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GOVERNMENT OF KIRIBATI
MINISTRY OF FINANCE & ECONOMIC DEVELOPMENT

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Date: 26th September, 2014

Mr. Jim Yong Kim
President
The World Bank
Washington, DC, 20433
USA

Dear President Kim

Re: Letter of Development Policy

Kiribati faces important fiscal and economic challenges. Over recent years, adverse external economic conditions have impacted Kiribati through several channels. Declines in remittances have contributed to weak growth, price shocks have led to periods of high inflation, while disruption in global financial markets saw the value of Revenue Equalization and Reserve Fund assets decline by nearly 20 percent.

Revenue has declined over recent years as a consequence of weak growth, problems with tax administration, and tax non-compliance of SOEs. Government has taken decisive action to control expenditure in the face of declining revenues. Large fiscal deficits have emerged, however, given Government's commitment to maintain expenditure on basic social services. These deficits have been financed through drawdowns from the RERF, which is now being depleted at an unsustainable rate. Windfall fishing license revenues in 2013 led to a significant budget surplus and were prudently used to replenish the Revenue Equalization and Reserve Fund and clear accumulated SOE debt, assisting government towards achievement of long-term fiscal sustainability.

We cannot rely on such windfall revenues in future. The Ministry of Finance and Economic Development therefore continues to work hard to develop sustainable solutions to current fiscal challenges. Government has developed an 'Economic Reform Plan', outlining reform priorities to improve fiscal sustainability. The plan supports the achievement of Government's broader development objectives as stated in the Kiribati Development Plan. Substantial progress has already occurred against the reforms identified in the Economic Reform Plan, including against reforms supported by the first World Bank development policy operation in 2013. The Economic Reform Plan identifies priorities under three pillars.

The first pillar of the Economic Reform Plan is increasing revenue. Government recognizes that recent declines in revenue must be reversed if we are to reduce deficits and achieve a sustainable fiscal position. Under this pillar, Government has recently introduced a Value-Added Tax to assist with strengthened revenue compliance. A range of administrative measures are also underway, including the introduction of the RMS7 IT system, which is expected to allow for substantial reallocation of revenue staff resources to compliance and enforcement activities. Reforms to processes and systems for issuing fishing licenses will also contribute to this pillar. Fishing license fees are the largest single source of revenue for the Government of Kiribati, and the passage of the National Fisheries Policy last year will provide a sound policy base to improve the management of this vital resource to both increase revenues and safeguard sustainability. This year, we are working with the Ministry of Fisheries to improve transparency and predictability around fishing license revenues and have, from this year, begun publishing a report on our external website detailing fisheries revenue performance by source. Kiribati has moved to comprehensively meet its commitments under the Vessel Day Scheme, administered by the Parties to the Nauru Agreement. Over time, Government intends to further increase the value derived from access to migratory fish stocks through increased use of market-based mechanisms for the allocation and utilization of fishing licenses under the Vessel Day Scheme.

The second pillar of the Economic Reform Plan is improving the management of public assets and liabilities. Significant progress has already been achieved under this pillar, including Government's decision to clear all overdraft debt using fishing license revenues in 2012. A new debt policy was agreed by Cabinet in 2013, which will ensure that appropriate processes are applied in the contracting of any new public sector borrowing. New legislation has been passed providing a legal framework for an ambitious program of SOE reform. New SOE legislation will support good practices in governance, financial reporting, oversight and management of SOEs. This year, Government is working towards implementation of key provisions of this new legislation, and has taken the following key steps: i) ensured that all SOE Board appointments are in compliance with the SOE Act; ii) received financial statements from the five largest SOEs within three months of the end of the fiscal year; and iii) included community service obligations in the annual budget for the first time, providing transparency and predictability regarding SOE subsidization for non-cost-recoverable activities. A key area of weak SOE performance is in the copra sector, where expenditure on the copra subsidy scheme is of poor quality and frequently exceeds budgeted limits because of administrative weaknesses in responsible SOEs. Government has now approved a roadmap for reform of the copra sector, involving the establishment of a single agency responsible for all aspects of the scheme, and including the merger of the Kiribati Copra Cutters Society and the Kiribati Copra Mill Limited. Government is also moving to implement important reforms to the management of Revenue Equalization and Reserve Fund assets to ensure a more appropriate risk exposure and investment strategies that are aligned with fund objectives. Cabinet has approved reallocation of RERF assets to new asset managers and reorientation of RERF's portfolio towards lower-risk instruments.

The third pillar of the Economic Reform Plan is structural reform. While Kiribati faces important constraints to private sector development arising from geography, measures are being taken to improve the business environment and encourage employment generation. Under this pillar, a law was passed in 2013 establishing the regulatory framework for a liberalized telecommunication sector. We are currently working towards attracting private investment through the liquidation and sale of our existing telecommunications utility. Invitations for expressions of interest in purchase of TSKL have recently been evaluated by Government and prequalified firms have been invited to submit bids. Prequalified firms are expected to soon complete due diligence, complete negotiations, and submit bids. Over the next year, Government also hopes to issue additional licenses for mobile telephone service providers, complementing new licenses recently issued for new private-sector internet providers. Private sector participation and competition in the telecommunication sector is expected to lead to increased coverage, improved services, and reduced prices, delivering a range of economic and social benefit to the people of Kiribati.

Despite the very difficult economic and fiscal situation the Government is facing, we remain firmly committed to implementing this medium-term reform program. The Government looks forward to the continued active engagement of the World Bank in Kiribati, and the Bank's continuing support to our reform process.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Tom Murdoch', with a stylized flourish at the end.

Hon. Tom Murdoch

Minister of Finance and Economic Development