SOLOMON ISLANDS BUDGET 2011

DRAFT BUDGET STRATEGY AND OUTLOOK

CIRCULATED BY
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FOR THE INFORMATION OF HONORABLE MEMBERS
ON THE OCCASION OF THE BUDGET 2011

Contents

Section 1 - Introduction

The 2011 Budget represents a fundamental shift in the way in which the Government will manage the finances of this country. The Consolidated Budget – comprising the Recurrent Budget and the Development Budget – strikes the appropriate balance between providing funding to deliver services to all Solomon Islanders, while at the same time ensuring the country's ongoing financial stability. Appropriated expenditure will total a record $2.2 billion, including nearly half a billion dollars allocated to new development projects. At the same time, strong revenue collection will enable the Government to deliver a surplus of $24 million as well as providing $53 million in contingency funding ($26.5 million each to both the recurrent and development budgets) to meet unforeseen spending needs throughout the year. This is the first time that the Government has budgeted to both deliver a surplus, while at the same time ensuring that the Budget is truly fully funded.

In addition to delivering a fiscally responsible budget in 2011, the Government is in the process of implementing a range of new systems and processes that will significantly strengthen financial management and controls through the year and in the years ahead. These improvements are a critical step in enabling the Government to make efficient decisions based on accurate and up to date information.

To date, the Government has implemented upgraded systems in the areas of financial management, payroll and budgets. These systems will allow the Government to accurately budget for its spending needs through the year and monitor ministries' month by month to ensure that they are implementing the Government's policy as directed. For the first time, the Government will have both the systems and processes to hold ministries to account for their financial and operational performance.

Through the course of 2011 the Government will use the newly established links between the upgraded financial management system and the budget system to track each ministry's spending against its budget. Where a ministry has exhausted its available budget for a specific budget line, government systems will prevent that ministry from spending any more money on that line item. In the event a ministry cannot manage within its budget for the year, that ministry will be required to justify to Cabinet its financial performance.

For the first time, the Government will issue individual ministries with accounting warrants for payroll. These changes place a cap on the payroll and make ministries explicitly accountable for managing their budget. As with their other charges expenditure, ministries that cannot manage within their payroll budget will be required to seek the approval of Cabinet for additional funding.

Delivering on the Government's Policy Priorities

The 2011 Budget clearly demonstrates how the Government will deliver on the major aspects of its policy platform. The Government has provided funding for $417.7 million in new development projects. This is an increase of $122.7 million (or 41.6 per cent) on the 2010 Budget. In addition, there is an extra $120.8 million in new funding for the recurrent budget to enable ministries to maintain service for the people of the Solomon Islands. As outlined in the Government's Policy Translation and Implementation Document, the key priorities are:

- Reconciliation and Rehabilitation;
- National Security and Foreign Relations;
- Infrastructure Development;
- Social Services Development;
- Economic and Productive Sector Development; and
- Assistance for Civic Affairs.

Full details of new spending in the 2011 Budget are set out in Section 5: New Spending Measures.

Section 2 - Financial Management and Budget Reform

The Government's public financial management reform priority is to increase public and donor confidence in the Government's public finance and systems and processes.

One of the key roles of the Ministry of Finance and Treasury is to allocate funding to Ministries to deliver services to the people. To this end, the NCRA Government is embarking on a comprehensive budget reform starting with the 2011 Budget. The overarching reform goals are to reduce public waste and increase efficiencies in public expenditure; ensure ministries are properly resourced to deliver services; to build infrastructure; and to lay the foundations for growth.

To drive these improvements, the Government has established the Public Expenditure Analysis Section (PEAS) in the Budget Unit. The PEAS Section, supported by the World Bank, will commence a Public Expenditure Review (PER) in 2011. The PER process will also be used to build the capacity of PEAS to provide public expenditure analysis needed to inform the budget reforms into the medium term. Ultimately, the outcomes of this process will include greatly enhanced decision making in respect to the allocation of funds and to establish stronger accountability for the use of public funds. These reforms will ensure public money is spent on policy priorities and that funded activities achieve desired results and outcomes.

This work commenced with the 2011 Budget with the introduction of a series of changes which were aimed at ensuring greater involvement of Cabinet Ministers and their Ministries in the development of the Budget, more transparency around the process and greater levels of accountability for key stakeholders in the process. These changes included:

- **Budget consultations with line Ministries**, facilitated by the Minister for Finance, to discuss the 2011 Consolidated Budget. The Minister was supported in these discussions by officials from the Ministry of Finance and Treasury, the Prime Minister's Office, the Ministry of Public Service and the Ministry of Development Planning and Aid Coordination. Discussions covered budget baselines, payroll issues and Ministry bids for additional funding. To assist with the discussions the Minister was provided with an information and analysis pack for each Ministry which included Ministry expenditure analysis (from 2006 to current), key points on Ministry baselines and bids and a list of supported bids, including reasons for support.

Ministries were provided with the expenditure analysis to facilitate the discussion.

- **Budget Cabinet deliberations were supported by an abridged Budget pack** which for the first time allowed Cabinet to view and consider the Consolidated Budget, that is, both the Recurrent and Development Budgets in the same format and at the same time. This process also allowed Budget Unit to factor in and turn around changes made by Cabinet to the Budget in very short timeframes, providing Cabinet with the opportunity to further consider changes requested.
- **2011 Budget Accounting Warrants for the Payroll Budget** will be distributed to Ministries for the first time. In previous years, as the payroll budget was administered centrally by MoFT, line Ministries have not been held accountable for their payroll budgets. The issuing of Accounting Warrants for the Payroll Budget now makes line Ministries explicitly accountable for the management of their Payroll Budgets. Line Ministries will be supported in this task of managing their payroll budgets by MoFT through the use of the enhanced payroll system, Aurion. In combination with this assistance, MoFT now has greater capacity to monitor and scrutinise the payroll budget and control expenditure through the integration of the payroll, financial management and budget systems.

While this was the first step in what will be a program of reforms that will be achieved over the next few years, it represents an important first step in building engagement between central Government and line ministries. These reforms will, over the coming years, facilitate much greater engagement between central agencies and line ministries on appropriate resourcing levels and performance expectations.

A further area of reform in 2011 is the establishment of Forward Estimates into the Consolidated Budget. This will support forward planning and prioritising of expenditure in the knowledge of the level of financial resources that are likely to be available in the medium term.

The Government's human resource, financial management and budget system capacity is critical to the implementation and maintenance of reforms. In 2009 work was focused on implementing a new payroll management application (Aurion) and a new Budget Management System. This work continued in 2010 and provided a number of tangible benefits including providing the Government with a greater and more detailed understanding of its workforce and a capacity to more accurately budget for current and future payroll needs.

In 2010 work began on the revision of the Chart of Accounts and the implementation of an upgraded Financial Management Information System (FMIS). This work will continue into 2011 with critical components including automating links between the payroll and budget systems and the FMIS due for completion in the second half of the year. These initiatives will enable the Treasury Division and Budget Unit of the Ministry of Finance and Treasury to provide enhanced and timely financial services and support to the whole of government, will provide greater controls and management of expenditure, will facilitate more rapid production of budget documentation and will allow for greater responsiveness and legibility to Cabinet and to the Government more broadly.

Section 3 - Economic Outlook

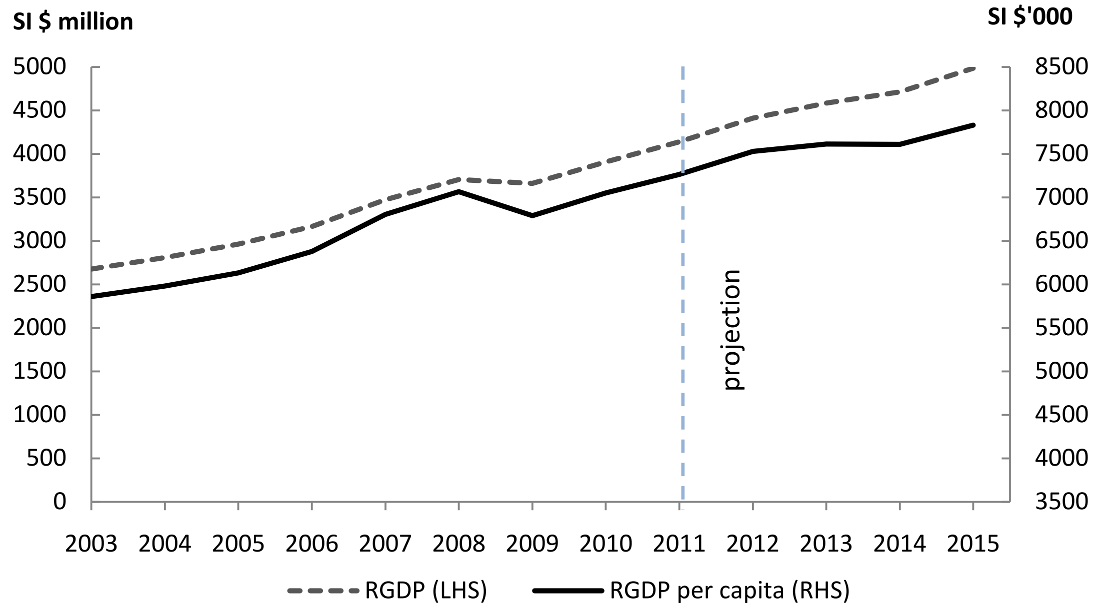
3.1 Overview

In 2010, the Solomon Islands economy recovered from the negative growth recorded in 2009. In real terms, the economy is estimated to have grown by around 6.75 per cent compared to a 1 per cent contraction in 2009. This was largely due to the expansion in log exports and an improvement in commodity demand and prices, aided by a recovery in the world economy. Logging production turned out to be higher than expected; around 30 per cent above the previous year in terms of volume, and about 42 per cent higher in export value, as logging companies capitalised on strong prices and demand. Improvements in telecommunication, construction, trade and the increase in aid inflows also supported higher growth.

The growth outlook for 2011 is expected to remain buoyant, with the real growth rate expected to be around 5.5 percent, driven mainly by the mining sector as Gold Ridge Mine is expected to start production. The production and demand for other major export commodities is expected to expand as the world's economic recovery leads to increased prices and demand. Fish production is anticipated to pick up following the reopening of the Soltai tuna cannery towards the end of 2010. Logging volume is expected to decline in 2011, however this will be offset in the short term by higher duties payable. Nonetheless, the impending decline in logging revenue and logging related employment suggests continued economic reform is needed across the economy to achieve growth and replace lost employment.

Throughout 2010, consumer prices in Honiara fell and have remained low due to lower fuel and food prices both domestically and internationally. Despite increases in global prices in late 2010, consumer prices as measured by the three months moving average (3mma) remain very low at 0.3 percent as at November 2010. However, risks to the outlook remain should higher global prices eventually flow on to higher local prices.

Chart 3.1: Real GDP and real GDP per capita, 2003 to 2015



Source: Ministry of Finance and Treasury

As the Medium Term Fiscal Strategy highlights, the medium term risks to economic growth and prosperity in Solomon Islands remain extremely high. The logging sector currently accounts for the largest single part of the formal economy and its decline, without significant growth in non-logging sectors, will reduce already low standards of living.

The reopening of the Gold Ridge Mine is significant in terms of growth prospects for the Solomon Islands economy in the first two years of operation (2011 – 2012) and comes at an important time when logging production is expected to decline. However, from 2013 – 2015 production each year will be steady, so the mine will add very little to real GDP growth of around 0.3 percent on average. Given the nation's population growth, GDP per capita growth is expected to be negative in 2013 and 2014.

In 2010, the 1.35 million cubic metres of log exports was higher than expected, an increase of around 30 per cent compared to the previous year. This contributed around $240 million to government revenue through export duties and accounted for about 13.5 per cent of domestically sourced revenue. In 2011, logging production is expected to reduce to below trend levels due to reduced supply and higher duties payable. The expected low economic growth as a result of the decline in logging presents real challenges for Government in raising the revenue needed to support the current level of service delivery.

Identifying appropriate responses to low economic growth is a central focus of the Government's current economic reform program. The Government has set out the parameters it will operate under in its Medium Term Fiscal Strategy. This offers a framework outlining the Government's commitment to sound financial management and measures to create a sustainable base for economic development. Central to the Government's policies are its commitment to support and improve rural infrastructure development, to advance its concepts of establishing Growth Centres, and private sector-led growth aiming to better connect and provide equal access to development opportunities and benefits for all Solomon Islanders. The Government has also committed to work directly with donors to ensure that their programs focus on employment and key economic infrastructure over the medium term.

3.2 The External Sector

The global economy is transitioning from its initial bounce-back from the global recession to a period of slower, more sustainable paced growth. Economic activity in the developing countries is leading the way with growth almost back to trend levels. Meanwhile, the recovery in many high-income countries continues to be held back by high debt and unemployment. It is expected that global growth will weaken slightly in 2011 before gradually picking up again in 2012. The International Monetary Fund estimates that after contracting by 0.6 per cent in 2009 and recovering to 5 per cent in 2010, global economic activity is expected to expand by around 4.4 per cent in 2011 and 4.5 per cent in 2012.

Since 2008, the Solomon Islands' balance of payments position improved from a deficit to a surplus of $361 million in 2009 and then to $906 million as at the end of 2010, leading to an improvement in official reserves of nearly $1 billion in less than two years. This result has largely been driven by logging receipts, donor funds and reinvested earnings in the country.

An improved financial account has allowed external reserves to rise over the course of 2010 to more comfortable levels. However, over the medium term, as import prices recover with the rebound in global demand and the appreciation of the local currency, it is expected that the current account deficit will continue to widen causing reserve levels to fall again if new sectors are not able to fill the gap in export revenue left by the projected decline in logging.

The Solomon Islands economy recovered in 2009 and has picked up in its overall economic activities in 2010. The global demand for most of the major commodities has increased in 2010 resulting in increased exports, improvement in fiscal revenues, the balance of payment, foreign reserve levels and the economic growth.

3.3 Balance of Trade

In 2010, the trade balance deficit gap has widened to $1 billion compared to the trade deficit gap of $598 million in 2009. The overall trade balance from 2009 to 2010 has deteriorated by 80 per cent. The significant increase in the trade balance deficit was driven mainly by capital imports such as machineries and equipments and the high cost of imported fuel.

As indicated in Chart 3.2 both exports and imports registered an increase in 2010. However, the imports increased much higher than the exports which resulted in the trade balance deficit worsen in 2010.

The Central Bank of Solomon Islands is appreciating the local currency against the US currency over a two year period starting from February 2011. This implies that the level of imports may increase because imports will become cheaper. The level of export volume on the other hand will depend on global demand. If global demand is persistent or inelastic, the export volume may continue to increase. However, the export value is expected to fall in the short term, thus widening the trade balance deficit gap. This is because as the local currency appreciates, the value of the US currency becomes less which means the same volume of exports exported in 2010 will have less value in 2011.

Chart 3.2: Balance of Trade, 1999 to 2010

Source: Central Bank of the Solomon Islands

3.4 Exports

In 2010, total exports recorded a significant increase of 39 per cent to $1.8 billion following a fall in exports by 18 per cent in 2009. This was driven by both increased domestic production and prices across almost all the commodity groups including logs, palm oil, cocoa and fish.

The major export destinations for the Solomon Islands are China (close to 50 per cent) followed, after a significant margin, by the Philippines and Spain. Exports consisted largely of primary products including logs, fish, palm oil, copra and cocoa.

The current high dependency on natural resources, in particular logs (accounting for more than 59 per cent of exports in 2010) is a serious risk to the medium term prosperity of the Solomon Islands. With the current levels of logging harvest, it is expected that the level of log stock available will be depleted in the next two years. It is therefore encouraged that other potential sectors such as fisheries, tourism and mining be improved for the economy to shift from being dependant on the logging industry to a broader based and more sustainable economy.

International prices of our domestic commodities will continue to play an important role in determining the level of domestic production. For example, supply of cocoa, copra and fish are believed to be highly elastic depending on the international prices for these commodities.

Overall, the export outlook for 2011 is optimistic as the Gold Ridge Mine is expected to start exporting gold by the end of the first quarter of 2011. It is expected that the mining industry and other potential sectors such as fisheries, agriculture and tourism will contribute to expanding the economy over the medium term. However, it is expected that exports receipts in 2011 will slightly fall as the local currency appreciates against the US dollar.

3.5 Imports

In 2010, imports increased by 51 per cent from $1.9 billion in 2009 to $2.9 billion. The main drivers for the increase in imports were capital goods imported by the Gold Ridge Mine and Bemobile for their initial setup of operations.

With the revaluation of the Solomon Island currency, the level of import value in 2011 is expected to decline implying that import prices become cheaper, increasing the total volume of imports.

The Solomon Islands is a small economy that is remote and disperse consisting of almost one thousand islands making it heavily reliant on imported fuel, manufactured items, machineries and other general merchandised goods. Therefore, the import outlook for 2011 is expected to increase.

3.6 International reserves and exchange rate

In 2010 the gross international reserves rose significantly from $1.1 billion (which is equivalent to 5 months of import cover) in 2009 to $2.1 billion (equivalent to 9.3 months of import cover) by the end of 2010. The increase in reserves reflects an increase in logging receipts in 2010, an increase in donor inflows, reinvested earnings and revaluation gains reflecting movements in foreign exchange rates. Despite the widening trade balance, reserves are expected to remain high due to gold exports, increased investment and expected continued donor inflows

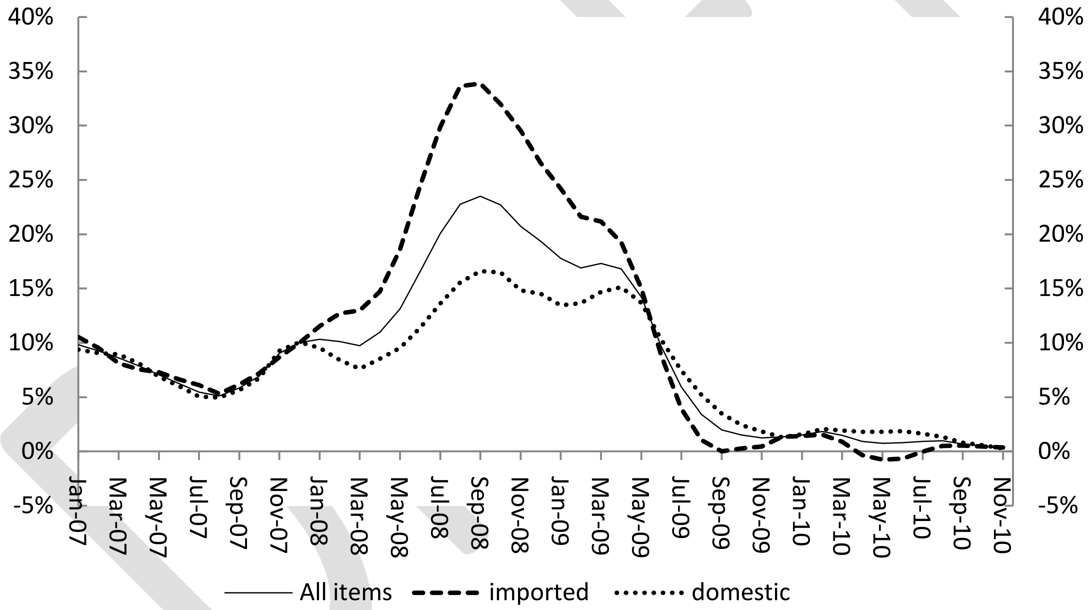
Over the course of 2010, the Solomon Island dollar has remained almost unchanged against the US dollar. However, mainly due to the weaker US dollar, to which it is closely aligned, the Solomon Island dollar has depreciated by 11 per cent against the Australian dollar, 3 per cent against the

UK Pound Sterling, 10 per cent against the New Zealand dollar and by 5 per cent against the Japanese Yen.

The CBSI intends to gradually appreciate the Solomon Islands dollar against the US dollar over a two-year period starting in February of 2011 which will lead to a much more flexible local currency. The appreciation of the Solomon Islands currency is likely to have a larger impact on imports than the exports. However, it is expected that the effect on trade over the medium term will be neutral as the appreciation will be gradual over the two-year period.

3.7 Inflation

Chart 3.3: Honiara Annual Inflation Rates (3-month moving average), January 2007 to Nov 2010)



Source: Statistic Bulletin 11/2010, Solomon Islands National Statistics Office

As Chart 3.3 shows, inflation remained low and stable throughout 2010. The annual inflation rate calculated by the National Statistics Office on the 3-months moving average (3mma) basis was 0.3 percent by the end of November 2010. This was driven mainly by lower imported fuel and food prices (both domestic and imported items) during the first half of 2010.

Despite the increased global food prices in mid-2010, local consumer prices continued to decline due to the time lag effects (around 3 to 6 months) reflecting the shipping and storage related lags. Also, many of the global food prices that rose in mid-2010 (mainly wheat and sugar) were not relevant for most domestic households in Solomon Islands as most households rely on locally grown foods.

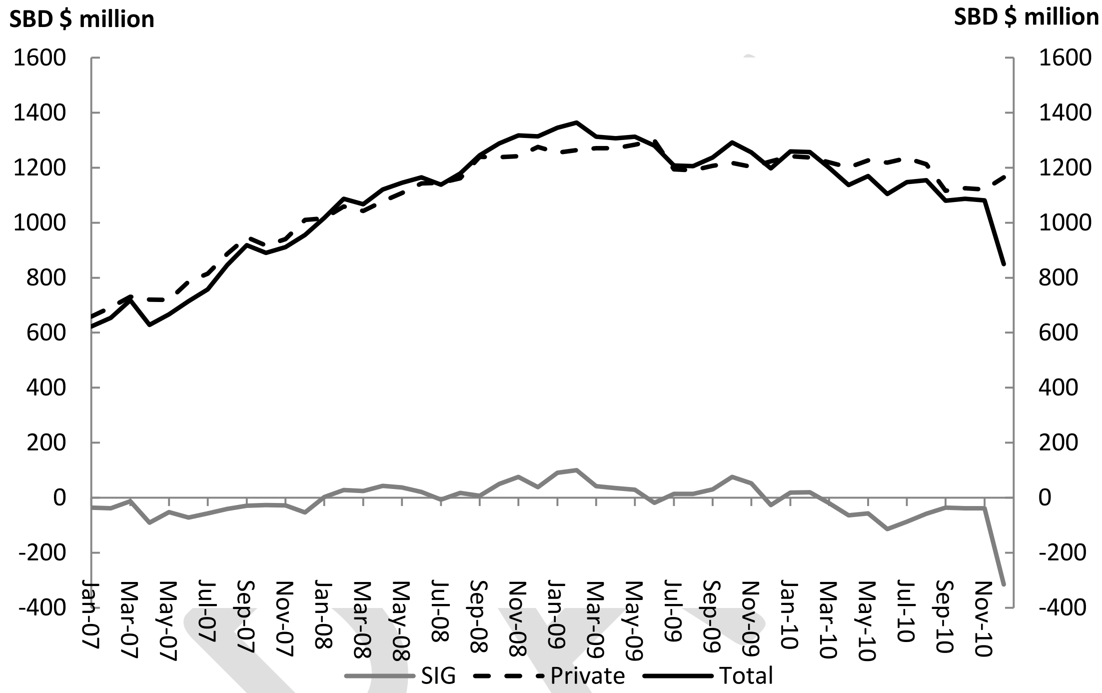
Inflation is expected to pick up in 2011 due to the upward trend in global prices which started towards the end of 2010. The excess liquidity in the banking system is likely to add pressure on inflation later in the year once lending activities pick up as the economic recovery continues. Because of Solomon Islands' dependency on fuel and imported items for production (and rice to a lesser extent) and the lack of immediate substitutes, the economy remains vulnerable to future price changes should there be supply disruptions or economic growth pick up quicker than expected. Continuing low inflation will be beneficial for local consumption but will reduce government revenue.

3.8 Monetary Sector

Throughout 2010, monetary conditions eased, with continuing excess liquidity in the banking system. The increase was driven mainly by the continuous rise in largely unsterilized inflows fuelled by foreign direct investment and donor funds. Money supply has continued the upward trend mainly due to the increase in Net Foreign Assets (NFA) stemmed from the increase in the NFA holdings of the Central Bank of Solomon Islands (CBSI) along with large donor inflows. In February 2011, CBSI resumed the sale of short-term bills (the 28-day Bokolo Bill) to ease the liquidity and monetary pressures on inflation.

As shown in Chart 3.4, credit growth remained very weak throughout the year despite the recovery in economic activities. Total domestic credit has declined by 20 percent to $1040 million at the end of September 2010 compared to the previous year. The decline was driven by the fall in credit to the private sector and net credit to the Central Government. Credit to the private sector went down by 8 percent to $1115.4 million at the end of Q3 2010 resulting from the fear of adverse selection coupled with perceived high existence of uncertainty in the economy by lenders. Net credit to the government stood at minus $315.5 million in December, reflecting the large build up of government deposits within the banking system. The distribution of private sector credit remains a concern with two of the largest sectors (as at September 2010), personal loans (28 per cent) and distribution (17 per cent), areas not directly linked to productive capacity, receiving the bulk of the funds. Credit to construction sector accounted for 13 percent while agriculture, tourism and fisheries, three potentially non-logging sectors, accounted for only 7 per cent of private credit.

Chart 3.4 Domestic Credit: Jan 2007 to Nov 2010



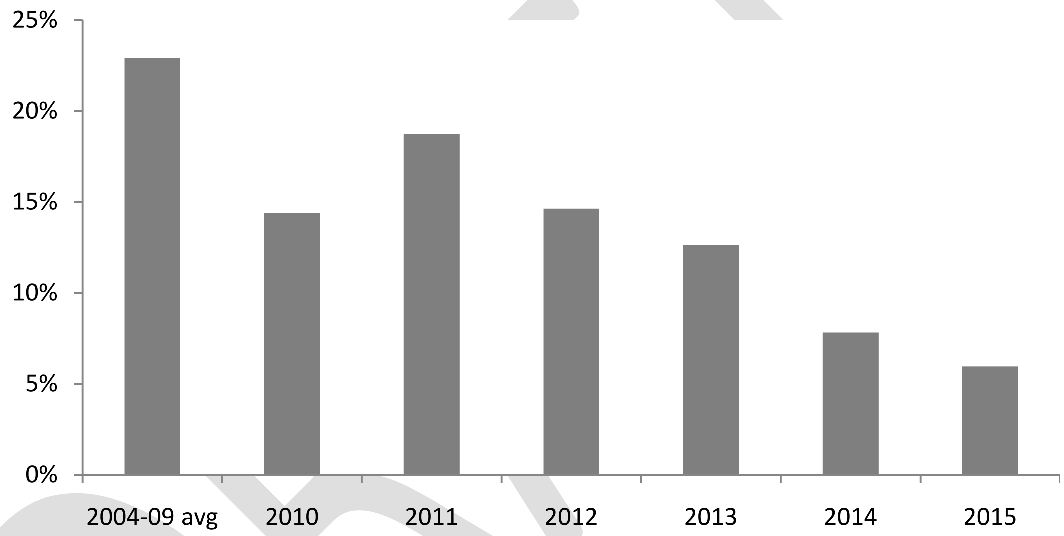
Source: Central Bank of Solomon Islands

3.9 Forward Estimates

In the first half of 2010, the Governments cash position remained threatened by the ongoing impacts of the Global Economic Crisis. Following the approach adopted in 2009, the Government sought to combat declining cash reserves by placing a 35 per cent reservation across all recurrent expenditure other than payroll, debt service and other essential services including health, education and Provincial Grants. This action, combined with stronger than anticipated domestic revenue collection in the latter half of the year, allowed the Government to release some reservation to allow Ministries to continue to provide services to the people of the Solomon Islands in the final months of 2010. The Government cash position was fortified in late 2010 through the receipt of budget support from the European Union, allowing it to carry a $261 million cash surplus into 2011.

The revised log output projection and slower growth over the next five years means that revenue growth will also slow. However, the reopening of the Gold Ridge Mine is expected to contribute a significant amount of revenue to the Government in terms of export duties on gold exports, Personal tax and Company tax over the medium term. Chart 2.5 shows the projected expenditure growth path for 2011 to 2015 needed to balance the budget including maintaining an adequate cash reserve equivalent to 2 months of recurrent budget expenditure for the same period. To maintain fully funded budgets, nominal expenditure growth will need to slow from around 29 per cent per annum for the period 2004 to 2009 to around 7 per cent by 2015.

Chart 3.5: Projected Expenditure Growth for Balance Budget



Source: Ministry of Finance and Treasury calculations

Section 4 - Fiscal Outlook

4.1 Overview

The 2011 Consolidated Budget is responsible in that it is a surplus Budget which provides for growth in the Government's cash holdings and provides funding to cover the potential for unforeseen contingency expenditure. Funding comes from local revenue and donor support. A summary of the Consolidated Budget is at Table 4.1.

Table 4.1 – Summary of the Consolidated Budget

	2009 YEAR END Actuals $m	2010 Budget Estimates $m	2010 Revised Estimates $m	2011 Draft Estimates $m
CONSOLIDATED BUDGET FUNDING				
REVENUE				
Domestically Sourced Revenue				
Inland Revenue	916.9	1018.9	1121.7	1280.0
Customs and Excise	371.7	433.2	496.3	502.4
Other Ministries	174.2	211.9	154.3	186.2
Total Domestically Source Revenue	**1462.8**	**1664.0**	**1772.3**	**1968.6**
Externally Sourced Funding				
Budget Support (Ledger 2)	1.0	58.0	215.2	92.0
Budget Support (Ledger 3)	100.0	115.0	115.0	115.0
Donor Funding (Development Budget)	90.0	80.0	80.0	80.0
Total Externally Sourced Funding	**191.0**	**253.0**	**410.2**	**287.0**
TOTAL REVENUE	**1653.8**	**1917.0**	**2182.5**	**2255.6**
CONSOLIDATED EXPENDITURE				
Recurrent Budget				
Payroll	508.6	494.4	563.5	587.5
National Debt Servicing	97.3	120.0	120.0	120.0
Other Charges	700.8	893.1	862.6	858.2
Budget Support (Ledger 3)	99.5	115.0	115.0	115.0
Total Recurrent Appropriation	**1406.2**	**1622.5**	**1661.1**	**1680.7**
Contingency Warrant Provision				26.5
Development Budget				
ROC funded development	90.0	80.0	80.0	80.0
SIG funded development	181.0	295.0	243.3	417.7
Total Development Budget Approp.	**271.0**	**375.0**	**323.3**	**497.7**
Contingency Warrant Provision				26.5
TOTAL CONSOLIDATED EXPENDITURE	**1677.2**	**1997.5**	**1984.4**	**2231.4**

4.2 Revenue

In 2010, total revenue is estimated to have reached $2,182.5 million. Total domestically sourced revenue is expected to be $1,772.3 million, 6.5 per cent higher than original 2010 Budget estimates. Of this $1,121.7 million was collected by IRD, $496.3 million by Customs and $154.3 by other ministries responsible for revenue collection.

The estimate of external funding in 2010 of $410.2 million will be higher than the original budget estimates. This is due to the European Union providing $157.2 million in budget support late in 2010 which was not included in the original 2010 Budget estimates.

In 2011, total revenue is expected to grow by 12.9 per cent from the 2010 Budget forecast to $2255.6 million, consisting of $1968.6 million in domestically sourced funding and $287.0 million in donor budget support. The growth in domestically sourced revenue from the 2010 Budget reflects growth in the national economy, ongoing improvement in revenue administration and compliance efforts, and specific policy changes including an increase in a range of fees and charges.

Inland Revenue will continue to be the largest source of domestic revenue, representing around 65 per cent of collections in 2011. Customs and excise collections will make up around 25.5 per cent, with the remainder – around 9.5 per cent – being collected by various other ministries in the form of licences, fees and charges.

The 2011 Recurrent Budget has provided additional funding for Inland Revenue, Customs and Treasury to continue the development of its staff and compliance program. In addition, a range of fees and licences have been increased and work continues to enhance the collection of ‘Other Government Revenues’ by a range of Ministries. This investment in strengthening revenue collection, when combined with the ongoing strength of the economies of the Solomon Islands trading partners, will assist the Government in maintaining a sound revenue base into the future.

Inland Revenue

Inland Revenue comprises company taxes, personal taxes, withholding tax, goods tax, sales tax, stamp duty and licence fees. Table 4.2 shows the breakdown of revenue by tax type.

Table 4.2: Inland Revenue by tax type, 2009 to 2011

	2009 YEAR END Actuals $m	2010 Budget Estimates $m	2010 Revised Estimates $m	2011 Draft Estimates $m
Company Tax	220.8	199.0	217.4	247.6
License Revenue	5.3	6.8	6.6	7.5
Personal Tax	214.5	249.0	293.6	335.4
Sales Tax	41.3	47.0	52.4	58.7
Stamp Duty	14.0	14.0	8.1	9.2
Withholding Tax	96.3	71.0	124.6	157.8
Goods Tax	324.8	432.9	419.2	463.9
	916.9	**1018.9**	**1121.7**	**1280.0**

Source: Ministry of Finance and Treasury.

Inland Revenue Division's 2011 revenue forecast is $1,280 million. It is $158.2 million or 14.1 per cent higher than the 2010 actual collection. IRD anticipates that 2011 will be a good year of strong revenue flows particularly with mining production expected to start in this year. Mining production is expected to bring significant revenue flows in PAYE and Goods taxes in the short term and corporate taxes in the longer term.

IRD's forecasted revenue collection also assumes no further statutory exemptions being added and a prudent approach taken on discretionary exemptions.

The continued growth in revenue over the last four years can be attributed to improved business confidence, better tax administration with a focus on education, services and enforcement, and strong strategic leadership.

Additional measures expected to bolster revenue in 2011 include:

- Continuing Improvement in how business is conducted for the customers so that it is simpler for the business community to comply with their tax obligations;
- Ongoing improvements in the policy and management of the exemption process with legislation expected to be introduced in 2011;
- Enhancements to Information Technology systems especially in the area of accounts management;
- Increased staffing provided for in the 2011 Budget with progressive recruitment throughout the course of the year; and

- A more integrated audit capability with more effective targeting of compliance risk areas and those operating outside the tax system.

Customs and excise

The main sources of Customs and excise revenue are export duties, import duties, excise duties, license fees, acceptance fees, attendance fees and Queen's warehouse rent and charges. Customs also plays an important role collecting revenue on behalf of other government divisions. Table 4.3 shows the breakdown of Customs revenue collection.

Table 4.3: Customs and excise revenue by type, 2009 to 2011

	2009 YEAR END Actuals $m	2010 Budget Estimates $m	2010 Revised Estimates $m	2011 Draft Estimates $m
Excise Duty	62.5	90.0	101.0	118.6
Export Duty	170.4	171.7	248.8	222.5
Fees, charges and other	1.1	1.1	5.8	6.0
Import Duty	137.8	170.5	141.0	155.4
	371.8	**433.3**	**496.6**	**502.5**

Source: Ministry of Finance and Treasury.

Revenue collected by Customs and Excise Division is expected to be $502 million for 2011. This is an increase of $69.2 million or 16 per cent above 2010 Budget. This is largely driven by logging export activity. While logging volumes are declining in volume, this is offset by price rises in the export rates. Imports are expected to rise as the global economy strengthens and revenue collection is expected to increase as tighter controls on exemptions and improvements in industry compliance through the establishment of a Compliance Audits Section are put in place.

Other Ministries

Many ministries besides the Ministry of Finance and Treasury (IRD and Customs) collect revenue for the Government. This revenue comprises non-tax items such as licences, fees and charges arising from the normal course of operations.

In 2011, revenue from other ministries is forecast at $186.2 million. This is $25.7 million less than the 2010 forecast, but $31.9 million higher than actual collections in 2010. The Government believes that the 2011 forecast represents a realistic estimate of what can be achieved by focussing on improving the efficiency of other government revenue collection.

The Ministry of Fisheries and Marine Resources continues to be the largest domestic source of non-tax revenue. In 2011, it is expected that Fisheries revenues will total $120.6 million. This represents nearly two thirds of the Government's total domestically sourced revenue. It should be noted that the majority of non IRD and Customs revenue expected to be collected by the Ministry of Finance is the balance of the sale of the Sasape Marina which was not completed in 2010.

Table 4.4 Revenue by Ministry, 2009 to 2011

Head Of Expenditure	2009 Actuals $m	2010 Original Budget Estimate $m	2010 Revised Budget Estimate $m	2011 Budget Estimate $m
Ministry of Agriculture and Livestock Development	3.7	2.3	4.4	4.2
Office of the Auditor General	0.4	2.8	0.3	1.4
Ministry of Education & Human Resources Development	1.0	1.8	1.5	1.5
Ministry of Finance and Treasury	18.7	27.5	6.3	10.3
Ministry of Health and Medical Services	0.2	0.2	0.3	0.5
Ministry of Infrastructure Development	1.7	2.4	2.4	3.0
Ministry of Forestry & Research	1.6	0.6	1.5	1.5
Office of the Prime Minister and Cabinet	0.1	0.1	0.4	0.0
Ministry of Police, National Security and Corrective Services	0.5	0.6	0.4	0.4
Ministry of Lands, Housing and Survey	4.3	21.8	2.6	5.6
Ministry of Culture and Tourism	0.0	0.0	0.0	0.0
Ministry of Commerce, Industry and Employment	8.3	11.7	12.5	13.0
Ministry of Communication & Aviation	18.2	17.8	8.5	16.5
Ministry of Fisheries and Marine Resources	108.9	115.6	105.8	120.5
Ministry of Public Service	1.7	1.2	0.0	1.9
Ministry of Justice and Legal Affairs	0.8	1.4	0.6	0.6
Ministry of Home Affairs	1.3	2.7	2.1	1.4
Ministry of Mines, Energy & Rural Electrification	2.0	0.9	1.6	1.6
National Judiciary	0.5	0.5	2.7	2.0
Ministry of Environment, Climate Change, Disaster Management and Meteorology	0.3	0.0	0.4	0.3
	174.2	**211.9**	**154.3**	**186.2**

Source: Ministry of Finance and Treasury

*The total for the Ministry of Finance and Treasury excludes revenue collected by the IRD and Customs

** The total for the Ministry of Education and Human Resource Development and the Ministry of Health and Medical Services does not include Budget Support

External Budget support

The Consolidated Budget also includes funding provided by donors through the Solomon Islands Government financial system. The funding is used to support Solomon Island Government service delivery in various areas.

Recurrent Budget

In the 2011 Recurrent Budget, a total of $207 million in budget support is provided to SIG.

Ledger 3 Budget Support

New Zealand is expected to provide $55 million in budget support to the education sector in 2011. New Zealand's budget support assists the Government with achieving its key education goals under the Education Strategic Framework. In particular, the support seeks to:

- provide equitable access to quality basic education for all children in Solomon Islands;
- provide access to community, technical, vocational and tertiary education that will meet individual, regional and national needs for skilled and competent people; and
- manage resources in an efficient and transparent manner.

Australia is expected to provide $60 million in budget support to the health sector in 2011 under a Sector Wide Approach (SWAp). This funding will support the Government in providing better health services to the people of Solomon Islands.

This total of $115 million, specifically targeted to the areas of education and health, is recorded as Ledger 3 Budget Support and is allocated to Ministry Heads 372 and 376 respectively.

Ledger 2 Budget Support

Australia will provide an additional $24 million to support the Education sector, including assistance in meeting the costs of the Government's Fee Free Education policy.

The Asian Development Bank will provide $40 million to meet recurrent budget commitments and will be associated with SIG undertaking a number of reform priorities relating to economic and public financial management.

The European Union will provide $28 million to support the Government's climate change initiatives across a range of sectors, including environment, forestry, infrastructure development and energy.

This total of $92 million will not be allocated to specific ministries, but is included in the Consolidated Revenue Fund and recorded in the budget documentation as Ledger 2 Budget Support.

Consolidated Development Budget

In the 2011 Consolidated Development Budget, funding from donors is expected to be $80.0 million. This funding is expected to be provided by the Republic of China.

The Republic of China will provide $80 million to support various Government priorities including:

- ROC Support to Constituency Development Fund ($20 million)
- ROC Millennium Constituency Development Fund ($20 million)
- Training awards ($16.7 million)
- Preparations for hosting the 2012 Pacific Arts Festival ($13.3 million)
- ROC Constituency Micro-Project Fund ($10 million)

4.3 Expenditure

The original estimate for total consolidated expenditure in 2010 was $1,997.5 million. Throughout 2010 the level of appropriation was increased by $200.7 million through the 2010 Supplementary Appropriation Bill (No 1) and Contingency Warrants agreed subsequent to that Bill (these will be 'legalised' through the 2010 Supplementary Appropriation Bill (No 2)). This resulted in a total 2010 Consolidated expenditure appropriation of $2,195.2 million. However, total actual consolidated expenditure for 2010 was $1,984.4 million. This lower than estimated level of expenditure was due in the main to two factors, the application of a reservation on the Warrant for the 'Other Charges' component of the 2010 Recurrent Budget, and, the placement of spending controls on the 2010 Development Budget. These measures were undertaken to assist Ministries to manage expenditure to ensure they could continue to provide essential services throughout 2010 and to assist the Government to manage its cash position.

The Government is budgeting to spend a record $2178.4 million in 2011, with an additional contingency provision of $53 million ($26.5 million each for both the recurrent and the development budgets). The Government will appropriate spending of $1680.7 million through the Recurrent Budget and $497.7 million through the Consolidated Development Budget. The Government has budgeted for an end of year operating result of $24 million surplus in the 2011 Budget.

Recurrent Budget

The estimates of 2011 Recurrent Expenditure have been set at $1,680.7 million, an increase of $58.2 million, or 3.6 per cent on the original 2010 Budget estimates, but more closely aligned with the 2010 actual expenditure estimates ($1,661.1 million). The Government adopted a fiscally responsible policy of containing recurrent expenditure through setting the 2011 'Other Charges' Recurrent Budget baseline at ninety percent of the 2010 Baseline[1].

The increase in 2011 Recurrent expenditure when compared to 2010 is largely due to the estimated payroll budget requirements. In 2011 the payroll makes up $587.5 million, or 35 per cent of the total Recurrent estimates for 2011. This is an increase of $93.1 million over the payroll Budget for 2010. The Government acutely aware that payroll growth needs to be managed but it is also aware that previous years' payroll estimates were difficult to establish due to a lack of reliable and timely data from old systems. As such, the 2011 payroll Budget is based on the 2010 payroll actual expenditure data derived from the updated payroll system. This will ensure that the 2011 payroll estimates are more accurate than in previous years, where the payroll estimates were rarely adequate to meet actual payroll needs and therefore required supplementation. The 2011 payroll budget also includes funding for a number of new positions in IRD, Customs and Treasury which will be devoted to increasing revenue and seeking new revenue opportunities. Overall, while this means a significant increase in the payroll budget, it will provide ministries with sufficient funding to manage their operations without

[1] The Ministries of Education and Human Resource Development and Health and Medical Services, and specific grants including Provincial Government Operation grants were provided with 100% of the 2010 Baseline. This was done to ensure that these critical services are maintained at real levels.

seeking supplementation during the year in order to meet their payroll obligations

Other charges expenditure will be $4.4 million less than was spent in 2010. This will allow the Government to manage the economy in a responsible manner, while at the same time delivering on its policy commitments. Details of new spending measures are set out in Section 5 below.

Consolidated Development Budget

Consolidated Development expenditure in 2011 will be $497.7 million, a rise of 32.7 per cent compared with the 2010 original Budget estimates. The Solomon Islands Government contribution of $417.7 million is an increase of $122.7 million over the 2010 original Budget and an increase of $174.4 million over 2010 actual expenditure. The 2011 Consolidated Development Budget allows for maintenance of effort on development projects which have carried over from 2010. This development expenditure allows the Government to progress its priorities as set out in the National Coalition for Rural Advancement Government Policy Statements. Details of new spending measures are set out in Section 5 below.

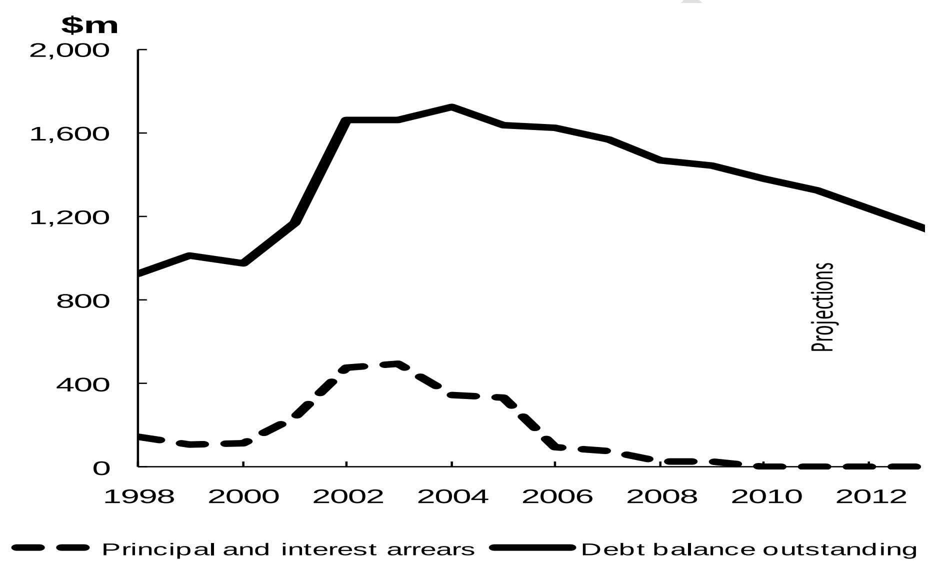
4.4 Debt Management

Consistent with responsible fiscal management and its commitments under the Honiara Club agreement, the Government does not intend to borrow any funds to finance its recurrent expenditures in 2011. The Government will not consider borrowing to finance its development expenditures until the Honiara Club Agreement is reviewed in 2011 or it reaches 'Green light' status under the joint IMF/World Bank Debt Sustainability Framework[2].

At the end of 2010, total government debt levels were around $1.446 billion, comprising $1.38 billion in official public sector debt and $66 million in other debts, including informal debt obligations, contingent liabilities and loan guarantees. Further reductions are expected in 2011 and beyond with the Government intending to continue its practice of responsible debt management.

[2] Green light status implies that the risk of developing debt distress is low and its achievement will improve the Government's capacity to fund its activities in the future. The Solomon Islands is currently at 'amber' light status corresponding with medium risk of developing debt distress.

Chart 4.1: Official Public Sector Debt



The size of any future reductions in debt will, to some extent, be dependent on other factors. For instance, movements in foreign exchange rates will have an impact. Because many of the government debts are denominated in currencies like USD, YEN and Euro, any depreciation of the Solomon Islands currency will tend to increase the level of the government's indebtedness to external creditors and the size of future repayments. The ongoing underperformance of the State Owned Enterprises also represents a risk that has the potential to undermine future debt repayment capacity should further guarantees or capital injections be required. Finally, and perhaps most significantly, the Government's capacity to balance the recurrent budget each year will be essential if debt levels are to continue their downwards trajectory

The current level of the government's contingent liabilities and guarantees is estimated to be approximately $65.7 million.

Section 5 - 2011 New Spending Measures

5.1 Overview

Through the 2011 Consolidated Budget, the Government will fund a series of major packages designed to implement its policies as outlined in its NCRA Government Policy Statements. The Government's seven priority policy areas are:

- Reconciliation and rehabilitation
- National security and foreign relations
- Infrastructure development
- Social services development
- Economic and productive sector development
- Assistance for Civic Affairs
- Machinery of Government expenditure

5.2 Consolidated Budget

In 2011 the Government has allocated an additional $120.9 million for Recurrent Budget expenditure and $417.7 million[3] for Development Budget expenditure. This is a 18.2 per cent increase in the provision for new expenditure when compared to the provision for new expenditure in the 2010 Consolidated Budget. This additional allocation will ensure that the operational programs under the key NCRA policy priorities are implemented.

[3] This is the SIG contribution to the Development Budget, it does not include the ROC contribution of $80 million.

Reconciliation and Rehabilitation

Reconciliation and rehabilitation includes expenditure to achieve broad reconciliation across the community and rehabilitation of social dislocations.

The following Ministries have been appropriated funding from the Consolidated Budget for projects on Reconciliation and Rehabilitation:

Recurrent Expenditure

Ministry	Additional Allocation ($)
Ministry of National Unity, Peace and Reconciliation	100,000
TOTAL	**100,000**

Development Expenditure

Ministry	Additional Allocation ($)
Ministry of National Unity, Peace and Reconciliation	3,500,000
Office of the Prime Minister and Cabinet	1,000,000
TOTAL	**4,500,000**
GRAND TOTAL	**4,600,000**

The largest project in the Consolidated Budget for reconciliation and rehabilitation is:

- $2,000,000 for National Reconciliation Programme
- $1,000,000 for the Commission of Enquiry into Land Dealings on Guadalcanal.

National Security and Foreign Relations

The primary aim of National Security and Foreign Relations is to strengthening law and order in the country, ensure border security and to build and maintain beneficial relationships with foreign countries.

The following Ministries have been appropriated additional funding from the Consolidated Budget for projects on National Security and Foreign Relations:

Recurrent Expenditure

Ministry	Additional Allocation ($)
National Judiciary	1,526,780
Ministry of Justice and Legal Affairs	1,112,000
Ministry of Police and National Security	6,200,140
TOTAL	**8,838,920**

Development Expenditure

Ministry	Additional Allocation ($)
Ministry of Police and National Security	13,300,000
National Judiciary	1,700,000
Ministry of Justice and Legal Affairs	1,440,000
TOTAL	**16,440,000**
GRAND TOTAL	**25,278,920**

Some of the larger projects being undertaken are:

- $11,800,000 for Canberra Chancery
- $13,300,000 for New Police Housing and Upgrades to Police Stations throughout the Solomon Islands.
- $1,500,000 for the Reinvigoration of the Parole Board

Infrastructure Development

Infrastructure development include expenditure on rehabilitation of infrastructure and on building new infrastructure which is essential to stimulate economic growth, enhance rural advancement and foster national unity.

The following Ministries have been appropriated additional funding from the Consolidated Budget for projects on Infrastructure Development:

Recurrent Expenditure

Ministry	Additional Allocation ($)
Ministry of Infrastructure Development	4,850,000
Ministry of Communication and Aviation	2,782,000
Ministry of Land, Housing and Survey	500,000
TOTAL	**8,132,000**

Development Expenditure

Ministry	Additional Allocation ($)
Ministry of Communication and Aviation	37,100,000
Ministry of Infrastructure Development	38,100,000
Ministry of Lands, Housing and Survey	9,150,000
TOTAL	**84,350,000**
GRAND TOTAL	**92,482,000**

Some of the larger projects being undertaken are:

- $14,500,000 for the Rural Transport Infrastructure Fund.
- $6,000,000 for Malaita Infrastructure Contract Support Unit
- $3,500,000 for SIG Obligation to Domestic Maritime Infrastructure
- $3,000,000 for the MID Engineering Complex
- $17,600,000 for the Construction and Rehabilitation of Provincial Airports
- $11,000,000 for Henderson Navigation Equipment and Fire Truck
- $3,000,000 for the Auki Jetty Project

Social Services Development

Social Services Development includes expenditure on education and human resources and health and medical services.

The following Ministries have been appropriated additional funding from the Consolidated Budget for projects on Social Services:

Recurrent Expenditure

Ministry	Additional Allocation ($)
Ministry of Education and Human Resource Development	25,500,000
Ministry of Health and Medical Services	11,400,000
Ministry of Women, Youth and Children's Affairs	1,131,600
TOTAL	**38,031,600**

Development Expenditure

Ministry	Additional Allocation ($)
Ministry of Education and Human Resource Development	33,150,000
Ministry of Health and Medical Services	21,000,000
Ministry of Women, Youth and Children's Affairs	2,000,000
TOTAL	**56,150,000**
GRAND TOTAL	**94,181,600**

Some of the larger projects being undertaken are:

- $14,500,000 for Tertiary Scholarships
- $7,000,000 for Publishing Teaching Materials
- $4,000,000 for the Running Costs of Gizo hospital
- $3,000,000 for the Refurbishment of SIMTRI
- $3,000,000 to Upgrade SICHE
- $5,250,000 for Medical Equipment

Economic and Productive Sector Development

Economic and Productive Sector Development includes expenditure in agriculture, forestry, tourism, commerce and industries, fisheries, lands, mines and energy, rural, and finance and banking. The following Ministries have been appropriated additional funding from the Consolidated Budget for projects on Economic and Productive Sector Development:

Recurrent Expenditure

Ministry	Additional Allocation ($)
Ministry of Agriculture and Livestock	2,602,215
Ministry of Commerce, Industry and Employment	1,600,000
Ministry of Culture and Tourism	5,705,520
Ministry of Fisheries and Marine Resources	1,500,000
Ministry of Mines, Energy and Rural Electrification	330,000
Ministry of Rural Development	900,000
Ministry of Environment, Conservation and Meteorology	413,000
TOTAL	**13,050,735**

Development Expenditure

Ministry	Additional Allocation ($)
Ministry of Agriculture and Livestock Development	35,250,000
Ministry of Culture and Tourism	29,200,000
Ministry of Commerce Industry and Employment	15,500,000
Ministry of Environment, Conservation and Meteorology	10,100,000
Ministry of Fisheries and Marine Resources	3,750,000
Ministry of Forestry and Research	16,500,000
Ministry of Rural Development	53,000,000
Ministry of Mines, Energy and Rural Electrification	19,400,000
Ministry of Prime Minister and Cabinet	11,000,000
Ministry of Provincial Government	3,500,000
TOTAL	**197,200,000**
GRAND TOTAL	**210,250,735**

Some of the larger projects being undertaken are:

- $9,150,000 for the National Rice Development Project
- $7,000,000 for the Cattle Development Rehabilitation Project
- $4,000,000 for the Cocoa Support Scheme
- $6,000,000 for Suava Bay Economic Growth Centre
- $6,000,000 for Noro Industrial Estate
- $5,000,000 for the 2012 Pacific Arts Festival
- $5,000,000 for the School of Tourism and Hospitality Building
- $2,000,000 for the Establishment of the Early Warning Alert System for Natural Disasters
- $8,000,000 for the Downstream Processing of Timber
- $6,000,000 for Reforestation
- $8,000,000 for the Improvement of Water Supply System for Auki/Honiara
- $5,000,000 for Renewable Rural Electrification
- $4,000,000 for the Tina River Hydro Power Development Scheme
- $53,000,000 for the Rural Constituency Livelihood Project Grant Scheme
- $6,000,000 for the Development of Economic Growth Centres
- $5,000,000 for the Rehabilitation of RIPEL
- $3,500,000 for the Choiseul Township Development

Assistance for Civic Affairs

Assistance for Civic Affairs includes recurrent expenditures to include the participation and engagement of women and youths in decision making, ensuring the rights of children are protected and assisting the Solomon Islands to become a popular and competitive sporting nation in the region. This policy also improved sport and participation in Solomon Islands.

The following Ministries have been appropriated additional funding from the Consolidated Budget for Assistance for Civic Affairs:

Recurrent Expenditure

Ministry	Additional Allocation ($)
Ministry of Home Affairs	2,000,000
Ministry of Provincial Government and Institutional Strengthening	4,411,767
Office of the Governor General	250,000
TOTAL	**6,661,767**

Development Expenditure

Ministry	Additional Allocation ($)
Ministry of Home Affairs	5,000,000
Ministry of Provincial Government and Institutional Strengthening	10,300,000
National Parliament	3,982,000
Office of the Governor General	2,000,000
TOTAL	**21,282,000**
GRAND TOTAL	**27,943,767**

Some of the larger projects being undertaken are:

- $3,500,000 for Electoral Reform
- $5,800,000 for the Provincial Capacity Development Fund

Machinery of Government Expenditure

In order to allow the Government to deliver its policy priorities to the people of Solomon Islands, it is necessary to have public sector systems (known as machinery of Government) in place which allow for the smooth running of Government. The Government has identified various areas where reforms are required to keep Government systems operating and to ensure that sufficient revenue is collected in 2011 to meet Government needs.

The following Ministries have been appropriated additional funding from the Consolidated Budget for projects on Machinery of Government Expenditure:

Recurrent Expenditure

Ministry	Additional Allocation ($)
Ministry of Development Planning and Aid Coordination	150,000
Ministry of Finance and Treasury	28,795,124
Ministry of Public Service	5,515,000
Office of the Prime Minister	9,250,000
Office of the Auditor General	2,358,500
TOTAL	**46,068,624**

Development Expenditure

Ministry	Additional Allocation ($)
Ministry of Development Planning and Aid Coordination	1,550,000
Ministry of Finance and Treasury	10,628,000
Ministry of Public Service	10,000,000
Office of the Prime Minister	4,300,000
TOTAL	**26,478,000**
GRAND TOTAL	**72,546,624**

The largest additional expenditure items under the Development Budget for Machinery of Government in 2011 are:

- $16,500,000 for new Government Office Buildings
- $1,200,000 for the Relocation of the Office of Auditor General
- $10,000,000 for Assistance to State Owned Enterprises including the establishment of Community Service Obligations
- $15,000,000 Contingency for Potential Additional Payroll Expenses
- $2,316,893 for Strengthening the Revenue Collection Capacity of IRD, Customs and Treasury
- $7,500,000 for the Bureau of Economic and Social Reform