



**Solomon Islands Government
&
Delegation of the European Commission in Solomon Islands**

**Joint Annual Report 2004
Volume I Main Report and Conclusions**

March 8th 2005

Abbreviations and Currency Equivalents

Abbreviations

ADB	Asian Development Bank
AusAID	Australian Agency for International Development,
CBSI	Central Bank of SI
CSP	Country Strategy Paper
DAL	Department of Agriculture and Livestock
DBSI	Development Bank of SI
DFEC	Department of Forestry, Environment and Conservation
DNPAC	Department of National Planning and Aid Coordination
DNRP	Department of National Reform and Planning
DSE	Development Services Exchange
EC	European Commission (Brussels)
ECD	European Commission Delegation (Honiara SI)
EDF	European Development Fund
EIB	European Investment Bank
ERU	Economic Reform Unit
ESIRP	Education Sector Investment and Reform Programme
ESP	Education Sector Plan
EU	European Union
FFA	Forum Fisheries Agency
FMO	Framework of Mutual Obligations
FMP	Forest Management Project
FA	Financing Agreement
FP	Financial Proposal
FPA	Fisheries Partnership Agreement
GEF	Global Environment Facility
IP	Implementation Protocol
JAR	Joint Annual Report
JICA	Japan International Cooperation Agency
KSA	Key Strategic Area
MDG	Millennium Development Goals
MEHRD	Ministry of Education and Human Resources Development
MID	Ministry of Infrastructure Development
MIP	Marine Infrastructure Programme
MOF	Ministry of Finance
MPP	Micro Projects Programme
MTR	Mid Term Review
NAO	National Authorising Officer
NCA	National Competent Authority
NCA	National Council of Women
NEMS	National Environmental Management Strategy
NERRDP	National Economic Recovery, Reform and Development Plan
NGO	Non Government Organisation
NIP	National Indicative Programme
NSA	Non State Actor
NZAID	New Zealand Agency for International Development,
PCRPP	Post Conflict Rehabilitation Programme
PS	Private Sector
PSec	Permanent Secretary
RAMSI	Regional Assistance Mission to the Solomon Islands
ROC	Republic of China, Taiwan

RSIP	Royal SI Police
RTC	Rural Training Centre
RWSS	Rural Water Supply and Sanitation
SAP	Structural Adjustment Programme
SBD	Solomon Islands Dollar
SI	Solomon Islands
SICA	SI Christian Association
SIG	Solomon Islands Government,
SICHE	Solomon Islands College of Education
SIPL	Solomon Islands Plantation Limited
SME	Small Medium Enterprise
SPC	Secretariat of the Pacific Community
TA	Technical Assistance
TCF	Technical Cooperation Facility
TDTF	Transport Development Trust Fund
TPPU	Transport Policy and Planning Unit
UK	United Kingdom
UNDP	United Nations Development Program
UNICEF	United Nations Children's Fund
UNIFEM	United Nations Women's Fund
WB	World Bank
WDD	Women's Development Division
WP	Work Programme

Currency (as at end of December 2004)

€ 1.0 = SBD 10.0

AUD 1.0 = 5.8

USD 1.0 = 7.7

The exchange rate has changed significantly in recent months. In September 2004 the rate used by the EU was €1.0 = SBD 9.04, it rose to € 1.0 = SBD 10 by the yearend, whilst by the end of January 2005, it was €1.0 = SBD 9.8.

Volume II Annexes (separate volume)

Annexes with a Prospective Character

Annexes with a Retrospective Character

Thematic Annexes: Supporting Economic Data

Environment

Social

Conflict Analyse

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1. EXECUTIVE SUMMARY

An economic recovery process has begun following the restoration of law and order in mid-July 2003 with the arrival of the regional military and police force intervention force, RAMSI. Economic growth rose significantly by an estimated 6% in 2004, but this was largely due to record levels of timber sales. There has been a considerable macro-economic turnaround and a welcome build up in reserves to USD 70 million. SIG has a comprehensive National Economic Recovery, Reform and Development Plan (NERRDP) as a basis for its medium term development strategy. The challenge will be to achieve a lasting economic recovery on the basis of sustainable utilisation of natural resources, development of the moribund key private sector and most importantly improving the economy in the rural areas where the bulk of the population live. There is likely to be a downturn in logging in future, but it is hoped that reopening of the gold mine and oil palm plantations and increased tuna sales will compensate this. Many of the underlying causes of the ethnic tensions still remain to be addressed, particularly the need to demonstrate good governance, to resolve the deep-seated regional differences (notably between the peoples of Guadalcanal and Malaita), to demonstrate a more equitable allocation of resources between the provinces and the need for a resolution of land disputes and rationalise compensation claims.

Political tensions remain high, due to the arrest of several prominent politicians on corruption charges, trials of rebel leaders, the upcoming election in early 2006, the debate on federalisation and the demands for independence from certain provinces that could disrupt political stability. There is concern that although RAMSI has restored law and order and improved fiscal management, SIG has not been able to take this opportunity to effect needed fundamental reforms due to cabinet disunity, endemic corruption and a failure to stop the continued unsustainable exploitation of the country's natural resources. In summary, the present political situation is best described as fragile, with lasting stability and peace representing a major challenge to government, and the prospects for economic recovery on a sustainable basis are uncertain.

Social conditions have worsened over the period of ethnic tension and conflict. Poverty has undoubtedly increased in recent years, due to the near-collapse of the economy. Nevertheless there is no hunger or abject poverty or major food security problems because of the climate and subsistence based economy and the wantok social safety net mechanism. Health and school enrolment indicators are still relatively poor with concerns over the potential spread of HIV/AIDs, gender issues and domestic violence. The SIG has prepared a draft report on the situation of the Millennium Development Goals in 2004, and has highlighted lack of statistics and capacity as key problems in reporting. Environmental concerns expressed in the CSP remain, as SI has fragile ecological systems including marine systems and natural forests, in which unsustainable and ill-managed logging and over-fishing represent real threats. Landowners and governments have enabled overseas operators to exploit these resources for many years

Against this background, the 8th EDF focused on poverty reduction in the rural areas, with particular attention to education, maritime infrastructure and micro-projects. The CSP/NIP for the 9th EDF signed in 2002 maintained the focus on sustainable rural development, and added an emphasis on capacity building, but due to the ethnic tensions and conflict, implementation has been delayed. An MOU was signed in 2004 with NZAID and SIG endorsing a long-term commitment to education under Stabex 99. The new Stabex 98 FMO, which will be submitted for approval in March 2005, focuses on rural development including marine and rural transport, fisheries, forestry/conservation, agriculture and capacity building. The MTR of the 9th EDF was undertaken in 2004, which endorsed the current policies and the transfer of envelope B to envelope A. The combined resources available from the Stabex 98 and Stabex 99 (undisbursed funds of about € 43 million and € 17 million respectively), remaining funds from EDF funds and the 9th EDF, including the B envelope, give a total of € 80.1 million for disbursement, which will mean a doubling of disbursements from 2005 to 2009. This level represents a relatively large one-off opportunity to assist SI in its social and economic recovery and will place the EU as the second largest donor after Australia.

The major issues are whether political stability and law and order, an end to the culture of impunity, capacity building and the functioning and integrity of the civil service can be achieved, and whether the

opportunities created for income generation and the improvement in basic services will generate tangible economic benefits as a peace dividend to prevent a return to conflict and disintegration of the country.

2. UPDATE ON POLITICAL, ECONOMIC AND SOCIAL SITUATION

2.1 Update of Political Situation to end 2004

The serious breakdown of law and order and security and political turmoil, which started in 1999 resulting in the overthrow of government in 2001, was reversed with the arrival of the military intervention force, the Regional Assistance Mission to the Solomon Islands (RAMSI) by 24th July 2003. By late September 2003, some 280 RAMSI Police officers and 1840 military and police personnel, plus civilian advisers, were in place. RAMSI focused on and rapidly achieved a remarkable improvement in law and order and stabilisation of government finances during late 2003/2004 such that 2004 can be described as the first full year of a post conflict economic recovery. In addition some 3,700 weapons were recovered and some 365 arrests were made.

There remain, however, deep-seated constraints including corruption, distrust of government, the ruined infrastructure and the need to address the underlying issues that led to the troubles in the first place. A background and assessment of the conflict is presented in Annexes 16-19 in which the core issues affecting peace and conflict in the SI are summarised. These are: Land, Traditional versus Non-Traditional Authority Structures, Access to Information, Government Services and Public Resources, Economic Opportunity and Law and Justice. The hoped for reopening in 2005 of the oil plantation estate on the Guadalcanal plain and the gold mine at Gold Ridge, that were damaged and abandoned during the troubles, could rekindle these animosities if they again draw in significant labour from other islands. Anger amongst supporters over trials of rebel leaders and outstanding claims for compensation for properties seized from fleeing Malaitans are also contentious issues that are likely to have an added dimension in relation to the next election scheduled for the first quarter of 2006.

There have been signs of weaknesses that could destabilise the government. Examples are disunity in the cabinet as indicated by the sacking of three ministers in July 2004, the arrest of certain prominent politicians/minister on corruption and criminal charges that will continue in 2005, criticisms within cabinet of RAMSI, the failure to pass the new Forestry Bill (drafted and revised over an extended period and firmly supported by Australia and other donors), a number of scandals involving fishing licences and exemptions from customs duties, increased crime and cases of violence, including the killing of an Australian businessman and the shooting of an Australian Police Officer in December 2004.

Three reports were prepared by government reviewing the presence of RAMSI in SI and led to disunity within cabinet (although the PM has been consistently supportive) over the future of RAMSI and other difficulties include inconsistencies in policies between RAMSI and AusAID, the transfer of ownership from Australia to SIG, the transfer of capacity to SI staff and the system of short term employment and high turnover of RAMSI personnel leading to lessons not learnt.

Debate commenced in November 2004 on creating a federation of states, largely to satisfy calls for autonomy or independence from some provinces with the introduction of a draft federal constitution. The issues involved are likely to be increasingly raised in the run up to the election in early 2006. Most donors feel that the increased recurrent costs needed and the lack of human resource capacity in the provinces are major obstacles to successful federation. In addition, there are potential demands for independence by certain provinces (Malaita) and the reappearance of self-interest in provincial politics (Guadalcanal and others). Governance therefore remains a major issue.

With the general elections looming, attention is focusing on the need for concrete improvements in the country's infrastructure and living standards, especially in the rural areas. Unless adequate economic opportunities are generated on a more balanced regional basis, migration to Guadalcanal could trigger a return of ethnic tensions and conflict. Beyond that challenge, more long-term issues need to be addressed,

such as weak provincial governments and administrations, local ownership and participation and securing a sustainable improvement in governance. It requires firm commitment by government to address the inequitable distribution of resources, achieve capacity building, create opportunities for income generation, improve basic infrastructure and services and make tangible improvements in sustainable resource management, notably forest and marine conservation. In summary, the situation is fragile and lasting stability and peace represents a major challenge to government.

2.2 Update on the Economic Situation

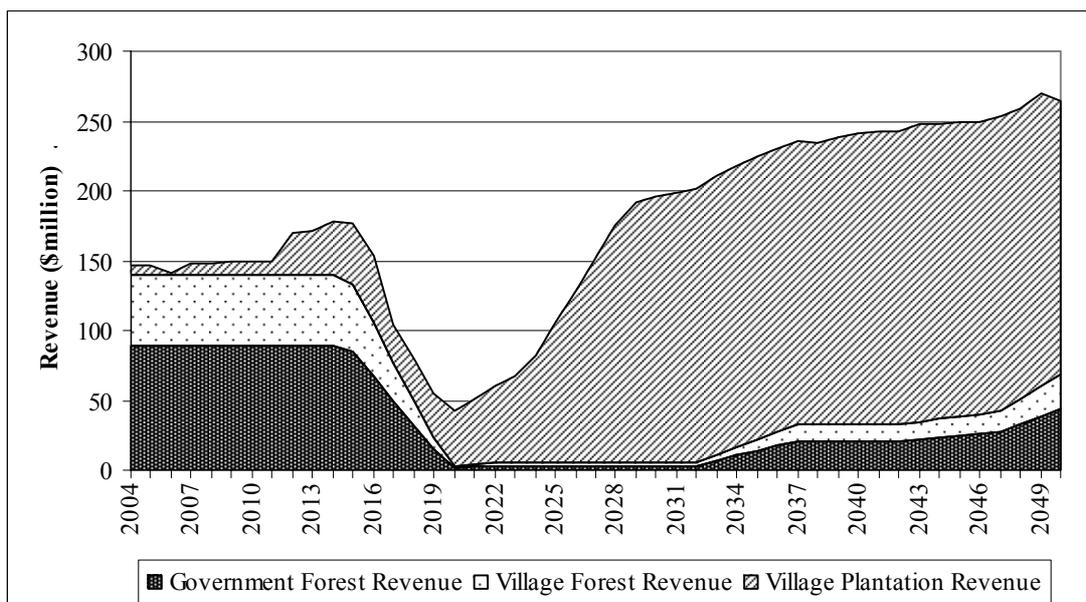
The effects of the troubles over the six years from 1998 to 2003 on the macro-economic situation were devastating and resulted in a 40-50% contraction of the economy and an approximate halving of GDP per capita from € 810 in 1998 to € 420 in 2002. Apart from the direct human impact, the legacy of the conflict is widespread damage to the social and physical infrastructure (in particular transport) – much of which had been poorly maintained for a long time also - and to public and private property, with an estimated cost of over SI\$200 million, equivalent to 20% of GDP.

With the deployment of RAMSI in mid-2003, governance and public finance management improved and, after four years of contraction, real GDP increased by 3.8% in 2003 and a remarkable estimated 6% in 2004. However, much of the renewed economic activity is donor driven and due to unsustainable log exports. Data on the financial situation as at end of 2004 produced by the MOF and IMF are attached in Annexes 9 and 10. Given the magnitude of debt, estimated at around SBD 2.1 billion at the end of 2004, the Government decided not to seek new loans and to make payments of past arrears only from revenue in excess of budget estimates. The Australian Government serviced the WB and ADB loan repayments until mid-2004, but repayments have subsequently been taken over by SIG in 2005. With the likely fall in revenues from logging, this may affect the country's debt repayment ability and balance of payments situation if alternative economic developments do not materialise.

Government's own revenue relies on improved tax collection, particularly from logging, which even in the absence of firm controls and with tax exemptions, have increased substantially since 2003 and accounted for 25% of SIG revenue in 2004. The increase in log exports, but in particular the foreign aid inflows, built up foreign exchange reserves to US\$70 million by the end of 2004, allowing 7 months of import cover. This has helped stabilise the exchange rate since mid-2004 between the SI dollar (SBD) and US dollar and the currencies of SI's major trading partners (however it fell against the strengthened Euro as indicated on the front currency equivalent page). Political will to adhere to budget discipline is of concern with recent examples of a 16% civil service pay rise and the decision to provide free primary education.

A National Economic Recovery, Reform and Development Plan (NERRDP), presented in November 2003 by the Government and endorsed by the donor community, comprises a medium term development strategy to redress complex post-conflict related problems and provided the framework for the resumption of more active donor programme. NERRDP entails an action programme in five key strategic areas as outlined in Section 3.1 together with a summary of progress in implementing the NERRDP that was presented at the donor meeting held in Honiara in November 2004.

It is expected that logging, fisheries and copra and cocoa production will remain the main short-term drivers of growth. Logging, at 1.1 million m³ per year exports in 2004, exceeded the sustainable level by a factor of four and if continued will lead to the natural forest being logged out within ten years and a serious reduction in government revenues from forestry will result - as indicated in the following graph prepared in 2002. It shows that revenues will plummet between 2016 and 2020. However, as logging volumes have been significantly above that shown on the graph, this point is likely to be reached much earlier, say by 2010 and will trigger revenue constraints as well as balance of payment difficulties in the absence of alternative sources. It also shows that village plantations, together with a few major plantations will gradually become the dominant timber-producing sub-sector.



Source: SI Forestry Management Project Phase 6, National Forest Resource Assessment, 2003

The reduction in logging should be compensated to some extent through re-opening of the gold mining and oil palm operations (which provided 25% and 20% of the value of exports in 1999, but have remained suspended since the troubles) and increased tuna fish sales. Negotiations are currently proceeding between SIG, traditional landowners and new developers on the reopening of the Gold Ridge Mine and the former SI Plantation Limited (SIPL), both on Guadalcanal. The latter, taken over by New Britain Palm Oil Ltd had originally planned to start on April 7th 2005 may be delayed due to land disputes with some former landowners and provincial leaders. The mine has been taken over by the Australian Solomon Gold (ASG) Mining Company that is aiming to restart after extensive rehabilitation in late 2005, although there are also disputes over employment and land that could delay start-up date. Another proposed oil palm plantation in the Aluta Basin in east Malaita is also earmarked for development, but no firm commitment has yet been made or a commercial developer identified.

The basis of the SI economy are the rural villages where 85% of the population reside gaining their livelihood and sustenance from subsistence farming and cash generating activities, especially the production of copra, cocoa and marine products. The private sector is relatively small and undeveloped. There are only a small number of private sector companies (many having closed operations during the troubles), with few new business start-ups observed. Lack of appropriate finance, investor confidence, business and entrepreneurial skills and inhibiting bureaucracy/legislation has contributed to this situation. An Economic Reform Unit has been established in the MOF to oversee and implement key economic reforms, such as the foreign investment code, taxation, *Forests Bill*, public service review, reintroduction of sectoral audits (forestry, fisheries) and the application of a medium term expenditure plan, amongst others..

The major economic constraint for SI is the wide dispersal of the population across the country's far-flung islands, most of which experience limited economic development and very poor communications, notably inter-island shipping. Inequitable development and the related pressure from migration, mainly to Honiara and its hinterland, have contributed to social tensions, and may do so again, if inadequate action is taken to create income opportunities in a more geographically balanced manner. The long-term prospects for the economy are uncertain and represent a major challenge. Whether sufficient economic growth and government revenue can be generated from the private sector and smallholders, plus the reopening of the gold mine and oil palm plantations, to replace the downturn in logging sales that is likely in future is the main issue.

2.3 Update of the Social Situation

The UN Human Development Index ranked SI as 124th out of 177 countries in 2002 and the ADB in 2004 ranked the SI below all but one of its Pacific Members. Social conditions have almost certainly worsened over the period of ethnic tension and conflict, and there are wide disparities between Honiara and the provinces. Poverty has undoubtedly increased in recent years, especially for women and children, due to the near-collapse of the economy. However, as 85% of population grow subsistence food crops and/or raise livestock, there is neither abject poverty nor starvation in the country, food security is generally not a problem (apart from periodic seasonal shortages) and the wantok system provides an effective social safety network mechanism for people in difficulties. Concerns relate to primary school enrolments that are low and gender disparities that are high. There has been slight progress on infant and child health indicators, but a worsening of maternal health indicators. High endemic rates of malaria and the potential threat of HIV/AIDS have not to-date been adequately addressed, considering the high rates within some neighbouring Pacific states.

2.3.1 Achievements in the Social Sectors (Social Indicators and MDGs)

The country has adopted the Millennium Declaration and Millennium Development Goals (MDG) for the first 15 years of the 21st century. With assistance from UNDP, the MDGs have been internalised in the NERRDP. They represent relatively ambitious goals with targets set for achievement by 2015. There are eight main goals: (i) Eradicate extreme poverty and hunger, (ii) Achieve universal primary education; (iii) Promote gender equality and empower women; (iv) Reduce child mortality; (v) Improve maternal health; (vi) Combat HIV/AIDS malaria and other diseases; (vii) Ensure environmental sustainability (viii) Develop a global partnership for development. The targets set to restore basic social services and foster social development in the NERRDP are summarised in the following table.

Table 1 Targets to Restore Basic Social Services Incorporated in NERRDP

Sector	Target
Education	<ul style="list-style-type: none"> • Universal access to nine years of basic education by 2015 • Textbooks and materials for all pupils in Forms 1-3 by 2004 • Payroll validation and staff reviews • Establish education management information systems
Health	<ul style="list-style-type: none"> • Reduce malaria mortality rate from 160/100,000 to 80/100,000 • Reduce infant mortality from 66/1000 to 50/1000 by 2005 • Reduce maternal mortality from 129 to 80 by end 2005 • 90% of children immunised by end 2004 • Determine child mortality rates for SI

Progress has been assessed in a Draft Report for 2004 by DNPAC. A summary of targets, with comments on the likelihood of reaching each target and associated issues is presented in the table below.

Table 2 SI Scorecard on MDG Targets (from Draft MDG Report 2004)

Target/Indicator	Scorecard	Comments
1. Halve, between 1990 and 2015, the proportion of people whose income is below one dollar per day	Insufficient Data	No national poverty assessment made and no poverty line based on 1\$/day
2. Halve, between 1990 and 2015, the proportion of people who suffer from hunger	Insufficient Data	No data on food line or time series on prevalence of underweight children
3. Ensure that by 2015 children, boys and girls alike, will be able to complete a full course of primary schooling	Likely	Increasing enrolment and retention rates indicate this target likely to be achieved
4. Eliminate gender disparity in primary and secondary schools by 2005 and in all levels of education by 2015	Unlikely	There is a gender gap that widens in secondary education, but in primary education disparity is likely to be eliminated by 2015
5. Reduce the under 5 mortality by two thirds	Insufficient data	No time series data on under 5

between 1990 and 2015		mortality
6. Reduce by three quarters between 1990 and 2015 the maternal mortality ratio	Likely	Maternal mortality is on downward trend
7. Have halted by 2015 and begun to reverse spread of HIV/AIDS	Insufficient data	HIV/AIDS detected cases although small in number are increasing presently
8. Have halted by 2015 and begun to reverse the incidence of malaria and other major diseases	Likely	Achieved for malaria since 1990 although recently increased
9. Integrate sustainable development principles into country policies and programmes and reverse loss of environmental resources	Unlikely	sustainable development principles are taken into account in programmes, but logging is unsustainable and loss of biodiversity continues
10. Halve by 2015 the proportion of people without sustainable access to safe drinking water and basic sanitation	Likely for water, potential for sanitation	Probably for drinking water, potentially for sanitation

A time series comparison of available data is given in Annex 15, but data for 2004 is unavailable for this report. The UN indices of HDI-1 (poverty index) and GEM (gender empowerment measure) cannot be calculated due to lack of data. There are therefore still major data gaps and inconsistencies for certain key indicators, especially data on poverty and hunger assessment, mortality rates in the under five year-olds, and the spread of HIV/AIDS. In general, some progress on a number of MDGs has been achieved, but in others SI has a long way to go before reaching the targets. Support to developing the statistical services is essential if the SIG is to measure progress in meeting the MDG's.

The public service has not been able to deliver effective services due to financial and management constraints at both national and local level. Improving the performance and accountability of central and provincial administrations and public utilities are fundamental to improving living standards, especially in rural areas. This is not an easy task for a widespread and challenging geography with poor transport and communications and is likely to be a long-term process. Currently, government is prioritising health and education improvements with heavy donor assistance, including from the EU. In the education sector this has included the abolition of primary school fees as from 2005, and immediate indications are that enrolment in primary has increased by a quarter.

2.3.2 Achievements in Cross Cutting Issues

Gender. The widespread abuse of women during the troubles has been noted by UNIFEM. Women are also severely under-represented in many political and government institutions. There are none in Parliament at present and only four Permanent Secretaries (PSec) out of a total of 28 PSecs. Women currently bear the brunt of poverty in rural areas and domestic violence is common. There is scope for significant improvements in the lot of women though education of both women and men, but without entirely discarding traditional cultures. The woman's lack of access to market income that is largely conducted by males is a widespread problem in rural households. Gender disparity develops in secondary schools and should be given priority in educational programmes.

Non State Actors. A government Task Force in November 2003 carried out a detailed investigation of NSAs as government was somewhat cautious of NSAs. The positive report recognised the important role that NSAs can make to rural development in a partnership approach to community development. NSAs have therefore now been accepted by SIG as potential partners in the facilitation of delivery of basic services and development of rural communities. Several international NGOs have established offices in SI over the past ten years and are currently implementing programmes in health, governance, youth income generating activities, women, child advocacy, education and environment and conservation. They include Save the Children, Oxfam (Australia), World Vision, WWF, NTC, CI and ADRA under various funding regimes and report good cooperation with SIG, although cooperation with the moribund Development Services Exchange (DSE) a national umbrella NGO created by government, has been pretty poor. There are

a large number of small local NSAs and several central organisations, including the DSE, NCW, SICA, the WDD and the Youth Council, some of which are supported by AusAID and NZ, although the capacity of, and coordination with, these umbrella organisations needs to be strengthened.

Capacity Building and Institutional Development. There is a marked shortfall in capacity and skills at all levels in both government and private sectors, including NSAs. In particular, there is the lack of capacity in provincial government to implement their functions of providing basic social services (let alone a federal structure), due to previous governments focus on a central government. Other specific areas of concern are the lack of coordination between SIG and donors, the relatively weak NSAs to implement community level projects and the weak and understaffed ministries at national level.

Migration. Immigration and emigration is not a significant phenomenon in SI. Only 1 % of Solomon Islanders are foreign-born. Of the small number of citizens who do emigrate, they do so mostly for the pursuit of higher education. However, there are significant illegal immigrants entering, or transiting SI, working in logging/fisheries, which have the potential to spread HIV/AIDS. In addition, inter-island migration of workers, especially from Malaita (due to population pressures) to Guadalcanal in pursuit of employment was one of the main causes of the ethnic tensions and conflict. It is feared that a failure to create other economic opportunities in Malaita, as well as in other provinces, and the re-opening of the goldmine and oil palm plantation that might draw in workers again from outside if inadequate local labour/skills are available, could trigger a return of ethnic tensions.

2.4 Environment

Environmental concerns expressed in the CSP remain. SI has fragile ecological systems including marine systems (coastal and marine, such as mangroves, fish, plants and coral reefs) and the remaining primary and secondary forests, in which unsustainable and ill-managed logging and over-fishing represent real threats. Landowners and successive provincial governments and some national leaders and officials have allowed/enabled the resources to be exploited for quick revenue generation. International loggers make deals with the landowners, which government allows through a relatively crude and inadequately supervised licensing system. The legislative and regulatory framework is inadequate to ensure sound resource allocation and management, including the application of a sound code of logging practice, which could help reduce the damaging impact of operations and facilitate earlier recovery. Unfortunately the current arrangement results in very limited local benefits, which are also of short duration, with the overseas operator creaming off the majority of the log value, with much of the tax burden falling on the local landowner company, which is the current permit holder (this burden has resulted in many tax exemptions being granted on log export tax, when the local company realises the disproportionate distribution of benefits).

The proposed new *Forests Bill* will transfer responsibilities, and the operating license, to the actual operator, instead of the landowner company, ensuring a better distribution of benefits and imposing real operational and financial requirements on the operator, which is currently the main beneficiary. The recent upsurge in log sales to record levels is seen as the last chance for companies to exploit the forests before the Bill comes into effect. Some observers believe the resources have already been utilised such that logging yields in 2004 are at a peak after which yields will decline. The advantages of postponement of the Bill until after the 2006 National Election, which has been achieved by vested commercial and political interests, are clear. Whilst the existing legislation already has powers that are not being applied, some observers believe that only the *Forests Bill*, combined with a markedly firmer political commitment to good governance in the sector will be able to effect significant changes.

The human and technical resources that could manage and monitor the use of the country's natural resources does not exist at present. Capacity is limited due to staff vacancies in key positions in the Department of Forests, Environment and Conservation. The latter (and UNDP) made a request for EU to support certain key posts in 2005 backed with TA in a capacity building role. The EU is currently preparing a sustainable forestry and conservation project under Stabex 98, in conjunction with AusAID, the WB/GEF

and SIG, which is envisaged would include support for a forestry and conservation trust fund to provide long-term support to sustainable community based initiatives in the sector.

It seems therefore that a low priority is still being given to environmental sustainability in favour of raising financial revenues and macro-economic growth. Major donor initiatives and inputs are needed to prevent the already dire situation from worsening even further. As yet no comprehensive environmental profile has been prepared, although a recent assessment of coral reef and marine resources has been carried out. A National Environmental Management Strategy (NEMS) was prepared in 1992 and remains as valid today, but implementation of the strategies incorporated in the report is lacking. An *Environment Act* with sound objectives and powers has been recently passed but not yet applied and requires appropriate regulations to be drawn up and effected. The impact of poor environmental practices on rural incomes and tourism is also significant. The preparation of a country environmental profile that will bring environmental matters into mainstream development planning is needed and could be incorporated in the preparation of an agricultural strategy. A summary of the main environmental needs/issues, programmes/activities required and the main critical points are presented in Annex 14.

3. DEVELOPMENT AGENDA OF PARTNER COUNTRY

3.1 Medium Term Development Strategy

The National Economic Recovery, Reform and Development Plan (NERRDP) prepared in 2003 forms the basis of the economic recovery plan and represents a medium term development strategy for the period to the end of 2006. Long-term strategy and sector strategies have yet to be prepared, although donor assistance to SIG to prepare certain sector plans is planned, notably for agriculture, transport and forestry. It also needs to be updated and refined to incorporate issues such as HIV/AIDS and environment. The *Key Strategic Areas (KSA)* in NERRDP are:

- Normalising Law and Order and Security Situation
- Strengthening of Democracy, Human Rights and Good Governance
- Restoring Fiscal and Financial Stability and Reforming the Public Service
- Revitalising the Productive Sector and Rebuilding Supporting Infrastructure
- Restoring Basic Social Services and Fostering Social Development..

Despite the encouraging results to date, the NERRDP is ambitious in scope in relation to overall country capacity and may therefore be difficult to implement fully within its medium-term timeframe. A summary of the assessment of progress made and presented to the donor conference in November 2004 is as follows:

- **Law and Order (KSA 1).** The security situation has been largely stabilised and police patrols and services have been re-established in all Provinces. The long-term issues that caused the troubles still need to be resolved for a lasting peace.
- **Democracy, Human Rights and Governance (KSA 2).** A draft Federal Constitution has been drafted and a consultative process is taking place. The concerns over lack of staff capacity/skills and the costs are of major concern. Considerable progress on transparency and accountability has been made by RAMSI and a number of trials have started or are expected of people charged with human rights abuses and corruption.
- **Economic Stability and Reforms (KSA 3).** Whilst good progress has been achieved, there is still a long way to go and some issues outstanding, namely the need for better budget discipline, balanced budgets, procedure reforms to combat corruption, the difficulty being to make these lasting.
- **Productive Sector (KSA 4).** Infrastructure constraints in wharves, rural infrastructure (roads and bridges) transport/shipping and how to stimulate the private sector and increase incomes in the rural population are still major issues.
- **Social Services (KSA 5).** Primary health care services and education have received considerable inputs, but free primary education introduced for 2005 will create severe budgetary tensions.

In May 2004, a report prepared by a parliamentary tripartite task force entitled “A New Road Map - A Bottom Up Perspective” proposed an alternative to the NERRDP, but, after discussion with donors, it was agreed that NERRDP and subsequent development budgets prepared by the DNPAC would remain the official medium term strategy. An Economic Reform Unit (ERU) has been established in the Ministry of Finance funded by Australia and comprising five TA experts to oversee, coordinate and implement economic reforms, especially related to encouragement of the private sector.

3.2 Budgets and Fiscal Framework in 2004/2005

The current fiscal and budgetary framework, into which EU funds are being integrated, is analysed in more detail in Annex 11, from which the main points arising are as follows:

- The Development Budget is almost entirely funded by donors including from NIP and Stabex;
- The Stabex transfers of € 41.8 million (SBD 418 million) are substantial in relation to annual domestically generated revenues;
- The size of the Stabex transfers demands that disbursement is effective over several years to ensure effective absorption, utilisation and to minimise inflationary pressures;
- The sector allocations in the development budget estimates indicate the low level of investment in Natural Resources and Commerce and Industry and the relatively major investment in basic services (health and education) and government reform and security. However, SIG has recognised that in order to develop the ability to finance basic services, there needs to be progressively greater emphasis on investment in infrastructure and productive assets;
- Following decades of under investment and inadequate maintenance, inter island shipping and roads need substantial investment, as they constitute the main constraint to economic development.

4. OVERVIEW OF PAST AND ONGOING CO-OPERATION

4.1 Allocations and Disbursements to end 2004

Table 3, below, provides summary details of funding sources and disbursements up to the end of 2004 from the 6th EDF onwards to the current 9th EDF through a number of mechanisms: the National Indicative Programme (NIP), Structural Adjustment Programme (SAP), STABEX, European Investment Bank (EIB) and a number of Budget Lines (in 1998, 1999 and 2004). The figures should be regarded as provisional, subject to some awaited clarifications on the EIB, SAP and the Budget Lines that may affect the figure for the NIP balance available for programming. The table also shows the amount available for programming from 2005 onwards and is discussed in Section 5 below.

Table 3 Allocations and Disbursements to End 2004 (€ million)

Funds source	Amount allocated	Yr of 1st Disbursement	Disbursements						TOTAL	Total Undisbur
			to 2000	2001	2002	2003	2004			
NIP										
EDF 6	16.3	1998	14.7	1.0	0.4	0.1	0.0	16.2		
EDF 7	20.6	1998	14.8	2.6	1	0.5	0.4	19.3		
EDF 8	13.0	2000	0.6	2.2	2.4	2.8	1.7	9.7		
EDF 9	14.5	2003	0	0	0	0	0	-		
Total NIP	64.4		30.1	5.8	3.8	3.4	2.1	45.2	19.2	
SAP	4.2	1998	1.8	0.3	-	-	-	2.1	2.1	
STABEX										
EDF 6	31.3	FMOs 86-93, 94-95	34.6	0.5				35.1		
EDF 7	8.1	FMO 96								
EDF 8	47.5	FMO 98			2	1.6	1.5	5.1		
	31.3	FMO 99		2	4	4.9	5.6	14.5		

Total Stabex	118.2		34.6	2.5	6.0	6.5	7.1	56.7	61.5
TOTAL AVAILABLE FOR FUTURE PROGRAMMING									82.8
EIB	2.0	1998	1.3	-	-	-	-	1.3	-
BUDGET LINES	1.8	1998	1.8					1.8	
	1.4	2005							
Total Budget Lines	3.2		1.8					1.8	
TOTAL	192.0		69.6	8.6	9.8	9.9	9.2	107.1	84.9

4.2 Current and Recently Completed Projects

Four projects have been recently completed (Table 4) funded under EDF 7 and 8 and STABEX 99, whilst there are eleven projects (Table 5) currently being funded under EDF 8, STABEX 98 and 99.

Table 4 LIST OF RECENTLY COMPLETED EU PROGRAMMES/PROJECTS at 31/12/2004

Programme/Project [Funding] Line Ministry/Organization	Description	Amount
1. Rural Fishing Enterprises Project, Phase III (7 SOL 46) [7th EDF] <i>Department of Fisheries and Marine Resources</i>	The Rural Fishing Enterprises Project offers assistance to many rural fisheries orientated developments including many rural fishing centres.	€ 1.9 million (SBD 19 million)
2.TA to Dept of Provincial Government and Constituency Development [EDF 7] <i>Dept of Provincial Government and Constituency Development.</i>	Provision of cost /benefit assessment of decentralization of governance and services at the rural/provincial level in the proposed federal/state government system	€480,000 (SBD 4.8 million)
3. Support to RSIP Project (8 SOL 18) [8th EDF] <i>Department of Police and National Security.</i>	Funding support to Commissioner of Police and two other Assistants in close collaboration with the RAMSI	€750,000 (SBD 7.5 million)
4. Support to SICHE [Stabex 99] <i>Department of Education and Human Resources Development</i>	Support to the Solomon Islands College of Higher Education (SICHE)in facilitating the restructuring of the college, reducing overhead costs and refining curriculum.	€2 million (SBD 20 million)

Table 5 LIST OF CURRENT EU PROGRAMMES/PROJECTS at 31/12/04

Programme/Project (Funding) Line Ministry/Organization	Description	Amount
1. Marine Infrastructure Project (8 SOL 12) (8th EDF) <i>Department of Infrastructure and Development</i>	The Marine Infrastructure Project was mandated to manage the rehabilitation and construction of 15 wharves and most navigational aids through out Solomon Islands..	€ 6 million (SBD 60 million)
2. Solomon Islands Micro Projects Programme (8 SOL 08) (8th EDF and Stabex 98) <i>Dept of National Reform and Planning</i>	The Micro – Projects Programme offers funding support for mainly rural based social and economic micro development projects	€ 4.73 million (SBD 47.3 million)

Programme/Project (Funding) <i>Line Ministry/Organization</i>	Description	Amount
3. Rural Training Centres, Phase II (8 SOL 06) (8th EDF) and (Stabex 99) <i>Department of Education and Human Resource Development</i>	Provide technical and financial support for rural vocational/training centres in staff training, procurement of school materials, curriculum development and capacity building.	€ 1.96 million (SBD 19.6 million)
4. NAO/Programme Management Unit (Stabex 98) <i>Department of National Reform and Planning</i>	Provide management and administrative support to the National Authorising Officer (NAO) in the coordination and management of EU development aid programmes in Solomon Islands.	€ 2.4 million (SBD 24 Million)
5. Ministry of Education (Stabex '99) <i>Department of Education and Human Resources Development.</i>	The Education Sector Investment and Reform Programme (ESIRP) 2003 – 2008 provides the framework for a sector wide approach drawing on funding from EU/Stabex, New Zealand Aid and SIG. <i>Sections 3 and 6 – 10 are components of ESIRP.</i>	€ 26.257 million (SBD 260.6 million).
6. Secondary Schools Grant (Stabex 99) <i>Department of Education and Human Resources Development</i>	The programme continues with capacity building in school based financial management, and to assist as many secondary schools are re-opened and fully functioning after tension.	€ 4 million (SBD 40 million)
7. Tertiary (Stabex 99) <i>Department of Education and Human Resources Development</i>	Assistance to graduate its 226 overseas students cleared outstanding fees and arrears owed to regional universities,	€ 6 million (SBD 60 million)
8. Capacity Building (Stabex 99) <i>Department of Education and Human Resources Development</i>	Assistance to the development at a sector wider reform and investment programme, for later multi donor support. An Educational MIS is being initiated and provincial Centres are being upgraded.	€ 2.6 million (SBD 26 million)
9. Education Materials (Stabex 99) <i>Department of Education and Human Resources Development</i>	Provision of education materials and equipments for improved quality in education at secondary level. (NZ Aid funds primary materials).	€ 1.98 million (SBD 19.8 million)
10. Infrastructure (Stabex 99) <i>Department of Education and Human Resources Development</i>	Provides for the rehabilitation and improvement of infrastructure of secondary schools.	€ 1.92 million (SBD 19.2 million)
11. PIU in the MEHRD (Stabex 99) <i>Department of Education and Human Resources Development</i>	Coordination and implementation of the programmes under the ESIRP programme	€ 0.8 million (SBD 8 million)

4.3 Focal Sectors in the 7th and 8th EDF

In the 8th EDF, the main focal sectors were Rural Transport and Communication, Human Resources Development and Agricultural Production. Implementation difficulties were experienced due to the civil unrest and in the post-conflict period in which the after effects of the unrest continued to impair implementation. The main constraints were the breakdown in transport (inter-island ferry services), and the seriously reduced government services including widespread staff vacancies at central and field levels.

Focal sector 1: Rural Transport and Communication

The *Marine Infrastructure Project (8th EDF)* for € 6 million involved the rehabilitation and construction of 14 wharves throughout SI. Design changes to extend life and reduce maintenance required increased capital

costs with the result that only half the original number of wharves were built. Further wharves will be built using Stabex 98 funding.

Focal sector 2 : Human Resources Development

Rural Training Centres, Phase II (8 SOL 06) for € 1.96 million provided technical and financial support for rural vocational/training centres in staff training, procurement of school materials, curriculum development and capacity building. The programme is being integrated into the ESIRP.

Support to RSIP Project (8th EDF) for € 0.75 million involved providing the Police Commissioner whose mandate was to strengthen the RSIP and was key in securing law and order up to the end of 2004.

TA to Department of Provincial Government and Constituency Development (EDF 7) for € 0.5 million provided help in cost/benefit analysis of decentralization and assistance in drafting the federal constitution.

Focal sector 3: Rural Development

The *Rural Fishing Enterprises Project Phase III (7th EDF)* for € 1.9 million offered assistance to rural fishermen through supporting six provincial fishing centres. The project was subject to a MTR that considered the project largely a failure. The breakdown of inter-island shipping, which prevented ready access to national and export markets and the high cost of fuel for fishermen were contributory factors. However, the project did identify the potential for seaweed exports that led to the seaweed project being included under Stabex 98.

The *Micro – Projects Programme (8th EDF and Stabex 98)* for a total of € 4.73 million provided funding support for mainly rural based social and economic micro development projects. 168 micro projects in nine provinces were supported and the project will be completed by February 2005. The main sectors of concentration comprised education (building and rehabilitation of classes, workshops, staff houses and ablution blocks and providing tools for schools and RTCs), health (clinics), water supply and income generating activities in rural areas. A Mid Term Review (MTR) was conducted in December 2003, which recognised the need for such projects in rural areas, especially in relation to unemployment amongst youth. Again, due to the civil disturbances and breakdown in ferry services that restricted the supply of materials outside Honiara and government services, implementation was difficult in some areas. Whilst it is too early to assess whether sustainability has been achieved, there are concerns over ownership and responsibility for on-going maintenance of the facilities. The lessons learnt have been incorporated into the design of a Phase II scheduled to commence in mid 2005 and includes a follow up of Phase I projects by a consultant to identify any sustainability problems that could be used to modify the approach in Phase II if necessary.

4.4 Focal Sectors of the 9th EDF

The main focal area of the National Indicative Programme (NIP) defined in the EU CSP for SI from 2002 – 2007 is sustainable rural development – with a particular emphasis on micro projects and capacity building. A log-frame for the 9th EDF is attached in Annex 1. The planned utilisation of the 9th EDF funds from envelopes A and B is described in Section 5.2 1 below.

4.5 Other Instruments

4.5.1 Utilisation of Envelope B (under 9th EDF)

The MTR of the 9th EDF carried out in 2004 agreed to combine the envelope B of the 9th EDF (€ 7.8 million) with the balances from EDF 6, 7 and 8 to generate the undisbursed funds for future programming activities that are discussed in Section 5 below.

4.5.2 Focal Sectors of the STABEX 98

For the undisbursed Stabex 98 funds, amounting to €40.7 million (based on audit at 31/12/03), the main focal area is sustainable rural development and capacity building. Details of the proposed programming of these funds are presented in Section 5 below, while a summary of the sectors targeted is given below. There is strong government interest in the Solomons to engage these funds as quickly as possible.

Focal Sectors Targeted

Rural Transport (54%). Poor transport and communication, the difficulty in accessing funding facilities, and long distances to market outlets inhibit rural development. Outside Honiara, the Solomon Islands have always had a limited infrastructure, but this further deteriorated substantially during the tensions. The poor road network, inadequate inter-island shipping, as well as a lack of adequate wharves pose considerable barriers to market access and impede the growth of rural production, also having negative social effects by limiting rural-urban linkages, labour mobility and inter-provincial trade.

Forestry (16%). The situation in the sector has further deteriorated since signature of the original FMO 98 in November 2000. The objective of Stabex-funded activities in the forestry sector is to support sustainable forestry use and conservation and will complement other current donor programmes (notably AusAID) and proposed donor funding (WB/GEF) for the sector. It will also help diversify the range of export commodities and sources of cash-income available for the rural population.

Marine Resources (8%). Fish and marine product exports earnings and revenue (including from licensing) is second only to log exports and the commercial sector provides employment for a substantial proportion of non-government jobs. Maintaining or further expansion of exports of fisheries and other marine products may be threatened if SI does not soon attain EU List 1 status. Diversification of export commodities including seaweed is another area that will be supported.

Agriculture (13%). The absence of an agricultural sector strategy and policy framework has meant that activities are piecemeal and inevitably donor-driven. The weak capacity of the Department of Agriculture and Livestock (DAL) has contributed to the current situation. There is an urgent need to define a coherent and comprehensive sectoral strategy and policy framework for agriculture and rural development in SI and for a strong agency to implement it. As part of this work an environmental profile should also be prepared.

Institutional Support and Capacity Building in Sector Programme Management (9%). Institutional capacity is very limited within the ministries to deal with the implementation of the Stabex 98 FMO. Support will be provided for strengthening the PMU at the NAO and the DNPAC's capacity to manage implementation of Stabex 98 and improve effective donor coordination. In addition, this will cover capacity building for Line Ministries implementing Stabex 98 activities.

4.5.3 Focal Sectors of STABEX 99

The main focal sector is Human Resource Development to assist the Ministry of Education in improving and reforming the educational system via the Education Sector Investment Programme (ESIRP), which provides the framework to support secondary schools, SICHE, capacity building, educational materials and infrastructure based upon the revised Education Strategic Plan (ESP). Whilst no joint MTR has yet taken place, successes of the Stabex 99 support to date are seen as:

- the establishment of a transparent financial management system based upon agreed budgets and quarterly retirement targets which has been established at secondary school and provincial level and which will be introduced into primary schools and the Ministry during 2005,
- the development of a national infrastructure programme for primary and secondary levels based upon community priorities and participation,
- a significant start to the restructuring of SICHE and the School of Education,

- an on going Provincial Support Programme involving the supply of educational materials and capacity building programmes at all levels of the educational system.

To date it has not been possible to enter into direct budget support to the education sector because the EC's preconditions for Budget support have not yet been met, but this remains a future objective (particularly for the disbursement of secondary school grants).

There is concern on the progress of infrastructure disbursements and the overall impact and sustainability of the educational programme. This relates to government funding constraints and staff shortages both in the central departments and of teachers in rural primary schools, and shortages of classrooms and materials to cater for the increased grade 1 intake expected in 2005. While the EU policy supports free primary education, the abolition of primary school fees at the end of 2004 has placed enormous strains on the education sector. Plans to remove exams for secondary schools will exacerbate this further. A joint MTR with SIG and NZAID is planned to review performance and impact to ensure that future funds are appropriately spent to maximise the benefits to the sector.

4.5.4 Budget Lines

The following projects have been funded:

- Rehabilitation Project in Guadalcanal and Malaita for six months undertaken in 2000 and costing € 0.6 million and implemented by an international NGO World Vision, Netherlands,
- Support through a German NGO to Don Bosco Vocational School for technical training and life skills for 3 years, approved in 2004 and costing € 0.75 million,
- WWF Marine Conservation and Sustainable Use Project in SI, PNG and Papua for 5 years approved in 2004 and commencing in 2005 and costing € 1.8 million.

4.5.5 EIB

EIB activities in SI were suspended as the Development Bank of Solomon Islands (DBSI) that received a € 2 million credit (€ 1 million released) defaulted on its repayments. The DBSI was mismanaged and was subject to political interference resulting in bankruptcy. Part of the loans comprised under performing investments and part ghost investments. The DBSI is now under administration by the CBSI. Repayment of the debt (estimated at about €3 million) to the EIB remains an issue to be resolved, but there is growing demand for the EIB to restart loans to the private sector.

4.5.6 Post Conflict Rehabilitation Programme (PCRP).

The EU disbursed € 12.65 million (drawn from Stabex 98, 99 and EDF sources) after an MOU was signed in July 2001. It was used for Electoral Support, for Strengthening the Police Force (Stabex 1998), the Re-integration of displaced persons into agriculture and rural livelihood (Stabex 1999), Educational rehabilitation including payment of outstanding tertiary student fees and secondary school grants programme (Stabex 1999) plus microprojects including rehabilitation of rural hospitals, clinics and water supplies. The PCRP was subject of some discussion during the visit of the ACP –EU Joint Parliamentary assembly mission foreseen in November but postponed to February 2005, with the Parliamentary Foreign Relations Committee of the SI presenting a justification for a logical extension of these funds.

4.5.7 Regional Programme.

The following Pacific regional programmes funded through the regional office on Fiji have benefited SI: (i) Economic Partnership Agreement (EPA) – started in 2004 and concerned with developing trading partnership arrangements in the Pacific region, (ii) Development of Tuna Fishing in Pacific ACP Countries, implemented through the SI based Forum Fisheries Agency for €3 million over 4 years starting in 2005, (iii) DSAP a regional agricultural programme for developing sustainable agriculture, (iv) South Pacific

Tourism Programme, (v) Fisheries Partnership Agreement (FPA) – to be finalised, (vi) Secretariat for Pacific Community, (vii) South Pacific Regional Environmental Programme (SPREP), (viii) Pacific Regional Development of Education (PRIDE) and (ix) Pacific Environment Information Network (PEIN) for 3 years to establish environmental information networks across all ACP Pacific countries.

4.5.8 Utilisation of Resources for Non-State Actors

NSAs at present have limitations in organisation and resources. In particular, external support is needed in the areas of organisational focus, administration and fund raising, communication by Internet and information sharing. Other donors are active in supporting NSAs with Australia and New Zealand supporting these organisations in their development projects (along with Japan, ROC and UNDP). NSAs received assistance from the EU in 2004 through the first phase Micro Projects Programme. However, the provision that included the facility for NGOs to propose community projects and to receive project management training was not taken up. NSAs lack the necessary capacity to utilise the available funding facilities and the few NGOs that do have sufficient capacity and expertise are usually at the limits of their available capacity. Therefore, under the 9th EDF, provision of €1.56 million has been submitted for NSA capacity building in a FP for approval for implementation in the 2005-2007 period.

5. PROGRAMMING PERSPECTIVE FOR THE FOLLOWING YEARS

5.1 Funds Available for Future Programming

A summary of the programme funds available for disbursement is presented in the table below.

Table 6 Programme Funds Available Summary at Dec 2004

PROGRAMME FUNDS	€ million	SBD million	COMMENTS
EDF 9th(including balances from previous EDFs) Programme	<u>20.1</u>	201	<u>€20.1 m available for disbursement</u>
Micro Projects	5.7		FA approved Nov '04
Technical Cooperation Facility (TCF)	1.3		FP submitted
Support to Non-State Actors	1.56		FP submitted
Capacity Building and Others	11.54		To be programmed
STABEX 98			
Total Funds allocated (including interest to end 2003)	<u>47.4</u>		<u>€43.1m available for disbursement</u>
Funds available for programming	43.1	431	
STABEX 99			
Total Funds allocated (including interest to end 03)	<u>31.4</u>	314	<u>€14.5m</u> disbursed
			<u>€16.9m available for disbursement</u>
Current Programme Funds (NIP and STABEX)	98.2	938	€ 80.1 m available for disbursement

Of the total of € 80.1 million, approximately half comes under the new FMO for Stabex 98, (€ 43.1 million) and half from a combination of Stabex 99 (€ 16.9million) and EDF funds (both envelopes) (€ 20.1million).

5.2 Programme Planning Framework

5.2.1 9th EDF NIP

The main programmes to be funded under the 9th EDF, and including the balances from previous EDFs, amounting to a total of €20.1 million, are:

- The MPP Phase 2 for € 5.7m that is scheduled to commence in mid 2005 concentrating on both social infrastructure and income generating projects at community level.
- The NSA Capacity Building Project to support capacity building of NSAs for €1.56million and expected to start by September 2005. This is a related but separate programme that will provide training and grants to NSAs including NGOs, churches, women groups and the private sector (PS).
- A TCF for € 1.3 million for capacity building and overseas training, the FP has been submitted,
- The balance of funds will be available for future programming aimed at capacity building and which have to be programmed in 2005

5.2.2 STABEX 98

FMO 98 was originally signed by the SIG and the EC in May 2000, but due to the civil unrest, the Commission “froze” the use of funds pending a resumption of law and order and a presentation by Government of credible plan for national economy recovery. These conditions were met and following the visit of the EC Commissioner to SI in February 2004, a revised FMO for approval was requested. The process of preparation has involved a long and extensive consultation period between the EC, SIG, and line-ministries to ensure that proposals reflect both immediate and long-term concerns. The process was delayed by personnel changes in both the ECD and DNRP. The process cumulated in an agreed revised FMO for the balance of funds (€40.7 million) that is to be submitted in early March 2005 for approval. Several project IPs are being prepared in advance of the anticipated signing of the FMO.

A partial log-frame is attached in Annex 2. Recognising the need to ensure effective disbursement, in line with absorptive capacity and management capabilities, as well as possible inflationary pressures, a two speed disbursement mechanism is envisaged. This addresses both immediate priorities that can be achieved realistically and a slower long-term mechanism requiring institutional strengthening and progressive fund release. A summary of the focal areas targeted, main activities and planned disbursements is shown below.

Table 7 Main Focal Areas Targeted, Activities and Planned Disbursements in Stabex 98

Focal sector targeted	Main Activity and Sector Allocation %	Planned Disbursts (€ mill)	Planned Disbursts SBD mill
Rural Transport	Activity 1 – Marine Wharves and Access Roads,	8.0	
	Activity 2 - Inter-island Shipping Support	1.5	
	Activity 3 – Transport Development Fund	12.5	
	Total Rural Transport (54%)	22.0	220
Forestry and Conservation	Activity 1 - Support to smallholder forestry development	2.5	
	Activity 2 – Community based conservation of biodiversity	1.5	
	Activity 3 – Export development of forest products	2.5	
	Total Forestry and Conservation (16%)	6.5	65
Marine Resources	Activity 1 – Strengthening the NCA (EU List 1 compliance)	0.95	
	Activity 2 – Support to Fishing Industry Exports (seaweed)	1.0	
	Activity 3 – Aquaculture development	1.25	
	Total Marine Resources (8%)	3.2	32
Agricultural Development	Activity 1 Agricultural/Rural Development Sector Strategy	1.0	
	Activity 2 – Cocoa and copra driers post harvest support	0.4	
	Activity 3 - Rural Economy Sector Programme	3.9	
	Total Agricultural Development (13%)	5.3	53
Capacity Building studies/audits	Activity 1- Programme management units (all sectors)	3.45	
	Activity 2 – Studies, Audits, Review and Evaluation	0.26	
	Total Capacity Building and Studies/Audits (9%)	3.71	371

5.2.2 STABEX 99

An FMO was signed in 2000 assigning 90% of the € 29.1 million transfer to the educational sector. Some funds were committed under the PCRFP. In June 2004 a tripartite MOU between SIG, EU and NZ

was signed committing €22 million along with NZAID funds of NZD 33 million in support of the ESIRP, which provides the framework for this major and important ongoing sector wide approach and will continue through to 2008. A summary allocation of ESIRP funds under Stabex 99 is shown below.

Table 8 Allocation of ESIRP Funds under Stabex 99

Programme Allocations	€ million	SBD million
Education Sector Investment and Reform	16.5	165
Capacity Building Work Programme (WP)	6.0	
Education Materials WP	2.0	
Infrastructure WP	6.0	
RTC Phase 3	2.5	
Secondary Schools Assistance	1.4	14
Development of Tertiary Education	3.1	31
Tertiary Support WP	1.4	
SICHE Phase 1 WP	1.7	
PIU Administrative Work Programme	0.5	5
TOTAL Funds	21.5	215

5.3 Longer Term Considerations

Key issues that will impact on cooperation are as follows:

a) Political

The likely change in the political landscape in the medium to long-term, especially federalisation and the need to capacity build at provincial levels, together with continued capacity building needs in government to restore good governance. The capacity of RSIP to take over from RAMSI in sustaining law and order is of concern and the need to address the long-term ethnic tension issues that still threaten to disunite and break up the country.

b) Economic

Further economic reform is needed to support private sector development, including legal and licensing constraints and privatisation. In the rural development sector, the main issues are constraints to increasing incomes from smallholder agriculture, the need for greater investment in support services, including the provision of micro-finance for the rural sector, and the general lack of entrepreneurial activity at rural level due to both the wantok system that inhibits entrepreneurial activity, the absence of business support services and the lack of investor confidence generally, often related to land ownership issues.

c) Social and Environment

Further health and education inputs will be required if the relevant 15 year target MDGs are to be met. Gender issues need special attention and further efforts are needed to prevent increased incidence of malaria and the potential spread HIV/AIDS. Financing of the educational sector will be in jeopardy if SIG is unable to meet the shortfall arising following the decision to give free primary education and possibly to be extended to secondary. Environmental concerns relate to the unsustainable level of logging, the impact of poor environmental practices on rural incomes and tourism and the preparation of a country environmental profile that will bring environmental matters into mainstream development planning.

5.4 Preparatory Work for Next Programming Cycle

Given the size of funds currently available to SI under Stabex and the 9th EDF, future programming should look at ways of consolidating the achievements to ensure value added from these investments. Possible preparatory work to developing a CSP for a 10th EDF is suggested as follows:

- The EDF funded support to the TA preparation of an agricultural long-term sector strategy and plan would identify new opportunities in the agricultural sector. To promote entrepreneurial activities in rural areas, collaboration with other relevant organisations to conduct a survey of existing SMEs, attitudes and constraints could be explored in order to identify a possible future programme,
- In relation to the environment, the preparation of an Environmental Profile for the country may highlight priority areas of concern (forestry and fisheries),
- In the education sector, a joint MTR is planned between the EU and NZAID to assess performance and future programming needs that may be included in the 10th EDF.
- NSA capacity to implement rural income generating projects and improve basic services through a community development approach may require further consultation with NSAs to identify constraints, changes in approach and further opportunities for expansion.

6. DIALOGUE WITH NAO, NSA'S AND DONOR COORDINATION

6.1 Dialogue in Country with the NAO

Dialogue between the NAO and EU was constrained in 2004 due to personnel changes in both the ECD in Honiara and in the DNRP. The EC Chargé d'Affaires finished in March 2004 but was not officially replaced until September 2004, and there were two Ministers of DNRP in 2004 and three Permanent Secretaries (PSec) during 2004 with a considerable gap between Ministers and again in early 2005. This clearly undermined continuity. With greater stability, dialogue in the NAO office is expected to improve in 2005. The Stabex 98 Committee comprising line ministers, MOF and chaired by the NAO has also proved an effective forum for dialogue on the design of the Stabex 98 programme. Training seminars were originally planned for the staff of the DNRP to be carried out by the EU-PMU but were not held due to the staffing vacancies in DNRP. The need to fill the vacant positions remains a priority but the PSC procedures are creating bottlenecks in the process.

6.2 Dialogue in Country with NSAs

Dialogue with NSAs has been relatively limited due to the weakness of local NGOs and their umbrella organisations. However with greater recognition by SIG of the role of NSAs and the EU funded NSA capacity building project (which will initially focus on building the central umbrella organisations) and the MPP Phase II, increased dialogue with NSAs is anticipated. NSAs have been consulted in the preparation of this joint annual report.

6.3 Donor Coordination

Donor coordination has been a vital and key feature of development in SI. A list of donor interventions by sector is attached in Annex 6 and a table of the total donor contributions to the 2004 and 2005 development budget estimates is presented in Annex 13. Australia is the dominant donor, but with the injection of substantial Stabex funds, the EU will become the second largest donor in SI, although with rather different objectives than those of Australia, which are focused on regional security.

The EU has coordinated with other donors resulting in a focus on education (along with NZAID), transport, agriculture and associated capacity building (with ADB, WB and AusAID), whilst other donors have focused on health and law and order (AusAID). It is SIG policy not to take any fresh loans (from the WB, ADB or IFAD), although the development banks have resumed dialogue and are actively involved with non-loan and TA funding. Regular in-field dialogue between ECD in Honiara and the donor community has been satisfactory with regular monthly donor coordination meetings. In addition, two high level donor conferences have been held in November 2003 and 2004 attended by senior SIG and donor officials including visiting officials from the WB, IFAD, ADB etc. A report was produced for the 2003 conference but not yet for the 2004 although papers are available. The main conclusions arising from the meetings were that that donors noted a lack of investment in the productive sector, that donor coordination should be

strengthened with SIG, as this would enhance ownership. The DNRP is being renamed the Department of National Planning and Aid Coordination (DNPAC) and a new strengthening project to provide capacity building to this department is included in the Stabex 98 programme proposals. Regular monthly management and monitoring meetings (4Ms) are also held between the Central Bank, Ministry of Finance, IMF Advisers, interested donors and the DNPAC to review and discuss financial and economic progress.

6.4 Member States

No significant donor contributions are currently being made by EU Member States (MS). The only MS with a presence on SI is the UK whose approach is that their contribution is donated through the EU. It does have a small discretionary fund managed by the High Commissioner. Other MSs have shown some interest in SI. France formerly contributed some funds from its New Caledonia base and has visited SI recently, as have representatives from Belgium and Italy.

7. CONCLUSIONS

7.1 Summary of Key Political, Economic and Social Developments

Political Developments. SI is emerging from several years of ethnic tension that had resulted in the overthrow of the government and subsequent armed conflict. The political and security situation has improved significantly though the process of building sustainable peace and security and resuscitating the economy will take time and depend on continued Government efforts, supported by RAMSI and the donor community. Rehabilitation will also depend on rapid progress in tackling important governance issues, public sector and economic reforms, and reconciliation between the warring parties. Three SIG reports on RAMSI reveal political disunity over its future role in the country. The presence of RAMSI remains vital to maintain law and order with many believing that if RAMSI were removed, the country would rapidly return to chaos. Political tensions remain high due to arrests of ministers on corruption charges, trials of warlords and leaders of rebel factions, the upcoming elections in 2006, the debate on federalisation and potential demands for independence by certain provinces (Malaita) and the reappearance of armed factions (Malaita) and self interest in provincial politics (Guadalcanal and others), pointing to a fragile political situation in the short-term. The impact of RAMSI and its future orientation will be the subject of a report to be prepared by an eminent persons group in early 2005.

A new constitution and federal system of government was introduced for debate in 2004. The desire for decentralization appears to be a response to the perceptions that the national government has failed in effectively fulfilling its core functions, and that resources have not been equitably shared between the capital and the rest of the country. However, the benefits, costs, and implementation challenges of decentralization, especially the limited managerial capacity in the provinces to take on local government functions, give rise to doubts on the likely success of this form of change.

Governance. There is still concern over corruption, misuse of public funds, discretionary tax and duty exemptions, non-adherence to existing rules and procedures, and political appointments to the civil service. Corruption is widely acknowledged to be pervasive and ingrained. Its removal will require top-level political commitment and a long-term process of strengthening key governance institutions, reforming the public service, and educating the public. There is concern that although RAMSI has restored law and order and improved fiscal management, SIG has not been able to take this opportunity to effect reforms due to cabinet disunity, endemic corruption and a failure to stop the continued unsustainable exploitation of the country's natural resources.

Economy. After four years of contraction, real GDP increased (from a very low base) by an estimated 6% in 2004 as a result of strengthened law and order and further progress in public financial management. Forestry exploitation (which has reached a record unsustainable level of 1.1 million m³ per year, four times the sustainable level) fisheries, cocoa and copra production are the main drivers of growth. Gold mining and oil palm operations remain suspended, but there are real prospects that the oil palm plantations will re-open under new ownership in early 2005, which would give a significant boost to the economy, if land disputes and compensation claims are resolved. Growth prospects would also improve considerably if constraints were eased in the areas of security of land tenure, business regulatory environment, employers' rights to employ labour of their choice and inter-island transport. An Economic Reform Unit with TA staff from Australia has been established in the MOF to oversee and implement a raft of economic reforms, including the foreign investment code, taxation reforms, public service review, and many others.

Several years of serious fiscal mismanagement were turned around with the arrival of the RAMSI budget stabilization team in 2003. The 2004 and 2005 budgets provide for a balanced cash position and reserves are up to USD 70 million, equivalent to 7 months import cover. However, political will to adhere to budget discipline is of concern with recent examples of a 16% civil service pay rise and the decision to provide free primary education. Servicing of the estimated official public sector debt of SBD 1.6 billion (equivalent to 130% of GDP) is of concern, as it will continue to claim a sizeable portion of revenues. With the likely fall

in revenues from commercial logging (25% of SIG revenues stems from logging), debt service payments and balance of payment difficulties may result in other activities failing to make up the shortfall in revenues. Public expenditure has been reallocated towards the key service areas of health and education, financial administration, provincial affairs, and law and justice. This has meant that the productive sector receives a lower priority yet is fundamental to sustainable development of the economy, improving livelihood in rural areas and the country's ability to pay for social services.

The basis of the SI economy lies in the rural villages where 85% of the population reside gaining their livelihood and sustenance from subsistence farming and cash generating activities, especially the production of copra, cocoa and fish. The private sector is relatively small and undeveloped. There are only a small number of private sector companies (many having closed operations during the troubles), with few new business start-ups observed. Lack of appropriate finance, lack of investor confidence, lack of business and entrepreneurial skills and inhibiting bureaucracy and legislation have all contributed to this situation.

The prospects of sustained economic growth are uncertain and present a major challenge and will depend to a large extent on the successful application of the reforms. To ensure sustainable peace, it will be crucial to address the inequitable distribution of resources, create opportunities for income generation, especially in the smallholder sector, and provide basic infrastructure and services. Solutions to the fundamental issue of customary land ownership need to be found. Capacity of government at all levels is a major constraint with the high number of vacancies in line ministries, worsened by the slow functioning of the Public Service Commission process.

Social Situation. Poverty has undoubtedly increased in recent years, especially for women and children, due to the near-collapse of the economy. However, as 85% of population grow subsistence food crops and/or raise livestock, there is neither abject poverty nor starvation in the country, food security is not a major problem and the wantok system provides an effective social safety network mechanism for people in difficulties. Concerns relate to primary school enrolments that are low and gender disparities that are high. The country has adopted the Millennium Declaration and Millennium Development Goals (MDG) for the first 15 years of the 21st century. They represent relatively ambitious goals with targets set for achievement by 2015. There are still major data gaps and inconsistencies for certain key indicators, especially poverty and hunger assessment, mortality rates in the under five year-olds, and the spread of HIV/AIDS. In general some progress on a number of MDGs has been achieved but in others SI has a long way to go before reaching the targets. The SIG will need to develop capacity in the Statistics Office, DNPAC and responsible line agencies in order to monitor progress, and to prioritise goals to reflect the specific nature of the country.

The widespread abuse of women during the troubles, their under-representation in many political and government institutions, plus the fact that women currently bear the brunt of poverty in rural areas and suffer domestic violence, are major gender issues that still need to be addressed.

Development Agenda. The NERRDP, which was finalized in November 2003 through a consultative process with donors, represents a major effort to introduce order to policy, planning, and public expenditure. It sets out a program in five *Key Strategic Areas* (KSA) but is ambitious in scope and will be difficult to implement fully within its medium-term timeframe due to capacity limitations. Progress towards the NERRDP goals were presented to the donor conference in November 2004 in an Action Matrix report by the DNPAC, the main points from which are as follows:

- **Law and Order (KSA 1).** The security situation has been largely stabilised and police patrols and services have been re-established in all Provinces. The long-term issues that caused the troubles still need to be resolved for a lasting peace.
- **Democracy, Human Rights and Governance (KSA 2).** A Draft Federal Constitution has been drafted and a consultative process is taking place. The concerns over lack of staff capacity/skills and costs are of major concern. Considerable progress on transparency and accountability has been made by RAMSI and a number of trials have started or are expected of people charged with human rights abuses and corruption.

- **Economic Stability and Reforms (KSA 3).** Whilst good progress has been achieved, there is still a long way to go with some issues outstanding, namely the need for better budget discipline, balanced budgets, procedure reforms to combat corruption, the difficulty being to make these lasting.
- **Productive Sector (KSA 4).** Infrastructure constraints in wharves, rural infrastructure (roads and bridges) and transport/shipping and how to stimulate the private sector and increase incomes in the rural population are still major issues.
- **Social Services (KSA 5).** Primary health care services and education have received considerable inputs, but free primary education to be introduced for 2005 will create severe budgetary tensions.

External Trade. The importance of trade issues is now recognised by the SIG, which is anxious to find complementarities between their commitments under PICTA, PACER and EPAs. Negotiations on the latter started in 2000 and since then National consultations have taken place annually and twice in 2004, concerning particularly the private sector, civil society, and the chambers of commerce. Key problems identified include: how to involve the provinces, how to develop a national strategy and comprehensive policy and how to tackle the lack of capacity in this sector? The SIG does not want to lose its preferential treatment under Cotonou. SI will benefit from expertise available under the hubs and spokes programme with support from the Commonwealth Secretariat.

The establishment of a National Trade Facilitation Committee is planned for next year to inaugurate a trade seminar and a trade show. The committee would play an interactive role with the Regional Trade Facilitation Programme (RTFP) under the Pacific Agreement on Closer Economic Relations with Australia and New Zealand, and would ensure the country's active participation in regional and multilateral trade negotiations, including, the Melanesian Spearhead Group Trade Agreement, Pacific Island Countries Trade Agreement, the ACP-EU Economic Partnership Agreement and WTO rules. The Committee would also advise relevant government departments on how to increase the country's capacity to compete with outside products and ensure strengthening of coordination between government, NGOs and the private sector.

Environment. Environmental concerns expressed in the CSP remain. SI has fragile ecological systems including marine systems (coastal and marine, such as mangroves, fish, plants and coral reefs) and the remaining primary and secondary forests, in which unsustainable and ill-managed logging and over-fishing represent real threats. The impact of poor environmental practices on rural incomes, including prospective economic activities such as tourism, is also significant. Human and technical resources that could manage and monitor the use of the country's natural resources do not exist at present. It seems therefore that a low priority is still being given to environmental sustainability in favour of short-term financial gain and macro-economic growth.

As yet no comprehensive environmental profile has been prepared. A National Environmental Management Strategy (NEMS) was prepared in 1992 and remains as valid today but implementation of the strategies incorporated is lacking. An environmental assessment can be incorporated as background to the agricultural and rural development strategy. Regional fisheries agreements may help to curb illegal fishing, but the current level of log harvesting is inherently unsustainable. The new *Forests Bill* that was brought before Cabinet in November 2004 but was subsequently withdrawn from the Parliamentary agenda. It would have given the Government greater powers to control logging and its delay, due to vested commercial and political interests, means that it is unlikely to be passed before the 2006 election. Whilst the existing legislation already has powers that are not being applied, some observers believe that only the Forest Bill, combined with a markedly firmer political commitment to good governance in the sector, will be able to effect significant changes.

7.2 Progress Achieved in Poverty Reduction

MDGs have become a major focus and are internalised in the NERRDP, but concerns on sustainability and lack of capacity and other limitations will make achievement of the 2015 goals difficult for some of the indicators, especially those relating to HIV/AIDS and gender. Heavily supported by donors, the

Government is seeking to redress the situation in rural areas through restoring basic social services and revitalising the productive sector and supporting infrastructure. Further support to rural education and to agricultural development opportunities is needed and more attention needs to be devoted to prevention of HIV/AIDS and the incidence of malaria. Reliable access to domestic and international markets for rural produce is a key strategy to re-start rural economies, reduce the demand for migration to the capital in search of employment and reduce conflict between competing groups for limited opportunities. The major issue is whether the opportunities created for income generation and the improvement in basic services will generate sufficient tangible economic benefits, especially in rural areas, to prevent a return to conflict.

7.3 Results and Activities in Focal Sectors and Relevant Programmes

Progress in cooperation has advanced rapidly now that conditions in the country are more conducive to development. However for development to be meaningful, the programmes must reflect the new priorities of the SIG, and this inevitably entails some planning delay. The major effort made in programming this year will pay off in commitments made next year.

The main focal sectors of the 8th EDF in 2004 were human resource development and rural development. In human resource development support was given to rural training centres and these are expected to be integrated into the overall technical and vocational policy of the ministry. The EU with NZAID is supporting the implementation of the sector wide Education Sector Investment and Reform Programme (ESIRP) utilising the STABEX 99. In rural development, a successful marine infrastructure project is due for completion in 2005. Further wharf construction is envisaged using Stabex 98 funds. The first micro-projects programme (MPP) from 2000 – 2005 is due to be concluded in February 2005 having completed 168 projects in all nine provinces, including social infrastructure (clinics, classrooms and water supplies) and income generating initiatives (honey bees, pigs, poultry and seed nurseries). In view of the appreciation of this programme by rural communities a second phase will start in 2005.

The main focal areas for the 9th EDF are sustainable rural and community development and capacity building with the following projects prepared to-date: a second Micro Projects Programme to be started under the EDF 9 in 2005 (FA approved in December 2004) and a NSA Capacity Building Project (FP submitted). For the former, lessons learnt have been incorporated from the first MPP phase. A large programme of support to capacity building will be planned in 2005.

Programming was delayed for Stabex 98 due to the civil unrest, but a new FMO has been prepared for approval, which supports rural transport (rehabilitation of infrastructure to facilitate access to markets), agricultural development, forestry and conservation, marine resources and capacity development related to implementation. This is expected to be approved and started in 2005.

Stabex 99, which commenced in 2002, will continue the important ongoing sector wide approach to education through to 2009. The main focal areas are: Education Sector Investment and Reform, Secondary Schools Assistance, Development of Tertiary Education and MEHRD capacity building. There will be a move to prepare one single work programme in the absence of the imminent prospect of direct budget aid, (though the secondary school grant programme will remain outside the combined ESIRP work programme, and be progressively integrated with the Education Department procedures from 2007, as far as possible).

The MTR of the 9th EDF was undertaken in 2004, which endorsed the current policies and the transfer of envelope B to envelope A (apart from a small reserve of €0.55 million retained by ECHO). The combined resources available from the Stabex 98 and Stabex 99 (undisbursed funds of € 43 million and € 17 million respectively), remaining funds from the past EDFs and the 9th EDF, including the B envelope (€20.1 million), to give a total of € 80.1 million available for disbursement and represents a large one-off opportunity to assist the SI with its major challenges..

7.4 Key Perspectives for the Future

Key issues that will impact on cooperation are as follows:

a) Political

The likely change in the political landscape in the medium to long-term, includes possible federalisation, but the need is to build capacity at both the provincial level, and in the national government in order to restore good governance.

The capacity of RSIP to take over from RAMSI in sustaining law and order is of concern and the need to address the long-term ethnic tensions issues that still threaten stability.

b) Economic

Further economic reform is needed to improve economic performance, governance, and private sector development, including legal and licensing constraints and privatisation. In the rural development sector, the main issues are constraints to increasing incomes from smallholder agriculture, the need for greater investment in support services, including the provision of micro-finance, and the general lack of entrepreneurial activity at rural level due to the absence of business support services and the lack of investor confidence generally, often related to land ownership issues.

c) Social

Further health and education inputs will be required if the relevant MDGs are to be achieved by 2015. Gender issues need special attention and further efforts are needed to prevent the incidence of malaria and the potential spread of HIV/AIDS.

Financing of the educational sector will be in jeopardy if SIG is unable to meet the shortfall arising following the decision to give free primary education, possibly to be extended to secondary.

d) Environment

Environmental concerns focus especially upon the unsustainable level of logging and the lack of progress in passing the new *Forests Bill*, the impact of poor environmental practices on rural incomes and tourism and the need for the preparation of a country environmental profile that will bring environmental matters into mainstream development planning.

7.5 Efforts in Use of EDF Resources

The civil unrest delayed disbursement of EU funds generally and thereafter further delays have occurred in 2004, due to the need to review past FMOs in the light of the changing priorities of the SIG. From 2005 to 2009, disbursements must be trebled from the present €5 million each year. This represents a relatively large one-off opportunity to assist SI to further economic and social recovery and would place the EU as the second largest donor after Australia. To assist this opportunity to be achieved, real efforts are being made to improve the functioning of government institutions and to develop long term capacity at all levels of government, as well as in the EC Office.

Measurement of performance in the focal sectors remains weak due to the relatively difficult implementation conditions in SI, the lack of statistics for clear monitoring and evaluation, particularly for social indicators and income generating activities. Attention needs to be directed at improving M & E efforts in all sectors and projects. The weak capacity in the statistics division in the MOF needs to be strengthened, although RAMSI has greatly improved the accountability and transparency of government revenues and expenditure.

The role of NSAs in development has been recognised by SIG but much remains to be done to improve coordination and raise their capacity as rural service providers at community level. The EU is funding a NSA Capacity Building Programme and the MPP Phase II will also contribute to an increased level of NSA/community activities in rural areas. Whilst inter-donor coordination is satisfactory, coordination between donors and SIG needs to be improved and strengthened with greater efforts to fill staff vacancies in the DNPAC.