

TECHNICAL ASSISTANCE COMPLETION REPORT

Division: PAHQ

TA No. and Name TA 4527-SOL: Diagnostic Assessment of Interisland Transport		Amount Approved: \$350,000	
		Revised Amount:	
Executing Agency: Ministry of Finance and National Planning (formerly Ministry of Transport, Works, and Utilities)	Source of Funding: Technical Assistance Special Fund (TASF) \$200,000 Government of Australia \$150,000	TA Amount Undisbursed \$56,564.63	TA Amount Utilized \$293,435.37
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Description			
<p>The operative Solomon Islands Country Strategy and Program Update 2005–2006 at the time of approval aimed to achieve rapid, pro-poor, and private sector-led economic growth by (i) providing transport infrastructure and services and (ii) strengthening the enabling environment for the private sector. Those program objectives have remained constant over subsequent country programs. The TA supported the Government's policy framework by complementing the national development plan focus on transport for development.</p> <p>The TA was intended to provide background information and analytical support to reinforce the development plan and ADB's country strategy through strategic planning for (i) optimal use of resources for rehabilitating and maintaining physical infrastructure, (ii) coordinated and sustainable interisland transportation services, and (iii) enhanced private sector participation in transport operations.</p>			
Expected Impact, Outcome, and Outputs			
<p>The goal of the TA was to increase the efficiency and effectiveness of interisland air and sea transport services, while minimizing the fiscal burden on and exposure to risk of public institutions and finances. The purpose was to review the status of interisland transport services, determine constraints to their development, and develop strategies for improving them. The outputs were diagnostic assessment reports that informed a strategy for future policy dialogue and programming.</p> <p>The TA was initially intended to produce (i) a review of existing documentation and an analysis of the operational and financial situations of air and sea transport operators; (ii) an analysis of the entities involved in the ownership, planning, and regulation of interisland transport services; and (iii) the identification of opportunities for improving private sector participation; and (iv) the identification of implementation strategies and action plans for reform.</p> <p>Subsequent to approval but prior to inception, the Government changed its aviation policy in response to a financial crisis in the national airline, and requested that the TA be modified to concentrate primarily on additional assistance in the aviation sector, and reduce the inputs in the maritime sector. ADB provided immediate advice through a staff consultancy to evaluate options for improving the operations of Solomon Airlines, effectively addressing the first three parts of the planned TA for the aviation sector. As a result of the consultations and findings from that work, the government requested that ADB continue urgent assistance to the sector and immediately develop a privatization strategy, prepare the airline for divestment, and guide the privatization process. Since consultations revealed that some stakeholders were advocating non-competitive asset sales and long-term service agreements that would violate principles of good governance as well as the government's own internal policies, ADB agreed and processed a major change in scope. Although the main focus shifted to aviation, the government requested that initial activities be retained in shipping to maintain momentum for reform.</p> <p>In aviation, the revised methodology and key activities deleted the initial three components above, as these were already completed, and expanded the fourth component to prepare and implement a phased privatization strategy by (i) improving the airline's operational and financial performance; (ii) determining and documenting the legal entity and assets to be sold; (iii) establishing an appropriate regulatory framework for air transport; and (iv) preparing and supervising the process of proposals, evaluations, and transactions. In shipping, the revised methodology shifted the emphasis to preparation of action plans for reform, while the first three components were retained but minimized</p>			

to review of existing documentation and recommendations for more in-depth analysis and data collection to design and implement the detailed reform program.

The original Executing Agency (EA) was specified as the Ministry of Transport, Works, and Utilities (MTWU), due to its responsibility for strategic transportation planning and coordination. With the new focus on privatization, this ministry was no longer appropriate. The EA was changed to the Ministry of Finance and National Planning (MFNP) in close cooperation with the Economic Reform Unit.

The government's request essentially accelerated parts of the approved country assistance pipeline and deferred others, as technical assistance to both the aviation and maritime sectors was programmed for two consecutive years. Work in aviation was done first under this TA, and planned work on shipping was carried out later (under TA 4588-SOL).

Delivery of Inputs and Conduct of Activities

The TA was initially intended to provide a 6 month program of assistance during the first half of 2005. The team was to include four consultants in the areas of transport planning and economics, aviation operations, maritime operations, and private sector development for a total of 12 person months. After the change in scope, the team was revised to include four specialists. A firm provided three international consultants in airline privatization, airline operations, and airline financial management. An individual international consultant was recruited as the maritime operations specialist. Total inputs were 12 person months but provided intermittently over the span of a year.

In the maritime sector, the TA conducted a thorough review of domestic shipping and documented the operational status of domestic service operators, their fleets and other assets, routes and markets, competitors and partners, safety management, organizational structure, and human resources. The TA also reviewed the regulatory and legislative frameworks and identified impediments to private sector development. These inputs were used to prepare an action plan for restructuring operations and institutions.

In the aviation sector, the TA began with a thorough operational review of the airline and a comprehensive financial analysis using a dynamic simulation model to establish a value for the airline using a discounted cash-flow model. The results were analyzed in the context of a range of possible privatization models that became the subject of extensive consultations with a wide range of stakeholders in the public and private sectors within the country and internationally. Additional work was done to analyze the problem of providing social services on uneconomic routes to ameliorate political concerns about the potential impact of commercialization. These activities resulted in a recommended reform program to prepare the airline for sale and a recommended transaction structure.

All inputs were provided successfully, but the total duration expanded to nearly two years due to the government's changing policy stance and inability to reach clear decisions through Cabinet. In the maritime sector, the work progressed smoothly, and was completed by the end of 2005. In the aviation sector however, due to political instability and a fluid and uncertain policy environment, activities were put on hold at about the midpoint of the work near the end of 2005. The government then changed in early 2006. After about 6 months of dormancy, the aviation activities of the TA were revived and draft final reports on most activities presented in December 2006. Following extensive but intermittent policy dialogue on the recommendations, the final reports on aviation were delivered in March 2007.

In the maritime sector, the individual consultant was rated as excellent. In the aviation sector the firm's overall inputs as well as the work of each specialist were rated as satisfactory. ADB's supervision and conduct of policy dialogue was also satisfactory.

Evaluation of Outputs and Achievement of Outcome

The quality of the outputs in both the aviation and maritime sectors was satisfactory. The consultants prepared well-grounded analyses based on thorough data development; detailed action plans for implementation; and feasible recommendations for reforms to public sector policy, operations, and incentives for promoting private sector participation. All outputs were carefully documented and made available to stakeholders in both printed and electronic form, including the operational and financial models.

In the maritime sector, the outputs had the desired results, in that they led to design and approval of a follow on TA (4588-SOL) that has been implemented over 2006-2007 for implementation of reforms according to the action plan developed under this TA. The reports are comprehensive and provide a valuable reference as the only readily-available source for the data collected and synthesized under the TA.

In the aviation sector, outcomes were mixed. On the positive side, four outcomes were noted: (i) the operational analyses and financial modeling revealed practical solution to the severe problems the airline was facing, and led to significant improvements in the airline's performance and cost and revenue control that have continued; (ii) the analysis of social services on uneconomic routes was well accepted and was incorporated into the Economic Reform Unit's recommendations on the National Transport Plan, (iii) dialogue on the benefits of competition led to the government acceding to the Pacific Islands Air Services Agreement, a regional liberalization initiative, and (iv) the overall findings of the TA made the benefits of regulatory harmonization clear to the government and resulted in Solomon Islands reforming its legislation to adopt the New Zealand regulatory system to facilitate full membership in the Pacific Islands Safety Office. On the negative side, recommendations for proceeding with privatization were not accepted and the airline remains in government ownership. Although the government was satisfied with the quality of the work, a change in government policy reversed the earlier decision.

Overall Assessment and Rating

Partly successful. Three of the four components were fully successful. Within the fourth component, the activities and outputs were completed successfully and accepted with respect to the maritime sector but did not result in positive government action with respect to privatization of the airline.

Major Lessons

In the maritime sector, wide-ranging consultation was necessary for development of an action plan. Although the TA team conducted initial direct consultations and group workshops, the time allowed was not sufficient to complete the task in adequate depth, given the diversity and geographic disparity of the sector. However the TA did establish a solid basis to proceed with the subsequent TA, which consequently was able to accelerate its activities. The experience demonstrated the need for more time for more diverse consultations.

In the aviation sector, there was good support for financial and operational improvements at the airline, primarily due to the extreme crisis it was facing at the time. However, when it came to preparing for privatization, there was insufficient consensus between the other major stakeholders. Although the government is the ultimate owner of the airline and made a direct request to ADB to conduct a privatization process, it did not ensure that the airline itself provided the necessary cooperation, nor was it able to resolve conflicts between the boards of the airline and the Investment Corporation of Solomon Islands (ICSI) which holds the government's shares. The experience demonstrated the need for a clear policy decision at Cabinet level, supported by resolutions at the Board level in both the airline and ICSI, before such fundamental reform can be pursued.

Recommendations and Follow-Up Actions

In the maritime sector, the TA recommended (i) mechanisms for a contestable route franchise scheme, (ii) improved economic and safety regulation, and (iii) institutional reforms including creation of an independent maritime authority. These recommendations are being developed further under a subsequent TA and will be considered for ongoing implementation through ADB's regular country programming activities.

In the aviation sector, in view of the government's decision to not pursue the privatization of the airline, introducing competition on both the international and domestic networks should be the overarching strategy for the development of the air transport market in the Solomon Islands. Greater competition – particularly from the private sector – is the most effective way of increasing services and lowering costs. ADB should continue its dialogue on these issues in the context of its work in both the transport sector and in private sector development, however, clear government commitment at Cabinet level should be required for ADB to again consider active support.

Whether or not ADB is involved, when the aviation market in Solomon Islands becomes more liberal, which is inevitable given the unsustainable nature of current policy, the government will need to consider policy options for provision of essential air services to small and remote communities. In a competitive market it is not appropriate to place the burden of cross-subsidizing uneconomic routes on one carrier. The political reality in the country is that facilitating the movement toward market liberalisation, greater competition and private sector participation in the sector will require introducing some form of contestable subsidies on uneconomic routes. If there are future attempts to reform government ownership and sector policies there will need to be corresponding support mechanisms that do not distort the emerging market.