Budget Support**

ADB:

Subprogram 1: \$5.0 million (grant) and \$5.0 million (loan)

Subprogram 2: \$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, NDC = National Determined Contribution, PFM = public financial management, SIICAC = Solomon Islands Independent Commission Against Corruption, SOE = state-owned enterprise, TBC = to be confirmed.

<sup>a</sup> Government of Solomon Islands. 2016. *National Development Strategy, 2016–2035*. Honiara.

<sup>b</sup> In line with the Staff Instruction on Business Processes for Policy-Based Lending (issued 19 January 2021): “The indicative policy actions and outcome(s) are presented in a preliminary format in the concept paper, with further details elaborated and/or confirmed during fact-finding and presented in the RRP.” Dates of approval and/or effectivity will be added as they become available. An outcome indicator may cover multiple reform areas. Baseline values for some indicators are pending availability, and will be provided in the RRP. Indicative actions are based on available information at the concept stage.

<sup>c</sup> 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 bill 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 tax administration bill 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.

<sup>d</sup> 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.

<sup>e</sup> Discouraging sugar consumption may help reduce conditions such as obesity and diabetes that are more prevalent among women. 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*. <https://www.who.int/publications/m/item/diabetes-slb-country-profile-solomon-islands-2016> 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.

<sup>f</sup> 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. However, the objective is for 100% of positions to be filled. The target will be confirmed during fact-finding for subprogram 2.

<sup>g</sup> The expansion of the government’s health taxes is under discussion. Further details on the targeting will be elaborated and/or confirmed during fact-finding and presented in the RRP.

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- <sup>h</sup> 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.
  - <sup>i</sup> 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. 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 would also formally establish a Procurement Unit within MOFT to undertake training in line ministries, check compliance and to maintain the regulatory framework over time.
  - <sup>j</sup> The MTDMS will be implemented through to 2024, and implementation is institutionalized through the cabinet approval of the strategy. The implementation period of subprogram 2 will cover the implementation of the 2023 budget and the 2024 budget strategy.
  - <sup>k</sup> The Automated Transfer System is intended to enable automation and digitisation of transactions for payroll, customs, and tax payments. This will enable the government, business, and individuals to benefit from faster transactions with reduced scope for corruption and errors. Adoption of the Automated Transfer System should enable significant efficiency gains where government capacity is currently limited.
  - <sup>l</sup> 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. [Regional Policy Advisory and Technical Assistance for the Pacific Private Sector Development Initiative, Phase III.](#)
  - <sup>m</sup> The amendments to the SOE Act (2007) and Regulations (2010) will provide that (i) gender diversity is established as an objective of each SOE, and (ii) require that at least one female candidate meeting the requisite qualifications be shortlisted for each vacancy.
  - <sup>n</sup> The budget allocation for SIICAC will be established under the Office of the Prime Minister and Cabinet budget head and budget appropriations are intended to continue in future years.
  - <sup>o</sup> Solomon Islands' SOE portfolio consists of six active SOEs. The three largest SOEs, which are Solomon Islands Electricity Authority, Solomon Islands Port Authority and the Solomon Islands Water Authority, comprise 92% of the portfolio by value. None of the SOEs report on gender diversity in their annual reports, and very few deliver their audited accounts to the Minister within 3 months of the financial year. The ultimate objective is to have 100% of the SOE portfolio reporting on gender diversity in their Annual Reports.

Source: Asian Development Bank

**LIST OF LINKED DOCUMENTS**

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

1. Initial Poverty and Social Analysis
2. Sector Assessment (Summary): Public Sector Management