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INTERNATIONAL DEVELOPMENT ASSOCIATION

PROGRAM DOCUMENT FOR A PROPOSED DEVELOPMENT POLICY GRANT

IN THE AMOUNT OF SDR 2.1 MILLION
(US$3.0 MILLION EQUIVALENT)

TO

THE REPUBLIC OF KIRIBATI

FOR THE

SECOND ECONOMIC REFORM DEVELOPMENT POLICY OPERATION

October 22, 2014

Macroeconomic and Fiscal Management Global Practice
Country Management Unit for Timor Leste, Papua New Guinea and Pacific Islands
East Asia and Pacific Region

Republic of Kiribati
GOVERNMENT FISCAL YEAR
January 1 – December 31

CURRENCY EQUIVALENTS
(Exchange Rate Effective as of October, 2014)

Currency Unit
US$1.00 = AUD1.15

ABBREVIATIONS AND ACRONYMS

AusAID	Australian Agency for International Development	KDP	Kiribati Development Plan
ADB	Asian Development Bank	KPF	Kiribati Provident Fund
CEDAW	Convention on the Elimination of All Forms of Discrimination Against Women	LDP	Letter of Development Policy
CAS	Country Assistance Strategy	MTEF	Medium-Term Expenditure Framework
CFAA	Country Financial Accountability Assessment	MDGs	Millennium Development Goals
CMS	Customs Management System	MFED	Ministry of Finance and Economic Development
DBK	Development Bank of Kiribati	NER	Net Enrolment Rate
DWFN	Distant-Water Fishing Nations	NZ-IDG	New Zealand International Development Group
EU	European Union	NGO	Non-Government Organization
GEC	Global Economic Crisis	PFTAC	Pacific Financial Technical Assistance Center
GoK	Government of Kiribati	PEFA	Public Expenditure and Financial Accountability
GDP	Gross Domestic Product	PER	Public Expenditure Review
GNI	Gross National Income	PFM-PR	Public Financial Management Performance Report
HIES	Household Income and Expenditure Survey	RERF	Revenue Equalization and Reserve Fund
IBRD	International Bank for Reconstruction and Development	RMS	Revenue Management System
IDA	International Development Association	SDR	Special Drawing Rights
IFC	International Finance Corporation	SOE	State-Owned Enterprise
IMF	International Monetary Fund	TSKL	Telecommunication Services Kiribati Limited
PHRD	Japan Policy and Human Resources Development Trust Fund	UN	United Nations
KCMCL	Kiribati Copra Mill Company Limited	UNDP	United Nations Development Program
KCCSL	Kiribati Copra Cooperative Society Limited	VDS	Vessel Day Scheme

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REPUBLIC OF KIRIBATI

SECOND ECONOMIC REFORM OPERATION

TABLE OF CONTENTS

SUMMARY OF PROPOSED GRANT AND PROGRAM
1. INTRODUCTION AND COUNTRY CONTEXT 1
2. MACROECONOMIC POLICY FRAMEWORK 3
2.1. RECENT ECONOMIC DEVELOPMENTS 3
2.2. MACROECONOMIC OUTLOOK AND DEBT SUSTAINABILITY 9
3. THE GOVERNMENT'S PROGRAM 14
4. THE PROPOSED OPERATION 14
4.1. LINK TO GOVERNMENT PROGRAM AND OPERATION DESCRIPTION 14
4.2. PRIOR ACTIONS, RESULTS AND ANALYTICAL UNDERPINNINGS 18
4.3. ANALYTICAL UNDERPINNINGS 28
4.4. LINK TO CAS AND OTHER BANK OPERATIONS 29
5. OTHER DESIGN AND APPRAISAL ISSUES 30
5.1. POVERTY AND SOCIAL IMPACT 30
5.2. ENVIRONMENTAL ASPECTS 32
5.3. PFM, DISBURSEMENT AND AUDITING ASPECTS 33
5.4. MONITORING AND EVALUATION 34
6. SUMMARY OF RISKS AND MITIGATION 34

ANNEXES

ANNEX 1: POLICY AND RESULTS MATRIX 37
ANNEX 2: LETTER OF DEVELOPMENT POLICY 39
ANNEX 3: FUND RELATIONS ANNEX 41

TABLES AND FIGURES IN TEXT

TABLE 1: BASIC NEEDS POVERTY BY REGION (%) 3
TABLE 2: STANDARD MACROECONOMIC INDICATORS 7
TABLE 3: BOP FINANCING REQUIREMENTS AND SOURCES (AUD MILLION) 8
TABLE 4: KEY FISCAL INDICATORS (% OF GDP) 9
TABLE 5: LIST OF TRIGGERS AND PRIOR ACTIONS 16
TABLE 6: PRIOR ACTIONS AND ANALYTICAL UNDERPINNINGS 28

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SUMMARY OF PROPOSED DEVELOPMENT POLICY GRANT AND PROGRAM

REPUBLIC OF KIRIBATI
SECOND ECONOMIC REFORM OPERATION

Borrower	REPUBLIC OF KIRIBATI
Implementation Agency	MINISTRY OF FINANCE AND ECONOMIC DEVELOPMENT
Financing Data	IDA Grant; IDA terms; amount: SDR 2.1 million (US$3 million equivalent).
Operation Type	The proposed operation is the second in a series of two development policy operations and consists of a single tranche to be disbursed upon effectiveness.
Pillars of the Operation And Program Development Objective(s)	This series of two development policy operations supports the Government of Kiribati's Economic Reform Plan. The operation is structured around three objectives included in the Economic Reform Plan (which correspond to Program Development Objectives): (i) improved management of fisheries revenues; (ii) improving the management of public assets and liabilities; and (iii) expanding private sector opportunities.
Result Indicators	Under the development objective (i): *1.* Improved predictability of fishing license fee revenues Under the development objective (ii): *2.* SOEs become less reliant on ad hoc Government subsidies *3.* Inefficient expenditure through the copra price subsidy is reduced *4.* No increase in non-concessional debt *5.* RERF performance will reflect lower risk reflected in closer alignment between portfolio performance and relevant market benchmarks Under the development objective (iii): *6.* Reduced prices in the telecommunications sector
Overall risk rating	Substantial
Operation ID	P149888

IDA PROGRAM DOCUMENT FOR A PROPOSED DEVELOPMENT POLICY GRANT TO THE REPUBLIC OF KIRIBATI

1. INTRODUCTION AND COUNTRY CONTEXT

1. **This proposed second operation in a series of two development policy operations (DPOs) aims to support improved public services and fiscal sustainability.** Fiscal sustainability has been undermined by weak growth, volatile fishing license receipts, and deteriorating revenue performance in the context of substantial investment needs to adapt to climate change impacts and improve the delivery of basic public services. The proposed operation will support the Government of Kiribati in the continued implementation of its Economic Reform Plan, which is intended to restore fiscal sustainability, while safeguarding vital public services and infrastructure investments, through improvements in revenue performance and the quality of public expenditure. The proposed operation is consistent with the World Bank Group's Country Assistance Strategy for the Republic of Kiribati, FY11-FY14, which is structured around two themes: i) building resilience against external shocks; and ii) mitigating economic isolation by encouraging regional and global integration. The proposed amount for the grant is US$3.0 million.

2. **Kiribati is one of the most remote and geographically dispersed countries in the world,** consisting of 33 islands spread over 3.5 million square kilometers of ocean – an area larger than India. The population of about 100,000 people lives on 20 coral atolls and a single volcanic island, with a total land area of less than 800 square kilometers. Economic activity is dominated by subsistence agriculture, the public sector, and a service economy centered in the capital of South Tarawa. State-owned enterprises play a prominent role in the economy, including in utilities, shipping, hotels, air transport, and fuel wholesaling. Public expenditure was 103 percent of GDP in 2013, including donor grants of around 43 percent of GDP. 80 percent of formal jobs are in the public sector. The country is highly reliant on imports, including for food and fuel, and faces a structural trade deficit (58.2 percent of GDP in 2013). Systemic volatility is exacerbated by Kiribati's exposure to natural hazard risks, particularly drought and the loss of groundwater.

3. **Kiribati relies heavily on the Revenue Equalization and Reserve Fund (RERF) for budget support and intergenerational saving.** Capitalized from the proceeds of phosphate mining, which ceased with the exhaustion of phosphate deposits in 1979, the RERF is used to supplement recurrent revenues and smooth volatility in other important revenue sources, including fishing license fees. The Government has an informal policy target of maintaining the value of the RERF at 1996 real per capita levels. Rapid drawdowns over the past decade and a decline in capital value during the Global Economic Crisis have seen real per capita values, in 1996 terms, decline to AUD3,500, less than half of their 2003 peak of around AUD7,300. Fiscal

deficits contributing to the decline in RERF values have been driven by weakening tax revenues, increased subsidization of an inefficient SOE sector, and highly volatile fishing revenues.

4. **The Kiribati Economic Reform Plan (ERP) outlines a strategy for restoring sustainability in government finances.** Developed with World Bank technical assistance in 2011, significant progress has already been achieved against the plan, supported by the First Economic Reform Development Policy Operation, which disbursed in March, 2014. Major gains under the plan and supported by the first operation include: i) clearing of Government overdraft debt; ii) adoption and effective implementation of a debt policy to constrain uncoordinated non-concessional borrowing; iii) passage of a new SOE Act providing the legislative basis for improved SOE performance; iv) adoption of a new fisheries policy, to guide improved compliance with regional regulations and increased value of catch; and v) passage of a new Telecommunications Act providing a foundation for private participation in the telecommunications sector. This operation supports continued progress against the priority reform areas identified in the Economic Reform Plan. Specifically, the operation will support: i) improvements in the management of fisheries revenues; ii) reforms to the management of RERF assets to achieve stronger alignment with long-term objectives and more appropriate balance between risk and return; iii) implementation of key provision of the SOE Act, including those relating to financial reporting, governance, transparency of subsidies, and continued restructuring of the SOE portfolio; and iv) further steps towards the introduction of private participation and competition into the telecommunications sector. The programmatic series of development policy operations has been deliberately ambitious in the choice of reform areas, seeking to ensure policy focus and capacity around vital reforms for fiscal sustainability. Policy reforms supported by this operation are consistent with the World Bank Group goals of eliminating extreme poverty and boosting shared prosperity**.**

5. **Kiribati has low levels of extreme poverty but faces important challenges to achieving shared prosperity.** In 2010, MFED with UNDP assistance produced an analysis of the 2006 Household Income and Expenditure Survey (HIES). Without accurate PPP conversion factors, poverty incidence using the US$1.25 per day criteria cannot be calculated for Kiribati. Food and Basic Needs poverty lines were derived and used to estimate the incidence of poverty nationally and by region. This analysis suggests that extreme (food) poverty is low in Kiribati, at around 5 percent, but basic needs poverty is relatively widespread and concentrated in the main urban center of South Tarawa. 21.8 percent of the national population lives below the basic needs poverty line and 24.2 percent of those living in South Tarawa. Poverty rates vary significantly by island group. 16 percent of the population of the Southern Gilbert Islands lives below the food poverty line reflecting impacts of isolation, limited potential for agricultural production, and vulnerability to drought. These islands have the highest proportion of older people and therefore a lower proportion of working age adults and a higher dependency ratio. In contrast, the Line Islands face the least poverty, reflecting a younger migrant population and more abundant natural resources. According to the 2006 national household survey, around one

in five households is headed by single females. These households are over-represented among the poor, comprising around one in four households in the poorest quintile in South Tarawa. Stakeholder consultations suggest that problems with the provision of basic services in urban centers – especially water, electricity, health and education – have a large impact on the lives of the poor and especially households headed by women. A large proportion of the population is vulnerable to falling into poverty. A 20 percent increase in the basic needs poverty line would see 34 percent of the population in poverty. Female-headed households are overrepresented in poverty statistics, and children are also more likely to experience poverty. Children living in households with older people tend to be most at risk of poverty, with a poverty rate of 25 percent. Prosperity is not evenly shared, with broad disparities in social outcomes and incomes between urban and rural areas, and across different islands (Table 1). Poverty is concentrated in the urban areas of South Tarawa, and lowest in the Line and Phoenix Islands. Poverty rates are higher among households headed by women and elderly persons. With a Gini coefficient of 0.39, the degree of inequality is similar to that observed in other Pacific Island countries. An AusAID social protection assessment conducted in 2012 suggests slightly higher levels of basic needs poverty (26.3 percent) in 2009, largely due to the impact of higher food and fuel prices. Government is currently seeking donor support to undertake both a national census and a Household Income and Expenditure Survey. The World Bank may provide technical assistance for poverty analysis of survey data.

Table 1: Basic Needs Poverty by Region (%)

	2006
National Average	21.8
South Tarawa	24.2
Rest of Gilberts	22.0
Line and Phoenix	8.9

2. MACROECONOMIC POLICY FRAMEWORK

2.1. RECENT ECONOMIC DEVELOPMENTS

6. **After a period of volatility, growth has been moderate and stable over recent years.** Kiribati is one of the poorer countries in the Pacific, with GNI per capita of about $2,600. The country is highly reliant on imports, including for food and fuel, and faces a structural trade deficit (58.2 percent of GDP in 2013). Main exports are seaweed, copra, fish, and shark fins. Main sources of external income are investment earnings from the Revenue Equalization Reserve Fund (RERF - established in the 1950s to invest royalties from now depleted phosphate reserves), the sale of fishing licenses, and aid. These external income sources were equivalent to

about 85 percent of GDP in 2013. Over the past decade, growth has averaged less than 1 percent per annum, reflecting increases in prices for imported goods and a decline in opportunities for I-Kiribati seafarers up to and during the Global Economic Crisis. Growth since reached 2.8 percent in 2012 and 2.9 percent in 2013, driven largely by the roll-out of aid-financed infrastructure projects (in the road, port, and aviation sectors) and some recovery in remittances, feeding through into vibrant activity in the retail sector. Recent strong fishing license fee performance has also buoyed growth.

7. **The current account deficit is expected to widen substantially over the coming years.** The current account deficit widened slightly in 2013 to 27.4 percent of GDP due to an increase in imports of machinery and equipment associated with donor projects, partially offset by lower values of food imports because of moderating prices. Remittances, which are dominated by transfers from seafarers, continue to decline, due to the slowdown in world shipping activity. Income on the RERF was stable, reflecting in particular favorable relative yields on Australian assets.

8. **Following a period of rapid inflation during the food and fuel crisis, prices have remained fairly stable over recent years.** Inflation peaked at around 19 percent in 2008 due to increasing import prices. Inflation subsided in subsequent years as import prices declined and the Australian dollar strengthened, averaging 0.5 percent between 2009 and 2012. With continued declines in import prices, inflation was negative in 2013, at -1.5 percent.

9. **The financial sector is small and dominated by government.** Total outstanding credit has declined from 37 percent of GDP in 2008 to 23.8 percent of GDP. This decline has been driven by reductions in government overdraft debt to the commercial bank, but private sector credit has also declined from 18 percent of GDP in 2008 to 15 percent of GDP in 2013, in the context of general weakening of economic conditions. Aside from the sole commercial bank, the Development Bank of Kiribati has provided credit to the private sector of around 8.7 percent of GDP. Around 22 percent of existing loans are non-performing. In response to concerns regarding tightening of credit conditions from the commercial bank during the Global Economic Crisis, the Government has also introduced a credit mechanism through which households can access credit from the Kiribati Provident Fund, collateralized against member deposits. The balance sheet of the Kiribati Provident Fund currently shows a deficit of around AUD$20 million, with member balances exceeding the value of investments, partly due to high interest rates paid to members.

10. **Tax revenues have been declining since 2006, reflecting compliance problems and weak performance of SOEs.** Over the past decade, revenues have fluctuated between 27 percent and 34 percent of GNI. Revenue volatility is driven primarily by fishing license income, which varies according to migration patterns of fish stocks. Volatility in license revenue, however, has obscured a decline in tax revenues from around 14 percent of GNI in 2006 to 12 percent of GNI in 2013. Company tax receipts declined from 2.8 percent of GDP in 2012 to 2.6

percent in 2013, while income tax receipts declined from 4.2 percent of GDP to 4.0 percent. Significant declines in import duty collections and a more-recent fall in personal income tax revenues have not been adequately offset by increasing company tax receipts. While the tax-free threshold on income tax was increased in 2008, recent declines are too great to be explained by any policy changes. Import duties have declined as a proportion of imports, without any adjustment to rates, potentially indicating growing compliance problems with border taxes. Weak performance of SOEs is also driving revenue declines, with several insolvent SOEs no longer meeting company tax obligations, and withholding income tax deductions of their employees.

11. **Government recurrent expenditure has declined in real terms, placing pressure on services.** In the context of revenue declines, the Government has managed expenditure so as to minimize the extent of unsustainable drawdowns from the RERF. Real expenditure has decreased by 13 percent since 2006, including a 19 percent decline in health expenditure, and a 7 percent decline in education expenditure. With inherent inflexibilities in the wage bill, real expenditure declines have led to substantial increases in the payroll as a proportion of expenditure, exacerbating challenges for service delivery with declines having to be absorbed in spending on goods and services. While payroll spending has remained almost constant in real terms, payroll has increased from 45 percent of recurrent expenditure in 2007 to 49 percent in 2013. In some ministries, payroll now accounts for up to 70 percent of expenditure. While the impacts of expenditure cuts are not easily assessed given the absence of up-to-date data, declines in expenditure on core public services are a source of concern in the context of a worsening of some social indicators (especially infant mortality rates) since the Global Economic Crisis.

12. **The value of the RERF has declined precipitously over recent years.** In the late 1990s, the Government made a policy decision that the fund should not be allowed to decline below its 1996 real per capita value of approximately AUD4,700, which at the time appeared easy to achieve—at its peak in 2000, the real per capita level exceeded the target by more than 50 percent. However, large drawdowns, coupled with poor investment results, reduced the actual value to below the target in 2008. The RERF was severely impacted by the Global Economic Crisis including through exposure to Icelandic banks. The portfolio suffered a large, irrecoverable loss when the three largest Icelandic banks defaulted on their debt in the fall of 2008, and the Icelandic króna became non-convertible. The real value of RERF assets declined by AUD 75 million, or around 12 percent of the fund’s total value. The real per capita value of the RERF is now around 25 percent lower than the target. Government has adopted another informal policy target of limiting drawdowns to around AUD15 million per year, but even this more modest objective has not been achieved over recent years, reflecting continued expenditure pressures in an economy reliant on public sector demand and employment and where poverty is increasing, but revenue performance is weak.

13. **The Global Economic Crisis not only saw a reduction in the value of the RERF, but also increased pressure for subsidy payments and public sector employment.** In the wake of the crisis, the Government responded to pressures for increased social expenditures through an increase in allocations to an agricultural production subsidy scheme providing incomes to outer-islands, an increase in pension payments and an expansion in eligibility, and an increase in the number of temporary workers employed by government. Reduced RERF values and earnings combined with increased expenditure on social subsidies and public sector employment has exacerbated challenges of maintaining public services in the context of revenue declines. Explicit allocations to SOE subsidies have increased over the past decade, primarily due to persistent overspending on the poorly managed copra subsidy scheme.

14. **The fiscal outturn in 2013 was unexpectedly positive, reflecting unusually high fishing license receipts.** Government had budgeted for an AUD24 million deficit in 2013 (equal to 14 percent of GDP), to be financed almost entirely through RERF drawdowns. Expenditure exceeded budgeted levels by around AUD4 million, reflecting unplanned additional expenditure needs for SOE subsidies. Income tax receipts slightly exceeded budget forecasts, but overall tax receipts fell well below budgeted levels (AUD27.8 million compared to budget of AUD32 million), with weak duty and company tax performance. Fishing license fees, however, exceeded budgeted levels by AUD40 million, reaching nearly AUD89 million. Record fisheries revenue performance reflected both large catch volumes and recent increases in the value of fishing licenses due to regional coordination efforts, but may not be sustainable under current licensing arrangements (as discussed below). AUD10 million of the resulting surplus was used to finance a RERF replenishment.

Table 2: Standard Macroeconomic Indicators

	2011	2012	2013	2014	2015	2016	2017
Real sector			Annual Percent Change				
Real GDP (percentage change)	2.7	2.8	2.9	3.0	2.7	2.5	2.4
Inflation (period average)	1.5	-3.0	-1.5	2.5	2.5	2.5	2.5
Nominal GDP at market prices (in millions of AUD)	167.3	169.0	175.4	185.1	194.9	204.8	215.0
Government finance			Percent of GDP				
Total revenue and grants	62.0	90.4	112.9	87.6	93.5	91.6	91.0
Revenue	37.0	54.0	69.9	39.1	40.9	40.5	40.2
External grants	25.0	36.4	43.0	48.5	52.6	51.1	50.8
Total expenditure and net lending	83.2	97.2	102.6	109.7	104.5	98.3	89.7
Current expenditure	58.0	61.0	59.8	61.7	56.7	54.9	53.7
Of which: Wages and salaries	27.4	28.3	29.7	28.8	27.9	27.1	26.4
Development expenditure	25.2	36.2	42.8	48.0	47.8	43.4	36.0
Overall balance	-21.2	-6.7	10.3	-22.1	-10.9	-6.8	1.3
RERF balance (end of period; in millions of AUD)	579	581	668	666	668	673	681
Real per capita balance (in 2006 AUD)	4759	4592	5058	4837	4643	4472	4326
Balance of payments			Percent of GDP				
Current account balance	-32.2	-26.3	-27.4	-53.4	-53.4	-49.3	-41.3
Trade balance	-48.2	-58.0	-58.2	-58.8	-56.6	-51.5	-44.3
Balance on services	-34.6	-41.8	-41.6	-41.4	-40.8	-39.9	-39.1
Balance on factor income	33.7	49.9	64.9	35.8	35.2	33.8	34.9
Balance on current transfers	16.8	23.6	7.5	11.0	8.8	8.3	7.2
External debt (in millions of USD; end of period)							
External debt	14.2	14.1	13.6	15.0	17.0	22.5	24.7
(In percent of GDP)	8.4	8.0	8.6	8.1	8.7	11.0	11.5
External debt service	0.6	0.6	0.5	0.5	0.6	0.7	0.8
(In percent of exports of goods and services)	2.8	3.0	3.0	3.1	3.2	3.4	3.7

Table 3: BOP Financing Requirements and Sources (AUD million)

	2013	2014	2015	2016	2017
Current account balance	-48.1	-98.9	-104.0	-101.0	-88.7
Trade balance	-102.1	-108.9	-110.3	-105.4	-95.3
Exports, f.o.b.	7.2	7.7	8.4	9.1	9.8
Imports, f.o.b.	109.2	116.6	118.7	114.5	105.1
Balance on services	-72.9	-76.6	-79.5	-81.8	-83.9
Credit	11.2	11.9	12.6	13.4	14.3
Debit	84.2	88.5	92.2	95.2	98.2
Balance on factor income 1/	113.8	66.2	68.6	69.1	75.1
Credit	121.6	74.5	77.6	78.7	85.3
Fishing license fees	88.6	42.2	43.3	44.3	45.4
Investment income	22.4	21.8	23.4	23.3	28.7
Remittances	10.5	10.5	10.8	11.0	11.1
Debit	7.8	8.4	8.9	9.6	10.2
Balance on current transfers	13.2	20.4	17.2	17.0	15.4
Credit	18.4	25.9	23.0	23.2	21.9
Of which: Government	16.6	21.9	19.0	18.9	17.6
Debit	5.1	4.9	5.1	5.3	5.5
Of which:G overnment	0.0	0.0	0.0	0.0	0.0
Financial and capital account balance	86.5	92.8	100.6	98.6	87.2
Government	57.9	64.2	71.3	66.9	56.7
Capital transfers	58.1	64.2	69.3	61.9	54.7
Loans (net)	-0.3	0.0	2.0	5.0	2.0
Direct investment	9.0	1.3	1.3	1.3	1.3
Financial institutions 2/	19.7	27.3	28.0	30.4	29.1
Errors and omissions	0.0	0.0	0.0	0.0	0.0
Overall balance	38.4	-6.1	-3.4	-2.4	-1.5
Change in external assets (increase -) 3/	-38.4	6.1	3.4	2.4	1.5
Revenue Equalization Reserve Fund	-38.4	6.1	3.4	2.4	1.5
Government funds 4/	0.0	0.0	0.0	0.0	0.0

Sources: Data provided by the Kiribati authorities; and Fund staff estimates and projections.

1/ Includes fishing license fees, which would be shown as current transfers under conventional international guidelines.

2/ Including errors and omisions for projections.

3/ Excludes valuation changes.

4/ Comprises the Consolidated Fund, Development Fund, and STABEX Fund.

Table 4: Key Fiscal Indicators (% of GDP) [1]

	2012	2013	2014	2015	2016	2017
Total revenue and grants	90.4	112.9	87.6	93.6	91.6	91.0
Revenue	54.0	69.9	39.1	40.9	40.5	40.2
Tax revenue	16.2	15.9	13.2	15.6	15.7	15.9
Nontax revenue	37.9	54.0	25.9	25.3	24.8	24.2
Of which : Fishing license fees	34.8	50.5	22.8	22.2	21.7	21.1
External grants	36.4	43.0	48.5	52.6	51.1	50.8
Total expenditure	97.2	102.6	109.7	104.5	98.3	89.7
Current expenditure	61.0	59.8	61.7	56.7	54.9	53.7
of which: SOE Subsidies	4.0	5.6	7.3	6.5	5.6	5.2
Copra Subsidy	3.5	4.2	3.9	3.5	3.1	2.9
Community Service Obligations			2.7	2.6	2.2	1.9
Others	0.5	1.4	0.7	0.4	0.4	0.4
Debt Repayments	0.6	1.3	4.8	0.5	0.5	0.0
Development expenditure	36.2	42.8	48.0	47.8	43.4	36.0
Overall balance	-6.7	10.3	-22.1	-10.9	-6.7	1.3
Financing	6.7	-10.3	22.1	10.9	6.7	-1.3
RERF	22.2	-10.1	14.5	13.2	4.3	-2.2
Others	-15.4	-0.2	7.6	-2.3	2.4	0.9
Memorandum items						
RERF balance (in percent of GDP)	344	381	360	343	328	317
RERF per capita balance (in 2006 A$)	4592	5058	4837	4643	4472	4326
Real GDP Growth	2.8	2.9	3.0	2.7	2.5	2.4

2.2. MACROECONOMIC OUTLOOK AND DEBT SUSTAINABILITY

15. **Growth is expected to remain at modest levels over the medium-term, driven by grant-financed infrastructure investments.** Growth is expected to reach 3.0 percent in 2014, driven by increased donor expenditure in support of several major grant-financed infrastructure projects in the road, airports, and sanitation sectors. Similar rates of growth are projected for 2015, contingent on continued successful project implementation. In the medium-term, growth is expected to remain at around 2.4 percent over the implementation period of major infrastructure

[1] One-off declines in tax revenues in 2014 reflect the implementation of the VAT and associated loss of one quarter of associated revenue, with the implementation of an ex-post collection system to replace real-time customs duty collections.

projects, before declining to around 1.8 percent following their completion. The current account deficit is expected to widen to around 53 percent of GDP in 2014 as infrastructure project implementation continues while RERF returns and license fee income will likely decline from unusually high levels in 2012 and 2013. The current account deficit is expected to narrow over subsequent years as infrastructure projects reach completion. Inflation is expected to remain moderate, at around 2.5 percent in 2014 and 2015. Constraints on shipping capacity may lead to some price pressure in the context of project-driven demand.

16. **Government expenditure and the fiscal deficit are expected to decline over coming years.** The expected expansion of the fiscal deficit in 2014 is driven by: i) the expected decline in fisheries revenues from very-high levels in 2013; ii) Government repayment of accumulated outstanding SOE debt of approximately AUD9.5 million; and iii) the impacts of phasing-in of the Value Added Tax (VAT) and associated introduction of a one-quarter delay in receipts. Recurrent expenditure excluding once-off debt repayments declined as a proportion of GDP in 2014. Total recurrent expenditure is expected to decline from 61.7 percent of GDP in 2014 to 53.7 percent in 2017 as a result of continued expenditure discipline and reduced subsidies to SOEs. Current exceptionally-high levels of total government expenditure are driven by grant-financed infrastructure projects (rehabilitation of the main road in South Tarawa and Bonriki International Airport and new sanitation infrastructure). As these projects are completed, total development expenditure is expected to decline from 48 percent of GDP in 2014 to 36 percent of GDP in 2017.

17. **Kiribati faces important challenges in achieving necessary fiscal consolidation.** Recent reliance on unsustainable RERF drawdowns needs to be curtailed if the value of the fund is to be maintained over the long-term. But Kiribati's economy is heavily dependent on public sector expenditure, both in financing the provision of vital social services, but also for employment. There is limited scope to reduce expenditure on the wage bill or core social services without negative impacts on social outcomes and livelihoods. At the same time, geographical constraints of smallness, isolation and dispersal limit the extent to which structural reforms or infrastructure investment can be expected to spur private sector growth and revenue generation. Required reductions in recurrent expenditure are expected to be achieved through several reforms supported under this series of development policy operations, including: i) reducing SOE subsidies (currently more than 10 percent of recurrent expenditure) through a program of privatizations, financial management reforms and governance improvements under a new legislative framework; and ii) the closure of expensive commercial overdraft facilities and avoidance of new non-concessional borrowing, significantly reducing debt servicing obligations (around 1.5 percent of recurrent expenditure in 2012). General restraint in setting payroll and recurrent expenditure allocations will also play a key role.

18. **Improved fiscal sustainability over the medium-term will depend on revenue and RERF-management reforms.** Facing limited scope for rapid consolidation on the expenditure

side, Government is also taking important steps under the series of development policy operations to improve revenue performance and management of the RERF. Improved processes for the sale of fishing licenses, including through rigorous implementation of regional frameworks to protect the sustainability of cross-border migratory stocks, present important opportunities for sustainable revenue growth. Government has moved to implement a VAT in 2014, and is now moving to focus on general strengthening of compliance measures within customs and the revenue division. Capacity within the revenue division has recently been tightly stretched with the implementation of the VAT. As this reform is bedded down, focus will move to general system strengthening and business process improvements to complement the impacts of VAT implementation in reversing the long-term trend of deteriorating revenue performance. The division is now working to develop a compliance strategy to promote voluntary compliance, monitor compliance of registered taxpayers and enforce compliance of non-compliant taxpayers. Subsequent priorities include building capacity in key compliance functions including detection of non-filers, collections of overdue accounts, development of an audit plan, and application of deterrent measures. These measures are estimated to have scope to return tax revenues to 2007 levels of 20 percent of GDP over the medium-term.[2] Government is also implementing reforms to the management of the RERF to realign the management of the fund to be consistent with its long-term objectives and risk tolerance parameters.

19. **Reform of the Development Bank of Kiribati (DBK) and the Kiribati Provident Fund (KPF) is also required over the medium-term to avoid longer-term problems.** The majority of DBK loans are collateralized against salary deductions and pension contributions. Nevertheless, the DBK has accumulated significant nonperforming loans in excess of 22 percent, with management measures required to prevent further accumulation. The KPF runs a small loans scheme collateralized by member's pension balance. The expanded scheme currently stands at AUD10 million and charges 8.5 percent annual interest rate, which is determined by the KPF board. Due to the misalignment of interest rates paid on deposits and investment earnings, the Kiribati Provident Fund balance sheet shows a deficit of more than AUD20 million as members' balances exceed the value of the KPF investments. IMF technical assistance is being provided to support reforms for long-term sustainability of the KPF, and reforms in KPF and DBK may be supported under subsequent operations.

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[2] This recovery of revenues is modeled in the MFED/World Bank medium-term Public Expenditure analysis and reflected in Box 1. A more conservative revenue scenario is presented in the IMF baseline macroeconomic tables, with tax revenues increasing from 13.2 percent of GDP in 2014 to 16.4 percent of GDP in 2019 and continuing on an upwards trajectory.

Box 1: The Revenue Equalization and Reserve Fund

The Revenue Equalization and Reserve Fund (RERF) serves two key roles. Firstly, it serves as a saving mechanism for intergenerational equity. Secondly, it plays a vital budget financing function. The RERF has been used to smooth volatile fishing license revenues, with larger drawdowns in years when fishing license revenues fall below expected levels. Rapid drawdowns over the past decade and a decline in capital value during the Global Economic Crisis have seen real per capita values, in 1996 terms, decline to AUD3,500, less than half of their 2003 peak of around AUD7,300.

Figure 1: RERF Per-Capital Value – 1996-2013

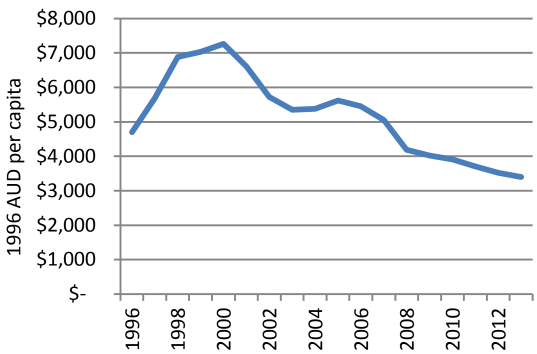
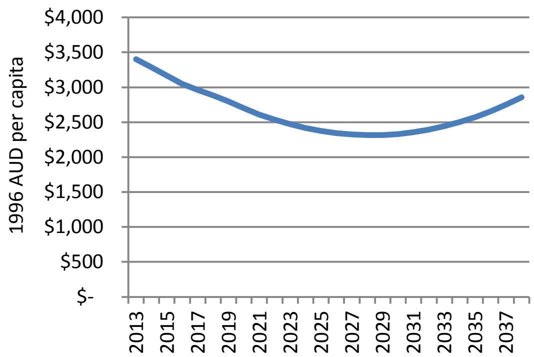


Figure 2: RERF Per-Capita Value - Projected



On current trends and without reform depletion of the RERF would continue. But IMF and World Bank analysis shows that stabilization and eventual recovery in RERF per capita values is possible, even with continued budget support drawdowns, if feasible reductions in the fiscal deficit are achieved. Reforms supported by the proposed program are consistent with achieving stabilization over the long-term through: i) reduced expenditure on SOE subsidies, including the copra subsidy scheme; ii) recovery in tax revenues as a share of GDP to 2007 levels; iii) improved fisheries revenue receipts following improvement in international license fee arrangements; and iv) continued grant support from donors.

Source: World Bank Public Expenditure Analysis

20. **Prospects for achieving a step-change in private sector growth performance are limited by geography.** Due to inherently higher cost structures associated with geographical isolation and smallness, growth opportunities are concentrated in areas where economic rents can be generated, such as fisheries and – to a lesser extent – niche tourism. While much could be done to improve the enabling environment for investment in these areas, their potential to effect changes in economy-wide output should not be overstated. It is not clear that any set of policy measures would lead to substantial and sustained improvements in economic growth given the magnitude of geographical disadvantages. Reflecting the seriousness of these constraints, the Government has prioritized fiscal consolidation through revenue and expenditure measures to resolve current fiscal challenges, rather than focusing solely on private sector growth. Structural reforms and increased infrastructure investment is being pursued including through WBG support to a new investment policy and investment in vital economic infrastructure (roads, airport, and seaport). The greater focus on fiscal consolidation is reflected in policy actions for

the proposed operation. Consolidation will support sustainable delivery of services, continued employment for civil servants, and maintenance of RERF assets. These improvements need be viewed against “a no-reform scenario” in which service delivery and the contribution to the economy of public employment and expenditure would be rapidly undermined through continued deficits and the exhaustion of the RERF.

21. **Kiribati is at a high risk of debt distress according to the 2014 IMF/World Bank Debt Sustainability Analysis, which is based on the assumption that future external financing would be in the form of loans.** The high risk of debt distress reflects the economy’s very limited capacity to take on debt financing but would be mitigated if major donors remain committed to providing their support through grants instead of loans. The last IMF/World Bank Debt Sustainability Analysis was carried out in early 2014, and assumes significant disbursement of borrowings on concessional terms, as opposed to grants, in the next five years for critical infrastructure. On the assumption of such borrowing, Kiribati’s external debt exceeds policy dependent thresholds. There is a sizable and protracted breach of the PV of debt-to-exports ratio threshold (100 percent) and of the PV of the debt to GDP ratio around 2026 (30 percent). The PV of external debt will increase from 8½ percent of GDP in 2013 to 30 percent of GDP in 2026, and reach over 100 percent of exports starting from 2026. Breaches of the present value of debt-to-export ratio and present value of debt-to-GDP occur earlier and are more protracted under the extreme stress test scenario, assuming the interest rate on new borrowing is 200 basis points higher than in the baseline. It is important to note that due to Kiribati’s high risk of debt distress rating under this assessment, major World Bank and Asian Development Bank supported infrastructure projects will now be financed on grant terms, substantially reducing the pace of debt acquisition relative to the pace reflected in the Debt Sustainability Analysis baseline scenario.

22. **The current macroeconomic policy stance is adequate for the operation, given the government’s policy agenda for fiscal consolidation supported by this operation and the anticipated reliance on external grants for public financing as opposed to loans.** Under the Government’s ambitious program of reforms, real RERF per capita values are expected to stabilize within the next decade, with fiscal consolidation on the expenditure and revenue side supporting a reduction in RERF drawdowns to sustainable levels (see Box 1). Macroeconomic sustainability will remain reliant on the availability of external grants, especially to meet the financing needs associated with climate change adaptation. Low levels of external debt and the existence of the RERF increase Kiribati’s capacity to deal with shocks over the short-term. However, the outlook remains subject to downside risks. Further international price shocks could exacerbate inflation and negatively impact growth and living standards. Kiribati also remains vulnerable to a variety of natural disasters, including tsunamis, draught, and cyclones. The IMF, during its 2014 Article IV consultations concluded that use of the Australian dollar remains appropriate for Kiribati, given strong trade linkages and the need for a fixed nominal anchor.

3. THE GOVERNMENT'S PROGRAM

23. **The Government of Kiribati has developed an Economic Reform Plan to address major threats to fiscal sustainability.** The plan is closely aligned with the Kiribati Development Plan (Kiribati's national development strategy) and focuses on the main opportunities to both improve revenue performance and increase the quality of public expenditure. The plan was approved by Cabinet and the Government has established an Economic Reform Taskforce, comprising permanent secretaries of key ministries and development partner representatives, to oversee and monitor implementation of the plan. The plan has the full support of development partners and the Economic Reform Taskforce plays an active role in coordinating development partner assistance around actions included in the plan. The combined impact of reforms included in the Economic Reform Plan is expected to be sufficient to restore fiscal sustainability over the long-term and allow recovery in per capita real values of the RERF, especially due to increased fishing license fees and tax revenues, reduced debt servicing costs, and reduced need for explicit and implicit subsidies across the SOE portfolio.

4. THE PROPOSED OPERATION

4.1. LINK TO GOVERNMENT PROGRAM AND OPERATION DESCRIPTION

24. **The proposed operation is the second in a programmatic series of two operations that support reforms across all three areas of the Government's Economic Reform Plan.** The areas of the Economic Reform Plan map directly to the PDOs of the operation, comprising: i) improved revenue performance; ii) improved management of public assets and liabilities; and iii) expanding private sector opportunities. Focus on these areas is deliberately ambitious in a fragile state context, with reform progress contingent on the continued availability of local capacity and international technical assistance, and continued government commitment to reforms that are politically contentious in some areas. Ambition of the reform program is necessitated by the seriousness of fiscal sustainability challenges facing Kiribati. Reform in these areas is vital to protect fiscal space for public service provision and required investments in climate change adaptation. With Government accounting for such a large share of the economy in Kiribati, and private sector opportunities constrained by geography, many I-Kiribati rely on public expenditure both for the delivery of services and income-generating opportunities – either directly as public servants or via private sector business that supply the public service and public servants. The operation will contribute to reduced poverty and shared prosperity by: i) ensuring the sustainable maintenance of Government expenditure as a source of demand for private sector employment opportunities, especially in urban areas where the poor are concentrated; and ii) contributing to improvements in access to and quality of basic public infrastructure and services on which the poor are heavily reliant (especially in densely populated urban areas), including water and electricity, health, and education. The operation will also ensure that Government

retains the fiscal space to respond appropriately to the threat posed by climate change over the medium-term, allowing sufficient investment to maintain essential infrastructure (such as roads and water supply) that are already being disrupted by climate change impacts, and supporting adaptation of those living in heavily-impacted areas.

25. **The planned operation builds on lessons learned from the first operation in the series and other DPOs completed in small Pacific Island Countries.** The operation follows established good practice in the use of a joint donor matrix for budget support coordinated by a joint government-donor working group. In Kiribati, and elsewhere, this has proven extremely effective in establishing a platform for broad economic dialogue, tracking progress against economic reform priorities, and coordinating the mobilization of required technical assistance. The operation will adequately reflect capacity constraints and exposure to macroeconomic and natural disaster risks through choice of a small number of strategic policy actions, all of which are being supported by technical assistance from various donors. The primary lesson learned from the first operation is the need for improved communication to track progress against reform actions beyond the Ministry of Finance. This is being addressed through the widening of the membership of the Economic Reform Taskforce to include permanent secretaries from other ministries with responsibilities for actions included in the Economic Reform Plan and supported by the operation.

26. **Prior actions for the second operation are largely consistent with indicative triggers indicated at approval of the first operation.** The program document for the first operation in this series noted that the decision to proceed with a second operation would be based on an assessment of overall progress in policy areas, and that flexibility to adjust triggers may be required given risks arising from capacity constraints, exposure to macroeconomic shocks, and a difficult political-economy context in some areas. While several triggers had to be adjusted as some of these risks materialized, the Government's overall reform program demonstrates substantial progress in all areas. The following table compares indicative triggers included in the program document for the first operation with prior actions for the second operation and explains any changes.

Table 5: List of Triggers and Prior Actions

Indicative Trigger for DPO2 included at approval of DPO1	**DPO2 Prior Action**	**Explanation**
Improving Revenue Performance		
a) The Ministry of Fisheries and Ministry of Finance will jointly review the consistency of fishing access arrangements with government policy and regional management agreements; and b) Cabinet will approve revisions to access arrangement based on the recommendations of this review.	The Recipient has produced a joint report of its Ministry of Fisheries and Marine Resource Development and Ministry of Finance and Economic Development on the sources of fisheries revenue containing disaggregated data regarding the sources of all fishing revenues, and has published the report on the website of the Ministry of Finance and Economic Development.	**Revised** to reflect the authorities' view that effective sharing of information between the Ministry of Fisheries and the Ministry of Finance is a key prerequisite for effective review of fisheries access arrangements. The revised Prior Action provides a foundation for a later review and represents an important advance in transparency.
Improving the Management of Public Assets and Liabilities		
Key provisions of the new SOE Act will be implemented, including: i) full compliance with legislative provisions for all board appointments; ii) the five largest SOEs will submit full financial statements to Government within three months of the end of the 2013 fiscal year; and iii) a concession contract for the management of the Betio Shipyards will be brought to the point of transaction.	I) The Recipient has adopted the following measures consistent with the State Owned Enterprises Act: (a) ensured full compliance of all SOE board appointments with the provisions of the SOE Act; (b) ensured that the five largest SOEs have submitted to it full financial statements within three months of the end of the Recipient's 2013 fiscal year; and (c) ensured the inclusion of SOE community service obligation subsidies in the Recipient's 2014 annual budget; and II) The Recipient, through its Cabinet, has approved a roadmap for reform and rationalization of its copra sector, including the merger of the Kiribati Copra Cooperative Society and the Kiribati Copra Mill Limited.	**I) a) and b) unchanged. c) revised** to reflect delays in planned process with concession contract but greater-than-expected progress in implementing explicit community service obligations for SOEs. **II) Added** to reflect faster-than-expected progress in the reform of copra sector SOEs.

Cabinet approves key RERF management reforms, including: i) reallocation of RERF assets to achieve consistency with clearly-stated investment objectives; ii) application of new concentration and deviation limits; and iii) application of more appropriate benchmarks to improve monitoring of asset manager performance.	The Recipient, through its Cabinet, has approved key reforms in the management of its Revenue Equalization Reserve Fund to achieve consistency with clearly-stated investment objectives, including: (a) reallocation of RERF's assets to new asset managers; and (b) reorientation of RERF's portfolio towards lower-risk instruments.	**Strengthened** to reflect the broader scope of reforms agreed by Cabinet following World Bank Treasury TA. Reforms agreed by Cabinet will fully encompass and expand upon the reforms included in the indicative trigger.
Expanding Private Sector Opportunities		
New ICT licenses are offered permitting at least a second national mobile operator to supply wireless mobile services to the public using its own infrastructure.	The Recipient has invited pre-qualified firms to bid for purchase of Telecommunication Services Kiribati Limited following completion of pre-qualification processes by the Recipient's Ministry of Communications.	**Revised** to reflect rapid progress with the privatization of the existing utility and slower-than-expected progress with the issuance of new licenses for addition providers.

4.2. PRIOR ACTIONS, RESULTS AND ANALYTICAL UNDERPINNINGS

Improving Management of Fisheries Revenues

Prior Action #1: The Recipient has produced a joint report of its Ministry of Fisheries and Marine Resource Development and Ministry of Finance and Economic Development on the sources of fisheries revenue containing disaggregated data regarding the sources of all fishing revenues, and has published the report on the website of the Ministry of Finance and Economic Development.

27. **Fisheries revenues are vital to Kiribati.** Revenues from tuna fishing license fees represent between 40 and 60 percent of total government revenue. Revenues are highly volatile, and generated from several sources: i) fishing license sales under regional arrangements; ii) fishing license sales and other compensation under bilateral arrangements; and iii) revenue arising from several fishery-sector joint ventures. The Ministry of Fisheries has not previously shared any information with MFED regarding the source of revenues, the agreements that revenues are generated from, or the commercial performance of joint ventures. This has two important consequences for MFED. Firstly, it is impossible for the budget team to make any meaningful projections of future revenue performance, undermining the credibility and execution of the budget, and risking revenue underperformance that could place additional pressure on RERF resources. Secondly, MFED – in its role as economic advisor to Government – is unable to assess and advise Cabinet as to whether Kiribati is: i) maximizing the sustainability and value of its fisheries resources through existing license agreements and joint venture arrangements; and ii) complying with catch limits and other conditions established under regional frameworks.

28. **Regional frameworks present an important opportunity for Kiribati if compliance can be ensured.** The Vessel Day Scheme was fully implemented in 2012. The scheme allocates a fixed number of 'vessel days' to participating Pacific Island countries, through which rights to undertake any fishing activity are allocated to purse seiner fishing vessels on a 24 hour period basis. By establishing a framework for managing supply, Pacific countries can ensure that a greater proportion of catch value is retained as license revenue. The scheme also provides benefits by allowing countries to mitigate the volatility of revenue from highly variable catch. Once fully operational, the scheme will allow countries to sell their allocated vessel days when allocations exceed the available catch within territorial waters, providing a source of revenue regardless of the location of migratory fish stocks. Fully operationalizing the VDS requires that all countries negotiate access arrangements that are consistent with the scheme and within the overall catch limits established by the scheme. Kiribati's progress in this regard has, at times, been slowed by a lack of whole-of-government commitment to the scheme, reflecting inadequate coordination between the Ministry of Fisheries and the Ministry of Finance.

29. **As a prior action for the previous operation, Government adopted a National Fisheries Policy.** The National Fisheries Policy outlines a broad range of policy and

administrative reforms to improve revenue returns from exploitation of Kiribati's fishery resource.[3] These include: i) strengthening implementation of and compliance with regional conservation and management measures – including the VDS – through review and updating of access agreements, license conditions and other regulations as required; and ii) reviewing and updating the Fisheries Act and other relevant acts as required to clarify and strengthen coastal and oceanic fisheries management. Other specific actions described in the policy relate to improved capacity for enforcing Distant-Water-Fishing-Nations (DWFN) compliance with access arrangements through strengthened monitoring, as well as conservation-focused measures for coastal fisheries management.

30. **Management of fisheries resources is improving in Kiribati.** In accordance with the new fisheries policy, Kiribati has broadly complied with vessel day limits under the PNA agreement in 2013 and to date during 2014. Kiribati has met all monitoring and reporting requirements under the scheme. Partly as a result of successful implementation of the scheme, the purchase price of vessel days has increased significantly, with Kiribati achieving record fees for vessel day licenses during 2014. Transparency and financial management of fisheries license revenues is improving, with the Ministry of Fisheries closing an offshore account for license fee revenue earlier in 2014, and transferring all receipts to the consolidated account at the request of MFED.

31. **Under the proposed operation, the Ministry of Fisheries and the MFED have produced a joint report containing disaggregated data regarding the sources of all fishing revenues and will update and publish this report on the MFED website annually.** The report provides an overview of recent fisheries revenue trends, showing a broad improvement in overall revenue performance, both in terms of total revenues and revenues per ton of catch. The report notes improved compliance with vessel day limits established under the PNA scheme. The report highlights potential loss of revenue arising from bilateral fishing license arrangements, where Kiribati may have been able to achieve increased revenues through greater reliance on direct VDS sales under the PNA. Finally, the report recommends increased use of market-based mechanisms, including auctions, for sale of vessel days to maximize fisheries revenues over the

[3] The strategy includes the following outcome objectives: i) support economic growth and employment opportunities through sustainable fisheries, aquaculture and marine resources development; ii) protect and secure food security and sustainable livelihoods for i-Kiribati; iii) ensure long term conservation of fisheries and marine ecosystems; iv) strengthen good governance with particular focus on building capacity of MFMRD to implement and support fisheries management, development and monitoring, control and surveillance; and v) build climate change resilience for fisheries and marines resources in Kiribati.

medium-term. Publication of the report on the MFED website represents a major advance in transparency, providing the public with information regarding the sources and amounts of fishing license revenues for the first time. The process of developing the report has allowed the MFED to: i) improve forecasting of fisheries revenues; and ii) assess the extent to which specific license sales and license agreements are consistent with international frameworks – including the VDS – and maximize overall revenue potential. From this information, MFED will work with the Ministry of Fisheries over coming years to identify and revise arrangements that are not in Kiribati's interests, supporting increases in sustainable fishing license revenue receipts.

32. **Results – these actions will contribute to improved predictability of fishing license fee revenues.** Variance between budgeted and actual fishing license fee revenues will decline from a discrepancy of 188 percent between estimates and actuals in 2013 to variance of less than +/-50 percent in 2015. This result will be achieved through improved access to fisheries license revenue information within MFED.

Improving the Management of Public Assets and Liabilities

Prior Action #2: I) The Recipient has adopted the following measures consistent with the State Owned Enterprises Act: (a) ensured full compliance of all SOE board appointments with the provisions of the SOE Act; (b) ensured that the five largest SOEs have submitted to it full financial statements within three months of the end of the Recipient's 2013 fiscal year; and (c) ensured the inclusion of SOE community service obligation subsidies in the Recipient's 2014 annual budget; and II) The Recipient, through its Cabinet, has approved a roadmap for reform and rationalization of its copra sector, including the merger of the Kiribati Copra Cooperative Society and the Kiribati Copra Mill Limited.

33. **SOEs have historically imposed substantial costs due to inefficiency and poor management.** The Government of Kiribati has spent AUD19.4 million (or 11 percent of current GDP) since 2003 on direct subsidies to SOEs through the budget, but service remains poor and unreliable. Further costs are imposed on the Government through the failure of several SOEs to pay corporate taxes and the current common practice of retaining withheld employee PAYE taxes. Improving the performance of SOEs is therefore a key priority for Kiribati. Reform of the existing portfolio of SOEs is at the core of the Government's reform agenda, with the long-term goal of privatizing or introducing private participation into the operation and management of all SOEs that are not fulfilling a genuine public good function. Support is being provided by the ADB on a broad range of legislative and governance reforms across the sector.

34. **Reforming the copra sector is an important component of the SOE reform agenda.** The Kiribati coconut industry is currently not financially viable. In 2011, the industry incurred a conservatively estimated AUD8.1 million net loss –equal to about 10 percent of total government revenues. The subsidized prize of AUD800 per ton of copra paid to copra farmers is 266 percent of the world benchmark farm gate copra price of around AUD300 per ton. The purchase price

paid to farmers is 23 percent higher than the dried copra export price. In 2010 and 2011 approximately 40 percent of the copra paid for under the Subsidy Scheme was lost through 'leakage' and never delivered to the Kiribati Cooperative Copra Society (KCCS) store in Betio. The direct cost of this leakage to the Government is estimated at AUD3.6 million in 2011 and AUD2.0 million in 2010. There are major inefficiencies in the operation of the scheme, with six agencies involved in administration of the subsidy, leading to poor coordination, unnecessary double handling of products, and limited accountability. Because the subsidy is paid for all copra delivered by copra agents, Government cannot control overall fiscal costs of the scheme, and direct subsidy payment frequently exceed budgeted levels. Government has recognized that the current operation of the copra scheme is not sustainable. Following mounting awareness and concern regarding the unsustainable cost and poor management of the scheme, the Ministry of Commerce, the MFED, and the World Bank reviewed the copra scheme in 2011. Following this review, Cabinet requested additional technical assistance to develop options for the reform of the scheme to improve efficiency and reduce fiscal costs.

35. **The previous operation supported Government in: i) submitting updated SOE legislation to Parliament; and ii) bringing to the point of transaction a concession contract for private management of the Otintaai hotel.** Among other things, the new Act: i) commercialized designated SOEs by establishing legal requirements that they operate on commercial terms; ii) established a formal process for budgeting and gaining approval for Community Service Obligations (CSOs); iii) introduced requirements that SOEs produce a Corporate Plan and Statement of Corporate Objectives to be agreed-upon with the Government; iv) established an independent committee to advise on the selection of SOE directors; v) established rules for director eligibility to prevent conflicts of interest in SOE management; and vi) established a Public Enterprise Review and Monitoring Unit within the MFED with responsibility for monitoring SOE performance, coordinating technical assistance to reforms, and overseeing future divestments and restructuring. The signing of a concession contract for the Otintaai Hotel opened the door for commercial operation and associated employment generation, while ending a long history of public subsidies to the hotel's operations.

36. **Broad progress continues to occur in the SOE sector.** While progress has at times been constrained by delays in the availability of technical assistance and inadequate private sector interest in private-public partnership opportunities, reform of a broad portfolio of SOEs is continuing. Following the failure to identify an appropriate concessionaire for the Betio shipyards under a previous process (a previous trigger), Cabinet has recently approved the issuance of invitations for expressions of interest in management of the SOE, with World Bank technical assistance in revising the concession agreement. Cabinet has approved liquidation of Bobotin Kiribati Limited (a retail company) and liquidation will proceed following the appointment of an appropriately qualified liquidator. Cabinet will soon approve a plan for

contracting out of all government shipping services, once appropriate technical assistance can be mobilized to support development of the plan.

37. **The proposed operation will support implementation of key management and governance provisions of the SOE Act.** Under the proposed operation, directors of SOEs are now being appointed in compliance with the provisions of the SOE Act. The five largest SOEs have submitted full financial statements to Government (SOE Monitoring Unit) within three months of the end of the fiscal year and these are now being audited by the Kiribati National Audit Office (the five largest SOEs are Kiribati Oil Importers Limited, Kiribati Housing Authority, Public Utilities Board, Broadcasting and Publication Authority, and Air Kiribati). Community Service Obligations have been included in the annual budget, providing full transparency and predictability regarding the scope of SOE operations that cannot be financed through tariffs, fees, and charges. Compliance with legislative provisions regarding Board membership will directly address current problems arising from politicization of SOE governance and decision-making, facilitating better management and improved compliance with the cost-recovery principles underpinning the new legislative framework. Compliance with legislative provisions regarding financial accounts will improve transparency, facilitate financial scrutiny of SOE management decisions by MFEP and other interested parties, and provide a vital foundation for future progress towards increased private participation in the operation of selected SOEs in future. Establishment of community service obligations will provide transparency, discipline, and predictability regarding the services that SOEs are expected to provide that are not cost recoverable, and obviate the need for explicit and implicit ad hoc subsidies that have previously disrupted Government budget execution and financial planning.

38. **Result – SOEs become less reliant on ad hoc Government subsidies.** Ad hoc subsidies to SOEs will have declined to less than AUD0.8 million in 2015 from a baseline of AUD2.5 million in 2013.[4] This result indicator reflects both the need to reduce the overall fiscal costs of SOE subsidization and also the legitimate role of Community Service Obligation subsidies in ensuring provision of non-cost recoverable services, including provision of network infrastructure to vulnerable groups. With legitimate financing needs for meeting service-delivery obligations adequately budgeted, the need for ad hoc subsidies will be reduced through financial performance improvements and selective SOE divestment.

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[4] Ad hoc subsidies are defined as all subsidies that are not; i) included as Community Service Obligation subsidies in the annual budget for the year; and ii) copra scheme subsidies.

39. **Under the proposed operation, Cabinet has approved a roadmap for reform and rationalization of the copra sector, including the merger of the Kiribati Copra Cooperative Society and the Kiribati Copra Mill Limited.** Many of the inefficiencies of the copra subsidy scheme could be addressed with management and system improvements. However, with responsibility fragmented across agencies, the scheme does not provide any incentives for efficiency or transparency regarding financial performance. For example, the Copra Cooperative Society effectively receives copra from growers without having to pay for produce, and then uses proceeds from sale to the copra mill to fund its own operations. Managers have no incentive to reduce costs or increase revenue to government from copra sales, and the financial performance of the agency does not reflect its economic benefits or costs. Officers with vital responsibilities on-the-ground are not accountable to agencies with financial control. Because responsibility and accountability for the administration of the scheme is divided across several agencies, management improvements in any one agency are inadequate to reduce overall costs. By bringing all functions and responsibilities within a single agency, accountability will be clearer and costs arising at different stages of the supply chain made more transparent. Management control will be centralized. The net costs of the scheme will become clear and a single agency will hold responsibility for managing these costs. With all staff handling financial transactions employed under the same agency, information will be available to address corrupt practices and management will face stronger incentives to act on this information. Planned World Bank TA support to management of the new entity will be effective, given its broad control across the sector.

40. **The eventual replacement of the copra scheme with an alternative mechanism for supporting outer island livelihoods remains the ultimate objective.** However, many I-Kiribati rely heavily on the copra scheme, and options for its immediate replacement are limited. It is therefore important to reform the scheme in the short-term to achieve immediate fiscal savings and efficiency gains while other options are being considered. Accordingly, initial reforms to the copra scheme will be targeted towards addressing inefficiencies and reducing leakage, rather than reducing legitimate payments to copra growers. With existing leakage and excessive overhead costs estimated to have a regressive impact – benefiting relatively well-off public servants – reforms are not expected to have negative poverty impacts. A more efficient copra sector would also facilitate increased private participation in the sector if Government decides to phase out or abolish the subsidy scheme in the longer term. If more holistic reform of the copra scheme (such as a phasing out or narrowing of copra subsidy payments) is considered in future, necessary analytical work will be undertaken to assess poverty impacts.

41. **Result – Inefficient expenditure through the copra price subsidy is reduced.** Expenditure on the copra price subsidy will decline to less than AUD6.8 million from AUD7.3 million in 2013. This result reflects expected savings from reduced leakage and efficiency

improvements under a restructured copra sector. The result does not rely on an overall reduction in the subsidy price level or legitimate payments to farmers.

42. **Potential future series of development policy operations could support further improvements in management of government assets and liabilities.** Government priorities that could be supported under future operations include: i) broader private participation in the provision of services currently provided by SOEs, including shipyard and shipping services; ii) implementation of key reforms included in the roadmap for reform of the copra sector, including improved targeting of copra price subsidy expenditure; and iii) implementation of RERF reforms, including the selection of new asset managers through competitive processes and under an appropriate investment mandate.

Prior Action #3: The Recipient, through its Cabinet, has approved key reforms in the management of its Revenue Equalization Reserve Fund to achieve consistency with clearly-stated investment objectives, including: (a) reallocation of RERF's assets to new asset managers; and (b) reorientation of RERF's portfolio towards lower-risk instruments.

43. **A recent review of the RERF found that RERF asset allocations were poorly matched to the overall investment goals and identified a number of weaknesses in the performance of asset managers, benchmarks, and performance targets**. Kiribati's long-term fiscal sustainability is heavily reliant on sound management of RERF assets. Losses incurred on investments during the Global Economic Crisis and recent poor performance of RERF investments indicates inadequacies in current management arrangements. A review of RERF management was conducted with IMF assistance in 2011. Key recommendations included: i) improved alignment between strategic asset allocation and investment objectives; ii) revised investment guidelines to remove ambiguity and avoid excessive risk-taking; and iii) more appropriate mechanisms for monitoring and assessing performance of asset managers. Following further analysis and technical assistance provided by a World Bank Treasury team over the past year, the Government of Kiribati has recognized the importance of implementing these recommended reforms and approved a series of substantive reform actions that will significantly transform existing RERF management arrangements.

44. **Under the proposed operation, Cabinet has approved key RERF management reforms in line with the recommendations of the recent IMF review.** The RERF investment committee and Cabinet has approved a series of reforms that were recommended in the IMF review and have been subsequently elaborated through the efforts of the MFED with World Bank Treasury technical assistance. These measures will ensure a more appropriate match between management risk-tolerance parameters and investment objectives, including through: i) reorientation of the portfolio towards lower-risk instruments and passive management; and ii) development of new investment mandates and identification of appropriate benchmarks for the existing and newly selected asset managers. Cabinet has also approved a review of existing

management arrangements of the RERF, to ensure that existing legislated responsibilities of the RERF Committee, Cabinet and Parliament remain appropriate in relation to RERF governance. Reorientation of the portfolio towards lower risk exposure is not expected to lead to any significant reduction in RERF earnings, given the historically poor performance of existing asset managers, with performance tracking significantly below performance targets and market benchmarks. World Bank Treasury technical assistance is being provided to support the reorientation of investments and establishment of appropriate legal and oversight arrangements.

45. **Result - RERF performance will reflect lower risk reflected in closer alignment between portfolio performance and relevant market benchmarks**. During 2015, RERF portfolio performance will not be more than two percent below the appropriate market benchmark for similar investment portfolios (compared to an underperformance by 8.29 percent below the market benchmark in year to March 2013). The result indicator captures the intended outcome of reduced risk exposure for RERF assets relative to broader market movements. While overall performance will be impacted by many exogenous factors, lower risk exposures should ensure that RERF portfolio performance is closer to market benchmark levels than has been achieved over recent years and better-aligned with long-term investment strategy and objectives.[5]

Expanding Private Sector Opportunities

Prior Action #4: The Recipient has invited pre-qualified firms to bid for purchase of Telecommunication Services Kiribati Limited following completion of pre-qualification processes by the Recipient's Ministry of Communications.

46. **Kiribati is one of the least "connected" countries in the world.** Evidence from the region demonstrates the potential impact of easily-available telecommunication technologies in providing new business opportunities and reducing costs for existing firms. Telecommunications access has also proven an important means of accessing transport and health services. In Kiribati, however, ICT services reach only about 14 percent of the population. Total broadband Internet take-up is about 600 subscribers (less than 1 percent penetration). The prices for local,

[5] The benchmark is used to evaluate the return on investment relative to market returns for investments with similar portfolio allocations and asset classes. Benchmarks can be expressed in terms of an absolute target rate of return or in relation to a market index or composite index. The appropriate benchmark will be explicitly identified by the Government of Kiribati with World Bank technical assistance, and reflected in investment agreements with Asset Managers.

inter-island and international calls are very high in absolute terms and relative to regional comparators. Internet prices are also very high: approximately twice or three times those in comparable markets. Connectivity is particularly limited outside South Tarawa and Kiritimati, with public, dial-up internet access and telephony available on nine of 22 inhabited islands. There are no mobile services outside South Tarawa and Kiritimati. The outcome of current arrangements imposes high business and social costs, including the isolation of entire island communities and missed opportunities for economic and social development. The main reasons for the limited and costly service include the monopolistic market structure (the sole provider is the Government-owned TSKL) and the high costs of connecting remote and sparsely-populated islands. Poor coverage and quality of telecommunications services significantly increase the costs of doing business in one of the world's most dispersed countries.

47. **As a prior action for the first operation, Government approved submission to Parliament of legislation to liberalize the telecommunications sector.** The new legal enabling environment included provisions for: i) establishing an open and transparent, technology neutral licensing process; and promoting non-discrimination in regulation between licensees; ii) ensuring transparency in how wholesale access (including interconnection and access to essential facilities) is regulated and that access rates will be cost-oriented; iii) strengthening operators' rights to access each other's infrastructure, to lower barriers to entry and expansion; and iv) adding regulatory tools to address anti-competitive conduct and to protect the interests of users of ICT services. Overall, this legislation will allow for an adequately regulated competitive market in the delivery of telecommunication services in Kiribati. By ending the current monopoly of the state-run provider, regional experience suggests the costs can be expected to decline and quality of services increase. Since passage of the legislation, the World Bank has provided extensive technical assistance to the development of required regulatory capacity and governance arrangements under the new legal framework under an International Development Association (IDA) and Pacific Regional Infrastructure Facility (PRIF) financed Telecommunications and ICT Development Project. This project has provided sustained support to both the sector ministry and the newly-established regulator, including technical, legal, policy and regulatory advice and assistance.

48. **Under the proposed operation, pre-qualification processes have been completed and prequalified parties have been invited to bid for purchase of Telecommunication Services Kiribati Limited.** With World Bank technical assistance, telecommunication regulatory functions have been sufficiently developed within the Communications Commission of Kiribati (CCK) to allow private and competitive provision of telecommunication services. An invitation for expressions of interest was issued for purchase of the assets of the current government-owned monopoly provider, TSKL, in May. Expressions of interest have now been assessed by government, and pre-qualified firms have paid registration fees, begun due diligence, and been invited to negotiate transaction agreements. These represent key steps towards the reform of TSKL which will enable the company to function effectively in a competitive market for

telecommunication services in Kiribati. The next stage will involve the submission of bids by pre-qualified firms in early November 2014. This process will provide a conditional contract for the sale provided that one of the bidding firms meets the Government's reserve price. The conditional contract will commit parties to the transaction, subject to several preconditions relating to investment approval processes by Government and securing of necessary finance by the private sector firm. The closure of the sale transaction will occur within 1 to 3 months from the date of the auction. An appropriately qualified international transaction advisor has supported government through all stages of the process. Given the extent of existing inefficiencies and the need for new capital investment, and the presence of an adequate regulatory framework and capable regulatory agency, privatization of the utility is expected to quickly lead to improvements in service and reductions in costs. The benefits of private participation and competition in telecommunication provision are well-established across the Pacific as outlined in the 'analytical underpinnings' section.

49. **Progress is also occurring with the issuance of new licenses (a previous trigger), although more slowly than initially envisaged because of delays in contracting a private firm to support the issuance of new licenses**. The liberalization process will also involve the issuance of additional licenses for private sector provision of various telecommunications services. Issuance of licenses for additional private sector providers was included as an indicative trigger for this operation during approval of the first operation in this series. Licenses have already been issued for a private sector provider to offer Wi-Fi internet services in competition to the existing state-owned utility. The Government is currently progressing licensing processes for a second provider of mobile telephone services, but this has taken longer than expected due to: i) difficulties in procuring private sector advisory services to support the issuance of new licenses; and ii) the fact that privatization of TSKL must precede the issuance of new licenses, with government facing significant fiscal risks if the poorly-managed utility was forced to compete against private sector providers while still under government ownership. Expressions of interest were recently received from firms interested in advising on the license issuance process, and Government has invited a technical proposal from the best-qualified firm. Negotiations are currently underway and, once finalized, the advisor will support Government through subsequent steps in issuing new licenses for private sector mobile telephone service providers. An advisory firm could be contracted by the end of 2014, with additional mobile providers entering the market by mid-2015, subject to sufficient private sector interest. Competition among private providers under appropriate regulatory settings is expected to further improve service quality and reduce costs.

50. **Result – reduced cost of telecommunication services.** By end-2015 the cost of a three-minute peak-hour mobile-to-mobile call within Tarawa will have fallen to AUD0.70 from a baseline of AUD0.90 in 2013. This result will be achieved through efficiency improvements arising from a private utility operating under appropriate regulatory settings.

51. **Potential future series of development policy operations could support further progress in expanding private sector opportunities.** Government priorities in this area that could be supported by future operations include: i) the issuance of licenses for additional providers of mobile telephone services to establish full competitive pressure in the sector; and ii) finalization of a recent review of the Foreign Investment Act and implementation of key associated legislative and regulatory reform recommendations.

4.3. ANALYTICAL UNDERPINNINGS

Table 6: Prior Actions and Analytical Underpinnings

Prior actions	Analytical Underpinnings
Improving Revenue Performance	
The Recipient has produced a joint report of its Ministry of Fisheries and Marine Resource Development and Ministry of Finance and Economic Development on the sources of fisheries revenue containing disaggregated data regarding the sources of all fishing revenues, and has published the report on the website of the Ministry of Finance and Economic Development.	World Bank analytical work to inform Pacific Fisheries sector engagement strategy. Highlights the importance of effective implementation of international agreements in order to both maximize fisheries revenue and ensure sustainable management of fish stocks.
Improving Management of Public Assets and Liabilities	
The Recipient has adopted the following measures consistent with the State Owned Enterprises Act: (a) ensured full compliance of all SOE board appointments with the provisions of the SOE Act; (b) ensured that the five largest SOEs have submitted to it full financial statements within three months of the end of the Recipient's 2013 fiscal year; and (c) ensured the inclusion of SOE community service obligation subsidies in the Recipient's 2014 annual budget.	World Bank expenditure analysis TA. Identified improving the commercial management of SOEs, reducing inefficiencies, and increasing the transparency of subsidies as priority reforms for achieving fiscal sustainability.
The Recipient, through its Cabinet, has approved a roadmap for reform and rationalization of its copra sector, including the merger of the Kiribati Copra Cooperative Society and the Kiribati Copra Mill Limited.	World Bank review of the existing copra subsidy scheme. World Bank TA report "Roadmap for reform of the Kiribati copra subsidy scheme". Identified restructuring of copra sector entities under a single SOE as a prerequisite for necessary efficiency gains and governance and accountability improvements.
The Recipient, through its Cabinet, has approved key reforms in the management of its Revenue Equalization Reserve Fund to achieve consistency with clearly-stated investment objectives, including: (a) reallocation of RERF's assets to new asset managers; and (b) reorientation of RERF's portfolio towards lower-risk instruments.	IMF MCM TA report. Identifies major problems with the performance of the RERF and substantial risks associated with the current investment strategy. Recommends: introduction of concentration limits in the investment agreement, improved oversight for fund manager performance, shift to a passive investment strategy, revision of reported asset values to take account of recent losses, adjusting the currency composition of investments to better match trade exposures, introduction of a liquidity buffer, establishment of more realistic investment targets, shifting towards a more conservative investment strategy, and renegotiating the contract with the custodian.

	World Bank Treasury has also been providing programmatic technical assistance to the MFED and the Investment Committee, including analysis of current investment arrangements and recommendations for implementation of IMF report findings.
Expanding Private Sector Opportunities	
The Recipient has invited pre-qualified firms to bid for purchase of Telecommunication Services Kiribati Limited following completion of pre-qualification processes by the Recipient's Ministry of Communications.	Pacific Institute of Public Policy 'Net Effects' report. Collected substantial survey evidence regarding pro-poor and pro-business impacts of telecommunications access following sector liberalization in the Pacific.

4.4. LINK TO CAS AND OTHER BANK OPERATIONS

52. **The World Bank Group's Country Assistance Strategy for the Republic of Kiribati, FY11-FY14, identified two central themes.** These themes are: i) building resilience against external shocks; and ii) mitigating economic isolation by encouraging regional and global integration. The proposed operation supports both of these themes. The broad objective of the programmatic series of DPOs is to achieve fiscal adjustment to reduce unsustainable RERF drawdowns. Such adjustment, through sustaining the value of the RERF, will leave Kiribati better placed to deal with external shocks, including economic shocks, natural disasters, or the longer-term challenge of climate change adaptation. Specific actions supported by the proposed operation, including measures towards liberalization of the telecommunication sector and enhanced implementation of regional fisheries management arrangements, will also contribute to regional and global integration.

53. **The proposed operation provides a key mechanism for strengthening policy engagement as financial support is scaled up.** Total IDA and Trust Fund commitments to Kiribati over the past three years amount to nearly US$60 million. All assistance has been provided on 100 percent grant terms. The proposed operation and associated joint-donor budget support process represent an opportunity to broader economic policy dialogue as major Bank investments take place in: i) climate change adaptation (US$3 million); ii) road infrastructure (US$20 million); and iii) airport rehabilitation (US$27 million). IFC has been working closely with the GoK to support private participation in the Otintaai hotel. Policy actions supported through this operation will be closely aligned with Bank and IFC project engagements. Since 2012, the World Bank Treasury has been providing advisory assistance to the MFED to support improvements in management of the RERF.

4.5. CONSULTATIONS, COLLABORATION WITH DEVELOPMENT PARTNERS

CONSULTATIONS

54. **The program reflects broader stakeholder consultation.** In selecting economic reform priorities, the team consulted with NGOs and civil society and participated in broader

community consultations regarding the causes and nature of poverty in Kiribati. Discussions with women's NGOs highlighted the importance of increased employment opportunities for the economic empowerment of women, and the disproportionate costs of inadequacy in current health, water and sanitation services being borne by women. Consultation with church groups and the community provided insights regarding the extent to which poverty and hardship would increase following any large reduction in public employment and expenditure, as well as revealing concerns that RERF values be maintained to benefit future generations.

COLLABORATION WITH OTHER DEVELOPMENT PARTNERS

55. **The Economic Reform Taskforce provides for close coordination.** At the request of the Secretary of Finance, an Economic Reform Taskforce was established during the development of the Economic Reform Plan in 2011, comprising relevant directors from the Ministry of Finance and Economic Development and donor agencies working in economic sectors (World Bank, the Australian Government, ADB, New Zealand Aid Program, European Union, IMF, and PFTAC). The Taskforce was intended to ensure close coordination of donor Technical Assistance towards the objectives established in the Economic Reform Plan and monitor progress towards objectives established within the plan. The Taskforce continues to meet on a regular basis and has been active in determining the policy actions to be supported through the proposed operation. These actions have been discussed and agreed by Cabinet, and represent the reform priorities from within the Economic Reform Plan, of the Minister of Finance. During 2014, membership of the Economic Reform Taskforce has been expanded to include secretaries of other ministries involved in reform actions supported by the proposed operation, including the Ministry of Communications and the Ministry of Fisheries. Following successful implementation of the first DPO, ADB and New Zealand are both likely to provide budget support against Economic Reform Plan actions coordinated under the Economic Reform Taskforce during 2014.

5. OTHER DESIGN AND APPRAISAL ISSUES

5.1. POVERTY AND SOCIAL IMPACT

56. **The operation will support the WBG twin goals of eliminating extreme poverty and boosting shared prosperity.** Actions supported by the operation are expected to have a disproportionately positive impact on i-Kiribati living in extreme poverty (below the food poverty line) and among the bottom 40 percent. Over the medium-term, reforms supported by this operation will benefit these groups through both improved economic opportunities and maintaining access to basic services.

57. **Supporting long-term fiscal sustainability will ensure that Government expenditure can continue to support the delivery of public services and sustain aggregate demand for**

private sector activities and associated employment in a context where business opportunities are heavily constrained by geography. A recent public expenditure analysis conducted by the World Bank concluded that overall expenditure allocations in Kiribati were broadly appropriate and pro-poor, with a relatively large proportion of the recurrent budget allocated to basic services (allocations to health and education as a proportion of total recurrent expenditure are 15 percent and 26 percent respectively). Improved fisheries and SOE performance will generate fiscal space for the improvements in basic infrastructure and public services on which the poor rely, as well as allowing necessary investments to avoid disruptions to livelihoods and infrastructure resulting from climate change (which international evidence suggests are likely to have a disproportionate negative impact on the poor). SOE reforms will both reduce the fiscal burden associated with the SOE portfolio and open new opportunities for private sector job creation, especially in South Tarawa where the poor are concentrated. Evidence gathered during consultations suggests that women are particularly concerned about access to basic services, including education, health and sanitation, and bear a disproportionate burden of the costs of dealing with disruptions to and unavailability of these services. Improved fiscal sustainability is therefore expected to bring positive impacts for women. The public sector is by far the largest source of formal employment for women in Kiribati, and ensuring sustained availability of good quality public sector employment opportunities will benefit women.

58. **Increased transparency regarding fishing license fees will lead to improved revenue predictability and support increases in fisheries revenues over time.** Increased revenues will support strengthened service delivery to poor households during a time when revenue performance is poor and growth prospects are limited. Increased fishing license fees will support government expenditure on core public services such as health and education, following recent real expenditure declines in these areas.

59. **New governance and accountability arrangements will reduce inefficiencies in the SOE sector**. Merger of copra sector SOEs will cause a small number of job losses (less than 20 in total). These negative impacts are expected to be more than offset by: i) reallocation of resources from inefficient and poorly-targeted subsidy payments to basic services that serve the needs of the poor (the benefits of such reallocation have been shown in the recent expenditure analysis, conducted by MFED with World Bank technical assistance); ii) expected job creation in a privately operated telecommunications utility; and iii) broader private sector job creation through the divestment of SOEs that are crowding out private sector opportunities, with new opportunities likely to be concentrated in South Tarawa, where poverty rates are highest. Reforms in the copra sector are expected to disproportionately benefit the poor by improving the management of the existing subsidy. This will: i) prevent regressive 'leakage' which benefits those engaging in corrupt practices at the expense of resources availability for basic services; and ii) facilitate subsequent reforms (including potential privatization of the copra industry) to improve the targeting of public spending and the replacement of the copra scheme with a more efficient social protection intervention.

60. **Improvements in management of the RERF will protect the government's capacity to maintain public employment and service delivery into the future.** Improved RERF management will serve intergenerational equity and allow the maintenance of basic services on a sustainable basis.

61. **Proposed reforms in the telecommunications sector are expected to significantly increase telecommunications coverage, including in remote areas, providing access to market information to poor rural communities.** Introduction of private participation under adequate regulatory arrangements is likely to reduce costs of telecommunications services, reducing costs to poor households, especially in Tarawa where both phone usage and poverty are currently concentrated. Recent research from other Pacific Island Countries has demonstrated the widespread use by women of mobile phone technologies in business, with a large proportion of women business owners reporting that it would be difficult or impossible to run their business without mobile phones.[6] Privatization of the telecommunications utility is not expected to lead to significant numbers of redundancies. Experience elsewhere in the Pacific has demonstrated the potential offsetting job-creation benefits of telecommunications liberalization, including increased opportunities in retail of mobile credit as network coverage expands and broader employment opportunities in businesses that have greater scope to expand with mobile phone access.

5.2. ENVIRONMENTAL ASPECTS

62. **The policy actions supported under the operation are not expected to have a significant impact on Kiribati's environment, natural resources, or forests.** Policy actions related to revenue, SOEs, debt, and telecommunications are not expected to have any significant environmental impacts.

63. **Improved transparency of fisheries revenues is expected to contribute to more effective implementation of regional frameworks over the medium-term, with positive environment impacts.** Measures related to fishing licenses supported by the operation are not intended to lead to any increase in total catch. Rather, these actions will lead to improved processes for the issuance of fishing licenses and more successful implementation of regional

[6] O'Connor, S. "Net Effects: The Impacts of Telecommunications Liberalization in Vanuatu" Pacific Institute of Public Policy, Port Vila, 2012.

allocation schemes. These measures will both increase the value of catch and achieve progress towards consistency with sustainable catch limits.

5.3. PFM, DISBURSEMENT AND AUDITING ASPECTS

64. **Overall, the fiduciary risk to this operation arising from Kiribati's PFM system, use of budget resources, and foreign exchange environment as controlled by the Central Bank is substantial.**

65. **The 2010 PFM-PR highlighted a number of weaknesses in public financial management in Kiribati,** including: i) the lack of accounting and bank reconciliations, weak expenditure commitment controls as well as outdated legislation and regulations that all combine potentially to undermine aggregate fiscal discipline; ii) limited available information about possible fiscal risks arising from its SOEs that may potentially undermine aggregate fiscal discipline and the Government's future financial position; and iii) weakening of strategic resource allocation processes due to the lack of robust medium-term forecasts and poor links between capital investments and recurrent budgets that may have a negative influence on the delivery of basic community services by the government.

66. **Opportunities to gradually reduce the fiduciary risk have been identified and associated actions have been considered.** The GoK, with EU assistance, developed a PFM Reform Plan during 2011 to address some of the key weaknesses identified in the assessment. The PFM Reform Plan incorporates the following strategic objectives: i) firm expenditure control; ii) enhanced revenue management systems and revenue flows; iii) improved standard of internal and external financial reporting; and iv) increased donor use of Kiribati PFM systems. Progress has since been achieved against specific elements of the reform plan, including through the mobilization of: i) an ADB technical assistance project focused on accounting and expenditure control; ii) ongoing assistance on chart of accounts and FMIS improvements from PFTAC PFM advisors; and iii) technical assistance on budget formation from an ADB technical advisor within MFED. The National Budget is available online at the Ministry of Finance and Economic Development website.

67. **The disbursement measures proposed are to ensure that the grant funds disbursed by the Bank are deposited in a dedicated ANZ account, and then an amount equivalent to the grant is credited to an account of the government available to finance budgeted expenditures.** The grant will be disbursed according to IDA disbursement procedures for development policy operations. The full grant amount of USD 3 million equivalent will be disbursed against satisfactory completion of the specified policy actions as listed in Table 3 and the Government agreement as summarized in the letter of the development policy, and is not tied to any specific purchases. Once the grant is approved by the Board and becomes effective, the proceeds of the grant will be deposited by IDA in one tranche, in Australian dollars, at the

request of the Recipient, into a dedicated Local Currency Deposit Account at the ANZ. ANZ Bank is a large Australian Bank and they own 75% of the Banking Company which operates in Kiribati. The government owns the other 25%. This is the only commercial banking network operating in Kiribati. All investment lending funds to Kiribati which require a Designated Account have used the ANZ. There are no FM issues in using the ANZ for this purpose.

68. **Flow of funds (including foreign exchange) is subject to normal Financial Management processes.** Grant proceeds will flow into a dedicated Local Currency Deposit Account at the ANZ and from it to the budget of the Government, and are thus subject to normal PFM processes and procedures. As a due diligence measure, the Borrower will provide, by way of a letter, confirmation to the Bank that the grant amount has been credited to a Local Currency Deposit Account used to finance budgeted expenditures within 30 days of receipt of the IDA funds. Disbursement would not be linked to specific purchases. The proceeds of the operation would not be used to finance expenditures excluded under the Agreement. If, after being deposited in a government account, the proceeds of the operation are used for ineligible purposes as defined in the Financing Agreement, IDA will require the Borrower to refund the amount directly to IDA.

69. **The Bank will require the auditors of the Government, in this case the Kiribati National Audit Office, to conduct a special audit of the dedicated Local Currency Deposit Account established in ANZ.** The audit will cover the following: (i) the accuracy of the summary of the transactions of this account, including accuracy of exchange rate conversions; (ii) that this account was only used for the purposes of the operation and that no other amounts were deposited into this account, including confirmation from corresponding bank(s) involved in the funds flow; and (iii) that payments from this dedicated Local Currency Deposit Account were in a timely manner (normally within 30 days of disbursement) transferred to an account available to finance budgeted expenditure. The audit will be provided to the Bank as soon as available, but not later than six months after the last disbursement from the Association, and will be made publicly available in a timely fashion.

5.4. MONITORING AND EVALUATION

70. **The Economic Reform Taskforce provides a structure for monitoring and evaluation.** Data to assess progress against both policy actions and outcome indicators will be collected from relevant Government ministries and publicly available reports. This information will be collated by the World Bank and shared at Economic Reform Taskforce meetings. Progress against actions and outcomes will be collaboratively tracked and any necessary mediation actions identified.

6. SUMMARY OF RISKS AND MITIGATION

71. **The overall risk rating level for the DPO is substantial.**

72. **Macroeconomic – vulnerability to shocks.** Kiribati is vulnerable to price shocks and other global economic factors impacting on returns to RERF investments. Macroeconomic disruption arising under several feasible scenarios would distract available capacity and resources from implementation of actions supported by the program, as well as undermining the impact of these actions on growth and poverty-reduction. Kiribati also remains vulnerable to natural disasters, which could have severe impacts on growth and revenue, or exacerbate existing expenditure pressures, as well as diverting scarce Government administrative capacity towards emergency operations. Risks are being mitigated through close collaboration between government and development partners (including the IMF) on economic and fiscal management issues. This has facilitated: i) the provision of policy advice to government, supporting progress towards greater resilience to external shocks; and ii) flexible provision of development partner financing and technical assistance in response to emerging challenges and changing priorities in the context of fluid external conditions.

73. **Macroeconomic - required fiscal consolidation.** Ongoing macroeconomic stability is dependent on successful fiscal consolidation and continuing grant support from development partners. Delay in implementation of policy reforms required for necessary fiscal consolidation may threaten broader sustainability of the macroeconomic framework. An adequate combination of revenue and expenditure measures is required to ensure that RERF drawdowns can return to sustainable levels, including through continued control of recurrent expenditure growth, continued progress with the planned program of SOE reforms, and improvements in revenue and customs compliance. Risks to timely implementation of these reforms are mitigated by strong current political commitment to necessary consolidation and strong dialogue regarding fiscal management issues between Government and donors. The planned subsequent series of World Bank development policy operations will only proceed if sufficient progress is achieved towards required consolidation.

74. **Political and governance risks**. While there is strong government support for the current program of policy actions, political opposition may increase as sensitive reforms are implemented. The current reform program includes areas that have previously been subject to political contestation in Kiribati. SOE reforms, and especially privatizations, have attracted opposition from special interests. There is strong international interest in the fisheries sector, and some fishing nations with political influence in Kiribati stand to lose from planned reforms. To mitigate risks associated with the political sensitivity of key reforms, development partners are working closely with government on appropriate communications strategies and to ensure poverty impacts are closely monitored and negative impacts ameliorated. The World Bank is also planning to develop a subsequent series of development policy operations focusing on further progress in areas supported under the current operation. This subsequent series of DPOs will bridge planned elections in 2015, providing a foundation program of economic policy reforms for any incoming government. Through continued engagement and provision of budget support

in support of key reforms donors are jointly seeking to maintain reform momentum and take advantage of reform opportunities as they arise, while also responding flexibly with reorientation of the program in response to potential political opposition.

75. **Operational implementation.** Kiribati experiences the thin capacity typical of public sectors in very small states, with a small number of public servants called upon to implement the many tasks of a central government. Reallocation or turnover of the limited number of staff with required technical qualifications and experience to undertake supported reforms may mean that the reform program cannot be implemented as successfully or as quickly as expected. This risk is being somewhat mitigated by strong dialogue through which the Government and the Bank have carefully selected a limited number of policy actions that are key priorities to the Government. The Government and the Bank have also discussed the implementation requirements for each action at length, to ensure that expectations regarding the timeframes for implementation are realistic. Dedicated technical assistance from various development partners is being provided to nearly all specified actions.

76. **Risks to sustainability.** Ongoing effort will be required by Government and donors to fully implement reforms agreed upon and initiated under this series of operations. In the fisheries sector, there are risks that recent advances in transparency are not maintained and that political support for broader review of existing licensing arrangements may falter following elections and with any lessening in the intensity of dialogue around these issues. This risk is being mitigated through plans for a second series of World Bank DPOs which could maintain the focus on fisheries reforms. Inclusion of Kiribati under the World Bank's Pacific Regional Oceanscape Project and ongoing New Zealand technical assistance in the Ministry of Fisheries should also support continued progress in this area. Recent improvements in SOE financial management and governance are subject to risk of reversal if continued policy attention and technical effort is not dedicated to both maintaining improved management practices and progressing the planned program of private participation and selective divestment across the SOE portfolio. This risk is being mitigated through dedicated World Bank and ADB technical assistance to continued SOE reforms over the next year, and the likely inclusion of SOE reforms in ongoing multi-donor budget support programs. With a poorly-performing asset manager now terminated, Government is committed to reforming RERF management. Given the technical complexity of this process, it will be important to ensure continued provision of adequate and timely technical assistance, as currently provided by the World Bank Treasury team. Government is fully committed to liberalization of the telecommunication sector. There is already limited competition in the internet sector, and sale of TSKL will irreversibly introduce private participation into the mobile phone sector subject to sufficient private sector interest. Continued technical assistance will be required to ensure an adequate regulatory framework and to facilitate the selection and entry of competitor mobile providers.

ANNEX 1: POLICY AND RESULTS MATRIX

Prior Actions under First Economic Reform Support Operation	Prior Actions under Second Economic Reform Support Operation	Results
Improving the management of fisheries revenues		
The Recipient has approved a national fisheries policy to strengthen the sustainable management of fisheries resources and maximize license revenue income.	The Recipient has produced a joint report of its Ministry of Fisheries and Marine Resource Development and Ministry of Finance and Economic Development on the sources of fisheries revenue containing disaggregated data regarding the sources of all fishing revenues, and has published the report on the website of the Ministry of Finance and Economic Development.	**Result:** ***Improved predictability of fishing license fee revenues*** Indicator: Variance between budgeted and actual fishing license revenues. Baseline: +/- 188 percent (2013) Target: Less than +/- 50 percent (2015)
Improving the management of public assets and liabilities		
The Recipient has: i) approved a bill to establish a legal framework for improved governance, strengthened financial reporting, and commercial management of state owned enterprises and has submitted said bill to Parliament for approval; and ii) brought to the point of transaction a concession contract for private operation of the Otintaai Hotel. The Recipient has approved a debt policy establishing policy criteria for concessional and non-concessional public borrowing consistent	I) The Recipient has adopted the following measures consistent with the State Owned Enterprises Act: (a) ensured full compliance of all SOE board appointments with the provisions of the SOE Act; (b) ensured that the five largest SOEs have submitted to it full financial statements within three months of the end of the Recipient's 2013 fiscal year; and (c) ensured the inclusion of SOE community service obligation subsidies in the Recipient's 2014 annual budget; and II) The Recipient, through its Cabinet, has approved a roadmap for reform and rationalization of its copra sector, including the merger of the Kiribati Copra	**Result:** ***SOEs become less reliant on ad hoc Government subsidies*** Indicator: Ad hoc subsidies to SOEs[7] Baseline: AUD2.5 million (2013) Target: Less than AUD0.8 million (2015) **Result*: Inefficient expenditure through the copra price subsidy is reduced*** Indicator: Actual copra price subsidy expenditure Baseline: AUD7.3 million (2013) Target: AUD6.8 million (2015) **Result:** ***No increase in non-concessional debt***

[7] The term 'ad hoc subsidies' refers to all subsidies to SOEs except: i) explicit Community Service Obligations included in the annual budget; and ii) payments to the copra subsidy scheme, which also have a separate budget line.

with sustainable macroeconomic management.	Cooperative Society and the Kiribati Copra Mill Limited. The Recipient, through its Cabinet, has approved key reforms in the management of its Revenue Equalization Reserve Fund to achieve consistency with clearly-stated investment objectives, including: (a) reallocation of RERF's assets to new asset managers; and (b) reorientation of RERF's portfolio towards lower-risk instruments.	Indicator: Central government non-concessional debt balances Baseline: Total central government non-concessional debt of AUD14 million (mid-2012) Target: Total central government non-concessional debt of no more than AUD1 million. (2015) **Result: *Closer alignment between RERF portfolio performance and relevant market benchmarks*** Indicator: Performance of the RERF portfolio relative to benchmark Baseline: -8.29 percent (year to March 2014) Target: Better than -2 percent underperformance (2015)
Expanding private sector opportunities		
The Recipient has approved a bill to liberalize the telecommunication sector in the Recipient's territory, including commercialization of the incumbent state-owned operator and the introduction of competition. The Recipient has brought to the point of transaction a concession contract for private operation of the Otintaai Hotel	The Recipient has invited pre-qualified firms to bid for purchase of Telecommunication Services Kiribati Limited following completion of pre-qualification processes by the Recipient's Ministry of Communications.	**Result: *Reduced prices in the telecommunications sector*** Indicator: Cost of 3-minute peak-hour mobile-to-mobile telephone call within Tarawa Baseline: AUD0.90 (mid-2014) Target: AUD0.70 (end-2015).

ANNEX 2: LETTER OF DEVELOPMENT POLICY

GOVERNMENT OF KIRIBATI
MINISTRY OF FINANCE & ECONOMIC DEVELOPMENT
Phone: (686) 21806 or 21802, Address: PO Box 67, Tarawa, Kiribati

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

Hon. Tom Murdoch

Minister of Finance and Economic Development

ANNEX 3: FUND RELATIONS ANNEX

INTERNATIONAL MONETARY FUND

COMMUNICATIONS DEPARTMENT

Press Release No. 14/242
FOR IMMEDIATE RELEASE
May 23, 2014

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2014 Article IV Consultation with Kiribati

On May 16, 2014, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Kiribati.[1]

Kiribati sustained its growth for three consecutive years and grew close to 3 percent in 2013, supported by donor projects and private sector activity. Inflation remained subdued, underpinned by moderate commodity prices, but it is projected to pick up to 2.5 percent in 2014 on account of increased expenditures related to major donor-funded infrastructure projects.

The current account balance deteriorated slightly in line with the trade balance and higher project imports, while benefiting from exceptionally high fishing license revenue. The overall external balance thus recorded a substantial surplus equivalent to nearly 22 percent of GDP and reflected in the replenishment of the Revenue Equalization Reserve Fund (RERF).

The high fishing license revenues in 2013 also resulted in an overall budget surplus of 10 percent of GDP despite a substantial increase of capital expenditure. Tax revenue continued to lag, however, as underperforming state-owned enterprises (SOEs) and tax compliance issues contained government's tax collections. The value added tax was introduced on April 1, 2014, as planned.

The Government continues to implement its reform program with the support of development partners. Key reforms to public financial management, tax systems, SOEs and the private sector are ongoing, in line with the IMF advice. Significant progress has been made in SOE reform. In addition work is underway to implement the recently-approved fisheries policy and improve cash and debt management. Based on this reform progress, the World Bank has provided budget support for 2014 and further donor budget support is envisaged based on the continued progress of the reform agenda.

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[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

Although the formal financial sector lending remains limited, household and private business credit has risen briskly, as reliance of public sector on commercial borrowing was reduced. Non-performing loan ratios in the Development Bank of Kiribati remained relatively high.

Executive Board Assessment[2]

Executive Directors commended recent progress in sustaining growth and the authorities' concerted efforts to increase fiscal revenues, replenish the sovereign wealth fund, and reform state-owned enterprises in the context of the reform program supported by the international community. Directors observed that Kiribati faces significant challenges stemming from scale diseconomies, remoteness, undiversified product and export bases, and vulnerability to exogenous—including climatic—shocks. They recommended continuing fiscal consolidation efforts and a deepening of structural reforms aimed at strengthening resilience and improving the prospects for sustainable, job-rich growth through private sector development and enhanced external competitiveness.

Directors considered the stabilization of the Revenue Equalization Reserve Fund (RERF) in real per capita terms an appropriate fiscal anchor. While welcoming the recent introduction of new value added and excise tax systems, they noted that a further strengthening of budget performance would be needed should fishing license fees fall below recent high levels, and that any additional fishing license receipts above the current conservative baseline should be saved to replenish the RERF. They also noted that enhancing tax administration would improve revenue prospects.

Looking ahead, Directors recommended strengthening public financial management in order to help rebuild fiscal buffers, including through better operational efficiency of the copra subsidy scheme and the Public Utilities Board. While welcoming recent state-owned enterprise (SOE) reforms, Directors advised the continued curtailment of fiscal risks through the privatization or commercialization of SOEs, where feasible, recognizing that some SOEs fulfilling key social mandates would continue to require government involvement. They also encouraged the adoption of centralized debt management guidelines, and continued avoidance of non-concessional borrowing.

Directors recommended bolstering financial stability through stricter adherence to operational and lending standards and risk management practices. They encouraged the authorities to reduce non-performing loans and improve the financial positions of the development bank and the Kiribati Provident Fund.

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[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

Directors supported lifting Kiribati's growth prospects and reducing high unemployment through improved global integration and the creation of an enabling environment for private sector investment. The business climate and competitiveness could be strengthened through the streamlining of business approval and registration processes, better public service delivery, and enhanced access to finance through improved property rights and investor protections. Directors also recommended the creation of additional opportunities for seasonal employment abroad through strengthened regional cooperation and appropriate education and skills training. They encouraged the development of the marine sector, including onshore marine processing, and welcomed planned fisheries' infrastructure development on Christmas Island.

Directors also encouraged the authorities to continue improving the quality and timeliness of the country's economic and financial statistics.

Kiribati: Selected Economic Indicators, 2009–15

Nominal GDP (2011): US$172.7 million | GDP per capita (2011): US$1,670
Nominal GNI (2011): US$236.1 million | Population (2011): 103,365
Main export products: fish and copra | Quota: SDR 5.6 million

	2009	2010	2011	2012	2013	2014	2015
				Est.		Proj.	
Real GDP (percent change)	-0.7	-0.5	2.7	2.8	2.9	3.0	2.7
Real GNI (percent change)	-4.0	-1.3	-2.4	15.3	13.2	-15.2	2.3
Consumer prices (percent change, average)	9.8	-3.9	1.5	-3.0	-1.5	2.5	2.5
Consumer prices (percent change, end of period)	-1.3	-1.9	-0.8	-3.9	0.8	2.5	2.5
Central government finance (percent of GDP)							
Revenue and grants	70.9	72.5	62.0	90.4	112.9	83.9	84.1
Total domestic revenue 1/	42.7	47.8	37.0	54.0	69.9	39.1	40.9
Grants	28.1	24.7	25.0	36.4	43.0	44.8	43.2
Expenditure and net lending	82.8	85.2	83.2	97.2	102.6	109.7	104.5
Current	54.7	58.0	58.0	61.0	59.8	61.7	56.7
Of which: wages and salaries	24.7	27.0	27.4	28.3	29.7	28.8	27.9
Development	28.1	27.1	25.2	36.2	42.8	48.0	47.8
Current balance 2/	-12.0	-10.2	-21.0	-6.9	10.1	-22.6	-15.8
Overall balance	-12.0	-12.7	-21.2	-6.7	10.3	-25.8	-20.4
Financing	12.0	12.7	21.2	6.7	-10.3	25.8	20.4
Revenue Equalization and Reserve Fund (RERF)	11.1	10.5	11.8	22.2	-10.1	14.5	13.2
Other	0.9	2.1	9.5	-15.4	-0.2	11.3	7.1
RERF							
Closing balance (in millions of US$)	512	576	586	607	600	587	580
Closing balance (in millions of A$)	571	581	579	581	668	666	668
Per capita value (in 2006 A$)	5,209	5,040	4,759	4,592	5,058	4,837	4,643
Balance of payments (in millions of US$)							
Current account including official transfers	-29.6	-25.4	-55.7	-46.1	-46.5	-87.8	-90.9
(In percent of GDP)	-23.3	-16.9	-32.2	-26.3	-27.4	-53.4	-53.4
External debt (in millions of US$)	14.3	18.4	14.2	14.1	13.6	18.7	26.4
(In percent of GDP)	9.8	11.3	8.4	8.0	8.6	11.4	15.6
External debt service (in millions of US$)	1.0	0.6	0.6	0.6	0.5	0.5	0.6
(In percent of exports of goods and services)	4.8	3.2	2.8	3.0	3.0	3.1	3.2
Exchange rate (A$/US$ period average) 3/	1.3	1.1	1.0	1.0	1.0	...	...
Real effective exchange rate (period average) 4/	130.5	132.5	138.0	134.2	126.1	...	...
Memorandum item:							
Nominal GDP (in millions of Australian dollars)	162.8	164.1	167.3	169.0	175.4	185.1	194.9
Nominal GDP (In millions of US dollars)	127.0	150.9	172.7	175.1	169.8	164.3	170.3

Sources: Data provided by the Kiribati authorities; and IMF staff estimates and projections.
1/ Assumes conservative path for fishing license fees in 2014 and onwards. Higher fishing license fees at the level of A$60 million would imply a current deficit of 13 percent of GDP in 2014.
2/ Current balance excludes grants and development expenditure.
3/ The Australian dollar circulates as legal tender.
4/ Index, 2005=100.