International Monetary Fund

Solomon Islands and the IMF

Press Release:
Press Release: IMF Executive Board Completes First Review Under the Extended Credit Facility Arrangement for Solomon Islands, and Approves US$ 0.22 Million Disbursement
June 28, 2013

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Solomon Islands: Letter of Intent, Memorandum of Economic and Financial Policies, and Technical Memorandum of Understanding

June 10, 2013

Letter of Intent

June 10, 2013

Ms. Christine Lagarde
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Ms. Lagarde:

The successful implementation of sound economic programs supported by the IMF has helped consolidate macroeconomic and financial stability in Solomon Islands, and facilitated donor support. In 2012, real GDP expanded by 4.8 percent, albeit slower than the record level of 2011, inflation fell to 5 percent in December (down from the peak of 11 percent in late 2011), and, by end-year, gross international reserves stood at a record US$500 million (above eight months of imports), while the external public sector debt fell to 13 percent of GDP.

Good overall performance under the Extended Credit Facility arrangement (ECF) has been achieved. We met all of the end-December 2012 performance criteria (PCs) with one exception; the PCs on net credit to the government, net international reserves, and net domestic assets of the central bank were all met with large margins. However, despite a better than anticipated fiscal outcome for 2012, the PC on the cash balance was missed by a very small amount (less than 5 per cent of the target) due to a brief delay in transferring government deposits already at the central bank to the specific government accounts that comprise the cash balance. Accordingly, we are requesting a waiver of nonobservance for this performance criterion based on the fact that the deviation from the performance criterion was minor and temporary. Finally, we also request the modification of the end-June 2013 performance criteria on the cash balance, net credit to the government, and net domestic assets of the CBSI in order to reflect recent developments and the updated outlook, including the need to lock in some of the over-performance in the net domestic assets of the CBSI relative to the December target and to use some of the fiscal space earned in 2012 to fund high priority spending and development needs in 2013.

We are also making sustained progress in meeting program benchmarks, notwithstanding a heavy workload. We have successfully met the end-December 2012 benchmarks on the multi-year budget framework, customs and excises act (*albeit* with some delay), Central Bank of Solomon Islands Act and the end-March 2013 benchmark on the workshop on financial inclusion. However, Cabinet's approval on changes to the tax system related to the new mining tax regime (end-December 2012 benchmark) has been delayed due to capacity constraints, in particular in the area of drafting legislation. Work is ongoing on the submission to Cabinet of instructions for state-owned enterprise borrowing (end-March 2013 benchmark). Both of these reforms are at an advanced stage, and we are confident that they will be implemented in the coming months. We request that the test date for both of these reforms be modestly extended by a few months to end-June 2013.

The attached Memorandum of Economic and Financial Policies (MEFP), which supplements the previous one dated November 13,2012, provides an update on achievements under our program so far, and sets out our PCs to end-2013 and indicative targets for March and June 2014, and a structural agenda for the first half of2014. We believe that the policies set forth in the MEFP are adequate to achieve the objectives of our program. However, if necessary, we stand ready to take further measures, in consultation with the IMF. We will consult with the Fund on the adoption of these measures, and in advance of revisions to the policies contained in the MEFP, in accordance with the Fund's policies on such consultation. Furthermore, we will provide the Fund with any information it may request on policy implementation, as necessary, to achieve program objectives. In this context, the Government of the Solomon Islands is requesting completion of the first review under the ECF arrangement. We consent to publication of the staff report and the Letter of Intent and attachments.

Sincerely yours,

/s/
Hon. Gordon Darcy Lilo, MP
Prime Minister
Acting Minister of Finance and Treasury

/s/
Denton Rarawa
Governor
Central Bank of Solomon Islands

Attachments: - Memorandum on Economic and Financial Policies;
- Technical Memorandum of Understanding.

Attachment I. Memorandum of Economic and Financial Policies

June 2013

Recent Developments and Outlook

1. **Recent macroeconomic performance.** The successful implementation of IMF-supported programs has helped consolidate macroeconomic and financial stability and facilitated donor support. While slowing down from the extraordinary level in the previous year (over 10 percent), in 2012 real GDP expanded by 4.8 percent, inflation moderated, and external buffers were rebuilt. At end-2012, inflation fell to 5 percent, down from a peak of 11 percent in late 2011; gross international reserves stood at a record US$500 million; and public external sector debt fell to 13 percent of GDP.

2. **Macroeconomic outlook and risks.** Growth is expected to moderate further in the near and medium term—to 3½–4 percent—as forestry, the traditional engine of growth, is expected to be adversely affected by the depletion of logging stocks well within a decade. In the medium-term, service sector is expected to drive growth. Despite some delays, planned investments in fiber-optic infrastructure and hydroelectric energy are expected to provide a boost to the economy over the medium-term, particularly to the telecommunications and energy sectors, and improve business opportunities by delivering low-cost, high-quality internet service and reliable energy. With inflation rising in early 2013 due to weather-related supply disruptions, it is projected to remain around 6 percent in the medium-term. Overall risks to the economy have become more balanced, even as near-term uncertainty remains elevated. On the upside, global and regional prospects have improved somewhat, assisting the outlook for Solomon Islands' external demand and foreign direct investment. Mining activity and the impact on growth of improved connectivity could be greater than anticipated. On the downside, the road to recovery for the global economy may remain bumpy, affecting Solomon Islands' prospects.

3. **Program performance.** Good overall performance under the Extended Credit Facility (ECF) arrangement has been achieved for most benchmarks. Performance criteria (PCs) for end-December 2012 on net credit to the government, net international reserves, and net domestic assets of the central bank were all met with large margins. However, the PC on the cash balance was missed by a small amount (SI$20 million, or less than 5 per cent of the target). This was due to the brief delay in transfer of government deposits already at the central bank to the specific government accounts that comprise the cash balance at the end of the 2012 financial year. Technically, the timely transfer of these end-of-year government deposits to the cash balance would have enabled Government to meet this PC. In addition, we are making sustained progress with our structural reform agenda, notwithstanding the heavy workload. We have successfully met the end-December 2012 benchmarks on the multi-year budget framework, customs and excises act, Central Bank of Solomon Island (CBSI) Act (*albeit* with some delay), and the end-March 2013 benchmark on the workshop on financial inclusion. However, Cabinet's approval of changes to the tax system related to the new mining tax regime (end-December 2012

benchmark) have been delayed due to capacity constraints, especially in the drafting of legal documents. At the same time, work is ongoing on the submission to Cabinet of instructions for state-owned enterprise borrowing (end-March 2013 benchmark). Both of these reforms are at an advanced stage and we request a modification in their test dates, to end-June 2013 for both of them.

Program Policies

4. **Our policies aim at enhancing the economy's resilience to shocks and promoting sustainable and inclusive growth through sound policies and reforms**. We will focus on strengthening the fiscal framework, improving monetary operations, maintaining a strong foreign exchange position, ensuring debt sustainability, and containing financial risks. We will also focus on reforms improving institutions to strengthen macroeconomic management and facilitate private sector development.

A. Fiscal Policies

5. **We are committed to preserving sound public finances while providing adequate resources for critical development spending.** The fiscal position remained strong in 2012, despite overly-optimistic revenue forecasts that were not achieved. This was due to careful control of spending, including bringing recurrent and development spending to levels consistent with economic fundamentals and the economy's absorptive capacity. We expect logging revenues to hold up in the near term and decline over the medium-term, while the expected mining revenues are still very uncertain. Therefore, our budgets will incorporate prudent revenue estimates, while careful control over expenditures will protect our policy buffers. At the same time, we will intensify our efforts to improve the quality of public spending to lift the economy's growth potential. To achieve these goals, we will ensure that fiscal policy for the near and medium-term is consistent with the following:

- **The cash balance.** We are committed to using the cash balance as a fiscal anchor at its current level (at least two months of recurrent spending), which requires careful financial planning of the budget's implementation. We believe that a prudent fiscal stance is further warranted given the uncertainty surrounding the global economy. Should revenue surprise on the upside, or the budget be under-spent due to capacity constraints, we will finance some unavoidable and high priority spending pressures, while also seeking to save for future development spending or to strengthen buffers.
- **Public expenditure.** We will strengthen control over public expenditure and enhance its quality, while meeting priority and developmental needs. One near-term priority is to address the erosion of real public wages—public sector wages have increased much slower than inflation in the past decade. We intend to increase basic wages for the public sector by a cumulative of 6 percent in 2013, and, in addition, strengthen teachers pay for length of service and qualification. At the same time, we will work towards consolidating the number

and magnitude of public-sector allowances and benefits into the base remuneration and review stricter controls in the use of other allowances, such as overtime.

- **Constituency funds and tertiary scholarships.** We are improving the transparency and accountability in the use of constituency funds in order to enhance the effectiveness of public service delivery in the rural areas. To this effect, Parliament just approved the Constituency Development Fund Act that introduces a legal framework to enhance control over the use of these public funds. As a complement, we intend to issue implementing regulations by end-December 2013 (end-December 2013 program benchmark) that would establish the effectiveness date of the approved legislation, provide guidelines for the selection and prioritization of projects, and spell out the mechanisms to improve transparency and reporting, control, audit, and evaluation of constituency development funds spending, which will be line with the new Public Finance Management Act (PFMA). In addition, we intend to publish the Auditor General's report on constituency spending by end-November 2013 (end-November 2013 program benchmark). We will apply these same public financial procedures to spending on tertiary educational scholarships, which have risen significantly. Moreover, in light of the challenges of decreasing levels of per capita spending on basic education, we will strengthen the eligibility criteria for tertiary scholarships abroad, linking it to our development needs, and striking a balance between financing tertiary education abroad and investing in primary education.

- **Domestic revenue mobilization.** To improve compliance and operational effectiveness, a new comprehensive bill on customs and excise taxes is being drafted with the assistance of the Asian Development Bank and AusAID. In February 2013, Cabinet approved the release of the draft for public consultation. We plan to submit the bill to Parliament by November 2013 (end-November 2013 benchmark). Moreover, implementing a natural resource taxation regime is critical for Solomon Islands to benefit from its natural resource wealth. To this effect we will seek Cabinet approval of draft amendments to income, custom, excise, and goods tax legislations to implement such a regime. These amendments have benefited from IMF technical assistance and are in line with IMF recommendations. The amendments will be submitted to Cabinet by end-June 2013 (program benchmark) and submitted to Parliament by November 2013 (program benchmark). This reform has taken longer than anticipated in light of a broader consultation process with stakeholders and also due to resource constraints at the drafting stage. Until the new mining tax regime is in place, we will refrain from approving new mining licenses. At the same time, we will adopt measures to enhance tax administration in the area of mining to ensure that the government receives its share of revenue. Also, we will continue to apply, as we have done since January 2012, the full market price for log exports with an automatic quarterly adjustment, to support revenue-mobilization efforts. Looking forward, we are considering additional tax reforms aimed at strengthening and broadening the tax base.

- **The fiscal framework and public financial management**. We will strengthen the fiscal framework and public financial management by upgrading the current Public Finance Act (PFA). The new Public Financial Management Act (PFMA) will incorporate provisions on fiscal responsibility, management and use of public funds, and management of public debt. We have drafted and published four discussion papers and presented them in a public workshop. We will also submit to parliament the draft PFM Bill by end-October 2013 (end-October 2013 benchmark). In addition, we will be revising the Financial Instructions and accompanying finance regulations, manuals and guidelines during the course of 2013. These are subsidiary instruments to the new PFMA, which will come into effect in January 1, 2014. Training will be an integral component in embedding these reforms. To better monitor priority spending, we will continue to improve our budget presentation, even as we already have taken some important steps during the preparation of the 2012 Budget: (i) the budget presentation was revised to include output line items; (ii) we extended the consultation process with stakeholders; and (iii) a new chart of accounts has been put in place to better capture public expenditure and improve transparency and accountability. Moreover, we will continue to seek assistance from development partners to further advance ongoing efforts to strengthen procurement, financial management information systems and internal audit processes in order to reduce leakages affecting public service delivery.

- **Medium-term budget.** We are currently implementing a multi-year budget framework, with forward estimates of revenues and recurrent expenditure already included in this year's budget (end-December 2012 benchmark). We will expand this process next year by including forward estimates for the Development Budget. Casting budget decisions in a multi-year perspective will help us design realistic fiscal plans in line with the objectives laid down in the National Development Strategy (NDS). The multi-year budget framework will also help build consensus on the appropriate sequencing of development projects.
- **Public debt management.** We will continue to follow prudence in resuming concessional borrowing to preserve domestic and external stability, while tapping resources to finance high-priority development projects. These projects include the Submarine Cable System Project and potentially the Tina River Power Project, which will reduce the cost of doing business, encourage private sector investment, and improve growth prospects. The cable project will reduce communication costs significantly, enhance efficiency, create new information and communication industries, and ease the business registration process. Another potential project is the Tina River Project, which would significantly reduce the cost of energy. The Debt Management Strategy (DMS), endorsed by the Cabinet in May 2012, builds on the Honiara Club Agreement (HCA) and provides the appropriate framework to anchor borrowing plans going forward. The DMS has been incorporated in the HCA, which was reviewed in July 2012. We have set a limit for new borrowing in the 2013 Budget which includes domestic, external and SOE borrowing and guarantees. This limit is based on the analysis of the Debt Management Unit and will be revised on a yearly basis. The limit depends on the macroeconomic outlook and takes a conservative approach, allowing for economic shocks. Our next actions include implementing instructions for SOE borrowing (proposed end-June 2013 benchmark); identifying the outstanding debt of SOEs; developing an on-lending policy framework; and designing a framework to estimate the cost of guarantees.

B. Monetary, Exchange Rate, and Financial Sector Policies

6. **Strengthening monetary and exchange rate policy management.** Monetary and exchange rate policies will continue to be geared to maintaining price and external stability. The CBSI has continued to mop up excess liquidity by issuing its short-term Bokolo bills, the stock of which have risen to SI$512 million at end-January 2013 from SI$368 million at end-2012. While the previous de facto exchange rate peg to the U.S. dollar in place since 2002 had provided a strong nominal anchor, in October 2012, we moved to a basket exchange rate peg using as weights the currency denominations of the largest shares of our external payments. This action is intended to promote greater exchange rate flexibility and foreign exchange market development, and followed technical assistance from the IMF. To reinforce the effectiveness of the CBSI in conducting monetary policy and its supervisory activities, a new CBSI Act was approved by Parliament in November 2012 (end-December 2012 benchmark).

7. **Strengthening the financial supervisory and regulatory frameworks and improving access to financial services.** Reforming the National Provident Fund (NPF) to improve its governance and investment framework is important to strengthening financial stability and ensuring the soundness of pension savings. To this effect, Cabinet endorsed drafting instructions for the NPF Act. We will submit the revised NPF Act to Parliament by October 2013 (end-October 2013 benchmark). To address the challenges we face on financial access to a broader segment of the population, especially in rural areas, we intend to provide financial literacy training and education in schools. We also presented our work developed by the financial inclusion taskforce in a public workshop in February 2013 (end-March 2013 benchmark). Credit unions play an important role in providing financial services outside of Honiara, offering credit to a broader segment of the population. In this regard, we are working on a new Credit Unions Act (CUA) with assistance from the ADB to promote the performance of the sector. We will seek Cabinet approval of the draft CUA by end-March 2014 (program benchmark) and will submit it to Parliament by end-June 2014 (program benchmark). Finally, our efforts to improve financial services include bringing the payment system up to best international practices. With assistance from the World Bank, we are preparing a new Payment System Act, which will enhance the reliability of the payment system, and increase the certainty of operations.

C. Structural Policies to Promote Private Sector Growth and Other Issues

8. **Facilitating private sector-led growth over the medium and long term.** We plan to continuously improve the business climate by enacting appropriate business friendly policies and laws. The conditionality under the ECF arrangement will continue to be aligned with the SIG-donor program of economic and financial reforms (economic and financial reform matrix) developed under the Core Economic Working Group (CEWG)—a government-donor partnership. We are planning to submit to the IMF a revised National Development Strategy at the time of the second review of the ECF arrangement, together with the sector strategies developed by the Ministry of Planning and Aid Coordination (MDPAC) and key development partners that will serve as the Poverty Reduction Strategy Paper.

9. **Update on Safeguards assessment.** The Central Bank of Solomon Islands will take the necessary steps to implement the recommendations of the safeguards assessment update.

10. **Statistics**. Progress is being made in strengthening the quality of economic statistics and fiscal and monetary data for program purposes, and to address some delays in the timely release of national accounts data. The Solomon Islands National Statistics Office (NSO) will complete the business survey data analysis in May 2013, which will form a key source of data input in the compilation of the national accounts statistics by July 2013. To address the weaknesses of CPI data collection and compilation, the SISO will ensure the timely implementation of the CPI Action Plan, which has benefited from PFTAC technical assistance recommendations.

D. Program Monitoring

11. **Program monitoring.** Progress under our program will continue to be monitored through performance criteria and indicative targets, structural benchmarks, and other necessary measures in order to complete semi-annual program reviews. Quantitative performance criteria and indicative targets for June 2013, September 2013, December 2013, March 2014, and June 2014 are set out in Table 1 and structural benchmarks are set out in Table 2. They are guided by the Technical Memorandum of Understanding. The second and third reviews are expected to take place on or after November 15, 2013 and June 15, 2014, respectively.

Appendix 1. Table 1–Solomon Islands: Quantitative Performance Criteria (PC) and Indicative Targets (IT)

	12/31/2012				3/31/2013				6/30/2013		9/30/2013		12/31/2013	3/31/2014	6/30/2014
	PC (EBS/12/145)	PC with adjustors	Act.	Status	IT (EBS/12/145)	IT with adjustors	Act.	Status	PC (EBS/12/145)	PC	IT (EBS/12/145)	IT	PC	IT	IT
Performance criteria 1/															
Net international reserves (NIR) of the Central Bank of Solomon Islands (CBSI) (floor, end-of-period stock, in millions of U.S. dollars (US$)) 2/	470	463	479	Met	475	473	477	Met	480	480	485	485	490	495	500
Net domestic asset (NDA) of the CBSI (ceiling, end-of-period stock, in millions of Solomon Islands dollars (SI$)) 3/	-1,173	-1123	-1,366	Met	-1,122	-1104	-1,655	Met	-1,120	-1,279	-1,102	-1,202	-1,150	-1,268	-1,159
Net credit to central government (NCG) (ceiling, cumulative change from the beginning of the year, in millions of SI$) 4/	95	145	-196	Met	6	24	-115	Met	-33	-15	-60	-6	-14	-24	-14
New nonconcessional external debt maturing in more than one year, contracted or guaranteed by the public sector (ceiling, end-of-period stock since the beginning of the program, in millions of US$) 5/	0	0	0	Met	0	0	0	Met	0	0	0	0	0	0	0
New nonconcessional external debt maturing in one year or less, contracted or guaranteed by the public sector (ceiling, end-of-period stock since the beginning of the program, in millions of US$) 5/	0	0	0	Met	0	0	0	Met	0	0	0	0	0	0	0
Accumulation of new external payment arrears by the public sector (ceiling, end-of-period stock since the beginning of the program, in millions of SI$) 5/	0	0	0	Met	0	0	0	Met	0	0	0	0	0	0	0
Central government program cash balance (floor, end-of-period stock, in million of SI$) 4/	425	375	355	Not met	440	422	474	Met	420	399	383	390	411	429	409
Indicative Targets (cumulative)															
Government funded recurrent spending on health and education (cumulative from the beginning of the year, in millions of SI$) 6/	611	...	558	Not met	147	...	179	Met	294	300	441	449	599	167	334
Memorandum items:															
The threshold of indicative target on health and education (actual 32 percent of government funded recurrent spending)	...	...	565	...	...	...	153	...	...	...	...	...	...	...	...
Budget support from bilateral and multilateral donors other than IMF (cumulative change from the beginning of the year, in millions of US$), program level.	61	...	54	...	11	...	9	...	26	27	44	48	67	9	22
Outstanding stock of Solomon Islands government (SIG) treasury bills, excluding restructured government bonds (end-of-period stock, in millions of SI$), program level.	40	...	40	...	40	...	40	...	40	40	40	40	40	40	40
Balance of SIG Consolidated Deposits Account, millions of SI$ 7/	140	...	140	...	140	...	140	...	140	140	140	140	140	140	140

1/ Evaluated at the program exchange rate.

2/ The adjustors are specified in the Technical Memorandum of Understanding (TMU) and include: the floor on NIR will be adjusted upward (downward) by the amount of budget support from bilateral and multilateral donors (excluding IMF) in excess (short) of the program level.

3/ The adjustors are specified in the TMU and include: the ceilings on NDA will be adjusted downward (upward) by the amount of budget support from bilateral and multilateral donors (excluding the IMF) in excess (short) of the program level. Following the recommendations of the IMF Safeguards Assessment, the program targets starting from end-December 2010 incorporate the recommended changes in the measurement of reserve money.

4/ The adjustors are specified in the TMU and include: the floor on central government program cash balance will be adjusted downward and the ceiling on NCG will be adjusted upward by the stock amount of budget support from bilateral and multilateral donors (excluding the IMF) short of the program level; the floor on the program cash balance will be adjusted upward (downward) by the stock of government treasury bills, excluding restructured government bonds, in excess (short) of the program level; the floor on the program cash balance will be adjusted upward by the balance in the SIG Consolidated Deposits Account short of the program level.

5/ These performance criteria are applicable on a continuous basis.

6/ An indicative target for spending on health and education at no less than 32 percent of government-funded recurrent spending.

7/ The SIG Consolidated Deposits Account functions like a contingency fund for the government and transfers to and from this account can affect the program cash balance. Negative deviations from the projected balance in this account will therefore be used to adjust the program cash balance targets upward.

Appendix 1. Table 2–Solomon Islands: Structural Benchmarks

Actions	Macroeconomic criticality	Date	Status
Extended Credit Facility Arrangement			
Obtain Cabinet's approval of a draft amendment to income tax, customs and excise tax, and goods tax legislations related to the new mining tax regime in line with IMF TA recommendations.	To broaden the tax base and increase revenue transparency.	December 31, 2012	Not met. The benchmark was rescheduled to end-June 2013 due to limited resources in the Attorney General's Chambers (see below).
Obtain Cabinet's approval to release the draft bill implementing the new Custom and Excise Act for public consultation including the clauses related to the exemptions and the draft amendments to the other revenue acts (income tax, and sales tax acts).	To promote fiscal transparency and enhance the efficiency of revenue collections.	December 31, 2012	Met in February. Cabinet approved to release the draft bill for public consultation on 15 February, 2013.
Submit to Parliament the final CBSI Act to strengthen the monetary policy and supervisory framework.	To strengthen the effectiveness of monetary policy.	December 31, 2012	Met in November. The new Central Bank Act was submitted to Parliament and passed in November 2012, one month ahead of schedule.
Submit to Parliament the multi-year budget framework on revenues and recurrent spending	To strengthen the quality and monitoring of government spending.	December 31, 2012	Met in December in the context of the 2013 budget.
Submit to Cabinet the instructions for SOE borrowing.	To strengthen debt management and maintain public debt sustainability.	March 31, 2013	Not Met. The benchmark was rescheduled to end-June 2013 (see below).
Workshop organized by the National Financial Inclusion taskforce taking stock of progress to date to better access financial services in rural areas.	Increase access to financial services ensure inclusive growth.	March 31, 2013	Met in February.
Submit to Parliament the revised NPF Act that strengthens its governance structure and investment framework.	To improve the long-term financial viability of the NPF and reduce financial risks.	October 31, 2013	
Submit to Parliament the draft of new Public Finance Act covers fiscal responsibility provisions, management and use of public funds, and management of public debt.	To promote fiscal transparency and enhance the efficiency of revenue collections.	October 31, 2013	
Submit to Parliament the new Customs and Excise bill, including the clauses related to exemptions and the draft amendments to other revenue acts (income tax, stamp duties, goods and sales tax acts).	To promote fiscal transparency and enhance the efficiency of revenue collections.	November 30, 2013	
Submit to Parliament draft amendment to income tax, customs and excise tax, and goods tax legislations related to the new mining tax regime in line with IMF TA recommendations.	To broaden the tax base and increase revenue transparency.	November 30, 2013	
Revised and Proposed new benchmarks			
Obtain Cabinet's approval of a draft amendment to income tax, customs and excise tax, and goods tax legislations related to the new mining tax regime in line with IMF TA recommendations.	To broaden the tax base and increase revenue transparency.	June 30, 2013	
Submit to Cabinet the instructions for SOE borrowing.	To strengthen debt management and maintain public debt sustainability.	June 30, 2013	
Release to public the results of the audits conducted by the office of the Auditor General on spending of constituency funds by the fifty constituencies, and project achievements in 2012.	To promote the transparency and accountability in the use of public funds.	November 30, 2013	
Submit to Cabinet the implementing regulations for the Constituency Development Funds Act that provide guidelines for the selection and prioritization of projects, and spell out the mechanisms to promote transparency and reporting, control, audit, and evaluate constituency funds spending in line with the new Public Finance Act.	To promote the transparency and accountability in the use of constituency funds.	December 31, 2013	
Submit to Cabinet the draft Credit Unions Act.	To promote financial sector development.	March 30, 2014	
Submit to Parliament the draft Credit Unions Act.	To promote financial sector development.	June 30, 2014	

Attachment II. Technical Memorandum of Understanding

1. The program will be monitored through quantitative performance criteria, indicative targets, structural benchmarks, and reviews. This memorandum sets out the definitions for quantitative performance criteria and indicative targets under which performance under the program will be assessed. Monitoring procedures and reporting requirements are also specified.

Quantitative Performance Criteria and Indicative Targets

2. Performance criteria for end-June 2013 and end-December 2013 and indicative targets for end-September 2013 and end-March and end-June 2014 have been established with respect to:

- Floors on the level of net international reserves (NIR) of the Central Bank of Solomon Islands (CBSI);
- Ceilings on the level of net domestic assets (NDA) of the CBSI;
- Ceilings on the level of net credit to the central government (NCG); and
- Floors on the central government cash balance.
- An indicative target (cumulative) for spending on health and education at no less than 32 percent of government-funded recurrent spending.

3. Performance criteria applicable on a continuous basis have been established with respect to:

- Ceilings on the contracting and guaranteeing by the public sector of new medium- and long-term nonconcessional external debt;
- Ceilings on the contracting and guaranteeing by the public sector of new short-term nonconcessional external debt; and
- Ceilings on accumulation of new external payment arrears by the public sector.

Institutional Definitions

4. The central government includes all units of budgetary central government and extra budgetary funds.

5. Depository corporations (DCs) include the CBSI and other depository corporations (ODCs). ODCs include commercial banks, the Credit Corporation of Solomon Islands, and credit unions. Financial corporations include DCs and other financial corporations (OFCs). OFCs are the National Provident Fund (NPF), the Development Bank of Solomon Islands, and the Investment Corporation of Solomon Islands.

Monetary Aggregates

6. **Valuation.** Foreign currency-denominated accounts will be valued in Solomon Islands dollar (SI$) at the program exchange rate of SI$7.36 per U.S. dollar, as of end-June 2012. Foreign currency accounts denominated in currencies other than the U.S. dollar and monetary gold will first be valued in U.S. dollars at actual exchange rates and gold prices used by the CBSI, respectively, before they are converted to Solomon Islands dollars.

A. Reserve Money

7. Reserve money consists of currency issued by the CBSI (excluding CBSI holdings of currency) and all transferable deposits held at the CBSI.

B. Net International Reserves of the CBSI

8. A floor applies to the level of NIR of the CBSI. The floor on NIR will be adjusted upward (downward) by the amount of budget support from bilateral and multilateral donors (excluding the IMF) in excess (short) of the programmed level.

9. NIR will be calculated as gross international reserves (GIR) less international reserve liabilities. For program monitoring purposes, the stock of foreign assets and foreign liabilities of the CBSI, as reported in Solomon Islands dollars, shall be valued at program exchange rate in U.S. dollars, as described on paragraph 6.

10. GIR of the CBSI are defined as the sum of:

- Foreign currency assets in convertible currencies held abroad and as vault cash that are under the direct and effective control of the CBSI and readily available for intervention in the foreign exchange market or the direct financing of balance of payments imbalances and are of investment grade or held with an investment-grade institution.
- The reserve position of the Solomon Islands in the IMF;
- Holding of SDRs; and
- Monetary gold.

Excluded from the definition of GIR are:

- Foreign currency deposits of ODCs and OFCs held at the CBSI;
- Any foreign currency claims on residents, capital subscriptions in international institutions, and foreign currency assets in nonconvertible currencies, and;

- GIR that are in any way encumbered or pledged, including, but not limited to, reserve assets used as collateral or guarantee for third-party external liabilities.

11. International reserve liabilities of the CBSI are defined as the sum of:

- All outstanding liabilities of the Solomon Islands to the IMF, excluding IMF SDR allocations; and
- Foreign currency liabilities in convertible currencies to nonresidents with an original maturity of up to and including one year.

C. Net Domestic Assets of the CBSI

12. A ceiling applies to the level of NDA of the CBSI. The ceiling on NDA will be adjusted downward (upward) by the amount of budget support from bilateral and multilateral donors (excluding the IMF) in excess (short) of the programmed level.

13. NDA of the CBSI will be calculated as the difference between reserve money and the sum of NIR of the CBSI and other NFA of the CBSI. Any revisions to the historical stock of reserve money based on changes to the accounting treatment of the profit/loss account of the CBSI will be notified to the Fund immediately and used to adjust monetary aggregates by an equivalent amount, as deemed appropriate. Other NFA of the CBSI includes:

- Foreign assets related to holdings of foreign currency deposits, and securities not included in NIR of the CBSI, and loans, shares, financial derivatives, or accounts receivable with nonresidents; and other foreign assets that are not included in NIR of the CBSI, as defined in Section III. B; and
- Foreign liabilities related to IMF SDR allocations; deposits, securities, loans, financial derivatives, and other accounts payable with nonresidents; and other foreign liabilities that are not included in NIR of the CBSI, as defined in Section III. B.

D. Net Credit to the Central Government

14. A ceiling applies to the NCG measured cumulatively from the beginning of the year. The ceiling on NCG will be adjusted upward by the amount of budget support from bilateral and multilateral donors (excluding the IMF) short of the programmed level.

15. NCG is defined as the sum of net claims of: (i) the CBSI, (ii) commercial banks and other ODCs, (iii) OFCs, (iv) insurance companies, (v) and government treasury bills held by the general public.

Fiscal Aggregates

A. Cash Balance of the Central Government

16. A floor applies to the program cash balance of the central government. The floor on the program cash balance will be adjusted downward by the amount of budget support from bilateral and multilateral donors (excluding the IMF) in short of the programmed level. The floor on the program cash balance will also be adjusted upward (downward) by the stock of government treasury bills, excluding restructured government bonds, in excess (short) of the program level of SI$40 million. The floor on the program cash balance will be adjusted upward by the difference between SI$140 million (hereafter known as program level) in the SIG Consolidated Deposits Account and its actual balance, should the actual balance in the SIG Consolidated Deposits Account be lower than SI$140 million.

17. The program cash balance of the central government is defined as the gross cash balance minus the total amount of unpaid payment orders and unpresented checks.

18. The gross cash balance is defined as the sum of government deposits, which are not in any way encumbered or pledged as collateral or used as a guarantee against government incurred liabilities, in the following accounts:

- In CBSI: Solomon Islands Government (SIG) Revenue Account, SIG Funded Development Account, SIG Debt Servicing Account;
- In Australia New Zealand Bank: SIG Creditors Account; Payroll Imprest Account, and Airport Service Fees Account;
- In Bank of South Pacific: Provincial Revenue Holding Account, SIG Inland Revenue Account, Sub Treasury Gizo Account, and Sub Treasury Auki Account; and
- Donor funded budget support accounts that are created by and under control of the government.

External Debt

A. Medium- and Long-Term External Debt

19. A ceiling applies to the contracting and guaranteeing by the public sector of new nonconcessional borrowing with nonresidents with original maturities of more than one year. The ceiling applies to debt and commitments contracted or guaranteed for which value has not yet been received. This applies to private debt for which official guarantees have been extended and which, therefore, constitutes a contingent liability of the public sector. The public sector comprises the central government, the CBSI, nonfinancial public enterprises (i.e., enterprises in which the government owns more than 50 percent of the shares), and other official entities.

20. The definition of debt, for the purposes of the program, is set out in Point 9 of the Guidelines on Performance Criteria with Respect to External Debt in Fund Arrangement Executive Board Decision No. 6230-(79/140), as revised on August 31, 2009 (see Annex I).

21. Excluded from the ceiling are (i) the use of Fund resources; (ii) lending from the World Bank and the Asian Development Bank; (iii) debts incurred to restructure, refinance, or prepay existing debts, to the extent that such debt is incurred on more favorable terms than the existing debt and up to the amount of the actually restructured/refinanced/prepaid debt; (iv) concessional debts; (v) any SI$-denominated treasury bill and bond holdings and Bokolo bonds held by nonresidents.

22. For program purposes, the guarantee of a debt arises from any explicit legal obligation of the central government, the CBSI, nonfinancial public enterprises, or other official entities on behalf of the central government or the CBSI to service debt in the event of nonpayment by the main obligor (involving payments in cash or in kind).

23. For program purposes, a debt is concessional if it includes a grant element of at least 35 percent, calculated as follows: the grant element of a debt is the difference between the net present value (NPV) of debt and its nominal value, expressed as a percentage of the nominal value of the debt. The NPV of debt at the time of its contracting is calculated by discounting the future stream of payments of debt service due on this debt. The discount rates used for this purpose are the currency specific commercial interest reference rates (CIRRs), published by the Organization for Economic Cooperation Development (OECD). For debt with a maturity of at least 15 years, the 10-year-average CIRR will be used to calculate the NPV of debt and, hence, its grant element. For debt with a maturity of less than 15 years, the 6-month average CIRR will be used. To both the 10-year and 6-month averages, the same margins for differing repayment periods as those used by the OECD would continue to be added (0.75 percent for repayment periods of less than 15 years, 1 percent for 15 to 19 years, 1.15 percent for 20 to 29 years, and 1.25 percent for 30 years or more).

B. Short-Term External Debt

24. A ceiling applies to the contracting and guaranteeing by the public sector of new nonconcessional borrowing with nonresidents with original maturities of up to and including one year. The ceiling applies to debt and commitments contracted or guaranteed for which value has not yet been received. This applies to private debt for which official guarantees have been extended and which, therefore, constitute a contingent liability of the public sector. The public sector comprises the central government, the CBSI, nonfinancial public enterprises (i.e., enterprises in which the government owns more than 50 percent of the shares), and other official entities.

25. For program purposes, the definition of debt is set out in Point 9 of the Guidelines on Performance Criteria with Respect to External Debt in Fund Arrangement approved by the Executive Board Decision No. 6230-(79/140), as revised on August 31, 2009 (see Annex I).

26. Excluded from the ceiling are (i) debts classified as international reserve liabilities of the CBSI; (ii) debts incurred to restructure, refinance, or prepay existing debts, to the extent that such debt is incurred on more favorable terms than the existing debt and up to the amount of the actually restructured/refinanced/prepaid debt; (iii) SI$-denominated treasury bills and bonds and CBSI and Bokolo bills held by nonresidents; (iv) concessional debts; and (v) normal import financing. A financing arrangement for imports is considered to be "normal" when the credit is self-liquidating.

External Payment Arrears

27. A continuous performance criterion applies to the non-accumulation of external payments arrears by the public sector, comprising the central government, the CBSI, nonfinancial public enterprises, and other official entities. External payments arrears consist of external debt-service obligations (principal and interest) that have not been paid at the time they are due, as specified in the contractual agreement, subject to any applicable grace period.

Data Provision

28. The data listed below will be provided for monitoring performance under the program based on data templates agreed with Fund staff. Under each section, reporting responsibilities are indicated in parentheses. Weekly data are requested for submission to Fund staff by the end of the following week. Monthly and quarterly data are requested for submission within six weeks of the end of the observation period. The authorities have committed to using the best available data, so that any subsequent data revisions will not lead to a breach of quantitative performance criteria or benchmarks. All revisions to data will be promptly reported to Fund staff.

A. Monetary Data (CBSI)

On a weekly basis:

- Daily exchange rates, both buying and selling rates, of the Solomon Islands dollar against the U.S. dollar, including the official, interbank, and parallel market exchange rates;
- Stock of NIR and sales and purchases by the CBSI in the foreign exchange markets;
- Stock of reserve money and its components; and
- Treasury bill auction reports.

On a monthly basis:

- Financial corporations' survey, including the balance sheet of CBSI, the consolidated balance sheet of ODCs, and the consolidated balance sheet of OFCs;
- Liquid asset ratios and/or reserves requirement of the commercial banks;

- Interest rates, including average interbank rate, bank deposit rates, and bank lending rates;
- A detailed breakdown of NCG from the CBSI, commercial banks and other ODCs, and OFCs;
- Foreign exchange cash-flow of the CBSI, including donor disbursements; and
- Balances of each central government account specified in Section IV. A., as recorded or collected by the CBSI.

B. Fiscal Data (Ministry of Finance and Treasury (MoFT)

On a monthly basis:

- Consolidated accounts of the central government, including detailed data on:
    - Revenue, including tax and nontax revenues, and recurrent and development grants included in the consolidated budget;
    - Recurrent expenditure, including payroll, goods and services, and other recurrent outlays, including those funded by donor support;
    - Other recurrent charges of the Ministry of Education and Ministry of Health, separating spending funded by donor support;
    - Debt service payments, classified into amortization and interest payments on (i) domestic debt, (i) external debt, (iii) domestic arrears, and (iv) external arrears; and
    - Development expenditure funded by (i) central government of the Solomon Islands, and (ii) foreign grants and loans included in the consolidated budget.
- Detailed financing components of central government's accounts, classified into foreign and domestic sources.
    - Foreign financing includes (i) disbursement and amortization of project and program loans, and (ii) changes in external debt arrears, classified into principal and interest arrears.
    - Domestic financing includes (i) borrowing from and repayment to the CBSI, commercial banks and other ODCs, and OFCs; (ii) changes in deposits at the CBSI, commercial banks and other ODCs, and OFCs; and (iii) privatization receipts and changes in domestic debt arrears, classified into principal and interest arrears.
- Stock of domestic debt, including the outstanding balance of government securities, treasury bills, cash advances, and other debt instruments.

- Balances of each central government account specified in Section IV. A., as recorded by the MoFT.

- Stock of unpaid government payment orders and unpresented checks.

C. External Sector Data (CBSI and MoFT)

On a quarterly basis:

- New external debt obligations contracted and/or guaranteed by the government of the Solomon Islands, CBSI, and other official entities, including details on the amounts, terms, and conditions of each obligation.

- Stock of outstanding external debt at end-month and disbursement, amortization, and interest payments for short-term external obligations contracted or guaranteed by the government or the CBSI by creditor in original currency and U.S. dollars.

- Stock of external debt at end-month and disbursement, amortization, and interest payments for medium- and long-term external obligations contracted or guaranteed by the government or the CBSI by creditor in original currency and U.S. dollars.

- Stock of arrears on the external debt contracted or guaranteed by the government or the CBSI by creditor in original currency and in U.S. dollars at end-month.

On a quarterly basis:

- Balance of payment data, including detailed components of current accounts and capital and financial accounts.

D. Real Sector Data (MoFT, National Statistical Office)

On a monthly basis:

- The monthly consumer price index and a detailed breakdown by major categories of goods and services included in the consumer basket.

ANNEX I. GUIDELINES ON PERFORMANCE CRITERIA WITH RESPECT TO FOREIGN DEBT

Excerpt from Executive Board Decision No. 6230-(79/140), as revised on August 31, 2009

9. (a) For the purpose of this guideline, the term "debt" will be understood to mean a current, i.e., not contingent, liability, created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which requires the obligor to make one or more payments in the form of assets (including currency) or services, at some future point(s) in time; these payments will discharge the principal and/or interest liabilities incurred under the contract. Debts can take a number of forms, the primary ones being as follows:

(i) loans, i.e., advances of money to the obligor by the lender made on the basis of an undertaking that the obligor will repay the funds in the future (including deposits, bonds, debentures, commercial loans and buyers' credits) and temporary exchanges of assets that are equivalent to fully collateralized loans under which the obligor is required to repay the funds, and usually pay interest, by repurchasing the collateral from the buyer in the future (such as repurchase agreements and official swap arrangements);

(ii) suppliers' credits, i.e., contracts where the supplier permits the obligor to defer payments until sometime after the date on which the goods are delivered or services are provided; and

(iii) leases, i.e., arrangements under which property is provided which the lessee has the right to use for one or more specified period(s) of time that are usually shorter than the total expected service life of the property, while the lessor retains the title to the property. For the purpose of the guideline, the debt is the present value (at the inception of the lease) of all lease payments expected to be made during the period of the agreement excluding those payments that cover the operation, repair or maintenance of the property.

(b) Under the definition of debt set out in point 9 (a) above, arrears, penalties, and judicially awarded damages arising from the failure to make payment under a contractual obligation that constitutes debt are debt. Failure to make payment on an obligation that is not considered debt under this definition (e.g., payment on delivery) will not give rise to debt.