FOR
AGENDA

EBS/83/81

CONFIDENTIAL

April 22, 1983

To: Members of the Executive Board

From: The Secretary

Subject: Solomon Islands - Request for Stand-By Arrangement

Attached for consideration by the Executive Directors is a paper on a request from the Solomon Islands for a stand-by arrangement equivalent to SDR 2.4 million. A draft decision appears on page 24.

It is proposed to bring this subject to the agenda for disucssion on Monday, May 23, 1983.

If Executive Directors have technical or factual questions relating to this paper prior to the Board discussion, they should contact Mr. Hyong C. Kim, ext. 75671.

Att: (1)

CONFIDENTIAL

INTERNATIONAL MONETARY FUND

SOLOMON ISLANDS

Request for Stand-by Arrangement

Prepared by the Asian and Exchange and Trade Relations Departments

(In consultation with Fiscal Affairs, Legal, and Treasurer's Departments)

Approved by P.R. Narvekar and Donald K. Palmer

April 21, 1983

Contents

Text Tables

Contents | Page

I. Introduction

In a letter dated April 21, 1983, a copy of which is attached, the Government of Solomon Islands has requested from the Fund a stand-by arrangement for a period of one year in an amount equivalent to SDR 2.4 million, or 75 per cent of quota. The amount would be available from ordinary resources. The letter describes the economic and financial policies of the Government in support of which this request is made.1/ The requested stand-by arrangement would be the second such arrangement with Solomon Islands.

Under the first arrangement which covered the 12-month period to May 1982 for an amount equivalent to SDR 1.6 million (50 per cent of quota), Solomon Islands made purchases totaling SDR 0.8 million. Only half of the amount available was purchased, because the subceiling on net credit to the Government was exceeded during most of the program period due to an unexpected delay in foreign financing of an investment project. In October 1982, Solomon Islands also purchased the equivalent of SDR 1.6 million under the compensatory financing facility. Fund holdings of Solomon Islands dollars currently amount to SDR 5.58 million, or 174.4 per cent of quota; Fund holdings in credit tranches total SDR 0.78 million, or 24.4 per cent of quota.

It is proposed that the total amount be phased in five equal installments. Three purchases (60 per cent of the total) will be available in 1983 and the remaining two purchases in 1984 subject to the completion of the review and observance of performance criteria. On the assumption that Solomon Islands purchases the full amount under the requested stand-by arrangement, Fund holdings of Solomon Islands dollars would increase to SDR 7.98 million, or 249.4 per cent of quota by the end of the stand-by period (SDR 6.38 million, or 199.4 per cent of quota, if the CFF purchase is excluded) (Table 1). A waiver of the limitation in Article V, Section 3(b)(iii) of the Articles of Agreement is, therefore, required. Further information on Solomon Islands' relations with the Fund is presented in Appendix I.

II. Economic Background and Recent Developments

The Executive Board reviewed recent developments and policies on October 25, 1982 in the context of the 1982 Article IV consultation with Solomon Islands.2/

1/ A staff team consisting of Messrs. Hyong C. Kim, Jean-Pierre Golle (both ASD), Ms. Wanda Tseng (ETR), Mr. M. Zubair Khan (ASD; EP), and Ms. Nadia Khattak (ETR, secretary) visited Honiara during November 1-10, 1982 to conduct negotiations for the requested stand-by arrangement. The negotiations with the authorities were concluded in Washington during March 21-24, 1983.

2/ Staff Report (SM/82/199; 10/4/82) and the associated report on Recent Economic Developments (SM/82/203; 10/12/82); and EBM/82/136.

Table 1. Solomon Islands: Projected Changes in Fund Holdings of Solomon Islands Dollars in Relation to the Stand-By Arrangement, 1983-84

(In millions of SDRs; end of period)

	1982	1983			1984	
	Dec.	May	July	Oct.	Jan.	April
Proposed purchases	--	0.48	0.48	0.48	0.48	0.48
Repurchases	--	--	--	--	--	--
Fund holdings (cumulative)						
Total	5.58	6.06	6.54	7.02	7.50	7.98
Excluding CFF	3.98	4.96	4.94	5.42	5.90	6.38
As per cent of quota						
Total	174.4	189.4	204.4	219.4	234.4	249.4
Excluding CFF	124.4	139.4	154.4	169.4	184.4	199.4

Source: Staff estimates.

During 1980-81, Solomon Islands experienced a 38 per cent decline in the terms of trade, a development that had a pronounced adverse impact on economic activity, particularly in the export sector which had provided the major stimulus to growth during the past decade. During the two years, real GDP declined at an annual average rate of 2.5 per cent, the rate of inflation (as measured by annual average changes in retail prices) increased to 15 per cent, and the current account deficit (excluding official transfers) of the balance of payments deteriorated from the equivalent of 6 per cent of GDP in 1979 to 22 per cent in 1980 and to 27 per cent in 1981. These adverse trends occurred even though the budgetary position improved slightly, with the overall budget deficit (excluding grants) declining from 14 per cent of GDP in 1979 to less than 13 per cent in 1981; current operations were nearly in balance but the growth of capital expenditure decelerated despite the transfer of functions from colonial to national authorities and the enlargement of the Government administration following independence in mid-1978.

In 1982, the performance of the Solomon Islands economy suffered a further setback. The terms of trade deteriorated further by 3 per cent (Chart 1), which, combined with a decline in the output of some major export commodities, severely eroded the profitability of many enterprises and led to the curtailment and postponement of new investment. In addition, difficulties emerged in the planning and execution of public sector development projects. In the face of the unfavorable external developments, the Government adjusted its policies with the objective of expanding exports, restraining less essential imports, and increasing domestic resource mobilization. The policy measures included a 10 per cent depreciation of the Solomon Islands dollar in August 1982, substantial increases in import duties, and improvements in tax collection.

1. Production and prices

Preliminary estimates suggest that real GDP declined by about 2 per cent in 1982 (Table 2). Fish catch declined by 36 per cent, because of abnormally cool ocean temperatures and a shortened fishing season. Rice production fell by 23 per cent on account of pest problems, which necessitated a change in rice variety in mid-year. Production of palm oil and cocoa, on the other hand, rose by 10 per cent and 6 per cent, respectively, in 1982, with the former benefiting from a new pollination process, and the latter, from the planting efforts of recent years. Timber output rose slightly, most of this coming in the last quarter, when prices in Japan rose in response to reduced output of logs in Southeast Asia.

Various indicators suggest that investment in 1982 was well below the levels of recent years: imports of investment goods declined by 28 per cent in nominal terms; bank credit to the private sector rose marginally; and except for fishing and logging operations, foreign private direct investment virtually ceased on account of the uncertain export prospects; government investment also fell. Consumption expenditure was depressed as a consequence of a fall in agricultural incomes and the stagnant level of real wages.

Table 2. Solomon Islands: Selected Economic and Financial Indicators, 1980-83

	1980	1981	1982	1983 Program
		(Percentage change)		
Output and prices				
GDP at constant prices	-5.5	0.6	-1.7	3.0
Consumer prices (average)	12.6	16.4	13.0	10.0
GDP deflator	11.8	18.2	13.9	10.0
Money and credit				
Total liquidity	-8.7	-16.4	24.8	14.5
Domestic credit 1/	14.5	21.2	14.9	22.1
Government 1/	-7.5	8.8	11.1	1.5
Private sector 1/	22.0	12.4	3.8	20.6
Velocity (GDP/liquidity)	3.2	4.5	4.0	3.9
		(As per cent of GDP)		
Budget				
Domestic revenue	19.8	22.6	22.9	21.6
Expenditures	34.1	35.4	32.8	31.7
Overall deficit (-)	-14.2	-12.8	-10.0	-10.0
Grants	11.5	5.8	3.1	5.8
Foreign loans	2.8	2.3	2.9	3.1
Domestic financing	-0.1	4.7	4.0	1.2
Of which: Banking system	(-2.6)	(2.3)	(2.3)	(0.3)
Balance of payments				
Current account (excluding grants)	-21.9	-27.2	-13.7	-16.8
Current account (including grants)	-8.5	-16.4	-6.6	-7.4
Overall balance	-4.7	-7.5	5.5	-1.6
(In millions of SDRs)	(-5.2)	(-10.3)	(6.2)	(-2.5)
Public external debt	5.3	11.4	21.9	26.3
Debt service ratio 2/	--	1.1	3.8	3.6
Gross official reserves in months of imports	3.6	3.5	6.1	6.0
		(Percentage change)		
Nominal effective exchange rate 3/	-0.5	-4.2	-8.4	-14.3 4/
Real effective exchange rate 3/	3.9	2.3	-4.0	...
Exports, f.o.b.	6.2	-0.4	-6.1	2.5
Export volume	4.4	9.7	-4.9	8.0
Imports, f.o.b.	25.9	13.0	-16.8	8.6
Non-oil imports, f.o.b.	21.5	3.6	-18.8	11.2
Import volume	-3.1	-2.2	-18.0	10.2
Terms of trade 5/	-16.6	-21.4	-2.8	-3.5

Sources: Data provided by the Solomon Islands authorities; and staff estimates.

1/ Percentage change in relation to stock of liquidity at beginning of period.

2/ Interest plus amortization on public debt as ratio of exports of goods and services.

3/ Positive numbers imply appreciation.

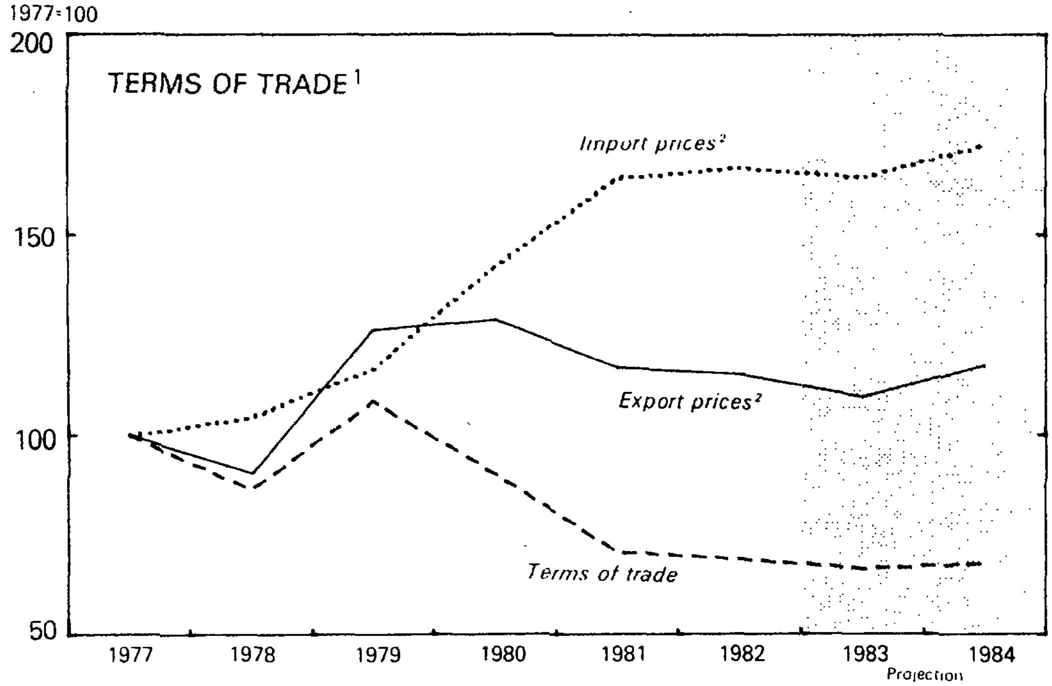
4 February 1983 over February 1982.

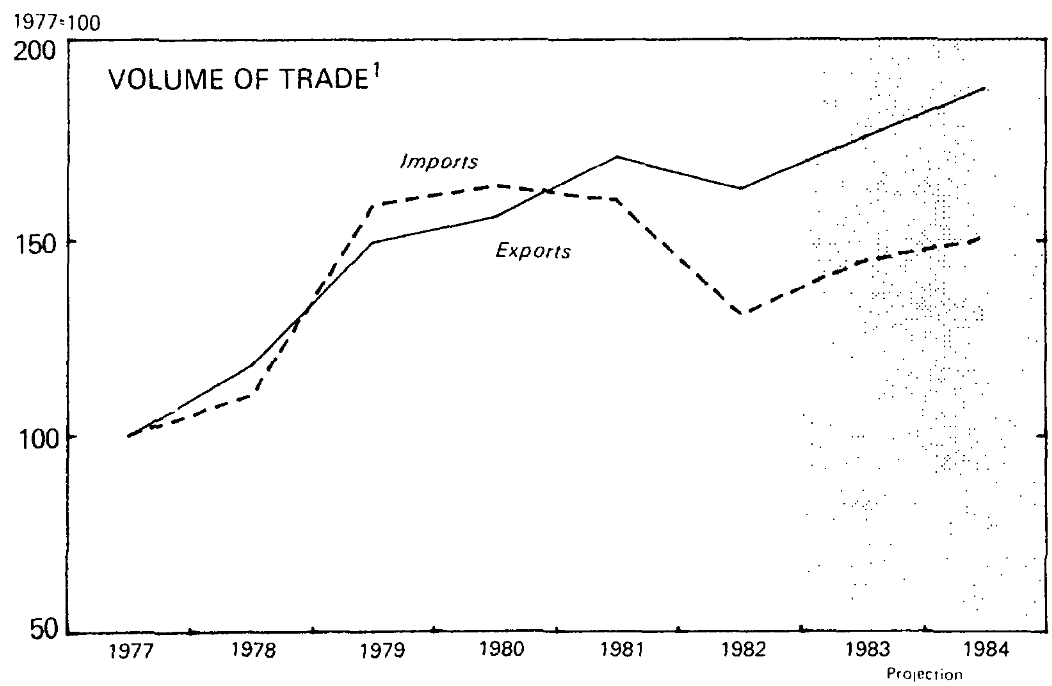
5/ Negative numbers imply a deterioration.

CHART 1

SOLOMON ISLANDS

FOREIGN TRADE INDICES, 1977-84





Sources: Data provided by the Solomon Islands authorities and staff estimates.
[1]Staff estimates
[2]In terms of SDRs

As measured by annual changes in retail prices, the rate of inflation decelerated from 16 per cent in 1981 to 13 per cent in 1982. The rate of inflation gradually fell from an annual rate of 14.5 per cent at the beginning of 1982 when import duty rates were sharply raised, to slightly less than 10 per cent at the end of the year, with a temporary increase following the 10 per cent depreciation of the Solomon Islands dollar in August.

2. Public finance

The objective of the Government's fiscal policy has been to balance its current operations, while expanding capital expenditures which are largely financed by foreign grants and concessionary external project loans. In 1982, however, the current fiscal position deteriorated as a result of both a shortfall in revenues and an overrun in current expenditures. This deterioration was more than offset by a sharp fall in capital expenditures. As a result, the overall fiscal deficit (excluding grants) as a ratio of GDP declined from nearly 13 per cent in 1981 to 10 per cent in 1982. Close to two-thirds of the deficit was financed by external project loans and foreign grants, and the remainder by domestic borrowing. The larger-than-expected budgetary recourse to domestic borrowing was mostly on account of a considerable shortfall in official grants in 1982 because of administrative delays in claiming aid reimbursement; the main reason for this delay was a change made by one major donor from an advance grant disbursement system to one in which reimbursement is made after expenditure has been made.

In 1982, domestic revenues rose by 12 per cent to SI$35.7 million, or SI$1.6 million below the budgeted level (Table 3). The weaker-than-expected revenue performance was due entirely to a shortfall in nontax revenue which declined as the depressed level of economic activity curtailed the rental of government-owned vehicles and plants. Tax revenue increased by 23 per cent, in line with original budget estimates, although revenue performance in each tax category differed from the budget. Receipts from taxes on international trade rose by 28 per cent (as against 36 per cent in the budget) reflecting lower exports and imports than initially envisaged. The increase in import duty collection (40 per cent) was largely on account of new tax measures introduced in the 1982 budget which permitted a rise in the average rate of import duties to imports to 23 per cent in 1982 from 14 per cent in 1981. In contrast, income tax collection showed a high buoyancy and revenue from that source was larger than initially envisaged, because income tax payments by individuals rose by 40 per cent on account of a large collection of arrears (SI$0.6 million); meanwhile, however, corporate income tax revenue declined by 20 per cent, reflecting the poor profitability of many enterprises in the previous year.

On the expenditure side, current expenditures rose by 13 per cent, or by substantially more than had initially been budgeted (5 per cent) with all categories expanding faster than initially estimated. The increase of 17 per cent in the wage bill reflected adjustments of 8-11 per cent in wages, special long-service allowances, and an increase

Table 3. Solomon Islands: Summary of Central Government Budget, 1980-83

	1980	1981	1982 Budget	1982 Provisional Estimate	1983 Budget	1983 Estimate
	(In millions of Solomon Islands dollars)					
Domestic revenue	23.7	31.8	37.3	35.7	37.1	38.3
Tax revenue	18.5	24.2	29.8	29.7	31.0	32.2
Income tax	(7.3)	(9.6)	(10.3)	(11.2)	(11.1)	(11.1)
Tax on international trade	(10.0)	(13.4)	(18.2)	(17.1)	(18.2)	(19.4)
Import duties	(5.6)	(9.3)	(13.4)	(13.0)	(13.2)	(15.2)
Export duties	(4.4)	(4.1)	(4.8)	(4.1)	(5.0)	(4.2)
Other	(1.2)	(1.2)	(1.4)	(1.4)	(1.7)	(1.7)
Other revenue	5.2	7.6	7.5	6.0	6.1	6.1
Current expenditure	24.1	32.2	33.9	36.5	37.4	37.7
Wages	8.7	10.8	11.4	12.6	13.2	14.3
Other goods and services	7.9	12.0	12.5	12.7	13.0	12.4
Subsidies and current transfers	7.5	9.4	10.0	11.2	11.2	11.0
Current balance	-0.4	-0.4	3.4	-0.8	-0.3	0.6
Capital expenditure and net lending	16.6	17.6	25.7	14.8	28.9	18.4
Overall balance	-17.0	-18.0	-22.3	-15.6	-29.2	-17.8
Grants	13.7	8.2	14.0	4.9	15.2	10.2
Foreign financing	3.4	3.2	7.5	4.5	10.6	5.5
Domestic financing	-0.1	6.6	0.8	6.2	3.5	2.1
(Bank financing)	(-3.1)	(3.3)	(--)	(3.5)	(1.5)	(0.6)
	(In per cent of GDP)					
Revenue	19.8	22.6	23.8	22.9	20.9	21.6
Current expenditure	20.2	22.9	21.7	23.3	21.1	21.3
Capital expenditure	13.9	12.5	16.4	9.5	16.3	10.4
Current balance	-0.4	-0.3	2.2	-0.5	-0.2	0.3
Overall balance	-14.2	-12.8	-14.2	-10.0	-16.5	-10.0
Domestic financing	--	4.7	0.5	4.0	2.0	1.2
Domestic bank financing	-2.6	2.3	--	2.3	0.8	0.3

Sources: Data provided by the authorities; and staff estimates.

in the Government's contribution to the National Provident Fund (NPF). The growth of transfers to local governments reflected in part the Government's policy of strengthening the administrative apparatus of local governments through expanded training programs and technical assistance from expatriates. Transfers to public enterprises also rose due to the larger-than-expected loss in the operation of the marine fleet which, inter alia, handles interisland transportation of export commodities.

In 1982, capital outlays (including net lending) declined by 16 per cent to a level that was only 58 per cent of the budgeted level. The decline in 1982 was brought about by delays in project formulation and implementation as a result of shortages of skilled manpower and the dismantling of the central planning office in mid-1981 following the change of Government. Contributing also to the decline was a fall in net lending by 15 per cent reflecting the Government's policy of limiting its loans to local governments for a maximum of three months. As a result of the delay in claiming aid reimbursement and the sharp reduction in capital outlays, the utilization of foreign grants and loans was substantially lower than originally envisaged.

3. Money and credit

Monetary and credit developments in 1982 deviated from the trends of the past two years. Broad money, after a cumulative decline of 24 per cent during 1980-81, increased by 25 per cent in 1982, mainly reflecting a reconstitution of private sector deposits and a sharp rise in deposits by the NPF following the increase in contribution rates paid by employers from 5 per cent to 7.5 per cent of wages and salaries. Total domestic credit expanded by 15 per cent of broad money outstanding at the end of 1981 (21 per cent in 1981), the main factor being the Government's recourse to bank credit; domestic credit to the private sector rose marginally.1/ These developments in broad money and domestic credit were accompanied by a rise in net foreign assets of SI$8.5 million during the year, a sharp turnaround from the trend of the past two years.

In 1982, the authorities continued their efforts to promote the mobilization of financial savings and the development of monetary and credit policy instruments of the Solomon Island Monetary Authority (SIMA).2/ The interest rate on Treasury bills was raised by 0.5 percentage point to 7.5 per cent in mid-year. In September, the rate offered on five-year development bonds was raised by 1 percentage point to 11 per cent, and the denomination was reduced from SI$500 to SI$100 per unit to encourage subscription by individuals. The issuance of these bonds was accompanied by a vigorous publicity campaign to induce participation by the general public. The public response was favorable, as evidenced by a sharp increase in the number of individual subscribers.

1/ These implied growth rates in domestic credit and net credit to the Government of 18.9 per cent and 152.2 per cent, respectively, in 1982.

2/ On January 24, 1983, SIMA became the Central Bank of Solomon Islands (CBSI).

4. External developments

Following the 55 per cent increase in the current account deficit in 1981, the current imbalance narrowed considerably in 1982, despite the 3 per cent deterioration in the terms of trade. The current account deficit narrowed from SDR 37 million (27.2 per cent of GDP) in 1981 to SDR 19 million (13.7 per cent) in 1982. This reduction, however, reflected the underlying weakness of the economy.

The trade balance swung from the deficit of over SDR 8 million in 1981 to near balance in 1982, due to an estimated 18 per cent decline in the volume of imports. The largest fall was in imports of investment goods. Imports of petroleum products, largely for fishing and logging operations, were also less than the previous year's level. The volume of exports, which had increased by 10 per cent in 1981, dropped by an estimated 5 per cent, largely on account of the 35 per cent decline in the volume of fish exports; the volume of most other exports, including timber, palm oil, copra, and cocoa increased. The deficit in the services account also narrowed considerably as the smaller imports led to a fall in freight and insurance payments, and the shortened fishing season reduced the payments for use of the fishing fleet.

While the inflow on account of official transfers was substantially smaller than in 1981 for the reasons explained above, the net inflow of nonmonetary capital nearly doubled. Private capital inflows were significantly larger than in 1981, reflecting in part the financing of a new fishing boat and of imported logging equipment as well as the use of one short-term credit of SDR 1.9 million to finance the use of the fishing fleet. A shift by donor countries from grants to loan finance for public projects accounted for the increase in official capital inflow, despite the lower level of public investment. The overall balance of payments recorded a surplus of SDR 6.2 million in 1982. Reflecting the overall surplus and the drawdown of SDR 9 million in respect of an Eurodollar loan contracted in 1981, gross international reserves at end-1982 amounted to SDR 34.9 million, equivalent to about six months of projected imports for 1983.

Disbursed external public debt, including Fund obligations, rose from SDR 15.5 million (11.4 per cent of GDP) in 1981 to SDR 29.5 million (21.9 per cent) in 1982, due largely to the drawdown of the Eurodollar loan of US$20.0 million contracted in 1981.1/ Except for the Eurodollar loan, all of Solomon Islands' external public debt is on highly concessional terms, with an average maturity of 27 years (including a grace period of 9 years) and carries an average annual interest rate of 1 per cent. Although it has risen since 1980, the debt service ratio was less than 4 per cent in 1982 (7 per cent including private debt).

1/ In a recent survey undertaken by the Central Bank of Solomon Islands, private external debt, excluding short-term trade credits, is estimated to total SDR 13.9 million at end-1982. Including private debt, external debt at end-1982 is equivalent to 32.2 per cent of GDP.

5. Exchange rate

The exchange rate of the Solomon Islands dollar is determined on the basis of a basket of currencies of the country's major trading partners. The real effective rate of the Solomon Islands dollar was on an appreciating trend from 1979 until mid-1982. From March 3, 1981 to August 12, 1982, the Solomon Islands dollar was pegged to a settlement-weighted currency basket dominated by the U.S. dollar, although the United States has been a relatively minor trading partner. Over the same period, the trade-weighted nominal effective exchange rate index appreciated by about 6 per cent due to the sharp appreciation of the U.S. dollar against other major currencies. In real effective terms, the appreciation was about 15 per cent. This development compounded the fall in foreign prices of exports and adversely affected export profitability.

On August 13, 1982, important changes were made in the conduct of exchange rate policy; the authorities devalued the Solomon Islands dollar by 10 per cent against the basket. Also, since that date, the Solomon Islands dollar has been pegged to a trade-weighted basket of currencies of four of its major trading partners (U.S. dollar, Japanese yen, Australian dollar, and British pound) and CBSI was empowered to make discretionary changes of up to 2 per cent on either side of the peg in any four-week period. As a result of these changes, the nominal trade-weighted effective exchange rate index, as calculated by the staff, depreciated by 14 per cent between August 1982 and February 1983, and the real effective exchange rate index is estimated to have depreciated only slightly less during the same period (Chart 2).

III. The Economic and Financial Program for 1983-84

In the authorities' view, if the recent trend of depressed investment and economic activity continues in 1983, the productive base of the economy will be seriously weakened. Therefore, their basic strategy is to promote a recovery in economic activity, particularly through investment in export industries in order to strengthen the balance of payments over the medium term. In light of relatively weak external demand conditions, the resumption of investment and associated import requirements will inevitably lead to a widening of the current account deficit of the balance of payments in 1983. Hence, while bringing investment and economic activity back to normal levels, the objective of economic policies in 1983 and 1984 will be to contain the current account deficit of the balance of payments to 17 per cent of GDP (compared with 14 per cent in 1982) and to reduce it to 15 per cent of GDP in 1984. This will be achieved by limiting the overall budget deficit to 10 per cent of GDP in 1983 as in 1982, but with an improvement in current operations and a shift in expenditures toward investment; by maintaining a flexible exchange rate policy; and by increasing interest rates on bank deposits significantly (Appendix IV). Consistent with these policies will be a growth of GDP of 3 per cent during 1983-84 and a reduction in the rate of inflation from 13 per cent on average in 1982 to 10 per cent in 1983 and to about 8 per cent in 1984. Details of the policy framework for 1984 will be discussed at the time of the program review in

October 1983 and will include a flexible exchange rate policy and continued fiscal restraint.

The medium-term adjustment strategy anticipates a sustained improvement in the balance of payments, with the current account deficit declining to 14 per cent in 1985. A deficit of this magnitude is sustainable in view of the availability of foreign grants and concessionary external project loans, the capacity of the Solomon Islands to service existing and prospective debt, and a relatively comfortable level of international reserves. The external terms of trade are projected to deteriorate by about 4 per cent in 1983 and to improve modestly in 1984-85. With a recovery in the production of major export commodities partly in response to the investment undertaken in 1983, the volume of exports is expected to rise during 1983-85. Over the medium term, an annual growth in real GDP of about 3 to 4 per cent is anticipated to be maintained while the rate of inflation is expected to decline significantly below 10 per cent. Appropriate fiscal and monetary and credit policies will continue to be directed at ensuring that the expected economic growth takes place without undue pressure on the balance of payments and prices. In particular, the recovery of economic activity and intensification of efforts to improve tax administration are expected to strengthen government revenues. This, together with expenditure restraint, will reduce the overall budget deficit toward a level consistent with the medium-term adjustment strategy.

1. Investment, production, and energy policies

The investment strategy for 1983 will aim principally at stimulating investment in export industries by influencing the domestic cost/price structure and by implementing the existing incentives efficiently. The increased flexibility in exchange rate policy, together with the projected improvement in commodity prices, is expected to enhance export profitability and direct resources to the tradable sector. In order to boost investment in priority sectors (export- and import-competing industries), the authorities introduced in 1982 a scheme whereby duties paid on imports of capital goods for projects in these sectors were remitted wholly or partially, depending on the importance of individual projects. Also, the rates of depreciation for new capital assets were further accelerated for projects deemed essential to restore the productive base of the economy. These measures will continue to operate in 1983. In its credit guidelines to commercial banks, CBSI will continue to press banks to lend for investment and export. CBSI is also considering the establishment of another lending facility to back up long-term project financing by banks in priority sectors. Private investment will also be stimulated by a more active role of the Government Shareholding Agency (GSA), particularly in the form of joint ventures;1/ in 1983, the fishing fleet

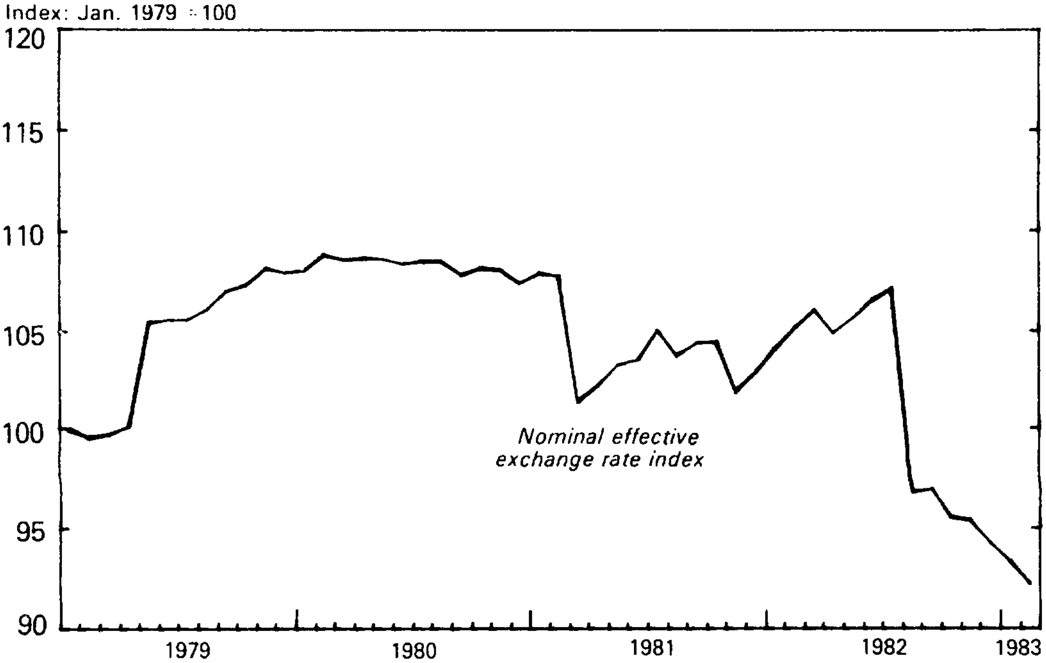
---

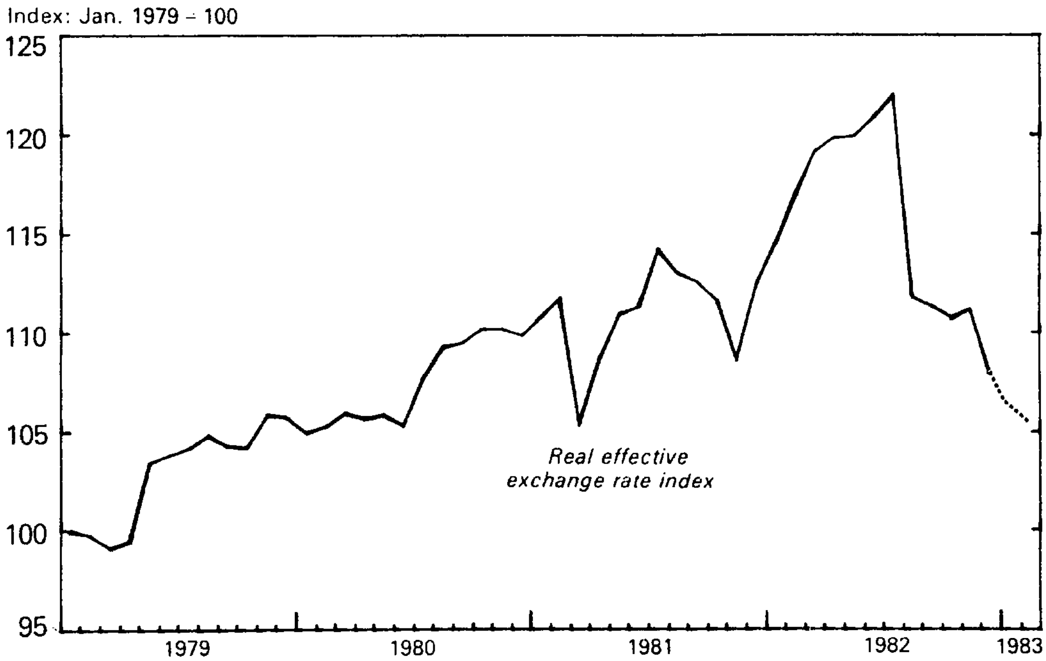
1/ Most investment projects in Solomon Islands are joint ventures between the Goverment and foreign investors and produce almost entirely for export. The Government's participation in joint ventures is carried out through the GSA. The twin objectives of the GSA are to acquire for the Government a substantial part of the ownership of major commercial operations and to promote development in accordance with national priorities.

CHART 2

SOLOMON ISLANDS

EFFECTIVE EXCHANGE RATE INDICES OF THE SOLOMON ISLANDS DOLLAR[1], 1979-FEB. 1983





Source: Staff calculations.
[1] Increase represents an effective appreciation.

will be expanded and the construction of a major fish cannery will start at Noro. Licenses were awarded recently to two new companies for exploitation of timber resources, and negotiations with a private concern have begun on a reforestation project. The Government recently established a Forest Fund with receipts from the export tax on timber in order to provide financial support to private firms participating in reforestation projects.

Production of most of the major export commodities of Solomon Islands is projected to increase in 1983, largely reflecting a recovery in world demand and, to a smaller extent, an expansion of productive capacity from new investments. Copra output will increase, partly as a result of increased participation of smallholders in response to an improved and expanded collection network in the outer islands, as well as the expected higher dometic price of copra for export. The total fish catch is expected to recover, reflecting the addition of two more boats to the fishing fleet and the return to a normal fishing season. Long-term projections indicate an annual increase in fish catch of about 1,000 tons through 1990 (to 30,000-35,000 tons) and a significant increase in canned fish exports commencing from 1985 with the completion of the new cannery. Log production is projected to increase by 8 per cent with the advent of two new firms. Cocoa production will continue to rise sharply, with prospects for improved prices and increasing participation by smallholders. Palm oil production is, however, expected to remain on a plateau until new plantings, currently proceeding at about 200 hectares a year, come into bearing from 1985.

Energy policy will continue to aim at containing the growth of energy consumption and at developing domestic energy resources. Imported oil provides the major source of energy in Solomon Islands and accounted for a quarter of total imports in 1982. To encourage energy conservation, the Government will continue its policy of pricing energy at least at cost;1/ the rates of taxation on imported petroleum products were raised on the average in 1982 from 20 per cent to 30 per cent of the value (c.i.f.) of imports. The Government also recently established an Energy Savings Fund with part of the proceeds from import duties on petroleum products for the purpose of co-financing private investment in energy savings projects. As part of its efforts to reduce the dependency on imported oil, the Government had earlier proposed the construction of a hydropower plant on the Lungga river with a capacity to meet the expected electricity demand of the region through 1990. The project has, however, been postponed indefinitely in light of the unacceptably high estimated cost, and the Government is considering the development of a wood-burning power plant instead. The feasibility of producing biowaste energy and solar energy economically is also being studied. Over the longer term, the Government intends to develop ways of harnessing the water resources of the Lungga river.

1/ Petroleum products are imported and distributed by a private company, and the Government does not provide any subsidy in the consumption and distribution of petroleum products.

2. Domestic financial policies

Domestic financial policies in 1983 will focus on restraint in current fiscal expenditures, expeditious implementation of public sector projects, and appropriate credit policy supported by a significant upward adjustment of interest rates on bank deposits. These measures are intended to ensure that the needed recovery in private investment and economic activity takes place without undue pressures on the balance of payments and prices.

a. Fiscal policy

In 1983, the overall budget deficit will be contained at SI$17.8 million, or 10 per cent of GDP, consistent with the short-term economic recovery and the medium-term strategy. The principal aims of budgetary policy for the year are: to improve current fiscal operations to help finance the development effort and reduce recourse to domestic borrowing; and to increase public investment. The fiscal aims are to be achieved primarily through restraint in current expenditures and through an institutional improvement in the planning and execution of development projects. Domestic revenue is projected to increase by 7 per cent (12 per cent in 1982), and total expenditure, by 9 per cent (3 per cent).

In 1983, most of the increase in total domestic revenue will come from import duties, which are to increase by 17 per cent, broadly maintaining the effective duty rate on total imports achieved in 1982. The small increase in domestic revenue is on account of an estimated fall in receipts from the business income tax as a result of the less favorable company profit situation in 1982 and the need to provide incentives for new investments and attract expatriate managerial and technical expertise. The authorities believe that taxation of the monetized sector cannot be increased further without jeopardizing the prospects for economic recovery in 1983. Therefore, while recognizing the need to broaden the tax base and to adjust the tax rates over the medium term, they will focus their revenue efforts in the short term on further improvements in tax administration and collection and on timely adjustments of service charges and user fees. For these purposes, the Government has established a centralized tax collection office in Honiara to coordinate and facilitate tax collection. Computerization of most tax work has been completed, which is also expected to improve tax administration and strengthen investigation activities. Government ministries have been instructed to make timely adjustments to service charges and user fees to fully cover cost increases in 1983, particularly for water, the marine fleet, telecommunications, and plant and vehicle hire. In early 1983, fees relating to passports, arms licences, and school registration were raised to cover increased operational costs. Increases in main user charges, including water rates and rent of government land, are expected to be made in mid-year.

The policy for current expenditures is framed in the context of resource stringency. Current expenditures are budgeted to increase by only 3 per cent in nominal terms. Allocations for priority sectors (education, health care, and transfers to local governments) will increase by up to 10 per cent, but those to less essential sectors will be either frozen at their respective 1982 levels or will decline in nominal terms. The transfers to local governments are in accord with the constitutional mandate on the devolution of a wide range of powers and responsibilities to the provinces, and will be disbursed monthly against improvement in the administrative capacity of these governments; previously, grants were fully disbursed at the beginning of the fiscal year. Outlays for the operation of the marine fleet will remain unchanged at the 1982 level, while that for plant and vehicle hire will decline, following the transfers of certain plant/vehicle stations to local provinces. The original budget did not provide for any increase in wages and salaries of government employees. The Government, however, decided in early 1983 to grant wage increases of 8.5 per cent on average.1/ The additional cost of the wage increase will be met by cuts in other expenditures through a 10 per cent reservation on non-statutory expenditures imposed early in the year.

Capital expenditure and net lending is budgeted to increase by 24 per cent in 1983 to reach a level slightly above the one realized in 1981. The main priority of development expenditures is in infrastructure which will support private investment, including the Noro township project (in conjunction with the construction of the fish cannery referred to above), the construction of bridges on Guadalcanal and Kotombangara, and the modernization and expansion of the telephone system.2/ In 1983, net lending is expected to decline from SI$5.8 million in 1982 to SI$4.3 million; lending to local governments is budgeted to contract, reflecting the Government's policy of limiting budgetary advances to local governments and repayments of some outstanding loans. Net lending to the Development Bank of Solomon Islands and to the GSA for equity participation in key industries is expected to increase. In order to enhance the capital absorptive capacity of the public sector, a National Planning Department was created within the Office of the Prime Minister. The new office is expected to streamline the procedures for planning public projects and to expedite project implementation with better coordination among the ministries and local governments involved. The expeditious implementation of public projects and improvement in aid reimbursement claims are in turn expected to speed up aid disbursements.

The authorities consider that expenditure control through prior allotments issued by the Ministry of Finance is generally effective, but

---

1/ In 1981, the Government entered into a three-year wage agreement with the Union of Government Employees under which wages are to increase by half the rate of inflation in the preceding year plus 1 percentage point (for higher grades) to 3 percentage points (lower grades).

2/ As indicated in Appendix II, World Bank operations in Solomon Islands have been limited, and the Government's current and prospective investment programs are to be reviewed by a World Bank mission in the latter part of 1983.

they are prepared to impose, if needed, additional expenditure reservations upon approved expenditures. The use of computers is expected to provide timely information for more efficient budgetary control. Monitoring of government revenue and expenditure by the Budget Unit of the Ministry of Finance will also be strengthened in close collaboration with Accounting Officers.

With the restraint in the growth of current expenditure, the overall budget deficit is projected to remain at 10 per cent of GDP in 1983. Foreign grants are projected to double to reach SI$10 million, reflecting the bulging of grant aid from a major donor, improved aid reimbursement procedures and, to a small extent, the catch-up of aid reimbursement associated with the 1982 shortfall. Foreign loans are to rise to SI$5.5 million. Recourse to domestic borrowing is projected to decline from SI$6.2 million in 1982 to SI$2.1 million, with bank financing limited to SI$0.6 million.

b. Monetary and credit policies

From its establishment in 1979 through 1980, SIMA refrained from using the usual control powers of a central bank, preferring to allow interest rates and domestic credit expansion to the private sector to be determined largely by commercial bank decisions. From early 1981, however, SIMA has taken a series of steps to strengthen its control over commercial banks, including the introduction of reserve requirements (up to a maximum of 15 per cent of deposit liabilities) and a short-term lending facility, and the issuance of Treasury bills. The transformation of SIMA into the Central Bank of Solomon Islands in January 1983 has further enhanced the role of the central bank in influencing monetary and credit developments. The central bank is authorized: (1) to prescribe interest rates for classes of bank deposits and advances; (2) to introduce, with the approval of the Minister of Finance, a lending facility to support long-term lending of banks to priority sectors; and (3) to impose reserve requirements on banks up to a maximum limit of 40 per cent.

In 1983, monetary policy will principally aim at mobilizing financial savings, which will help finance the upturn in economic activity within the environment of financial stability. To this end, in February-March 1983, the Treasury bill yield was raised by 1.5 percentage points to 9.0 per cent, while reducing the minimum denomination from SI$10,000 to SI$1,000. Also, interest rates payable on passbook savings deposits were raised by up to 3 or more percentage points and interest rates on term deposits of less than SI$25,000 by lesser amounts. Deposit rates on SI$25,000 or more, which make up about 80 per cent of total deposits, continue to be negotiable.1/ Savings deposits constituted about 35 per

1/ Most large time deposits with the banking system belong to the NPF and to a relatively small number of companies. In September 1982, the average yield on such deposits was 11 to 12 per cent (17.7 per cent when adjusted for the tax-exempt character of interest income), compared with the average rate for all time deposits of 9 per cent (or 14 per cent).

cent of total quasi-money during 1981-82. As part of its effort to extend the banking system into rural areas, the National Bank of Solomon Islands (NBSI), a joint venture between a foreign commercial bank and the Government, will continue to expand the number of its agency branches in the outlying islands and to improve these facilities.

In 1983, broad money is projected to increase by 14.5 per cent (Table 4), in response partly to the upward adjustment of deposit rates and the continued efforts to expand and improve the banking facilities in rural areas. The projected growth in broad money also takes into account a further rebuilding of company deposits to more normal levels in relation to their operations (following a sharp decline in such deposits in 1980-81) and larger deposits by the NPF resulting from the 1982 increase in the contribution rate. Reflecting these factors and expectations of declining inflation, the income velocity of money is projected to decline somewhat in 1983.

Taking into account the balance of payments and price objectives, and consistent with the expected demand for liquid assets by the public, the authorities intend to limit the growth of total domestic credit in 1983 to 22 per cent of broad money outstanding at end-1982.1/ The domestic credit expansion for 1983 is principally intended to provide the liquidity needed to support the increased economic activity, particularly in the private sector. The relatively large credit expansion envisaged for the program period partly reflects the depressed credit level in 1982, when credit to the private sector increased by only 4 per cent, and bank financing of planned expansion in the fishing fleet and timber operations. In line with the limit on total domestic credit expansion and the projected budget deficit, the authorities will limit the expansion of net credit to Government during 1983 to not more than SI$0.6 million. The increase in credit to the private sector will be limited to 21 per cent in 1983.

3. External prospects and policies

Balance of payments projections for 1983 envisage an increase in the current deficit to SDR 25 million (16.8 per cent of GDP), taking into account the recovery in investment and the associated import requirements (Table 5). The terms of trade are projected to deteriorate further by nearly 4 per cent. Export prices are forecast to decline by 5 per cent, reflecting the decline in prices of timber and palm oil, while prices of non-oil imports are forecast to rise by about 1 per cent; oil product prices are expected to decline by 9 per cent. Exports are projected to grow by 3 per cent in value and 8 per cent in volume, due largely to increased fish exports (Table 6). Total imports are projected to increase by 9 per cent in value and 10 per cent in volume. The increase in investment goods imports accounts for all of the increase in imports. Increased imports will raise freight and insurance payments, resulting in a widening of the deficit on services account.

1/ This will imply total domestic credit expansion of 29 per cent in 1983.

Table 4. Solomon Islands: Monetary Survey, 1980-83

(End of period)

	1980	1981	1982	1983 Program
	(In millions of SI dollars)			
Net foreign assets	22.5	12.0	20.5	17.6
Net domestic credit	16.9	24.9	29.6	38.3
Government	(-5.6)	(-2.3)	(1.2)	(1.8)
Private sector	(22.5)	(27.2)	(28.4)	(36.5)
Broad money	37.7	31.5	39.3	45.0
Other items	1.7	5.4	10.9	10.9
	(Annual percentage change in relation to broad money) 1/			
Net domestic credit	14.5	21.2	14.9	22.1
Government	(-7.5)	(8.8)	(11.1)	(1.5)
Private sector	(22.0)	(12.4)	(3.8)	(20.6)
	(Annual percentage change)			
Net domestic credit	55.0	47.3	18.9	29.4
Government	(-124.0)	(58.9)	(152.2)	(50.0)
Private sector	(67.9)	(20.9)	(4.4)	(28.5)
Broad money	-8.7	-16.4	24.8	14.5
Memorandum item:				
GDP/broad money	3.2	4.5	4.0	3.9

Sources: Data provided by Solomon Islands authorities and staff estimates.

1/ In terms of broad money outstanding at end of previous year.

Table 5. Solomon Islands: Balance of Payments, 1980-84

(In millions of SDRs)

	1980	1981	1982 Estimate	1983 Projection	1984 Projection
Trade balance	-0.6	-8.2	-0.8	-4.1	-1.7
Exports, f.o.b.	56.3	56.1	52.7	54.0	61.8
Imports, f.o.b.	-56.9	-64.3	-53.5	-58.1	-63.5
Oil	(-9.1)	(-14.8)	(-13.3)	(-13.4)	(-14.1)
Investment	(-31.8)	(-30.5)	(-20.9)	(-26.3)	(-28.9)
Other	(-16.0)	(-19.0)	(-19.2)	(-18.4)	(-20.5)
Services (net)	-24.0	-24.2	-14.9	-17.7	-20.2
Receipts	9.0	12.2	16.5	16.9	17.2
Payments	-33.0	-36.4	-31.4	-34.6	-37.4
Private Transfers (net)	0.6	-4.9	-4.1	-3.4	-3.4
Current account balance	-24.0	-37.3	-19.7	-25.2	-25.3
Official transfers (net)	14.7	14.8	10.3	14.1	10.5
Nonmonetary capital (net)	2.4	5.7	10.4	8.6	13.5
Official	3.1	3.3	4.2	4.6	8.4
Private	-0.7	2.4	6.2	4.0	5.1
Allocation of SDRs	0.2	0.2	--	--	--
Errors and omissions 1/	1.5	6.3	5.2	--	--
Overall balance	-5.2	-10.3	6.2	-2.5	-1.3
Monetary movements	5.2	10.3	-6.2	2.5	1.3
Monetary authorities (net) 2/	4.7	9.5	5.8	2.5	1.3
Assets, increase (-)	(4.9)	(4.7)	(-16.4)	(-3.4)	(0.3)
Liabilities	(0.2)	(4.8)	(10.6)	(5.9)	(1.0)
Of which: IMF	(--)	(0.8)	(1.6)	(1.4)	(1.0)
Commercial banks	0.5	0.8	0.4	--	--
Memorandum items:					
Gross official reserves	23.2	18.5	34.9	33.3	38.0
(In months of imports, c.i.f.	(3.6)	(3.5)	(6.1)	(6.0)	(...)

Sources: Data provided by the Solomon Islands Monetary Authority; and staff estimates.

1/ Includes valuation adjustment.
2/ Includes Central Government.

Table 6. Solomon Islands: Value, Volume, and Unit Value of Major Exports, 1980-84

	1980	1981	1982 Revised Estimate	1983 Pro-jection	1984 Pro-jection
Fish, fresh and frozen					
Value (SDR mn.)	18.3	18.5	9.2	11.4	15.3
Volume ('000 m.t.)	21.6	23.7	15.3	18.9	23.0
Unit value (SDR/m.t.	847	779	604	607	665
Fish, canned and smoked					
Value (SDR mn.)	3.2	2.8	3.8	4.0	4.2
Volume ('000 m.t.)	1.0	0.8	1.2	1.2	1.2
Unit value (SDR/m.t.)	3,305	3,519	3,144	3,381	3.500
Cocoa beans					
Value (SDR mn.)	0.6	0.9	1.5	1.7	2.0
Volume ('000 m.t.)	0.4	0.6	1.1	1.2	1.3
Unit value (SDR/m.t.)	1,616	1,480	1,345	1,409	1,539
Copra					
Value (SDR mn.)	9.7	7.9	7.6	7.7	8.5
Volume ('000 m.t.)	31.7	31.8	33.9	34.0	34.0
Unit value (SDR/m.t.)	307	248	222	228	250
Timber, logs					
Value (SDR mn.)	13.8	14.3	19.9	19.0	20.4
Volume ('000 cu.m.)	258	315	332	360	370
Unit value (SDR/cu.m.)	54	46	60	53	55
Palm oil					
Value (SDR mn.)	6.2	6.9	6.4	6.2	7.1
Volume ('000 m.t.)	15.6	16.9	17.6	18.0	18.7
Unit value (SDR/m.t.)	394	408	362	345	380
Sawn timber					
Value (SDR mn.)	1.0	1.3	1.4	1.3	1.3
Volume ('000 m.t.)	7	7	7	7	7
Unit value (SDR/m.t.)	143	187	201	181	181
Other exports					
Value (SDR mn.)	3.5	3.5	2.9	2.7	3.0

Sources: Data provided by the Solomon Islands authorities; and staff estimates.

The growth in the current account deficit in 1983 will be largely financed by an increase in foreign concessional loans. Improvements in the administration of public sector projects are expected to result in an increase in transfers, reflecting in part a catch-up in aid reimbursement, and inflows of official nonmonetary capital. Private nonmonetary capital is, however, forecast to decline as a short-term credit for use of the fishing fleet is repaid in 1983. The overall payments deficit is expected to be limited to SDR 2.5 million. The envisaged purchases from the Fund (SDR 1.4 million) and a drawdown of the undisbursed balance of US$5 million of the Eurodollar loan contracted in 1981 will permit the financing of this deficit as well as to maintain gross official reserves at end-1983 at the equivalent of about six months of projected 1984 merchandise imports. In view of the variability of export earnings and the lumpiness of import payments, the Solomon Islands authorities consider it prudent to maintain a level of gross reserves equivalent to 4-6 months of imports of goods and services.

Balance of payments projections for 1984 show a current account deficit of SDR 25 million (15 per cent of GDP). Although import prices are forecast to increase by 5 per cent, the terms of trade are projected to improve by 2 per cent due to a recovery in most export prices. The growth in export volume is expected to continue at 7 per cent. Following the recovery in imports in 1983, the growth in import volume is expected to resume the normal relationship with that of real activity in the economy. Foreign concessional financing is projected to remain at about the same level, although there will be a shift from grants to concessional loans. Private capital inflows are projected to increase, reflecting in part investment in a fish cannery scheduled for completion in 1984. The overall payments deficit is expected to be reduced to SDR 1.3 million, most of which will be financed by purchases from the Fund and the remainder by a drawdown of official reserves.

Solomon Islands has traditionally had access to foreign grants and highly concessional loans somewhat in excess of its capacity to identify and implement projects; this trend is expected to continue in 1983. The Government, therefore, does not intend to undertake any new borrowing on commercial terms. However, a certain amount of external borrowing is scheduled for 1983-84 to help finance the major commercial investments (the fish cannery, coconut and cocoa replanting projects, and the purchase of an airplane) that will be undertaken by corporations in which the GSA holds equity. Since the GSA is prevented by statute from providing repayment guarantees, such guarantees will be provided by the Government. Consistent with this, the authorities intend to limit the contracting or guaranteeing of external debt by the Government with original maturities of between 1 to 12 years to no more than US$5.0 million during 1983. There will be no contracting or guaranteeing of external debt by the Government with original maturities of between 1 and 5 years. The authorities have not contracted any external debt of less than 1-year maturity (apart from normal trade credits) and they have no intention of doing so in 1983. The debt service ratio is projected to rise from 4 per cent in

1982-83 to 8 per cent in 1986-87 when the grace period on the Eurodollar loan expires and repurchases in respect of the proposed purchases from the Fund become due (Table 7). The ratio is projected to fall afterwards.

The authorities conducted their exchange rate policy in a flexible manner since mid-1982 with the effect that, through several discretionary adjustments to the exchange rate in light of developments in and prospects for the balance of payments, the appreciation of the real effective rate up to mid-1982 is being reversed. During the program period, the authorities are committed to implementing a flexible exchange rate policy so as to prevent any erosion in the competitiveness of Solomon Islands' exports.

4. Performance criteria

The quantified performance criteria for the proposed program will include quarterly ceilings on total domestic credit of the banking system and net credit to the Government and a ceiling and subceiling on the contracting and/or guaranteeing by the Government of external debt in the 1- to 12-year maturity range and the 1- to 5-year maturity range, respectively (Table 8). A mid-term review is also included as performance criterion. The review will require understandings with respect to budgetary policy for 1984 and quantitative performance criteria for the remaining period of the arrangement. In addition, the arrangement contains the usual performance criteria throughout its duration relating to restrictions on payments and transfers for current international transactions, multiple currency practices, bilateral payments agreements with Fund members, and import restrictions for balance of payments reasons.

IV. *Staff Appraisal and Proposed Decision*

At the conclusion of the 1982 Article IV consultation with Solomon Islands in October 1982, Executive Directors supported the authorities' policy objective of strengthening the current account of the balance of payments and laying the basis for growth over the medium term through investment effort in the export sector. Executive Directors recognized the need to strengthen the budgetary position, particularly through restraint in current expenditures, and to gear exchange rate and wage policies to sustaining export profitability. Realistic interest rate levels were also considered important to foster greater mobilization of domestic savings. The thrust of these comments remains valid for 1983 and the negotiated program appropriately focuses on these policy aspects.

The strategy of the authorities for 1983, which aims at stimulating investment in export industries in order to strengthen the balance of payments over the medium term, is appropriate. The expected recovery in external conditions should improve export prospects and contribute to the revival of investment. The recovery of private investment should also benefit from a number of financial incentives, particularly maintenance of the flexible exchange rate policy to which the authorities are committed under the program.

Table 7. Solomon Islands: External Public Debt Service Payments, 1981-88

(In thousands of U.S. dollars)

	1981	1982 Est.	1983	1984	1985	1986	1987	1988
			Projections 1/					
Amortization	14	12	63	435	2,978	6,364	7,044	5,772
United Kingdom	14	12	13	13	13	13	13	13
Asian Development Bank	--	--	--	--	--	--	71	184
OPEC Special Fund	--	--	50	200	300	300	300	300
Commercial borrowing	--	--	--	--	2,222	4,444	4,444	4,444
IMF 2/	--	--	--	222	443	1,607	2,216	831
Interest	916	2,600	2,767	2,870	2,779	2,296	1,752	1,218
Multilateral organizations	94	142	221	320	405	494	589	683
Commercial borrowing 3/	800	2,400	2,300	2,200	2,045	1,530	1,020	510
IMF 2/	22	58	246	350	329	272	143	25
Total	930	2,612	2,830	3,305	5,757	8,660	8,796	6,990
As per cent of exports of goods and services	1.2	3.9	4.0	4.1	6.1	8.4	7.7	5.6
Total (excluding Fund obligations)	908	2,554	2,584	2,733	4,985	6,781	6,437	6,134
As per cent of exports of goods and services	1.1	3.8	3.6	3.3	5.3	6.6	5.6	4.9

Sources: Data supplied by the Solomon Islands authorities; and staff estimates.

1/ Based on projected external public debt during 1983-88; Fund-related obligations include a CFF purchase of SDR 1.6 million in 1982 and a proposed stand-by in 1983-84 of SDR 2.4 million.

2/ Assumes full purchase of SDR 2.4 million under the proposed program.

3/ The interest rate on the Eurodollar loan is assumed to be 11.5 per cent in 1983-89.

Table 8. Solomon Islands: Quantitative Performance Criteria, 1983 1/

	Apr. 1- June 30	July 1- Sept. 30	Oct. 1- Dec. 31
	(In millions of Solomon Islands dollars)		
Total domestic credit from the banking system	35.5	37.0	38.3
Of which: Net credit to Government	2.5	2.0	1.8
	(In millions of U.S. dollars)		
New external borrowing contracted and/or guaranteed by the Government (cumulative from January 1, 1983)			
1 to 12 years maturity	5	5	5
Of which: 1 to 5 years maturity	--	--	--

Source: Data provided by the Solomon Islands authorities.

1/ Data on all performance criteria are to be cabled to the Fund monthly during the period of the arrangement. However, complete data pertaining to total domestic credit and net credit to Government are available about 4-5 weeks after the end of the month to which they apply. The "data at the end of the preceding period" in paragraph 3(a) of the stand-by arrangement refer to the data for the end of the month.

Budgetary policy is of crucial importance for ensuring attainment of the external objectives, while enabling a recovery of private investment. The staff supports the focus of fiscal policy on restraint in current expenditures and on coordinated efforts to implement public projects expeditiously. Given the constraints on the growth of domestic revenue in a period of economic weakness, restraint in the growth of current government expenditure in 1983 is all the more essential in containing the overall budget deficit within the programmed level and attaining the overall balance in the economy. Efforts should also be made to raise the implementation rate of public investment in infrastructure in order to support the recovery in private investment and facilitate the greater inflow of grants and concessional external loans.

Monetary policy should be conducted in a manner that covers the credit needs of the private sector in an environment of financial stability. The present financial program, which envisages a limited access to bank credit by the Government but ample credit to the private sector within prudent overall credit limits, will help sustain economic recovery. The staff welcomes the recent upward adjustment of interest rates on bank deposits for the purpose of attracting more financial savings into the banking system. Investment decisions taken in the light of a realistic cost of capital will promote efficiency in the use of resources and facilitate attainment of the Government's objective of diversifying the productive base of the economy into areas where Solomon Islands has a comparative advantage.

The sharp reduction in the external deficits on trade and the current account in 1982 reflected mostly the underlying weakness of the economy. As investment recovers in 1983, some increase in these deficits can be expected. The projected increase in the current account deficit is consistent with Solomon Islands' capacity to service the present and projected levels of external debt. Prospects for achieving the projected aid inflows during 1983-84 are good. In recent years, the Government has had access to foreign grants and highly concessional loans in excess of its capacity to identify and implement projects. This trend is expected to continue during 1983-84. Also, given the focus of investment on the export sector, the projected increase in external deficits is in line with a medium-term strategy of development and growth in the context of a sustainable external position. The increased flexibility in exchange rate policy should help enhance export profitability and ensure the maintenance of balance of payments viability.

In the staff's view, the objectives and policies for 1983, described in the annexed letter, represent a suitable response to short-term developments and are consistent with an appropriate path of external adjustment over the medium term. Efforts being made by the Solomon Islands authorities deserve the support of the Fund. Accordingly, the following draft decision is proposed for adoption by the Executive Board:

1. The Government of Solomon Islands has requested a stand-by arrangement for the period from May , 1983 to May , 1984 for an amount equivalent to SDR 2.4 million.

2. The Fund approves the stand-by arrangement attached to EBS/83/81.

3. The Fund waives the limitation in Article V, Section 3(b)(iii).

Fund Relations with Solomon Islands
(as of March 31, 1983)

Date of membership:	September 22, 1978.
Quota:	Present: SDR 3.2 million. Proposed: SDR 5.0 million
Article VIII status:	The Solomon Islands Government accepted the obligations of Article VIII, Sections 2, 3, and 4.
Trust Fund:	Not eligible.
Use of Fund resources:	Under the one-year stand-by arrangement (May 29, 1981-May 28, 1982) for SDR 1.60 million, SDR 0.8 million was purchased leaving an undrawn balance of SDR 0.8 million on expiry of the arrangement.
Fund holdings of Solomon Islands dollar:	SDR 5.58 million or 174.4 per cent of quota, of which SDR 1.6 million (50 per cent of quota) under the CFF.
SDR holdings:	SDR 1.19 million, or 182.7 per cent of net cumulative allocation of SDR 654,400.
Exchange rate system:	Since August 1982, the Solomon Islands dollar has been pegged to a trade-weighted basket of currencies of four of its major trading partners: the U.S. dollar, the Australian dollar, the Japanese yen, and the pound sterling. The Central Bank is authorized to make discretionary adjustments to the exchange rate of the Solomon Islands dollar with respect to the currency basket, which do not exceed, on balance, 2 per cent in any four-week period. The representative rate of the Solomon Islands dollar, established with the Fund, is the rate for the U.S. dollar obtained on the basis of the mid-point between buying and selling rates for the Solomon Islands dollar against the Australian dollar and the representative rate for the Australian dollar.
Technical assistance:	The Central Banking and Fiscal Affairs Departments and the Bureau of Statistics have provided technical assistance in the areas of monetary management, provincial taxation, and in balance of payments and general statistics. The Fund is currently providing three experts under the CBD Technical Assistance Program serving as Deputy Governor-Managing Director, Operations Manager, and Research Manager of the Solomon Islands Monetary Authority. In addition, the CBD is providing short-term assistance in foreign exchange field.
Last Article IV consultation:	October 25, 1982 (SM/82/199); staff discussions during July 19-30, 1982; and the Board meeting (EBM/82/136).

World Bank Group Operations in Solomon Islands

Summary

	Project Status	Date of Approval	Beneficiary	Purpose	Amount US$ mn.	Terms
1.	Approved	March 1981	Development Bank of Solomon Islands (DBSI)	Relending	1.5	IDA
2.	Approved	Feb. 1982	Government of Solomon Islands	Primary education	5.0	IDA

Project Description

1. The project will assist the DBSI in providing finance for investments in all sectors of the economy for the period 1981-82. The AsDB is the lead cofinancier for this operation. Its US$2.0 million credit became effective on May 21, 1981 and disbursements from the credit have commenced. DBSI operations are proceeding approximately as planned and disbursement requests for the IDA credit are expected to commence soon.

2. The proposed project would support Government development plans in the education sector. It would assist the Government in helping provinces and communities increase access to primary schools by creating new, and upgrading established, facilities, providing training to raise the quality of teachers, assisting in the development of more relevant curricula, and improving management.

Solomon Islands

Basic Data

Area	28,896 square kilometers			
Population (1982)	241,000			
GDP per capita (1982)	SDR 600			

	1980	1981	1982 Estimate	1983 Projection
Output and prices (annual rates of change in per cent)				
Real GDP	-5.5	0.6	-1.7	3.0
Consumer prices (average)	12.6	16.4	13.0	10.0
Money and credit (annual rates of change in per cent) 1/				
Broad money	-8.7	-16.4	24.8	14.5
Total domestic credit	14.5	21.2	14.9	22.1
Credit to private sector	22.0	12.4	3.8	20.6
Public finance (annual rates of change in per cent)				
Domestic revenue	21.5	34.1	12.3	7.3
Current expenditure	21.1	32.8	13.4	3.3
Capital expenditure and net lending	10.7	6.0	-15.9	24.3
Total expenditure	16.6	21.9	3.0	9.4
Foreign trade (annual rates of change in per cent)				
Export volume	4.4	9.7	-4.9	8.0
Export unit value	1.8	-9.2	-1.3	-5.0
Import volume	-3.1	-2.2	-18.0	10.2
Import unit value	22.1	15.5	-1.5	-1.5
Terms of trade	-16.6	-21.4	-2.8	-3.5
Balance of payments (SDR million)				
Exports (f.o.b.)	56.3	56.1	52.7	54.0
Imports (f.o.b.)	56.9	64.3	53.5	58.1
Trade balance	-0.6	-8.2	-0.8	-4.1
Current account balance	-24.0	-37.3	-19.7	-25.2
Overall balance	-5.2	-10.3	6.2	-2.5

Solomon Islands (concluded)

Basic Data

	1980	1981	1982 Estimate	1983 Projection
Gross international reserves (end of period)				
In millions of SDRs	23.2	18.5	34.9	38.3
In months of imports	3.6	3.5	6.1	6.0
Selected financial ratios (in per cent)				
Current account surplus or deficit/GDP	-21.9	-27.2	-13.7	-16.8
Government budget deficit/GDP	14.2	12.8	10.0	10.0
External debt/GDP 2/	5.3	11.4	21.9	26.3
External debt service ratio 3/	--	1.1	3.8	3.6
Oil imports/total imports	16.0	23.0	24.9	23.1

Sources: Data provided by the Solomon Islands authorities; and staff estimates.

1/ In relation to stock of broad money at beginning of period.
2/ External public sector debt.
3/ Interest plus amortization on public debt as ratio of exports of goods and services.

Solomon Islands: Summary of the Financial Program

Assumptions:	Terms of trade	-3.5 per cent
	(Export prices)	(-5.0 per cent)
	(Import prices)	(-1.5 per cent)
	Real GDP growth	3.0 per cent
Targets: (1983)	Inflation	10 per cent
	Balance of Payments	
	Current account deficit	SDR 25.2 million (16.8 per cent of GDP)
	Overall deficit	SDR 2.5 million (1.6 per cent of GDP)

Principal elements of the program

1. Exchange rate

10 per cent depreciation in August 1982.
Flexible exchange rate policy aimed at maintaining export competitiveness.

2. Investment

To encourage private investment through exchange rate policy, fiscal incentives, and more active involvement by the Government Shareholding Agency.

3. Budget

To reduce the current account deficit (excluding grants) from 0.5 per cent of GDP in 1982 to a surplus of 0.3 per cent in 1983, and to reduce recourse to domestic borrowing to SI$2.1 million (1.2 per cent of GDP).
To raise the implementation rate of developments projects to close to 65 per cent. To contain the overall deficit to SI$17.8 million (10 per cent of GDP).

4. Money and credit

To limit total credit expansion to 22 per cent and net credit to the Government to 1.4 per cent of stock of liquidity at end-1982 and monetary expansion to 14.5 per cent with appropriate quarterly ceilings as performance criteria.
Increases in interest rates on deposits averaging 2 to 3 percentage points in early March 1983.
The income velocity of money is assumed to decline slightly in 1983.

5. External medium-term borrowing

To limit public and publicly guaranteed external borrowing with maturities of 1 to 12 years to US$5 million and no borrowing in the 1- to 5-year maturity range.

6. Review

Progress under the program will be reviewed no later than December 31, 1983, and understandings will be reached on policies and quantitative performance criteria for the first quarter of 1984.

Solomon Islands--Stand-By Arrangement

Attached hereto is a letter dated April 21, 1983 from the Minister of Finance of Solomon Islands and the Governor of the Central Bank of Solomon Islands requesting a stand-by arrangement and setting forth: (a) the objectives and policies that the authorities of Solomon Islands intend to pursue for the period of this arrangement; (b) the policies and measures that the authorities of Solomon Islands intend to pursue for the period through December 31, 1983; and (c) understandings of Solomon Islands regarding the review that will be made of progress in realizing the objectives of the program and of the policies and measures that the authorities of Solomon Islands will pursue for the remaining period of this arrangement. To support these objectives and policies, the International Monetary Fund grants this stand-by arrangement in accordance with the following provisions:

1. For a period of one year beginning May , 1983, Solomon Islands will have the right to make purchases from the Fund in an amount equivalent to SDR 2.4 million, subject to paragraphs 2, 3 and 4 below, without further review by the Fund.

2. Purchases under this arrangement shall not, without the consent of the Fund, exceed the equivalent of SDR 0.48 million until July 31, 1983, the equivalent of SDR 0.96 million until October 31, 1983, and the equivalent of SDR 1.44 million until January 31, 1984, and the equivalent of SDR 1.92 million until April 30, 1984, but none of these limits shall apply to a purchase under the stand-by arrangement that would not increase the Fund holdings of Solomon Islands' currency in the credit tranches beyond 25 per cent of quota.

3. Solomon Islands will not make purchases under this arrangement that would increase the Fund holdings of its currency in the credit tranches beyond 25 per cent of quota:

(a) During any period through December 31, 1983 in which the data at the end of the preceding period indicate that the limits on total domestic credit of the banking system or the limits on net credit from the banking system to the Government referred to in paragraph 14 of the attached letter and the table attached thereto are not observed; or

(b) After December 31, 1983 until suitable performance criteria have been established in consultation with the Fund as contemplated by paragraph 19 of the attached letter, or after such performance criteria have been established, while they are not being observed;

(c) During the entire period of this stand-by arrangement, if Solomon Islands

(i) imposes or intensifies restrictions on payments and transfers for current international transactions, or

(ii) introduces multiple currency practices, or

(iii) concludes bilateral payments agreements which are inconsistent with Article VIII, or

(iv) imposes or intensifies import restrictions for balance of payments reasons, or

(v) fails to observe the limits on the contracting of new public and publicly-guaranteed external borrowings described in paragraph 17 of the attached letter.

When Solomon Islands is prevented from purchasing under this arrangement because of this paragraph 3, purchases will be resumed only after consultation has taken place between the Fund and Solomon Islands and understandings have been reached regarding the circumstances in which such purchases can be resumed.

4. Solomon Islands' right to engage in the transactions covered by this arrangement can be suspended only with respect to requests received by the Fund after (a) a formal ineligibility, or (b) a decision of the Executive Board to suspend transactions, either generally or in order to consider a proposal, made by an Executive Director or the Managing Director, formally to suppress or to limit the eligibility of Solomon Islands. When notice of a decision of formal ineligibility or of a decision to consider a proposal is given pursuant to this paragraph 4, purchases under this arrangement will be resumed only after consultation has taken place between the Fund and Solomon Islands and understandings have been reached regarding the circumstances in which such purchases can be resumed.

5. Purchases under this arrangement shall be made in the currencies of other members selected in accordance with the policies and procedures of the Fund, and may be made in SDRs if, on the request of Solomon Islands, the Fund agrees to provide them at the time of the purchase.

6. Solomon Islands shall pay a charge for this arrangement in accordance with the decisions of the Fund.

7. (a) Solomon Islands shall repurchase the outstanding amount of its currency that results from a purchase under this arrangement in accordance with the provisions of the Articles of Agreement and decisions of the Fund, including those relating to repurchase as Solomon Islands' balance of payments and reserve position improves.

(b) Any reductions in Solomon Islands' currency held by the Fund shall reduce the amounts subject to repurchase under (a) above in accordance with the principles applied by the Fund for this purpose at the time of the reduction.

8. During the period of the arrangement, Solomon Islands shall remain in close consultation with the Fund. These consultations may include correspondence and visits of officials of the Fund to Solomon Islands or of representatives of Solomon Islands to the Fund. Solomon Islands shall provide the Fund, through reports at intervals or dates requested by the Fund, with such information as the Fund requests in connection with the progress of Solomon Islands in achieving the objectives and policies set forth in the attached letter.

9. In accordance with paragraph 19 of the attached letter, Solomon Islands will consult the Fund on the adoption of any measures that may be appropriate at the initiative of the Government or whenever the Managing Director requests consultation because any of the criteria in paragraph 3 above have not been observed or because he considers that consultation on the program is desirable. In addition, after the period of the arrangement and while Solomon Islands has outstanding purchases in the upper credit tranches, the Government will consult with the Fund from time to time, at the initiative of the Government or at the request of the Managing Director, concerning Solomon Islands' balance of payments policies.

Honiara, Solomon Islands

April 21, 1983

Dear Mr. de Larosiere:

1. The economic strategy of successive governments of Solomon Islands has been aimed at broadening and strengthening the productive base of the economy, so as to sustain a continuous growth of the economy, led by an expansion of export earnings. These policies met with success during the 1970s, when real increases in income per head were achieved, which in turn contributed to an increase in welfare and services to the growing population. Since 1979 we have experienced a sharp deterioration in our terms of trade, which has been more prolonged and more serious in its impact on investment than we had expected. The decline in profitability of many enterprises led to a curtailment or postponement of planned investments and made it harder to induce the creation of new enterprises. Government investment has also remained well below planned levels, due partly to lack of capacity to identify and implement projects.

2. In response to these difficulties, the Government has instituted a set of policy measures designed to assist the private sector to regain profitability and recommence a strong flow of investment; make fuller use of the capacity of private and statutory corporations; reduce the bottlenecks on government absorptive capacity; and to strengthen the balance of payments over the medium term. In support of this program, which is detailed below, the Government of Solomon Islands requests a one-year stand-by arrangement from the International Monetary Fund in an amount of SDR 2.4 million.

3. In 1982, external demand remained weak, and the terms of trade deteriorated further. Private investment and consumption remained depressed. Preliminary estimates suggest that GDP declined by 2 per cent during the year. To assist in preserving competitiveness of our exports, we depreciated the Solomon Islands dollar by 6 per cent in March 1981 and 10 per cent in August 1982, and we are now committed to a flexible exchange rate policy designed to offset erosion of competitiveness. Substantial tariff increases, together with the Solomon Islands dollar depreciation, largely account for the 13 per cent domestic price inflation we experienced in 1982.

4. The current account deficit of the balance of payments in 1982 was only about half that of 1981. This, however, was due mainly to a very marked fall in imports of machinery and equipment, attributable to reduced levels of private and government investment contributing to a 17 per cent fall in the value of total imports. A continuation of this trend would undermine the existing productive base of the economy, precluding prospects for resumed growth.

5. Our objectives for economic policy in 1983-84 are therefore to stimulate an increase in economic activity through an expansion of production from our established export industries, assisted toward profitability

by our fiscal, monetary, and exchange rate policies; and to bring about an increase in private and government investment aimed at enlarging the productive base for medium-term growth. We recognize that such aims also require clear and cost-effective government policies and financial stability. Our programs in relation to the government budget, credit, savings, exchange rate, and the development of financial institutions are therefore coordinated in pursuit of those same objectives.

6. The aim of budgetary policy in 1983 is to improve the current balance, restoring the balance of recurrent revenues with recurrent expenditures, including public debt service. Recourse to domestic financing will be reduced, and will be solely for development projects. Any revenue shortfalls will be met by expenditure cuts. Revenue measures taken in the last two years have raised taxation of the monetized sector to a level which we believe is the highest we can sustain and still look for economic recovery in 1983. We are aware of the need to reduce the vulnerability of revenues to fluctuations in international trade by broadening the tax base; but in 1983 our main improvements will come from the centralization of collection of all government revenues, facilitating both the accounting and pursuit of revenues. Government ministries have been instructed to adjust service charges and user fees fully to cover cost increases for 1983, particularly for water supply, marine fleet, telecommunications and plant and vehicle hire.

7. The rise of 3 per cent in government recurrent expenditures in 1983, against a projected general price rise of 10 per cent, implies a significant reduction in real terms. Allocations to priority sectors, including health, education, natural resources, and provincial governments will increase up to 10 per cent in nominal terms, while other sectors receive no increase. Increases in employment are strictly limited to the manning needs of projects and programs in the high priority sectors. No financial provision was made for pay increases in the budget for 1983. By agreement with the government employees' union, however, wages have been increased in 1983 by 8.5 per cent on average. This increase in pay will be financed by cuts in other current expenditures and for this purpose reservations have been imposed on nonstatutory expenditures.

8. Devolution to provincial government has been an aim of successive governments, and will continue to receive priority, as one of the improvements needed to stimulate greater economic activity in rural areas. To ensure that this does not weaken the executive performance of the public sector, further transfer of authority will be made only as the administrative capacity of provincial governments is strengthened. Improved administrative and accounting skills are a necessary prerequisite for any increase in provincial governments' tax effort. Central government advances to local governments are now limited to three months, and disbursement of grant funds is done monthly against performance. Expatriate accountants are being attached to provincial governments.

9. The Government is determined to improve the implementation rate in the development budget. The financing of projects is not an operative constraint. Solomon Islands has generally had access to grants and highly concessionary loans in excess of our capacity to identify, plan, and carry out projects. We have no wish to do projects that are not worthwhile in terms of our development goals. The central planning capability of the Government, which has become run-down, is being re-established to ensure that projects are identified, planned, coordinated, and followed through to implementation with coherent negotiation of development assistance and prompt claiming of external financing. Vacant technical and planning posts in executing ministries are being filled, by expatriate recruitment where necessary, to increase executive capacity.

10. Overall, the deficit in the government budget is expected to decline considerably in 1983, despite the increased effort in the development field. Net domestic financing is planned at SI$2.1 million, and will be controlled to this level to ensure that adequate funds are available for lending to private investment. If, during the course of the year the budgetary position weakens, the Government will promptly take measures, including the imposition of additional expenditure controls to ensure that our budgetary objectives are achieved. The Government recognizes the need for persistent application of its policy measures over several years for them to be effective, and will continue a prudent fiscal policy stance into 1984.

11. We have considerable capacity for increased production in agriculture, forestry, and fisheries, subject always to sound resource management and the need to ensure regeneration of resources that do not adequately replace themselves. In the private sector, 1983 is expected to see further increases in the volume of production in timber and cocoa, and a return to more normal fishing output after a poor 1982 season. Palm oil production will remain relatively stable until new plantings, proceeding at about 200 hectares a year, come into bearing. New plantings of coconut and cocoa are continuing by smallholders and established companies, using a combination of domestic and external loan finance. Experimental plantings of coffee have yielded promising results. The construction of a major new fish cannery, scheduled to enter production in 1985, will start in 1983, backed by government investment in port facilities and urban infrastructure. Steps are being taken to expand fishing fleet capacity in support of the new cannery and existing frozen fish outlets. Discussions have begun for a major investment in reforestation, the first by a private company. In this and many other key projects, the Government Shareholding Agency will play an important role. It is being strengthened accordingly. Construction projects in Honiara and provincial centers will contribute to an upturn in economic activity. Import duties on capital goods needed for investment projects continue to be remitted, and increased rates of accelerated depreciation of new capital assets for tax purposes have been introduced.

12. Many productive activities are significant users of imported petroleum fuels, now accounting for one quarter of imports. Our energy policies seek to diversify energy sources and promote efficient use. The Lungga hydropower plant, to serve Honiara and central North Guadalcanal, has been delayed because of its very high capital cost, but it will be necessary to harness the resources of the Lungga River in the longer term. Meanwhile the Government is pursuing the use of mini-hydro schemes in several locations; studying a smaller, wood-burning plant for interim power needs of Honiara; and watching with close interest work on use of solar power. In 1983 we established an Energy Saving Fund to co-finance private investments that conserve energy. Import duties were raised to 20-30 per cent of c.i.f. value, and we shall continue to make domestic prices to at least reflect the long-term trend in import prices of oil.

13. Monetary policies will aim to mobilize savings and make them available to help finance the upturn in economic activity. In 1982 the contribution rate for the National Provident Fund was raised from 10 per cent of income to 12.5 per cent, making a substantial increase in the flow of contractual savings into the monetary system. We recognize the role of interest rates as one of the key factors in determining the rate of saving, and ensuring the availability of savings within the Solomon Islands monetary system rather than abroad. In 1982 we increased the interest rates offered on Treasury bills and development bonds by 0.5 percentage point and 1 percentage point, to 7.5 and 11 per cent, respectively. In February 1983, the yield on Treasury bills was raised further to 9 per cent and the minimum denomination was reduced from SI$10,000 to SI$1,000. A number of changes in interest rates paid on deposits with banks also came into effect in early March; the changes included increases of up to 3 or more percentage points in interest rates payable on passbook savings deposits and lesser amounts in the interest paid on term deposits of less than SI$25,000. We shall also continue to build up the financial system and improve the coverage of banking services through the expanded operations, and joint provision of services, where appropriate, of the National Bank of Solomon Islands and the Development Bank of Solomon Islands. The Government increased the equity capital of Development Bank of Solomon Islands by SI$1.0 million before the end of 1982, to provide additional resources for expanded operations.

14. Credit policy during 1983 will aim to provide the liquidity needed to support the increased economic activity, particularly in the private sector. The ability of the Central Bank of Solomon Islands to influence credit developments has been strengthened by relaxation of limits on its power to prescribe reserve requirements and to discount securities, and to extend longer term backup to commercial banks engaged in lending to the priority sectors. We believe that growth in broad money of about 14 per cent will be consistent with the expected rate of real GDP growth of 3 per cent and a 10 per cent general rise in prices. On this basis, and taking into account the balance of payments projection, domestic credit expansion in 1983 would be 22 per cent of broad money outstanding at the end of 1982. Bearing in mind the marked lumpiness of the components making up the monetary aggregates and the strong

seasonality in fishing activity and government operations, we intend to limit total domestic credit of the banking system and net credit to the Government as indicated in the attached table.

15. Balance of payments projections for 1983 and 1984 take into account the projected increase in activity and the associated rise in imports of investment goods. Export prices are expected to deteriorate further and the profitability of the export sector needs to be supported as necessary by exchange rate policies. Export volumes should rise, particularly in timber and fish, by about 8 per cent in total in 1983 and 7 per cent in 1984. Import volumes are expected to rise by 10 per cent, mainly in investment goods, in 1983 and 4 per cent in 1984. The need to lay the foundation for resumed economic growth by increased investment will cause the current account deficit to rise from an estimated SI$10 million in 1982 to a projected SI$13 million in 1983 and to SI$17 million in 1984. The projected increases in the current external deficit will be financed by larger utilization of available foreign resources, and, as a result, the overall balance of payment deficit will decline from SI$2.9 million in 1983 to SI$1.4 million in 1984.

16. In view of the nature of the transactions that determine our balance of payments flows, our reliance on a few export commodities, and the wide price fluctuations that beset them, we require substantial working capital in our external reserves. We consider it prudent to maintain a level of external reserves equivalent to four to six months' imports of goods and services. To assist in maintaining these levels, we intend in 1983 to draw the remaining US$5 million of the US$20 million Eurodollar loan we arranged in 1981. The proceeds of this loan are deposited by the Government with the Central Bank and are not used for budgetary purposes.

17. Apart from the Eurodollar loan, our external financing so far has all been in the form of grants and concessionary loans; disbursed public debt outstanding total now about SI$15 million. Outstanding borrowings from abroad by the private sector total a similar amount. Public debt service payments, including the Eurodollar loan, presently total about 4 per cent of exports of goods and services, and with existing debt, this will rise to 5-6 per cent of exports in 1985-87. In 1983, a certain amount of the external financing for the major commercial investments scheduled for 1983-84 will be borrowed by corporations in which the Government Shareholding Agency holds equity. The Agency will play its part in such fund raising, some of which will be on commercial terms. During 1983, we will limit the contracting of new public and publicly-guaranteed external nonconcessional borrowing with an original maturity of more than one year and up to and including 12 years to an amount not to exceed US$5 million. We will not contract any new public and publicly-guaranteed external borrowing with original maturities of one to five years.

18. During the period of the stand-by arrangement, the Government of Solomon Islands does not intend to introduce any multiple currency practices; impose any new or intensify any existing restrictions on payments

and transfers for current international transactions; enter into any bilateral payments arrangements with Fund members; or introduce any new or intensify any existing restrictions on imports for balance of payments reasons.

19. The Government of Solomon Islands believes that the policies set forth in this letter are adequate to achieve the objectives of its program, but will take any further measures that may become appropriate for this purpose. The Government will consult with the Fund on the adoption of any such measures, in accordance with the policies of the Fund on such consultation. The Government of Solomon Islands will review the developments under the program and will reach with the Fund before December 31, 1983, understandings regarding the Government's budgetary policy as well as quantitative performance criteria referred to in paragraphs 14 and 17 for the remaining period of the stand-by arrangement.

Yours sincerely,

A.V. Hughes
Governor
Central Bank of Solomon Islands

Bartholomew Ulufa'alu
Minister of Finance

Attachment

Mr. J. de Larosiere
Managing Director
International Monetary Fund
Washington, D.C. 20431
U.S.A.

Solomon Islands: Limits on Net Credit to Government and Total Domestic Credit of the Banking System, 1983

(In millions of Solomon Islands dollars)

	Limits on 1/	
	Net credit to government	Total domestic credit
During April 1, 1983 to June 30, 1983	2.5	35.5
During July 1, 1983 to September 30, 1983	2.0	37.0
During October 1, 1983 to December 31, 1983	1.8	38.3

1/ At the end of December 1982 net credit to government and total domestic credit of the banking system amounted to SI$1.2 million and SI$28.4 million, respectively.