



Program Information Document (PID)

Concept Stage | Date Prepared/Updated: 05-May-2023 | Report No: PIDC35430



BASIC INFORMATION

A. Basic Project Data

Country Solomon Islands	Project ID P178676	Project Name The First Solomon Islands Resilience DPO with a Catastrophe Deferred Drawdown Option (P178676)	Parent Project ID (if any)
Region EAST ASIA AND PACIFIC	Estimated Board Date Nov 10, 2023	Practice Area (Lead) Macroeconomics, Trade and Investment	Financing Instrument Development Policy Financing
Borrower(s) Solomon Islands	Implementing Agency Ministry of Finance and Treasury		

Proposed Development Objective(s)

The proposed series of two operations supports the Solomon Islands Government in its efforts to improve fiscal management, private sector growth, and disaster resilience

Financing (in US\$, Millions)

SUMMARY

Total Financing	25.00
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DETAILS

Total World Bank Group Financing	25.00
World Bank Lending	25.00

Decision

The review did authorize the preparation to continue



B. Introduction and Context

Country Context

Solomon Islands is a remote archipelago that faces a unique set of development challenges. The population of 721,000 is dispersed over 90 inhabited islands, stretching across 1.6 million square kilometers of ocean. Such geographical dispersion, combined with remoteness to international markets, shapes the development challenges. In addition, limited capacity in government combined with institutional fragility pose a continuous threat to sustainable development. These constraints make the design and implementation of public policy challenging, resulting in large development gaps and persistent fiscal challenges. The need for economic diversification is urgent given over-reliance on a declining logging sector. Attempts to find new sources of economic growth, however, are constrained by several impediments, including an unfavorable business environment. Over the past 30 years there have been seven major disasters triggered by natural hazards, resulting in loss of life and severe adverse economic impacts.¹ In the next 50 years, the country is expected to incur an average annual loss of 5 percent of GDP due to earthquakes and tropical cyclones. Climate change impacts are expected to compound these negative effects, with projected increases in air temperature, sea-level rise and increases in the incidence of extreme weather events. This makes natural disasters and climate change critical development challenges for the country.

A recovery is currently underway, following three consecutive years of economic contraction. The current account deficit more than doubled compared to 2021, reaching 13.3 percent of GDP in 2022. Stagnating revenue collection and increasing development expenditures resulted in a widening fiscal deficit, from 3.6 percent of GDP in 2021 to 4.1 percent of GDP in 2022. Public debt increased to 16.9 percent of GDP as of end-2022, up from 7.9 percent of GDP in 2019. In response to inflationary pressures, Central Bank of Solomon Islands tightened its monetary policy stance in March 2023. The financial system has shown relative stability during recent adverse shocks. The economy is expected to recover in the medium term, with an average growth rate of 2.7 percent over the period 2023-2026. Inflation is projected to average 3.8 percent during 2023-2026. The current account deficit is projected to remain large, averaging 10.1 percent of GDP over the period of 2023–2026. Large-scale investments for the 2023 Pacific Games combined with expenditures for the preparation of the 2024 elections will add to existing budget pressures. The fiscal deficit is projected to decline over the medium term. Revenue is projected to stabilize at 26.2 percent of GDP in the medium term. Public spending is expected to consolidate and stabilize at 31 percent of GDP over the medium term (2023-2026). According to the April 2023 IMF/World Bank Debt Sustainability Analysis (DSA), Solomon Islands remains at a moderate risk of debt distress. The banking system has been relatively stable, although risks have increased post-pandemic. The macroeconomic policy framework is considered adequate for the purposes of the proposed operation. The proposed operation supports the government to improve fiscal management, private sector growth, and disaster resilience

Relationship to CPF

The proposed operation is aligned with the priorities laid out under the Country Partnership Framework. The World Bank Group's Country Partnership Framework for Solomon Islands is structured around three focus areas, namely i) strengthening the foundations of well-being; ii) promoting inclusive and sustainable growth; and iii) managing uneven development. The program development objectives (PDOs) of the DPO series -- improving fiscal management, improving the enabling environment for sustainable private sector growth, and improving disaster resilience – are fully aligned with focus areas of the CPF. The PDOs are expected to support Solomon Islands' transition to more sustainable growth and

¹ The worst recorded catastrophic disaster event was Tropical Cyclone Namu in 1986 which caused 101 casualties leaving around 90,000 people homeless. Recent catastrophic events include the 2016 7.8 magnitude earthquake which triggered a tsunami that destroyed 191 houses, 11 schools and 1 medical clinic and impacted an estimated 34,000 people across three provinces (Makira, Malaita and Guadalcanal).



thereby contribute towards the Bank's twin goals of ending extreme poverty and promoting shared prosperity. The proposed operation aligns closely with broader World Bank Group engagements, including the World Bank's Climate Change Action Plan. These comprise World Bank projects in the mining, energy, and health sector, IFC's strategic priority to strengthen the country's financial infrastructure, and ongoing analytical engagements in public expenditure management, economic growth and private sector development. Furthermore, the proposed operation complements the Bank's engagement through the IDA Sustainable Development Financing Policy (SDFP). The approval of the VAT Bill – prior action # 1 – constitutes a Performance and Policy Action (PPA) for FY23. Pillar 3 is aligned with the World Bank Group's Climate Change Action Plan. The Plan notes that climate action is fundamental to alleviating poverty and promoting shared prosperity. Policy actions supported by this operation are also closely aligned with the IDA20 special themes.

C. Proposed Development Objective(s)

The proposed series of two operations supports the Solomon Islands Government in its efforts to improve fiscal management, private sector growth, and disaster resilience.

Key Results

Pillar 1: Improving fiscal management

The overall objective of Pillar 1 is to improve fiscal management by (i) increasing the productivity of the tax system, (ii) increasing revenue collection in the mining sector, and (iii) strengthening the effectiveness of public investments.

Increasing the productivity of the tax system

The results indicator will measure the country's progress in implementing the VAT reforms. After the enactment of the VAT Bill, a 2-year implementation period is foreseen, including capacity building, measures to mitigate VAT fraud and actions to optimize refund management.

Increasing revenue collection in the mining sector

The results indicator measures whether nickel shipments are valued based on a contained metals basis and whether new mining contracts were subject to a third-party review.

Strengthening the effectiveness of infrastructure investments

The results indicator will measure improvement in the infrastructure score of the Logistics Performance Index (LPI).

Pillar 2: Creating the enabling environment for private sector growth

The objective of Pillar 2 is to create the enabling environment for private sector growth by (i) improving the affordability of energy prices, and (ii) strengthening credit information systems and boosting access to credit.

Improving the affordability of energy prices

The results indicator will measure commercial electricity tariff differential relative to structural peers in the region (US\$/kwh).

Strengthening credit information systems and boosting access to credit

The results indicator will measure private sector credit as share of GDP.

Pillar 3: Improving resilience to climate change, natural disasters, and health emergencies

The overall objective of Pillar 3 is to improve resilience to climate change, natural disasters, and health emergencies by (i)



strengthening public health emergency preparedness, response, and recovery, (ii) improving the quality and resilience of buildings, and (iii) enhancing the framework for climate change mitigation and adaptation.

Strengthening public health emergency preparedness, response, and recovery

The results indicator will measure the National Health Emergency Council established and operational.

Improving the quality and resilience of buildings

The results indicator will measure share of new public buildings comply with the National Building Code.

Enhancing the framework for climate mitigation and adaptation

The results indicator will measure climate adaptation investments identified through vulnerability assessments at both community and sub-national level.

D. Concept Description

The proposed series supports the government's objective to improve fiscal management, address key constraints to private sector growth and enhance resilience to climate change, natural disasters and health-related risks. Pillar 1 aims to support fiscal management by reforming the tax system, improving the fiscal regime of the extractives sector and a better management of public investments. This is aligned with the government's policy to implement tax reforms for revenue mobilization. Pillar 2 serves to improve the business environment by reducing energy costs and enhancing private sector credit, aligned with the government's policy statement to create and promote more opportunities for business. Finally, pillar 3 aims to enhance resilience to natural disasters and health emergencies by improving the policy and institutional framework for health emergencies, increasing resilience of the built environment and a reviewing and updating the climate change policy. This pillar is aligned with the government's policy to strengthen preparedness and response protocols for health emergencies, and build resilience to climate change through adaptation and risk reduction.

The Prior Actions are:

Prior Action #1: To improve revenue collection, the Recipient, through its Cabinet, has approved the Value Added Tax (VAT) Bill, which *inter alia* will tax goods and services at a standard rate of 15 percent and zero-rate all exports.

Prior Action #2. To increase revenue collection in the mining sector, the Recipient, through its Minister of Finance and Treasury, has issued a Ministerial Order to apply a nickel royalty based on the contained metal in the ore.

Prior Action #3. To strengthen the effectiveness of public investments, the Recipient, through its Ministry of Finance and Treasury, has approved a revised framework for the appraisal of externally financed public investments which *inter alia* stipulates the appraisal of economic benefits and operation and maintenance costs.

Prior Action #4. To improve the financial performance of the Electricity Authority, the Cabinet has approved an amended SOE Act, including subsidiary regulations, which *inter alia* enhance the SOE regulatory framework.

Prior Action #5. To increase access to credit, the Board of the Central Bank of Solomon Islands (CBSI) has approved an amendment to the 2012 CBSI Act which *inter alia* broadens and improves the scope of credit reporting.

Prior Action #6. To improve public health emergency preparedness, response and recovery, the Recipient has submitted to Parliament the 2023 Public Health Emergency Bill.

Prior Action #7. To improve the resilience of buildings against natural hazards and the impacts of climate change, the Recipient, through its Cabinet, has approved the new National Building Code.



Prior Action #8. To build adaptive capacities and pursue a low carbon development approach towards climate change, the Recipient, through its Cabinet, has approved the new National Climate Change Policy (2023-2027).

E. Poverty and Social Impacts, and Environmental, Forests, and Other Natural Resource Aspects

Poverty and Social Impacts

The reforms under the first pillar to improve fiscal management are expected to have positive poverty and social impacts, especially over the medium- and long-run. By improving the government's revenue collection (PA#1 and PA#2) and strengthen the effectiveness of public investments (PA#3), these reforms could support translate into improved allocations on social assistance programs and improved access to basic infrastructure and services, with significant pro-poor benefits. The successful implementation of a Value-Added Tax (PA#1) could lead to large efficiency gains and improve the fairness of the tax system. To maximize these gains and secure sufficient revenue, the system should be simple and have a broad tax base. Exempting basic foodstuffs (e.g., bread and cereals, fruits, and vegetables) would reduce income inequality, however, to maintain the level of revenue and achieve progressive redistribution, the standard rate would need to be set at 16-17 percent. The reforms under the second pillar are not expected to have adverse poverty or social impacts and should benefit poor people and vulnerable groups. The reforms under the third pillar are expected to have a positive impact on poverty, by enhancing resilience against climate, disaster, and health-related shocks among the poor and vulnerable groups.

Environmental, Forests, and Other Natural Resource Aspects

The policy reforms supported by this operation will not have any negative effects but expected to strengthen the environment risk management framework of Solomon Islands. The reforms supported under Pillar 2 to increase revenue collection and profit sharing in the mining sector will provide an opportunity for further dialogue on strengthening the country's environmental regulatory framework for the mining sector as set out in the respective laws and policies. Reforms under Pillar 3 on the building code and the revised climate change policy are also expected to further strengthen the environment and risk management framework by establishing the processes to safeguard and promote environmentally friendly building practices as well as promoting the protection of biodiversity and ecosystems, as critical strategies to help mitigate and adapt to the negative impacts of climate change. The building code will complement the resilient construction and environmentally standard designs that are being promoted under other World Bank investment projects in Solomon Islands including the Integrated Economic Development and Community Resilience Project (IEDCR). A core reform agenda under the IEDCR Project is to develop resilient and environmentally friendly construction standards and designs that will be applied across all sub-national economic and social infrastructure funded through the Provincial Capacity Development Fund (PCDF) and promoting ecosystem-based solutions as important climate change adaptation measures.



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APPROVAL

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Approved By

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