TRANSITION FINANCE 2020
Solomon Islands

As part of its Transition Finance work stream and through its "Assessing, Benchmarking and Counselling" (ABC) approach, the DAC/OECD is carrying out several country pilots in countries facing different transition challenges as they move through the development continuum. The Solomon Islands country pilot looks particularly at the transition challenges faced by a SIDS country scheduled to graduate from the least developing country (LDC) status.

ASSESSING

The substantial economic and social progress achieved by Solomon Islands over the past decade puts the country on track for LDC graduation by 2024. Between 2000 and 2019, its Gross National Income (GNI) per capita doubled from USD 1 010 to USD 2 020 and simultaneously the country also show major achievements in terms of human development (e.g. its Human Asset Index (HAI) reaches 74.8, over the 66 threshold[1], allowing the country for a recommendation to be graduated).

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

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

BENCHMARKING

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

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

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[1] The three criteria for LDC graduation are a GNI per capita of 1 230 or above; a HAI of 66 or above; and an EVI of 32 or below. The graduation thresholds, as determined by the Committee for Development Policy (CDP), must be met for any two of the three criteria in two consecutive triennial reviews. Alternatively, the GNI per capita of the country is at least twice the graduation threshold in two consecutive triennial reviews (income-only criterion).

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

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

COUNSELLING

Last but not least, Solomon Islands' development partners have a crucial role to play supporting the implementation of the country's National Development Plan and its "smooth transition" strategy for LDC graduation. To help the Solomon Islands Government achieve these two objectives, DAC providers along with other development partners should use their ODA strategically to implement a combination of measures along the three following dimensions:

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

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

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