



## Concept Paper

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Project Number: 47314-001  
August 2014

# Proposed Policy-Based Grant Kiribati: Strengthening Fiscal Stability Program

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**Asian Development Bank**

## CURRENCY EQUIVALENTS

(as of 29 July 2014)

Currency unit	–	Australian dollar (A\$)
A\$1.00	=	\$0.9406
\$1.00	=	A\$1.0631

## ABBREVIATIONS

ADB	–	Asian Development Bank
GDP	–	gross domestic product
IMF	–	International Monetary Fund
KERP	–	Kiribati Economic Reform Plan
MFED	–	Ministry of Finance and Economic Development
RERF	–	Revenue Equalization Reserve Fund
SFSP	–	Strengthening Fiscal Stability Program
SOE	–	state-owned enterprise
TA	–	technical assistance

## NOTE

In this report, "\$" refers to US dollars unless otherwise stated.

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## PROGRAM AT A GLANCE

1. Basic Data		Project Number: 47314-001	
Project Name	Strengthening Fiscal Stability Program	Department /Division Executing Agency	PARD/SPSO Ministry of Finance and Economic Development
Country Borrower	Kiribati Kiribati		
2. Sector	Subsector(s)	ADB Financing (\$ million)	
✓ Public sector management	Public expenditure and fiscal management		1.00
	Reforms of state owned enterprises		2.00
		Total	3.00
3. Strategic Agenda	Subcomponents	Climate Change Information	
Inclusive economic growth (IEG)	Pillar 1: Economic opportunities, including jobs, created and expanded	Climate Change impact on the Project	Low
4. Drivers of Change	Components	Gender Equity and Mainstreaming	
Governance and capacity development (GCD)	Institutional development	No gender elements (NGE) ✓	
Partnerships (PAR)	Public financial governance Implementation Regional organizations		
Private sector development (PSD)	Public sector goods and services essential for private sector development		
5. Poverty Targeting		Location Impact	
Project directly targets poverty	No	Nation-wide	High
6. Risk Categorization:	Low		
7. Safeguard Categorization	Environment: C Involuntary Resettlement: C Indigenous Peoples: C		
8. Financing			
Modality and Sources		Amount (\$ million)	
ADB		3.00	
Sovereign Program grant: Asian Development Fund		3.00	
Cofinancing		9.08	
New Zealand Grant		0.88	
World Bank		8.20	
Counterpart		0.00	
None		0.00	
Total		12.08	
9. Effective Development Cooperation			
Use of country procurement systems		No	
Use of country public financial management systems		No	

## I. THE PROGRAM

### A. Rationale<sup>1</sup>

1. Kiribati, as a fragile micro-state, faces challenges of geographic isolation, limited human and financial resources, and a narrow economic base. Its economy is extremely vulnerable to external shocks due to high exposure to climate change, strong import dependency, and heavy reliance on income from external sources. This has led to high volatility in economic growth. The country's private sector is small, restricted by high transport costs and a limited production base. The large public sector crowds out entrepreneurial activity through the activities of state-owned enterprises (SOEs) operating in competitive sectors. Copra and fish constitute the bulk of local production and exports. Development indicators are low.<sup>2</sup>

2. With its adoption of the Australian dollar the government is reliant on fiscal policy to manage the impact of shocks and stimulate inclusive growth. Central government's current revenues have increased as a share of gross domestic product (GDP) from an average of 42% in 2009–2011, to an average of around 53% in 2012–2013, driven by strong fishing license revenue performance. However, this has masked an overall decline in tax receipts which have fallen from 17.7% of GDP in 2009 to 16.1% in 2013 due to a narrow tax base; weak tax compliance; and, the poor corporate tax performance of the SOEs. In light of the highly volatile nature of the revenue base, the government has exercised expenditure restraint. The public sector wage bill has remained constant in real terms since 2007 and overall, real expenditure has declined by 13%. However, annual SOE subsidies at 4% of GDP remain high.

3. The government posted a budget surplus of 10.3% of GDP in 2013 due to a combination of better fishing conditions and a substantial rise in fishing license fees. Nevertheless, it will take time to restore the country's main fiscal buffer—the Revenue Equalization Reserve Fund (RERF)—which was heavily drawn upon to support fiscal deficits of between 5% and 20% of GDP during 2009 and 2012. Unsustainably high drawdowns from the RERF of between 11% and 22% of GDP over this period,<sup>3</sup> as well as losses on RERF investments during the recent global economic crisis, have led to the RERF balance almost halving in constant per capita terms. In turn, this has severely limited the government's ability to manage economic volatility and react to shocks.

4. The 2013 International Monetary Fund (IMF) Article IV Consultation projected that fiscal sustainability would require (i) undertaking structural reforms aimed at stimulating private sector development; and (ii) gradually reining in fiscal deficits to an average of 2.7% of GDP and RERF drawdowns to 2.0%–2.8% of GDP during 2022–2030. This is expected to increase economic growth to 2.0%–2.3% on average during 2019–2030.<sup>4</sup> To accomplish this, the government embarked on a wide-ranging reform program guided by policy actions defined in the Kiribati Economic Reform Plan (KERP), a medium-term, joint government and development partner effort to improve fiscal sustainability.<sup>5</sup> In line with the priorities of the Kiribati Development Plan 2012–2015<sup>6</sup>, the reform agenda is aimed at improving (i) public expenditure quality, (ii) revenue performance, (iii) management of public assets and liabilities, and (iv) the business environment.

5. The KERP is being supported by the Asian Development Bank (ADB), the World Bank, and the governments of Australia and New Zealand, who provide (i) budget support on an

<sup>1</sup> Data in sections A and C are from ADB's Asian Development Outlook database if not otherwise indicated.

<sup>2</sup> World Bank. 2014. *Hardship and Vulnerability in the Pacific Island Countries*. Washington DC; ADB. 2004. *Hardship and Poverty in the Pacific*. Manila.

<sup>3</sup> Staff calculation based on Kiribati government budgets from 2010–2014.

<sup>4</sup> IMF. 2013. *Kiribati Article IV Consultation 2013. IMF Country Report No. 13/158*. Washington DC.

<sup>5</sup> The KERP (Appendix 4) is complemented by detailed action plans outlining fiscal and structural reforms.

<sup>6</sup> Government of Kiribati. 2012. *Kiribati Development Plan 2012–2015*. Tarawa.

alternating basis to create fiscal space for critical reforms and set incentives to keep up reform momentum; and/or (ii) technical assistance (TA) to support reform implementation. The KERP builds upon ADB's sound experience in policy-based operations in the Cook Islands, Nauru, the Marshall Islands, Samoa, Solomon Islands, Tonga, and Tuvalu, as well as other partners' experiences across the region, including in Kiribati.<sup>7</sup> Lessons incorporated in the KERP include the need to (i) build strong political reform consensus; (ii) limit reform to few substantive areas; (iii) institutionalize a coordinated government–partner mechanism to monitor implementation of the reform process; and (iv) adopt a medium- to long-term perspective in recognition of the severity of challenges.<sup>8</sup>

6. The current government's strong reform commitment has resulted in the (i) approval of a national fisheries policy to strengthen resource management and maximize license revenues; (ii) passing of tax legislation to improve compliance and introduce a value-added tax to broaden the revenue base; (iii) reduction of temporary workers in non-priority ministries to curb salary expenditures; (iv) approval of a debt policy that has prevented new non-concessional borrowing; (v) the establishment of a RERF investment committee; (vi) significant SOE reform progress and approval of a private sector strategy, and (vii) an upgrade of the public financial management information system. ADB's TA has provided crucial support to the government toward implementing SOE reform.<sup>9</sup>

7. The government is committed to continue reforms up to the end of the current election cycle in late 2015 and has requested budget support from development partners that will provide fiscal space for further important reforms. As part of this medium-term, multi-partner dialogue, ADB proposes a stand-alone policy-based operation: the Strengthening Fiscal Stability Program (SFSP). The SFSP extends support in fiscal management and structural reform—areas of historical ADB involvement—and is consistent with Kiribati's Development Plan, ADB's Pacific Approach 2010–2014, and ADB's country partnership strategy, 2010–2014.<sup>10</sup> While the SFSP adopts a stand-alone lending modality, it is being developed in the context of a programmatic policy discussion with all partners, and is based on the KERP, which is envisaged as a multiyear policy framework designed to support medium-term reform efforts led by the government. This will ensure follow-through and sustainability of reform actions.

## **B. Impact, Outcome, and Outputs**

8. In line with the KERP, the intended impact of the SFSP is to improve the country's fiscal sustainability. Based on IMF projections, strong reform efforts—supported by the SFSP—will help stabilize the RERF's real value and narrow the current fiscal deficit, reducing the need for budget support in the future. Using the importance of the public sector as an entry point for reform, the program outcome aims at improved government capacity for fiscal stabilization.<sup>11</sup> This will be achieved through improvements in several areas critical to Kiribati's fiscal position.

9. **Output 1.** To improve expenditure quality, the inefficient and poorly coordinated copra industry will be reformed to improve performance and reduce leakages, and SOE subsidies cut, except community service obligations for unprofitable social services delivered by SOEs.<sup>12</sup>

<sup>7</sup> An overview of ADB's regional lessons can be obtained from ADB. 2009. *Special Evaluation Study: ADB's Support for Public Sector Reforms in the Pacific*. Manila.

<sup>8</sup> The government and partners support a gradual transition from public expenditure-driven growth to broader based private sector growth while recognizing the need to maintain basic social services as well as the importance of subsidies (and wages) as livelihood support and a form of social protection. Abrupt fiscal adjustment would jeopardize development outcomes and further deepen hardship and vulnerabilities.

<sup>9</sup> ADB. 2008. *Economic Management and Public Sector Reform*. Manila (TA 7166-KIR).

<sup>10</sup> ADB. 2009. *Pacific Approach, 2010–2014*. Manila; ADB. 2010. *Country Partnership Strategy: Kiribati, 2010–2014*. Manila.

<sup>11</sup> Government spending is in excess of 100% of GDP, coinciding with high import dependency.

<sup>12</sup> The reform of the copra sector is supported jointly by the World Bank and ADB.

10. **Output 2.** On the revenue side, the implementation of a value-added tax—supported through the IMF’s Pacific Financial Technical Assistance Center and the Government of Australia—to broaden the tax base is underway. This is complemented by the implementation of the national fisheries policy, which will address major shortcomings in fishing license management by setting up a transparent coordination mechanism for reviewing and setting license prices.<sup>13</sup>

11. **Output 3.** Improved RERF asset management through the adoption of new management policies—developed with World Bank support—will support fund stabilization efforts, while debt policy implementation will prevent non-concessional borrowing and introduce a high level of scrutiny and oversight for other government borrowing and guarantees.

12. **Output 4.** With support from ADB, fiscal drain from inefficient SOEs will be significantly reduced through the implementation of (i) rationalization strategies for selected SOEs, and (ii) the SOE Act 2013, resulting in improved corporate governance.<sup>14</sup>

13. Private sector development to provide a sustainable basis for growth and fiscal stabilization is being pursued in parallel to the SFSP by the government supported by the World Bank and the governments of Australia and New Zealand. This development includes (i) the liberalization of the telecommunications sector (a KERP action supported by the World Bank in 2014), (ii) financial and energy sector development, (iii) transport infrastructure development, and (iv) skills development and support to seasonal labor migration. ADB-supported structural reform also contributes to market development by opening up selected sectors to competition, especially in areas where private enterprises are ready to participate.

## C. Investment and Financing Plans

14. It is proposed that ADB provide a policy-based grant of \$3.0 million to assist in the implementation of KERP actions scheduled for 2014 and help the government meet its projected current fiscal deficit of \$39.7 million (22.6% of GDP) (footnote 4). The gap will be financed through RERF drawdowns of \$25.5 million and budget support of \$14.2 million. For 2014, the World Bank will provide budget support linked to the KERP of \$8.2 million, and the Government of New Zealand has agreed to provide \$3.0 million. No procurement is required.

## D. Indicative Implementation Arrangements

15. The Ministry of Finance and Economic Development (MFED), as the executing agency, will oversee implementation of agreed policy actions. The MFED will be responsible for program administration, disbursements, and maintaining all records. The implementing agencies will be the MFED, which will be responsible for outputs 1 (with the Ministry of Commerce, Industries and Cooperatives), 2 (with the Ministry of Fisheries), and 3 and 4 (with the Ministry of Communication, Transportation and Tourism and the Ministry of Public Works). TA by ADB and other partners have been, and will continue to be, available to support the government to accomplish the policy actions.<sup>15</sup> Joint progress monitoring will be carried out through the joint Economic Working Group.<sup>16</sup>

<sup>13</sup> This KERP action is supported by World Bank TA in 2014.

<sup>14</sup> ADB. 2013. *Enhancing Economic Competitiveness through State-owned Enterprise Reform*. Manila (TA8478-KIR).

<sup>15</sup> See footnote 14, and ADB. 2013. *Pacific Economic Management (Phase 2)*. Manila (TA 8565-REG); and ADB. 2013. *Pacific Private Sector Development Initiative (Phase 3)*. Manila (TA 8378-REG).

<sup>16</sup> The Economic Working Group comprises representatives from the government and development partners. The Secretary for Finance and Economic Development is the chairperson of the working group.

## II. DUE DILIGENCE REQUIRED

16. Given a safeguard categorization of C, due diligence will focus on two key areas:
- (i) **Economic and financial.** The ADB team will work with government officials to ensure prudent fiscal and financial management and a sound understanding of development issues. An IMF letter of comfort will be provided.
  - (ii) **Governance.** ADB will update an assessment of the state of SOE governance systems in Kiribati, building on analysis undertaken in a previous TA on Economic Management and Public Sector Reform (TA7166-KIR)
17. Key risks are: (i) political support to continue KERP implementation may weaken as sensitive reforms are implemented, and (ii) staff turnover may leave insufficient suitably qualified personnel for implementation. The program is designed to mitigate these risks by sustaining political consensus through continuous policy dialogue and concerted outreach and by building upon government leadership to drive allocations of sufficient financial and human resources.

## III. PROCESSING PLAN

### A. Risk Categorization

18. The SFSP is categorized as “low risk” as it has all of the following features: (i) a grant amount not exceeding \$50 million for programs (the program grant is \$3 million), (ii) builds on ADB's previous experience in the sector in the concerned country (ADB has a sound track record in public financial management and structural reforms in Kiribati and the Pacific region), (iii) executing agency capacity in terms of externally financed project administration (the MFED has sufficient experience in administration of ADB TA projects), and (iv) safeguard categorization other than A (the SFSP has a safeguard categorization of C with no adverse impact on the environment and no impact on involuntary resettlement and indigenous people).

### B. Resource Requirements

19. ADB staff will prepare the SFSP, utilizing an estimated 6 person-months of international and 8 person-months of national staff time. Ongoing TA (footnote 15) will support the program.

### C. Processing Schedule

**Table 1: Proposed Processing Schedule**

<b>Milestones</b>	<b>Expected Completion Date</b>
Approval of concept paper	1 August 2014
Grant fact-finding	4–8 August 2014
Staff review meeting	14 August 2014
Grant negotiations	1–5 September 2014
Board consideration	24 October 2014
Grant effectiveness	30 November 2014

Source: ADB staff estimates.

## IV. KEY ISSUES

20. Particular attention during processing and implementation will be paid to (i) maintaining ongoing political support for the program; and (ii) coordinating with other development partners that are providing budget support and TA to Kiribati during 2014–2016.



## DESIGN AND MONITORING FRAMEWORK

Design Summary	Performance Targets and Indicators with Baselines	Data Sources and Reporting Mechanisms	Assumptions and Risks
<b>Impact</b> Improved fiscal sustainability	<p>By 2018:  RERF real per capita value (in 2006 A\$ equivalent) no less than A\$4,050 (baseline: A\$4,436 in 2013, with projected value of A\$3,327 in 2018 in policy stagnation scenario based on simulations in IMF Country Report No. 13/158)</p> <p>Current fiscal deficit reduced to 6.6% of GDP (baseline: 18.2% of GDP in 2018 in policy stagnation scenario based on simulations in IMF Country Report No. 13/158)</p>	<p>National budget documents</p> <p>RERF annual reports</p> <p>National budget documents</p> <p>IMF Article IV reports</p>	<p><b>Assumption</b>  Government maintains fiscal discipline and implements ambitious reforms</p> <p><b>Risk</b>  Broad reform consensus weakens due to political pressure</p>
<b>Outcome</b> Improved capacity for fiscal stabilization	<p>By 2015:  Copro subsidy leakages reduced by 90% (baseline: \$3.6 million in 2011)</p> <p>Increase in VAT revenue to 9.9% of GDP (baseline: 0.0% of GDP in 2013)</p> <p>Total value of government and SOE non-concessional debt reduced to \$1.8 million (baseline: \$24.3 million in 2012)</p> <p>Subsidies to SOEs (excluding explicit CSOs) eliminated (Baseline: 3.9% of GDP in 2012)</p>	<p>National budget documents</p> <p>National budget documents</p> <p>National budget documents</p> <p>SOE monitoring unit report</p> <p>National budget documents</p>	<p><b>Assumptions</b>  KERP implementation continues</p> <p>No major adverse economic shocks</p> <p><b>Risks</b>  Political pressure to slow down reform process</p> <p>Capacity constraints and staff turnover reduce continuity and quality of reform implementation</p>
<b>Outputs</b> 1. Improved quality of expenditure	<p>By 2014:</p> <p>Rationalization strategy for KCCS and KCM approved by cabinet (Baseline: No existing strategy in 2013)</p> <p>SOE subsidies as CSOs are fully reflected in the annual budget (Baseline:</p>	<p>MCIC annual report</p> <p>National budget documents</p>	<p><b>Assumptions</b>  Government maintains commitment to reform public finances</p> <p>Government maintains commitment to improve SOE governance and to rationalize selected SOEs</p>

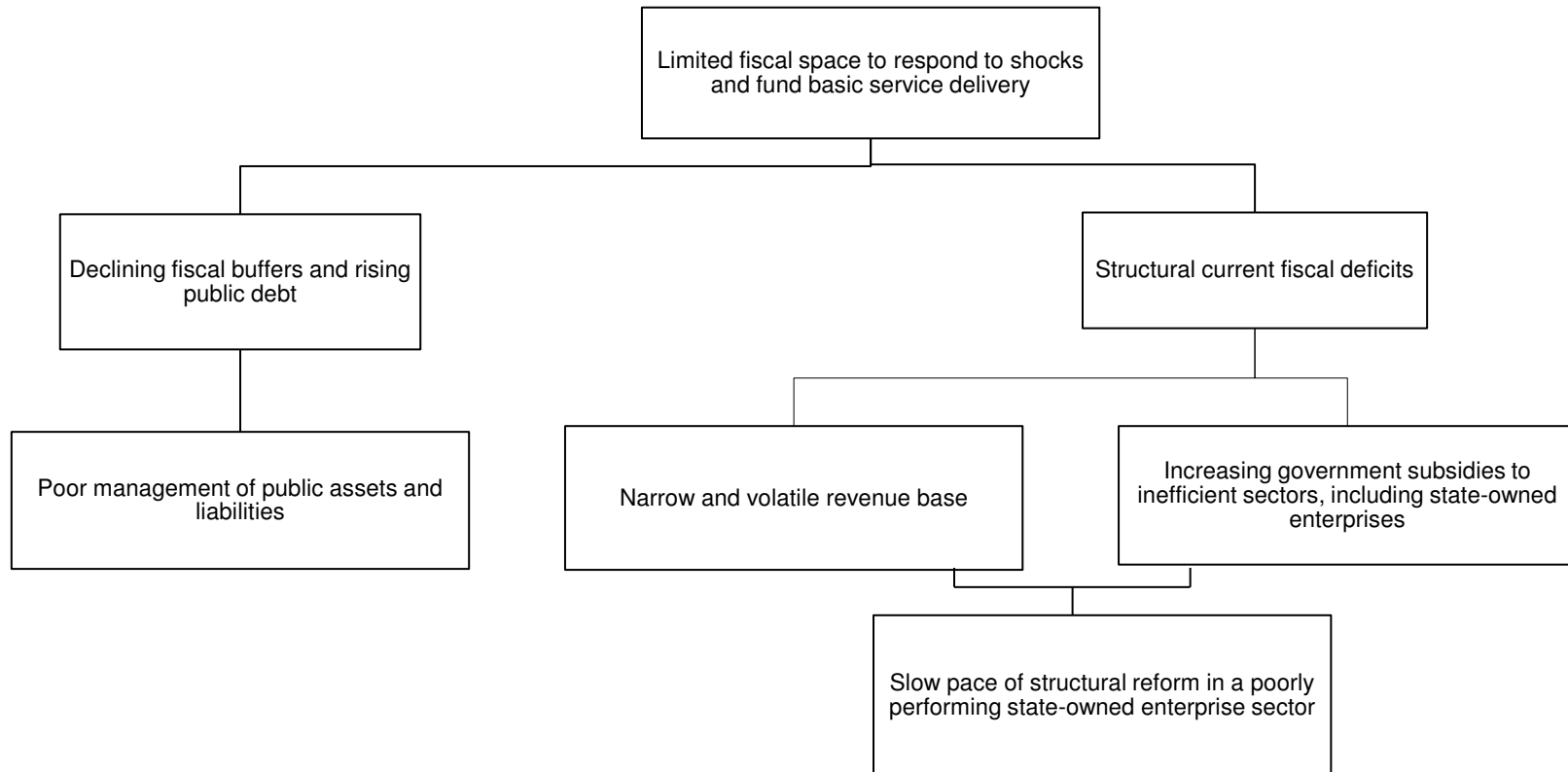
Design Summary	Performance Targets and Indicators with Baselines	Data Sources and Reporting Mechanisms	Assumptions and Risks
	No CSOs reflected in 2013 budget)		<b>Risks</b> Stakeholders interfere with reform process due to converse individual interests  Staff changes and already high workload reduce continuity and quality of reform implementation  Limited capacity in the MFED to reform SOEs and scrutinize financial performance
2. Improved revenue administration	VAT system put in place and administered (Baseline: No VAT system in 2013)	MFED annual reports	
3. Improved management of public assets and liabilities	No new non-concessional loans taken on by government and SOEs as agreed to in the debt management strategy (Baseline: A\$8.8 million in 2013)	MFED annual reports	
	Cabinet approval of RERF management policies (Baseline: No RERF management policies existing in 2013)	Cabinet minutes	
4. Improved structural reform implementation	Rationalization strategies for BSL, BKL, KSSL and PVU approved by cabinet (Baseline: No existing rationalization strategies in 2013)	Cabinet minutes	
	Full compliance with legislative provisions of SOE Act for board appointments in all SOEs (Baseline: No SOEs complied with SOE Act for board appointments in 2013)	SOE monitoring unit annual reports Attorney General's Office reports	
	Fully costed SOIs for 15 SOEs submitted for information to cabinet and parliament (Baseline: No SOEs had fully costed SOIs in 2013)	Cabinet minutes	

Activities with Milestones	Inputs
<p><b>1. Improved quality of expenditure (31 August 2014)</b></p> <p>1.1 Develop strategy for the merger of KCCS and KCM and submit for cabinet approval for implementation</p> <p>1.2 SOEs develop and submit CSO bids to MFED for negotiation in preparation of the 2015 budget</p> <p><b>2. Improved revenue administration (31 August 2014)</b></p> <p>2.1 VAT system established and staff trained on its administration</p> <p>2.2 Report from the joint MOF and MFED committee on the review of fisheries license arrangements and revenue performance of individual licenses submitted to cabinet</p> <p><b>3. Improved management of public assets and liabilities (31 August 2014)</b></p> <p>3.1 MFED appoints a debt management officer to monitor the implementation of the national debt management policy</p> <p>3.2 RERF management policies finalized and submitted for cabinet approval</p> <p><b>4. Improved structural reform implementation (31 August 2014)</b></p> <p>4.1 Finalize concession contract for BSL</p> <p>4.2 Develop rationalization strategies for PVU, BKL, and KSSL and seek cabinet approval for implementation</p> <p>4.3 Appoint all SOE boards in full compliance with the SOE Act</p> <p>4.4 Develop fully costed SOIs for 15 SOEs and submit for cabinet approval</p>	<p><b>ADB:</b> \$3.0 million</p> <p><b>Government:</b> Fulfillment of grant conditions and counterpart support for technical assistance</p>

BKL = Bobotin Kiribati Limited, BSL = Betio Shipyard Limited, CSO = community service obligation, GDP = gross domestic product, IMF = International Monetary Fund, KCCS = Kiribati Copra Cooperative Society, KCM = Kiribati Copra Mill, KERP = Kiribati Economic Reform Plan, KSSL = Kiribati Shipping Services Limited, MCIC = Ministry of Commerce, Industries and Cooperatives, MOF = Ministry of Fisheries, MFED = Ministry of Finance and Economic Development, PVU = Plant and Vehicle Unit, RERF = Revenue Equalization Reserve Fund, SOE = state-owned enterprise, SOI = statement of intent, VAT = value-added tax.

Source: Asian Development Bank.

## PROBLEM TREE



## INITIAL POVERTY AND SOCIAL ANALYSIS

Country:	Kiribati	Project Title:	Strengthening Fiscal Stability Program
Lending/Financing Modality:	Stand-alone policy-based grant	Department/ Division:	PARD/SPSO

### I. POVERTY IMPACT AND SOCIAL DIMENSIONS

#### A. Links to the National Poverty Reduction Strategy and Country Partnership Strategy

The second key policy area of the Kiribati Development Plan 2012–2015 focuses on promoting economic growth and poverty reduction. The key macro strategies identified include (i) expanding and diversifying the government's revenue base, (ii) implementing a new tax regime, (iii) improving public finance management, (iv) improving the government's fiscal position by improving SOE performance, and (v) improving livelihoods through effective implementation of subsidies such as the copra subsidy.

To implement these macro strategies, the government, in close collaboration with development partners, has agreed on a set of policy reform actions in the KERP. The KERP focuses on four areas: (i) the quality of public expenditure, (ii) government revenue performance, (iii) the management of public assets and liabilities, and (iv) the business environment. The SFSP is a direct response to the KERP. To improve the quality of expenditure, the SFSP will support reform of copra subsidies. To increase revenues, the SFSP will help implement a value-added tax to replace import duties as well as the review of fisheries agreements to support sustainable resource management and increase future fisheries license receipts. Increased transparency regarding fishing license fees will also lead to improved revenue predictability. An increased and more stable revenue base will enable the government to more sustainably finance basic social services and livelihood support to poor and vulnerable groups. Increased sustainability in fishery resource management will further promote intergenerational equity by extending benefits from natural resource endowments over a longer time period.

To improve the management of public assets and liabilities, the SFSP will support the implementation of the government's debt management policy and develop policies for the management of the RERF. Sustainable RERF management will provide the government with a fiscal buffer to (i) react to external shocks with the aim of reducing vulnerabilities and hardship of the affected population and (ii) protect the government's capacity to maintain public employment and service delivery into the future. To improve the business environment, the SFSP will support the implementation of the SOE Act to (i) improve the governance and performance of SOEs, (ii) rationalize selected SOEs, and (iii) liberalize the telecommunications sector. Improved performance of SOEs through strengthened governance and accountability arrangements in the SOE sector will contribute to better service delivery, including water and electricity services that benefit the poor. This improved performance will also free up inefficiently targeted SOE subsidies that can be reallocated to basic service sectors that cater for the needs of the poor. Further, the introduction of competition in state-dominated sectors through the divestment of SOEs that are crowding out private sector opportunities will promote broad-based economic growth and private sector job creation, with new opportunities likely to concentrate in South Tarawa, where poverty rates are highest. Proposed reforms in the telecommunications sector are likely to reduce costs of telecommunications services and improve connectivity for poor households.

#### B. Targeting Classification (Select one):

☒ General Intervention ☐ Individual or Household (TI-H) ☐ Geographic (TI-G) ☐ Non-Income MDGs (TI-M1, M2, etc.)

The overall objective of the program is to achieve macroeconomic stability in the long run through stabilization of the RERF's real value, a gradual current fiscal deficit reduction, and private sector-led growth. This stability will help the government stabilize public spending and maintain fiscal buffers while promoting broad-based, private sector led economic growth. The poor and vulnerable will benefit from the improved fiscal stance through expanded basic services, improvements in service efficiency and quality through increased SOE performance and predictable public spending, including in the education and health sectors. Improving targeting of livelihood subsidies will benefit the poor directly. Further, private sector development will promote job creation and lower costs of goods and services in newly competitive sectors, which will benefit the poor.

### C. Poverty and Social Analysis

#### 1. Key issues and potential beneficiaries

In 2010, analysis using the 2006 Household Income and Expenditure Survey showed that food poverty is low in Kiribati, at around 5%.<sup>1</sup> However, basic needs poverty is relatively widespread and concentrated in the main urban center of South Tarawa—21.8% of the national population lives below the basic needs poverty line, with 24.2% of those living in South Tarawa. This analysis was subsequently updated using price and income adjustments for a Government of Australia-funded social protection assessment in 2012.<sup>2</sup> This updated analysis suggested a slightly higher level of national basic needs poverty (26.3%) in 2009, largely due to the impact of higher food and fuel prices.

The restoration of macroeconomic stability through improved expenditure, asset, and liability management; increased revenue; and an enabling business environment will ensure resources are freed up to allow the government to respond to future shocks, increase allocations to the health and education sectors, and enable private sector job creation. This will benefit the general public in Kiribati, including the poor and the vulnerable that have been affected by frequent shocks and from real expenditure reductions in health and education since 2006.

#### 2. Impact channels and expected systemic changes

Better governance of SOEs, including of the Public Utilities Board, will promote more efficient and higher quality service provision directly benefiting the poor. The development of SOE statements of intent and subsequent government scrutiny will help ensure a pro-poor orientation of SOE investments and service delivery. Better targeted copra subsidies as livelihood support, especially for the vulnerable outer island population, will directly provide benefits to the poor while reduced leakages can be reallocated in line with government priorities. Additional resources in the medium to long term will allow the government to fund basic social spending in health and education and lift service delivery levels. Expected price reductions for goods and services in sectors that are exposed to competition, including the telecommunications sector, will benefit the poor.

#### 3. Focus of (and resources allocated in) the PPTA or due diligence

There is no PPTA. Due diligence is supported by ADB's ongoing engagement in the KERP discussions and the technical assistance ADB provides for economic management and public sector reform.

#### 4. Specific analysis for policy-based lending

The policy intervention requires demonstrated government commitment to improving public sector management. Specific actions in the short term include: (i) reform of the copra subsidy and merger of the copra mill and copra society; (ii) introduction of a value-added tax; (iii) stocktaking and review of fishing licenses and production of a joint report from the MFED and the Ministry of Fisheries detailing the source of all fishing revenues, disaggregated between vessel day scheme revenue, bilateral revenues, and individual joint ventures to support accurate forecasting of fisheries revenues in future years; (iv) implementation of the debt policy; (v) reform of RERF management following the provision of World Bank technical assistance; (vi) implementation of key provisions of the SOE Act, including (a) the submission of fully costed statements of intent to the cabinet and Parliament, (b) the inclusion of all SOE subsidies in the 2015 budget (including community service obligations), and (c) full compliance with legislative provisions for all board appointments; (vii) approval of rationalization strategies of Kiribati Shipping Services Limited, Bobotin Kiribati Limited, and the Plant and Vehicle Unit; (viii) conclusion of a public-private partnership for Betio Shipyard Limited; and (ix) issuance of an invitation to tender for a private firm to enter the Kiribati telecommunications sector as a provider of telephony and internet services. These measures will contribute toward fiscal stability and private sector-led growth in the medium term, which will benefit the poor through (i) boosting quality of public spending, (ii) freeing up resources for increased social and other pro-poor spending, and (iii) promoting private sector job creation.

## II. GENDER AND DEVELOPMENT

1. What are the key gender issues in the sector/subsector that are likely to be relevant to this project or program?  
Given the macroeconomic nature of this program, there are no key gender issues that are likely to be relevant.

2. Does the proposed project or program have the potential to make a contribution to the promotion of gender equity and/or empowerment of women by providing women's access to and use of opportunities, services, resources,

<sup>1</sup> Tekena Tiroa. 2010. *Analytical Report on the 2006 Kiribati Household Income and Expenditure Survey*. Tarawa.

<sup>2</sup> Australian Government Department of Foreign Affairs and Trade. 2014. *Kiribati Program Poverty Assessment*. Canberra.

<p>assets, and participation in decision making?  <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No</p> <p>The program will improve public sector management and increase private sector participation. This will result in improved services and increased employment for women and men.</p>
<p>3. Could the proposed project have an adverse impact on women and/or girls or widen gender inequality?  <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No</p> <p>The program has no adverse impact on women or girls and does not widen gender inequality.</p>
<p>4. Indicate the intended gender mainstreaming category:</p> <p><input type="checkbox"/> GEN (gender equity theme) <input type="checkbox"/> EGM (effective gender mainstreaming)  <input type="checkbox"/> SGE (some gender elements) <input checked="" type="checkbox"/> NGE (no gender elements)</p>
<p align="center"><b>II. PARTICIPATION AND EMPOWERMENT</b></p>
<p>1. Who are the main stakeholders of the project, including beneficiaries and negatively affected people? Identify how they will participate in the project design.</p> <p>All residents of Kiribati are potential stakeholders in this budget support program. Specific interest groups among stakeholders include SOE and private sector actors who are potential beneficiaries of proposed policy actions. Key implementing ministries (the MFED; the Ministry of Commerce, Industries and Cooperatives; the Ministry of Communications, Transport and Tourism Development; and the Public Works Department) are also key stakeholders. Key stakeholders are continuously consulted through the KERP process. The program is aligned to and supports implementation of government strategies and plans, which have been developed through community consultations.</p>
<p>2. How can the project contribute (in a systemic way) to engaging and empowering stakeholders and beneficiaries, particularly, the poor, vulnerable and excluded groups? What issues in the project design require participation of the poor and excluded?</p> <p>The program will be based on government strategies and plans, including the Kiribati Development Plan 2012–2015, which was developed through a consultative approach and provides mechanisms for ongoing monitoring and public reporting on performance. During program processing, specific stakeholders (i.e., the MFED; the Ministry of Commerce, Industries and Cooperatives; the Ministry of Communications, Transport and Tourism Development; and the Public Works Department) will participate in the program design. Other stakeholders, such as public enterprises and the private sector (through the chamber of commerce), will be consulted on specific policy issues.</p>
<p>3. What are the key, active, and relevant civil society organizations in the project area? What is the level of civil society organization participation in the project design?</p> <p><input type="checkbox"/> Information generation and sharing <input checked="" type="checkbox"/> Consultation <input type="checkbox"/> Collaboration <input type="checkbox"/> Partnership</p> <p>Kiribati's civil society is limited in size. The chamber of commerce will be consulted in program preparation. Extensive consultations with civil society organizations have been carried out during the preparation of the Kiribati Development Plan 2012–2015, which forms the overarching framework for the program.</p>
<p>4. Are there issues during project design for which participation of the poor and excluded is important? What are they and how shall they be addressed? <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No Please explain.</p> <p>The program addresses macroeconomic challenges and therefore does not allow direct participation of the poor and excluded. However, the government regularly consults with and ensures participation of all stakeholders in economic and fiscal reform through national development planning, budget preparation, and the KERP process.</p>
<p align="center"><b>III. SOCIAL SAFEGUARDS</b></p>
<p>A. Involuntary Resettlement Category <input type="checkbox"/> A <input type="checkbox"/> B <input checked="" type="checkbox"/> C <input type="checkbox"/> FI</p>
<p>1. Does the project have the potential to involve involuntary land acquisition resulting in physical and economic displacement? <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No</p>
<p>2. What action plan is required to address involuntary resettlement as part of the PPTA or due diligence process?</p> <p><input type="checkbox"/> Resettlement plan <input type="checkbox"/> Resettlement framework <input type="checkbox"/> Social impact matrix  <input type="checkbox"/> Environmental and social management system arrangement <input checked="" type="checkbox"/> None</p>
<p>B. Indigenous Peoples Category <input type="checkbox"/> A <input type="checkbox"/> B <input checked="" type="checkbox"/> C <input type="checkbox"/> FI</p>
<p>1. Does the proposed project have the potential to directly or indirectly affect the dignity, human rights, livelihood systems, or culture of indigenous peoples? <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No</p>
<p>2. Does it affect the territories or natural and cultural resources indigenous peoples own, use, occupy, or claim, as their ancestral domain? <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No</p>

3. Will the project require broad community support of affected indigenous communities? <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No
4. What action plan is required to address risks to indigenous peoples as part of the PPTA or due diligence process? <input type="checkbox"/> Indigenous peoples plan <input type="checkbox"/> Indigenous peoples planning framework <input type="checkbox"/> Social Impact matrix <input type="checkbox"/> Environmental and social management system arrangement <input checked="" type="checkbox"/> None
<b>IV. OTHER SOCIAL ISSUES AND RISKS</b>
1. What other social issues and risks should be considered in the project design? <input type="checkbox"/> Creating decent jobs and employment <input type="checkbox"/> Adhering to core labor standards <input checked="" type="checkbox"/> Labor retrenchment <input type="checkbox"/> Spread of communicable diseases, including HIV/AIDS <input type="checkbox"/> Increase in human trafficking <input type="checkbox"/> Affordability <input type="checkbox"/> Increase in unplanned migration <input type="checkbox"/> Increase in vulnerability to natural disasters <input type="checkbox"/> Creating political instability <input type="checkbox"/> Creating internal social conflicts <input type="checkbox"/> Others, please specify _____
2. How are these additional social issues and risks going to be addressed in the project design? There is potential for labor retrenchment due to SOE rationalization. As the rationalization strategies are yet to be designed, mitigation strategies will be included in the RRP. It is envisaged that this risk will be minimal as the government has already started the reform process in these SOEs.
<b>VI. PPTA OR DUE DILIGENCE RESOURCE REQUIREMENT</b>
1. Do the terms of reference for the PPTA (or other due diligence) contain key information needed to be gathered during PPTA or due diligence process to better analyze (i) poverty and social impact; (ii) gender impact, (iii) participation dimensions; (iv) social safeguards; and (v) other social risks. Are the relevant specialists identified? <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No The program draws from the 2012 Government of Australia-funded social protection assessment, the World Bank's 2013 Country Performance and Institutional Assessment, and ADB's 2013 Country Performance Assessment.
2. What resources (e.g., consultants, survey budget, and workshop) are allocated for conducting poverty, social and/or gender analysis, and participation plan during the PPTA or due diligence? Basic poverty, social and gender analysis in the design phase will be carried out by the ADB team responsible for the processing of the program, building upon existing assessments from ADB and other development partners. An ADB safeguards specialist will be involved to oversee the due diligence.

ADB = Asian Development Bank, KERP = Kiribati Economic Reform Plan, MFED = Ministry of Finance and Economic Development, PPTA = project preparatory technical assistance, RERF = Revenue Equalization Reserve Fund, RRP = report and recommendation of the President, SFSP = Strengthening Fiscal Stability Program, SOE = state-owned enterprise.

Source: Asian Development Bank.



## Kiribati Economic Reform Plan for 2013–2016

#	2013		2014	2015–2016
	Actions	Status	Actions	Envisaged Policy Reform Areas
<b>Improving the quality of expenditure</b>				
1	Expenditure analysis work completed by World Bank to assess linkages between current policy priorities and existing expenditure.	Completed.	None.	Increased alignment of budget allocations with policy priorities, especially in social sectors and in areas promoting gender equality.
2	Expenditure on the copra subsidy does not exceed budgeted levels. Technical assistance is engaged to provide recommendations for reform of the copra subsidy scheme and other mechanisms for protecting livelihoods on the outer islands.	Expenditure on copra exceeded budgeted levels. World Bank review of copra scheme complete. World Bank and/or ADB technical assistance for improving management of the copra scheme based on review forthcoming.	Cabinet agrees to key reforms of the copra subsidy scheme, including merger of the Copra Society and the Copra Mill, and the implementation of improved expenditure control and accounting measures.	Continued implementation of copra subsidy reforms and review of other government subsidies, including for air transport.
3	Reduction in the number of temporary workers (increased by more than 1,000 during 2011) in non-priority ministries.	Number of temporary workers reduced. Public Service Commission currently working to review temporary worker contracts to ensure consistency with hiring rules and processes.	None.	<p>Completion of temporary worker contract review and implementation of findings to ensure adherence to hiring rules and processes. Avoidance of new hiring of temporary workers outside non-priority ministries.</p> <p>Initiation of wider public service review and development of long-term management strategy for public sector employment.</p>
<b>Increasing government revenues</b>				
4	Implementation of a new automated tax management system with an increased proportion of revenue division staff time dedicated to enforcement and compliance.	Work ongoing due to delays with associated donor contracts.	None.	Strengthening of revenue administration capacities to ensure full adoption of the new automated tax management system.
5	Cabinet will submit to Parliament legislation to introduce a value-added tax in order to reduce reliance on trade taxes and expand the tax base.	Completed.	Value-added tax is introduced on schedule and with sufficient integrity to support an overall revenue increase over the import duty regime it will replace.	Continued implementation of value-added tax towards full compliance of formal private sector.

#	2013		2014	2015–2016
	Actions	Status	Actions	Envisaged Policy Reform Areas
6	Cabinet will approve a national fisheries policy to strengthen the sustainable management of fisheries resources and maximize license revenue.	Completed.	Ministry of Fisheries and MFED work collaboratively to produce a joint report detailing the source of all fishing revenues, disaggregated between vessel day scheme revenue, bilateral revenues, and individual joint ventures to support accurate forecasting of fisheries revenues in future years.	Full implementation of national fisheries policy, including the review of fishing license agreements; transparency and disclosure of agreements and license revenue performance; and compliance of all new negotiations and concluded agreements with policy.
<b>Improving the management of public assets and liabilities</b>				
7	Cabinet will approve a debt policy establishing i) policy criteria for commercial and non-commercial borrowing consistent with sustainable macroeconomic management, and ii) formal processes for cabinet approval when incurring debt and issuing guarantees.	Completed. No new non-concessional borrowing has been incurred.	The debt policy is effectively implemented with no new non-concessional borrowing by the government and all borrowing and issuance of guarantees formally agreed by cabinet and the President, following the provision of advice by the Minister of Finance.	Continued adherence of government to the national debt management policy principles, including transparent borrowing and issuance of guarantee processes following sound advice, avoidance of non-concessional borrowing, and assessment of all borrowing and issuance of guarantees to provide financial returns as well as social and economic benefits.
8	The RERF investment committee will i) approve reallocation of assets to achieve consistency with clearly stated investment objectives, and ii) improve public reporting on RERF performance, drawdowns, and balances.	Based on IMF and World Bank Treasury advice, the cabinet has agreed in principle to proposed changes. A World Bank treasury technical assistance team is scheduled to visit before June 2014 to complete implementation.	Cabinet will agree to specific measures for reform of RERF management following the provision of World Bank technical assistance, and begin the process of implementation.	Complete implementation of agreed upon reform measures for RERF management.
<b>Improving the business environment</b>				
9	Cabinet has approved submission to Parliament of legislation to establish a legal framework for improved governance and has strengthened financial reporting and commercial management of SOEs.	Completed. Most SOEs have now met reporting requirements. Subsidies for SOEs were made explicit in the 2014 budget and are limited to \$4.5 million.	Key provisions of the SOE Act are implemented, including the Parliament approval of fully costed statements of intent, subsidies to SOEs fully reflected in the 2014 budget as community service obligations, and full compliance with legislative provisions for all board appointments.	<p>Comprehensive oversight of SOEs through the SOE monitoring unit and scrutiny of performance by cabinet and Parliament through transparent financial and performance reporting.</p> <p>Full disclosure and continued reduction of SOE subsidies excluding community service obligations in the budget process.</p>

#	2013		2014	2015–2016
	Actions	Status	Actions	Envisaged Policy Reform Areas
				Cabinet to approve reform strategy to improve operational performance of the Public Utilities Board in line with the SOE Act 2013.
10	Government has issued a tender for expressions of interest in a concession contract for private management of the Otintaai Hotel.	Completed.	Government has brought the concession contract for the Betio Shipyards to the point of transaction, and completed the rationalization of Kiribati Shipping Services Limited, Bobotin Kiribati Limited, and the Plant and Vehicle Unit.	Continued review and implementation of commercialization and/or rationalization actions for remaining SOEs.
11	Cabinet has approved submission to Parliament of legislation to liberalize the telecommunications sector, including commercialization of the incumbent state-owned operator and the introduction of competition.	Completed.	An invitation to tender is issued for a private firm to enter the Kiribati telecommunications sector as a provider of telephony and internet services.	Completion of the tender process and establishment of government regulatory oversight to ensure competition in the liberalized telecommunications sector.
<b>Improving public financial management</b>				
12	The attaché system upgrade is implemented within the MFED, with appropriate technical assistance provided for use of the updated system.	Completed. As of April 2014, commitment control systems have been implemented, improving ability of the MFED to ensure expenditure control across the government.	None.	Cabinet approval of fiscal responsibility ratios. Reform of legal framework for public financial management based on technical advice from the IMF's Pacific Financial Technical Assistance Center. Strengthening of budget processes, including through the inclusion of a medium-term perspective. Review of the government procurement policy and procedures with a focus on improving transparency, accountability, and value for money.

ADB = Asian Development Bank, RERF = Revenue Equalization Reserve Fund, IMF = International Monetary Fund, SOE = state-owned enterprise.

Note: Actions for the 2015–2016 envisaged policy reform areas to be detailed through the Economic Working Group consultation process in 2014 and 2015.

Sources: Government of Kiribati, Asian Development Bank, World Bank.