

**SCHEDULE 2: IMPLEMENTATION STRATEGY FOR PARTNERSHIP PRIORITY OUTCOME**  
**4 – ADDRESSING ECONOMIC AND FISCAL CHALLENGES**

*The Solomon Islands-Australia Partnership for Development was formalised by Prime Minister Dr Derek Sikua and Prime Minister Kevin Rudd in Port Moresby on 27 January 2009. The Partnership for Development initiative represents a new era of cooperation between Australia and Solomon Islands and other Pacific Island nations. The initiative provides the guiding and practical framework for the implementation of the Port Moresby Declaration that was announced by Prime Minister Rudd on 6 March 2008.*

*The Solomon Islands-Australia Partnership for Development is founded on the principles of mutual understanding, mutual respect and mutual responsibility for improved development outcomes. The Partnership reflects the shared vision of the two Governments to work together in close cooperation to meet our common challenges and to achieve improved development outcomes and sustainable improvements in the quality of life of all Solomon Islanders as articulated in the Medium Term Development Strategy 2008 – 2010 or its successors and national sectoral plans. Specifically, this Partnership seeks more rapid progress towards poverty reduction and the other Millennium Development Goals by 2015. To this end the Solomon Islands-Australia Partnership has identified an initial four priority outcomes that will help secure the end objective of improved living standards for all Solomon Islanders.*

**(i) Aim of the Partnership**

The Partnership will assist Solomon Islands to manage economic and fiscal challenges and to improve the environment for long term fiscal certainty, more effective public expenditure and broad-based economic growth.<sup>1</sup>

Improving the fiscal and economic environment in the Solomon Islands is a necessary pre-cursor to improving prospects for economic growth. Private investors are unlikely to invest in an environment where, for example, a government struggles to meet its financial obligations, where regulations impede business development, where public utilities charge high prices for poor services and where public infrastructure is not maintained. While there are a number of factors outside the control of the Solomon Islands that impact on economic growth, there are also many that can be influenced or even determined by its government.

The Solomon Islands economy grew strongly between 2003-2008, driven by the restoration of law and order, significant donor assistance, logging activity and improvements in public finance. However, the Solomon Islands Government's 2008 *Medium Term Fiscal Strategy* identified a number of critical challenges for Solomon Islands that suggested the country faces serious economic decline unless significant policy changes are put in place. The analysis showed that:

- Logging has been a major driver of growth and contributes over SBD200 million to the Government budget each year. The projected depletion of natural forests

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<sup>1</sup> For the purposes of the Partnership, broad-based economic growth is taken to mean growth that benefits all sectors of society and that is achieved across all geographical regions of the Solomon Islands.

commencing from 2009 will reduce economic growth and government revenue thereby impacting adversely on the Government's budget and its ability to provide services to its people. Other sectors of the economy need to be developed to provide opportunities for the economy to grow, to create new jobs and to present new sources of government revenue.

- While Government revenue is expected to fall, there have been steady increases in Government spending. If not brought under control, Solomon Islands will risk a widening fiscal deficit and macroeconomic instability.

This type of economic decline and instability increases the risk of social dislocation in a country emerging from a period of internal conflict.

Due to underlying structural issues the global recession has hit Solomon Islands hard and led to a declining financial position. This has been largely felt in the logging sector (log exports are predicted to fall by around 35 per cent in 2009) as well as a broader decline in economic activity leading to reduced government revenue and foreign reserves.

The Solomon Islands Government has implemented measures to address immediate fiscal pressures brought about by the global recession (see *Government Response to GEC* at Attachment A). This is a difficult process requiring further work to make sure resources are directed towards those areas most important for the future well-being of the country and its people.

While efforts are being made to identify potential new sources of economic growth, the emergence of new productive sectors will take years to develop even in a favourable economic environment. It will be essential for Solomon Islands to foster an environment that encourages private sector investment in non-logging areas. Despite a number of recent reforms the foundations for private sector growth in Solomon Islands remain weak. The essential features of a good environment for entrepreneurship, investment and risk taking do not exist and most public goods required to support the functioning of businesses and contracting are absent or inadequate.

The Solomon Islands Government recognises its role in improving conditions for private sector growth, including by reducing impediments to investment and entrepreneurship, accelerating reform of state owned enterprises, and strengthening public goods such as the legal system and property rights. Examples of recent reforms include passing of: the *Foreign Investment Act in 2005*; the *State-Owned Enterprises Act 2007* (and setting up of a State Owned Enterprises Monitoring Unit within the Ministry of Finance and Treasury); the *Secured Transaction Act 2008*; and the *Companies (Insolvency and Receivership) Act 2009*.

The Solomon Islands Government has documented its current activities relating to improving the business environment and addressing underlying structural problems in the economy (see *Matrix of Priority Government Policy Actions* at Attachment B). The Solomon Islands Government is also in the process of documenting its medium to long term reform objectives. A coherent and substantive program of structural adjustment, including macroeconomic stabilisation, budgetary prioritisation

(including the protection of core services and maintenance of critical infrastructure) and structural reforms will provide a sound basis for longer-term economic growth.

The Partnership aims to provide support and assistance to the Government to continue to drive and expedite priority economic and public sector reforms (as articulated in the attached *Matrix of Priority Government Policy Actions* and other government policy and planning documents, for example the *Medium Term Development Strategy*) through the use of output-based and performance-linked funding.

## **(ii) Measurement**

The success of the Partnership will be measured by its contribution to improvements to the fiscal and economic environment within the Solomon Islands. Intended outcomes that will contribute to this objective are:

- An affordable and sustainable budget that improves Solomon Islands Government decision-making processes and focuses on development goals; and
- Continued progress on structural reform that promotes economic growth and makes Solomon Islands an attractive and reliable place for businesses to invest.

A joint Solomon Islands Government-Donor Core Economic Working Group has been established that will provide the basis for dialogue between the Solomon Islands Government and donors on the Solomon Islands Government's program of reform actions. The Working Group will jointly determine baseline information, intermediate indicators and specific targets relating to these reforms. The Working Group will meet monthly to monitor economic and fiscal developments and to review progress towards the agreed performance indicators.

A range of key economic reports and data will provide the baseline for measuring progress towards Partnership outcomes including: the Public Expenditure and Financial Accountability (PEFA) report which provides a ranking of Solomon Islands Government performance against a range of public financial management benchmarks; IMF Article IV assessments; and reporting on Solomon Islands economy from the Central Bank of the Solomon Islands.

## **(iii) Implementation Approach**

### *Links to other Implementation Strategies*

Improving the quality of Government expenditure on essential services for the people of Solomon Islands and on support for the growth of productive sectors of the economy is a key objective for this priority outcome. However, quality expenditure can only go so far in the absence of increased revenue. A healthy private sector and broad-based economic growth will not only create employment but will also provide much needed revenue. Activities under this priority outcome are therefore linked closely with those being undertaken in other Partnership priority outcomes.

### A Multi-donor Approach

In concert with other development partners - New Zealand, the European Commission, the Regional Assistance Mission to the Solomon Islands (RAMSI) and the multilateral development banks - Australia has been active in coordinating donor efforts to engage the Solomon Islands Government on the challenges arising from the global recession. The joint Solomon Islands Government-Donor Core Economic Working Group is monitoring fiscal and macroeconomic developments and supporting measures that encourage broad-based growth. This dialogue is also advancing efforts by the RAMSI Economic Governance Program and the multilateral development banks and would complement any IMF assistance to address balance of payments deficits, in the event it was requested by the Solomon Islands Government.

Solomon Islands Government leadership of the joint Solomon Islands Government-Donor Core Economic Working Group is ensuring that donors are responsive to the Solomon Islands Government's reform agenda. Donors have agreed, where possible, to speak with a single voice using the *Matrix of Priority Government Policy Actions* as a common platform for dialogue. The Solomon Islands Government and donors are seeking to promote the aid effectiveness principles and advance the Accra Agenda for Action by investigating opportunities to use government disbursement, monitoring and evaluation procedures to the greatest extent possible.

### Encouraging and Supporting Reform

Provision of Australian incentive funding is intended to encourage and support progress in reform implementation. The *Matrix of Priority Government Policy Actions* includes a consolidated summary of Solomon Islands Government efforts and future plans to strengthen its public financial management. Features of the Solomon Islands Government's current reform plan include:

- Strengthening the rigour of budget development including mandating the Ministry of Finance and Treasury's role in assessing spending proposals;
- Preparing annual cash-flow forecasts; and
- Improving procurement practices, including public disclosure of contracts awarded.

The joint Solomon Islands Government-Donor Core Economic Working Group provides a forum in which public financial management reforms could be appropriately prioritised and sequenced, and in which additional reforms could be agreed, for example:

- A public expenditure review to identify areas of unproductive spending and ensure appropriate resources are allocated for the delivery of core service; and
- A Public Expenditure Tracking Survey to provide a baseline to track expenditure on public expenditures in the delivery of services, as well as regular updates to track progress over time.

The *Matrix of Priority Government Policy Actions* also identifies a range of structural reforms aimed at promoting a regulatory environment conducive to private sector development, including improved performance of state owned enterprises. Possible areas for future action include:

- Review of the regulatory environment and how it impacts on private sector development;
- Review of the financial structure of Solomon Airlines;
- Provision of management expertise to improve the performance of Solomon Islands Water Authority and Solomon Islands Electricity Authority; and
- Investigation into privatisation of the Solomon Islands Printers Ltd and Sasape Marina.

An updated *Matrix of Priority Government Policy Actions*, agreed by the joint Solomon Islands Government-Donor Core Economic Working Group, would provide a basis for Australia (and other donors if they so chose) to agree with the Solomon Islands Government those reforms that would be linked to incentive funding. Solomon Islands Government would agree with Australia the level of performance required, which would serve as a trigger for release of funds. Australia would agree to disburse funds in a predictable manner based on the completion of actions agreed with the Solomon Islands Government over an agreed time period. The level of Australian funding provided will be commensurate with the scope of the reforms proposed and this would scale up as the Solomon Islands Government's reform program becomes more substantive.

An iterative approach is envisaged that would begin with dialogue between Australia and the Solomon Islands Government to agree initial reform actions and performance measures, along with associated funding commitments, in line with priorities identified in the *Matrix of Priority Government Policy Actions*. Over time the Solomon Islands Government and Australia would work to establish a multi-year program of reform linked to indicative funding projections. The dialogue between the Solomon Islands Government and Australia would increase in scope to identify short, medium and longer term objectives across a more substantive reform agenda. An example of this approach for strengthening the Solomon Islands Government budget process could include:

| <b>Budget Process and Cost of Government</b>   |   |  |
|--|---|--|
| <i>Short term</i>  | <i>Medium Term</i>  | <i>Long Term</i>   |
| Strengthening the rigour of budget development including ensuring the Ministry of Finance and Treasury's role in assessing spending proposals. | Improved capacity of line ministries and agencies to prepare rigorous budget bids that advance Solomon Islands Government policy objectives, are based on sound analysis and have been rigorously costed. | Solomon Islands Government has the ability to conduct analysis on cost of government that provides a budget framework that ensures sustainable service delivery. |

### Australian Funding

Australian support would be provided as incentive funding to support and encourage the Solomon Islands Government while it undertakes reforms. The size and shape of this program would be informed by dialogue with the Solomon Islands Government, but could evolve through a number of stages as outlined above. The initial aim would be to build confidence in the benefits of the program which would then build the case for a more substantive program to be developed over time as the reform agenda progresses.

Funding allocation to Partnership priorities will be determined in the context of each Country's annual development process and will take into account progress in implementing mutually agreed commitments under the Partnership. It is intended that multi-year funding projections will be developed for inclusion in this implementation strategy and updated annually.

The funding requirement for achieving the objectives in the Partnership can be derived primarily from both the Solomon Islands Government ensuring resources are directed to priority reforms as well as increased levels of development assistance from Australia, consistent with the Partnership commitment as well as assistance from other development partners through increased aggregate development assistance and/or a reprogramming of existing activities.

Notionally, AUD3 million has been allocated in support of this priority outcome in 2009-10. Funding could be from the Pacific regional performance-linked aid budget initiative but could also include reprioritised bilateral funding.

### Gender and the Environment

There is a real risk that the urgency to find new sources of economic growth and the pressure to move quickly to implement fiscal and economic reforms will overshadow Australian and Solomon Islands Government commitments to gender equity and environmental sustainability. Broad-based and sustainable growth in the Solomon Islands depends critically on maintaining the integrity of the environment and the full contribution of women. It is therefore imperative that implementation of this priority outcome fully integrates these considerations when negotiating incentive funding, and avoids any negative impact on gender equity and the environment.

## SOLOMON ISLANDS – AUSTRALIA PARTNERSHIP FOR DEVELOPMENT

### SUMMARY PERFORMANCE FRAMEWORK

| <b>PRIORITY OUTCOME 4 – ADDRESS ECONOMIC AND FISCAL CHALLENGES</b>  |  |  |  |
|---|--|--|--|
| Assist Solomon Islands to manage expected economic and fiscal challenges and to improve the environment for long term fiscal certainty, more effective public expenditure and broad-based growth  |  |  |  |
| <b>Solomon Islands Medium Term Fiscal Strategy: 2008-2013 Objectives</b>  | <b>Partnership Outcomes</b>  | <b>Indicators</b>  | <b>2009 Milestones</b>   |
| <ul style="list-style-type: none"> <li>• Objective 1: An affordable and sustainable Government budget that improves Government decision making processes, and focuses on achieving the development goals of the Solomon Islands.</li> <li>• Objective 2: Structural reform to make Solomon Islands an easy and reliable place for businesses to invest and for industries to grow.</li> </ul> | <ul style="list-style-type: none"> <li>• An affordable and sustainable budget that improves Government decision-making processes and focuses on development goals.</li> <li>• Structural reform that makes Solomon Islands an attractive and reliable place for businesses to invest.</li> </ul> | <ul style="list-style-type: none"> <li>• To be agreed between Solomon Islands Government and Australia once the Solomon Islands Government-Donor Core Economic Working Group has prioritised areas for financial and economic reform.</li> </ul> | <ul style="list-style-type: none"> <li>• To be agreed between Solomon Islands Government and Australia once the Solomon Islands Government-Donor Core Economic Working Group has prioritised areas for financial and economic reform.</li> </ul> |