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PROGRAM INFORMATION DOCUMENT (PID)
APPRAISAL STAGE

June 7, 2016
Report No.: 107231-KI

Operation Name	Kiribati Third Economic Reform Development Policy Operation
Region	East Asia and Pacific
Country	Kiribati
Sector	General public administration (50%); Public administration—Information and communications (25%); Public administration—Other social services (50%)
Operation ID	P155540
Lending Instrument	Development Policy Lending
Borrower(s)	Republic of Kiribati
Implementing Agency	Ministry of Finance and Economic Development
Date PID Prepared	June 7, 2016
Estimated Date of Appraisal	June 21, 2016
Estimated Date of Board Approval	September 13, 2016
Corporate Review Decision	Following the corporate review, the decision was taken to proceed with the preparation of the operation.

I. Country and Sector Background

Kiribati is one of the smallest, remotest, and most geographically dispersed countries in the world. It comprises 33 atolls and islands, which have a total land area of less than 800 square kilometers and are spread across 3.5 million square kilometers of ocean—an area larger than India. About half its population of around 120,000 lives in the capital, South Tarawa. The country is thousands of kilometers away from the nearest markets—about 4,000 kilometers from Australia, Hawaii, and New Zealand. Moreover, Kiribati's low-lying atolls rise little more than 1.8 meters on average above sea level, and as such, are at the forefront of climate change.

With such a difficult physical environment, the private sector remains small. The public sector dominates the economy, which includes 16 state owned enterprises (SOEs), and accounts for as much as 50 percent of GDP and nearly 80 percent of jobs in the formal sector. The private sector has struggled to grow because of the inherent lack of economies of scale due to remoteness and dispersion of population across dozens of islands—problems compounded by the country's severe infrastructure deficits and difficult business climate.

The country is highly vulnerable to shocks. As other countries in the Pacific, Kiribati is exposed to extreme weather. Its narrow export base (copra and fish) and dependence on imported food and fuel leave it further exposed to external shocks. Fisheries revenue—reaching 69 and 97 percent of GDP in 2014 and 2015, respectively—remains highly volatile. It's estimated AUD775 million (around 370 percent of GDP) sovereign wealth fund (the Revenue Equalization Reserve

Funds, RERF) supports Kiribati's capacity to deal with shocks, but weaknesses in the management practice and frequent drawdowns in the previous two decades have significantly reduced its per capita value.

II. Operation Objectives

The program has two development objectives corresponding to the two pillars of the proposed operation: (i) to strengthen public financial management, through greater transparency in managing fisheries revenue, improved governance of the RERF, and better reporting and monitoring of public debt and contingent liabilities; and (ii) to create an environment for inclusive and private sector led growth, through reducing the costs, improving the quality, and expanding the coverage of essential public services (electricity, water, sewage, and telecommunications). Under the first pillar, the government has reviewed existing joint ventures to examine their financial performance, contribution to the economy, and compliance with national and regional policies, appointed the new external asset managers for the RERF who are selected through transparent and competitive processes, and established a complete and up-to-date database of public debt including that of SOEs and joint ventures. Under the second pillar, the government has introduced competition in the domestic mobile telecommunications market, and appointed a new CEO for the Public Utilities Board to implement its medium term reform plan to achieve operationally and financially sustainable delivery of electricity, water, and sanitation services in the capital.

The two pillars of the proposed operation support priorities in the government's reform programs. Strengthening public financial management is critical for protecting the fiscal space for public provision of essential services. Accelerating reforms of SOEs, especially those responsible for delivering essential public services, will be critical for ending the health and sanitation crisis and reducing widespread poverty. With an estimated 2,000 young people entering the labor market each year, better management and sustainable investment in essential infrastructure (water, electricity, and telecommunication) would also be critical for encouraging job creation led by the private sector to curb high and rising unemployment.

III. Rationale for Bank Involvement

Kiribati's recent economic performance has been strong. The country is on track for its sixth year of consecutive growth in 2016, after reaching close to 4 percent in 2014 and 3.4 percent in 2015 supported by record fisheries revenue and large donor-financed infrastructure projects in road, airport, water and sanitation. Growth is projected to moderate somewhat to around 3 percent this year reflecting winding down of the infrastructure projects and expected moderation in fisheries revenue.

While the government has run a large fiscal surplus over the last two years owing to record fishing license fee revenue, it is committed to ensuring fiscal sustainability in the medium term by improving transparency in the management of revenue and expenditure and continued prudence in the management of the RERF. The government has already successfully privatized some SOEs and opened the door for commercial operation and employment. Continued efforts to improve the performance of the country's large SOE sector, including through management reforms and commercialization, will be accelerated under this operation to improve delivery of basic public services, reduce high costs of living for the bottom 40 percent, and encourage job creation and private sector activities.

The operation follows an established good practice in the Pacific of using a joint donor matrix for budget support. The World Bank team has worked closely with the Asian Development Bank, the Australian Department of Foreign Affairs and Trade, and New Zealand Ministry of Foreign Affairs and Trade to prepare this operation. The team has also consulted Japan International Corporation Agency, the IMF, and its Pacific Financial Technical Assistance Centre, especially in areas of public financial management and SOE reforms.

IV. Tentative Financing

Source:	($m)
Borrower/Recipient	0
IDA	2
Others	0
Total	2

V. Institutional and Implementation Arrangements

The Ministry of Finance and Economic Development is responsible for coordinating the monitoring and evaluation of the results indicators for the proposed operation. The Ministry of Finance and Economic Development will cover the results indicators relating to the first pillar of the operation, including through collaboration with the relevant agencies involved in these areas of work. The Ministry of Finance and Economic Development will collaborate with the Ministry of Information, Communications, Transport and Tourism Development, and the Ministry of Public Works and Utilities on the results indicators relating to the second pillar of the operation. In addition, progress will be collaboratively tracked, and any necessary remedial actions identified and executed, jointly by the members of the joint donor-government Economic Reform Taskforce.

VI. Risks and Risk Mitigation

The proposed operation carries a substantial risk, relating to the recent political change in the country, its limited institutional capacity, and its vulnerability to external shocks. The country has elected a new president in March 9 after three 4-year terms served by the former president. In addition, the reforms supported under the proposed operation include some that have been politically sensitive in the past, such as strengthening transparency of the fisheries revenue and developing reform options to regularize fiscal transfers to and from the RERF. The risk is mitigated by focusing on the areas where the Bank has developed a strong engagement with the government, closely aligning prior actions with government priorities, and selecting policy triggers for the subsequent operation that would help maintain reform momentum but also allow some flexibility to respond to new opportunities for dialogue under the new leadership. Like other small states, Kiribati struggles with thin capacity with a small number of civil servants who are called upon to implement many tasks. Highly skilled and experienced civil servants are difficult to retain, and once they leave, program implementations could be adversely affected. This risk is mitigated by having a strong engagement with the government, carefully selecting a limited number of policy actions, closely aligning policy actions with government priorities, and having dedicated technical assistance from various development partners to support the actions. A further risk emanates from Kiribati's exposure to external shocks, including slower global growth led by a sharper-than-expected slowdown in China, which could have knock-on effects on fisheries revenue and seamen's remittances; volatilities in global financial markets that would negatively affect the returns on the RERF; and extreme weather events, which could increase expenditure pressure and divert the government's administrative capacity. The risk is mitigated by the reforms supported by the proposed operation, including the prudent management of the RERF and the growth-enhancing structural reforms, as well as financial support and technical assistance provided by the World Bank and other development partners.

VII. Poverty and Social Impacts and Environment Aspects

Poverty and Social Impacts

Policies supported by the proposed operation are expected to have positive impact on poverty and shared prosperity. Improving public financial management and safeguarding fiscal sustainability will ensure that the government can maintain public investment in physical and human capital. More predictable and transparent revenue will enhance the government's ability to focus on the medium-term priorities and allocate the budget accordingly. Strengthening the RERF will help anchor the country's fiscal and external stability. Improving public debt management will help avoid unsustainable borrowing, costly mistakes, and ultimately, a debt crisis which would disproportionately hurt the poor who cannot easily accumulate buffers, insure against risk, or migrate and escape the brunt of ensuing economic hardship.

Improving access and reducing costs of public utilities and telecommunications services should also help improve the business climate, encourage private investment, and create jobs, which are "the best insurance against poverty and vulnerability" (World Development Report 2011). Because smaller domestic businesses are more reliant on the public/ locally provided services than larger transnational companies, these improvements will likely disproportionately benefit smaller businesses, encouraging them to expand, which will also help create more jobs.

Environment Aspects

Policies supported by the proposed operation are not expected to have significant effects on the environment and natural resources. Policies to support transparency of revenue, sound management of the RERF and the public debt, more competitive telecommunication, and improved public utilities services are unlikely to have any physical impact on the environment. Indirectly, the proposed operation is expected to have some positive environmental impacts. Greater availability of water and sanitation services in the overcrowded capital will reduce environmental degradation by easing water contamination and solid waste problems. Strengthening the transparent management of the fisheries revenue will promote efficient and sustainable allocation of fishing licenses, ensuring sustainable fish stocks.

VIII. Contact point

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