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July 30, 1985

To: Members of the Executive Board

From: The Secretary

Subject: Solomon Islands - Staff Report for the 1985 Article IV Consultation

Attached for consideration by the Executive Directors is the staff report for the 1985 Article IV consultation with Solomon Islands, which has been tentatively scheduled for discussion on Wednesday, August 28, 1985.

Mr. Baumgartner (ext. 7307) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

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INTERNATIONAL MONETARY FUND

SOLOMON ISLANDS

Staff Report for the 1985 Article IV Consultation

Prepared by the Staff Representatives
for the 1985 Article IV Consultation with
The Solomon Islands

Approved by Richard C. Williams and Manuel Guitian

July 29, 1985

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I. Introduction

A staff team visited Honiara during May 22-31 to hold the 1985 Article IV consultation discussions with the Solomon Islands. Discussions were held with Sir Peter Kenilorea, Prime Minister and Minister of Finance, 1/ Mr. A.V. Hughes, Governor of the Central Bank of Solomon Islands, and senior officials of the Ministry of Finance, the Central Bank, and other ministries and government agencies, and representatives of private business and labor organizations. The staff team consisted of Messrs. Baumgartner (head), Choudhry, and Feldman (all ASD), Mr. Fisher (ETR), and Mrs. Eulate (ASD).

Solomon Islands has accepted the obligations of Article VIII, Sections 2, 3, and 4, and maintains an exchange system free of restrictions on payments and transfers for current international transactions.

A stand-by arrangement covering the period June 22, 1983-June 21, 1984 for an amount equivalent to SDR 2.4 million (48 percent of quota) was approved by the Executive Board in June 1983 (EBS/83/81). Under the arrangement, the Solomon Islands made two purchases totaling SDR 0.96 million; the remaining purchases were not made because (i) the ceiling on net credit to the Government was exceeded during the period July-December 1983, 2/ and (ii) unexpectedly favorable balance of payments developments led the authorities not to request purchases in 1984. Fund credit outstanding amounted to SDR 2.96 million (59.2 percent of quota) on June 30, 1985; this included SDR 1.6 million (32.0 percent of quota) of purchases under the CFF.

The authorities requested that, in view of the deterioration in the external situation since early 1985, the next Article IV consultation be held on the standard 12-month cycle rather than on an 18-month cycle as hitherto.

II. Background

The Solomon Islands comprise an archipelago of six main islands and many smaller ones extending over 1,400 km. The total population is

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1/ Mr. P. Kejoa, who was designated Minister of Finance in late 1984, assumed office in June 1985.

2/ Following a modification of the credit ceilings for December 1983, involving an increase in the subceiling on net credit to the Government and a lowering of the overall ceiling on total domestic credit, and a rephasing of purchases, the remaining amount of purchases, SDR 1.44 million, would have become available in the period January-April 1984.

about 260,000 and is estimated to be growing at some 3.5 percent per annum, which is significantly higher than in other Pacific Islands. The adult literacy rate of 15 percent is lower than in neighboring islands. Per capita income is estimated to have been SDR 675 in 1984, below that of Fiji and broadly the same as in Papua New Guinea and Western Samoa.

The Solomon Islands' economy consists of a modern, monetized sector comprising mostly plantations, forestry, commercial fishing, and services, and a large rural subsistence sector. Agriculture, including agro-based industries, is estimated to account for about 70 percent of GDP, to which the modern sector contributes about one half. Manufacturing accounts for no more than 5 percent of GDP; government services generate about 15 percent of GDP, and other services account for the remainder of about 10 percent. The modern sector, which produces mainly copra, palm oil, cocoa, timber, and fish, is highly export-oriented, and the average export/GDP ratio during the period 1980-84 was about 45 percent. Even though Solomon Islands' exports are more diversified than those of many other Pacific Islands, commodity price fluctuations have resulted in substantial swings in income and the external accounts. To dampen the impact of cyclical forces, a price stabilization fund has been in operation for sales of copra. Trend growth of real GDP was 3.6 percent, barely above the growth rate of the population, between 1978, the year of independence, and 1984. Solomon Islands has received substantial amounts of foreign assistance, mainly from Australia, the United Kingdom, Japan, and multinational organizations. Grants and concessional loans were equivalent to about 13 percent of GDP during 1980-84.

III. Recent Developments

The period from 1980 to 1982 was marked by adverse developments in growth, investment and the balance of payments, largely caused by a 25 percent deterioration in the terms of trade. Real GDP stagnated between 1980 and 1982 and investment at constant prices declined by about 40 percent, while gross international reserves fell to a low of three months of imports in 1981. These difficulties led to the adoption of adjustment programs in 1981 and 1983 which were supported by two one-year stand-by arrangements from the Fund.

The basic strategy adopted in the program for 1983-84 aimed at strengthening the productive base of the economy and improving the balance of payments over the medium term. The relatively weak external demand conditions experienced in the early 1980s were expected to continue in 1983-84, and the planned recovery in investment was projected to lead initially to a widening of the current account deficit. The principal policy measures for 1983-84 were: a redistribution of public expenditure toward investment, while keeping the total fiscal deficit unchanged in 1983 and reducing it in 1984; an increase in interest rates; and the maintenance of a flexible exchange rate policy, following a 10 percent depreciation of the Solomon Islands dollar in August 1982. Also, a number of measures were introduced to stimulate investment and raise government revenues. Furthermore, expenditure control was to be strengthened, and the planning and implementation of public projects were to be improved.

Beginning from mid-1983, external economic conditions turned strongly and unexpectedly in favor of the Solomon Islands. As a result, the outcome in 1984 in terms of growth, the balance of payments and the overall fiscal deficit was significantly better than anticipated in the program, while inflation was higher than projected and the increase in investment was not achieved. The turnaround in the external environment was caused by shortfalls in the production of vegetable oils in major exporting countries. This brought about a steep rise in the world prices of copra and palm oil: the price of copra rose from US$319 per ton in the first quarter of 1983 to a peak of US$792 per ton in the second quarter of 1984, and the price of palm oil increased to US$860 per ton in the first quarter of 1984 from US$372 per ton a year earlier. Export prices of timber and cocoa also strengthened in 1984, while fish prices fell somewhat. It is estimated that, as a result of these price developments, the Solomon Islands' terms of trade improved by more than 30 percent in 1984 (Chart 1).

Responding to the substantial rise in the price, copra production increased by 50 percent in 1984. Most of this increase reflected higher production by smallholders, who have been adjusting the pattern of agricultural activities in line with relative price movements. In contrast, the output of palm oil and cocoa rose only moderately, because production is largely confined to plantations which have higher fixed costs than smallholders; production is therefore less responsive to short-term price fluctuations. The fish catch remained high, as continued good fishing conditions coincided with an expansion of the fishing fleet; and production and exports of timber rose significantly, partly reflecting better prices. In all, export volume increased by close to 15 percent in 1984 and the value of exports in SDR terms rose by more than 50 percent (Table 1).

Imports of food and consumer goods rose significantly in 1984 owing to the export-led increase in income, but imports of investment goods fell in real terms. The value of total imports, in terms of SDRs, rose by about 12 percent, most of which reflected an increase in volume. The trade account, which was approximately in balance in the period 1980-83, recorded a surplus of SDR 25 million in 1984. However, the deficit in the services account almost doubled, mainly due to larger profit remittances and an increase in overseas expenditure of companies operating in the Solomon Islands. The current account deficit nevertheless declined from close to SDR 20 million (13 percent of GDP) in 1983 to SDR 9 million in 1984 (5 percent of GDP). Official transfers remained unchanged at about SDR 14 million in 1984, while total foreign borrowing by both

Table 1. Solomon Islands: Balance of Payments, 1982-90

(In millions of SDRs)

	1982	1983	1984		1985	1986	1987	1988	1989	1990
			Program	Act.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
Exports, f.o.b.	52.8	58.0	68.9	89.4	79.0	88.0	94.0	100.0	110.0	117.0
Imports, f.o.b.	-53.6	-57.5	-63.2	-64.2	-70.0	-77.0	-81.0	-85.0	-91.0	-98.0
Trade balance	-0.8	0.5	5.7	25.2	9.0	11.0	13.0	15.0	19.0	19.0
Services and private transfers (net)	-19.0	-20.0	-23.6	-34.2	-39.5	-42.0	-45.0	-47.0	-49.5	-54.0
Current account	-19.8	-19.5	-17.9	-9.0	-30.5	-31.0	-32.0	-32.0	-30.0	-35.0
Official transfers	10.7	14.2	9.9	14.2	12.5	14.0	15.0	17.0	19.0	19.0
Nonmonetary capital (net)	10.8	9.6	9.2	7.0	7.0	10.0	11.0	13.0	15.0	16.0
Government (net)	(4.7)	(6.3)	(5.6)	(4.0)	(4.5)	(5.5)	(7.0)	(8.5)	(9.5)	(11.0)
Private sector (net)	(6.1)	(3.3)	(3.6)	(3.0)	(2.5)	(4.5)	(4.0)	(4.5)	(5.5)	(5.0)
Short-term capital and errors and omissions	2.2	0.5	--	-1.8	1.0	1.0	3.0	3.0	2.5	2.5
Overall balance	3.9	4.8	1.2	10.4	-10.0	-6.0	-3.0	1.0	6.5	2.5
Assets (increase -)	-14.9	-9.4	...	-1.7	10.0	7.0	4.0	1.5	-4.5	--
Liabilities	11.0	4.6	...	-8.7	--	-1.0	-1.0	-2.5	-2.5	-2.5
Of which:										
(IMF)	(1.6)	(1.0)	(...)	(-0.2)	(-0.4)	(-1.2)	(-1.3)	(-0.3)	(--)	(--)
(Euro-currency loan)	(9.1)	(4.7)	(...)	(-9.8)	(--)	(--)	(--)	(-2.5)	(-2.5)	(-2.5)
Memorandum items:										
Export volume (percent change)	-7.4	24.3	14.5	14.6	-2.3	8.0	3.0	--	5.0	1.0
Import volume (percent change)	-18.4	8.5	9.0	8.7	6.0	7.0	1.0	--	1.5	2.5
Terms of trade (percent change)	-0.8	-10.6	--	31.0	-12.5	0.5	--	2.0	--	--
Export unit values (SDRs)	1.5	-11.5	7.0	34.4	-10.0	3.5	4.0	7.0 1/	5.0	5.0
Import unit values (SDRs)	2.4	-1.0	7.0	2.6	3.0	3.0	4.0	5.0	5.0	5.0
Current account/GDP 2/ (percent)	-13.4	-13.3	-11.5	-5.2	-17.5	-15.7	-14.1	-12.2	-9.9	-10.2
Gross reserves										
(Millions of SDRs)	33.5	42.9	...	44.6	34.5	27.5	23.5	22.0	26.5	26.5
(Months of imports)	6	7	5	7	5	4	3	3	3	3
Debt service ratio 3/	...	4.2	3.5 4/	6.0 5/	8.1	9.0	9.4	11.0	11.1	10.9
External debt/GDP (percent)	30.3	43.9	27.5 4/	33.0	36.0	35.1	34.2	33.0	32.2	31.5

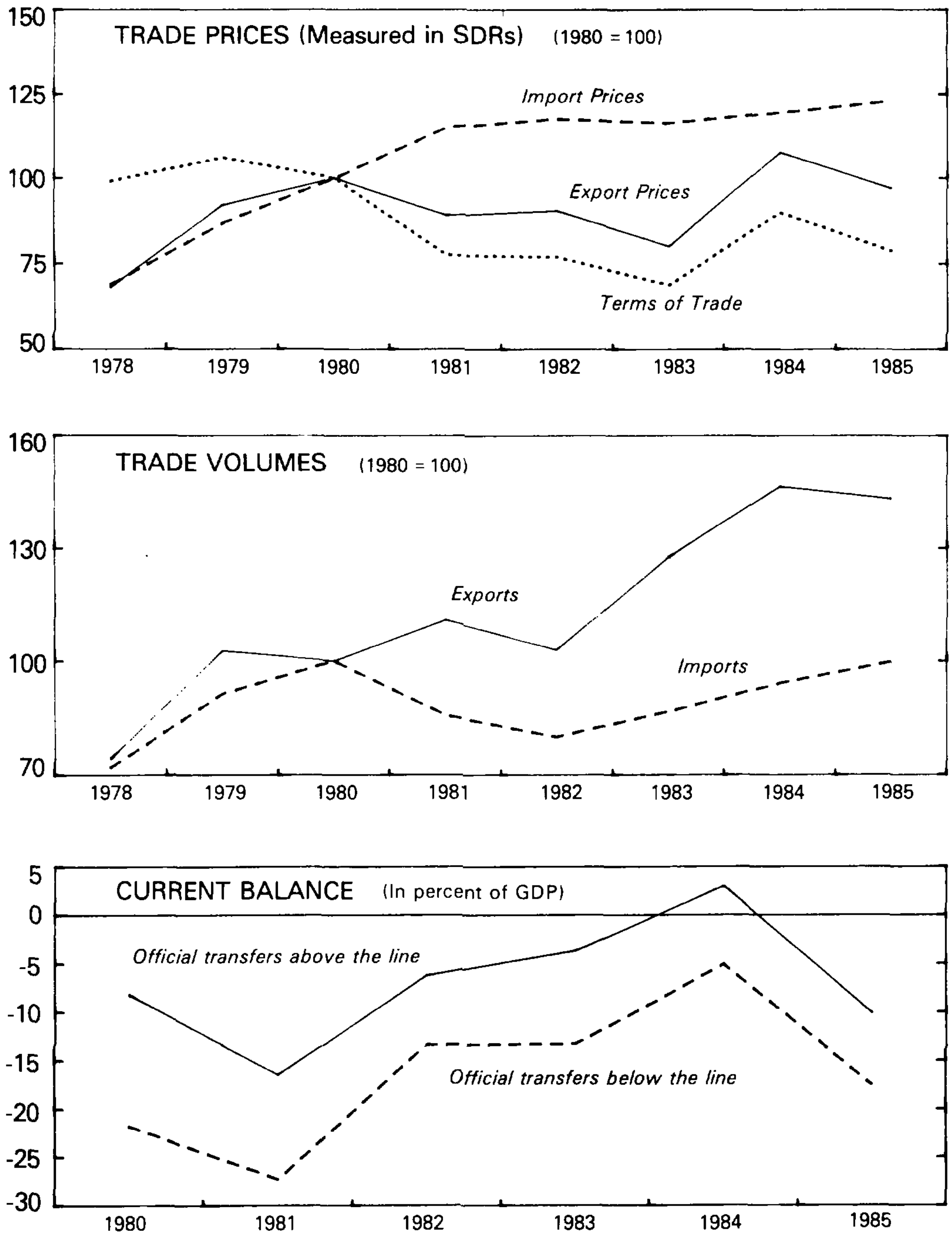
Sources: EBS/83/261; data provided by the Solomon Islands authorities; and staff projections.

1/ Reflects in part the change in composition of exports from frozen to canned fish.
2/ With official transfers below the line.
3/ In percent of exports of goods and services.
4/ Public debt only.
5/ Excluding early repayment of the US$20 million Euro-currency loan.

CHART 1

SOLOMON ISLANDS

TRADE AND PAYMENTS INDICATORS, 1978-1985[1]



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

[1] All figures for 1985 are staff estimates.

the public and private sectors declined. Virtually all of the official borrowing was at concessionary terms. The overall balance was in surplus by about SDR 10 million in 1984, and, by the end of the year, gross reserves amounted to the equivalent of seven months of imports.

Real GDP is estimated to have increased by about 15 percent in 1984, with real incomes in the monetized sector rising by as much as 21 percent (Chart 2). 1/ The large increase in GDP reflected partly the impact on incomes in the monetized sector of the sharp improvement in the terms of trade. Indicators of investment activity suggest that investment, at constant prices, declined by about 30 percent in 1984, implying that the windfall gains in income were absorbed mainly by higher levels of both private and public consumption.

Monetary growth was rapid in 1984 and was accompanied by an acceleration of inflation. Credit to the private sector expanded rapidly and this, combined with the large increase in net foreign assets, resulted in a surge in the growth of broad money by 36 percent, compared with a 19 percent rise in 1983. Inflation rose from 7 percent in 1983 to about 11 percent in 1984. Government revenue benefited substantially from the favorable external developments, as taxes on incomes and international trade rose markedly. However, there was also a large increase in current expenditure, mainly for wages and transfers, so that the recurrent balance showed only a small surplus. Capital expenditure and net lending fell by some 30 percent in nominal terms, mainly as a result of problems with project implementation. The overall fiscal deficit declined to the equivalent of 4 percent of GDP in 1984, from 11 percent in 1983.

IV. Report on the Discussions

1. Developments in 1985 and the immediate outlook

The consultation discussions took place against the backdrop of a reversal of much of the improvement in the external environment in the early months of 1985. By the end of May, the world price of copra had fallen to one half of its peak level in mid-1984, and the world prices of palm oil and cocoa were also significantly lower. Meanwhile, domestic demand remained strong, as a result of an acceleration in domestic credit expansion and the maintenance of high domestic producer prices of copra; the borrowing needs of the public sector were also

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1/ These estimates need to be interpreted with some caution: the estimate of GDP in the monetized sector is based on estimates of wages and salaries and of the operating surpluses of the business, government, and household sectors, while real GDP in the nonmonetized sector has been assumed to remain broadly unchanged in per capita terms. Official estimates of GDP by expenditure or industrial origin are not available.

large in the first part of 1985. With demand management on an expansionary course, the pressure on prices and the balance of payments increased. Inflation rose to 13 percent in the 12 months to April 1985, and net foreign assets declined by about SDR 6 million in the first 4 1/2 months of the year, offsetting more than half the gain in 1984. 1/

Reflecting the decline in world prices of vegetable oils, the terms of trade are now expected to deteriorate by some 13 percent in 1985. A small decline in export volumes is foreseen, due mainly to a reduction in exports of copra, reflecting a downward adjustment of the domestic producer price in the second half of the year. As a result of the adverse developments in the terms of trade and in export volume, real income in the monetized sector is expected to decline by about 14 percent in 1985, with total GDP falling by 8 percent. The rate of inflation is projected to be around 10 percent.

Total export value is now estimated to decline to SDR 79 million in 1985 from SDR 89 million in 1984, while imports are expected to be significantly higher than in 1984. The trade surplus is forecast to decline steeply from its 1984 level and the services account is projected to remain in deficit, at a level somewhat higher than in 1984. Based on these projections, the current account deficit is likely to increase from SDR 9 million in 1984 (5 percent of GDP) to about SDR 30 million in 1985 (17.5 percent of GDP). Inflows of foreign aid are expected to be broadly unchanged in 1985, as no substantial increase in public investment is foreseen. The overall balance of payments deficit is projected to be about SDR 10 million in 1985, implying a reduction in reserves from the equivalent of seven months of imports at the end of 1984 to five months by end-1985. While this level might appear comfortable, the authorities emphasize that, with the economy subject to magnified effects of cycles in the world economy, it is desirable to have a high level of reserves in relation to imports.

2. Medium-term outlook

The performance of the economy will continue to be closely linked to the external sector. The additional export capacity which is due to come on stream in the plantation and commercial fishing sectors during the next few years is not large. Total capacity of copra production is expected to increase by about 5 percent per annum from 1985 onward, owing to an expansion of the largest plantation, but, with smallholders accounting for the larger part of production, the export volume of copra is expected to continue to move closely in line with developments in the real producer price. Palm oil production is expected to attain its capacity limit (somewhat above the current level) in 1986. The fishing

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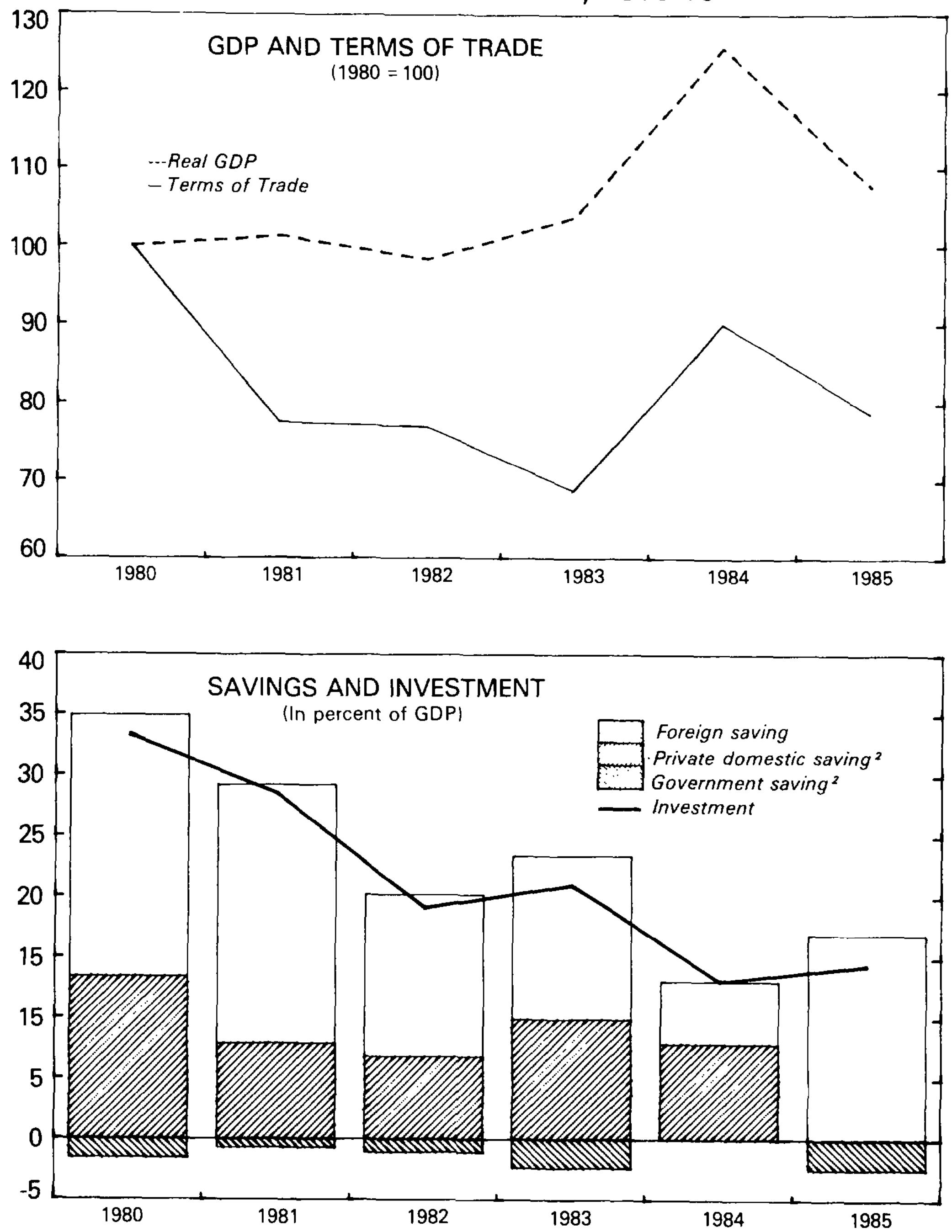
1/ Most recent developments indicate a slowdown in inflation, due to lower food prices, but a continuation of the decline in foreign reserves.

CHART 2

SOLOMON ISLANDS

REAL GDP, TERMS OF TRADE, SAVINGS AND INVESTMENT, 1980-85[1]



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

[1] All figures for 1985 are staff estimates.

[2] Government saving in 1984 and private domestic saving in 1985 are negligible.

fleet is expected to reach its maximum size by end-1985; however, a new fish cannery will start production in 1987, resulting in a shift in exports from frozen to canned fish and an increase in domestic value-added. The production of cocoa is projected to rise until 1989, but its share in total exports is expected to remain relatively small. An increase in the volume of timber exports is not expected, as the present level of production exceeds the maximum sustainable yield at the current rate of reforestation.

This outlook for productive capacity in the export sector suggests a potential for export volume growth of about 8 percent in 1986, but much lower growth, of about 2 percent, in subsequent years. Medium-term projections of commodity prices are necessarily subject to great uncertainties, but most forecasts suggest that prices were approximately at cyclical average levels in the second quarter of 1985 and will be maintained in real terms.

The outlook for foreign aid is also of crucial importance for the balance of payments prospects. The utilization of foreign assistance has been below its potential in recent years, but the authorities believe that, with improvements in budgetary planning and project implementation, a larger inflow is possible, though they are concerned about the increased tying of aid and the complexity of reimbursement procedures. Private capital inflows are expected to increase moderately to finance some of the above-mentioned investments in the export sector, notably the fish cannery.

Given these prospects, limiting debt service to an acceptable level and maintaining a bare minimum of reserves will impose a tight limit on growth. It seems likely that the resources available will be sufficient to finance import growth of no more than 1-2 percent per annum, well below the average rate of increase of 6 percent during 1978-1984, which was associated with trend growth of GDP of no more than 3.6 percent per annum.

3. Policy discussions

The present situation and the balance of payments outlook pose a twin challenge to economic policy: to prevent a deterioration in balance of payments in the short run beyond that implied by the return of export prices to more normal levels; and to promote growth of export capacity over the medium term faster than currently envisaged.

At the time of the consultation discussions, the authorities had just begun to reassess the current economic situation in the light of the change in the external environment, and policies had yet to be adapted to the new situation. The recent unfavorable developments in the balance of payments were initially regarded as largely self-correcting, reflecting the lagged response to the temporary boom in incomes from exports. Subsequently, the authorities have recognized a need to promote adjustment in the short run, and have recently introduced measures in a number of areas. For the medium term, the authorities are concerned about the low rates of investment and the prospects for growth and exports. It is with these concerns that the preparation of a development plan has been initiated to step up investment and, more generally, to provide direction to the policies over the medium term.

In concluding the 1983 Article IV consultation and reviewing the 1983/84 stand-by arrangement, Executive Directors emphasized the need for restraint in the growth of wages and salaries and for improvement in external aid flows. They noted the persistence of administrative problems in the implementation of development projects and in external aid reimbursement. Executive Directors also emphasized the importance of sustaining export profitability and the maintenance of positive real interest rates.

a. External policies

The authorities stated that the primary objective of exchange rate policy is to ensure competitiveness on the basis of adequate and stable profitability of the export sector over commodity price cycles. A related consideration is the effect of exchange rate changes on domestic prices. To promote stability in both profitability and prices, the authorities aim to avoid large, discrete changes in the exchange rate. The exchange rate has been determined on the basis of a basket of the currencies of the Solomon Islands' main trading partners. Between September 1982 and early 1984, a policy of flexible management of the exchange rate was pursued, resulting in a depreciation of the Solomon Islands dollar by about 15 percent in terms of the official basket and a real effective depreciation of some 8 percent (Chart 3). Following the substantial strengthening of the balance of payments, the flexible exchange rate policy was suspended in early 1984 and the Solomon Islands dollar was kept stable in terms of the official basket.

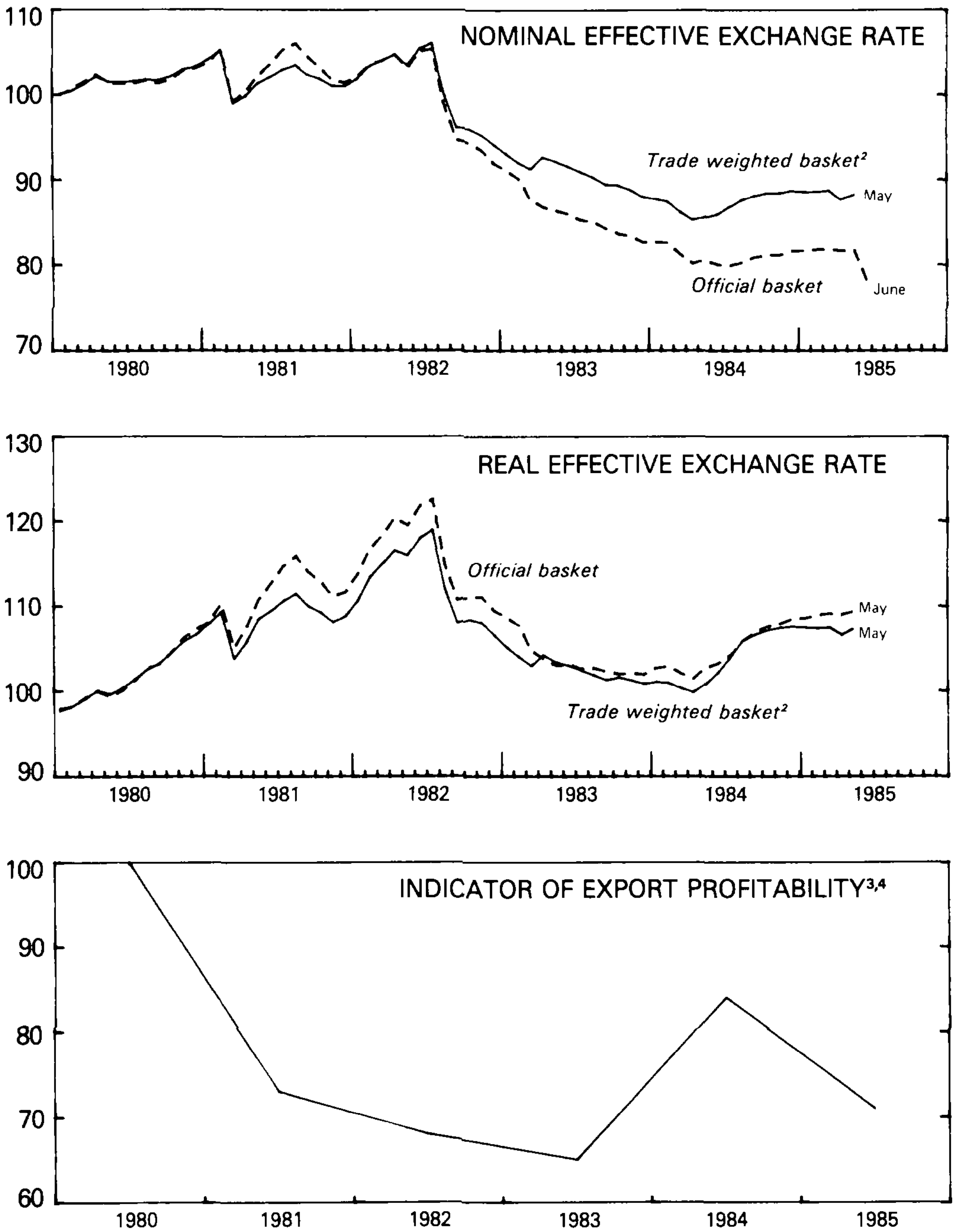
The staff expressed the view that exchange rate policy should not respond to short-run fluctuations in export prices, but should be guided by underlying trends in export profitability and the balance of payments. It was pointed out that the Solomon Islands dollar had appreciated by about 8 percent in real effective terms between April 1984 and March 1985, and that profitability in the export sector was coming under pressure. Although most commodity prices are now near cyclical average levels, at the exchange rates prevailing through May 1985, aggregate export profitability in 1985 would fall below the average of the last five years, close to the depressed levels of 1982-83. With the rate of inflation likely to continue to be above the rate of increase of export prices in 1986, profitability would decline further in the immediate future. These recent and prospective developments in export profitability and the less favorable balance of payments outlook have prompted the authorities to resume the flexible management of the exchange rate: the Solomon Islands' dollar was depreciated by

CHART 3

SOLOMON ISLANDS

EFFECTIVE EXCHANGE RATE AND PROFITABILITY INDICATORS, 1980-1985[1]

(January 1980 = 100)



Source: Staff calculations.

1 Increase represents an effective appreciation or higher profitability.

2 Includes major export competitors in addition to trading partners.

3 Ratio of export unit price index to CPI.

4 The value for 1985 is based on the assumption that the exchange rates of April 1985 are maintained during the remainder of 1985.

almost 8 percent against the official basket in June 1985, and the authorities intend to maintain a flexible exchange rate policy.

The situation in two export industries, copra and fishing, which together account for about one half of exports, deserves special attention. The domestic producer price of copra is determined by the Copra Board, the sole exporter of copra, on the basis of developments in world prices and domestic costs. The Copra Board took advantage of the high world prices prevailing between mid-1983 and mid-1984 to accumulate a large amount of reserves by raising the domestic producer price by less than the increase in the world price. However, even though the world price was falling rapidly in the second half of 1984 and in early 1985, the Copra Board continued to raise the producer price. Losses were small at first but increased to about 30 percent of the world price by the end of May 1985. At this rate of price support, reserves would be depleted in about one and a half years. The staff noted that, with the world price being close to its cyclical average in real terms at that time and projected to remain at about this level over the medium term, the Copra Board should not incur a loss. A substantial price adjustment was therefore needed.

With the world price having fallen by about 20 percent further in June-July, the Copra Board decided in July to reduce the producer price gradually over the next few months, so as to contain the loss to SI$2.5 million, equivalent to about a quarter of reserves, during the next 12 months. Achieving this objective, however, will require a substantial and quick reduction of the producer price. The staff believes that it is acceptable to provide a small amount of price support, given the change in the world price since May. The Copra Board's policy decision, however, needs to be reviewed within the next few months, and, if the lower price then appears to be a more permanent feature than currently envisaged, price support will need to be discontinued and the authorities will have to ensure the maintenance of adequate producer incentives through appropriate exchange rate action.

The fishing industry has incurred losses in the last two years despite substantial increases in the fish catch. To reduce costs, the Government has introduced a number of measures: these include a reduction in the export tax from 7.2 percent to 3.5 percent with effect from January 1, 1985, 1/ and the gradual replacement of high-wage foreign fishing crews by local fishermen over the next few years. The resumption of a flexible exchange rate management should help the fishing industry, but a return to profitability in the short run would require a significant increase in fish prices from present levels.

The authorities have pursued a prudent external borrowing policy, making limited use of commercial borrowing to supplement the flow of

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1/ Duties on fish exports were rebated in 1983 and 1984.

foreign aid (which has increasingly been in the form of soft loans rather than grants). Total external debt (both public and private) was equivalent to 33 percent of GDP in 1984; the stock of official debt was equivalent to about 20 percent of GDP. In 1981, the Government secured a US$20 million Euro-loan to boost its reserves; this loan was fully drawn down by 1983. With the balance of payments having improved sharply in 1984, the Government repaid the US$20 million Euro-loan toward the end of the year and arranged for a US$30 million line of credit at better terms, of which an amount of US$10 million was drawn down for the repayment of the earlier loan. The debt service ratio stood at 6 percent of exports in 1984. 1/ The authorities stated that they remain committed to a prudent external debt policy. The remaining balance of the current Euro-loan will be drawn down only if needed to cushion the effect of transitory shocks on the economy.

b. Monetary policy

During 1984, large amounts of liquidity were injected into the banking system through increased export earnings. The easing of the liquidity situation enabled banks to step up their lending: credit to the private sector increased by over 50 percent in 1984 and the pace of bank lending to the private sector increased further in the first part of 1985 (Table 2). The banks' excess liquidity in 1984 also eroded their profitability. To forestall a large deterioration in profits, banks were permitted to reduce rates on term deposits; lending rates, which are not regulated, declined somewhat in 1984.

A number of measures were introduced toward the end of 1984 to curtail the banks' ability to lend. First, the Government Shareholding Agency--a statutory corporation holding the Government's shares in various enterprises--was requested to refinance outside the banking system a SI$4 million loan from the Central Bank. Second, the Copra Board was requested to deposit a large part of its reserves with the Central Bank. Third, the Central Bank announced in December 1984 that the required ratio of liquid assets to liabilities would be raised to 25 percent from 15 percent, with effect from February 1, 1985. Despite these measures, banks' liquidity continued to be at high levels until mid-1985, when the decline in net foreign assets began to squeeze liquidity.

The authorities stated that monetary policy has been guided by the desire to prevent monetary conditions from constraining real growth. While being mindful of the adverse consequences of inflation, they indicated that a rate of inflation of about 10 percent would be acceptable, if that were the price of not constraining growth. Nevertheless, the authorities agreed with the staff that the growth of both narrow and broad money in 1984 had been excessive, and they were

1/ Excluding early repayment of the Euro-dollar loan.

Table 2. Solomon Islands: Monetary Survey, 1982-85 1/

(In millions of Solomon Islands dollars)

	1982	1983	Dec. 1984 Prog.	Dec. 1984 Actual	1985 March	1985 2/ Dec.
Net foreign assets	21.9	29.5	27.0	43.4	37.4	30.0
Domestic credit	29.7	30.4	39.0	38.4	43.7	48.5
	(22.7)	(2.4)	(10.3)	(26.3)	(44.7)	(26.3)
Central Government (net)	1.5	3.1	4.0	3.6	6.5	6.6
Provincial Government (net)	-0.3	-0.4	)	-1.0	-0.9	)
Statutory corporations	6.0	8.1	)	5.9	3.3	)
Private sector	22.5	19.6	) 35.0	29.9	34.8	) 41.9
	(5.1)	(-12.9)	(12.9)	(52.6)	(78.5)	(20.4)
Broad money	40.2	48.0	55.0	65.2	62.8	61.9
	(22.6)	(19.4)	(13.4)	(35.8)	(22.4)	(-5.0)
Narrow money	16.7	19.5	...	29.3	25.0	...
	(7.7)	(16.8)	(...)	(50.3)	(6.8)	(...)
Other items (net)	-11.4	-11.9	-11.0	-16.6	-18.3	-16.6
Memorandum item:						
Velocity of broad money 3/	2.7	2.6	2.4	2.5	...	2.5

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

1/ Figures in parentheses are growth rates in percent over the corresponding period of the preceding year.
2/ Staff projections.
3/ In relation to GDP of the monetized sector.

also concerned about the continued rapid growth of credit in the first part of 1985. They stressed, however, that a more effective control of credit developments would require a broader range of monetary policy instruments. In this context, the authorities noted that a proposed revision of the Central Bank law, if enacted, would permit the Central Bank to manage liquidity more flexibly through the issuance and repurchase of Central Bank bonds. For 1985, no targets for the growth of credit or money have been established, but banks have been urged to exercise caution in extending credit, in particular, for the financing of imports, and the most recent indications provided by the banks suggest that the demand for credit was slackening.

The staff pointed out that the expected decline in nominal incomes in the monetized sector in 1985 indicated the need for a reduction in the stock of money. Staff estimates suggest that the required decline in broad money would be of the order of 5 percent between the end of 1984 and the end of 1985. Accordingly, if the decline in net foreign assets is to be held to a maximum of SDR 10 million, credit growth should be no more than SI$10 million (26 percent) during 1985. With total domestic credit having already increased by some SI$5 million in the first quarter, the staff stressed the need for immediate action. The staff also observed that interest rates in real terms had become negative and that an upward adjustment would contribute to containing the demand for credit, stimulating savings and preventing the transfer abroad of nonresident funds.

The authorities agreed that further monetary measures were needed, and in June deposit rates were raised by 2-3 percentage points to up to 11 percent. At the same time, the interest rate on Central Bank funds provided to banks was raised by 2 percentage points; Government bonds with interest rates of 11-12 percent were issued, the proceeds of which were to be deposited with the Central Bank; and an additional portion of the Copra Board's reserves was withdrawn from the commercial banks and redeposited with the Central Bank.

c. Fiscal policy

Fiscal policy, as reflected in the annual budgets, has aimed at generating small surpluses on the current account and achieving high levels of public investment (Table 3). However, the fiscal outcome has fallen short of these objectives, largely because of weak expenditure control and problems in the planning and implementation of projects.

The fiscal outcome in 1984 was heavily influenced by the unexpectedly favorable external environment. Tax revenue was some 18 percent above the program estimate, and the recurrent balance showed a small surplus, but still only about one half the amount projected. Staff estimates indicate that, on the basis of cyclical average levels of export prices, the recurrent balance was in deficit by close to SI$1 million in 1984, compared with approximate balance in the recurrent

Table 3. Solomon Islands: Summary of Central Government Fiscal Operations, 1982-85

	1982	1983	1984			1985	
			Budget	Program	Prel. act.	Budget	Rev. Est.
			(In millions of Solomon Islands dollars)				
Total revenue	33.0	34.2	41.3	44.4	47.2	50.6	49.6
Tax revenue	29.4	28.9	35.0	36.9	43.6	43.9	43.6
(Income tax)	(10.8)	(10.6)	(11.2)	(...)	(14.1)	(13.3)	(13.3)
(International trade)	(17.2)	(17.1)	(22.0)	(23.1)	(28.4)	(29.2)	(28.9)
Nontax revenue	3.6	5.3	6.3	7.5	3.6	6.7	6.0
Current expenditure	34.6	38.5	39.6	42.4	46.4	48.5	55.4
(Wages)	(15.5)	(18.0)	(17.4)	(...)	(21.2)	(19.9)	(23.3)
(Subsidies and current transfers)	(12.4)	(12.3)	(13.4)	(...)	(14.8)	(17.0)	(18.1)
Current balance	-1.6	-4.3	1.7	2.0	0.8	2.1	-5.8
Capital expenditure and net lending	16.3	15.1	23.8	17.5	10.7	27.4	12.5
Overall balance	-17.9	-19.4	-22.1	-15.5	-9.9	-25.3	-18.3
Financing	19.4	17.8	22.1	15.5	9.4	25.3	18.3
Grants and foreign borrowing	13.0	13.7	15.0	12.5	7.0	24.8	12.8
Domestic borrowing	6.4	4.1	7.1	3.0	2.4	0.5	5.5
(Bank borrowing)	(4.2)	(1.6)	(...)	(1.0)	(0.5)	(...)	(3.0)
			(In percent of GDP)				
Memorandum items:							
Total revenue	20.8	19.0	18.2	23.0	20.7	22.1	21.6
Current expenditure	21.9	21.4	17.4	21.7	20.4	21.2	24.2
Capital expenditure and net lending	10.2	8.4	10.5	9.0	4.7	12.0	5.5
Overall balance	-11.3	-10.8	-9.7	-7.9	-4.4	-11.0	-8.0

Source: Data provided by the Solomon Islands authorities.

accounts in both 1982 and 1983, a deterioration equivalent to about half of one percent of GDP of the monetized sector. Current expenditure was 9 percent above the program estimate, due to an increase in wages of some 13 percent granted to government employees, higher transfers and subsidies to public enterprises, unexpectedly high inflation, and the national elections. The increase in tax revenue in 1984 was achieved despite continuing weaknesses in tax collection which are mainly due to shortages of trained staff. Nontax revenue declined markedly in 1984 mainly due to poor performance of some departmental enterprises. Capital expenditure and net lending in 1984 fell short of the programmed amount by about 40 percent, as few new projects were undertaken and delays were incurred in existing projects, largely due to shortages of engineers and construction equipment. The shortfall in investment was the main factor behind the lower overall deficit (4 percent of GDP) compared with the program estimate (8 percent of GDP). Domestic borrowing came close the program estimate, while the disbursement of foreign aid was less than expected despite measures adopted in 1983 to facilitate the flow of aid. 1/

The 1985 budget was approved only in April 1985, as the formulation of the budget was delayed by the national elections in late 1984. As in earlier years, the budget envisages a surplus on the current account and a sharp increase in capital spending, resulting in an overall deficit of some 11 percent of GDP. With the growth of revenue expected to slow down, the current surplus is to be generated by restraining the growth of current expenditure to about 5 percent. In the event, developments in the first part of 1985 were marked by further slippage in expenditure control, and continued administrative problems with respect to the reimbursement of development expenditure. As a result, bank borrowing by the Government increased well beyond the normal seasonal needs. In response to these developments, the Government is now putting administrative measures into effect to strengthen revenue collection, tighten expenditure control, and speed up external reimbursement.

Against this background, the mission discussed the likely fiscal outcome in 1985. Total revenues are estimated to be somewhat below the budget estimates, because of shortfalls in nontax revenue, though tax revenue is likely to reach the budgeted level. 2/ Even if tight control over expenditure is quickly re-established, total current expenditure is now projected to be 14 percent higher than budgeted, partly reflecting an 8 percent increase in government wages which took effect on January 1, 1985, but was not considered in the budget. The recurrent

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1/ These measures included the establishment by some donors of revolving funds for reimbursement of expenditure on development projects.

2/ Following the discussions, the tax on copra exports was reduced from 20 to 15 percent with effect from mid-July. This is not expected to have a significant impact on total revenues.

balance is now expected to show a deficit of about SI$6 million, indicating a further deterioration in the underlying position. While capital expenditure is projected to increase from its 1984 level, it is not expected to exceed the equivalent of 45 percent of the budget estimate. Based on these estimates, the overall deficit is expected to reach SI$18 million (8 percent of GDP). The authorities aim to hold bank financing to SI$3 million; this will require a substantial step up in the inflow of aid in the second half of the year, including elimination of the delays in external reimbursement incurred in the first part of 1985.

At this stage, the Government is not considering any major policy initiatives in the 1986 budget. However, it intends to carry out a complete review of the tax and tariff systems and to improve budget planning and control. It also intends to break with the longstanding practice of presenting unrealistically high estimates for capital expenditure and utilization of foreign aid in the budget. Based on the current status of several large projects, however, some increase in public investment can be expected in 1986. The staff argued that, in formulating the 1986 budget, the Government should consider an adjustment and rationalization of import tariffs and measures to raise revenue from exports of timber; the tariffs charged by public enterprises would also need to be raised. Further, the staff stressed the need for restraint in public sector wages and allowances and in transfer payments and subsidies.

d. Investment and development planning

Private investment, both foreign and domestic, has been impeded by the slowness in developing the economy's infrastructure, administrative barriers to foreign investment and the low profitability in the export sector in the period 1981-83; in some instances, land tenure problems have also complicated or delayed projects, although the traditional land tenure system has been adapting to changing economic circumstances. The authorities observed that, as regards administrative barriers to foreign investment, the new Foreign Investment Law passed in 1984 has somewhat liberalized the restrictive provisions on the employment of expatriates. The staff expressed the view that it seemed doubtful, however, that the new law, seen in its entirety, has substantially changed the climate for foreign investment. The role of foreign investment is now being reconsidered in the context of formulating the development plan.

The declining investment rates and the insufficiency of infrastructure have also brought new emphasis to development planning. In the view of the World Bank, development planning has been impeded by (i) the absence of an appropriate medium-term framework, resulting in an ad hoc focus on individual projects in the context of the annual budget, (ii) insufficient links between the recurrent and capital budgets, and

(iii) shortages of qualified staff. The World Bank believes that, with improvements in the planning process, development expenditures financed by foreign concessional assistance could be raised substantially.

The Government recognizes these difficulties and is currently preparing a development plan for a period of five years, which is to be presented to the Cabinet in July/August 1985 and to Parliament later in the year. The main purposes of the plan are to identify projects in the areas of agriculture, natural resources and education, and to ensure sectoral consistency of development spending. However, progress in preparing the plan has been slow, due to manpower constraints and the need to reconstitute the planning machinery after a hiatus of several years in planning. The authorities were, therefore, not in a position to discuss the plan in detail. Implementation of projects identified in the plan is not expected to start before 1987. The authorities noted that shortages of skilled manpower will continue to constitute the most binding constraint on development, even though efforts are currently being made to expand the number of skilled workers, chiefly through recruitment of expatriates. Foreign aid will continue to be the main source of capital for public investment expenditure. The authorities recognize that improvements in project identification and presentation as well as other administrative changes will be needed to step up the use of foreign aid.

V. Staff Appraisal

Solomon Islands is a small island economy in the early stages of development. Its dependence on exports of a few primary commodities has made the economy highly susceptible to fluctuations in export prices. Solomon Islands' endowment of natural resources is substantial: some are yet to be tapped, while restraint and better management is called for in the exploitation of forestry resources. The development of the infrastructure has been impeded by the country's scattered topography. The economy has also suffered from shortages of skilled manpower, while unskilled labor has been plentiful. The use of foreign aid has been substantial but still below its potential.

External developments in 1984 were highly favorable to the Solomon Islands, but the immediate outlook for the balance of payments is less auspicious. The world prices of copra and palm oil have returned to close to average historical levels, and, as a consequence, the Solomon Islands' terms of trade are projected to deteriorate by some 13 percent in 1985. Profitability in the export sector has been squeezed by falling export prices and rising inflation, and export volumes are expected to decline somewhat in 1985. At the same time, import volumes are expected to continue to rise substantially in 1985. The immediate prospects are therefore for a marked widening of the current deficit and a decline in reserves. Against this background, the staff welcomes the resumption of the flexible management of the exchange rate. Providing adequate price incentives over the medium term is a key element in ensuring continued growth of export production, and exchange rate policy should not be influenced by transitory factors affecting export prices. The staff also welcomes the authorities' intention to maintain their prudent external debt policy.

A significant part of the windfall in earnings from copra exports in the first half of 1984 was absorbed by the Copra Board to replenish its reserves. While the world price of copra began to decline in the middle of 1984, coming close to a cyclical average level in the second quarter of 1985, the domestic producers price was kept high. As a result, the Copra Board has been incurring large losses. Even though a policy decision has now been taken, specifying a limit for the decline in reserves in the next 12 months, recent developments indicate the need to establish clear objectives for the Copra Board's pricing policy. With exchange rate policy geared to the underlying trends in export profitability and the balance of payments, the principal objective of the Copra Board should be to cushion producers' income against fluctuations in the world price. The Copra Board should accumulate reserves at times of cyclically high prices and provide support to producers only during periods of downswings in prices below sustainable levels. Further, domestic production costs should not be permitted to dominate pricing decisions, lest the stabilization scheme become a vehicle of subsidizing production.

Credit expansion has been rapid and has exacerbated the pressure on prices and the balance of payments in 1985 originating from the temporary increase in incomes in 1984. The delay in applying restraint on this front reflected the authorities' desire not to constrain real growth and, when measures to curb the growth of money were introduced toward the end of 1984, their effectiveness was reduced by the bluntness and inflexibility of the available instruments of monetary policy. The formulation of monetary policy is no doubt complicated by the large externally induced fluctuations in reserves, but a consistent expansionary bias increases the burden on other macroeconomic policies and runs the risk of sudden shifts in policy when adjustment can no longer be postponed. The main objective for 1985 must be to exercise tight control over credit developments both to prevent a further deterioration in the external position and to contain inflation. The staff therefore welcomes the recent measures designed to curtail the growth of credit. These measures include an upward adjustment of interest rates which is warranted by the rise in inflation. It is also important that the range of monetary policy instruments available to the Central Bank be widened to enable more flexible control over banks' liquidity.

Fiscal policy has suffered from weaknesses in budget planning and control, and budget estimates have been unrealistic with respect to both current and capital expenditures. The resulting difficulties in monitoring fiscal developments were aggravated by slippage in tax administration and expenditure control, and Government borrowing was a major factor contributing to the rapid growth of credit in the first part of 1985. In these circumstances, a strengthening of revenue administration and expenditure control is of immediate importance. In formulating the 1986 budget, the authorities will need to make every effort to restrain the growth of salaries and allowances and of transfers. While the staff strongly supports the authorities' intention of reviewing the entire structure of taxes and tariffs, the fiscal situation makes it undesirable to delay measures until this study is completed. The largest scope for raising revenues appears to be in the areas of import tariffs, where there are numerous exemptions, and exports of timber; public enterprises will also need to adjust their tariffs. Furthermore, measures are needed to strengthen budgetary control and budgetary planning, with a view to providing more realistic budget estimates.

Looking to the medium term, no sizable build-up in export capacity is currently envisaged, implying that external pressure is likely to be a feature of the next few years. In these circumstances, particular importance attaches to the design of policies to promote investment. This requires improvements, in particular, in the areas of public investment and development planning, foreign private investment and manpower policies, and the maintenance of adequate profitability in the export sector.

The staff supports the authorities' request to hold the next consultation on the standard 12-month cycle.

APPENDIX I

Solomon Islands - Fund Relations
(As of June 30, 1985)

(Amounts in millions of SDRs, unless otherwise indicated)

I. Membership Status

(a)	Date of membership:	September 22, 1978
(b)	Status:	Article VIII

(A) Financial Relations

II. General Department

(a) Quota:	SDR 5.0 million		
(b) Total Fund holdings of SI dollars: (as of June 30, 1985)	Amount	Percent of quota	
	7.5	149.3	
(c) Fund credit:	3.0	59.2	
Of which: Credit tranches	1.4	27.2	
CFF	1.6	32.0	
(d) Reserve tranche position:	0.5		
(e) Lending to the Fund:	None		

III. Current Stand-by and Special Facilities

(a) Current stand-by or extended arrangement — None

(b) Previous stand-by arrangements during the last 10 years

I.	(i)	Duration:	June 22, 1983-June 21, 1984
	(ii)	Amount:	SDR 2.4 million
	(iii)	Utilization:	SDR 0.96 million
	(iv)	Undrawn balance:	SDR 1.44 million
II.	(i)	Duration:	May 29, 1981-May 28, 1982
	(ii)	Amount:	SDR 1.6 million
	(iii)	Utilization:	SDR 0.8 million
	(iv)	Undrawn balance:	SDR 0.8 million

(c) Special facilities
Compensatory financing: SDR 1.6 million in respect of an export shortfall for the period ended June, 1982; approved by the Board on October 25, 1982 and purchased on October 28, 1982.

IV. SDR Department	Amount	Percent of allocation
(a) Net cumulative allocation:	0.65	100.0
(b) Holdings:	1.06	161.6
(c) Current Designation Plan:	--	--

V. Administered Accounts

(a) Trust Fund loans:	None
(b) SFF Subsidy Account:	None

VI. Overdue Obligations to the fund

None

(B) Nonfinancial Relations

VII. Exchange Rate Arrangement

The exchange rate is determined daily on the basis of a currency basket; market rate of US$1 = SI$1.501 on June 28, 1985.

VIII. Last Article IV Consultation

Staff discussions were held between October 18 and November 1, 1983. The Staff Report (EBS/83/261) for the 1983 Article IV consultation and review under the stand-by arrangement was discussed by the Executive Board on January 9, 1984. The 1983 Article IV consultation was conducted after a 15-month interval.

IX. Technical Assistance

The Central Banking and Fiscal Affairs Departments and the Bureau of Statistics have provided technical assistance in the areas of monetary management, financial management system of the Government, provincial taxation, and in balance of payments and general statistics. In early 1985, the Bureau of Statistics sent two missions to provide technical assistance in general economic data and government finance statistics. The Fund is currently providing two experts under the CBD Technical Assistance Program serving as Operations Manager and Research Manager to the Central Bank of Solomon Islands. The Research Manager has been appointed to the position of Advisor to the Governor of the Central Bank of Solomon Islands effective June 1985.

X. Resident Representative None

Solomon Islands: Basic Data

Area:	27,556 square kilometers
Population (1984):	260,000
Population growth:	3.5 percent
GDP per capita (1984):	SDR 675

	1982	1983	1984 Program	1984 Actual	1985 Staff Proj.
Output and prices					
(Annual rate of change in percent)					
Real GDP	--	4.8	5.0	14.9	-8.0
Monetized sector	-3.0	5.6	...	21.1	-14.4
Consumer prices (annual average)	12.5	7.3	6.0	11.0	10.0
Money and credit					
(Annual rate of change in percent) 1/					
Broad money	22.6	19.4	13.4	35.8	-5.0
Total domestic credit	16.8	1.7	10.3	16.7	16.1
Credit to private sector	3.4	-7.2	8.2	21.5	18.4
Credit to the government	12.8	4.0	2.1	1.0	4.6
Public finance					
(Annual rate of change in percent)					
Total revenue	10.7	3.6	17.5	38.0	5.1
Total expenditure	10.2	5.3	8.1	6.5	18.9
Current expenditure	12.3	11.3	6.3	20.5	19.4
Capital expenditure and net lending	5.8	-7.4	12.9	-29.1	16.8
Foreign trade					
(Annual rate of change in percent)					
Export volume	-7.4	24.3	14.5	14.6	-2.0
Export unit value (SDRs)	1.5	-11.5	7.0	34.4	-10.0
Import volume	-18.4	8.5	9.0	8.7	6.0
Import unit value (SDRs)	2.4	-1.0	7.0	2.6	3.0
Terms of trade	-0.8	-10.6	--	31.0	-12.5
Balance of payments (SDR million)					
Exports (f.o.b.)	52.8	58.0	68.9	89.4	79.0
Imports (f.o.b.)	-53.6	-57.5	-63.2	-64.2	-70.0
Trade balance	-0.8	0.5	5.7	25.2	9.0
Current account balance 2/	-19.8	19.6	-19.5	-9.0	-30.5
Overall balance	3.9	4.8	1.2	10.4	-10.0
Gross international reserves					
(End of period)					
In millions of SDRs	33.5	42.9	...	44.6	34.5
In months of c.i.f. imports	6	7	5	7	5
Exchange rates					
Solomon Islands dollar/SDR 3/	1.153	1.279	...	1.317	...
Nominal effective exchange rate 3/ 4/	94.2	88.0	...	88.7	...
Real effective exchange rate 3/ 4/	106.6	100.8	...	107.5	...
Selected financial ratios (in percent)					
Current account/GDP 2/	-13.4	-13.3	-11.5	-5.2	-17.5
Government budget deficit/GDP	-11.3	-10.8	-7.9	-4.4	-8.0
External debt/GDP 5/ 6/	30.3	43.9	27.5 7/	33.0	36.0
External debt service ratio 6/ 8/	2.1	4.2	3.5 7/	6.0 9/	8.1
Official grants and concessional loans/GDP	10.4	14.0	9.8	10.5	10.3
Official grants and concessional loans/ imports of goods and services	18.4	21.5	...	15.5	13.9

Sources: Data provided by the Solomon Islands authorities; and staff estimates.
1/ In relation to stock of broad money at beginning of period.
2/ With grants below the line.
3/ End of period.
4/ Trade and competitor weighted.
5/ Total external debt.
6/ Including IMF.
7/ Public debt only.
8/ Total interest plus amortization as a proportion of exports of goods and services.
9/ Excludes early repayment of the US$20 million Euro currency loan; with this, the ratio would have been 25.1 percent.

World Bank Group Operations in Solomon Islands

(As of April 30, 1985)

Summary

Beneficiary	Purpose	Amount US$ mn.	Date of Approval	Disbursed	Terms
1. Development Bank of Solomon Islands (DBSI)	Relending	1.5	1981	0.58	IDA
2. Government of Solomon Islands	Primary education	5.0	1982	3.02	IDA
3. Government of Solomon Islands	Rural services	3.5	1984	0.01	IDA
4. Government of Solomon Islands	Guadalcanal road project	2.0	1985	--	IDA
	Total	12.0		3.61	

Project Description

1. The project will assist the DBSI in providing finance for investments in all sectors of the economy for the period 1981-83. The AsDB is the lead cofinancier for this operation.

2. The project supports government development plans in the education sector. It assists the Government in helping provinces and communities to 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.

3. The project, which is co-financed by the AsDB, concentrates on development in the rural areas. It will assist the Government in establishing an agricultural infrastructure which would support the needs of the rural community. Its main objectives are to create an opportunity to develop land and to provide agricultural support services to small farmers.

4. This project is co-financed with the AsDB and the OPEC Development Fund. Its main objective is to upgrade maintenance of the main road on Guadalcanal.

Technical assistance:

The IBRD provides technical assistance to Solomon Islands through its standard lending operations for projects as well as in the context of its economic analysis.

Recent Economic Missions:

Economic mission, October 1983.

Solomon Islands - Statistical Issues

The main sources of statistics are the Central Bank and the office of the Government Statistician in the Ministry of Finance. Substantial progress has been made in recent years to establish an adequate statistical base. Nevertheless, considerable problems remain, notably in the areas of the national accounts, production, prices, wages and public finance. In some of these areas, it has been necessary to include staff estimates in the data presented.

1. Outstanding statistical issues

a. National accounts, production and prices

Statistics on national income in the monetized sector are available, but national accounts by industrial origin and expenditure category are not compiled. The data on GDP in the nonmonetized sector are very rough estimates. Statistics on production of major agricultural commodities are available but there is no information on manufacturing activity. The price index used pertains to Honiara only and the weights are outdated, but they are being revised. Only partial information is available on wages in the private sector.

A technical assistance mission visited Honiara in January 1985 and reviewed the methodologies underlying the compilation of the statistics on the national accounts, production, prices, and external trade. A report containing recommendations in these areas was submitted to the authorities in May 1985.

Regarding the national accounts, the mission recommended that the scope of data be expanded to encompass estimates of GDP by industrial origin and by expenditure categories. Subsistence agriculture is estimated to account for more than 50 percent of GDP but the underlying production estimates are extremely weak, being based on data for calorie intake for other developing countries and population growth for the Solomon Islands. Although some surveys on household income and expenditure have been conducted during 1981 and 1982, the results have not been processed due to the lack of technical expertise.

The mission suggested that price indices be compiled for at least two other major population centers and that a weighted average be constructed to represent the whole country. Work is underway in revising the base period of the Honiara retail price index to 1982.

The mission also suggested that the authorities begin the collection of price data in respect of the major export and import commodities at the wholesale level, although the computation of a wholesale price index has to be deferred to a later stage due to shortages of staff.

b. Monetary accounts

The monetary statistics as presented in the IFS differ from those shown in this report, which follow the presentation by the Central Bank of Solomon Islands (CBSI) in its Annual Reports. The principal difference between these two presentations are with respect to the CBSI's foreign liabilities and the CBSI's claims on the Government (net). This difference is mainly due to the treatment of a US$20 million Euro-dollar loan in 1981 and a US$30 million Euro-currency credit line made available in 1984. 1/ In both cases, the official borrower is the Government but the counterpart funds of disbursements are deposited in a blocked account with the Central Bank. In reporting to the Bureau of Statistics, the CBSI shows the movements in the counterpart funds indistinguishably from other government deposits, while in its Annual Reports, these are shown as changes in its foreign liabilities. For purposes of IFS presentation, it would be desirable to identify the counterpart funds and to classify them as such rather than as foreign liabilities of the CBSI or as the latter's deposit liabilities to the Government. In addition, IFS nets out the Fund-related accounts, as the Treasury IMF accounts are classified under CBSI's claims on the Government, and treats certain nonmonetary assets and liabilities differently.

c. Government finance

Statistics on the consolidated public sector are not compiled, as government finance statistics are available only for the Central Government.

The Government finance data presented are derived from budget documents.

There are two major problem areas in Central Government finance statistics: the present system of reporting results in some improper classification of current expenditure as capital expenditure and vice versa; and the monetary survey statistics on government bank borrowing differ from those recorded in government accounts.

The unavailability of data on the operations of provincial governments is of particular concern since the trend toward devolution is increasing. This has resulted in a larger transfer of financial resources from the Central Government to the provincial governments who are also increasingly borrowing from the banking system.

The 1984 Government Finance Statistics Yearbook contains institutional derivation and the main statistical tables for the years 1975 through 1978. A technical assistance mission in government finance statistics was undertaken in February 1985. As a result of this visit, the full range of tables for 1983 will be available for publication in the 1985 GFS Yearbook. It is also expected that data for the missing

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1/ This explains also the difference between the overall balance of payments shown in this report and in IFS.

years will be provided in time for publication of that issue. The report of the technical assistance visit, which was submitted to the authorities recently, made recommendations to improve upon all the major problem areas in government finance statistics.

d. External sector

Balance of payments and trade statistics are available on a regular and timely basis. The latest data published in Balance of Payments Statistics relate to 1983. The general statistics mission in January 1985 reviewed the methodology underlying the construction of the export and import unit value indices and suggested revised procedures for improving the import unit value index.

2. Coverage, Currentness, and Reporting of Data in IFS

A country page for Solomon Islands was introduced with the July 1985 issue of IFS. The table below shows the currentness and coverage of data published for the Solomon Islands in this issue. These data are based on reports sent to the Fund's Bureau of Statistics by the Central Bank of Solomon Islands, which have been provided on a timely basis.

Status of IFS Data

		Latest Data in July 1985 IFS
Real Sector	- National Accounts	1982
	- Prices: consumer prices	December 1984
	- Production	n.a.
	- Employment	n.a.
	- Earnings	n.a.
Government Finance	- Deficit/Surplus	1978
	- Financing	1978
	- Debt	1978
Monetary Accounts	- Monetary Authorities	December 1984
	- Deposit Money Banks	December 1984
	- Other Financial Institutions	September 1984
External Sector	- Merchandise Trade:	
	Value - Exports	September 1984
	Value - Imports	October 1984
	Unit Values (exports)	1984 Q3
	- Balance of Payments	1983 1/
	- International Reserves	May 1985
	- Exchange Rates	March 1985

1/ Data for 1984 have been received recently and will appear in the September 1985 issue of IFS.