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Enhancing Effectiveness of Solomon Islands' Fiscal Framework

Masafumi Yabara

SIP/2025/63

IMF Selected Issues Papers are prepared by IMF staff as background documentation for periodic consultations with member countries. It is based on the information available at the time it was completed on January 29, 2025. This paper is also published separately as IMF Country Report No 25/50.

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Enhancing Effectiveness of Solomon Islands' Fiscal Framework
Prepared by Masafumi Yabara*

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ABSTRACT: Solomon Islands faces the immediate fiscal challenges of rebuilding cash reserves, improving the quality of public spending, and imposing fiscal discipline on domestic borrowing. To address these challenges while financing necessary investments, it is an urgent priority to improve the effectiveness of the fiscal framework, in parallel with the efforts to strengthen basic public financial management (PFM) functions. Staff analysis indicates that the current debt ceiling of 35 percent of GDP remains broadly appropriate as a medium-term debt anchor. Given the weak PFM foundation and the absence of effective operational fiscal rules, staff proposes the introduction of a simple ex-ante guideline for annual budget formulation, as an interim measure. The proposed guideline sets a ceiling on the domestically financed primary budget deficit, to be consistent with a potential fiscal rule covering both domestic and external sources. The government should assess ex post whether the budget was implemented in line with the guideline and whether the fiscal outlook is consistent with the medium-term anchor.

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SELECTED ISSUES PAPERS

Enhancing Effectiveness of Solomon Island’s Fiscal Framework

Solomon Islands

Prepared by Masafumi Yabara[1]

[1] “The author appreciates extensive support from Weining Xin, Irina Yakadina, Yasuhisa Ojima (all APD), Raphael Lam, Andresa Lagerborg (both FAD), Leonardo Martinez, and Sofía M. Anastacio (both ICD). This paper benefited from useful suggestions and comments from Solomon Islands authorities and IMF colleagues, including Nada Choueiri, Paulo Medas, Jiro Honda, Mark Griffiths, Nico Pierri, Iulai Lavea, Bryn Welham, and Raphael Lam.

INTERNATIONAL MONETARY FUND

SOLOMON ISLANDS

SELECTED ISSUES

January 29, 2025

Approved By
Asia and Pacific Department

Prepared By Masafumi Yabara (APD)

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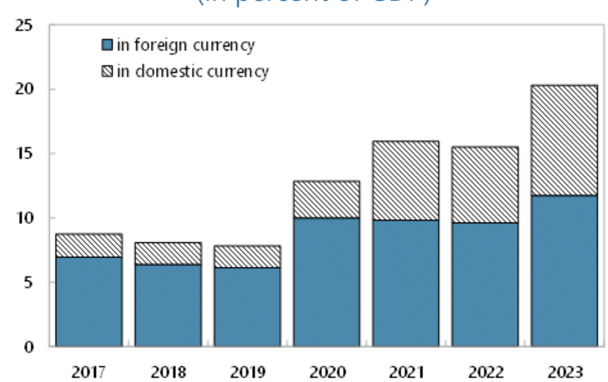
ENHANCING EFFECTIVENESS OF SOLOMON ISLANDS' FISCAL FRAMEWORK[1]

Solomon Islands faces the immediate fiscal challenges of rebuilding cash reserves, improving the quality of public spending, and imposing fiscal discipline on domestic borrowing. To address these challenges while financing necessary investments, it is an urgent priority to improve the effectiveness of the fiscal framework, in parallel with the efforts to strengthen basic public financial management (PFM) functions. Staff analysis indicates that the current debt ceiling of 35 percent of GDP remains broadly appropriate as a medium-term debt anchor. Given the weak PFM foundation and the absence of effective operational fiscal rules, staff proposes the introduction of a simple ex-ante guideline for annual budget formulation, as an interim measure. The proposed guideline sets a ceiling on the domestically financed primary budget deficit, to be consistent with a potential fiscal rule covering both domestic and external sources. The government should assess ex post whether the budget was implemented in line with the guideline and whether the fiscal outlook is consistent with the medium-term anchor.

A. Fiscal Challenges Facing Solomon Islands

1. A series of crises and landmark events have significantly deteriorated Solomon Island's fiscal position. The government has been running a deficit in recent years, driven by increased spending pressures. These pressures have arisen from the need to respond to the pandemic, the riot in Honiara, the successful hosting of the Pacific Games, and the general elections. Additionally, stagnant revenues owing to structural declines in logging activity and the pandemic have further contributed to the fiscal deterioration. The government's cash reserves have been significantly depleted, and public debt has nearly tripled from its pre-pandemic level, with a noticeable increase in expensive domestic bonds (Figure 1). The depletion of the cash reserves exposes the government to liquidity risk and complicates its ability to respond to future shocks. While the latest debt sustainability analysis indicates the moderate risk of overall debt distress in Solomon Islands, the

Figure 1. Public Debt Composition, 2017-23
(in percent of GDP)



Sources: Solomon Islands auhtorities and IMF staff estimates

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authorities' threshold, public debt at 35 percent of GDP, is projected to be breached by the early 2030s under current policies.

2. **Solomon Islands is tasked with the challenge of replenishing its cash balance and ensuring fiscal sustainability, while creating fiscal space for priority spending to achieve inclusive and sustainable growth.** Compared to its peers, the country falls behind in access to infrastructure and human capital development, and it faces significant vulnerability to natural disasters and climate change. Staff estimates that the country would need additional spending of about 6.9 percent of 2030 GDP every year, to meet the Sustainable Development Goals (SDGs) on health, education, and infrastructure, while building climate resilience (IMF 2022).

3. **The urgency of the fiscal challenge requires Solomon Islands to take measures to enhance the effectiveness of its fiscal framework, in parallel with strengthening public financial management (PFM) functions.** The depleted cash reserves and rising domestic debt underscore the urgent need to improve the effectiveness of fiscal policy. While a well-designed fiscal framework can serve this purpose, a strong PFM base is a prerequisite for effective implementation of such a framework. However, the urgency of the challenges does not allow the country to wait until it has built up sufficient PFM capacity—it needs to explore a practical option to facilitate the functioning of the fiscal framework that can be implemented in the current weak PFM settings. This paper, building on the recent IMF work on fiscal frameworks, assesses the performance of the existing fiscal framework in Solomon Islands, discusses challenges facing the country in implementing its fiscal framework, and proposes a practical option to support the operation of the fiscal framework.

B. Existing Fiscal Framework in Solomon Islands

4. **Solomon Islands has implemented certain fiscal rules.** Fiscal frameworks can be delved into three key elements: (i) fiscal rules; (ii) medium-term fiscal frameworks (MTFFs); and (iii) independent fiscal councils (IMF 2024).[2] Solomon Islands has two sets of fiscal rules: a golden rule and debt rules. Firstly, the Public Finance Management Act (PFMA) restricts the government from borrowing to cover planned recurrent budget deficits, permitting borrowing solely for high-priority infrastructure and development projects (golden rule). This rule includes an escape clause for short-term borrowing under exceptional circumstances, such as a significant economic downturn or natural disaster. Secondly, the government's debt management strategy has set two debt thresholds (ceilings): a public debt-to-GDP ratio of 35 percent and a debt service-to-domestic revenue ratio of 10 percent. The government sets an annual borrowing limit when formulating the annual budget, so that the 35 percent ceiling is not breached over a 15-year forecast period. Additionally, the annual budget specifies a ceiling on the Treasury Bill issuance under the escape clause. These limits have

[2] Fiscal rules set numerical limits on key fiscal aggregates (e.g., debt, deficit, expenditure, revenue). MTFFs involve setting medium-term fiscal targets and formulating policies to achieve them. Fiscal councils are independent institutions providing oversight and analysis of fiscal policies and promoting greater transparency and accountability (IMF 2024).

been gradually raised, with the annual borrowing limit standing at SI$558 million and the Treasury bill cap at SI$200 million in the 2024 budget.

5. The fiscal rules have not effectively guided fiscal policy. The golden rule has not served as an effective fiscal discipline, since development expenditures—which are eligible for borrowing under the rule—have continued to grow, reaching 6 percent of GDP in 2023. This increase has been driven by rising government investment, including for the Pacific Games, as well as an inconsistent classification between the recurrent and development expenditures.[3] In addition, compliance with the rule has not been given notable weight: in the 2021 budget, the government invoked the escape clause for the golden rule "to meet essential recurrent expenditure to cushion the effect of the pandemic on the national economy." However, there was no comprehensive discussion, including specifics of the deviation and its consequences on the government's financial position. In the budgets for 2023 and 2024, the estimated amount of government-funded recurrent expenditures exceeded the amount of tax and other revenues, seemingly violating the golden rule, yet this discrepancy sparked no debate. The debt rules have not been constraints on fiscal policy either, as the outstanding public debt has remained below the ceiling since their introduction. The annual borrowing limit has been gradually raised, despite the rapid accumulation of public debt, without disclosing the details of the calculation.

6. Medium-term planning and independent monitoring are weak in Solomon Islands' budget. Previously, the government published a medium-term fiscal strategy that detailed economic conditions and fiscal performance, projected fiscal aggregates, and outlined economic and fiscal strategies. However, this strategy was not integrated into the annual budgeting process and has not been published on the government website since 2014. The Public Accounts Committee (PAC) under the National Parliament reviews the government's budget proposal and provides a report with recommendations to the Parliament. The work of the PAC has made significant progress in recent years; in the 2024 budget report, the committee discussed economic conditions, budget trends, and risks in addition to the investigation of budget items. However, discussions on medium-term outlook are limited. In addition, the independence and impartiality of the assessment is not guaranteed as the PAC is composed of legislators, with the Auditor General of the government serving as the secretary.

7. Cash shortages and expenditure controls have mitigated further fiscal deterioration. Solomon Islands' budgets have consistently faced substantial financing gaps over recent years that could not be met by estimated donor support and domestic bond issuances. In addition, the preparation of a supplementary budget has become routine, necessitated by unaccounted mandatory expenditures in the original budget and expenditures financed by additional donor support. When these financing gaps cannot be resolved through additional donor support and domestic bond issuance, the government has imposed strict expenditure controls. These controls include freezing discretionary spending, suspending procurement processes, and delaying payments

[3] World Bank (2022) pointed out that the distinction between recurrent and development expenditures in the budget has not been consistent over time and does not accurately reflect the actual recurrent and capital expenditures.

to suppliers and vendors. Such measures, coupled with low execution rates, have curtailed non-

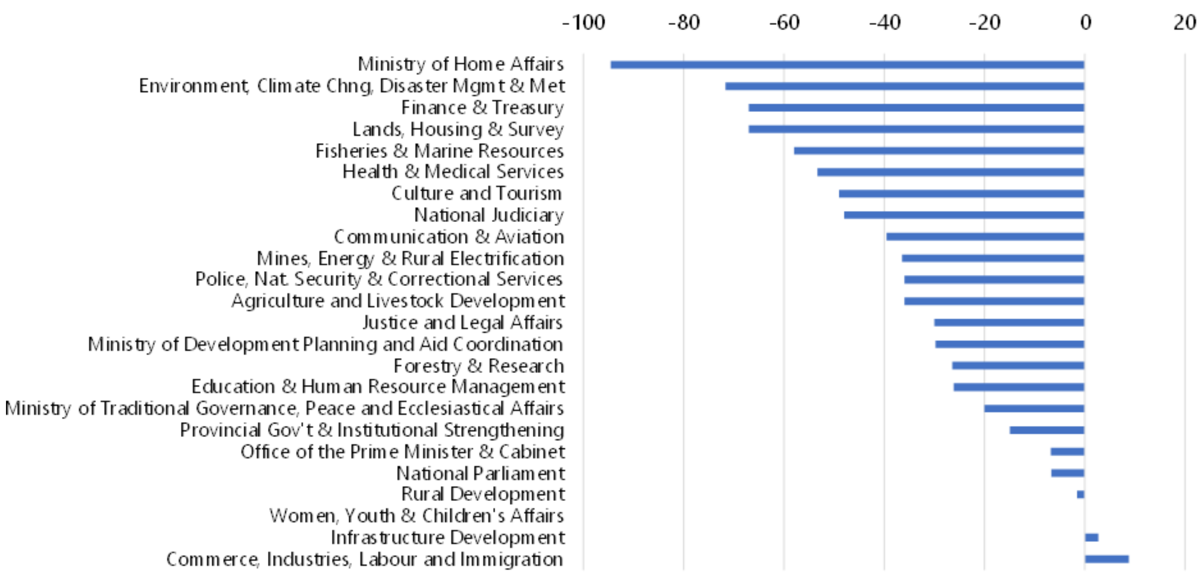
payroll[4] recurrent expenditures and development expenditures, reducing the final financing gap to a level that can be covered by drawing down on the government's cash reserves. For instance, the 2021 budget initially projected a financing gap of SI$329.6 million, which expanded to SI$479.3 million in the supplementary budget, but reduced to SI$15.5 million in the end (Text Table 1). This significant reduction in the financing gap was mainly due to increased donor support and decreased non-payroll current

Table 1. Solomon Islands: Approved Budgets and Outturns, 2021

	Original Budget (SI$ million)	Supple-mentary Budget (SI$ million)	Actual (SI$ million)	Actual - Original Budget (percent)
Total expenditure	4,039.7	4,597.1	3,919.3	-3.0
Recurrent expenditure	3,101.6	3,614.8	3,104.4	0.1
Government funded	2,831.1	2,929.9	2,666.0	-5.8
Payroll	1,290.6	1,293.0	1,347.4	4.4
Other Charges	1,520.5	1,606.9	1,293.5	-14.9
Contigency Warrant	20.0	30.0	25.2	25.8
Donor funded	270.5	684.8	438.4	62.0
Development expenditure	938.0	982.3	814.9	-13.1
Government funded	848.0	892.3	724.9	-14.5
Donor funded	90.0	90.0	90.0	0.0
Total revenue	3,008.5	3,002.0	3,034.4	0.9
Tax	2,576.1	2,612.4	2,648.8	2.8
Others	432.4	389.6	385.6	-10.8
Grants and budget support	360.5	774.8	528.4	46.6
Overall budget balance	-670.6	-820.3	-356.5	-46.8
Development bond	341.0	341.0	341.0	0.0
Remaining Gap	-329.6	-479.3	-15.5	-95.3

Sources: Ministry of Finance and Treasury; IMF staff calculations.
Note: The figures, scope, and presentation follow those of the authorities' budget documents and are different from staff estimates.

Figure 2. Changes in Development Expenditures from Original Budget to Actual, 2021
(Percent of Original Budget)



Sources: Ministry of Finance and Treasury; IMF staff calculations.

[4] Payroll expenditures have occasionally exceeded the original budget, due to the weak control by the government.

expenditures and development expenditures funded by the government. Comparing development expenditures in the original budget with actual spending in 2021, six ministries, including the Ministry of Health and Medical Services, had underspending of more than 50 percent (Text Figure 2).

8. Repeated cash shortages and expenditure controls have severely undermined the quality of public spending and stifled private sector economic activity and market development. The implementation of stringent expenditure controls demonstrates the authorities' commitment to balance the budget. However, the across-the-board spending cuts have made it almost impossible for line ministries and agencies to implement their policies and deliver services according to their plans. In addition, service providers to the government have been plagued by persistent payment delays, identified as a threat to financial stability (CBSI 2023). The uncertainty around the financing needs from the domestic market and the unpredictability of the auction schedules have deterred potential investors from adequately preparing for these auctions, thus impeding market development. All of these indicate that eliminating the financing gap in budget proposals is the critical first step towards reliable fiscal policy management.

C. Solomon Islands' Challenges in Implementing Its Fiscal Framework

9. Solomon Islands, along with its peers in the region, faces significant constraints and challenges in designing and operating its fiscal framework (IMF 2024). These challenges include:

- **Limited scope and control of the budget.** A considerable portion of donor support, including infrastructure projects funded through external concessional borrowing, is managed off budget.[5] Consequently, the accumulation of external debt occurs outside the purview of the budget framework.[6] Estimates in the budget often fail to account for all mandatory expenditures, necessitating significant in-year adjustments[7].

- **Absence of reliable and timely fiscal data** (see the 2024 Solomon Islands Article IV Selected Issues Paper "Strengthening Fiscal Data Governance in Solomon Islands). For instance, the unaudited outturns of the 2022 and 2023 budgets were not published until November 2024. The ministry does not disseminate monthly or quarterly fiscal updates and the results of the mid-year budget review. This hampers informed budget formulation and transparent monitoring.

- **Unpredictable revenues and grants.** As a small, commodity-exporting archipelago nation, the country's economy and revenue are susceptible to exogenous shocks such as commodity price

[5] The World Bank estimates that potentially around 90 percent of total donor spending for Solomon Islands was off budget in 2019 (World Bank 2022).

[6] The Debt Management Advisory Committee assesses the impact of a loan project on the government's financial position at the project appraisal stage. In addition, the authorities have made efforts to include more information on non-appropriated projects financed by donor support in the budget documents, although they have faced challenges in obtaining credible and comprehensive data.

[7] In addition, an array of off-budget projects makes it difficult for the authorities to oversee them holistically and align them with development priorities.

volatility and natural disasters. Estimating grants and budget support during the budget planning phase is challenging due to the varying cycles and systems of donors. A comparison between the budget estimates and actual outcomes reveals that revenue discrepancies over the past three years have been within ±1 percent, whereas disparities in donor support have exceeded 50 percent.

- **Limited Resources.** Budget formulation and implementation is coordinated by a limited number of staff in the Ministry of Finance and Treasury (MoFT), making it unrealistic to take on additional tasks that require significant resources in the short- to medium-term.

10. These constraints suggest that Solomon Islands is not in a position to implement a full-fledged fiscal framework, highlighting the urgent need to address weaknesses in basic PFM functions. Regardless of the precision in designing a fiscal framework, its efficacy is contingent upon a sound PFM foundation. This includes, among other aspects, the impracticality of adhering to a particular fiscal rule when a financing gap remains open at the budget formulation stage and when significant adjustments to mandatory spending are required within the fiscal year. Moreover, the prompt reporting of budget outcomes is essential to assess budget performance against the established targets.

11. Developing a strategic roadmap to strengthen PFM mechanisms with the support of the IMF would be beneficial. This roadmap should outline an immediate action plan focusing on fundamental PFM requirements as well as broader reforms over the medium- to long-term. Many of these actions could be achieved by reinstating past practices that are not currently enforced. Near-term actions should include:

- **Budget formulation.** Prepare a credible estimate of the budget envelope, including the planned domestic bond issuance and donor support, and keep expenditure within the limit. Enhance the accuracy and comprehensiveness of expenditure estimates. Publish the medium-term fiscal strategy that includes medium-term projections of fiscal aggregates.

- **Budget implementation.** Improve cash management and forecasting, including through closer communication with donors. Observe the commitment made in the initial budget, including regarding the hiring of government officials.

- **Budget monitoring and transparency.** Release budget documents in a timely manner, in particular the mid-term budget review and budget outcomes. Resume publication of monthly and quarterly fiscal data.

D. Enhancing Effectiveness of Solomon Islands' Fiscal Framework

12. Urgent action is needed to enhance the effectiveness of fiscal policy to address the following fiscal challenges:

- **Rebuilding the cash balance.** A concrete plan is needed immediately, given the liquidity risk and the country's vulnerability to shocks. However, the pace of the restoration needs to be gradual, as growth is still below potential, the fiscal space is limited, and the shallow domestic market precludes one-off borrowing to quickly rebuild the balance. Staff's recommendation to restore the broader cash balance[8] to at least two months of total spending remains valid.

- **Improving the quality of public spending.** Repeated cash shortages and spending cuts during budget implementation have severely compromised the quality of public spending, as discussed in section B.

- **Imposing fiscal discipline on domestic borrowing.** The rapid increase in domestic borrowing (Figure 1) raises concerns about the sustainability of financing from the domestic market, given the narrow investor base[9] and the underdeveloped financial market. As discussed in Section B, currently there is no effective restriction on domestic borrowing. As a result, expenditures are budgeted on a bottom-up basis, driven by each ministry's spending estimate, with no effective top-down controls on aggregate spending.

To help the government address these challenges while preserving fiscal space for needed investments, this section will explore a practical policy tool to improve the effectiveness of Solomon Islands' fiscal framework, taking into account the country's constraints.

13. Well-designed fiscal frameworks have a medium-term fiscal anchor and operational rules that are simple, implementable, flexible, and monitorable. Fiscal frameworks are generally structured around two types of rules: (i) a medium-term fiscal anchor linked to the final objective of fiscal policy and (ii) operational rules on fiscal aggregates guiding annual budget formulation to navigate to the medium-term anchor. Such a set of fiscal rules should be simple so that they are easily understood by decision makers and the public, and the targets should be largely under the control of policymakers. They should not be so rigid as to hinder response to large shocks, while compliance with the rules should be easy to monitor (IMF 2018b, IMF 2024). These arguments are particularly pertinent for Solomon Islands, given the country's limited resources, aid dependency, and susceptibility to shocks, as discussed in the previous section.

14. Solomon Islands has a medium-term fiscal anchor, but no effective operational rules to guide fiscal policy consistent with the anchor. A natural candidate for a fiscal anchor is a debt-to-GDP ratio, which is already adopted in Solomon Islands (35 percent). However, there is no effective framework to ensure that the annual budget is formulated to be consistent with the medium-term debt anchor. The golden rule has not been binding partly because of inconsistent classification of expenditures: the rule is not linked to the anchor in the first place. The annual borrowing limit is derived from the debt ceiling, but it has also failed to control the budget because

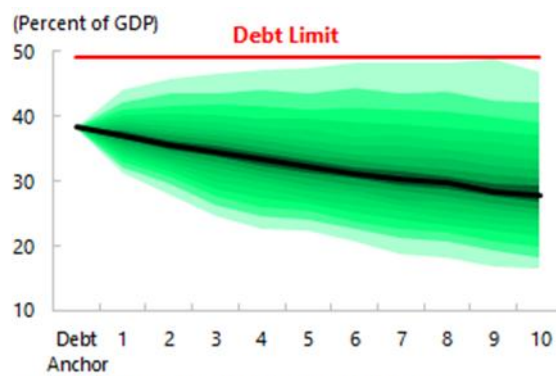
[8] The broader cash balance equals the sum of government deposits held at the CBSI and the commercial banks minus unpaid payment orders and unpresented checks, plus reserves in the government consolidated deposit account.

[9] About half of government bonds are held by the Solomon Islands National Provident Fund, about a quarter by the CBSI, and about 20 percent by two state-owned enterprises.

its complexity and lack of transparency have prevented people from understanding the rule and allowed it to be circumvented.

15. Simulations suggest that the current debt ceiling remains broadly appropriate as a medium-term fiscal anchor. While there is no consensus on the appropriate debt threshold, one approach in the literature is first to define a debt limit, above which there is a high risk of triggering debt distress, and then to calibrate a debt threshold so that debt remains below the debt limit with a chosen probability over a medium term, despite the occurrence of negative shocks (IMF 2018b). In this paper, a debt anchor for Solomon Islands is calibrated using the toolkit developed by the IMF Fiscal Affairs Department (FAD). In Figure 3, the debt limit is set at 49 percent of GDP, which corresponds to the benchmark for a country with weak debt carrying capacity, such as Solomon Islands, in the IMF-World Bank Debt Sustainability Framework for Low-Income Countries. Stochastic simulations based on Solomon Islands' macroeconomic variables suggest that a debt anchor of 35.7 percent of GDP would limit the risk of the debt-to-GDP ratio reaching 49 percent in a decade to less than 5 percent, taking into account macroeconomic shocks, fiscal shocks, and natural disasters[10]. In other words, raising the ceiling further means that the government assumes the risk of hitting the debt limit with a probability higher than 5 percent.[11]

Figure 3. Calibration of Debt Anchor



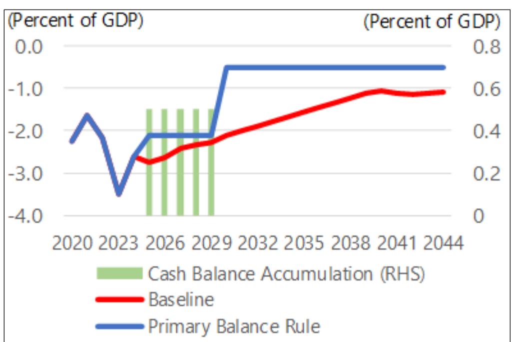
Souces: Solomon Islands authorities; staff estimates.

[10] In simulating the impact of a natural disaster, it is assumed that a natural disaster occurs with a probability of 13.5 percent and causes a loss of 7.1 percent of GDP, based on Lee, Zhang, and Nguyen (2018).

[11] The 5 percent probability is chosen given Solomon Islands' weak debt carrying capacity and history of debt restructuring. If the government assumes a 10 percent risk of hitting the debt limit, for example, the estimated debt anchor will rise to 41 percent of GDP.

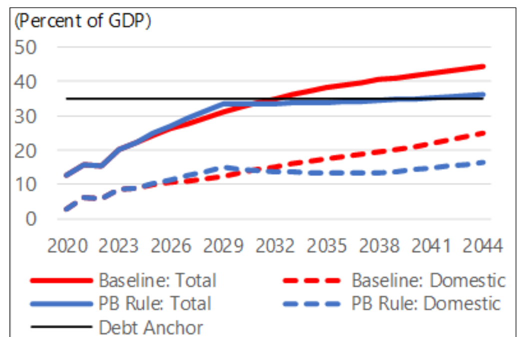
16. A possible operational fiscal rule should allow the government to gradually rebuild the cash balance, while financing infrastructure projects and other investments. It should be noted that major infrastructure projects such as the Tina River Hydropower Development Project are planned until 2029, to be financed by external loan disbursements of 1.8-1.9 percent of GDP per year.[12] Any proposal for an operational fiscal rule needs to accommodate this, in addition to fiscal space for other necessary spending and investment. Staff analysis indicates that the above-mentioned objective would be achieved by targeting a primary fiscal deficit of 2.1 percent of GDP from 2025 to 2029 and 0.5 percent of GDP from 2030 onwards.[13] This assumes domestic borrowing of 0.5 percent GDP each year to build up the broader cash balance to two months of total spending by 2029, in addition to borrowing to finance budget deficits. It is projected that public debt will remain below the 35 percent of GDP ceiling by 2040, if the government manages to control its expenditures and externally financed projects under the rule (Figure 4).

Figure 4a. Primary Balance



Sources: Solomon Islands authorities; staff estimates.

Figure 4b. Public Debt



Sources: Solomon Islands authorities; staff estimates.

17. In light of the weak PFM foundation, staff proposes the introduction of a simple ex-ante guideline for annual budget formulation that is consistent with the primary balance rule suggested above, as an interim measure. As discussed above, the government is not in a position to implement a full-fledged fiscal framework as presented in the previous paragraph: considerations of donor-supported projects, including infrastructure projects financed by concessional loans, are not integrated into the annual budget process, and credible budget data are not available on a timely basis to track the implementation of the fiscal rule. However, the urgency of the fiscal challenges requires a guideline that can be implemented immediately in the current weak PFM settings to enable the government to prepare a budget proposal that addresses these challenges. Therefore, staff proposes the introduction of a simple ex-ante guideline for annual budget formulation, which is not an operational fiscal rule per se, but consistent with it, as an interim

[12] These loan disbursements are projected on the basis of donor resources allocated to Solomon Islands and will need to be updated as donor resources are revised.

[13] This analysis is based on staff's baseline assumptions, which assume around 3 percent growth and 3.3 percent inflation in the long run, as well as average interest rates of 1.8 percent for external debt and 4.0 percent for domestic debt. It is assumed that adverse impacts of fiscal adjustments on growth could be minimized through enhanced efficiency of public expenditures.

measure while the government builds up sufficient PFM capacity. As the proposed guideline is not intended to be a fiscal rule, strict compliance, such as through legislation, would not (and cannot) be required. The government could decide to adopt the guideline, for instance, by a cabinet decision and reaffirm its commitment in the budgetary strategy developed at the beginning of the budgetary process. Such a guideline would force the government to prioritize expenditures within the envelope when preparing a budget proposal, rather than cutting spending during the fiscal year in the face of a cash crunch.

18. Staff proposes that the guideline set a ceiling on the primary budget deficit financed by domestic borrowing. In other words, the ceiling would apply to the balance between domestic revenues (i.e. tax and other revenues) and primary spending financed by these resources: such spending is under the control of the government and can be reliably estimated at the stage of a budget proposal. In order to follow the primary balance path set out in paragraph 16, taking external financing in the staff baseline as given, the government would need to maintain the domestically financed primary balance at around 0.3 percent of GDP until 2029. This assumes that the government would borrow domestically by 0.5 percent of GDP each year from 2025 to 2029 to build up the cash balance, in addition to borrowing to finance budget deficits (Text Table 2).

Table 2. Solomon Islands: Fiscal Balance and Financing
(Percent of GDP)

	2020	2021	2022	2023	2024	2025		2026		2027		2028		2029	
						Base-line	Guide-line	Base-line	Guide-line	Base-line	Guide-line	Base-line	Guide-line	Base-line	Guide-line
Primary Balance	-2.2	-1.6	-2.2	-3.5	-2.6	-2.7	-2.1	-2.6	-2.1	-2.4	-2.1	-2.3	-2.1	-2.3	-2.1
Domestically financed	-0.8	-0.5	-2.1	-0.6	-0.4	-0.9	-0.3	-0.7	-0.2	-0.5	-0.2	-0.5	-0.3	-0.5	-0.3
Externally financed	-1.4	-1.1	-0.1	-2.9	-2.3	-1.8	-1.8	-1.9	-1.9	-1.9	-1.9	-1.8	-1.8	-1.8	-1.8
Less: Interest expense	0.2	0.2	0.3	0.3	0.5	0.5	0.5	0.6	0.6	0.7	0.7	0.7	0.8	0.8	0.9
Overall Balance	-2.4	-1.9	-2.5	-3.8	-3.1	-3.3	-2.7	-3.2	-2.7	-3.1	-2.8	-3.1	-2.9	-3.1	-3.0
Financial Transactions	2.4	1.9	2.5	3.8	3.1	3.3	2.7	3.2	2.7	3.1	2.8	3.1	2.9	3.1	3.0
Liabilities:	2.4	1.9	2.5	3.8	3.1	3.3	3.2	3.2	3.2	3.1	3.3	3.1	3.4	3.1	3.5
Domestic	1.0	0.7	2.4	0.9	0.8	1.5	1.3	1.3	1.3	1.2	1.4	1.2	1.6	1.3	1.7
External	1.4	1.1	0.1	2.9	2.3	1.8	1.8	1.9	1.9	1.9	1.9	1.8	1.8	1.8	1.8
Less: Assets: Cash Balance							0.5		0.5		0.5		0.5		0.5

Source: IMF staff estimates.

19. The government should assess ex-post whether the budget was implemented in line with the guideline and whether the fiscal outlook is consistent with the medium-term anchor. It is important that the government reviews the implementation of the guideline ex post and explains the reasons for deviations from the guideline. The budget outcome report would be an appropriate venue for this. It is also important that the government regularly monitors whether the envisaged evolution of its financial position is consistent with the medium-term anchor. This would allow the government to recalibrate the guideline as necessary, especially when the debt to GDP ratio is projected to reach the 35 percent ceiling in the near future. To this end, the government should resume the publication of the medium-term fiscal strategy.

20. The PAC could contribute to overseeing the implementation of the guideline. When the government adopts the guideline and resumes the publication of the medium-term fiscal strategy, the PAC will be in the best position to assess the implementation of the guideline and medium-term fiscal outlook by the government. This oversight would bolster the fiscal framework's credibility and transparency, provided that the committee is equipped with sufficient resources and time. It is not realistic to create an additional independent fiscal agency in Solomon Islands, given limited human resources.

E. Conclusion

21. Solomon Islands faces the immediate fiscal challenges of rebuilding cash reserves, improving the quality of public spending, and imposing fiscal discipline on domestic borrowing. To address these challenges while financing needed investments, it is an urgent priority to enhance the effectiveness of its fiscal framework, in parallel to efforts to build basic PFM capacity. Among other things, it is essential to improve the budget formulation process by improving the accuracy of budget estimates and keeping expenditures within the estimated budget envelope.

22. Given the weak PFM foundations and the absence of effective operational fiscal rules, staff proposes, as an interim measure, the introduction of a simple ex-ante guideline for annual budget formulation that sets a ceiling on the domestically financed primary deficit. Staff analysis suggests that the current 35 percent debt-to-GDP ratio threshold remains broadly appropriate as a medium-term debt ceiling. The proposed guideline, which is consistent with a possible fiscal rule to keep public debt below the 35 percent ceiling in the long run, sets a ceiling on the domestically financed primary budget deficit at around 0.3 percent of GDP until 2029. This assumes that the government would borrow domestically by 0.5 percent of GDP until 2029 to build up the cash balance, in addition to borrowing to finance budget deficits.

23. The government should assess ex post whether the budget was implemented in line with the guideline and whether the fiscal outlook is consistent with the medium-term anchor. The government should explain deviations from the guidelines in the budget outcome report, while recalibrating the guideline as necessary to be consistent with the medium-term debt anchor. The PAC is best placed to monitor the implementation of the guideline and medium-term fiscal outlook by the government.

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