

## **PRESS RELEASE**

EMBARGO: NOT FOR PUBLICATION UNTIL  
13:00 GMT 22 SEPTEMBER 1998

PRESS/TPRB/81  
22 September 1998

### **ECONOMIC RECOVERY IN THE SOLOMON ISLANDS DEPENDS ON RAPID IMPLEMENTATION OF COMPREHENSIVE REFORMS**

The Solomon Islands must implement comprehensive economic reforms if it wants to keep serious macroeconomic imbalances and structural weaknesses from intensifying. A new WTO Secretariat report urges the Solomon Islands to accelerate its efforts to achieve a balanced budget, to privatize and deregulate key service utilities, liberalize investment rules and eliminate generous tax exemptions.

The WTO Secretariat report and a policy statement prepared by the government of the Solomon Islands will provide the basis for a review at the WTO of the Solomon Islands' trade policies and practices on 21 and 22 September 1998.

The WTO's report notes that the Solomon Islands is now focusing on rehabilitating its public finances. The new government, in place since September 1997, inherited an economy in crisis and in need of urgent fundamental reform. Prospects for improving the economy worsened further last year in the wake of the Asian financial crisis and the collapse of world timber prices, a main export of the Solomon Islands.

The government sees trade-related reforms as an important means of fostering private-sector-led growth and enhancing productivity and competitiveness. External trade is vital to the Solomon Islands' economy. Merchandise exports and imports averaged 51% and 47% of GDP during 1993-97. Exports consist largely of timber, fish and traditional agricultural goods. In 1996, over three quarters of exports went to Asian markets. Timber is sold principally to Japan and other Asian countries. Fish exports, mainly of canned tuna, go almost entirely to the United Kingdom under preferential EU access arrangements.

The WTO report states, however, that the erosion of these preferences, as well as their extension to other least-developed countries (LDCs) may intensify competitive pressure on the fishing industry. Similarly, the future viability of the logging industry depends not only on how quickly world timber prices recover, but also on the extent to which export restrictions by other lumber suppliers, such as Indonesia, are relaxed. Furthermore, unsustainable logging of commercial forests is threatening the industry's survival beyond 10-15 years. By contrast, in the case of fishing, off-shore catches of tuna are well below sustainable levels.

Trade taxes are the Solomon Islands' main intervention measures and the government's principal source of revenue, currently accounting for more than half of total tax income. Export taxes apply to a wide range of primary products, especially round logs (at a rate of 35% or 38%) and uncanned fish (5% or 10%). The taxes aim to promote the development of wood and fish processing industries. While reliance on trade taxes has been declining in recent years, thereby mitigating their import substitution and export restraining effects, the government's continued heavy dependence on these taxes for revenue is a major constraint on trade liberalization. Moreover, export taxes contribute to the "high-cost" nature of the Solomon economy. The WTO report states that a comprehensive tax reform is needed to reduce reliance on trade taxes.

The Solomon Islands is a signatory to the Lomé Convention and receives non-reciprocal preferences from the European Union on many goods as well as additional financial assistance. It is also granted duty-free and unrestricted access to Australia and New Zealand as a party to the South Pacific Regional Trade and Economic Cooperation Agreement (SPARTECA), a non-reciprocal preferential agreement. Furthermore, the Solomon Islands is a beneficiary of the General System of Preferences (GSP).

In the Uruguay Round, the Solomon Islands bound its entire tariff at ceiling rates (around 80%) generally well above applied rates. The simple average applied MFN rate is 22.7%. These rates range from a minimum of 5% to a maximum of 70%, the latter applying to many food items and consumer products. Much higher composite duties (excluded from the estimated total average) apply to alcoholic beverages, motor vehicles and used clothing. While tariffs are almost exclusively *ad valorem*, the transparency of the past tariff system was undermined by the widespread use of discretionary exemptions and remissions. The government has recently taken steps to remove these exemptions and the WTO's report notes that the removal of tariff concessions together with a move to lower, more uniform levels would further enhance the efficiency, simplicity and transparency of the customs tariff.

The Solomon Islands has put into place different measures to attract investment such as tax concessions, discretionary use of concessions on trade and excise taxes, income tax holidays and other fiscal incentives, whose effectiveness is dubious. The government is also reviewing its investment procedures with the aim of making them more transparent and conducive to foreign investment. The WTO report, however, notes that the efficient supply of basic services is essential to attracting foreign investment and that most basic services in the Solomon Islands, such as electricity, telecommunications, ports, water, air and maritime services, are still provided by state-owned statutory monopolies sheltered from competition. The Solomon Islands also limits certain economic activities - agriculture, forestry, fishing, manufacturing, construction, wholesale and retail trade, communications and tourism - to its indigenous population. Foreigners are allowed to lease but not to buy land.

The WTO report concludes that the Solomon Islands must take immediate action in key areas to prevent paralysis of the reform programme or it risks jeopardizing its economic recovery. Achieving a balanced budget in 1998 will be a critical milestone in the government's resolve to implement reform. Liberalization of investment rules, complemented by trade reforms, is necessary to attract capital into efficient industries that can survive without government assistance. And faster

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privatization and deregulation of key utilities will also help revitalize the economy. While external aid will continue to be essential for the Solomon Islands, aid donors and the government will have to ensure that financial assistance is coordinated and provided in ways that encourage economic growth and development.

#### Notes to Editors

The WTO's Secretariat report, together with a policy statement prepared by the Solomon Islands Government, will be discussed by the WTO Trade Policy Review Body (TPRB) on 21 and 22 September 1998. The WTO's TPRB conducts a collective evaluation of the full range of trade policies and practices of each WTO member at regular periodic intervals and monitors significant trends and developments which may have an impact on the global trading system. The Secretariat report covers the development of all aspects of each of the Solomon Islands' trade policies, including domestic laws and regulations, the institutional framework, trade policies by measure and by sector. Since the WTO came into force, the new "areas" of services trade and trade-related aspects of intellectual property rights are also covered.

To this press release are attached the summary observations from the Secretariat report and the full government policy statement. The full Secretariat report is available for journalists from the WTO Secretariat on request (call 41 22 739 5019). It is also available for the press in the newsroom of the WTO internet site ([www.wto.org](http://www.wto.org)). The Secretariat report, together with the government policy statement, a report of the TPRB's discussion and the Chairman's summing up, will be published in hardback in due course and will be available from the WTO Secretariat, Centre William Rappard, 154 rue de Lausanne, 1211 Geneva 21.

Since December 1989, the following reports have been completed: Argentina (1992), Australia (1989, 1994 & 1998), Austria (1992), Bangladesh (1992), Benin (1997), Bolivia (1993), Botswana (1998), Brazil (1992 & 1996), Cameroon (1995), Canada (1990, 1992, 1994 & 1996), Chile (1991 & 1997), Colombia (1990 & 1996), Costa Rica (1995), Côte d'Ivoire (1995), Cyprus (1997), the Czech Republic (1996), the Dominican Republic (1996), Egypt (1992), El Salvador (1996), the European Communities (1991, 1993, 1995 & 1997), Fiji (1997), Finland (1992), Ghana (1992), Hong Kong (1990 & 1994), Hungary (1991 & 1998), Iceland (1994), India (1993 & 1998), Indonesia (1991 and 1994), Israel (1994), Japan (1990, 1992, 1995 & 1998), Kenya (1993), Korea, Rep. of (1992 & 1996), Lesotho (1998), Macau (1994), Malaysia (1993 & 1997), Mauritius (1995), Mexico (1993 & 1997), Morocco (1989 & 1996), New Zealand (1990 & 1996), Namibia (1998), Nigeria (1991 & 1998), Norway (1991 & 1996), Pakistan (1995), Paraguay (1997), Peru (1994), the Philippines (1993), Poland (1993), Romania (1992), Senegal (1994), Singapore (1992 & 1996), Slovak Republic (1995), South Africa (1993 & 1998), Sri Lanka (1995), Swaziland (1998), Sweden (1990 & 1994), Switzerland (1991 & 1996), Thailand (1991 & 1995), Tunisia (1994), Turkey (1994), the United States (1989, 1992, 1994 & 1996), Uganda (1995), Uruguay (1992), Venezuela (1996), Zambia (1996) and Zimbabwe (1994).

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**TRADE POLICY REVIEW BODY**  
**SOLOMON ISLANDS**

**Report by the Secretariat – Summary Observations**

The Solomon islands is a small archipelago in the south pacific. Despite having relatively abundant forestry and fish resources, it is one of the region's poorest countries; GDP per capita was us\$950 in 1995, and the islands have least-developed country status. Inept economic management by previous governments has constrained development and often favoured vested interests at the community's expense. The present government, which assumed office in September 1997, inherited an economy in crisis and in need of urgent fundamental reform.

The government's commitment to broad reforms is clear from its policy and structural reform programme. Rapid implementation is essential to prevent the economy's chronic macroeconomic imbalances and serious structural deficiencies from intensifying.

**ECONOMIC ENVIRONMENT**

After gaining independence from the United Kingdom in 1978, the Solomon Islands adopted inward-looking trade policies aimed at promoting the processing of primary resources, such as fish and timber, as well as encouraging manufactures. These interventionist policies were manifested in high and disparate trade taxes on imports and exports; a heavy state role in industrial development; a large public service; and high, unsustainable fiscal deficits underpinned by expansionary monetary policies.

These policies resulted in the economy becoming virtually insolvent by 1997, with the government unable to service public debt, which escalated to over 65% of GDP in 1997. Arrears grew sevenfold to SI\$184.3 million in 1997, over three times that year's fiscal deficit, and equivalent to 13% of GDP. Monetary policy has also been ineffective since August 1995 when the Central Bank suspended new credit to the Government under rules limiting public debt to 40% of average budget revenues.

Inflation is expected to rise from 8% to double-digit levels in 1998. Although annual average real GDP growth of 5% has exceeded population growth by 2% since 1991, its durability is threatened by the unsustainability of the logging activities that have fuelled this growth. Long-term viability of the timber and fishing industries, upon which the economy critically depends, is a major concern.

The managed exchange rate has appreciated in real terms during recent years, despite the recent 20% devaluation, potentially undermining export competitiveness. A more flexible and market-determined exchange rate system may improve international competitiveness and insulate the external balances from outside shocks.

The history of poor fiscal and monetary management has reduced confidence of international investors and aid donor. Foreign direct investment has fallen to low levels and the external balance remains vulnerable.

Achieving a balanced budget in 1998 will be a critical milestone in the Government's resolve to implement reform. Restoring fiscal balance requires stringent controls to meet expenditure and revenue targets and achieving other key policies, including downsizing of the public service; asset sales from privatization to help pay off debt; and the elimination of generous tax exemptions. However, progress has been slow and further delays need to be resisted. Action is necessary in key areas to prevent paralysis of the reform programme, which would jeopardize the economic recovery.

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The Solomon Islands' economic difficulties have been accentuated by recent external developments, including the Asian crisis. Its two main exports, logs and fish, have been adversely affected by the collapse in world timber prices in late 1997 and the reduction of EU preferences for processed fish.

#### THE SOLOMON ISLANDS IN WORLD TRADE

External trade is vital to the Solomon Islands' economy. Merchandise exports and imports averaged 51% and 47% of GDP, respectively, during 1993-97. External balances have fluctuated considerably; at the end of 1997, reserves provided less than two months of import cover. Deficits on merchandise and services trade have been offset by capital and aid inflows.

Exports consist largely of timber, fish and traditional agricultural goods of palm oil, copra and cocoa. Over three quarters of exports in 1996 went to Asian markets. Timber is sold principally to Japan and other Asian countries; log exports have declined substantially following the collapse of world timber markets in late 1997. Fish exports, mainly of canned tuna, go almost entirely to the United Kingdom under preferential EU market access arrangements (Lomé Convention).

Imports are mainly of manufactures, especially machinery and transport equipment, food, fuels and lubricants. Well over half of imports are from Australia and New Zealand.

#### LEGAL AND INSTITUTIONAL FRAMEWORK

The Solomon Islands is a constitutional monarchy with substantial devolution of powers to provincial governments. Although responsibility for trade-related policies rests with the national Government, provincial governments may pass ordinances affecting such policies, including the provision of agricultural grants and protection of on-shore fishing. They must also approve forestry, mining and fishing developments on customary land, which accounts for over 90% of land ownership.

Legislative power resides in a unicameral national Parliament. Executive power is vested in the national Government, elected every four years. The Prime Minister is elected by Parliament. A Cabinet of senior ministers formulates policy.

With the aim of improving the coordination of trade and economic policies, the Government has developed an organizational decision-making structure involving the Ministries of National Planning and Development, the Prime Minister's Office and Ministry of Finance, as well as the Central Bank, to help implement the reform programme. Two new ministerial task forces — one examining economic reform and the other public sector reform — report to a Cabinet sub-committee (the Policy and Structural Reform Committee, PSRC) chaired by the Prime Minister. The Government reform blueprint is being formulated in the Medium-Term Development Plan (1999-2003).

The Government consults frequently with the private sector through the Chamber of Commerce, which is represented on the PSRC. No independent statutory body exists to advise the Government on, or to review, trade-related policies, including the provision of tariff and other industry assistance.

#### TRADE POLICY FEATURES AND TRENDS

The Solomon Islands, a de facto GATT contracting party since independence, acceded to the WTO as an original member in July 1996. Its entire tariff was bound under the Uruguay Round, mainly at a ceiling level of 80%. It scheduled GATS commitments on professional, construction, tourism and financial services. It is not a signatory to any of the Plurilateral Trade Agreements.

The Solomon Islands' only exception to MFN treatment concerns tariff preferences within the MSG (Melanesian Spearhead Group) Trade Agreement of 1996. These cover imports of tea from Papua

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New Guinea and beef from Vanuatu; and its canned tuna exports to these countries enter duty free. Fiji is now a member of the Group, and more products are covered, such as fruit, nuts, coffee and cement.

As a signatory to the Lomé Convention, the Solomon Islands receives non-reciprocal preferences from the European Union on many goods. Additional financial assistance, totaling ECU 28 million to 1996, has been provided under Lomé IV, mainly as grants under STABEX or EDF.

The Solomon Islands is also a party to the South Pacific Regional Trade and Economic Cooperation Agreement (SPARTECA), a non-reciprocal preferential agreement covering the Forum island countries (FICs) aimed at achieving duty-free and unrestricted access for FIC exports to Australia and New Zealand. It is also a beneficiary of the GSP schemes of most industrialized economies.

#### RECENT EVOLUTION

The Government's immediate priority is comprehensive economic reform to redress serious macroeconomic imbalances and structural weaknesses. Great importance is attached to the rehabilitation of public finances. Economic policy is to be export-oriented and outward looking. Trade-related reforms are seen as an important means of fostering private-sector-led growth and enhancing productivity and competitiveness.

The main policy priorities are tariff and tax reforms, notably reduction of exemptions; downsizing of the public sector; more transparent and facilitative foreign investment policies; and sustainable management of key natural resources, especially forestry and fishing.

While the Government's intent was to commence the main policy reforms from mid-1998 after fully reviewing existing policies, several important decisions were taken in advance. These included the cancellation of export tax remissions on logs in November 1997, and implementation of a moratorium on new logging licences. This was followed by a 20% currency devaluation in December 1997. Furthermore, the tariff was substantially revised in March 1998; this involved the compression of the duty structure from 20 ad valorem rates, ranging from zero to 225%, into five rates of 5, 10, 20, 40 and 70%, the modal rate being 10%. Subsequently, a 10% across-the-board import surcharge was introduced in the April 1998 Budget to raise revenue.

The Government sees meeting its multilateral commitments as playing an essential role in its reform agenda. It intends to implement, for example, WTO-consistent policies on customs valuation, intellectual property protection, agriculture and quarantine, as required for least-developing countries, with technical support from bilateral and multilateral donors.

#### TYPE AND INCIDENCE OF TRADE POLICY INSTRUMENTS

Tariffs are the main instrument of trade policy. Applied MFN duties remain relatively high, with an unweighted average of 23%, excluding the 10% surcharge and specific duties. The top ad valorem tariff rate of 70% is mainly on processed foods and consumer goods, such as perfume, jewellery, electronics and furniture. However, higher composite duties, involving specific rates, apply mainly to tobacco products; alcoholic beverages, including beer; new and used motor vehicles; and worn clothing.

The five-rate tariff structure contains built-in escalation, with higher duties imposed on fully processed products. Average applied MFN tariffs 26% on these products of are two-thirds higher than for semi-processed products. However, de-escalation exists between raw materials and semi-processed products, reflecting much higher duties on raw materials. Although tariff transparency is

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enhanced by application of ad valorem duties to 97% of all tariff lines, it has been reduced by the widespread discretionary use by past governments of exemptions and remissions, often for obscure reasons. The present Government estimates that these cost 40% of collectable customs revenue, and is reviewing their use. Some were removed recently following changes to the Customs Act.

There are no duty drawback or similar arrangements for exporters. Removal of tariff concessions together with a move to lower, more uniform levels, if not a single rate, would further enhance the efficiency, simplicity and transparency of the customs tariff.

The Government aims to improve customs efficiency and reduce tariff evasion. It is considering introducing pre-shipment inspection services using a private contractor. The former Brussels Definition of Value (BDV) is used for customs valuation, and no minimum prices are applied. No legislation exists on safeguards nor on anti-dumping and countervailing actions.

Few formal non-tariff trade barriers apply. Certain import prohibitions and controls apply for environmental, health, public safety and security reasons as well as under international conventions, such as CITES. Import licensing exists on methylated spirits and ethyl alcohol (importable only by government pharmacies), alcoholic spirits, used clothing, arms and ammunition. There are no import quotas or trade embargoes; nor are there local-content requirements for domestic production. Government procurement is by open tender.

The Solomon Islands does not set or impose standards, nor is it a member of ISO. International standards are applied occasionally for public safety reasons, as on chemicals and hazardous fertilizers, herbicides and construction equipment. There are no marking, labeling or packing requirements. Quarantine provisions apply to imports of plant and animal products, mainly meat, dairy, eggs, honey, hides and skins, unless sourced from Australia or New Zealand.

Export taxes ranging between 5% and 38% apply to many unprocessed products, especially logs, fish, gold, copra, palm oil and cocoa; some of these taxes were increased in the 1998 Budget. Export licences are required for logs and, from 1997, for gold and other minerals. Other export controls are mainly for cultural, health and environmental reasons, or in accordance with international conventions, as in the case of export prohibitions on wildlife under CITES. Exports of war relics, bait fish, traditional artifacts, and endangered species, such as bêche-de-mer and trochus shells, are also prohibited or controlled.

No export quotas or voluntary export restraints apply and exports are not subsidized. However, profits from exports are non-taxable for up to six years (with possible extensions), depending upon the level of domestic value added.

While there are no production subsidies in the Solomon Islands, tax concessions are granted for investment and production. In addition to the discretionary use of concessions on trade and excise taxes, there are income tax holidays and other fiscal incentives, such as special write-offs and accelerated depreciation provisions. Many of these measures reflect the national policy of attracting export-oriented investment. These incentives currently under review, further erode the already narrow tax base. It is doubtful whether such incentives, are effective.

There is no specific competition law. However, the Government intends to introduce legislation to protect consumers from unfair trade practices. Price controls apply to a range of staple items, including milk, tinned meat and fish, sugar, soap, rice, cooking oil, bread, electricity, petroleum products and water charges. The Government also intends to privatize and corporatize several state-owned enterprises, including a number of holdings of the Investment Corporation, notably Solomon Telekom, and some other utilities.

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Renewed efforts are needed to ensure greater private participation in providing key utility services. This will improve efficiency and reduce prices. Poor, and relatively expensive, basic services by government monopolies deter foreign investment and restrain growth.

The Government is reviewing its investment procedures with the aim of making them more transparent and conducive to foreign investment. Although there are no maximum foreign ownership limits, the Foreign Investment Board examines proposed local ownership levels on a case-by-case basis. It may stipulate some divestment of foreign ownership over the project's life. A relatively large negative list reserves for indigenous people certain activities in agriculture, forestry, fishing, manufacturing, construction, wholesale and retail trade, communications and tourism. Non-Solomon Islanders can lease, but may not buy, land.

Trade taxes on imports and exports remain the main interventionist measures. A major constraint on trade liberalization is the Government's heavy reliance on these taxes for revenue. Although declining, they provide over half of tax revenue; until recently, export taxes, especially on logs, were the main revenue source. Thus, trade liberalization and tax reform are closely intertwined. Trade taxes are a distorting means of raising government revenue. Comprehensive tax reform is needed to reduce reliance on trade taxes, to strengthen tax administration and broaden the base.

#### SECTORAL POLICIES

The Solomon Islands is heavily dependent on agriculture and natural resources of forestry and fishing. These account for over half of GDP, with manufacturing, excluding fish processing, representing only 3%.

Most sectoral policies relate to the development of wood and fish industries. Trade and investment measures have been designed to promote downstream processing of these resources. Such policies include export taxes on unprocessed timber and fish, as well as efforts to make fishing and logging licences largely conditional upon domestic processing. These policies, which tax the unprocessed activity, risk creating economically and technically inefficient downstream processing industries reliant on continued government support. The present Government has not yet indicated whether it will uphold the previous Government's stated policy intention of prohibiting round log exports in 1999.

Export taxes, levied on producers, compound the anti-export bias inherent in the country's tariff and other economic policies that contribute to the 'high-cost' nature of the economy. They tax resource rents from forests and fishing inefficiently and undermine conservation by reducing domestic prices for the unprocessed product. The Government might usefully explore more efficient ways of securing their share of resource rents (such as the government auctioning of logging licences or levying of stumpage fees on production).

Sectoral policies have contributed to the poor management of these key natural resources. Unsustainable logging of commercial forests, with licensed harvest levels running at almost three times sustainable yields, until the current downturn in the global timber market, has threatened the industry's survival beyond 10-15 years. By contrast, in the case of fishing, off-shore catches of tuna are well below licensed, and much higher sustainable, levels. Both are uneconomic outcomes that reduce the economy's long-term growth prospects.

Copra, cocoa and palm oil products are important traditional agricultural commodities. The statutory monopoly exporter of copra and cocoa, the Commodities Export Marketing Authority, operates a copra price stabilization scheme, involving public funds, and a similar scheme will operate for cocoa from 1999. The Authority also markets coffee together with spices, such as chillies, turmeric, vanilla, ginger and cinnamon. Palm oil products, such as palm kernel and coconut oil, are the backbone of

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plantation agriculture. The Government directly participates through ownership interests in Solomon Islands Plantation Limited and the Russell Islands Plantation Estates Limited. The Government is considering privatizing some of these interests.

Tourism is targeted for development. The Government encourages private development by offering various tax concessions, including five-year tax holidays and accelerated depreciation.

Efficient provision of basic business input services is essential to improve international competitiveness and attract foreign investment. Most basic services, such as electricity, telecommunications, ports, water, air and maritime services are provided by as state-owned statutory monopolies sheltered from competition. For example, the Postal Corporation, although corporatized in 1996, retains its legislated monopoly over delivery of national and international standard letters. Solomon Telekom, which is 58% state-owned, has a 15-year statutory monopoly over telecommunications services until 2002.

Banking licenses must be approved by the Central Bank. Foreign banks may operate domestically as locally incorporated subsidiaries or as foreign branches, provided an assigned minimum level of capital is kept within the country. The Central Bank accepts that such branches will be adequately supervised by their own prudential regulators. Banks are prohibited from providing insurance services.

#### TRADE POLICIES AND FOREIGN TRADING PARTNERS

The Solomon Islands' economy is in urgent need of large-scale economic reform. Although some significant first steps have been taken, much more needs to be done. As a small, least-developed island economy, its economic prosperity hinges on becoming more integrated into the world economy. Trade measures are applied on a non-discriminatory basis, and its reliance on tariffs together with bindings as a result of the Uruguay Round have significantly increased the predictability of its trade regime. Preferential trading arrangements with MSG members and proposed initiatives within the Forum to establish a Free Trade Area among FICs should not be allowed to impede the process of non-discriminatory trade liberalization.

The Solomon Islands depends heavily on log and fish exports. However, the international competitiveness of both industries is under threat. Processed fish exports (mainly canned tuna) rely heavily on preferential EU access to the United Kingdom market under the Lomé Convention. Erosion of these preferences, as well as their extension to other LDC competitors, may be expected to intensify competitive pressure on the industry. Similarly, the future viability of the logging industry depends not only on how quickly world timber prices recover, but also on the extent to which export restrictions by other lumber suppliers, such as Indonesia, are relaxed.

Implementation of the Government's reform programme, including prudent use of monetary and fiscal policies, should substantially reduce the anti-export bias inherent in its trade regime and improve the efficiency of resource use. This should enhance competitiveness on both home and export markets. A more market-oriented economy would also benefit its trading partners.

Trade, investment and economic growth are closely linked. Increased efforts to remove impediments to international trade and investment can be expected to contribute to economic development. Liberalization of investment rules, complemented by trade reforms, is necessary to attract capital into efficient industries that can survive without government assistance. Faster privatization and deregulation of key utilities will also help revitalize the economy.

External aid will continue to be essential for the Solomon Islands. However, it needs to be recognized that over-dependence on aid may obstruct the economic restructuring needed to improve the

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economy's resilience, and have adverse side effects, by accentuating the 'high cost' economy and undermining international competitiveness. The difficult challenge facing aid donors and the Government will be to ensure that financial assistance is coordinated and provided in ways that encourage economic growth and development. In this context, the conditions resulting from renegotiation of Lomé IV in 2000 will be important.

The Solomon Islands will always be vulnerable to external disturbances and their effects on trade balances. Trade liberalization is an important means of increasing economic flexibility and the capacity of the economy to adjust to international influences. The future pace and depth of its trade reforms will be contingent upon the maintenance of an open, stable and predictable global trading regime that can successfully combat protectionist pressures in major export markets. The Solomon Islands' trading partners can greatly assist the Government's efforts to turn the economy around by ensuring non-discriminatory and stable access to their market.

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**TRADE POLICY REVIEW BODY**  
**SOLOMON ISLANDS**  
**Report by the Government**

**MACROECONOMIC PERFORMANCE**

Solomon Islands economic performance, until the onset of the Asian economic crisis of 1997 was characterized by strong export receipts, modest inflation but stagnant growth in domestic credit and critical problems in fiscal policy. GDP growth averaged around 3-4% generated largely from strong output performance in the forestry, fishing and agriculture plantation sectors.

Positive growth was experienced since the early 1990s. The forestry sector experienced a logging boom while developments in the fishing sector were stronger than in the past decade. The economy, however, became increasingly dependent on timber revenues, which by 1995 accounted for around half of export earnings and over a third of government revenues. By 1996 the export base was less diversified than at any time since the early 1970s. The government reached a crisis point in fiscal management by 1995. This placed strains on the domestic financial system and on relations with domestic and foreign creditors.

Since mid-1997, the slowdown in economic performance was exacerbated by the Asian financial crisis. The impact of this is being felt mainly through, the balance of payments and the exchange rate, inflation, production and government finances. The economy experienced lower than expected export receipts, a rise in inflation, depressed government revenues and a general slow down in economic activity.

These trends are expected to continue throughout the rest of 1998 and also in 1999. The short to medium term outlook for the Solomon Islands is not encouraging as the economy is heavily dependent on international trade with Asia, and the prolonged crisis in Asia will have a negative impact on the demand for and prices of Solomon Islands' export as well as upon economic growth in general.

Given the resource endowment of the Solomon Islands, the economy has the potential to grow in the long term. However, to achieve its potential, the right mix of policies and business environment need to exist in Solomon Islands. The government is fully aware of the adverse impact an expansionary and unsustainable fiscal policy can have on the economy and has already taken steps to ensure sound management of its finances as a critical prerequisite to restore economic stability. Fiscal budgets will be in future be drawn up to ensure stability and balance in revenues and expenditures. The government of the Solomon Islands is committed to the full and timely payment of its public debt (and arrears). Public policy will also be instrumental in assuring the rate of resource utilisation at sustainable levels and to ensuring the effective use of the incomes derived from the exploitation of national assets. The challenge in the medium term is to improve the efficiency of public policy and administration to enable the Solomon Islanders to contribute more effectively to, and benefit from, growth in the economy.

The government also recognizes the role played by the private sector and will continue to provide a conducive business climate for private sector to grow and invest. Government will therefore, concentrate on critical areas such as infrastructure development and rehabilitation, investment in human capital, and ensuring the existing legal framework simple and complementary to private sector development.

Prospects for 1999 and in the medium term future therefore, depend on policy decisions related to the governments' reform program, the level of assistance received from development partners and multilateral agencies and changes in the real economy. The Gold Ridge mine has commenced production in the third quarter of 1997, fish and palm oil are expected to be resilient but log exports will be depressed which could result in a vulnerable balance of payments position throughout 1999.

Recognizing the urgent need for an immediate turnaround to salvage the current economic down-fall, the Solomon Islands Alliance for Change (SIAC) Government in November 1997 released its statement of Policies structured and designed to restore macroeconomic stability and initiate microeconomic reforms to promote restructuring and improve efficiency which the Government is committed to achieve.

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Solomon Islands maintains a constant real exchange rate in order to enhance the country's international competitiveness. To this end, Solomon Islands is moving quickly to apply a comprehensive phased reform programme beginning from public sector reform, structural reform on high tariffs and freezing high wage rates.

## TRADE POLICIES AND PRACTICE

The significant changes in the global economy towards trade liberation, economic deregulation, trade and investment promotion are key factors influencing Solomon Islands development strategy. In October 1997, the Government announced its Structural Reform Programme, aimed at improving Solomon Islands current economic and a long term prospects. With this in mind, the Government is undertaking a phased reform programme to review the existing import restrictions and reduction of imports tariffs, tax reform, public sector reform, and export promotion and development.

The structural reform program announced in October 1997 by the Government is aimed at moving the economy towards sustainable, private sector led economic growth. The reform programme focuses on economic reform, including macro-economic stabilization policies and microeconomic policies for enhancing productivity and competitiveness, as well as policies aimed at redirecting and deploying resources from the public to private sector. There is a clear need for external and internal financial balance, appropriate monetary and fiscal policy aimed at achieving low inflation and interest rates, increase of employment, a stable exchange rate and a reduce on balance of payments deficit. Microeconomic reforms include trade and investment policies, tariffs and taxes as well as sectoral policies, focused on enhancing transparency of investment policies; accelerating tariff reductions on goods and services traded among Forum Island Countries; and reviewing duty remission policies.

Solomon Islands trade policy objectives include progressive removal of trade barriers. It is the Government's desires to promote and diversify export trade as an important means of economic development. To achieve this, the Government is undertaking a comprehensive review of the tax system, with a view to broadening its base and reducing tax rates, focusing in particular on tax and tariff reform. It is also moving towards the removal of administrative obstacles to investment aimed at improving the transparency of investment policies, and to creating a conducive environment for private sector growth and development. A further review of the trade taxes with a view to create uniform rates to eliminate trade distortions is also being considered. The government is also studying a consumption based 'value added tax' aimed at gradually removal of the tax imposed by tariffs.

A major objective of the Government's reform programme is the implementation of sustainable management policies over its key natural resources, such as forest, marine, minerals and agricultural commodities and implementing effective control over the unsustainable exploitation of such resources is also high on the agenda.

Since the early 1990's there has been a progressive move towards export oriented policies which is also the main trade policy objective of the Government. Policy is aimed at developing an open outward-looking and export oriented economic that generates rapid rates of growth and higher standards of living. Also, a national policy is in place to encourage export related investment. This includes a range of income and other tax concessions which are available under the Foreign Investment Act as investment incentives.

## TRADE POLICIES BY SECTOR

The Primary Sector accounted for 42% of GDP in 1995, with agriculture representing just over half of this share. The former accounted for around a quarter of formal employment, with agriculture and forestry the most important contributors. The primary sector is also the Solomon Islands main source of export earnings. In 1996, timber and fish accounted for 79% of the total exports. Traditional agriculture commodities of considerable export significance are palm oil, copra and cocoa. These traditional agriculture commodities and other export potential cash crops such as chillies and local fruit tress will be the primary focus of the Government's policies on agriculture.

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The Government's agriculture policies, outlined in the 1994 Agriculture Sector Plan are to facilitate export diversification for minor crops such as chillies, and the development of the local fruit trees like canarium nuts. Promoting and encouraging downstream processing of traditional tropical tree crops, such as copra, cocoa and palm oil is also high on the agenda.

Round log exports increased substantially during the 1990's largely because of high international log prices. However, exports fell substantially in 1997 in line with the fall in international log prices. Although log exports fell in 1997, projected log exports will remain at 600,000 cubic metres in 1998. The current harvesting rates equivalent to almost three times the estimated sustainable yield, raises concern by the new Government, and intends to put in place legislation aimed at sustainable management of the forest resources including a fundamental strengthening of the control mechanism governing the harvesting of the forest resources. In 1997 the Government formally recognised the Code of Practice for Timber Harvesting as a means of improving logging practices in Solomon Islands.

Oil palm products including copra are at present and will continue to be the backbone of the plantation sector in the Solomon Islands. Efforts have been made to extend the benefits of oil palm cultivation to shareholders in the Outgrower Scheme funded by the European Union. Under this Scheme, Solomon Islands Plantation Limited (SIPL) provides seedlings, management support, and input including markets for end products. The programme was designed to encourage further expansion of oil palm plantation, but close proximity to SIPL's processing mill.

Copra is an important commodity in Solomon Islands; as well as an important export earner. Commodities Export Marketing Authority (CEMA) has exclusive export rights over copra. CEMA operates a copra price stabilization scheme, aiming at stabilizing copra price in order to give rise to copra production. In its development policies the Authority is embarking on a program for all copra to be crushed domestically into coconut oil by 1999. CEMA has now established four copra crush mills.

The fisheries sector is an important source of foreign exchange; and contributed 8% of the total GDP in 1995, an increase from 5.5% in 1980. The fisheries export is mainly of processed chilled, frozen, canned and fresh 'sashimi' tuna; and other marine products such as bêche-de-mer and shark fin. The fisheries accounted for well over 18% of total export in 1996. Given the potential for the development of the fisheries sector, Solomon Islands has drafted a new fisheries act, aimed at facilitating further development of the industries and the necessary adjustments. The legislation is expected to be brought to Parliament in 1998.

Solomon Islands has maintained very high nominal rates of export taxes on logs in order to encourage downstream processing of timber resources and to generate revenue. Excessive logging has created considerable environmental concern, particularly over the control and management of country's key natural resources. These concerns have prompted the SIAC Government to put in place measures geared towards improving performance in logging and other natural resource based activities, largely to achieve sustainable economic growth. It must be noted that the Government is committed to encouraging the private sector lead development of downstream processing of marine and forest products. The Solomon Islands government will adopt Trade and Investment measures aimed at promoting downstream processing. However, unlike measures adopted in the past Solomon Islands will seek to develop an industry policy that will facilitate processing that aims at achieving international competitiveness within time-bound constraints.

Production and marketing of minerals is regulated under the Mines and Minerals Amendment - 1996. Legislation prohibits prospecting and mining on land without prior consent from the customary landowners. Solomon Islands encourages foreign investment in this sector at present through geological publications, and by providing these to potential investors. Applications for exploration and mining leases are considered by a statutory Minerals Board, which comprises of relevant Ministries, departments and provincial governments and landowner. Similar arrangement also apply to petroleum mining under the Petroleum Act - 1987, and Petroleum Regulation.

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Manufacturing, other than fish processing contributed only 4% of the Solomon Islands GDP in 1996, and accounted for just over 10% of formal employment. Solomon Islands intends to review its manufacturing policies; to attract foreign investment by improving the labour market; and reducing trade and production distortions, such as excessive tariff barriers as well as improving infrastructures.

The services sector including public administration account for a large and growing share of production in Solomon Islands. In 1995 it accounted for around 47% of the total GDP. Solomon Islands recognise the importance of having a vibrant and efficient service sector for development of its exports as well as implementation of its policies. The SIAC government has undertaken measures assuring the right-sizing of the public sector.

Tourism is one of the Government's priority sectors. Policies for tourism development are designed especially to encourage eco-tourism. This has been an area in which some good progress has been made. The Government, in its reform program to develop tourism industry, intends to further review its policies on tourism including reviewing current international airfares with a view to reduce them so as to further assist the development of the sector.

Given the geography of the Solomon Islands sea transport, including an efficient port services and inter-island shipping services is an important priority. Sea transport provides vital links to remote islands and resources, and the Government intends to either subsidise non-commercial routes, or through licensing tender unprofitable routes to private shipping operators.

Air transport is and will always play an important role in Solomon Islands export of agriculture and perishable products including fresh 'Sashimi' tuna. The Government recognizes the advantage of creating competition in international travel to enhance the growth in trade, tourism and the domestic economy. The Solomon Islands government has recently granted approval to a privately owned operator, King Solomon Airlines to operate the route to Cairns, Australia.

Telecommunications are currently provided by Solomon Telekom which has a monopoly in the sector. The existing legislation which provides Solomon Telekom with a monopoly in telecommunications services is due to expire in the year 2002. The Government is considering the possibility of deregulating this sector to allow competition and hence to encourage quality services but at lower prices.

## TRADE POLICY - INSTITUTIONAL FRAMEWORK

Formulation of trade policy in the Solomon Islands involves cabinet approval. Laws enacted by Parliament are generally initiated from respective Ministries; submitted to cabinet for approval before being presented to Parliament for enactment, thereafter submitted to the Governor General for his assent.

The administration of trade policy comes under several Ministries, Departments and Government statutory bodies. Regular reviews of trade policies and devices long-term strategy is the responsibility of the Ministry of Commerce, Employment and Tourism. The private sector's input is channelled through the Chamber of Commerce, and has been regularly consulted in the trade areas.

There are laws and regulations governing the implementation of trade policies in Solomon Islands, including sector-specific Acts. The Government intends to closely examine and review a substantial number of these laws, particularly those that affecting trade-related policies; and to bring them into conformity with its WTO obligations. This includes an update of intellectual property rights.

Solomon Islands is a signatory to convention between the European Union (EU) and the Pacific ACP; the MSG Trade Agreement (MSG) between Papua New Guinea (PNG), Vanuatu, Solomon Islands and Fiji as well as SPARTECA. The Solomon Islands also benefits from other preferences such as the GSP of Japan and the USA. Solomon Islands generally, supports the notion of a regional free-trade area among the Pacific Island countries; as well as the regional trade initiatives begin undertaken within the Forum Economic Ministers Meeting.

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## TRADE POLICY IMPLEMENTATION

The continuous decline of nominal and effective tariffs is part of Governments policy to gradually move away from dependence on import duties as a source of revenue. Solomon Island has introduced a revised tariff schedule which commenced from March 1998. The new tariff condensed the original number of individual *ad valoren* rates which ranged from zero to 225%, down to five rates ranging from 5%, 10%, 40% and 70%. The highest rates of 40% and 70%, apply to 34% of tariff lines, cover mainly luxury goods for revenue reasons and to avoid over-exploitation.

Solomon Island applies MFN tariffs on imports from all countries, except Papua New Guinea and Vanuatu as founding members of MSG Trade Agreement, and recently Fiji following its admission to the agreement. This will allow Fiji eligible products to be imported duty free. Eligible imports from these MSG member states are duty free, and recently expanded to 229 items from 3 in 1993.

Custom duties are levied on the C.I.F value of the imported product since 1987, when the basis for duty is calculated from charge of "selling price to purchase". The method used for customs valuation is consistent with the former Brussels Definition of value (BDV). The Government is intending to implement the WTO customs Valuation Agreement (CVA) by 2002, and also further decreasing the rate of customs duty, and replacing it with value added tax (VAT).

All commodities, except logs are exported under general authority issued by the Central Bank of Solomon Islands (CBSI) provided under the exchange control regulations. Solomon Islands exporter do not need to be registered. However, export documentation generally required are shipping bill and a commercial invoice. On logs, exporters must provide tally sheets, a price certificate from the Commissioner of Forests as well as specific Authority from CBSI.

Realizing the short-fall faced in the past of inefficient and ineffective coordination of trade policies, the present Government is committed to introduced a more coordinated approach to trade and economic policy formulation and implementation.

## ECONOMIC ENVIRONMENT AND FACTORS INFLUENCING TRADE

In 1997, the Government introduced its key policy designed to move towards sustainable economic growth, realizing the difficulties paused as a result of the economic situation Solomon Islands currently faced.

The new Government has devised policies for economic reform; released in November 1997. An integral part of the reform program is the formulation of the Medium Term Development Plan, 1999 - 2003, aimed at achieving balanced and sustainable economic development and sound management of its natural resources.

To enhance the implementation of the proposed reforms, the Government has implemented an organizational and decision making structure to administer the proposed program. The Government also, recognizes the urgency of translating this commitment to reform into policy action.

In the 1998 Budget, the Government announced several initiatives aimed at improving financial control. It also outlined policies taken by the Government, in an endeavour to reduce public sector expenditures, namely: a wage freeze on public servants and a recruitment freeze. Already the Government has taken steps to increase revenue collection by reforming the customs tariff and eliminating tax exemptions where this is legally possible.

Introducing fiscal discipline to improve checks and controls; to reduce public sector expenditure and deficits is the Governments priority policy list in order to enhance sustainable economic growth. Under its reform program, it will review the present inefficient duty and tax collection and major exemption and concessions.

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In December 1997, the Government devalued the Solomon Islands dollar by 20% against United State dollar. This decision was taken primary to restore the country's international competitiveness. Since then the Solomon Islands dollars has stabilized against the US Dollar.

The 1998 Development Budget estimated a total of SI\$88.8 million foreign aid of which 70% occurs as grant. This is a large inflow to Solomon Islands economy, equivalent to 15% of total exports receipts in 1996, making it the third - largest source of foreign currency source after timber and fisheries. The Government under its reformed macroeconomic policies is determined to ensure that these aid inflow do not create macroeconomic instability.

One of the main objectives of SIAC Government's reform policies is to improve the export-led growth strategy aimed at a generation of new entrants into the Solomon Islands labour market, and to achieve an improvement in the standard of living. The Government has noted the importance of a flexible and competitive labour market.

The downturn in the Asian economies has been instrumental in the current decline in the logging sector. South Korea and Japan have been our traditional markets for South Sea logs. Solomon Islands is now seeking alternative markets for logs stock piled in log ponds.

Solomon Islands intends to implement its Uruguay Round obligations; by reforming legislation affecting trade. However, while Solomon Islands wishes to begin these reforms at the earliest possible, limited resources will affect the progress of the review of these policies. The Solomon Islands will be seeking technical assistance from developed WTO members to assist in the preparation of legislation to assure compatibility of WTO laws with existing obligations.

Lack of expertise, marketing skills, and distance to markets; and vulnerability to natural disaster, will remain the major constraints to the development of the Solomon Islands export sector.

Solomon Islands is strongly supportive of the Multilateral Trading System and the liberalization of global trade bearing in mind the special needs of least developed and highly vulnerable island states.

In its effort to liberalize trade the Government in 1997 under its Reform Programs restructured, the Import and Export Tariffs and reduced the number of rates from some twenty different rates to seven basic rates with 5% being the minimum and 70% the maximum. The other rates are 10%, 20% 40% and 50%.

The restructuring reflects most products now bearing 10%-40% whereas before the reduction those commodities carried between 50%-100% and in some cases were even as high 200%. The 70% rate in many cases is used as a protective rate but this protection is subject to review and maybe removed if a local manufacturer does not improve his product quality and stay competitive in the market.

In the areas of export tax, most exports are either free of duty or carry low duty rates between 5% - 10%. The 5% rate is imposed on major exports such as palm oil, cocoa, copra and tuna. The 10% rate is imposed on all marine products except trocus shell which bears 30% as a protective rate. Farmed marine products are free of export duty to encourage export of locally bred products.

There are no export taxes on manufactured products there is no export duty levied on those. This is to encourage local manufacturing and export of those products.

Solomon Islands has made a progress in restructuring of its import tariff by reducing the number of duty rates and lowering the rates in may cases although a few essential items have been increased for revenue and protective reasons.

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## CONCLUSION

The government has recently undertaken a comprehensive program aimed at achieving sustainable private sector led economic growth. It is also committed to fulfill its WTO obligation towards trade liberalization policy measures. However, Solomon Islands will need more time to adjust its existing laws and regulation affecting trade. Because of its small but open economy, Solomon Islands will have to carefully monitor the pace of its import and export liberalization, in order to allow time to enhance local efficiency productivity and strengthen competitiveness. With this in mind, Solomon Islands will employ a phasing reform approach towards its trade liberalization.

Solomon Islands Trade Policy Review preparatory work which began in March 1998, has given us an opportunity to identify our constraints and opportunities for trade development. This will enable us, to reform our trade policies and create a trading environment for the private sector to get maximum economic benefits from reforms and adjustments made to our trade development policies.

The government is presenting the country's legal framework as a priority with a view to accommodate any policy changes for the effective development of the private sector .

It is the Government policy to continue to promote and encourage greater transparency, harmonization of tariffs, and slowly remove trade distortions and trade barriers. To that end the Government of the Solomon Islands intends to bring legislation to parliament that will see all tax incentives granted to investors gazetted and publicly notified.

Solomon Islands will continue to support private sector lead growth through the improvement of economic infrastructure, Human Resources Development, aimed at improving domestic labour market productivity; and the provision of competitive market environment.

Since accession to the WTO in June 1996 Solomon Islands is committed to continue to make modifications to existing laws and regulations, and implements various measures to assure compliance with its commitments in the WTO, despite the complexity of the work involved.

Solomon Islands recognizes the importance of free and open trade, and will, therefore, continue to conduct its trade policy in a transparent and fair manner.

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