SOLOMON ISLANDS TRANSITION FINANCE COUNTRY DIAGNOSTIC: PREPARING FOR GRADUATION FROM LEAST DEVELOPED COUNTRY (LDC) STATUS

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Abstract

This working paper aims to better understand the process of graduation from least developed country (LDC) states in a Pacific small island developing state (SIDS), and provides the Development Assistance Committee (DAC) and other development partners with evidence-based analysis and recommendations on how to better manage transition in such context.

Solomon Islands is engaged in a multifaceted transition stage with financial, technical, geopolitical and environmental dimensions. Solomon Islands is scheduled to graduate from the category of LDC by 2024, and the global alliance for vaccines and immunisations (GAVI) financial support by 2022.

The transition finance approach used in this study shows that Development Assistance Committee (DAC) members have a crucial role to play to support the country's transition and should utilise their official development assistance (ODA) in a way that maximises its impact. This would entail: helping the country move towards a sustainable economic model (both in terms of environmental and financial/debt sustainability), supporting the progressive substitution of ODA by other financing sources (in particular domestic resources and private investment), and adapting their role and strategy to the country's evolving circumstances and needs (for example by establishing new economic partnerships in support of the country's strategy of economic diversification and promotion of higher value-added trade and private investment).

Background

In the communiqué issued at its 2017 High Level Meeting (OECD DAC, 2017[1]), the Development Assistance Committee (DAC) set an objective for itself "to better understand the broad catalytic effect of official support and other resources by understanding the interlinkages among ODA, partner countries' domestic resources, private investment, remittances, philanthropy, trade finance and export credits, and other sources of finance", and to "continue to collaborate with other experts within the OECD and beyond in order to have a global overview and outlook on financing for development" (para 15).

Responding to this call, the OECD Development Co-operation Directorate (DCD) developed a new work stream on transition finance and set the scene with the publication of a working paper[1] that outlines the analytical basis of this new framework. The paper sets out an "ABC methodology" for transition finance diagnostics, which involves: *Assessing* the transition context in the country; *Benchmarking* the substitution effects between public, private, domestic and international resources; and *Counselling* on how development partners can help phase out ODA and secure the progressive growth of other sources of finance.

The DCD has to date carried out six pilot studies on countries facing different transition challenges: Cabo Verde, Zambia, Uganda, Lebanon, Viet Nam and Chile. This seventh pilot study on Solomon Islands explores the financial challenges faced by a small island developing state (SIDS) transitioning out of the least developed country (LDC) category. This case study will complement the lessons learnt and recommendations derived from the transition finance pilot already undertaken in an African SIDS, Cabo Verde, which graduated from the LDC group in 2007.

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As part of the mission, the mission team participated in the UN-led workshop on Solomon Islands' LDC graduation (17-18 October 2019) and presented the preliminary findings of the transition finance mission in a panel on "Access to Finance and Mobilisation of Resources during the Transition". The event was attended by representatives of Solomon Islands Government and Vanuatu Government, as well as development partners and civil society actors (e.g. Solomon Islands Chamber of Commerce and Industry). This allowed the mission team to share views, obtain early feedback on the mission findings and discuss the potential for future collaboration with the following entities: UNDESA, UNDP, UNESCAP, UNCDF, UNOHRLLS and ADB.

Finally, the Development Co-operation Directorate would like to thank the government of New Zealand for its direct financial contribution to this country diagnostic.

Abbreviations and acronyms

AAA	Addis Ababa Action Agenda
ADB	Asian Development Bank
AIFFP	Australian Infrastructure Financing Facility Partnership
CBSI	Central Bank of Solomon Islands
CDP	Committee for Development Policy
DAC	Development Assistance Committee
DCD	Development Co-operation Directorate
DRM	Domestic resource mobilisation
EBA	Everything But Arms
EPA	Economic Partnership Agreement
EU	European Union
EVI	Economic Vulnerability Index
FAO	Food and Agriculture Organisation
FDI	Foreign direct investment
FSD	Financing for sustainable development
GAVI	Global Alliance for Vaccines and Immunization
GF	Global Fund
GNI	Gross national income
GDP	Gross domestic product
HAI	Human Asset Index
IDA	International development association
IMF	International Monetary Fund
INFFs	Integrated national financing frameworks
IRENA	International Renewable Energy Agency
LDC	Least developed country
LMIC	Lower middle-income country
ODA	Official development assistance

OOF	Other official flows
PACER	Pacific Agreement on Closer Economic Relations
PFM	Public financial management
PFTAC	Pacific Financial Technical Assistance Centre
RAMSI	Regional Assistance Mission to Solomon Islands
SDGs	Sustainable Development Goals
SIDS	Small island developing states
SIG	Solomon Islands' Government
TIWB	Tax Inspectors Without Borders
UMIC	Upper middle income country
UNDP	United Nations Development Programme
UNICEF	United Nations Children's Fund
UNSG	United Nations Secretary-General
VAT	Value Added Tax
WHO	World Health Organisation

Executive summary

The substantial economic and social progress achieved by Solomon Islands over the past decade puts the country on track to graduate from least developed country (LDC) status by 2024. With support from its regional partners, the country was able to transition away from a period of ethnic and political violence, known as the "Tensions" (1999-2003), and was able to put in place sound macroeconomic policies that led the country to significant development achievements.

The direct implications of Solomon Islands' graduation from the LDC category are expected to be largely manageable. The country's main development partners (Australia, Japan and New Zealand) do not anticipate a decline of their official development assistance (ODA) flows following Solomon Islands' graduation. In addition, one of the main effects anticipated by the government and its development partners – the loss of European Union (EU) trade preferences for the country's exports of fish and agricultural products – has been mitigated through the signing of an Interim Economic Partnership Agreement with the EU in late 2019.

However, Solomon Islands has to face many other challenges that could undermine its development and domestic resource mobilisation is at risk due to the decline of the logging industry. Indeed, the decline of the logging industry, which constitutes the main source of government revenue, alongside the global health and economic crisis spurred by the COVID-19 pandemic, are likely to affect the country's finances as much as its healthcare system. In addition, the emergence of the People's Republic of China ("China") as a new provider of development finance is likely to create turbulence in the country's financing landscape, presenting as many risks as opportunities.

Official development assistance (ODA) occupies a prominent place in the country's financing mix, even by the standards of other Pacific SIDS. If not compensated by other financing sources, there is a risk of seeing a financing gap in key development areas, such as the health sector. The fact that the country recently entered the GAVI accelerated transition phase and is expected to completely substitute GAVI co-financing by 2022 represents an additional challenge. Other official flows, on the other hand, are still at low levels, raising questions on the country's capacity to achieve a smooth transition towards private finance.

The benchmarking analysis shows, however, that the country could learn from the experiences of its peers to optimise the mobilisation of domestic resource and to achieve efficiency gains through improved public expenditure and public investment management. Many of Solomon Islands' peer countries perform much better in terms of capacity to attract private finance. Lessons learned from their experiences show that land governance reforms and investment strategies dealing with the infrastructure deficit are key to attract private finance, and will be indispensable to make viable the government's strategy of economic diversification.

Last but not least, Solomon Islands' development partners need to support the implementation of the country's national development plan and its "smooth transition" strategy for LDC graduation. To help Solomon Islands government achieve these two objectives, Development Assistance Committee (DAC) providers along with other development partners should use their ODA strategically to implement a combination of measures along the three following dimensions:

The co-operative approach: Helping the country move towards a sustainable economic model will be paramount to ensure that growth preserves the long-term prospects of inclusive and sustainable development.

DAC members could help Solomon Islands overcome its challenges by deploying appropriate technical assistance and financing to: ensure the transition to sustainable economic production; improve domestic resource mobilisation and public financial management; and build its capacity to navigate its new financing landscape (e.g. for the negotiation of complex financial transactions).

The competitive approach: To anticipate the progressive substitution of ODA by other financing sources, a competitive approach should also be pursued by development partners to help the country attract private finance. DAC members along with other development partners would help Solomon Islands create an enabling environment for sustainable and private-led infrastructure investments that could ensure economic value added and upgrading, job creation, and investments geared towards the diversification of the economy.

Renewed partnerships: Development partners should also reconsider their role and their areas of support in light of Solomon Islands' evolving financing needs. Specific support is required to help the country face the costs associated with its smooth transition strategy (e.g. evaluate the creation of a new LDC Transition Unit within the Ministry of National Planning and Development Co-operation), as well as to facilitate its integration in regional and global trade. Other challenges and opportunities, such as the emergence of China as a new provider of development finance in the country, require to consolidate the DAC's position as a global standard setter to promote DAC good practices in development co-operation.

1. Assessing

1.1. Key findings

The substantial economic and social progress achieved by Solomon Islands over the past decade puts the country on track to graduate from least developed country (LDC) status by 2024. With support from its regional partners, the country was able to transition away from a period of ethnic and political violence, known as the "Tensions" (1999-2003), and was able to put in place sound macroeconomic policies that led the country to significant development achievements.

The direct implications of Solomon Islands' graduation from the LDC category are expected to be largely manageable. The country's main development partners (Australia, Japan and New Zealand) do not anticipate a decline of their ODA flows following Solomon Islands' graduation. In addition, one of the main effects anticipated by the government and its development partners – the loss of EU trade preferences for the country's exports of fish and agricultural products – has been mitigated through the signing of an Interim Economic Partnership Agreement with the EU in late 2019.

However, Solomon Islands has to face many other challenges that could undermine its development in the future. The decline of the logging industry, which constitutes the main source of government revenue, and the global health and economic crisis spurred by the COVID-19 pandemic, are likely to affect the country's finances as much as its healthcare system. In addition, the emergence of China as a new provider of development finance is likely to create turbulence in the country's financing landscape, presenting as many risks as opportunities.

1.2. Solomon Islands achieved substantial economic and social progress over the past decade despite persisting vulnerabilities

Solomon Islands is a sovereign small island developing state (SIDS) and lower middle-income country (LMIC) located in the Pacific region. The country is among the world's least developed countries (LDCs) and categorised as a fragile context under the OECD Fragility Framework.[2] Situated just off the eastern coast of Papua New Guinea, it counts more than 900 islands and atolls, and its population of 674 000 inhabitants is distributed across 347 islands.

Regional partners supported a successful post-conflict transition

Years of conflict have taken their toll on the development trajectory of Solomon Islands. In the late 1990s, the country experienced a period of civil unrest, known as the Tensions, sparked by ethnic and political violence. The ensuing conflict, which lasted for five years (1999-2003), led to widespread turmoil and lawlessness, leaving the country bankrupt and in chaos.

Box 1.1. Solomon Islands at a glance

Figure 1.1. Map of Solomon Islands

Source: (Pacific Community, 2020[2]),Solomon Islands https://www.spc.int/our-members/solomon-islands/details

Government: Independence and UN membership (1978), Commonwealth membership (1978), Pacific Community membership (1978)

Population: 674 000 inhabitants (22% urban)

Ethnic groups: Melanesian (95%), Polynesian (3%), Micronesian (1.2%)

Area: 28 370 km² (76% forests)

Coastline: 5 310 km

EEZ: 1 553 440 km²

Life expectancy: 73 years

GNI per capita: USD 2 020 (2018)

Currency: Solomon Islands dollar (SBD)

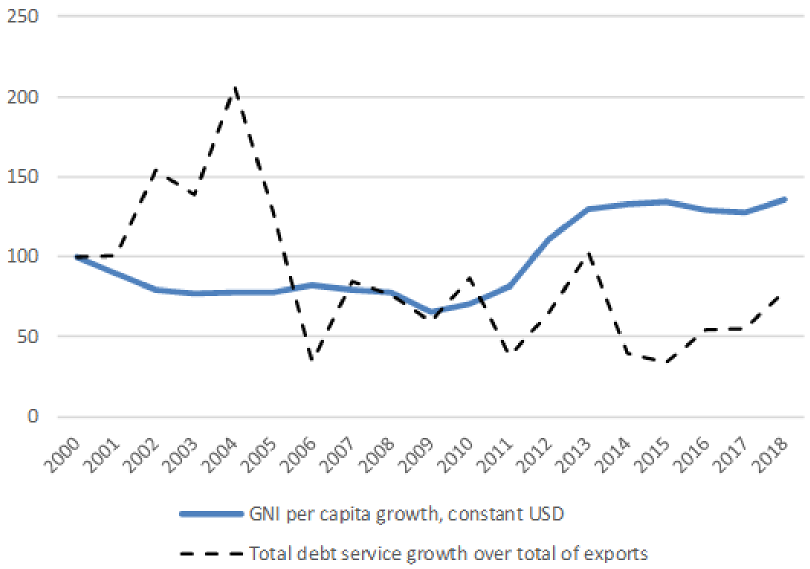
Support from several DAC members was key to restoring peace and preserving development gains. The intervention of a Regional Assistance Mission to Solomon Islands (RAMSI) was successful in restoring stability and order. Established through a partnership between Solomon Islands' Government (SIG) and 15 contributing countries of the Pacific region, the RAMSI was funded by Australia, Japan, the EU and New Zealand. Throughout the post-conflict period (2003-17), RAMSI was crucial to restore trust in the government, strengthen the country's institutions, and ensure the provision of basic services to the population, in a showcase of the humanitarian-development-peace nexus. The RAMSI formally ended in 2017, even though its civilian development programmes had already been transferred to the Australian High Commission and other bilateral aid partners in July 2013.

The implementation of sound macroeconomic policies led to significant development achievements

Solomon Islands presents sound macroeconomic fundamentals. During the RAMSI period, and closely accompanied by the International Monetary Fund (IMF), the country engaged in major macroeconomic structural reforms. Today, Solomon Islands' economy exhibits a regular and positive growth (+4.7% by year over the period 2009-2018[3]), moderate levels of public debt to GDP (8,4% in 2018)[4], a controlled rate of inflation (3.9% on average[5] over the period 2009-17) and a stable and well-managed exchange rate.

Figure 1.2. GNI per capita is increasing while debt service remains at prudent levels

Solomon Islands, 2000=100.



Source: Author's design based on (World Bank, 2019[3]) World Development Indicators https://databank.worldbank.org/source/world-development-indicators

Some caution, however, is required in regards to the country's fiscal position. While the overall macroeconomic situation is stable, fiscal risks are looming on the horizon. Government revenue, already down by 4% in 2019, is expected to continue on a downward trend, while the hosting of the 2023 Pacific Games will likely result in budgetary pressures. In addition, the country's deficit, which rose to 1.7% of GDP in 2019, is projected to continue on an upward trend in coming years.[6]

Box 1.2. Macroeconomic management in times of crisis: the importance of International Monetary Fund support

In 1996, the government defaulted on its domestic debt obligations. Macroeconomic conditions worsened further after violence between the residents of the Guadalcanal and Malaita islands erupted in mid-1999.

Nonetheless, policy performance improved markedly following the arrival of the multinational intervention force (RAMSI) in mid-2003, which restored law and order. The IMF, on its part, was crucial in helping the government engage in adequate monetary policy reforms. Inflation fell back to single-digit levels in the early 2000s (15% in 1999) as the nominal effective exchange rate stabilised, and the budget deficit (10% of GDP in 2002) was reduced to 1.5% in 2003.

The central bank (CBSI) was vigilant in ensuring that commercial banks comply with prudential guidelines, and bank profitability improved. Indeed, the central bank's policy resisted upward pressure on the exchange rate appropriately as the CBSI has de facto pegged its currency to a dollar basket of currencies since 2003[7]. With the conduct of monetary policy likely to become more challenging, the CBSI continues to stand ready to take appropriate measures, in the event credit growth becomes inflationary.

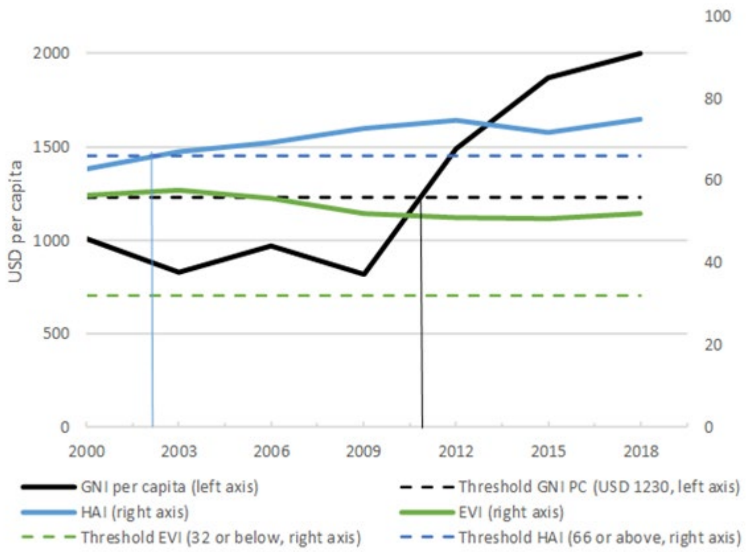
Additionally, the authorities continue to promote an open trade regime. Starting in 1998, the authorities reduced tariff rates from five bands that ranged from 5–70 % to three bands that range from 5–20 %. The weighted average tariff stands at 11 % in 2005, and there were no significant non-tariff barriers.

Source: (IMF, 2004[4]), Solomon Islands: 2004 Article IV Consultation https://www.imf.org/external/pubs/ft/scr/2004/cr04258.pdf (IMF, 2005[5]), Staff Report for the 2005 Article IV Consultation https://www.imf.org/external/pubs/ft/scr/2005/cr05365.pdf ; (IMF, 2007[6]), Solomon Islands: 2007 Article IV Consultation https://www.imf.org/external/pubs/ft/scr/2007/cr07304.pdf ; (IMF, 2020[7]), Financial position in the Fund https://www.imf.org/external/np/fin/tad/exfin2.aspx?memberKey1=865&date1key=2099-12-31; (IMF, November 2019[8]), End-of-Mission Press Release https://www.imf.org/en/News/Articles/2019/11/12/pr19407-solomon-islands-imf-staff-completes-2019-article-iv-mission-to-solomon-islands.

Significant progress has been achieved in key development areas in the last two decades thanks to a concerted effort of the government and its development partners. Between 2000 and 2019, the gross national income (GNI) per capita doubled from USD 1 010 to USD 2 020. Over the same period, major achievements were also made in terms of human development. The country's maternal mortality ratio, for example, decreased by 58% between 2000 and 2017, from 245 to 104 deaths per 100 000 live births.

The improvement in living standards puts the country on track for graduation from the LDC category in 2024. In its 2018 triennial review, the Committee for Development Policy (CDP) recommended Solomon Islands for LDC graduation after noting that the country had met two out of three possible graduation criteria on two consecutive occasions. Currently, Solomon Islands has a GNI per capita of USD 2 020 and a Human Asset Index (HAI) score of 74.8.[8] Like many graduating SIDS, however, Solomon Islands does not meet the requirements for the third criteria: an Economic Vulnerability Index (EVI) inferior to 32. At the time of the 2018 triennial review, Solomon Islands' EVI stood at 51.9. The geographical characteristics of the country explain in large part Solomon Islands' EVI score. Indeed, four of the EVI's eight components weigh heavily on the country's score: the small size of its population; its remoteness; the share of the population living in low-lying coastal areas, but also the level of merchandise export concentration.[9]

Figure 1.3. The country meets two out of the three possible criteria for LDC graduation



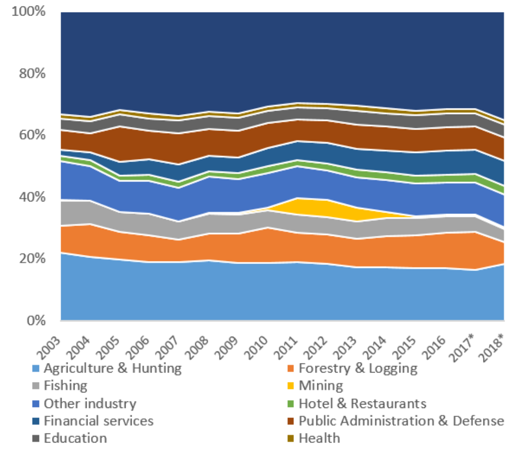
Source: Author's calculations based on (Ferdi, 2020[9]), Ferdi Indicators https://ferdi.fr/donnees ; (World Bank, 2019[3]) World Development Indicators https://data.worldbank.org/indicator/ and (Committee for Development Policy, 2020[10]) Data Resources https://www.un.org/development/desa/dpad/resources.html?target=data.

As of 2018, Solomon Islands has also entered GAVI's accelerated transition phase. In 2017, GAVI (Global Alliance for Vaccines and Immunisation) announced that the country had met the requirement to initiate the transition out of GAVI support, thanks to a GNI per capita superior to USD 1 580 over three consecutive years. That same year, the SIG developed a GAVI Transitional Plan 2018-2022 in consultation with WHO, UNICEF, GAVI and other partners. According to the Transitional Plan, GAVI support is expected to progressively phase out in the next couple of years and should be totally replaced by government expenditure by 2022.[10]

Solomon Islands' growth remains fragile and mainly driven by the unsustainable exploitation of natural resources

The lack of diversification of the economy calls into question the country's capacity to achieve sustained growth over the long term. Solomon Islands is an agricultural society, with 80% of the population living in rural areas and largely dependent on subsistence farming. Agriculture and hunting are the main economic activities (19% of GDP in 2018), followed by financial services (8%) and forestry and logging (7%). While an important provider of foreign exchange, fisheries only account for 4% of the country's GDP, down from 5% in 2015 (see Figure 1.4). The mining sector, which represented 5% of GDP in 2011 and 2012, has seen its contribution dwindle following the withdrawal of foreign investors.[11]

Figure 1.4. Solomon Islands GDP by factor composition, 2003-2018



% of GDP	2003	2018	Trend
Agriculture & Hunting	22%	19%	↘
Forestry & Logging	9%	7%	↘
Fishing	5%	4%	↘
Mining	0%	1%	—
Other industry	13%	11%	↘
Hotel & Restaurants	2%	3%	↗
Financial services	2%	8%	↗
Public Administration & Defense	6%	7%	↗
Education	4%	4%	—
Health	1%	1%	—
Other services	33%	35%	↗

Note: 'Other industry' includes manufacturing, electricity & water and construction; 'financial services' includes financial intermediation, insurance services and business services; 'other services' includes wholesale and retail trade, transport and storage, communications, real estate and renting, owner occupied dwellings and other services.
Source: Authors' calculations based on (Central Bank of Solomon Islands, 2020[11]), Key Statistics of Solomon Islands http://www.cbsi.com.sb/statistics/key-statistics/ and IMF internal information.

The export of unprocessed logs constitutes the main source of government revenue but is on the decline. In 2018, custom duties from the logging industry accounted for 20% of the government's domestic revenue and 32% of total foreign exchange receipts. However, to counter the rapid depletion of the country's forest resources, the Solomon Islands government launched in 2018 a sustainable logging policy imposing yearly quotas on the production of logs. As a consequence, harvesting is projected to decrease drastically, from 1.9 million cubic metres in 2019 to 0.7 million cubic metres in 2023.[12]

The sunset of the logging industry is expected to negatively impact the country's fiscal position, and could increase its vulnerability to external shocks. In 2019, the economy of Solomon Islands already showed signs of running out of steam, with government revenue down by 4% and GDP growth decelerating to 2.7% (down from 3.9% in 2018). This slowdown, resulting from both from the decrease of log exports, the postponement of some strategic projects and the 2019 elections that halted domestic economic activities in the beginning of the year, fuels the risk of twin deficits (fiscal and external), which could also be exacerbated by the COVID-19 crisis.

1.3. Solomon Islands faces LDC graduation in an uncertain transition context

LDC graduation is expected to have a limited impact in the short term but could be challenging to manage in the current context

The main anticipated impact of Solomon Islands' LDC graduation was the loss of trade preferences for the country's exports of fish and agricultural products. As an LDC, Solomon Islands benefits from the EU's Everything But Arms initiative (EBA), which grants full duty-free and quota-free access to the EU single market for all products (with the exception of arms). Given that the EU is the primary destination of the country's fisheries (tuna) and agriculture (palm oil) exports, the loss of EU trade preferences following LDC graduation could have had dramatic consequences for these industries, with the imposition of a 35% tariff rate on their exports that could render them uncompetitive. While these two sectors represent a small share of the economy compared to logging, they generate substantial positive spill overs: for example, the tuna processing and export operation Sol Tuna is the single largest private employer in Solomon Islands (employing 2 200 staff).

The Solomon Islands' government and its development partners secured early on a new access to EU trade preferences. Following the submission of a formal request by the SIG in 2019, the Council of the EU approved in February 2020 the accession of Solomon Islands to the EU-Pacific States Interim Economic Partnership Agreement (EPA). Under this new partnership, the Solomon Islands joins Fiji, Papua New Guinea and Samoa, and will benefit from duty-free exports to the EU. An additional benefit from the interim EPA is that it allows asymmetric and gradual opening of Pacific countries' markets to EU goods, meaning that Solomon Islands will be able to exclude sensitive sectors from the agreement if EU imports are seen as threatening the local economy.

In the longer term, the country will also lose access to smaller LDC-specific mechanisms.[13] These include the LDC Fund (access ending in 2024), LDC Technology Fund (access ending in 2029), Aid for Trade Enhanced Integrated Framework (access ending in 2029), UN Capital Development Fund (co-financing after 2027, and access ending in 2029), and IDLO/OHRLLS Investment Support Programme (access ending in 2029). In addition, Solomon Islands' LDC graduation will also result in relatively small changes to the country's budget for UN peacekeeping and the loss of UN travel support by 2027.

Limiting the impact of LDC graduation will require careful planning and co-ordination by development partners. Although other country experiences have shown that LDC graduation can affect ODF patterns, for example resulting in reduced concessionality and increased use of tied aid,[14] the main development partners in Solomon Islands (Australia, Japan, and New Zealand) seem confident that there will be no impact on the volume and concessionality of their ODA flows to the country following its graduation. However, as a SIDS with limited capacity and faced with an unfavourable global environment, it may be difficult for Solomon Islands to effectively implement the recommendations made by UN member states on the LDC graduation process (which include establishing a consultative mechanism, preparing a smooth transition strategy and reporting annually to the CDP on its implementation).

The country's LDC graduation is the tree that hides the forest. The country's preparation for LDC graduation coincides with major evolutions in the global economy and the national financing landscape. The decline of the national logging industry, new diplomatic ties with China, and the impact of the COVID-19 pandemic could all have lasting implications on the country's access to financing and its capacity to manage a successful transition from the LDC category.

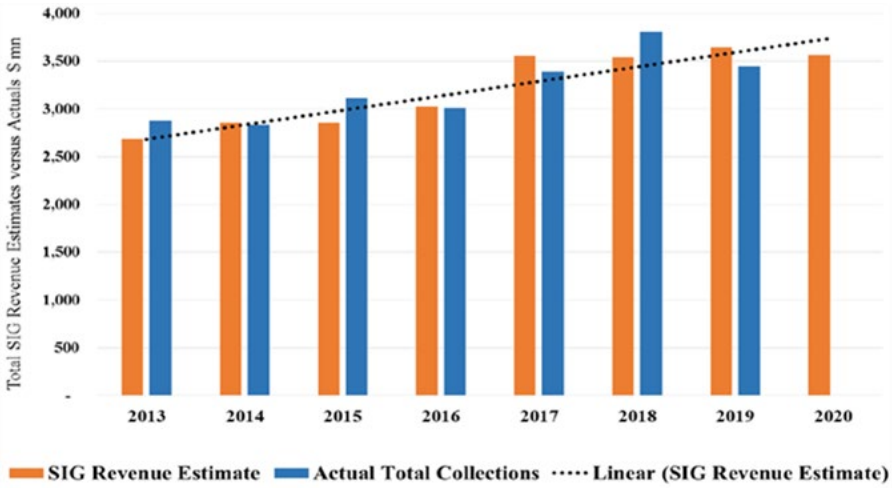
The decline of the logging industry dries up a critical source of government revenue

The entry into force of the ambitious logging sustainability targets set by the government is likely to amplify budget pressures. Logging currently accounts for half of the customs and excise duties collected by the government, making it the main source of government revenue. The decrease of the production and export of logs is thus likely to negatively affect the government's finances in the near future, and could also have consequences on its capacity to finance key development areas.

After two consecutive years of growth in government revenue, 2019 saw a first decline of collections, which went down by 9%. The downward trend of domestic revenue from the logging industry is expected to continue in the short to medium term. According to SIG estimates predating the COVID-19 crisis, the government's customs and excise revenue was already projected to decrease to SBD 976 million (USD 118 million) in 2020, down from SBD 997.5 million (USD 120 million) in 2019 and SBD 1 323 million (USD 159 million) in 2018. This would represent a -26% decrease over the period 2018-2020. Figure 1.5.

Figure 1.5. Government revenue shrank by 9% in 2019 due to the decline of logging export revenues

Solomon Islands government revenue estimates vs actual collections between 2013 and 2020.



Source: (National Parliament of Solomon Islands, 2020[12]), National Parliament of Solomon Islands http://www.parliament.gov.sb/?q=node/1292.

Social sectors, such as health and education, could be the most impacted by the decline in government revenue since they are heavily funded through ODA and government spending. In the case of the health sector, the fact that Solomon Islands has entered into the phase of accelerated transition from GAVI since 2018 and is scheduled to graduate from it in 2022 may pose an additional challenge since the government is expected to completely substitute GAVI funding before then.

Formalised diplomatic ties with China could profoundly modify the country's financing landscape

In September 2019, Solomon Islands officially announced the establishment of diplomatic ties with China. This decision implied the automatic recognition of Beijing's One China policy by Solomon Islands, and thus the end of diplomatic relations with Chinese Taipei dating back to 1983. One week after Solomon Islands, another Pacific SIDS, Kiribati, also announced the recognition of China, in an unequivocal sign of China's growing influence in the Pacific.

China's entry into Solomon Islands' financing landscape represents an opportunity to fill the country's huge needs in key development areas. Solomon Islands' government described the switch of diplomatic ties from Chinese Taipei to China as reflecting the country's long-term development interests. In a statement[15] published a few days after the Solomon Islands parliament recognised the One China policy, the SIG argued that this strategic move would allow the country to benefit from China's large financial clout. Since then, Solomon Islands has formally joined China's Belt and Road Initiative (BRI) and announced a first series of China-backed projects, in particular in areas related to infrastructure development.

One of China's "early harvests" from the new diplomatic ties is the takeover of the country's main mining site, Gold Ridge mine, by the Chinese mining group Wanguo International. At the official launch of the mine in October 2019, Wanguo announced that it had contracted the state-owned enterprise China State Railway Group on a USD 825 million deal to complete the infrastructure works. According to the project terms presented during the official launch, Wanguo International will own all the infrastructure developed as part of the project, including power and port facilities, roads, rail and bridges.

The experience of other SIDS shows that new financing opportunities need to be managed carefully. Several small island developing states, such as Cabo Verde and Samoa, have experienced a quick surge of their debt levels following LDC graduation, and moved from a moderate to a high risk of debt distress in a relatively short period of time (OECD, 2018[13]). In the case of Cabo Verde, the rapid deterioration of its debt sustainability was mainly driven by a surge in public non-concessional debt (Morris, Cattaneo and Poensgen, 2018[14]) and increased contingent financial liabilities related to SOEs. This example is a stark reminder that SIDS require careful borrowing and debt management to ensure debt remains at prudent levels and fiscal space is sufficient to finance sustainable development needs.[16]

The characteristics of China's financing generates concerns over aid quality and a possible "debt-trap diplomacy". Although Chinese financing to developing countries comes in many shapes, it tends to be less concessional, and often relies on the use of public-sector assets or commodities as collateral backing. Chinese investments are also closely tied in with Beijing's commercial interests: they often target strategic and large-scale economic infrastructure projects (raising questions regarding recipient countries' project prioritisation) and operate in a closed circuit.[17] For example, China-backed investments usually resort to Chinese suppliers and contractors selected through processes that are not open to international competition. They also tend to involve a large use of Chinese work force,[18] a practice at odds with the international best practice that calls for maximising local content. Given Solomon Islands' vulnerability to natural disasters and climate change, the new relationship with China will require close oversight to ensure that internationally recognised standards of quality are met (e.g. in terms of climate resilience). [19]

The ripple effect of the COVID-19 pandemic is likely to hit the country's economy as much as its health system

The COVID-19 pandemic will put Solomon Islands' fragile health system to the test. While Solomon Islands has only registered two confirmed COVID-19 cases at the date of writing of this report, the country is likely to suffer the effects of the pandemic in the medium term. With a score of 0.37 in the RAND's Infectious Disease Vulnerability Index,[20] the country ranks as the 45th most vulnerable country (out of 195 countries assessed), well ahead of other Pacific SIDS such as Vanuatu (68th) or Fiji (95th). In a context of constrained fiscal space, the reduced margin existing to increase health expenditure means that an important infectious disease outbreak could stretch the capacity of the country's healthcare system.

The global economic tsunami created by the COVID-19 crisis threatens Solomon Islands' economic outlook and could profoundly impact its fiscal position. The country's reliance on commodity exports (e.g. logs, fish, and palm oil) makes it particularly vulnerable to external shocks. A sharp decline of global and domestic demand due to unfavourable market conditions would durably impact the country's export industries (forestry, fisheries, agriculture), which are key economic drivers and represent a large source of formal employment.

The timing of the COVID-19 outbreak constitutes an unfortunate additional risk factor for the country's LDC graduation. The economic uncertainty generated by the COVID-19 crisis represents a serious challenge at a time where Solomon Islands and its development partners must carefully plan to ensure the country experiences a smooth transition from the LDC category. In times of economic tumult, the asymmetry of the LDC reverse graduation process could represent an extra challenge since a deterioration of the indicators used to decide the country's graduation would not automatically lead to a reintegration in the LDC category.[21]

Box 1.3. Solomon Islands in a transition finance context

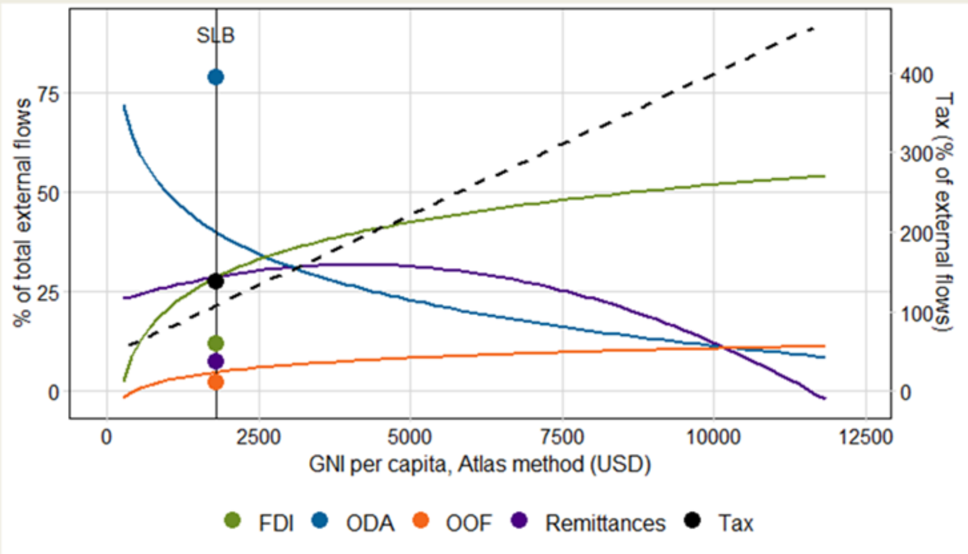
From a 'transition finance' point of view, Solomon Islands remains highly dependent on external funding. ODA accounts for nearly 80% of total external inflows.

Remittances are almost non-existent and private flows remain low (Figure 1.6). Indeed, private finance (both external and domestic) remains extremely low due to existing constraints on private sector development and private investment (in particular issues related to customary land ownership and governance). In addition, access to credit and finance remains an issue. Remittances are insignificant compared to peer countries due to the low levels of work-related migration, and are not expected to increase substantially in coming years.

Solomon Islands performs relatively well in terms of tax revenues, which appear higher than what is usually observed in countries at a similar phase of development (Figure 1.6). However, government revenue stemming from the export of logs is projected to decline in coming years due to the combined effect of new logging sustainability measures and the decrease of global demand.

Figure 1.6. Solomon Islands' ODA flows as a share of total external flows are higher than in countries of a similar GNI per capita

DAC, non-DAC and multilateral agencies' outflows, average 2012-18, net disbursements, 2018 prices



Note: Coloured dots correspond to Solomon Islands' situation and should be compared with the respective coloured lines (averages for all developing countries).

Source: Author's calculations based on (OECD, 2019[15]), Creditor Reporting System database https://stats.oecd.org/Index.aspx?DataSetCode=CRS1 for ODA and OOF flows; and (World Bank, 2019[3]) World Development Indicators https://data.worldbank.org/indicator/ and (UNWIDER, 2019[16]) Government revenue database https://www.wider.unu.edu/project/government-revenue-dataset.

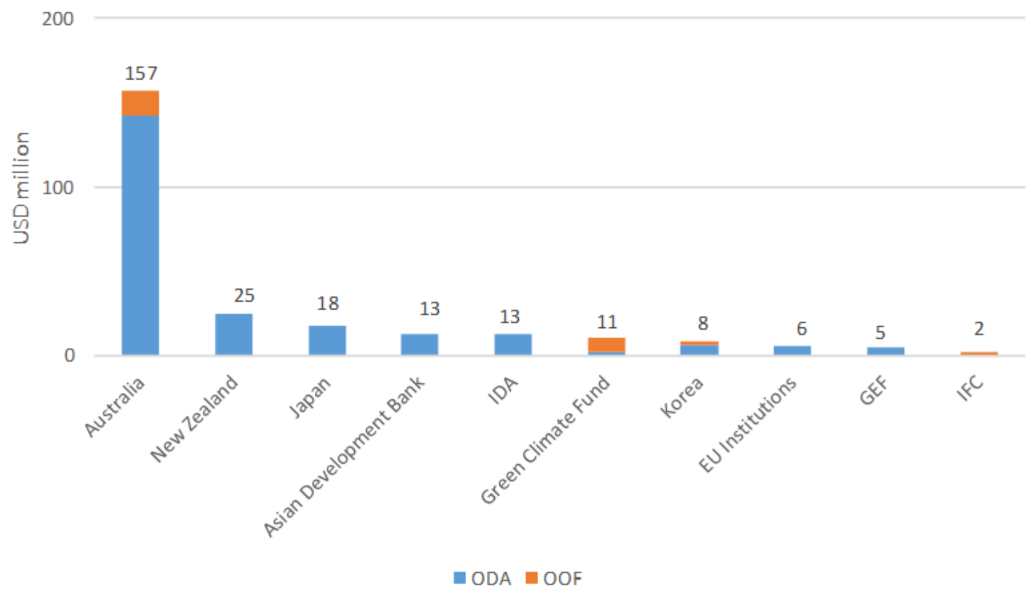
1.4. The geopolitical reshuffle questions the future role of DAC providers in the country's transition

A few DAC providers currently account for the bulk of official development finance flows to Solomon Islands

Due to historical ties or geographical proximity, several DAC providers have shown a longstanding commitment to support the country. In quantitative terms Australia is by far the largest partner of the Solomon Islands Government, followed by New Zealand, Japan and the Asian Development Bank. Four out of the ten biggest donors provide non-concessional loans in addition to ODA flows (e.g., Australia, the Green Climate Fund, Korea and the IFC) (Figure 1.7). Until the recent severing of diplomatic ties, Chinese Taipei was also an important ODF provider, contributing an annual USD 8.5 million to Solomon Islands.[22]

Figure 1.7. Main official development finance providers to Solomon Islands

USD million, 2011-18 average per year, 2017 prices.



Source: Authors' calculations based on (OECD, 2019[15]) Creditor Reporting System database https://stats.oecd.org/Index.aspx?DataSetCode=CRS1 and (OECD, 2020[17]) DAC2b statistics https://stats.oecd.org/Index.aspx?DataSetCode=TABLE2B.

Although DAC members' support is mostly provided through ODA grants, there is a discernible trend toward increased provision of ODA loans and other official flows. Grants accounted for 70% of total official development finance (ODF) commitments to Solomon Islands in 2017-18, as compared to 16% for ODA loans and 14% for OOF. Previous transition finance studies (Piemonte et al., 2019[18]) have shown that the gradual integration of ODA loans and other official flows (OOF) in a country's financing mix is key to ensure a successful transition between concessional public finance and private finance at market terms.

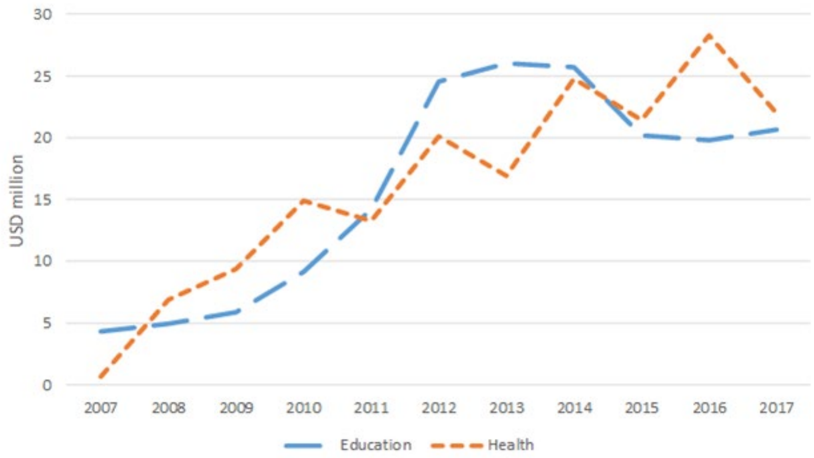
DAC providers' support has traditionally targeted government and social sectors

Throughout the post-conflict period (2003-17), DAC members heavily invested in state building and civic space. Funding for government and civil society, for example, accounted for more than 60% of DAC support in 2011-2012. Figure 1.10, left chart, showcases the importance of the RAMSI activities in ODA composition (under 'government and civil society') in the period analysed. This support, which aimed to recover key government functions and encourage the emergence of a vibrant civil society, is however gradually phasing out, and represented only 20% of the total DAC support in 2018.

DAC providers also granted particular attention to social sectors in order to guarantee the provision of basic services to the population. Development assistance to health and education have been on the rise in the last decade (Figure 1.8). To increase country ownership and promote the use of country systems, a significant and growing share of DAC providers' official development assistance is being provided as on-budget support.

Figure 1.8. Official development finance to education and health is increasing

Three-year moving average, 2006-18, USD commitments, 2017 prices.



Source: Author's calculations based on (OECD, 2019[15]) Creditor Reporting System database https://stats.oecd.org/Index.aspx?DataSetCode=CRS1.

DAC providers do not anticipate a sharp decrease of their support to social sectors following the country's LDC graduation. All DAC providers interviewed during the technical mission to Solomon Islands confirmed that LDC graduation is not an eligibility criteria for their ODA support. However, some providers, such as Australia, do have a long-term transition strategy to progressively transfer additional responsibilities to the SIG in sectors such as health, with a view to ensure government ownership and prepare the country for a smooth transition.

Box 1.4. DAC support to women's education and gender mainstreaming is key to address fragility

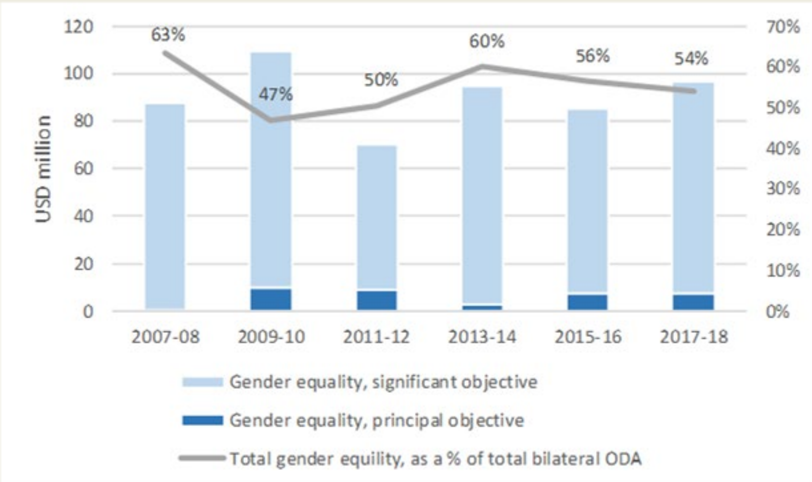
Despite experiencing a successful post-conflict transition, Solomon Islands remains classified as a 'fragile' context as per the OECD fragility framework. A close look at the indicators shows that the country's poor performance in terms of gender equality is the main factor explaining this classification.

Girls' low school enrolment rate and high prevalence of gender-based violence are a deep-seated challenge. Although equal rates of girls and boys enrol in primary school (60% of all children), a clear disparity appears in secondary education, where the gross rate for girls enrolled is only 27% (Hawley, 2018[19]) . Women in Solomon Islands also face high levels of gender-based violence (GBV), ranging from sexual violence, to coercion, emotional and/or physical violence (World Health Organization, Regional Office for the Western Pacific, 2011[20]); (UNICEF, 2014[21]); (UNDP; UN WOMEN; Solomon Islands Government, 2018[22])

In response to this situation, DAC members are mainstreaming gender equality in their aid assistance projects to Solomon Islands[1]: 8% of DAC members' aid assistance programmes in Solomon Islands target gender equality as a principal objective (compared to 4% on average across developing countries), and 56% with a significant objective (34% on average across developing countries) (OECD, 2019[23]) Figure 1.9.

Figure 1.9. DAC members' aid in support of gender equality and women's empowerment in Solomon Islands

USD commitments, 2019 prices



Note 1: In recent years, the SIG has also started to integrated gender equality objectives in its policy initiatives (Ministry of Women, Youth, Children and Family Affairs, 2018[24]).
Source: Authors' calculations based on (OECD, 2019[15]), Creditor Reporting System database https://stats.oecd.org/Index.aspx?DataSetCode=CRS1.

Unmet infrastructure needs to open new investment opportunities for both traditional and emerging donors

DAC providers contributed actively to basic infrastructure in the post-conflict period. Funding to several infrastructure-related sectors, such as energy and transport, has increased steadily in the past ten years. ODA to the energy sector, for example, rose from USD 1 million in 2010 to USD 9 million in 2017 (+800%). Over the same time period, funding to the transport and storage sector increased from USD 10.3 million to USD 27.5 million (+167%). The increase in infrastructure financing coincided with a growth in the provision of loans and OOF (Figure 1.10).

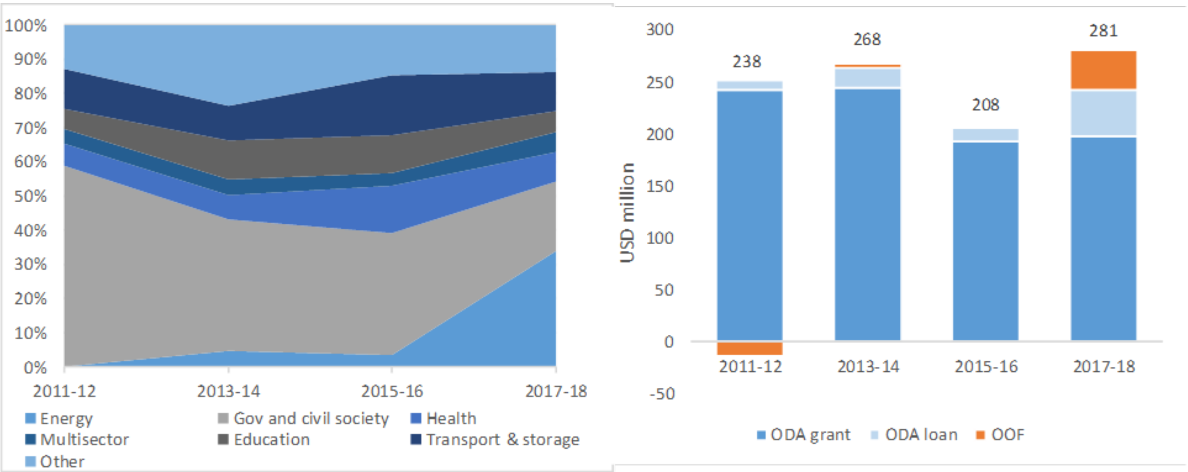
The Solomon Islands' government has several major infrastructure projects in the pipeline. Two projects in particular are expected to generate positive spill overs across the different sectors of the economy:

1. The USD 240.5 million Tina River Hydropower Project, which according to some estimates could reduce energy costs by at least 15% (currently, the country has one of the most expensive energy costs in the world, at 0,65 USD per kWh); and
2. A USD 93 million project with ADB and co-financing partners (Australia, Ireland, the GEF, the Green Climate Fund, the EU, the European Investment Bank and the World Bank) will improve access to safe water and sanitation in the capital Honiara and five other urban centres. Residents in Honiara will also benefit from a USD10 million project to build priority infrastructure identified in the government's plan for the capital.[23]

In addition, with support from development partners, the country finalised in 2019 the installation of the Coral Sea Cable System (CSCS), which will improve the country's telecommunications by connecting it to Australia's existing cable infrastructure (until recently, Solomon Islands' Internet service came exclusively from costly satellite connections).

Figure 1.10. Official development finance to Solomon Islands started turning to infrastructure after peace was restored

USD commitments, period 2011-18, 2017 prices, two-year moving average



Source: Authors' calculations based on (OECD, 2019[15]), Creditor Reporting System database https://stats.oecd.org/Index.aspx?DataSetCode=CRS1.

In spite of promising developments, infrastructure needs remain huge in Solomon Islands. There is only one tar-seal road in the capital, Honiara, connecting the city centre and the international airport.[24] In addition, only 6% of the population has access to energy,[25] half of the urban population lacks access to solid waste collection, and less than 30% of the population has access to improved sanitation sources.[26]

The government is exploring novel financing methods to boost infrastructure development. In a bid to fill the infrastructure gap, the SIG is turning to public-private arrangements to finance the development of major infrastructure projects. The Ministry of Fisheries and Marine Resources (MFMR) is for example advancing a project to develop the country's second tuna processing facility in Bina (Malaita province), with technical and financial support from the International Finance Corporation (IFC), as well as two DAC members: Australia and New Zealand. The project, which should take the form of a public-private partnership, requires a USD 70 million contribution from a private investor out of a total project cost estimated at USD 185 million.

The entry of China in the country's infrastructure landscape could confine DAC countries to the role of social safety net providers. Given China's financial firepower and its inclination to invest in economic infrastructure, there is a risk to see the emergence of a two-tier financing system, with DAC providers confined to subsidising social sectors through grant funding while China assumes a dominant position in economic sectors through lending at, or close to, market terms. Even if the establishment of diplomatic ties between the SIG and China is still recent, various agreements for the development of infrastructure projects have already come to light, including the construction of a stadium in view of the 2023 Pacific Games,[27] as well as the development of new power and port facilities.[28]

A two-tier development finance system would jeopardise the country's transition in the social sectors. Without adequate co-ordination of the project portfolios of traditional and emerging ODF providers by the SIG, there is a risk to see government resources increasingly diverted towards debt servicing for infrastructure projects and away from the provision of basic services, such as health or education. Besides putting the country's economy at risk of debt distress, this could increase the dependence of social sectors on external funding from DAC providers, and impede a successful transition in the social sectors. New financing sources targeting investments in infrastructure constitute an incredible opportunity for the country, but without a symmetric effort of donors to continue building SIG's capacity in macroeconomic oversight, public financial management, and developing human capital through continued support to social sectors, it is unlikely to lead to inclusive and sustainable development trajectories.

Box 1.5. DAC providers champion the development of quality and resilient infrastructure in Solomon Islands

DAC providers recognise the large infrastructure deficit and specific development challenges faced by Pacific small island countries.[1] They also have a long track record supporting the development of key infrastructure in the region.[2]

Local stakeholders in the Solomon Islands show great appreciation for DAC infrastructure investments, highlighting its high quality and endurance. A special mention is given to Japan-supported infrastructure, which is widely recognised among local development stakeholders for its durability and resilience in the face of climate-related events.

In recent years, other DAC countries have also been taking steps to increase their support in the area of infrastructure development. In July 2019, Australia announced the launch of the Australian Infrastructure Financing Facility Partnership (AIFFP), a USD 2 billion regional facility that will provide grant and loan financing for both government and private sector projects in areas such as transport, energy, telecommunications and water. According to Australia's Department of Foreign Affairs and Trade (DFAT), the AIFFP's infrastructure investments will include a strong focus on infrastructure quality and resilience, and ensure local content, as well as appropriate social and environmental safeguards. The AIFFP brochure emphasises that all the infrastructure financed "will be built to withstand the impacts of climate change and natural disasters". In a bid to avoid silos and maximise co-operation, the

AIFFP is expected to collaborate closely with other bilateral, multilateral and private partners. This initiative, and the expertise developed in this field by Australia and other DAC providers over the past decades, puts the DAC in an ideal position to contribute to the development of quality and resilient infrastructure in the country.

Note: 1. A 2016 study estimates the regional needs in terms of infrastructure investment at USD 3.1 billion per year to 2030.
2. See 'Pacific Regional Infrastructure Facility' (PRIF) at https://www.theprif.org/.

2. Benchmarking

2.1. Key findings

Like most small islands developing states (SIDS), Solomon Islands suffers from financing challenges linked to its structural vulnerabilities. A comparison with other Pacific SIDS reveals the difficulty of finding an alternative to the tax haven model common in many small islands developing states.

Official development assistance (ODA) occupies a prominent place in the country's financing mix, even by the standards of other Pacific SIDS. Other official flows, on the other hand, are still at low levels, raising questions on the country's capacity to achieve a smooth transition towards private finance.

Domestic resource mobilisation is at risk due to the decline of the logging industry – so far the main source of government revenue. If not compensated by other financing sources, there is a risk of a financing gap appearing in key development areas, such as the health sector, which is highly dependent on external assistance and government expenditure. The fact that the country recently entered the GAVI accelerated transition phase and is expected to completely substitute GAVI co-financing by 2022 represents an additional challenge.

The benchmarking analysis shows, however, that the country could learn from the experiences of its peers to optimise the mobilisation of domestic resource and to achieve efficiency gains through improved public expenditure and public investment management. Many of Solomon Islands' peer countries perform much better in terms of capacity to attract private finance. Lessons learned from their experiences show that land governance reforms and investment strategies dealing with the infrastructure deficit are key to attract private finance, and will be indispensable to make viable the government's strategy of economic diversification.

2.2. The country shares many financing challenges with other Pacific SIDS

Solomon Islands' structural characteristics condition largely its capacity to attract and mobilise various sources of development finance. Like many SIDS, the country suffers from the small size of its economy, remoteness from major economic markets, vulnerability to external shocks and dependence on imports. This translates into a constrained financing landscape, characterised by limited access to private finance.

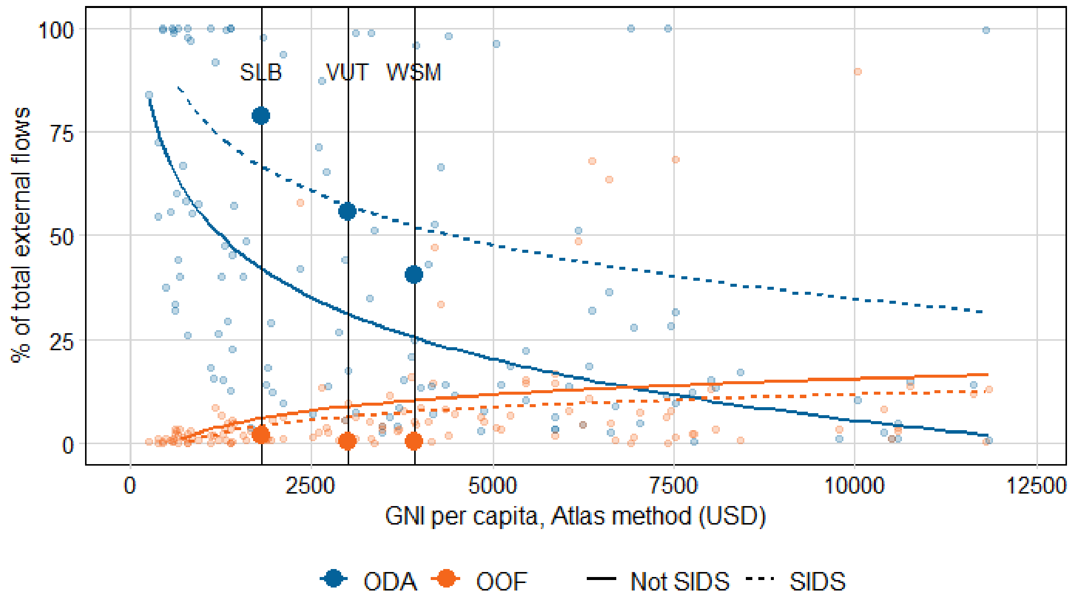
The economy is highly dependent on external assistance

Despite fulfilling the requirements for least developed country (LDC) graduation, Solomon Islands remains highly reliant on ODA compared to countries at similar stages of development. In 2017, ODA from Development Assistance Committee and non-DAC members accounted for more than 80% of the country's external financing mix, well above the average observed in countries with similar income levels (around 55%). The country's reliance on ODA is also higher than the trend observed in SIDS with similar income levels (around 65%), including other Pacific island countries that recently graduated (Samoa, 2014), or are scheduled to graduate (Vanuatu, 2020), from the LDC category.

The share of other official flows (OOF) is consistent with the average trend observed in SIDS with similar income levels. The low levels of OOF inflows can partly be explained by the preferential access of small island developing states to concessional financing windows, as they benefit from exceptions in recognition of their particular development challenges (e.g. World Bank IDA small states exception), but could also reflect a reduced ability to attract and absorb financing close to market terms or with commercial purposes.

Figure 2.1. The country is highly reliant on concessional finance compared to its peers

DAC, non-DAC and multilateral agencies' outflows, average 2012-2018, net disbursements, 2018 prices



Note: The dots correspond to Solomon Islands, Vanuatu and Samoa and should be compared with the two coloured lines (full line: average for all ODA recipient developing countries; dotted line: average for SIDS only.

Source: Authors' calculations based on (OECD, 2019[15]), Creditor Reporting System database https://stats.oecd.org/Index.aspx?DataSetCode=CRS1, (World Bank, 2019[3]) World Development Indicators https://databank.worldbank.org/source/world-development-indicators

This dual trend (high share of ODA and low levels of OOF) is consistent with the findings of previous transition finance studies, which showed that the substitution of ODA by non-concessional flows tends to happen at later stages of development for SIDS compared to the average country (Piemonte et al., 2019[18]). This generates a structural financing gap that could justify increased bilateral OOF support from development partners, in order to compensate the absence of OOF supply from multilateral donors.

The low levels of OOF observed in Solomon Islands call into question the country's capacity to achieve a smooth substitution over the long term. OOF plays a critical role in bridging the phase out of ODA and the entry of alternative sources of finance. In particular, OOF helps prepare countries' gradual transition to non-concessional sources of finance (e.g. private investment and commercial loans). The fact that total official development flows (ODA plus OOF) represent more than 90% of Solomon Islands' financing mix also indicates that the country struggles to attract or mobilise other financing sources.

Some sectors are particularly exposed to the risk of financing gap. This is especially the case in social sectors such as health and education, where the withdrawal of ODA is rarely compensated by private finance flows. This requires particular attention from development partners to ensure that government domestic expenditure can pick up the slack (see Box 2.1 below) left by external concessional finance. In addition, this calls for a reflection on the possible incentives to implement in order to promote the creation of markets in these sectors.

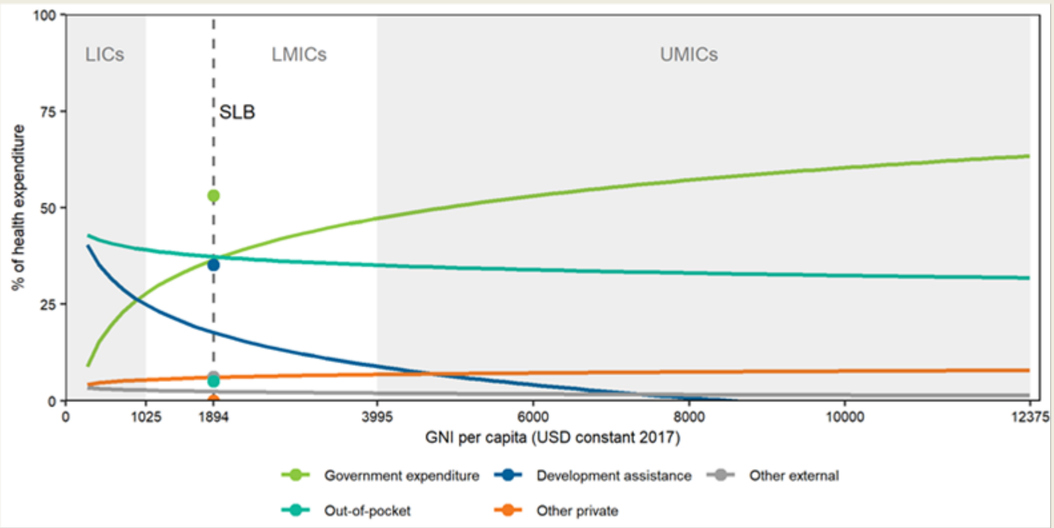
Box 2.1. Solomon Islands faces a delicate transition in the health sector

Solomon Islands' health sector is predominantly financed from public sources (domestic and external), which account for more than 90% of current health expenditure (see Figure 2.2 below). Like in most Pacific SIDS – but contrary to what is observed in traditional global health financing transitions – out-of-pocket expenditure is very low, although it should be noted that citizens also incur important indirect costs related to travel.[1]

The challenging transition context threatens the sustainability of the country's health sector. In a context of dwindling government revenue and a contractionary health budget (-1.8% in 2020 according to government projections predating the COVID-19 crisis[2]), which could be made worse by the COVID-19 crisis, a marked decline of external support in the health sector could put the country at high risk of financing gap. Given the important challenges the country is already facing in terms of access to, and quality of, health services, a drop of external support in this area could carry serious consequences.

Figure 2.2. Solomon Islands' health financing mix is typical of Pacific islands countries

Share in current health expenditure, 2013-2017 average per country



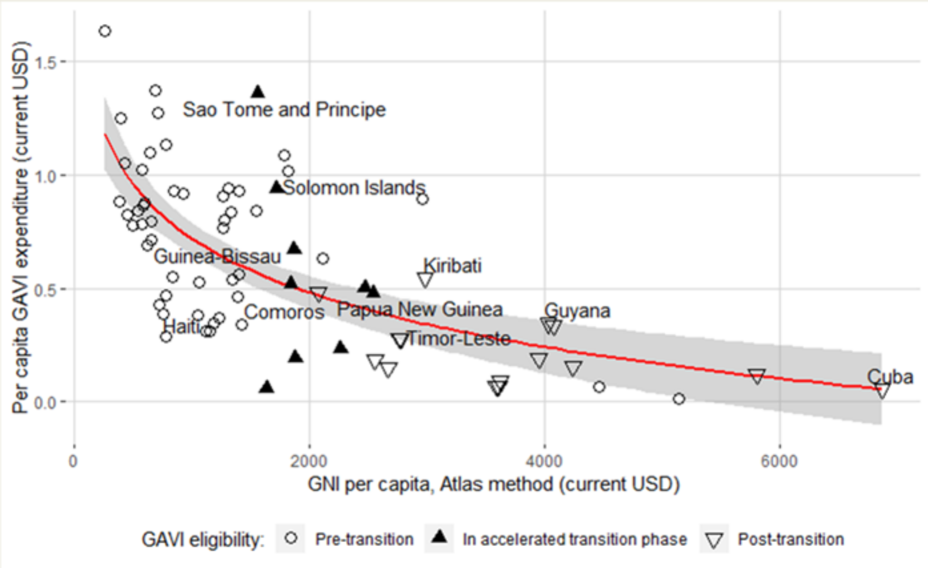
Note: The dots correspond to the Solomon Islands and each colour represents one of the following financing flows: external support from development partners (External), government domestic expenditure (Government), out-of-pocket expense by individuals (Private_OOP) and other private flows (Private_Other). The regression lines represent the trend for all ODA recipients.
Source: Authors' calculations based on (OECD, 2019[15]) Creditor Reporting System database https://stats.oecd.org/Index.aspx?DataSetCode=CRS1; (World Bank, 2019[3]) World Development Indicators https://databank.worldbank.org/source/world-development-indicators and following (Kim, Kessler and Poensgen, Forthcoming[25]), Financing transition in the health sector – What can DAC providers do?.

Solomon Islands also entered the GAVI accelerated transition stage (AT) in 2018, and is scheduled to graduate in 2022, meaning that GAVI support will completely phase out by then, and should be fully replaced by government health expenditure. While GAVI support does not represent huge amounts in absolute terms (USD 0.7 million in 2019), it fulfils a critical function in the health system (immunisation and vaccines) and should thus not be overlooked.

Compared to other countries with similar income, the level of GAVI per capita expenditure received by Solomon Islands is particularly high, and a benchmarking with other small islands states reveals that its status as a SIDS can only partly explain this result.

Figure 2.3. GAVI per capita expenditure is high in Solomon Islands compared to other SIDS

GAVI, net disbursements per capita, 2011-2018 average per country, 2017 prices.



Note: Adjusted R2 = 0.45 and p < 0.001.
Source: Authors' calculations based on (OECD, 2019[15]), Creditor Reporting System database https://stats.oecd.org/Index.aspx?DataSetCode=CRS1 and (World Bank, 2019[3]) World Development Indicators https://databank.worldbank.org/source/world-development-indicators.

Given the country's high reliance on GAVI support, government capacity to compensate for the phase out of GAVI assistance with public expenditure will be crucial to ensure a smooth transition. According to GAVI projections, the government is expected to step up its financing by +67% between 2020 and 2022 (from USD 0.3 million to USD 0.5 million) in order to substitute GAVI co-financing, but growth in government health spending could be constrained by macroeconomic and fiscal realities. In a context of dwindling government revenue and contractionary health budget (-1.8% in 2020 according to SIG projections) and COVID-19 crisis, a marked decline of external support in the health sector could put the country at high risk of financing gap. Given the important challenges the country is already facing in terms of access to, and quality of, health services, a drop of external support in this area could carry serious consequences.

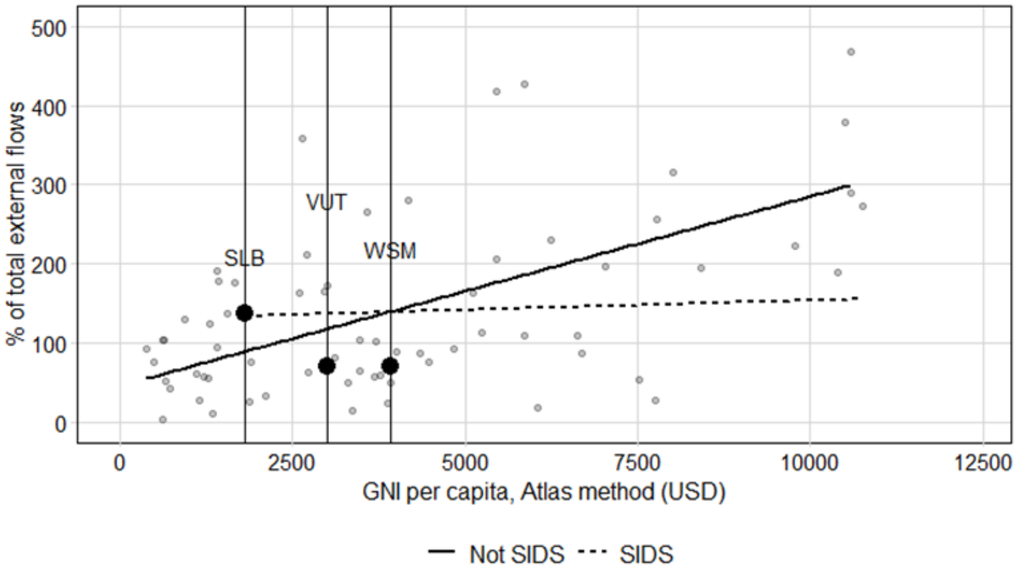
Notes:
[1].http://documents.worldbank.org/curated/en/481931528443850077/pdf/AUS00001537-6-2018-18-19-31-SolomonIslandsSpendBetterHealthFinancingSystemAssessmentfinal.pdf
[2].The SIG has recently increased spending on healthcare in response to COVID-19.

Dwindling government revenue and low private finance flows reflect the challenge of finding an alternative to the SIDS tax haven model

In Solomon Islands, the duties collected from the export of unprocessed logs to China play an important role in the country's finances: in 2018, they accounted for 20% of the government's domestic revenue and 32% of total foreign exchange receipts. This allows Solomon Islands to perform better in terms of domestic resource mobilisation than some peer countries from the Pacific region such as Vanuatu or Samoa. Any comparison with these countries should however take into account that Vanuatu and Samoa, like many other Pacific SIDS, are low-tax jurisdictions that purposely impose no or low effective tax rates on income to attract geographically mobile capital or investment.

Figure 2.4. Government revenue could plummet with the implementation of logging sustainability measures

SIG tax revenue as a share of total external flows, average 2012-2018, 2018 prices



Note: The dots corresponds to Solomon Islands, Vanuatu and Samoa, and should be compared with the two lines (the continued line represents the trend line for all ODA recipient developing countries, and the dotted line for SIDS only).
Source: Authors' calculations based on (OECD, 2019[15]), Creditor Reporting System database https://stats.oecd.org/Index.aspx?DataSetCode=CRS1 and (World Bank, 2019[3]) World Development Indicators https://databank.worldbank.org/source/world-development-indicators.

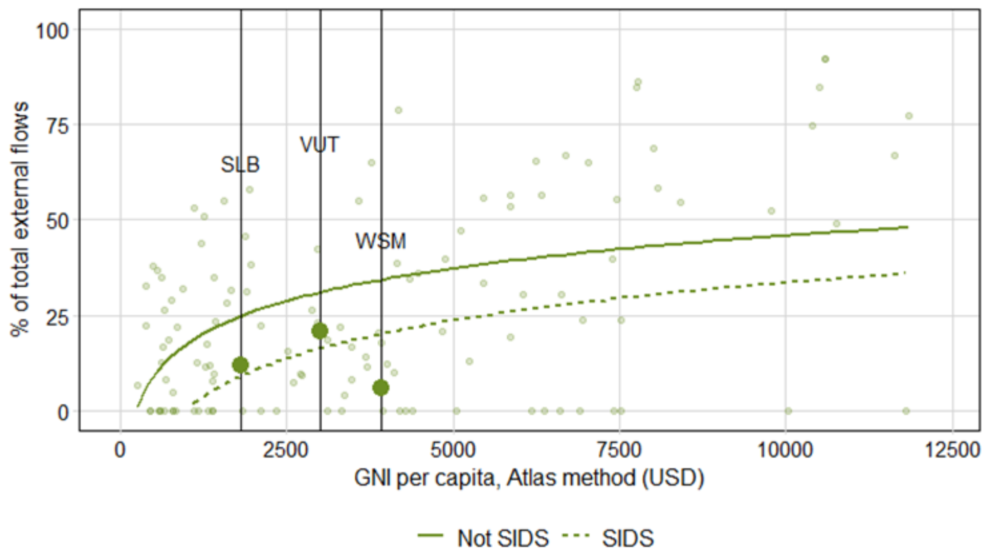
Government revenue stemming from the export of logs is projected to decline in coming years due to the combined effect of new logging sustainability measures and the decrease of global demand. This trend, which goes counter to the traditional transition finance trend of growing government revenue along a country's development, calls for careful planning from the government and its development partners to ensure that other sources of finance can be mobilised to substitute falling government revenue.

If not compensated by other sources of revenue, the downward trend of logging exports could have a significant negative impact on government finances. It could also cause growth to contract and affect the country's foreign exchange reserves. The government sees potential in mining, fishing, agriculture and tourism as alternative export sectors with the capacity to generate foreign exchange receipts but these industries are unlikely to compensate the decline of the logging industry in the near future.

As shown in Figure 2.5, private finance remains low in Solomon Islands. A comparison with the trend observed in other SIDS shows that Solomon Islands' low performance in this area reflects the usual handicap attributed to small island countries. The relatively high FDI figures observed in other SIDS, such as Vanuatu, should be interpreted with caution: the high figures could partly reflect "phantom" investment[29]" since many SIDS employ extremely liberal policies for capital entry. This is for example the case of Samoa, Vanuatu and Fiji, which are all included on the European Union's list of tax havens.[30]

Figure 2.5.Foreign direct investment inflows are in line with the trend for SIDS

FDI inflows as a share of total external flows, average 2012-2018, 2018 prices.



Note: The dots corresponds to Solomon Islands, Vanuatu and Samoa, and should be compared with the two coloured lines (the continued line represents the trend line for all ODA recipient developing countries, and the dotted line for SIDS only). FDI are used as a proxy for private investment.
Source: Authors' calculations based on (OECD, 2019[15]), Creditor Reporting System database https://stats.oecd.org/Index.aspx?DataSetCode=CRS1 and (World Bank, 2019[3]) World Development Indicators https://databank.worldbank.org/source/world-development-indicators.

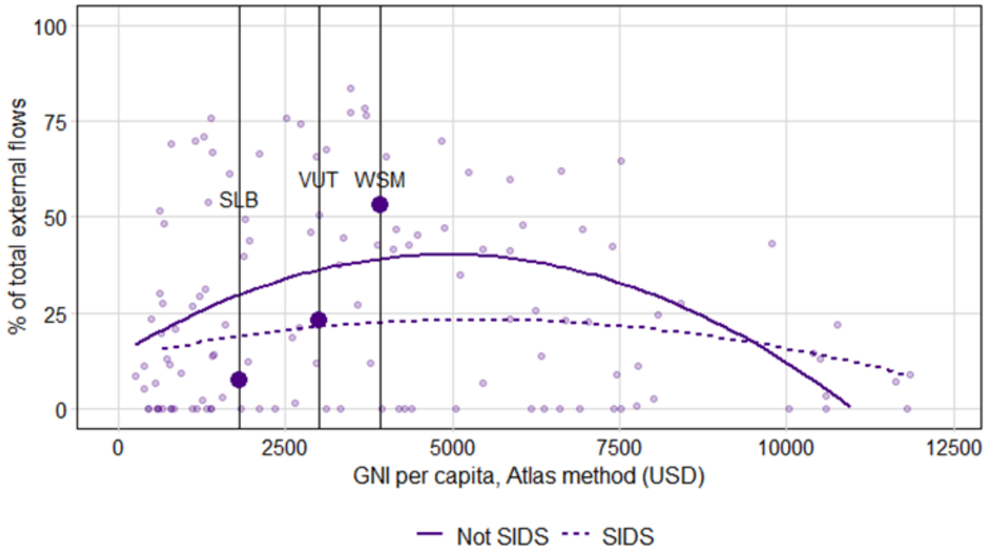
Remittances are minor compared to other SIDS

Remittances only account for a minor share of Solomon Islands' financing mix. Some regional peers with higher levels of work-related migration are able to attract a larger share of remittances. The latter have for instance become a prominent feature of the economy in Polynesian countries such as Samoa and Tonga.

Migrants' remittances play an important macro and microeconomic role in many small island states. Besides their contribution to these countries' balance of payments, they can constitute an effective safety net for modest households since they are relatively unaffected by the local economic cycles of recipient countries. Several studies focusing on remittances in Pacific countries also highlight that these transfers play an important role to cover education (e.g. school fees), health and housing costs, and may contribute to long term economic gains (see [31] and [32]). The COVID-19 crisis could, however, impact the flow of remittances to developing countries in the near to medium term as an indirect consequence of the lockdown measures implemented in many industrialised countries. Solomon Islands' low reliance on remittances could, thus, somewhat protect it from the volatility of much lower global remittance flows.

Figure 2.6. Solomon Islands presents low levels of remittances compared to its peers

Remittances as a share of total external flows, average 2012-2018, 2018 prices



Note: *The purple dots correspond to the situation of specific countries and should be compared with the two lines (plain line: averages for all ODA recipient developing countries, dotted line for SIDS only).*

Source: Authors' calculations based on (World Bank, 2019[3]), World Development Indicators https://databank.worldbank.org/source/world-development-indicators.

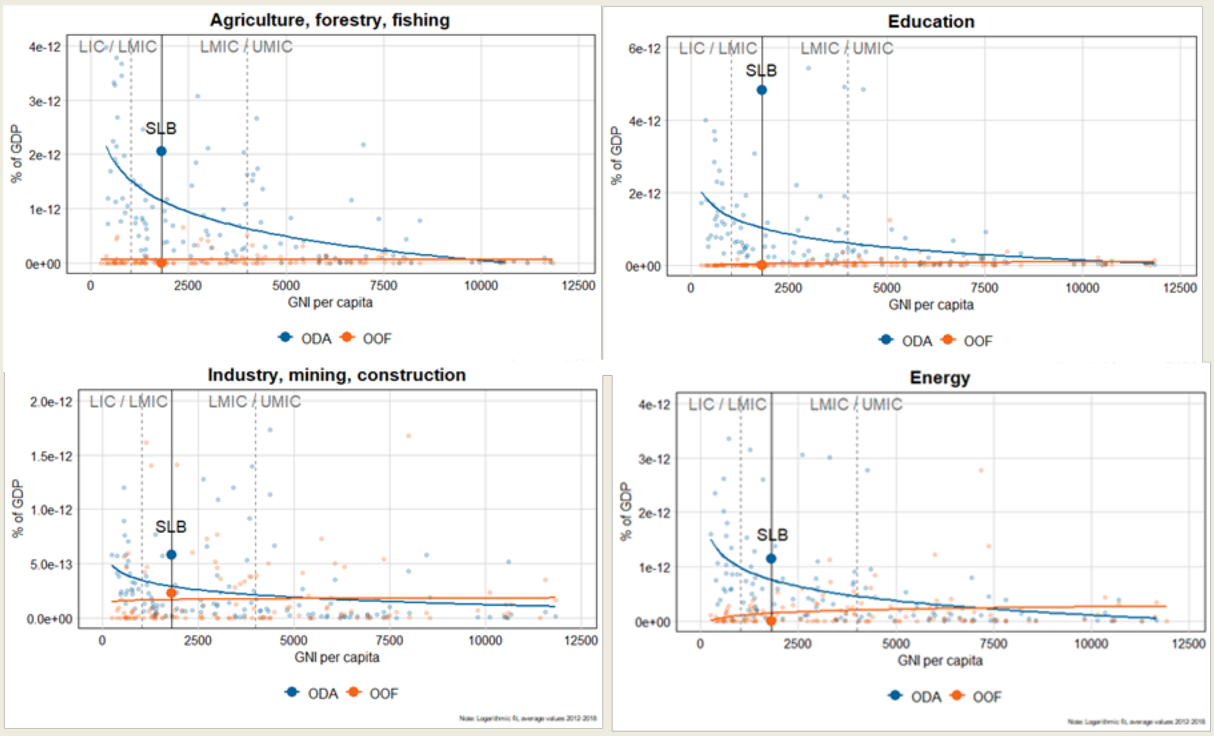
Box 2.2. Sectoral transition finance challenges and opportunities in Solomon Islands

Previous transition finance analyses have shown that the financing challenges faced by developing countries vary significantly across sectors. Because they provide higher levels of return, production and infrastructure-related sectors, such as energy, transport, or industry, are usually able to substitute decreasing ODA by non-concessional flows (OOF and private sector finance). Social sectors, on the other hand, remain largely reliant on external concessional finance along a country's transition, making them particularly prone to financing gaps when the latter are phased out abruptly.

The sectoral disaggregation of the official development finance (ODA plus OOF) received by Solomon Islands confirms that the country's sectors face different financing challenges, and present varying levels of maturity for non-concessional finance. The country's health and education sectors receive large amounts of ODA compared to the overall trend but seem unable to attract OOF. Solomon Islands' production sectors have benefitted from some other official flows (OOF) in recent years, targeting in particular the country's industry. In addition, bilateral and multilateral development partners have made several OOF commitments towards promising sectors, such as fisheries development and energy generation. The country has also received a large commitment of USD 73 million to finance the Tina River Hydropower project but the latter is not yet apparent in 2018 disbursement figures.

Figure 2.7. Solomon Islands' financing challenges vary across sectors

DAC, non-DAC and multilateral agencies' outflows, net disbursements, 2012-2018 average, 2018 prices



Source: Authors' calculations based on (OECD, 2019[15]), Creditor Reporting System database https://stats.oecd.org/Index.aspx?DataSetCode=CRS1 and (World Bank, 2019[3]), World Development Indicators https://databank.worldbank.org/source/world-development-indicators.

2.3. There is room to learn from peers on domestic resource mobilisation and private finance

Other SIDS sharing structural characteristics with Solomon Islands perform much better in terms of mobilisation of finance and overall development, showing that performance in these areas can be attained in spite of SIDS-specific vulnerabilities. This is for example the case of Fiji, the Maldives or the Seychelles. While more distant from Solomon Islands' reality, these aspirational models are helpful to identify good practices and policy options that can allow SIDS to surpass their vulnerabilities and make the most of their strengths.

Increasing government revenue and improving the efficiency of public expenditure and investment will be crucial to avoid financing gaps in social sectors

Historically, government revenue in Solomon Islands has relied heavily on the taxes and custom duties raised from the exports of logs. However, this source of income, which accounts for a significant portion of government revenue, is projected to decline in coming years, putting the country at risk of financing gaps in key development areas, such as health (see Box 2.2 above).

To compensate for the anticipated decline of the logging industry, the country is preparing a reform of its tax system. In this area, Solomon Islands could learn from other SIDS that conducted successful policy reforms to tackle informality, expand the tax base and build the capacity of the tax authorities.

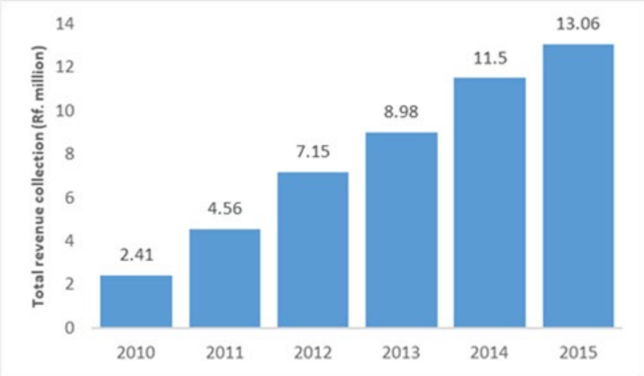
Lessons learned from the implementation of similar reforms in other SIDS can shed light on key success factors, common implementation challenges and pitfalls to avoid. In this sense, the highly successful tax reform implemented by the Maldives in a context of constrained government resources provides an aspirational example (See Box 2.3 below).

Box 2.3. Maldives fast-track reform

Between 2011 and 2015, the Government of the Maldives undertook a substantial reform of the country's tax administration system. The main objective pursued by the government was to increase tax collection and expand the country's tax base. The urge to reform stemmed in part from the need to identify and secure new sources of finance to cope with the combined economic impact of the 2004 tsunami and the 2008 global financial crisis.

The Asian Development Bank (ADB) supported the Maldives' tax reform through policy advice and technical assistance, helping the country to develop effective legislation and establish the Maldives Revenue Authority (MIRA). The result was a highly successful reform, with government revenue increasing rapidly at an annual rate of +43%, from Rf. 2.41 billion (USD 157 million) in 2010 to Rf. 13.06 billion (USD 848 million) in 2015, and the country's tax-to-GDP ratio more than doubling over the same period, from 9.8% to 25.2%.

Figure 2.8. Between 2010 and 2015, revenue collection increased at an annual rate of +43%



Source: Revenue statistics in Asian and Pacific economies, (OECD, 2020[26]) http://www.oecd.org/tax/tax-policy/revenue-statistics-in-asian-and-pacific-economies-26179180.htm.

The presence of an enabling environment was key to the success of this fast-track reform. Compared to many SIDS, the Maldives has a decent size formal economy and a burgeoning tourism industry, which provided a fertile ground to introduce direct and indirect taxes.

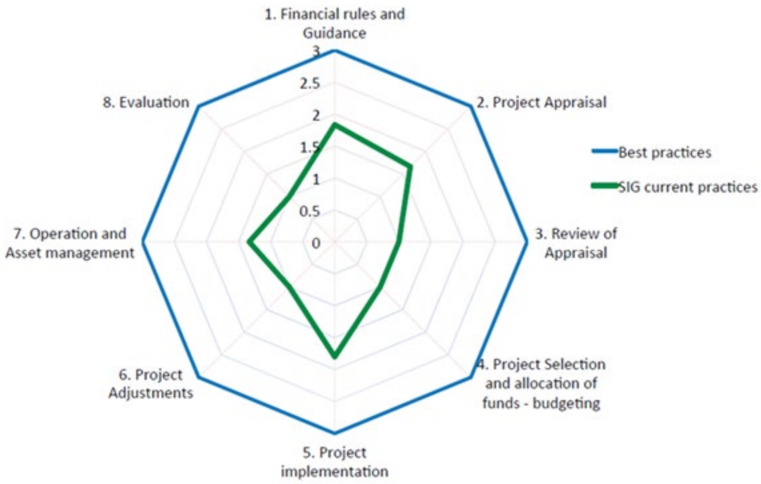
The external support received from development partners was another important success factor: the tight timing of the reforms required extensive support from development partners for the establishment of the MIRA, including human and financial resources necessary to develop regulations, administration and collection procedures, modern IT systems, and deliver staff training and public awareness programmes.

Given the huge differences between the Maldives and Solomon Islands' contexts in terms of development levels, economic structure and political economy landscape, the implementation of tax reform in Solomon Islands is likely to require a more gradual approach that balances the government's objectives in terms of resource mobilisation with pragmatic considerations in terms of implementation capacity and public acceptability.

Public expenditure is another area where Solomon Islands presents considerable room for improvement. In light of the massive investments planned by the government ahead of the 2023 Pacific Games, and the new financing opportunities for large infrastructure projects expected from China, improving the transparency and efficiency of public spending will be critical to ensure that public investment delivers concrete development benefits to the population. The latest public expenditure and financial accountability assessment (PEFA, 2012[27]) conducted in the country, which dates back to 2012, showed that Solomon Islands lagged behind many of its peers in areas such as budgeting, public procurement, transparency and oversight.

There is also scope for large efficiency gains in public investment management. A recent public investment management diagnostic[33] commissioned by the Ministry of Development Planning and Aid Coordination, shows that the country is still far from meeting best practice across most components of public investment management, and obtained particularly weak scores in the areas of project appraisals, project selection, budgeting, project adjustments and evaluation.

Figure 2.9. Public investment management diagnostic scores for Solomon Islands



Source: (Ministry of Development Planning and Aid Coordination., 2018[28]), Solomon Islands Public Investment Management Diagnostic https://theprif.org/media/61.

Attracting private sector resources: a first step towards economic diversification

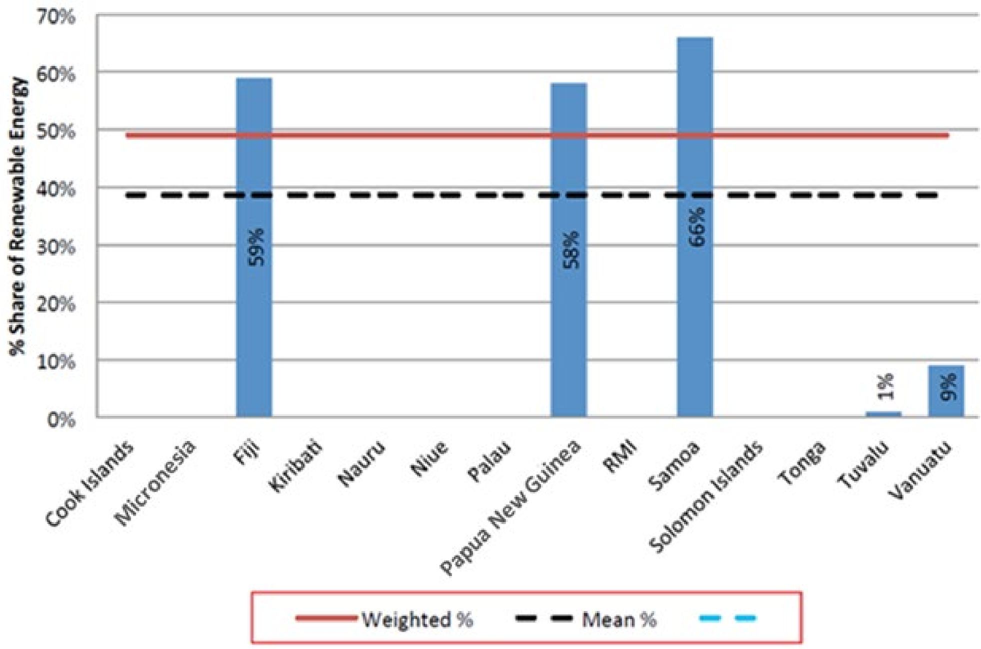
Solomon Islands' government is currently looking at several sectors to diversify its economy and extend its narrow production and export base: mining and the ocean economy (in particular fisheries and tourism), hold considerable potential and a comparison with peer countries shows that there is room to increase the role of these sectors in the country's economy.

Tourism is a promising area where Solomon Islands would benefit from increased private investment. The country's tourism industry, for example, currently represents only 4% of its GDP, as compared to 28% in Vanuatu, 22% in Fiji and 18% in Samoa. The experience of other pacific island countries shows that tourism can become a critical driver of inclusive and sustainable development (Scheyvens and Russell, 2012[29]), and has the potential to be one of the largest contributors to a country's GDP, especially in SIDS where other economic options are limited. Pacific islands' natural attributes make them a particularly favourable environment for the development of tourism. As a labour-intensive industry, tourism can have positive effects on the local economy when linked to ancillary sectors (such as construction, transport, and food and beverages) and has the potential to benefit communities in remote areas, including through supply chain linkages between tourism and agriculture (farm-to-table model).

Coastal (inshore) and oceanic (offshore) fishing constitutes another potential growth industry. While capture fisheries can represent up to 10% of small islands states' economic output,[34] they account for only 5% of Solomon Islands' GDP, reflecting the low level of value-added generated in the country. Efforts to capture more of the tuna value chain require increased private sector participation. Currently, the country counts only one onshore processing facility – the private-led canning plant SolTuna in Noro (Western province) – and its plans for the development of a second plant in Bina Harbour (Malaita province) have long been deferred due to issues related to land access.

The rich variety of renewable energy sources available in Solomon Islands presents serious opportunities for private investment. Several Pacific SIDS, such as Fiji, Samoa and Papua New Guinea, have taken steps to deploy renewable energy technologies as a viable and attractive alternative to fossil fuel imports. The experience of these early movers demonstrated however the challenges of leveraging private investment for the electrification of remote areas in Pacific small island states, and the need to make a strategic use of taxes and subsidies as incentives and economic drivers.[35]

Figure 2.10.Fiji, Samoa and Papua New Guinea have been the first movers in the deployment of renewable energy



Source: (Dorman, 2014[30]), Access to electricity in Small Island Developing States of the Pacific: Issues and challenges https://ideas.repec.org/a/eee/rensus/v31y2014icp726-735.html.

The country is also endowed with sizeable deposits of minerals, such as gold, bauxite, copper and silver. However, Solomon Islands has been struggling to attract and retain private investors due to the lack of adequate legal and regulatory framework, and serious governance issues affecting the mining industry. This is reflected in the downward trend of Solomon Islands' mineral rent, which contributed little more than 1% of the country's GDP in 2017 (down from 8% in 2012), in stark contrast with neighbouring Papua New Guinea's rent, which accounts for 12% of its GDP (2017).

Attracting private investment and finance in these up-and-coming sectors would pave the way for the much-needed diversification of the country's financing landscape. However, taking advantage of these opportunities requires addressing existing constraints to private investment, which include incomplete legal and regulatory frameworks, unfavourable investment climate, and poor infrastructure development.

The uncertainty surrounding land property constitutes a major block to private sector development in any of the above-mentioned sectors. The absence of statutory land tenure makes it difficult for private actors to invest in projects requiring land use (in particular greenfield project) due to the challenge of ascertaining land property and negotiating land deals. This issue also impacts the access to domestic credit, as it makes it difficult for commercial banks to lend against collateral. Countries like Vanuatu and Fiji, which share a similar culture (Melanesian) and have comparable population size and geographical features, have been able to circumvent some of these challenges. Valuable lessons could be drawn from their experience dealing with such issues (see Box 2.4 below) although particular care should be taken to ensure that land reforms are sensitive to citizens' interests and do not spur political instability.

Box 2.4. Land governance reforms to foster private-led development in Vanuatu and Fiji

Vanuatu, a neighbouring lower middle-income country of 272 000 inhabitants, and Fiji, an upper middle-income country of 883 000 inhabitants, have developed a prosperous tourism industry over the years, with domestic and foreign private investment as the main economic drivers. Both countries attract relatively high levels of private flows compared to the Solomon Islands.

Part of their performance in this area stems from the reforms that both countries have implemented to simplify the land tenure legislation and rights. These reforms allowed the investors to benefit from clearer leasing conditions, which in turn facilitated the entry of private investors in the tourism industry.

Tourism now accounts respectively for 30% and 22% of Vanuatu and Fiji's GDP, as compared to 4% in the Solomon Islands. The success of the reforms undertaken by these countries is manifest in their Doing Business scores: Vanuatu and Fiji are ranked 84th and 57th in terms of property registration. In comparison, the Solomon Island stands currently at the 155th place of the ranking. The experience of Vanuatu and Fiji shows that, under the right conditions, tourism has the potential to become a leading segment of the services industries and a key engine of growth in small island developing states.

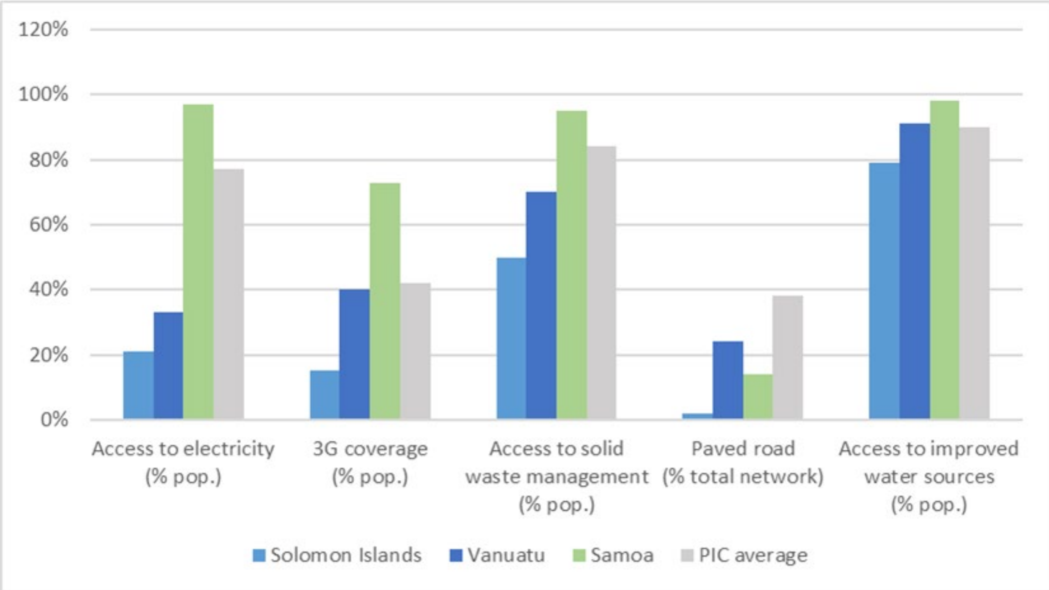
Fiji is an interesting case since the country possesses a long history dealing with land governance issues. Since 1940, Fiji counts with a Native Lands Trust Board (NLTB), now known as the iTaukei Land Trust Board (TLTB). Initially designed to facilitate the access of Indian-descent Fijians to farming land in the 1940s, the TLTB is a trustee which acts as an intermediary between landowning communities and private investors, and which now plays an important role to enable investments from foreign tourism developers.

This main function of the TLTB is to negotiate, on behalf of landowners, the leasing of customary land to tourism developers for up to 99 years. This 'simple' intermediary can guarantees to both parties: the security of preserving the community of its land property and negotiating a percentage of return of the results over investments – normally 9% -; and a horizon long enough for investors to be able to get the return expected over investment.

In brief, by providing legal protection for investors as well as granting communities the security of continuing rights over their land, the TLTB has largely contributed development and economic diversification in Fiji.

The country also needs to overcome its structural infrastructure deficit to attract private investment. In Solomon Islands, as in many Pacific island countries, infrastructure development is hindered by high costs in investment and maintenance due to hard-to-meet economies of scale, difficult access to isolated areas, and environmental vulnerability. This translates into low access to infrastructure for the population and businesses (see Figure 2.11). In addition, the country's limited fiscal capacity and low budget available for maintenance affect the long-term quality and resilience of infrastructure assets. Moving away from the "build-neglect-rebuild" model characteristic of many Pacific SIDS will require strong action from the government and its development partners to ensure that new opportunities in terms of infrastructure development do not divert financing away from other important areas, such as asset operation and maintenance.

Figure 2.11. Solomon Islands' poor infrastructure relative to other Pacific islands countries is a key inhibitor of private investment



Source: (Pacific Region Infrastructure Facility, 2016[31]), Pacific Infrastructure Performance Indicators https://www.theprif.org/documents/regional/infrastructure-planning-and-management/2016-pacific-infrastructure-performance

The lack of adequate legal and regulatory framework, and weak law enforcement, constitute another major drag on private investment in specific sectors. This is the case in the country's incipient mining sector, where a deficient legal and regulatory framework and problems related to licensing procedures have hindered the activity of existing exploitations, and act as a powerful deterrent to the entry of the industry's big players. Obsolete regulations have also hampered private investment in the energy sector, where the SOE Solomon Power retains a monopoly of energy distribution. The SIG is currently considering an update of its 2014 energy policy, which should foster private participation in the promising area of renewable energy (e.g. small scale energy plants, off-grid rural solutions).

3. Counselling

3.1. Key findings

Solomon Islands' development partners provide crucial support to the implementation of the country's national development Plan and its "smooth transition" strategy for LDC graduation. To help the Solomon Islands government achieve these two objectives, DAC providers along with other development partners should use their ODA strategically to implement a combination of measures along the three following dimensions:

The co-operative approach: Helping the country move towards a sustainable economic model will be paramount to ensure that growth preserves the long-term prospects of inclusive and sustainable development. DAC members and other development partners could help Solomon Islands overcome its challenges by deploying appropriate technical assistance and financing to: ensure the transition to sustainable economic production; improve domestic resource mobilisation and public financial management; and build its capacity to navigate its new financing landscape (e.g. for the negotiation of complex financial transactions).

The competitive approach: To anticipate the progressive substitution of ODA by other financing sources, a competitive approach should also be pursued by development partners to help the country attract private finance. Such an approach would help Solomon Islands create an enabling environment for sustainable and private-led infrastructure investments that could ensure economic value added and upgrading, job creation, and investments geared towards the diversification of the economy.

Renewed partnerships: Development partners should also reconsider their role and their areas of support in light of Solomon Islands' evolving financing needs. Specific support is required to help the country face the costs associated with its smooth transition strategy (e.g. evaluate the creation of a new LDC Transition Unit within the Ministry of National Planning and Development Co-operation), as well as to facilitate its integration in regional and global trade. Other challenges and opportunities, such as the emergence of China as a new provider of development finance in the country, require consolidating the DAC's position as a global standard setter to promote DAC good practices in development co-operation.

The design of financing strategies that address the transition challenges faced by Solomon Islands requires a hybrid approach that combines support along the three counselling dimensions outlined in the Transition Finance ABC Methodology:

1. Co-operative approach: supporting the country to achieve socio-economic progress by building its resilience against possible transition setbacks, and ensuring that social and economic vulnerabilities are adequately addressed;
2. Competitive approach: supporting the country's efforts to achieve sustained economic growth by investing in the economy's competitiveness, and increasing its attractiveness to private investment; and
3. Renewed partnership: promoting enhanced co-ordination and synergies on all aspects of sustainable development finance.

3.2. The co-operative approach: building sustainability and resilience to avoid socio-economic setbacks

Moving towards the sustainable exploitation of natural resources to secure stable revenues

Solomon Islands is endowed with a rich variety of natural resources providing a solid foundation to develop a diversified and resilient economy. Support from DAC and other development partners will be key to accompany the country in its efforts to transform and adapt its resource-intensive sectors, such as forestry, fisheries, mining, and energy. A successful move in this direction would contribute to put the country on a sustainable development path. Development partner providers can contribute by ensuring that their ODA is invested strategically, and with a long-term view to build the country's resilience.

Strong development partners' support is required to ensure the implementation of the new sustainable forestry policy. The government's decision to reduce logging production represents an important step to ensure the country's sustainable future. However, proper implementation of the policy represents a logistical challenge for the public administration because deforestation tends to happen far from economic centres, and the country currently lacks the financial capacity to conduct adequate monitoring and enforcement of the new policy. Ensuring that the country has the resources necessary to monitor illegal deforestation and to enforce penalties will be key to the success of this policy.

Supporting the adoption of international standards for the sustainable management of the country's forests would help the country obtain better prices from its exports of logs. The country's log exports are currently led by the sale of unprocessed and low-priced logs to China[36]. The government is considering joining the International Tropical Timber Organisation (ITTO) in an effort to move the industry from quantity to quality, and to benefit from ITTO-negotiated prices. DAC members' and other partners' financial support and technical assistance would be welcome in order to help the country meet the minimum standards of exploitation and transparency.[37]

In order to avoid bad practices such as the ones experienced in the logging sector, the incipient mining sector could benefit from development partners' help and recommendations in order to promote transparency and good governance. Donor support would lend credibility to the government's efforts to reform its mining sector and could help the country attract the right players in the industry. Addressing issues such as adjustments to tax administration, information collection and audit procedures, and implement the Global Standard for the Good Governance of Oil, Gas and Mineral Resources (EITI[38]) as a fast-track legislation can be of high value-added to engage in a safe and sustainable mining industry. Indeed, as highlighted in (IMF, 2018[32]) "the mining regime would need to be transparent, predictable and even-handed for the industry to be viable". In this, sense, and more largely, development partners could help Solomon Islands strengthen the enforcement of governance standards, improve transparency and advance the anti-corruption agenda.

The fishing sector requires special attention to help the country mitigate climate change impact on fish stocks. In the context of decreasing logging activity, the relatively low but stable revenue obtained from the sale of fishing rights and the exploitation of fishing stocks will become vital to the country's economy. The Solomon Islands' fish stocks are currently estimated to be at a sustainable level and the country's participation in regional initiatives for sustainable marine resource management produces good results[39]. However, climate change is affecting fish stocks and modifying the migration patterns of the main migrating species, such as tuna. Support from DAC members and other development partners would be useful to help the SIG maximise the revenue obtained from its existing vessel day scheme (VDS), which currently does not take into account the size of the catch, and to progressively reduce the sector's dependence on the activity of industrial foreign fleets. As a SIDS, Solomon Islands could also benefit from specific support to ensure the development of a sustainable ocean economy.[40]

Improving domestic resource management and the use of public resources to avoid financing gaps in the social sectors

The anticipated decline of government revenue from the logging industry requires the mobilisation of untapped resources to avoid financing gaps in key development sectors. Health and education are among the sectors most at risk, since they are highly dependent on ODA and public spending (see Assessment and Benchmarking chapters). Development partners should raise SIG awareness on the need to develop a transition strategy that leverages domestic resources in support of social sectors. domestic resource mobilisation (DRM) could also be used to mitigate the socioeconomic impact of the country's transition to new financing sources, characterised by lower concessionality, in particular if there are indications that the transition could shift resources away from social expenditures towards economic sectors (production, infrastructure, banking and business).

Development providers' ODA could set in motion a virtuous cycle of domestic resource mobilisation. Strong commitment from DAC members to support co-ordinated and mutually reinforcing improvements of the tax policy and tax administration could help trigger a much-needed DRM reform process. As highlighted by the IMF (see Box 3.1), introducing a value-added tax (VAT), even modest, could significantly increase the collection of domestic resources in Solomon Islands, and would be consistent with SIG's efforts to 'formalise' the economy. In parallel, accelerating a reform of the tax administration[41] aimed at increasing its capacity and efficiency could help strengthen tax enforcement and increase the tax base. Such progress would in turn boost citizen and private sector confidence in the fairness and usefulness of the tax system.

Box 3.1. The introduction of VAT in small economies

DAC members could support Solomon Islands through specific analysis and technical assistance to study the potential of introducing a VAT in Solomon Islands. There is conflicting evidence in the literature regarding the establishment of VAT systems in SIDS. Many small islands developing states, especially in the Caribbean (from the '90s onwards), have established VAT with relative success as part of a longer-term strategy: the introduction of the VAT was then seen as useful to develop familiarity with the tax (Ebrill et al., November 2001[33]). Others, like Vanuatu, have evaluated their VAT system and found less positive results: Vanuatu's 2016 Revenue Reform and Modernisation Review, for example, concluded that insufficient tax revenue was generated from VAT and suggested that Vanuatu "move away from taxing consumption" (OECD, 2018[13]).

The introduction of VAT in small economies presents a number of challenges that relate to capacity (administrative skills to operate it), fixed costs (e.g. fixed set-up, collection costs and compliance) and the possibility of finding alternative taxes that can result in similar outcomes to VAT. The experience of other SIDS shows there is no one-size-fits-all solution, and that the optimal solution will depend on the country characteristics and transition context (IMF, 2001[34]). Therefore, an in-depth assessment for Solomon Islands would be strongly recommended before undertaking a reform of the tax policy and system.

Continued support from development partners will be crucial to ensure the success of the country's tax reform over the long term. Tax reform is a long process, in particular when it involves a reform of the tax administration, which can take years to materialise. Long-term support and commitment from development partners can be particularly useful to overcome political economy obstacles, including pressure in favour of status quo exerted by influential domestic actors.

On the other hand, technical assistance in well-targeted areas could also yield concrete and medium term results on tax enforcement and revenues. Solomon Islands could benefit from sector-specific tax audit provided by the OECD/UNDP Tax Inspectors Without Borders initiative (TIWB) (OECD/UNDP, 2019[35]). In recent years, several SIDS have implemented TIWB programmes to receive specialised technical assistance from tax and industry experts (Cabo Verde, Maldives, Papua New Guinea, Seychelles) (TIWB, 2020[36]). Development partners have an important role to play fostering policy dialogue on tax issues, providing in-country support to raise awareness on TIWB among national decision makers, building political support for the initiative, and potentially helping set up a TIWB country programme. Given their experience in Solomon Islands, DAC providers could help ensure the alignment of TIWB assistance with the country's national development plan and SDG targets.

Box 3.2. Raising domestic revenue for development in Papua New Guinea

During the Third International Conference on Financing for Development held in Addis Ababa in 2015, the OECD and UNDP announced the launch of the Tax Inspectors Without Borders initiative (TIWB). The aim of this joint initiative was to support developing countries in building tax audit capacity, giving the host administrations of developing countries the lead role in their country programmes. TIWB, for example, allows developing countries to specify their needs and the scope of technical assistance they require on specific tax audit issues. A dedicated central unit (TIWB Secretariat), jointly managed by the OECD and UNDP, operates as a clearing house to match the demand for auditing assistance with appropriate expertise.

As of 30 April 2020, with 45 ongoing programmes, 33 completed programmes and an additional 19 upcoming ones, TIWB has helped raise more than USD 532 million in additional tax revenue and USD 1.75 billion tax assessments in developing countries (TIWB, 2020[36]), with a return estimated at USD 60 of raised revenue for every USD spent by donors.

Papua New Guinea, a country sharing many cultural, geographical and economic characteristics with Solomon Islands, officially joined the TIWB initiative in October 2018 in the side lines of the APEC Finance Ministers' Meetings. The main objective of the Papua New Guinea's Internal Revenue Commission (IRC) in setting up a TIWB country programme was to safeguard government revenue generated in the forestry industry, a key sector of the economy.

The IRC has also asked for TIWB support to address base erosion and profit shifting (BEPS) issues in the mining sector, and expects this knowledge to be used in the nearby future to perform audits in other key sectors like fisheries. As in many Pacific SIDS, these three sectors account for a sizeable share of the country's GDP and of the government's domestic revenue.

Papua New Guinea's TIWB forestry programme has deployed tax and industry experts working alongside local tax officials to ensure the country can collect its fair share of taxes from multinational enterprises (MNE) operating in this industry. Remote assistance has been provided between missions to ensure the IRC makes progress while managing its audit processes. Additional benefits for Papua New Guinea are the creation of a favourable investment climate and an increase in voluntary compliance.

In parallel with these efforts, the OECD is also collaborating with the Intergovernmental Forum on Mining, Minerals, Metals and Sustainable Development (IGF) to ensure the country gets a fair deal on its mineral resources through the negotiation of new mining contracts. The collaboration between the IGF and OECD in Papua New Guinea is part of a broader programme of work to address tax base erosion and profit shifting in the mining sector.

Another key focus of development partners' support to the country's transition should be to optimise the use of scarce public resources. To make the most from waning government revenue, an emphasis should also be put on improving the efficiency of public expenditure, for example, by supporting the improvement of the public financial management system. This would allow the country to catch up with its neighbours in terms of PFM performance, in particular in specific areas where its latest PEFA scores indicated room for improvement (e.g. budgeting, public procurement, transparency and oversight). Additionally, development partners' support could be useful to improve the country's public investment management system, in particular, to strengthen functions related to project appraisal and prioritisation. Strengthening the country's capacity in these areas would be particularly timely to ensure the country can deal with the emergence of non-traditional donors focusing on infrastructure finance. Improved public investment management would help ensure that public expenditure ultimately delivers high-quality outcomes, and that public sector assets are adequately maintained and managed – thus avoiding the build-neglect-rebuild cycle commonly observed in SIDS.

In the long run, the use of digital technology could also decrease the cost of public service delivery and offer an alternative model of transition in the social sectors. Like many Pacific SIDS, Solomon Islands has a largely rural – and spread out – population, resulting in costly delivery of basic services. With government revenue already projected to decline, the delivery of basic health and education services could become particularly challenging in the event of an outbreak of COVID-19. Building on DAC members' recent investments in information and communication technologies in the country (e.g. the Coral Sea Cable System), development partners and regional Pacific institutions should join forces to explore how technology could be leveraged to support the delivery of basic services in Pacific SIDS. While such an initiative would likely require substantial initial investment from DAC members and other development partners, it could decrease the cost of delivering such services in the future and offer a novel way of transition in the social sectors compared to regional peer countries' past practice presented in this report.

Strengthening debt management and building government capacity to negotiate complex financial transactions

The risks associated with Solomon Islands' access to new financing sources call for increased support in the area of debt management and negotiation of complex financial transactions. The arrival of China as a new provider of development finance and Solomon Islands government's interest in novel types of public-private arrangements (such as PPPs) open up new development opportunities for Solomon Islands. However, the country's historical development partners have an important part to play in building government awareness and capacity to navigate this new financing landscape.

In the short term, development partners should step up their existing support to the country's financial management functions.[42] Australia already supports Solomon Islands through the provision of technical advisors to the Ministry of Finance and Treasury, and the World Bank and Asian Development Bank assist the country in the assessment of PPPs falling within the scope of the projects they finance. Given Solomon Islands' limited experience with commercial finance, the participation of several DAC providers in the PPP envisioned for the country's second tuna processing facility in Bina Harbour constitutes an excellent opportunity to continue building SIG's capacity.

On the medium to long term, development partners should also explore possible mechanisms to ensure the country has access to neutral advisory services to assess and negotiate its access to new financing sources. Given the challenging transition context faced by the country, it is indeed crucial to ensure the Solomon Islands' government is able to meet its financing needs at the lowest possible cost, and at terms that do not jeopardise its creditworthiness. In this sense, it appears particularly important to help the country assess and compare the potential implications of different debt instruments, and identify the partners and instruments that are fit for purpose at different stages of transition. Particular attention should be paid to financing sources and instruments that involve less concessional terms (e.g. lending at market terms with risk premium, short maturities, tied aid, or the use of collateral). To be effective, such support should ideally be provided at an early stage, and be hosted by an honest broker to ensure advice is based on sound technical expertise and not seen as partial. As a first step, DAC members along with other development providers could gauge the interest from the government to benefit from such a mechanism, and could help the government identify specific sectors or programmes where such technical assistance would add value in order to assess the feasibility of a country pilot.

3.3. The competitive approach: creating an enabling environment for private-led growth and investing in economic diversification

Supporting legal and regulatory reforms to remove barriers to private investment

In the energy sector, assistance from development partners will be key to open up the sector to private participation. As explained in the Assessment chapter, Solomon Islands currently presents the highest electricity rates among Pacific SIDS (Utility Regulatory Authority of Vanuatu, 2017[37]). For years, the state-owned enterprise Solomon Power has been acting as the energy regulatory body[43] while maintaining a monopoly on the production and distribution of energy in the country. The new energy policy designed by the government should create an independent regulator and open the sector to private participation. It is also expected to eliminate the State utility's legal monopoly on the distribution of energy, which has so far been a strong deterrent to private investment in renewable energy projects. In this context, development partners' support will be important to support the implementation of the new policy, promote the participation of Independent Power Producers (IPPs), and help the country identify and assess specific opportunities for private investment.

Similarly, the telecommunications sector also presents regulatory challenges. Even though the telecommunications market was liberalised in 2010,[44] the recently inaugurated Coral Sea Cable System (CSCS) linking Solomon Islands to Australia constitutes an important achievement, removing the country's dependency on costly satellite connections. In order to live up to the expectations, the CSCS will however require an updated regulation enabling competition among service providers. DAC members' experience and advice could be valuable to help Solomon Islands' Telecommunications Commission adopt new regulations to benefit fully from this major breakthrough for the country.

DAC countries' expertise should also be leveraged to support Solomon Islands' authorities in their reform of the country's incipient mining sector. DAC along with other partners support to the legal and regulatory reform of the mining industry could help build an enabling environment for private investment, allowing the country to attract reputable mining companies that seek a level playing field and predictable legal and commercial terms. Development partners should also ensure that the legal and regulatory reform contributes to an orderly and responsible development of the incipient mining industry that maximises its contribution to the local economy (e.g. by solving issues related to mining groups' taxation, export duties and royalties), and averts or mitigates negative social and environmental impacts. Development partners' support would also be particularly useful to help strengthen the capacity of the mining administration with a view to preventing the sector from inheriting the bad practices prevailing in the logging industry. In recent months, the SIG has expressed interest to benefit from foreign technical advisors that could help to simultaneously undertake a reform of the sector and build the capacity of the mining administration.

Improving land governance is another important area where additional donor assistance is sought to unbridle private investment. Customary land rights are a deep-seated challenge in many Pacific SIDS, and constitute one of the main factors hampering private investment in Solomon Islands (Corrin, 2011[38]). Solutions allowing the development of new business models (e.g. leasing for tourism development) could help the country open new markets and private investment alternatives (IFC, 2009[39]). While DAC members are already providing some support to the SIG in this area, there seem to be opportunities for further DAC member involvement, in particular to support the government's efforts to improve land mapping, land recording and registering, and to link its Geographic Information System (GIS) to the land register.

DAC members along with other development partners could also play a role facilitating the exchange of experiences and solutions among Solomon Islands' neighbouring peer countries. South-South knowledge exchange through triangular co-operation could be useful to help tackle this issue. Indeed, most Pacific islands show similar communal landownership: over 90% of land is held under communal tenure in Vanuatu, the Cook Islands, Papua New Guinea, the Marshall Islands, Tokelau, Tuvalu, Niue and Nauru, and over 80% in Samoa, the Solomon Islands and Fiji. Nevertheless, some (e.g. Fiji, see Box 3.3) have been able to find solutions and overcome the constraints that such a type of land tenure presents, and could provide aspirational examples for Solomon Islands to follow.

Overcoming the infrastructure bottleneck

Infrastructure development is critical to enable private investment in key sectors of the economy and make viable the Government's strategy of economic diversification. Continued support from DAC members is needed to upgrade the country's physical and technological infrastructure in key economic sectors such as transport, telecommunications, energy, and water.

Development partners' expertise and track record should be leveraged to promote quality and resilient infrastructure. With the anticipated emergence of non-traditional providers of development finance in the country, it becomes critical to build SIG capacity to ensure new infrastructure meets standard requirements in terms of endurance and climate-resilience. Good practices from DAC members and development partners in terms of climate and disaster risk assessment, as well as integration of climate adaptation in the design of infrastructure projects, should be promoted to ensure that SIG investments result in long-term economic growth. In this sense, Japan's strong reputation as a provider of resilient infrastructure, and the explicit focus on infrastructure quality of the new Australian Infrastructure Financing Facility for the Pacific (AIFFP), could be leveraged to consolidate the position of the DAC in the country's infrastructure financing landscape.

DAC providers' investments in infrastructure should be used to promote the qualitative dimension of ODA. In accordance with DAC values and principles, particular emphasis should also be put on guaranteeing that DAC investments generate positive impacts for Solomon Islands' economy through local content and job creation. This could take the form of a public commitment from DAC providers to refrain from employing tied aid even after the country's LDC graduation (in principle, the DAC recommendation on untying aid applies to least developed countries, Heavily Indebted Poor Countries, other low income countries and IDA-only countries and territories[45]). In addition, DAC providers could follow the example set by the ADB of dividing large contracts into multiple smaller contracts to facilitate the participation of local firms in public procurement tenders. A 'good practice' guide could also be developed hand in hand with the authorities[46] and relevant local stakeholders such as the Solomon Islands Chamber of Commerce and Industry (SICCI), in order to promote quality infrastructure investment leading to positive effects on the economy (e.g. transfer of technology, creation of local jobs, capacity building, etc.).

The energy sector presents large opportunities for development partners' support and investment. The Government's ambitious plans to achieve 100% of renewable energy in Honiara's grid by 2030 will require huge scale capital investment. Japan is currently financing a renewable energy roadmap, which will provide an implementation framework for the Government's renewable energy strategy. This will open up prospects for further development partners' support and collaboration in the design, financing and implementation of renewable energy projects, which are regarded as pivotal to ensure affordable energy supply for the whole country (currently one of the most expensive energy in the world). Further assistance could also be provided by DAC members to help the country map its energy potential and develop a clear pipeline of renewable energy projects based on the roadmap.

Box 3.3. A New Zealand-supported PPP for the development of renewable energy in Tonga

Following in the footsteps of other Pacific islands states such as Fiji or Samoa, which were early adopters of renewable energy technologies, the Kingdom of Tonga entered into a partnership with the New Zealand electricity generator and retailer company Meridian Ltd in 2009 to develop the country's first solar farm.

This public-private partnership (PPP) contributed directly to the implementation of Tonga's Energy Roadmap, focused on reducing the country's reliance on fossil fuel. The Maama Mai solar facility now supplies 4% of the country's electricity demand, which was previously exclusively reliant on diesel fuel.

This new source of renewable energy has allowed the state-owned enterprise Tonga Power to reduce the country's consumption of diesel fuel by approximatively 470 000 litres. The project was supported by the Government of New Zealand, which offered full funding of NZD 7.9 million (USD 4.6 million) for the project through the New Zealand Aid Programme.

Solomon Islands' infrastructure sector illustrates the need for DAC members to adapt their financing strategies as partner countries transition. Recent years have witnessed an evolution of Solomon Islands' financing needs, with increased demand for large-scale economic infrastructure projects requiring private investment. DAC providers seem to have adjusted swiftly by increasing their ODA grants for infrastructure, and more recently, by collaborating with multilateral development partners and the private sector to co-finance major infrastructure projects, such as the Tina Hydropower plant and the Coral Sea Cable System. In the future, a collective mapping exercise of the wide range of DAC instruments available to support Solomon Islands' transition in the infrastructure sector could be particularly useful. Such an exercise could help to identify each DAC provider's comparative advantages, and agree on an effective division of labour among DAC members at each stage of the country's transition. It could also help detect potential gaps in the infrastructure finance offer of DAC providers, as well as possible solutions to fill these gaps, for example through collaboration with other public or private actors.

Box 3.4. Towards a DAC roadmap on sustainable infrastructure in SIDS

A case on the energy sector and climate change resilience

SIDS, which are among the countries most vulnerable to climate change, depend heavily on imported fossil fuels. This results in high and fluctuating electricity tariffs, and high carbon footprints. However, this situation has begun to change in recent years as new renewable energy technologies (solar, wind, geothermal, ocean energy, hydropower and biomass) have confirmed their feasibility and efficiency as affordable and attractive alternative energy sources to replace fossil fuels.

Thanks to platforms such as the 'SIDS Lighthouses Initiative' launched at the United Nations Climate Summit in 2014 and managed by IRENA, many SIDS, especially UMIC Caribbean SIDS, have been able to begin their transition towards renewable energy sources (IRENA, 2019[40]).

Nevertheless, in the case of low and lower-middle income SIDS such as Solomon Islands, an inadequate local regulation can discouraged alternative energy suppliers to emerge[47] . In principle, remote islands with low levels of population would be a favourable ground to the development of mini-plants and micro-grids through private sector financing, but no such evolution is so far taking place.

As recommended in the Transition Finance Compendium (OECD, forthcoming[41]), the DAC could make the energy sector a specific focus of its work in SIDS, and design a dedicated action plan. This would be in line with the DAC's commitment to contribute to the fight against climate change, and could help SIDS transition towards sustainable development. This would also be coherent with the new DAC common portfolio vision recommended in the transition finance compendium.

Increasing value-addition to ensure economic upgrading

ODA should be used strategically to guide public and private resources towards investments that generate economic value-addition and job creation. Promising industries or segments of value chains for economic upgrading include fisheries (tuna cannery operation), forestry (domestic processing of timber) and tourism (services).

Strong collaboration between the SIG, the private sector and development partners will be key to identity priority areas and ensure the alignment with the country's national development strategy. Development partners' support will be key to foster a holistic approach that goes beyond funding of tangible investments. For example, additional measures could include a revision of the tax system to stimulate local processing capacities or to introduce local processing requirements. Such measures could also help attract the "right" kind of investors, and raise local standards to join higher value-added supply chains.

Box 3.5. Development partners supported the upgrading of the fisheries sector in the Seychelles

In the Seychelles, the fisheries industry is the second economic sector after tourism and a key driver of the economy, accounting for 8-20% of GDP and employing 17% of the total population. Fish products represent around 95% of the total value of domestic exports. Thanks to private investments to develop post-harvest value adding opportunities and jobs, the capital Port Victoria has become a prime hub for tuna fisheries in the Indian Ocean.

Public policies put in place by the government and support from development partners have been key to preserve the country's natural capital and take advantage of its rich marine biodiversity. The Government of the Seychelles has for example adopted an ambitious marine conservation strategy, supported by the Fisheries Act (2014), calling for more effective and efficient management and sustainable development of fisheries in accordance with internationally recognised norms and standards. The government's strategy is backed up by a financing plan that involves support from various development partners to expand the sustainable use of marine protected areas, improve the governance of the fisheries sector, and increase revenue from the sector.

In 2018, the Government of the Seychelles also launched the world's first sovereign Blue Bond, a novel financial instrument designed to support sustainable marine and fisheries projects. The proceeds of the bond, which raised USD 15 million from international investors, are used in the form of grants and loans to encourage local public and private investment in activities consistent with sustainable fishing, including post-harvest value adding opportunities and jobs.

DAC support would also be useful to help the Government develop a skilled workforce that responds to the needs of the private sector. Reducing the disconnect between the educational system's outcomes and employers' needs should be a priority to accompany economic upgrading and avoid a growing number of youth being disengaged from the labour market. Technical and vocational education and training (TVET) could be a useful investment to support the move towards activities with more value added and to fill the skills gaps in various sectors of the economy, including the construction industry, power and energy, water distribution, hospitality and agro-processing sectors. Currently, TVET seems marginalised in the allocation of resources from national education budgets even though it represents a key ingredient to drive the government's agenda of transforming the economy through value-addition.

Box 3.6. Employment *versus* livelihood/entrepreneurship programmes: lessons learned

Solomon Islands' population is one of the youngest in the world. In 2009, the median age was just 19.7 years,[48] Moreover, its population is likely to continue its rapid growth until at least 2050 (the number of people aged 0-24 in Solomon Islands is projected to increase by 47% by 2050, or 300 000 people, three times Honiara City's current population). Demographic growth presents enormous opportunities but also major challenges to the SIG, as it has to integrate this potential work force to the labour market.

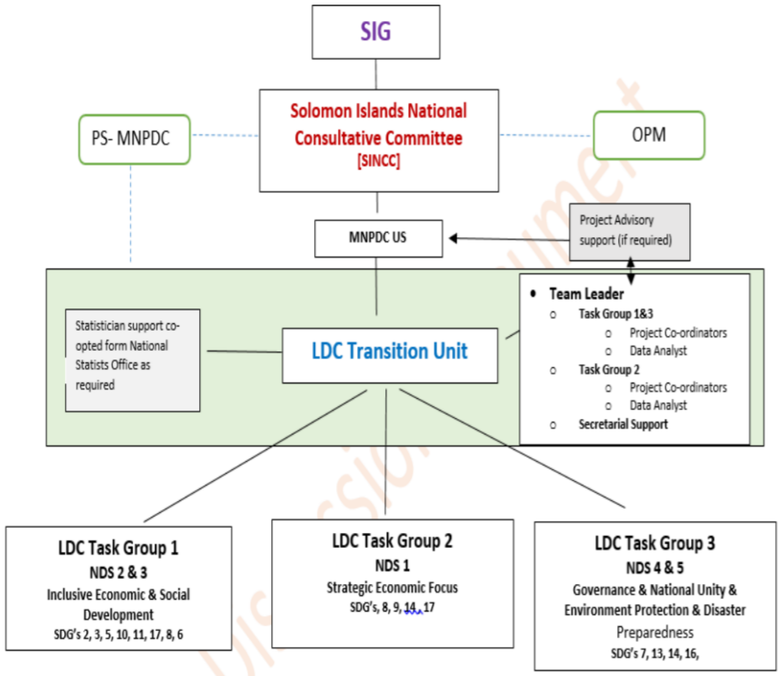
In recent years, some SIG partners have already ventured in initiatives involving youth skill training, although with uneven results (e.g. the Rapid Employment Project, REP, co-funded by the World Bank; or the Youth at Work - Y@W - an initiative by the Secretariat of the Pacific Community funded by several donors). The evaluation of the programmes has shown that projects that also provided self-employment possibilities have been the most successful and adequate to respond to the market needs. On the other hand, projects aimed at developing skills for the formal economy have not been as efficient because of a lack of formal employers in the job market). Consequently, changes were made to Y@W recruitment to match youths with assistance (with more focus on entrepreneur vs formal employment), support for youth entrepreneurs to obtain proper licensing, and other documents needed (Evans, 2016[42])

3.4. The case for renewed partnerships to bridge the divide between co-operative and competitive approaches

Targeted support to the country's LDC transition strategy

Development partners' continued engagement is key to ensure the country experiences a smooth transition from the LDC category. At a UN-led workshop to prepare the country for LDC graduation, held in Honiara in October 2019, the SIG unveiled its smooth transition strategy and requested development partners' support in specific areas. The SIG explicitly stated that the proposed strategy, designed in line with good practice and guidance received from the UN, represented an additional cost that could not be borne by the SIG budget alone. **Specific support is sought from development partners to strengthen the M&E functions within the Ministry of National Planning and Development Co-operation (MNPDC).** Targeted support[49] could help improve SIG data management systems, strengthen the monitoring and evaluation (M&E) capacity of MNPDC staff, and provide financial and human resources needed to create the MNPDC's LDC Transition Unit (see Figure 3.1). DAC members could request more clarity from the SIG on how M&E will be managed for non-traditional development partners, such as China.

Figure 3.1. The Solomon Islands' government's plan to create an LDC Transition Unit is likely to require financial support from external partners



Source: Ministry of National Planning and Development Co-operation.[50]

New economic partnerships through trade agreements, regional integration and aid for trade

Economic partnerships can be instrumental in supporting graduating LDCs throughout their transition. The idiosyncratic vulnerabilities affecting Pacific SIDS make them particularly vulnerable to the loss of LDC-related trade preferences: their remoteness from major markets, which already translates into higher logistical costs, means that the introduction of tariffs can quickly render their exports uncompetitive. In this sense, the fact that Solomon Islands recently joined the EU Interim Economic Partnership Agreement (IEPA) represents a very positive development since this agreement conditioned the survival of the country's exports of fish and palm oil (which are mainly destined to the European market), and hence also the Government's strategy of economic diversification[51].

At the regional level, additional efforts should be made to help the country develop new markets for its fish and agricultural products. A first step could involve helping the country implement the different steps required to ratify the Pacific Agreement on Closer Economic Relations (PACER). This regional Free Trade Agreement (FTA), which has been signed by Australia, New Zealand and nine Pacific SIDS, represents an opportunity for the future of the Solomon Islands' export industry. In addition, DAC providers could also step up their Aid for Trade investments in the country to help Solomon Islands address its supply-side capacity and trade-related infrastructure constraints (WFP, 2018[43]). This would be consistent with the country's strategy of economic diversification, and would allow Solomon Islands to fully use its trade potential as a leverage for poverty reduction.

SIG-China-DAC dialogue for aid co-ordination and debt transparency

China's emergence as a new ODF provider should spur the DAC to reconsider its role from that of a financier to that of FSD global shaper and standards setter. The DAC has a key role to play in encouraging China to adhere to internationally recognised best practices and standards, for instance in terms of debt sustainability and transparency, or investment qualities. Opening formal channels of communication, such as an annual China-DAC dialogue, could be a first step in that direction. The inclusion of China in the monthly donor coordination meetings in Honiara could also provide a useful avenue to advance such a dialogue at the local level. In this sense, DAC donors could make a case to the SIG for asking China to join such co-ordination meetings.

A key goal of the dialogue could be to agree on a mechanism to guarantee the availability and accessibility of information regarding the official debt contracted by governments of developing countries. This could be achieved through the extension of the current OECD Creditor Reporting System (CRS) to all official creditors (including emerging ones), or the creation of a new database to be hosted by an independent third party. Since such an endeavour is likely to take time, a country-specific mechanism co-managed by development partners of the donor co-ordination group in Honiara could provide an interim solution and serve as a pilot for the global mechanism.

The dialogue could also focus on improving aid co-ordination to avoid the development of aid silos. DAC members along with other development partners should encourage Solomon Islands to establish effective aid co-ordination mechanisms at country level to ensure that the emergence of new financing sources does not result in a divided aid system working in silos with conflicting values, standards, priorities and objectives.

Supporting SIDS' access to climate finance

As evidenced by its weak EVI score, the Solomon Islands remains deeply vulnerable to environmental and climate-related risks. Concessional climate finance should be an important component of the country's financing mix but is currently underutilised due to challenges in accessing and managing the multiple climate funds.

Continued development partners support is required to establish the institutional and budgetary arrangements necessary for an effective access to, and use of, climate funds. Currently, both the information and the responsibilities for managing these resources are scattered across a large number of entities and individuals in the administration. Helping the country set up an aid information management system could be a first step to facilitate co-ordination and reduce the level of effort required to collect information for climate funds applications.[52]

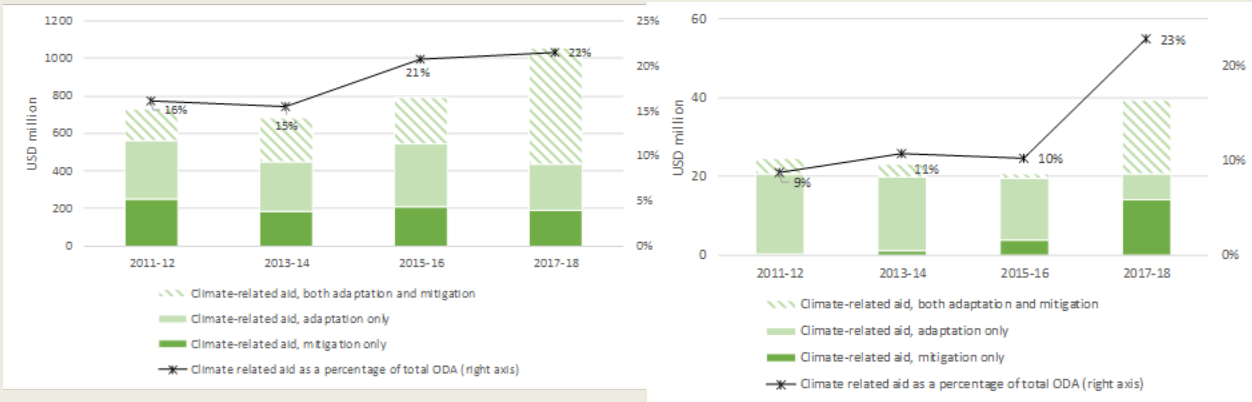
DAC members should also use their influence in multilateral fora to support the adoption of simplified application and management processes to climate facilities for SIDS. The complex architecture of climate funds and providers, and the long list of requirements, processes and procedures required to access the funds, imply high transaction costs for SIDS. Due to limited administrative and technical capacities, the Solomon Islands has so far been unable to benefit sufficiently from the multiplicity of climate funds established by the international community over the past decade. DAC members should explore whether Pacific regional and sub-regional institutions could play a role to facilitate Solomon Islands' access to climate finance, and reduce the cost of programme co-ordination and implementation.

Box 3.7. DAC and multilateral providers' support to climate finance in Solomon Islands

Bilateral climate financing to Solomon Islands shows progress

Conscious of SIDS' environmental vulnerabilities, the DAC has scaled up its efforts to integrate climate-related policy objectives into most of its development projects' financing options. DAC members' bilateral climate-related finance to SIDS has increased from 16% of total ODA commitments in 2011-12 to 22% in 2017-18, or USD 1,057 million on average per year. (Figure 3.2, left). In Solomon Islands specifically, DAC members' bilateral climate-focused aid has grown even faster to reach 23% of the total ODA commitments to the country – up from 9% in 2011-12, or USD 39 million on average per year in 2017-18 (Figure 3.2, right).

Figure 3.2. DAC members' climate finance commitments to SIDS (left) and to Solomon Islands (right)



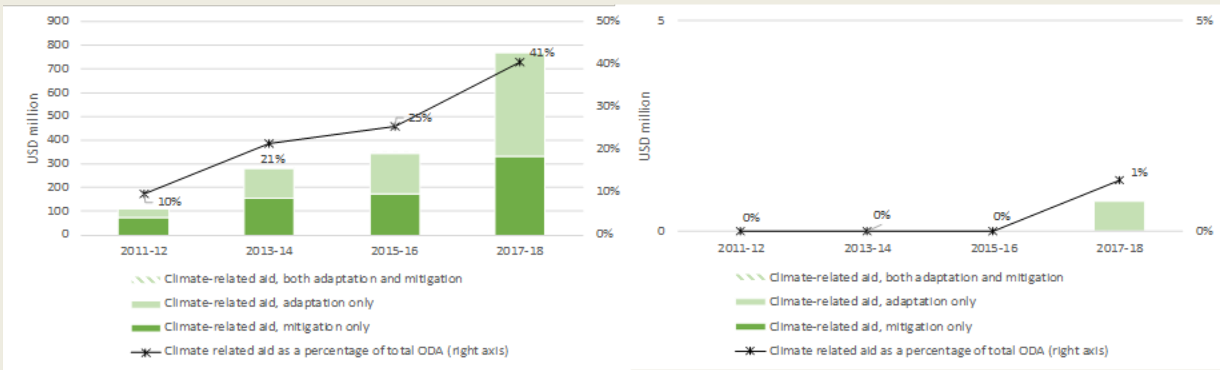
Note: Based on Rio markers DAC members' reporting to the Creditor Reporting System (CRS).
Source: Authors' calculations based on (OECD, 2019[15]), Creditor Reporting System database https://stats.oecd.org/Index.aspx?DataSetCode=CRS1.

Additionally, Figures 3.2 and 3.3 illustrate that multilateral climate finance to SIDS is becoming more adaptation-focused, while DAC members mostly focus on mixed objectives, that is, both mitigation and adaptation-related activities. In the particular case of Solomon Islands, both multilateral and bilateral mitigation aid are showing the more significant rates of growth.

Access to multilateral agencies' climate financing to SIDS is on a good track

In the last couple of years the widely documented[53] difficulties small countries face in preparing their applications to the multitude of existing climate funds seems to be easing. New facilities, such as the New Simplified Approval Process Pilot Scheme from the Green Climate Fund, have been able to deliver concrete results. Figure 3.3 left shows that 41% of total multilateral commitments focusing on SIDS were climate-related in 2017-18 (10% in 2011-12), and even if still not visible (Figure 3.3, right) Solomon Islands seems to follow the same trend. Indeed, recently[54] the country has signed an important climate-related concessional loan with the Green Climate Fund to partially fund the Tina hydropower project (e.g. a concessional loan for USD 73 million-plus a grant of USD 16 million that would radically change figure 3.3 right when integrated into official statistics, that is, in December 2020).

Figure 3.3. DAC and multilateral providers' support to climate finance in Solomon Islands



Note: Component methodology as reported by multilateral agencies to the Creditor Reporting System (CRS).
Source: Authors' calculations based on (OECD, 2019[15]), Creditor Reporting System database https://stats.oecd.org/Index.aspx?DataSetCode=CRS

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World Health Organization, Regional Office for the Western Pacific (2011), *Gender-based violence in Solomon Islands: Translating research into action on the social determinants of health*, https://www.who.int/sdhconference/resources/draft_background_paper4_solomon_islands.pdf. [20]

Notes

[1] (Piemonte et al., 2019[18])"Transition Finance: Introducing a new concept", *OECD Development Co-operation Working Papers*, No. 54, OECD Publishing, Paris, https://doi.org/10.1787/2dad64fb-en.

[2] See https://www.oecd.org/dac/states-of-fragility-2018-9789264302075-en.htm

[3] In real terms, World Bank data.

[4] Domestic debt stands at 1.6% of GDP and external debt at 6.7% of GDP. (IMF, 2020[46])

[5] Simple average, World Bank data.

[6] The local revenues expected to finance the 2020 Budget Strategy, (Ministry of Finance and Treasury, 2019[45]), and more broadly the National Development Strategy 2016-30, (Ministry of Development Planning and Aid Co-ordination, 2016[50]), depend heavily on log export earnings and fuel tax revenues, and are both expected to decrease.

[7] The Solomon Islands dollar is pegged to an invoice-based basket of currencies: US dollar (58%), Australian dollar (32%), New Zealand dollar (5%), Japanese yen (3%) and British pound (2%). The Central Bank of Solomon Islands sets the exchange rate vis-à-vis the US dollar in such a way as to maintain the value of the basket constant in Solomon Islands dollars given the movements of currencies in the basket relative to each other.

[8] The three criteria for LDC graduation are a GNI per capita of 1 230 or above; a HAI of 66 or above; and an EVI of 32 or below. The graduation thresholds, as determined by the CDP, must be met for any two of the three criteria in two consecutive triennial reviews. Alternatively, the GNI per capita of the country is at least twice the graduation threshold in two consecutive triennial reviews (income-only criterion). In 2020, the CDP refined the LDC criteria: https://www.un.org/development/desa/dpad/publication/outcome-of-the-comprehensive-review-of-the-ldc-criteria/. However, these changes are not expected to affect the graduation eligibility of Solomon Islands.

[9] This last factor, reflecting Solomon Islands' high dependence on logging exports, is the only one that can be influenced through policy.

[10] Note that some countries that have finished their transition period can benefit from GAVI's post-transition support if they still confront challenges on adapting sustainable immunisation programmes. This support mainly refers to technical assistance to ensure adequate institutional capacity https://www.gavi.org/types-support/sustainability/transition.

[11] The country's main mining site, the Gold Ridge mine located in Guadalcanal province, has changed ownership multiple times until its closure in 2015 following the extensive damage caused by Cyclone Ita and flooding the previous year.

12 See the following assessment studies and articles: Dynamics of Logging in Solomon Islands (Katovai, 2015[44]); Solomon Islands National Government Reference Level (REDD+ Implementation Unit, Ministry of Forestry and Research Solomon Islands, 2018[49]); Solomon Islanders tried to stop the logging of their forests https://news.mongabay.com/2019/05/solomon-islanders-tried-to-stop-the-logging-of-their-forest-and-may-pay-the-price/; Integrated Forest Management in the Solomon Islands (FAO, 2016[48]).

13 In practice, Solomon Islands seems to have rarely used these mechanisms.

14 See the Cabo Verde transition finance pilot and the Transition Finance factsheet on LDC graduation.

15 https://www.solomontimes.com/news/statement-by-the-prime-minister-hon-manasseh-sogavare-on-switch-to-china/9362.

16 As a response to the COVID-19 crisis, the IMF has provided Solomon Islands with debt relief under the Catastrophe Containment and Relief Trust (CCRT). Additionally, the IMF approved (1 June 2020) the disbursement of USD 28.5 million in emergency financing to the country to address urgent balance of payments needs created by COVID-19. Finally, the Fund approved an emergency financial support to Samoa under its Rapid Credit Facility and other emergency assistance for additional Pacific island countries is being considered by the IMF's Executive Board in the coming weeks. https://www.imf.org/en/News/Articles/2020/05/27/na-05272020-pacific-islands-threatened-by-covid-19. https://www.imf.org/en/News/Articles/2020/06/01/pr20229-solomon-islands-imf-executive-board-approves-disbursement-to-address-the-covid-19-pandemic.

17 China makes it clear that it engages in "mutual economic co-operation" and not development assistance in the definition of the OECD DAC.

18 https://www.brookings.edu/wp-content/uploads/2016/07/Chinas-Engagement-with-Africa-David-Dollar-July-2016.pdf

19 One should also acknowledge the fiscal risk from natural disasters in the absence of sufficiently resilient infrastructure.

20 The Infections Disease Vulnerability Index assesses the vulnerability of countries' public health systems and assigns them a score between 0 and 1, where 1 represents the frontier set by the country best prepared to affront an infectious disease outbreak.

21 Whereas two out of three criteria are required to be considered for LDC graduation, a reintegration in the LDC category requires all three indicators to pass the following thresholds: a GNI per capita of USD 1 025 or below (instead of USD 1230 for LDC graduation), a HAI score of 60 or below (instead of 66), and an EVI of 36 or above (instead of 32).

22 A large share of Chinese Taipei's contribution (around 70%) was channelled to the Rural Constituency Development Fund (RCDF), a controversial fund over which MPs have full discretion, and which has often been criticised for its lack of proper governance and accountability framework.

23 https://www.adb.org/news/adbs-investment-building-urban-resilience-pacific-hit-900-million.

24 Solomon islands road network, The Logistics Capacity Assessment (LCA, 2019[47])

25 See https://dlca.logcluster.org/display/public/DLCA/2.3+Solomon+Islands+Road+Network ; http://documents.worldbank.org/curated/en/670241549245228796/pdf/Project-Information-Document-

Integrated-Safeguards-Data-Sheet-Solomon-Islands-Roads-and-Aviation-Project-P166622.pdf; https://theislandsun.com.sb/solomon-islands-sign-grant-for-facility-to-improve-transport-projects/

[26] Pacific infrastructure performance assessment (2016)

[27]https://www.abc.net.au/news/2019-10-17/china-bankrolls-solomon-islands-stadium-ahead-of-pacific-summit/11612524

[28]https://www.constructionglobal.com/infrastructure/chinese-firms-target-825mn-mining-infrastructure-solomon-islands

[29] https://www.imf.org/en/Publications/WP/Issues/2019/12/11/what-is-real-and-what-is-not-in-the-global-fdi-network

[30] https://ec.europa.eu/taxation_customs/sites/taxation/files/eu_list_update_18_02_2020_en.pdf

[31] https://www.adb.org/sites/default/files/publication/28799/remittances-pacific.pdf

[32] https://www.ifad.org/documents/38714170/41038007/gfrid2018_report.pdf/a600fe3e-ed69-091f-673d-6cd21a9fa305

[33] Solomon Islands Public Investment Management Diagnostic: https://www.theprif.org/file/6779/download?token=oYtNmhs2

[34] http://www.fao.org/3/a-i3958e.pdf

[35] (Dorman, 2014[30]) Access to Electricity in Small Island Developing States of the Pacific: Issues and Challenges, *Renewable and Sustainable Energy Reviews*, 31, 726-735.

[36] The prices of logs per cubic meter were set at USD 113 (2017 data) instead of an international price of USD 262, this in favour to the Chinese market. http://www.cbsi.com.sb/wp-content/uploads/2017/06/QR-MAR2017.pdf

[37] Corruption, un-transparent negotiation of exploitation rights and lack of monitoring have been signalled as the more prominent causes for an over exploitation of this resource. See https://news.mongabay.com/2017/05/corruption-drives-dealings-with-logging-companies-in-the-solomon-islands/; https://journals.sagepub.com/doi/full/10.1177/194008291500800309

[38] https://eiti.org/standard/overview

[39] The Solomon Islands is one of eight parties to the Nauru Agreement Concerning Cooperation in the Management of Fisheries of Common Interest, along with the Federated States of Micronesia, Kiribati, the Marshall Islands, Nauru, Palau, Papua New Guinea, and Tuvalu.

[40] Link to OECD's Sustainable Oceans for All initiative: http://www.oecd.org/dac/developing-countries-and-the-ocean-economy/OECD-Sustainable-Oceans-for-All-brochure.pdf

[41] The IMF has recommended to broaden the tax rate and increase Solomon Islands' revenue transparency. The SIG responded by launching a tax review in September 2017 to reform the current tax system, focusing on modernising tax administration and considering whether to make the current system work better or to introduce a value-added tax (VAT). However the SIG has not yet a firm timeline for presenting the bill to Parliament. (IMF, 2020[46]);

42 Some efforts are already being made by some DAC members and the Asian Development Bank through the Pacific Financial Technical Assistance Centre (PFTAC) https://www.pftac.org/content/PFTAC/en1.html

43 (REDD+ Implementation Unit, Ministry of Forestry and Research Solomon Islands, 2018[49])

44 Solomon Islands has two mobile operators, three internet providers and one fixed-line telephone provider.

45 https://one.oecd.org/document/DCD/DAC(2018)33/FINAL/en/pdf (DCD/DAC(2018)33/FINAL)

46 Currently, the Ministry of Infrastructure and Development is responsible for the maintenance and construction of roads. Road maintenance is outsourced to private contractors but is managed by the Department of Infrastructure and Development.

47 Both in the capital and in remote islands. Indeed, in the capital itself, extremely high electricity tariffs seems to be the result of inappropriate tariff ‘regulation’. Out of the capital, barriers to entrance inhibits private suppliers to develop.

48 Solomon Islands Government, Statistical Bulletin 06/2011 (Honiara, 2011).

49 However, such a support should be properly evaluated in terms of costs involved and benefits expected.

50 Presentation of the Ministry of National Planning and Development Co-operation at the UN-led workshop to prepare Solomon Islands’ graduation from the LDC category: http://unohrlls.org/custom-content/uploads/2019/10/Session-6_SI-Government_LDC-Presentation.pdf.

51 Note that no date of expiration of such Interim Agreement has been communicated, but that its occurrence would affect Solomon Islands’ balance of payments and economic diversification prospects in the medium-term.

52 Even if some new efforts are emerging in order to correct this situation, e.g. the Simplified Approval Process Pilot Scheme led by the Green Climate Fund.

53 See (Watson et al., 2017[51]); (OECD, 2018[13])

54 In August 2019, see https://www.greenclimate.fund/news/gcf-and-world-bank-kick-hydropower-project-solomon-islands

Annex A. Mapping of DAC investment opportunities in Solomon Islands

The mapping exercise draws on the conclusions of Solomon Islands' sectoral transition finance analysis, and provides insights on the level of maturity of different sectors for specific FSD instruments. The results of the mapping are an illustration of the transition factor, i.e. the fact that the financing needs of the country vary over time and across sectors, requiring development partners to constantly adapt their instruments. They also demonstrate the value of strengthening the nexus between development co-operation and investment, and combining the soft (qualitative) and hard (quantitative) dimensions of their ODA to unlock new financing and investment opportunities.

The table below reflects the authors' general understanding of DAC investment opportunities in Solomon Islands but is not meant to capture the full financial and technical complexity of the country's investment and financing for development landscape. The mapping was developed based on the following methodology: (i) review of activity-level CRS data on bilateral and multilateral's investments in Solomon Islands (both concessional and non-concessional finance); (ii) review of relevant assessments, case studies related and articles on Solomon Islands' investment and development finance landscape; and (iii) information gathered from meetings and interviews with various stakeholders conducted during the field mission to Solomon Islands.

The mapping allows to identify areas where DAC support can best add value, and lays out policy options available to DAC members to optimise their contribution to Solomon Islands' national development strategy (NDS) and integrated national financing framework (INFF).

Legend:

Grey: Official development finance does not add value and/or risks crowding out other financing sources

Green: Immediate investment opportunity (the FSD market is mature for this type of investment)

Yellow: Medium-term investment opportunity (requiring prior action to remove constraints and/or create incentives)

Red: Long-term investment opportunity (the FSD market is not yet mature for this type of investment)

Table A.1. The mapping allows to identify where DAC support can best add value

Key sectors	Public concessional finance	OOF, blended finance, PPPs, de-risking instruments and credit enhancements	Private/ commercial finance	How could the DAC help unlock new investments or additional financing?
Health				• Improve DRM • Strengthen PFM
Education				• Improve DRM • Strengthen PFM
Water supply and sanitation				• Improve DRM • Strengthen PIM • Aid for FSD
Transport infrastructure				• Land property reform • Aid for FSD • Improve DRM • Strengthen PIM
Telecommunications				• Aid for FSD • Improve DRM • Strengthen PIM
Energy (hydropower)				• Regulatory reform • Land property reform • Aid for FSD • Strengthen PIM
Renewable energy (excluding hydropower)				• Energy regulatory reform • Land property reform • Technical assistance • Aid for FSD
Fisheries				• TVET (vocational training) • Economic partnerships (trade agreements)
Tourism				• Land property reform • Secondary education • TVET (vocational training) • Financial inclusion
Mining				• Governance reform • Regulatory reform • Technical assistance
Forestry and agriculture				• Governance reform • Financial support and technical assistance to monitor the implementation of the logging sustainability policy
Banking and financial services				• Land property reform • Transport infrastructure • Energy access

Source: Authors' design

BETTER POLICIES FOR BETTER LIVES