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Kiribati Fifth Economic Reform Development Policy Operation (P167263)

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Report No: PGD31

INTERNATIONAL DEVELOPMENT ASSOCIATION  
PROGRAM DOCUMENT FOR A PROPOSED DEVELOPMENT POLICY GRANT  
IN THE AMOUNT OF SDR 3.6 MILLION (US\$5 MILLION EQUIVALENT) TO  
THE REPUBLIC OF KIRIBATI  
FOR THE  
FIFTH ECONOMIC REFORM DEVELOPMENT POLICY OPERATION

October 31, 2018

Macroeconomics, Trade And Investment Global Practice  
& Governance Global Practice  
East Asia And Pacific Region

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**REPUBLIC OF KIRIBATI - GOVERNMENT FISCAL YEAR**

*January 1 – December 31*

**CURRENCY EQUIVALENTS**

(Exchange Rate Effective as of September 30, 2018)

Currency Unit

SDR 1 = USD 1.39522

USD 1 = AUD 1.39

**ABBREVIATIONS AND ACRONYMS**

A\$	Australian Dollar	MFED	Ministry of Finance and Economic Development
ADB	Asian Development Bank	MFMRD	Ministry of Fisheries and Marine Resources Development
CEO	Chief Executive Officer	PDO	Program Development Objective
CPIA	Country Policy and Institutional Assessment	PEFA	Public Expenditure and Financial Accountability
CPO	Chief Procurement Officer	PFM	Public Financial Management
CPU	Central Procurement Unit	PFTAC	Pacific Financial Technical Assistance Center
CSO	Community Service Obligation	PNA	Parties to the Nauru Agreement
DBK	Development Bank of Kiribati	PUB	Public Utilities Board
DFAT	Department of Foreign Affairs and Trade	PV	Present Value
DPO	Development Policy Operation	RERF	Revenue Equalization Reserve Fund
DSA	Debt Sustainability Analysis	RFP	Request for Proposal
ERT	Economic Reform Taskforce	RPF	Regional Partnership Framework
GDP	Gross Domestic Product	SAIDI	System Average Interruption Duration Index
GoK	Government of Kiribati	SAIFI	System Average Interruption Frequency Index
GRS	Grievance Redress Service	SOE	State-Owned Enterprise
HIES	Household Income and Expenditure Survey	US\$	United States Dollar
ICR	Implementation Completion and Results	VAT	Value Added Tax
ICT	Information and Communication Technology	VDS	Vessel Day Scheme
IDA	International Development Association	WDI	World Development Indicators
IMF	International Monetary Fund	WEO	World Economic Outlook
KDP	Kiribati Development Plan		
KOIL	Kiribati Oil Limited		
KPF	Kiribati Provident Fund		
KPPRP	Kiribati Public Procurement Reform Plan		
LIC	Low Income Country		
MFAT	Ministry of Foreign Affairs and Trade		

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**REPUBLIC OF KIRIBATI**

**KIRIBATI FIFTH ECONOMIC REFORM DEVELOPMENT POLICY OPERATION**

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## SUMMARY OF PROPOSED FINANCING AND PROGRAM

### BASIC INFORMATION

Project ID	Programmatic	If programmatic, position in series
P167263	Yes	1st in a series of 2

### Proposed Development Objective(s)

The program development objective is to: (i) Improve public financial management with respect to financial and physical assets; and (ii) support the prospects for inclusive growth by strengthening fisheries sector management and improving access to basic services.

### Organizations

Borrower: REPUBLIC OF KIRIBATI

Implementing Agency: MINISTRY FOR FINANCE AND ECONOMIC DEVELOPMENT

## PROJECT FINANCING DATA (US\$, Millions)

### SUMMARY

Total Financing	5.00
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### DETAILS

International Development Association (IDA)	5.00
IDA Grant	5.00

## INSTITUTIONAL DATA

### Change and Disaster Screening

This operation has been screened for short and long-term climate change and disaster risks

### Overall Risk Rating

Substantial



**Results**

Indicator Name	Baseline	Target
<b>Strengthening public financial management with respect to financial and physical assets</b>		
The RERF portfolio is implemented and managed in accordance with the revised investment strategy.	No (2017)	Yes (2021)
Cash reserves above the operational cash target that are earning zero interest are reduced.	5.4 months of recurrent spending (Jul 2018)	1 month of recurrent spending (2021 average)
Competitiveness in public procurement is improved through procurement processes being subjected to competition in accordance with the new legislation.	No (2017)	Yes (2021)
Transparency in public procurement is improved through the online publication of tender award notices in accordance with the new legislation.	No (2017)	Yes (2021)
Budget allocations for asset maintenance and repairs are made in accordance with the asset management strategy.	No (2017)	Yes (2021)
<b>Supporting the prospects for inclusive growth by strengthening fisheries sector management and improving access to basic services</b>		
A list of all fishing license conditions and the vessels they apply to is published not less than every six months, in accordance with the Fisheries (Amendment) Act 2017.	No (2017)	Yes (2021)
Transshipment revenue as a proportion of total public revenue from fisheries is increased.	4 percent (2017)	8 percent (2021)
The number of households in South Tarawa with access to reticulated water 24/7 is increased.	0 (Dec 2017)	400 (Dec 2021)
The percentage of women reporting a positive impact on their daily lives resulting from 24/7 access to safe water at home is increased.	0 (Dec 2017)	60 percent (Dec 2021)
The shares of Year 1 and 2 students in pilot schools demonstrating at least some reading comprehension is increased.	14 percent of Year 1 students and 64 percent of Year 2 students (2016)	24 percent of Year 1 students and 70 percent of Year 2 students (2021)



**IDA PROGRAM DOCUMENT FOR A PROPOSED  
FIFTH ECONOMIC REFORM DEVELOPMENT POLICY OPERATION TO THE REPUBLIC OF KIRIBATI**

**1. INTRODUCTION AND COUNTRY CONTEXT**

1. **The proposed Fifth Economic Reform Development Policy Operation aims to support the Government of Kiribati (GoK) to strengthen public financial management and support the prospects for inclusive growth.** It is the first in a proposed programmatic series of two development policy operations (DPOs), following two previous programmatic series each of two DPOs. The operation would provide grant financing of US\$5 million equivalent. With the support of the GoK, the World Bank's development policy engagement in Kiribati takes place jointly with other major development partners. The Asian Development Bank (ADB), Australian Department of Foreign Affairs and Trade (DFAT) and New Zealand Ministry of Foreign Affairs and Trade (MFAT) will each provide budget support against a joint policy matrix agreed with the GoK, which forms the basis for the policy actions and indicative triggers for this proposed DPO series.

2. **Kiribati is one of the smallest, most remote and most geographically dispersed countries in the world, which creates significant economic growth and service delivery challenges.** Kiribati consists of 33 islands with a total land area of only 810 square kilometers, spread over an ocean area of some 3.5 million square kilometers. The population of about 114,000 lives on 21 of the islands (20 coral atolls and a single volcanic island) in the three island groups that make up Kiribati. Kiribati is extremely remote from its nearest markets – about 4,000 kilometers from both Australia and New Zealand. Kiribati's low-lying atolls rise little more than 1.8 meters above sea level on average and, as such, are at the forefront of climate change. Kiribati is highly exposed to the effects of sea level rise, storm surge, coastal erosion and saltwater intrusion. Access to fresh water is particularly challenging, as population growth, saltwater intrusion and droughts increasingly jeopardize Kiribati's very limited groundwater supplies.

3. **With such extreme economic geography challenges, growth prospects are limited.** Private sector development opportunities are highly constrained by the lack of economies of scale possible in such a small and fragmented domestic market that is extremely remote from large markets abroad. Severe infrastructure deficits in utilities, transport and communications compound these constraints. Reflecting these constraints, unemployment is estimated to exceed 30 percent and youth unemployment to exceed 50 percent. Economic activity is dominated by the public sector, agriculture and fisheries, and a service economy underpinned by the public sector in the capital of South Tarawa (where nearly half the population live). Public expenditure was equivalent to 117 percent of GDP in 2017, funded primarily by fisheries license fees (61 percent of GDP) and grants from development partners (35 percent of GDP). Government services directly account for nearly 30 percent of GDP, and some 70 percent of formal sector jobs are in the public sector (formal sector employment represents only 20 percent of the labor force, however). Beyond agriculture and fisheries, the private sector remains small, mostly consisting of small firms in the wholesale, retail and transport sectors. The most significant opportunities for private sector development exist in the fisheries sector, with potential opportunities also in tourism and in strengthening backward linkages from the public sector (for instance, maintenance work on public assets). Aside from domestic opportunities, labor migration opportunities – hence human capital development – are critical.

4. **Kiribati's economic geography also makes service delivery very costly.** The small, dispersed and fragmented population significantly raises the cost of service delivery, affecting the affordability, scope



and quality of public services and infrastructure. Kiribati's geography and exposure to natural hazards, particularly drought and loss of groundwater, also raises public sector costs and makes the delivery of some services – like water and sanitation – very challenging. This has significant and pervasive implications for living standards, likely to intensify with the effects of climate change.

5. **The program development objective is to: (i) strengthen public financial management with respect to financial and physical assets; and (ii) support the prospects for inclusive growth by strengthening fisheries sector management and improving access to basic services.** The first pillar, on public financial management, includes actions to strengthen the management of Kiribati's sovereign wealth fund, improve cash management, and address weaknesses in the public investment cycle, including procurement and asset maintenance. This pillar consolidates and complements measures supported in previous series on the sovereign wealth fund, debt policy and management, and state-owned enterprise governance. Over time and in conjunction with other measures, these actions should contribute to improvements in the quality of public spending. The second pillar, on inclusive growth, includes actions to strengthen governance of fisheries, one of the few sectors with significant potential to drive growth and employment creation in Kiribati. This pillar also includes actions to expand access to safe drinking water and establish a legislative framework for early childhood care and education – basic services that are crucial building blocks for a healthy and educated workforce. This pillar complements measures supported in previous series on fisheries revenue, improving access to electricity for the poor, and telecom sector liberalization and service expansion in the outer islands. Over time and in conjunction with other measures, these actions should support expanded economic opportunities in the fisheries sector, improved health and wellbeing from safe, reticulated water, and better educational outcomes in the critical early grades.

6. **The overall risk rating for the proposed operation is substantial.** The main risks to achieving the program development objectives are: (i) institutional capacity risks arising from the extremely thin capacity of the public sector to implement the reform program and sustain it over time; (ii) sector strategies and policies in connection with water sector reforms; (iii) political and governance risks arising from the politically-sensitive nature of key aspects of the reform program; (iv) macroeconomic risks arising from the inherently volatile economic and fiscal situation, with any large shock likely to detract from the policy focus on the reform program; (v) environment risks arising from Kiribati's vulnerability to natural disasters and the impacts of climate change; and (vi) fiduciary risk. Key risk mitigating measures include: (a) the relatively strong and established policy dialogue, which focuses on reaching shared understandings and taking a step-by-step approach to reforms; (b) the selection of a limited number of policy actions that are aligned with government priorities; (c) dedicated technical assistance supporting implementation of most policy actions; and (d) regular missions to help maintain the momentum of the reform program.

7. **There is no recent data on poverty.** The World Bank, in conjunction with the Secretariat for the Pacific Community, is providing technical assistance to the GoK to undertake a Household Income and Expenditure Survey (HIES) scheduled for 2019, funded by MFAT. This will be the first HIES since 2006. It showed food poverty (based on national poverty lines) to be low in Kiribati, at about 5 percent of the population, but basic needs poverty<sup>1</sup> (based on national poverty lines) to be relatively widespread, at about 22 percent. Basic needs poverty was concentrated in South Tarawa, where the rate was about 24

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<sup>1</sup> The 'cost of basic needs' approach defines the minimum resources needed for long-term physical well-being, usually in terms of consumption. The poverty line is the amount of spending required to obtain those resources – defined by a list of food and non-food (clothing, shelter and services) 'basic needs'.



percent. Poverty rates varied significantly by island group, depending on available economic opportunities, the extent of isolation, and the age structure of the population. For instance, about 16 percent of the population of the Southern Gilbert Islands were found to be below the food poverty line, reflecting isolation, limited agricultural potential, and vulnerability to drought. These islands had the highest proportion of elderly people in the country, and a low proportion of working age adults. In contrast, poverty rates were very low in the Line Islands, reflecting a younger migrant population and more abundant natural resources. Female-headed households and households headed by the elderly were slightly over-represented in the poorest quintiles, and children were disproportionately likely to experience poverty. A large proportion of the population was found to be vulnerable to falling into poverty. If the basic needs poverty line were 20 percent higher, the poverty rate would have been 34 percent. With a Gini coefficient of 0.39, the degree of inequality in Kiribati was found to be similar to that in other Pacific Islands.

8. **Though the lack of panel data on poverty prevents the study of its dynamics, indications of changes in wellbeing can be gleaned from other measures of deprivation.** Between 2010 and 2015, census data indicate that the proportion of households with access to piped or rain water increased from 38 to 58 percent, and the proportion with access to a flush toilet or pit latrine increased slightly from 57 to 62 percent. Over the same period, maternal mortality is estimated to have declined to 90 per 100,000 live births, and under-5 mortality to have declined to 56 per 1,000 live births – rates that are still high by regional standards. Access to electricity for lighting increased significantly between the censuses, mainly due to donor-funded solar programs. According to WDI, net primary school enrolment is relatively high, at 97 percent, but little historical data is available to identify trends. While there is no data to indicate trends in income distribution over the period since the HIES, real GDP per capita declined by just over 10 percent between 2006 and 2011, before rising again, finally exceeding its 2006 level in 2015 – making it possible that poverty has declined only marginally since 2006.

9. **While significant gender gaps exist in some social and economic indicators in Kiribati, the picture is mixed.** In education, for instance, school participation rates for girls exceed those for boys in primary and secondary schooling, and the transition rate from primary to secondary schooling for girls exceeds that for boys. While migration opportunities have historically been skewed in favor of males (as seafarers), that is changing with new opportunities in Australia and New Zealand. In health, contraceptive prevalence is relatively low by regional standards, but unmet needs for family planning mirror the regional average. While obesity rates for women are significantly higher than men, smoking rates are significantly lower, and overall men have a higher rate of premature death due to non-communicable diseases (NCDs). The labor force participation rate for women is below that for men, and unemployment among women and female youths is higher than for males. The public service is a particularly significant employer for women. Rates of gender-based violence in Kiribati are high, with 68 percent of ever-partnered women aged 15-49 having experienced physical or sexual violence. In a positive move, earlier this year Kiribati submitted its first ever national report on measures taken to comply with the Convention on the Elimination of All Forms of Discrimination against Women (CEDAW), and the Ministry of Women, Youth and Social Affairs is now preparing an implementation plan for the gender-based violence legislation that was enacted in 2014.

## 2. MACROECONOMIC POLICY FRAMEWORK



## 2.1. RECENT ECONOMIC DEVELOPMENTS

10. **Recent economic performance has been relatively strong.** Although growth is inherently volatile, Kiribati had its seventh consecutive year of growth in 2017. After reaching 10.3 percent in 2015 on the back of strong wholesale and retail trade and construction activity, real GDP growth slowed to 1.1 percent in 2016, reflecting the completion of a major roads project and the normalization of fisheries revenues after the record level in 2015.<sup>2</sup> Growth picked up to an estimated 3.1 percent in 2017, again driven by construction and wholesale and retail trade.

11. **The current account has remained in surplus.** Like most small island economies, Kiribati relies heavily on imported foodstuffs, retail goods and construction materials, while exports are very modest (A\$14m in 2016, consisting mainly of coconut and fish products). However, large deficits on merchandise trade and services have been offset by very strong receipts of fishing license fees, as well as by current transfers, investment income on the sovereign wealth fund – the Revenue Equalization Reserve Fund (RERF)<sup>3</sup> – and remittances from seafarers. The current account surplus was an estimated 9 percent of GDP in 2017.

12. **Inflation has been low and stable in recent years.** Although lower electricity tariffs contributed to CPI inflation of only 0.4 percent in 2017, inflation has averaged around 2 percent in the first half of 2018, in line with trading partner inflation, international food and fuel prices, and the relative stability of the Australian dollar – which Kiribati uses as its currency. The IMF regards Kiribati’s use of the Australian dollar as providing a strong nominal anchor given its close trade links with Australia. The financial sector essentially consists of one private commercial bank and two public financial institutions (the Development Bank of Kiribati (DBK), and the Kiribati Provident Fund (KPF))<sup>4</sup>. The commercial bank primarily serves the public sector and larger private sector customers, with the public institutions financing most personal and small business loans, and therefore having a critical role in supporting access to finance. Ensuring long-term sustainability of the public financial institutions requires strengthened risk monitoring, improved financial supervision, and decisive efforts to address long-standing weaknesses in their balance sheets.<sup>5</sup> Importantly, concrete steps have now been taken to address the persistent funding gap of KPF and to link the crediting rate more closely with the actual returns of the fund.<sup>6</sup>

13. **The fiscal position has improved markedly in recent years, with high fishing license fee revenue contributing to consistent surpluses.** The fiscal balance has been dominated by fishing license fee revenue, which was low and volatile in the years to 2012 (averaging A\$34 million), but which has been significantly higher – though still volatile – in the years from 2013 (averaging A\$150 million). After peaking at A\$207 million in 2015 (88 percent of GDP), fisheries revenue fell in 2016 and 2017 but was still high by

<sup>2</sup> Real GNI contracted sharply in 2016 as a direct result of the reduction in fishing license fees compared with 2015 (license fees were A\$159m in 2016, compared with A\$207m in 2015).

<sup>3</sup> The RERF was established in the 1950s to invest royalties from the now-depleted phosphate reserves. Its value as at June 30, 2018, is about A\$980 million (about 365 percent of GDP).

<sup>4</sup> The GoK has a minority shareholding in the commercial bank.

<sup>5</sup> Previous DPOs have supported on-time submission of the annual financial statements of DBK and KPF for external audit, which – in the absence of a central bank to perform financial sector supervision – is the key oversight mechanism. The team continues to track compliance with the statutory timeframes, as part of its ongoing DPO engagement. All contingent liabilities are also now included in an up-to-date debt database, as supported by previous DPOs. The Private Sector Development Initiative is currently providing technical assistance to strengthen KPF’s governance structure.

<sup>6</sup> Note that regional withdrawal of correspondent banking relations has so far had limited impact in Kiribati.



historical standards, at A\$158 million (65 percent of GDP) and A\$157 million (61 percent of GDP), respectively. Correspondingly, Kiribati experienced a record fiscal surplus of 37 percent of GDP in 2015, and surpluses of 13 and 11 percent of GDP in 2016 and 2017. The regional Vessel Day Scheme (VDS) (discussed in Section IV), low fuel prices, favorable – though still variable – weather conditions, relatively favorable tuna prices, and the appreciation of the US dollar against the Australian dollar in 2015, have all contributed to these higher revenues and resultant budget surpluses. Deficits are projected from 2018 onwards, due to a combination of conservative revenue estimates for fisheries, and an increase in development project spending being financed below the line, through drawdowns on Kiribati's Development Fund.

<b>Table 1: Selected macroeconomic indicators</b>	2015	2016	2017e	2018p	2019p	2020p	2021p
	<i>Percent of GDP, unless otherwise noted</i>						
Real GDP (percent change)	10.3	1.1	3.1	2.3	2.4	2.3	1.9
Real GNI (percent change)	19.8	-13.0	2.7	-2.3	2.2	2.6	2.0
Consumer prices (percent change, average)	0.6	1.9	0.4	2.5	2.5	2.5	2.5
Nominal GDP (\$Am)	236.2	244.2	257.4	267.9	272.3	278.9	291.2
Central government finance (percent of GDP)							
Total revenue and grants	135.0	125.4	116.7	138.1	117.5	105.2	101.9
Domestic revenue	104.0	83.0	82.0	71.1	70.3	69.5	67.6
<i>Of which: fishing revenue</i>	87.7	65.0	61.2	50.7	50.0	48.9	46.9
External grants	31.0	42.4	34.7	67.0	47.2	35.7	34.3
Total expenditure	98.1	112.7	105.8	148.9	123.6	109.6	102.5
Current expenditure	47.7	53.0	61.1	67.1	66.8	66.1	64.2
Development expenditure	50.4	59.8	44.7	81.8	56.9	43.5	38.3
Overall balance (excluding budget support)	36.9	12.7	10.9	-10.7	-6.1	-4.4	-0.6
Financing	-36.9	-12.7	-10.9	10.7	6.1	4.4	0.6
Budget support grants	2.0	3.5	6.3	5.2	4.2	4.1	3.9
Loans	8.0	4.7	0.0	0.0	0.0	0.0	0.0
Domestic financing	-46.9	-20.9	-17.2	5.6	2.0	0.3	-3.3
Current account balance (percent of GDP)	46.7	19.4	9.0	16.9	7.1	1.7	1.0
External debt (A\$m)	48.6	53.2	52.5	51.7	50.3	48.8	46.8
(In percent of GDP)	20.6	21.8	20.4	19.3	18.5	17.5	16.1
External debt service (A\$m)	0.7	0.9	1.0	1.1	2.0	2.2	2.7
RERF closing balance (A\$m)	756.3	868.1	933.6	1018.1	1099.5	1187.5	1282.5
Cash reserves (A\$m) 1/	140.6	115.9	141.7	143.5	153.0	162.8	173.6
(Months of recurrent spending, excl. Copra Scheme)	15.0	10.8	10.8	11.6	12.2	12.8	13.4

Sources: Kiribati authorities and World Bank and IMF staff estimates and projections. Financing items and cash balances are staff estimates for all years. 1/ Positive domestic financing in 2018, 2019 and 2020 consists of drawdowns on the No. 4 account (for development projects), which is not included in the definition of the GoK's cash reserves. Hence cash reserves are increasing despite there being positive domestic financing.



Note: This presentation differs to the IMF assessment letter, as the IMF assumes new external borrowing for projects occurring from 2017 onwards. We have also included the Copra Scheme under current expenditure in all years, and defined development spending as including the GoK's approved expenditure out of the Development Fund in the fiscal year (excluding the Copra Scheme), rather than the amount it appropriates as revenue into the Development Fund.

14. **Efforts to increase domestic tax revenue have also borne fruit.** The GoK successfully introduced a VAT in mid-2014 to replace distortive tariffs and trade taxes, and has managed to maintain the VAT despite its politicization during the election in 2015. (A number of items considered essential to livelihoods on the outer-islands were exempted from the VAT at its introduction, and the GoK added essential public services to the list of exemptions in 2015 to address the perceived and actual regressive impact of the tax, but maintained the VAT nonetheless.) Tax revenue is estimated to have risen in 2017, partly as a result of improved revenue administration and efforts to collect arrears. Scope for further improvement is now thought to be quite limited.

15. **The GoK has made some transfers into the RERF and also accumulated large fiscal buffers from the budget surpluses of recent years.** All RERF earnings have been reinvested, instead of drawn down to finance public expenditure. In addition, the GoK transferred A\$120 million into the RERF over 2015 and 2016, representing a substantial replenishment. At the time, that left cash reserves of around 3-4 months of current expenditure (roughly in line with IMF recommendations). The significant transfers to the RERF in 2015 and 2016, continued reinvestment of RERF returns, good management of the RERF portfolio, and strong market conditions have contributed to the GoK achieving its targeted A\$1 billion in asset value for the RERF in mid-2018, two years ahead of schedule. Cash reserves have also continued to grow, now standing at about A\$200 million, well above the A\$50 million or so recommended by the IMF as a buffer. A significant segment of these cash reserves is not earning any interest, a situation which the DPO engagement aims to support the GoK to tackle.<sup>7</sup>

16. **With strong revenue receipts and some pressing expenditure needs, public expenditure has also risen rapidly in recent years.** On the current side, spending increases have been driven by increases in health and education spending, an increase in the copra subsidy<sup>8</sup> in the 2016 budget, and a public service pay rise in the 2018 budget. The increases in health and education spending, while significant, are still merely offsetting the significant declines in real per capita spending in these sectors after 2008 – with real per capita health spending nearly restored to 2008 levels, but real per capita education spending still below its level in the 2000s. The increase in the copra subsidy from A\$1 to A\$2 per kilogram in the 2016 budget has had a very significant fiscal impact, both directly and through the supply response, and now amounts to an outlay of around 12 percent of GDP. It is, however, extremely important from a social and political perspective and unlikely to be unwound (see Box 1).

17. **The 30 percent public service pay rise in the 2018 budget has contributed to an increase in the wage bill of 5 percent of GDP.**<sup>9</sup> The pay rise was intended to motivate public sector performance and adjust for changes in purchasing power. The last pay settlements were in 2010, and 2006 and 2001 prior

<sup>7</sup> The GoK also has about A\$60 million in funds appropriated for development projects but not yet expended, also being held in a non-interest bearing account.

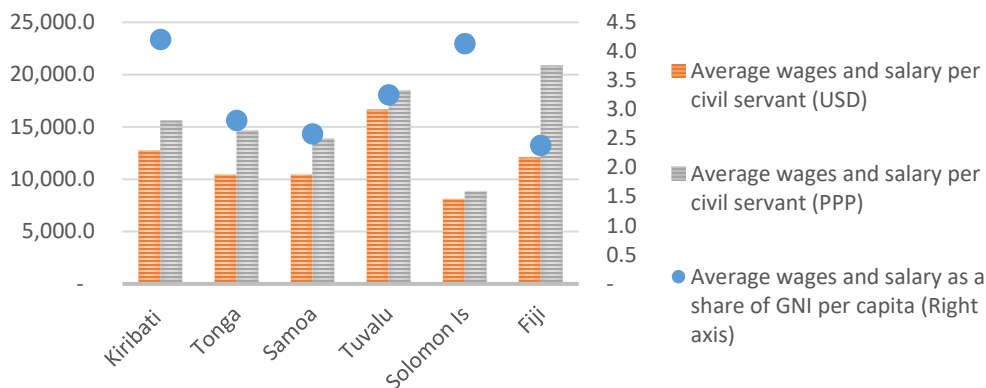
<sup>8</sup> Under the Copra Price Scheme (“copra subsidy”), the GoK purchases copra (dried coconut meat) from farmers at a guaranteed price that represents a large subsidy over market rates. An SOE then ships the copra to a mill in South Tarawa and converts it into oil for export. See Box 1 for more information.

<sup>9</sup> The wage bill increased by five percent overall in 2018, including the impacts of changes in established positions, vacancy rates, and other allowances (including a small reduction in overtime allowances), as well as the salary increase.



to that.<sup>10</sup> Although the CPI has increased by only 2 percent since the last settlement in 2010<sup>11</sup>, the 2010 pay rise was not enough to offset inflation in the preceding years. The team estimates that a 10-15 percent pay rise would have been needed in 2018 to restore real salaries to the same level as 2003 (the earliest year for which we have comprehensive data, and the high water mark for real wages over the period 2003-2017). The initial public proposal was for a larger increase, but this was reduced to 30 percent during the budget process so as not to breach the GoK’s balanced budget rule.<sup>12</sup> Following the pay rise, the Bank has prepared a comparative analysis of civil servant salaries in Pacific countries for the GoK, which shows Kiribati’s salaries to now be high relative to GNI per capita, and second or third highest (out of six) in in USD and PPP terms – see Figure 1.

Figure 1: Comparison of Average Public Sector Pay in Six PICs, 2018



18. **As part of the ongoing policy dialogue with the Bank and other budget support donors, the GoK has published its 2019 Fiscal Strategy (the first time a fiscal strategy has been made public), and the Strategy includes a commitment to no further step changes to salaries in the 2019 budget, and not until the impacts of the 2018 decision have been reviewed.** However, better pay and conditions for public servants remains a priority for the GoK, and the team assesses there will remain significant pressure on the wage bill going forward. The GoK has established a taskforce to consider housing allowance reforms, and the Public Service Office is working on a review of pay scales and job grading, both of which have the potential to remove significant inequities in remuneration across the public service, but with as yet unknown fiscal implications. In response to a request from the GoK, the Bank is currently scoping a potential engagement on public sector reform, for possible funding by MFAT. If funding is secured, this would proceed from late 2018, with the first priority being to support the preparation of a Public Service Act and provide ad-hoc advice to support the Public Service Office, including on remuneration issues.

19. **On the capital side, variations in spending have previously been driven by large infrastructure projects financed by donors, but GoK is now looking to increase its own capital spending program and invest in air connectivity.** Recent supplementary budgets have funded significant new capital spending,

<sup>10</sup> In 2001, every salary point was increased by AUD700 a year (equivalent to a 26 percent pay rise for the middle increment of level 19, and a 4.9 percent pay rise for level 2). In 2006, another AUD700 a year pay rise was granted (20.7 percent for the middle increment of level 19, and 4.7 percent for level 2). In 2010, a pay rise of AUD780 was granted (19.1 percent for the middle increment of level 19, and 5 percent for level 2).

<sup>11</sup> Inflation was -3 percent and -1.5 percent in 2012 and 2013, enough to mostly offset positive inflation since then.

<sup>12</sup> The GoK treats budget support as general revenue, so the budget must be balanced after including budget support.



but either from the originally forecast surplus or – if later in the year – from the revised revenue envelope based on higher-than-forecast fisheries revenue. In the August 2017 supplementary budget, the GoK committed A\$30 million for outer island infrastructure, to improve the basic infrastructure – particularly transport infrastructure – available to the half of the population residing there. Gaps between South Tarawa and the outer islands in access to connective infrastructure are estimated to be significant, making this policy commitment consistent with inclusive growth. In line with election commitments to build the national airline and address Kiribati’s extreme transport challenges, the GoK also allocated a total of \$6.8m in supplementary budgets in 2017 for the acquisition of a Dash 8 aircraft. The 2018 August supplementary budget has provided \$5.8m towards Embraer jet aircraft, with the GoK announcing tentative plans to dry lease an aircraft in the short term and then purchase two new jets in 2019 or 2020. Fisheries revenues for 2018 are on track to exceed the budget forecast by at least A\$20m – and possibly up to A\$60-70m – and the GOK may choose to allocate this surplus to the aircraft acquisition in a further supplementary budget in November/December.

20. **The team assesses that these capital expenditures will not undermine fiscal sustainability in themselves, given they are funded from above-forecast fisheries revenue and the GoK also has significant cash reserves.** Our initial estimates based on an upper bound cost scenario for the two aircraft indicate that the capital costs could probably be funded over and 18- to 24-month horizon, with cash reserves being drawn down to around the IMF’s minimum buffer of three months of recurrent spending. However, the sustainability of the ongoing operating costs is yet to be assessed. The Bank has offered assistance to the GoK with assessing those costs and their potential fiscal implications (as well as providing related support on aviation safety and operations) and will continue to engage in a dialogue with the GoK on its fiscal anchors and strengthening SOE oversight. More generally it will also be important for the GoK to improve its procurement and asset management systems to ensure value for money for its capital investments. The DPO is supporting reforms in this area. The IMF has also just concluded a Public Investment Management Assessment, whose recommendations (once published) could help inform the DPO policy dialogue in this regard.



<b>Table 2: Key fiscal indicators</b>	2015	2016	2017e	2018p	2019p	2020p	2021p
	<i>Percent of GDP, unless otherwise noted</i>						
Total revenue and grants	135.0	125.4	116.7	138.1	117.5	105.2	101.9
Domestic revenue	104.0	83.0	82.0	71.1	70.3	69.5	67.6
Tax revenue	14.8	15.4	17.8	16.7	17.3	17.6	17.6
Nontax revenue	89.2	67.6	64.2	54.4	53.0	51.9	50.0
<i>Of which: fishing revenue</i>	87.7	65.0	61.2	50.7	50.0	48.9	46.9
External grants	31.0	42.4	34.7	67.0	47.2	35.7	34.3
Total expenditure	98.1	112.7	105.8	148.9	123.6	109.6	102.5
Current expenditure	47.7	53.0	61.1	67.1	66.8	66.1	64.2
Wages and salaries	25.0	23.1	25.1	30.0	30.5	30.3	29.6
Copra Price Scheme 1/	3.4	9.3	11.9	11.6	11.4	11.2	10.7
Other current expenditure	19.3	20.5	24.0	25.5	24.8	24.6	24.0
Development expenditure	50.4	59.8	44.7	81.8	56.9	43.5	38.3
Donor-funded development	39.0	47.1	34.7	67.0	47.2	35.7	34.3
Government-funded development	11.5	12.7	10.0	14.7	9.7	7.8	4.0
<i>Memo item: Appropriated development spending 2/</i>	9.8	14.9	23.7	9.2	4.2	4.0	3.5
Overall balance (excluding budget support)	36.9	12.7	10.9	-10.7	-6.1	-4.4	-0.6
Overall balance (including budget support)	38.9	16.2	17.2	-5.6	-2.0	-0.3	3.3
Financing	-36.9	-12.7	-10.9	10.7	6.1	4.4	0.6
Budget support grants	2.0	3.5	6.3	5.2	4.2	4.1	3.9
Loans	8.0	4.7	0.0	0.0	0.0	0.0	0.0
Domestic financing	-46.9	-20.9	-17.2	5.6	2.0	0.3	-3.3
RERF	-21.3	-28.7	0.0	0.0	0.0	0.0	0.0
Cash account	-7.0	10.1	-2.9	0.0	-3.0	-3.0	0.0
Custodian account	-20.3	0.1	-0.5	0.0	-0.5	-0.5	-3.7
No. 4 account	1.7	-2.2	-13.7	5.6	5.5	3.8	0.4
<i>Memorandum items</i>							
Closing cash balances (excl. No. 4 account)	59.5	47.5	55.0	53.6	56.2	58.4	59.6
Months of recurrent spending (excl. Copra Scheme)	15.0	10.8	10.8	11.6	12.2	12.8	13.4
Nominal GDP (\$Am)	236	244	257	268	272	279	291

Sources: Kiribati authorities and World Bank and IMF staff estimates and projections. Financing items and cash balances are staff estimates for all years.

1/ The Copra Price Scheme was reclassified as development spending in the 2018 budget, but we have retained it under Current expenditure for ease of comparison over time.

2/ This is the amount appropriated as the Local Contribution to Development (to the Development Fund), excluding funding for the Copra Price Scheme. Funds are not necessarily expended in the same fiscal year that they are appropriated as revenue into the Development Fund. "Government-funded development" is the amount of approved expenditure out of the Development Fund for GoK projects during the fiscal year (again, excluding the Copra Scheme).

Note: This presentation differs to the IMF assessment letter, as the IMF assumes new external borrowing for projects occurring from 2017 onwards. We have also included the Copra Scheme under current expenditure in all years, and defined development spending as including the GoK's approved expenditure out of the Development Fund in the fiscal year (excluding the Copra Scheme), rather than the amount it appropriates as revenue into the Development Fund.



**Box 1: Copra subsidy reform in Kiribati**

**The copra subsidy, which began in the mid-1990s, has multiple objectives.** It is an agricultural subsidy to maintain copra production (a key export), a cash transfer to ensure a supply of cash in outer islands to maintain a monetized economy, an unemployment benefit to provide cash incomes to those who would otherwise be unemployed, a form of conditional cash transfer to encourage people to remain on the outer islands in order to slow urban migration, and one of the key transfer mechanisms that the government uses to redistribute its rising resource wealth (fishing license fee revenue) to the population of the outer islands.

**Consistent with the recommendations of technical assistance from the World Bank, the GoK merged the two previously existing copra SOEs to reduce the costs of handling the copra subsidy, a reform supported by the first DPO series.** The existence of two SOEs in the sector was identified as the cause of substantial duplication of functions, higher handling costs, and weakened accountability for effective copra purchasing, processing, and exporting. It was expected that reduced leakages and efficiency savings from merging the two copra SOEs would reduce the government spending on the copra subsidy. While efficiency savings may have been achieved, the overall objective of reducing expenditure on the copra subsidy scheme has not been achieved, due to significant increases in the amount of the copra subsidy itself. Having fallen from A\$7.7 million in 2013 to A\$5.3 million in 2014, public expenditure on copra subsidies rose to A\$7.9 million in 2015 (when the copra subsidy was increased from A\$0.80 to A\$1 per kilogram), before increasing sharply to A\$22.8 million in 2016 (when the copra subsidy was increased from A\$1 to A\$2 per kilogram during the first half of the year) and A\$33 million in 2017 (when the A\$2 per kilogram price was in place for the full year).

**The new government that came to power early in 2016 has a strong mandate to raise the living standard of the population of the outer islands.** It is considering government support to outer islands as a whole, including various government initiatives that aim to help create jobs and diversify income opportunities in outer islands, inequities in public spending against the population of the outer islands (for instance, public spending on health and education, infrastructure, and public utilities), the extent of connective infrastructure and services (both transport and communications), and the disadvantages facing people from the outer islands in finding work in the public sector, receiving overseas scholarships, and getting into overseas seasonal workers schemes.

**The World Bank has previously invested in building a knowledge base to support the policy dialogue with the GoK in this important area.** At the time of the first DPO series, the Bank undertook preliminary work on potential alternatives to the copra subsidy that could replace its role as a social protection scheme – looking at possibilities of cash for work, recalibrating the eligibility criteria for the existing social protection scheme for the elderly, increasing post-secondary scholarships, and providing transport grants to seafarers from the outer islands boarding foreign vessels. Preliminary indications were that these would be particularly advantageous as alternatives to the copra subsidy scheme. The trade-offs involved with the expenditure on the copra subsidy have risen very substantially since then, however, raising the importance of reassessing options to improve the poverty targeting of the scheme. The distortive effects of the copra subsidy on household production decisions have also increased significantly – and Kiribati now faces the problem that virgin coconut oil (which Kiribati could export competitively without a subsidy) is not as remunerative for households as copra, because of the magnitude of the copra subsidy increase. The Bank is contributing to MFAT-led analytical work on the copra sector which is about to commence, which will include analysis of these incentive problems. To strengthen the evidence required for further advice on the social protection impacts of the scheme, the Bank is supporting the new HIES in Kiribati scheduled for 2018/19.

Sources: AusAID (2012) *Kiribati Country Case Study*, World Bank (2013) *Policy Brief: Some Thoughts on Social Schemes for Protection and Promotion in Kiribati*.

## 2.2. MACROECONOMIC OUTLOOK AND DEBT SUSTAINABILITY

21. **The medium-term macroeconomic outlook is broadly favorable.** Growth is expected to be maintained at 2-2.5 percent over the medium term, higher than the historical average, from planned infrastructure investments by development partners and the GoK, and the expected persistence of the higher average level of fishing revenues Kiribati now enjoys. Inflation should remain contained on continued softness in international food and commodity prices, unless there is a significant weakening of the Australian dollar against the US dollar. Although the size of the current account surplus is forecast to



decline on lower fisheries revenues (because these are projected as a conservative average, which is lower than their recent average), the current account is expected to remain in surplus over the medium term, supported by still substantial fishing license fee revenue, aid flows, investment returns on the RERF, and remittances. Remittances, which had earlier been on a declining trend, have picked up in the last three years, both with the global recovery in shipping activities and as employment opportunities for I-Kiribati overseas increase with the creation of additional temporary labor schemes – a trend projected to continue in future.

22. **The fiscal outturn largely depends on fishing license fee revenues, grants from development partners, and the ability of the GoK to contain expenditure growth.** While the VDS has led to a structural increase in fishing license fee revenues, their level in any given year is difficult to predict (depending – among other things – on fuel prices, weather conditions, fish prices, and the movement of key currencies). The fiscal projections in Table 2 follow the IMF’s recommended conservative approach, explaining the 10 percentage points of GDP drop in fisheries revenues between 2017 and 2018-2020. Declines in external grants and development spending shown in the projections also reflect conservative assumptions around development finance, as the figures only include spending that has already been programmed under specific projects in the GoK’s Development Budget estimates. Although deficits are projected for 2018 onwards (even after budget support) this reflects the GoK beginning to spend down the funds it has already appropriated to the Development Fund in previous years for capital projects (including the A\$30m put aside for outer islands projects in 2017).<sup>13</sup>

23. **The two key risks to these fiscal projections are that fishing license fee revenues will be unusually low, and that the GoK will make new policy decisions that imply unsustainable permanent increases in recurrent spending.** The fiscal policy dialogue is the best avenue the Bank has to help the GoK mitigate the expenditure side risk. As part of that dialogue, the GoK recently committed to annually publishing its fiscal strategy. The 2019 Fiscal Strategy reaffirms the GoK’s commitment to at least a balanced budget,<sup>14</sup> no new borrowing or RERF drawdowns, no step change to public service salaries in 2019, and the continuation of the current copra price. However, as noted in Section 2.1, the potential for unsustainable operating losses from the state-owned airline, Air Kiribati Limited, is a particular fiscal risk. The Bank will offer its support to analyze the potential fiscal impact of the airline’s expansion plans, as well as track the timely submission of Air Kiribati’s financial reporting to the Ministry of Finance and Economic Development. In relation to wage bill pressures, the Bank is also exploring the possibility of engaging directly on public service reform with support from MFAT, including the analysis of measures with fiscal implications.

24. **The long-term outlook for the RERF is positive.** Figure 1a shows the projected trajectory of the real value of the RERF, based on the GoK’s current investment strategy and using reasonably conservative forecasts of market returns. The projections assume the reinvestment of returns and a drawdown of 1 percent per year of the total value of the fund to finance priority public investments from 2019, now that the GoK has achieved its nominal target for the fund of A\$1 billion. These assumptions align with the investment objectives for the RERF that the GoK has now adopted. These forecasts do not include any transfers of windfall fisheries revenues into the RERF (this remains part of the Bank’s dialogue with the

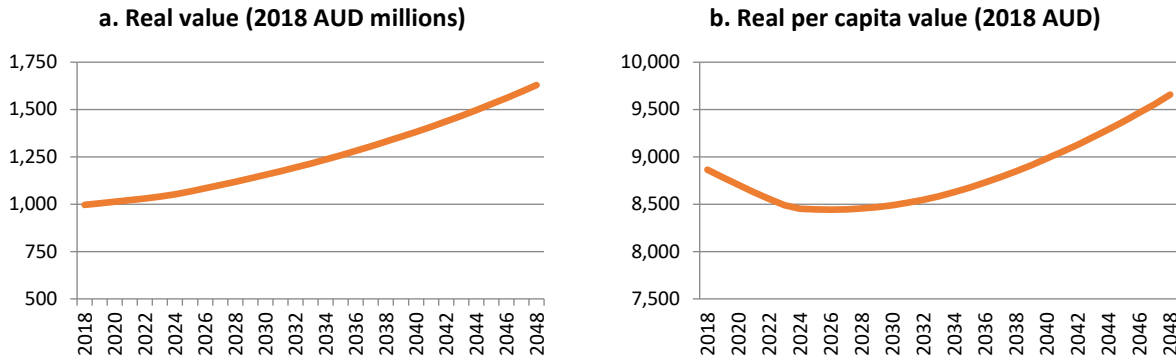
<sup>13</sup> Cash retained in the No. 4 account is for development projects under the Development Fund and is not included in the definition of the GoK’s cash reserves.

<sup>14</sup> Based on appropriated spending, including multiyear appropriations through the Development Budget. Budget support is also treated as revenue rather than financing.



GoK, but is not being factored into this forecast, to keep it conservative). The positive outlook for the real value of the RERF, given the current good management of the RERF and the structural shift in fisheries revenues that enables RERF returns to be reinvested (rather than being required to finance the recurrent budget), stands in stark contrast to the performance in the 2000s (see Figure 3). Figure 1b shows the outlook in real per capita terms. The initial downward trend is driven by the 1 percent drawdowns to finance priority public investments, but as population growth slows, the real per capita value of the RERF rises again – with the rate of increase rising as the population growth rate slows.<sup>15</sup>

Figure 2: Long-term RERF outlook



Note: The projected trajectories shown here are subject to wide margins of error – they are based on a forecast market return, whereas in practice market returns may be subject to considerable variability potentially leading to very different outcomes from those shown here.

Source: World Bank staff estimates and UN Population Fund.

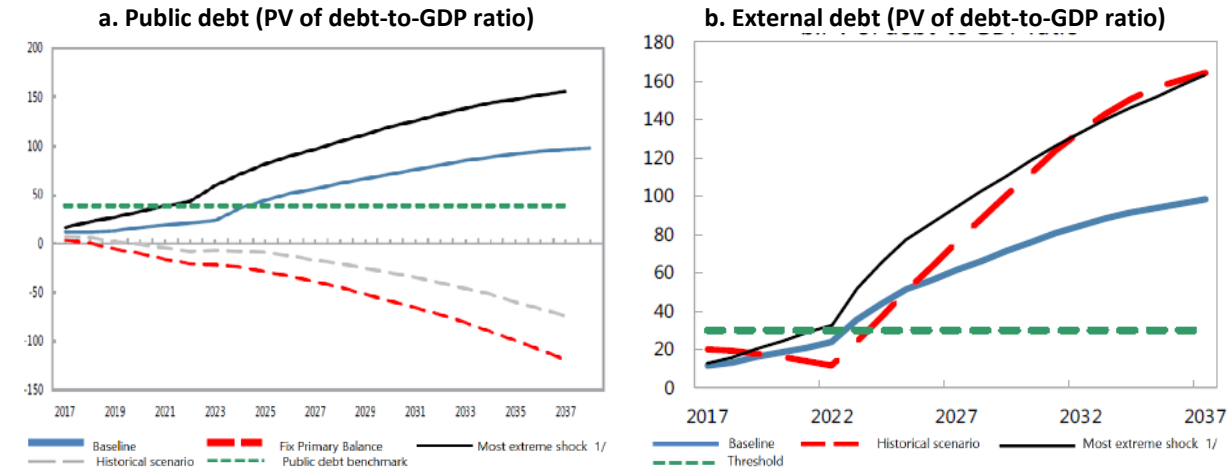
25. **Kiribati is assessed as being at high risk of debt distress, according to the latest IMF/World Bank Debt Sustainability Analysis (DSA), from December 2017.** This assessment reflects Kiribati’s limited capacity to service additional debt, given its historically low average growth rate and narrow export base. The debt trajectory becomes unsustainable even under the baseline DSA scenario of moderate new borrowing<sup>16</sup>, where fishing license fee revenue is assumed to remain above the historical average, there is moderate expenditure growth, fiscal deficits remain small, there is continued availability of highly-concessional loans and grants to finance development expenditure, and natural disaster risks – though not climate change risks – are accounted for to a modest degree. Containing this risk requires Kiribati to avoid any non-concessional borrowing, secure grants rather than concessional loans to finance its main development needs, maintain fiscal discipline, maintain adequate buffers against shocks, and continue to implement key reforms to support greater public sector efficiency and – to the extent possible – greater private sector development, to support Kiribati’s growth prospects.

<sup>15</sup> It is important to recognize that no assumption is being made here as to what the trajectory of the real per capita value of the RERF should be: the weight to be placed on the welfare and needs of the current generation relative to future generations is a valuation for the GoK to make.

<sup>16</sup> The DSA ‘baseline scenario’ shows the hypothetical result of new external borrowing by GoK, rather than the evolution of debt under the current baseline fiscal projections (shown in Table 2). No new borrowing is expected over the medium term.



Figure 3: Debt sustainability analysis



Note: 1/ In Figure 2a, a Combination shock, in Figure 2b, a Terms shock.

Source: IMF/WB DSA.

26. **Kiribati’s macroeconomic policy framework is adequate for the purposes of the proposed operation.** In recent years, Kiribati has substantially improved the management of the RERF, a critical anchor for economic and fiscal stability. It has also avoided borrowing on non-concessional terms, in accordance with its debt policy. In the face of very significant increases in revenues from fisheries license fees, the GoK has exercised sufficient fiscal discipline to keep the budget in surplus and to accumulate significant cash reserves over this period. Part of these cash reserves – equivalent to about 50 percent of GDP – has been transferred into the RERF and, along with reinvested returns, good management of the RERF portfolio and strong market conditions, has contributed to the RERF reaching the GoK’s targeted A\$1 billion value. The remainder is available as a buffer against shocks (though improvements in cash management are required, to avoid foregoing revenue on these significant cash reserves). The GoK has now adopted a clear set of objectives for the RERF, which is expected to establish an appropriate strategy for drawdowns from the RERF. It remains important for Kiribati to carefully target spending to its most pressing expenditure needs – of which there are undoubtedly many – and to avoid setting an unsustainable path for recurrent spending. In particular, the ongoing fiscal costs of the planned expansion of Air Kiribati Limited’s fleet and operations will need to be carefully assessed and monitored. Given recent substantial increases in subsidies, public service wages and capital spending, if further fiscal space emerges, priority should be given to non-wage recurrent expenditure that is essential to complement wage and capital spending in the delivery of services – such as asset maintenance.

27. **Risks to the macroeconomic outlook are substantial, and tilted to the downside.** While current indications suggest that revenue from fishing license fees will significantly exceed the budget forecast in 2018 (as has been the case in the past several years), this revenue stream is inherently volatile, and could decline significantly in future as a result of higher fuel prices, unfavorable weather conditions, or anything that undermines the VDS. Negative dynamics in global financial markets would have an adverse impact on returns to the RERF, just as the recent strong growth in global equities markets has generated significant upsides for the RERF. The economic policy dialogue between the GoK and development partners offers an important – though challenging – means of mitigating the risks on the expenditure side. Any stepping back from the GoK’s current fiscal anchors – a balanced budget and sustainable management of the RERF – would have significant adverse consequences for the RERF, as well as for broader macroeconomic management. However, the GoK has demonstrated strong commitment to its fiscal anchors to date, including as shown by its recent decision to publish its fiscal strategy as part of the budget



process. This risk is further mitigated by the Bank’s economic policy dialogue with the GoK, and the specific engagement of World Bank Treasury on the RERF. Delays in the implementation of major investment projects would negatively affect growth, as would further natural disasters. Remittances from migrant workers could be negatively affected by a sharper-than-expected slowdown in China spilling over into declining global shipping activities, and lower-than-expected growth in New Zealand and Australia (where I-Kiribati have emerging temporary labor opportunities). Higher-than-expected prices for imported food and fuel would have a significant impact on inflation, growth and poverty.

### 3. GOVERNMENT PROGRAM

28. **The Kiribati Development Plan 2016–19 (KDP) identifies key priority areas for the medium term, with the overarching vision, “Towards a better educated, healthier, more prosperous nation with a higher quality of life.”** The KDP focuses on six priority areas: (i) human resource development; (ii) economic growth and poverty reduction; (iii) health; (iv) environment; (v) governance; and (vi) infrastructure. Among the strategies under the human resource development priority are: fostering the development of early childhood education; and strengthening teacher skills to improve literacy and numeracy achievement in primary school. Among the strategies under the economic growth and poverty reduction priority are: enhancing management of the RERF; ensuring effective public financial administration and debt management; providing for the sustainable development of the fishing industry and maximizing economic returns from marine resources; and ensuring that the most vulnerable groups in the population are cared for. Under the health priority, the KDP emphasizes the need to increase access to and use of safe water and basic sanitation, because of the links between poor hygiene and the prevalence of communicable diseases. Complementing that, with respect to infrastructure, the strategies include reforming the Public Utilities Board to achieve operationally and financially sustainable electricity, water and sanitation services.

29. **The priorities in the KDP have been reinforced and set within a longer-term development strategy in the Kiribati 20-Year Vision 2016-2036 (“KV20”), finalized earlier this year following a series of community consultations.** KV20 is structured around four pillars: (i) wealth – natural, human and cultural capital; (ii) peace and security; (iii) infrastructure for development; and (iv) governance. The two crossing-cutting issues are: (i) gender, youth, vulnerable groups, equity; and (ii) environment, climate change and sustainable development. Ensuring macroeconomic stability to support long-term development, ensuring sound management of the RERF, maximizing returns from the sustainable exploitation of fisheries and marine resources, supporting early childhood development, and tackling poor hygiene as a contributor to the prevalence of communicable diseases, are key elements of the wealth pillar of KV20. Extending access to potable water is a key element of the infrastructure for development pillar of KV20.

### 4. PROPOSED OPERATION

#### 4.1. LINK TO GOVERNMENT PROGRAM AND OPERATION DESCRIPTION

30. **The first pillar of the proposed operation on strengthening public financial management (PFM) with respect to financial and physical assets is closely aligned with the economic growth and poverty reduction priority of the KDP, and with the wealth pillar of KV20.** The actions under this first pillar



support the GoK's objectives and strategies on the RERF, PFM and infrastructure. This pillar builds on measures supported in previous series on RERF management and procurement reform, and complements measures supported in previous series on debt policy and management, and state-owned enterprise governance. Over time and in conjunction with other measures, this pillar should contribute to improvements in the quality of public spending and – through improved management of the RERF – strengthen Kiribati's fiscal position. This should help ensure that the GoK can maintain and improve public services and public investment in human and physical capital, which tend to be of disproportionate importance to the poor – supporting poverty reduction and shared prosperity.

**31. The second pillar of the proposed operation on supporting inclusive growth through fisheries reform and better basic services is closely aligned with the human resource development, economic growth and poverty reduction, health and infrastructure priorities of the KDP, as well as with the wealth and infrastructure for development pillars of KV20.** The actions under this second pillar support the GoK's objectives and strategies on maximizing returns from the sustainable exploitation of fisheries assets, expanding access to safe drinking water, and fostering the development of early childhood education. This pillar complements measures supported in previous series on fisheries revenue and joint venture management, improving access to electricity for the poor, and telecom sector liberalization and service expansion in the outer islands. Over time and in conjunction with other measures, this pillar should support expanded economic opportunities in the fisheries sector, better health and wellbeing through improved hygiene and reduced time spent collecting water, and better educational outcomes in the critical early grades – again supporting poverty reduction and shared prosperity.

**32. The design of the proposed operation reflects the lessons learned in the implementation of the previous DPO series in Kiribati.** These include:

- *Budget support to small states with thin capacity can provide benefits far beyond the financial resources transferred* – in Kiribati, the policy dialogue afforded by the DPO engagement can be more significant than the specific actions in the policy matrix, which any evaluation of the value of the engagement needs to take into account. A coordinated policy matrix between budget support donors also strengthens the policy dialogue and helps to manage capacity constraints. The prior actions and triggers for this DPO are shared with the Governments of Australia and New Zealand, and are very closely aligned with the Asian Development Bank's program.<sup>17</sup>
- *Project-level engagements can assist in identifying key policy and institutional priorities to support through policy-based operations* – this is evident with the water and education sector reforms.
- *The flexibility built into the Bank's approach to programmatic series of DPOs is vital in fragile states and very thin capacity environments* – while every effort will be made to define feasible triggers for the second operation, the team would expect these to require revision between the programs, as has been the case in previous programmatic series in Kiribati, to reflect changing policy emphasis and/or more severe than expected capacity constraints affecting the timeframes and ambition of the steps in the supported reform processes.
- *Tackling more contentious policy areas – particularly in fragile states – involves taking greater risks, which the Bank should support* – this DPO series continues to work on RERF and fisheries

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<sup>17</sup> The only differences with the ADB program are that it substitutes an SOE reform for the fisheries sector action, and it includes additional actions on the submission of SOE financial statements (which the Bank supported in a previous DPO and thus continues to monitor) and the first steps of the GoK's asset management reforms (which feeds into the asset management strategy that will be a trigger for the Bank's second operation).



management, significant yet contentious areas whose risks are acknowledged.

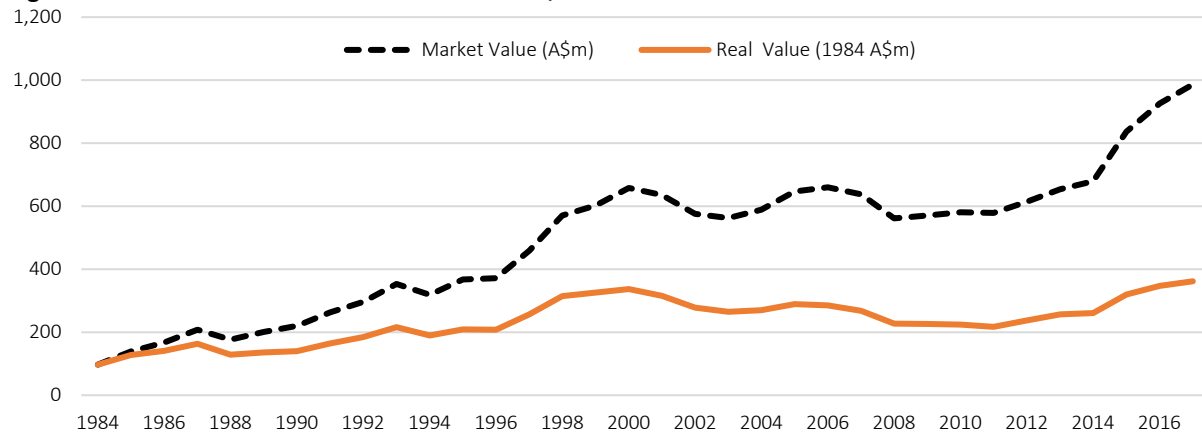
#### 4.2. PRIOR ACTIONS, RESULTS AND ANALYTICAL UNDERPINNINGS

##### Pillar 1: Strengthening public financial management with respect to financial and physical assets

**Prior Action 1: The Recipient, through its Cabinet, has endorsed a set of clear investment objectives for the Revenue Equalization Reserve Fund.**

The RERF is Kiribati’s main mechanism to provide for inter-generational equity and serve as a buffer against current shocks. In the first decade of the 2000s, the real value of the RERF declined significantly as a result of both unsustainable fiscal management and poor RERF management (Figure 3). On the fiscal management side, a combination of low and volatile fisheries revenues and relatively high public expenditure needs resulted in large fiscal deficits and frequent drawdowns from the RERF. On the RERF management side, a review conducted in 2011 with technical assistance from the IMF identified a number of weaknesses, including the misalignment of the asset allocation with the RERF’s long-run investment objectives. The review recommended closer oversight of the asset managers, shifting to a passive investment strategy, renegotiating the contract with the custodian, and setting more realistic investment targets.

Figure 4: RERF balance in nominal and real terms, 1984-2017



Source: World Bank staff estimates

33. In 2013 the GoK began implementing the recommended reforms, with technical assistance from World Bank Treasury. A review of the performance of the incumbent asset managers was undertaken, which found they had taken inappropriate risks while achieving returns that were persistently below market benchmarks over an extended period and charging management fees that were well above competitors, for no additional services.<sup>18</sup> New asset managers were appointed through a transparent and

<sup>18</sup> The inappropriate risks had included – among other things – exposure to multiple Icelandic banks, which led to irrecoverable losses in the aftermath of the Global Financial Crisis.



competitive selection process, the RERF portfolio was reoriented towards lower-risk instruments and a benchmarked investment strategy adopted, a review of custodial arrangements was undertaken to assess whether the services of the incumbent provider were aligned with current market practice and benchmarks, and a request for proposal for custodial services was issued. These reforms were supported by successive DPOs in the previous two series and represent one of their most significant achievements. Since the last DPO, the GoK has completed a comprehensive evaluation and selection process for custodial services, with oversight provided by World Bank Treasury,<sup>19</sup> and the selected custodian has been advised of the outcome of the process. The improvement in the management of the RERF that has resulted from this reform process has been striking. Critically, the return on the RERF portfolio is now aligned with the relevant market benchmark. Management costs have also fallen.<sup>20</sup> In addition, increased fishing revenue and relatively prudent fiscal management in recent years have allowed the GoK to make transfers into the RERF to replenish it (A\$50 million in 2015 and A\$70 million in 2016), while also reinvesting returns. In August 2018, the RERF reached A\$1 billion in fund value, a significant milestone which the GoK had originally targeted to reach by 2020.

**34. Following these successes in strengthening the management of the RERF, the GoK is now looking more to the future – with Cabinet adopting a set of clear investment objectives for the RERF, including a transparent rule for sustainable drawdowns.** Now that the RERF has reached the A\$1 billion milestone, Cabinet has agreed that the purpose of the RERF will effectively be to serve Kiribati as a long-term endowment fund for the benefit of both current and future generations. Consistent with this purpose, Cabinet has adopted a set of clear investment objectives for the RERF, which will in turn govern the investment strategy and its implementation. These objectives are to: (i) maximize long-term returns without incurring undue risk; (ii) ensure that the real long-term value of the assets is maintained; and (iii) make sustainable drawdowns from the RERF to enable the GoK to finance development projects. It is the view of World Bank Treasury that the purpose and objectives that Cabinet has approved are an appropriate reflection of the balance the GoK is seeking to achieve between the welfare of current and future generations. The current generation will benefit from priority investment projects funded via sustainable drawdowns from the RERF, while future generations will benefit from the maintenance of the real value of the RERF as well as the expanded domestic capital stock financed by current investments.

**35. With these investment objectives now established by Cabinet, it is possible for the GoK to redefine its investment strategy to align with these objectives.** The investment strategy will specify parameters such as the risk tolerance, investment horizons, allowable asset classes, strategic asset allocations, and so forth, within which the asset managers will work. World Bank Treasury will provide technical assistance to the RERF Investment Committee on the formulation of this investment strategy, consistent with the investment objectives that Cabinet has approved. The adoption of this investment

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<sup>19</sup> The involvement of Treasury has added significant value in this process. The initial response to the request for proposal was limited, with few of the targeted global custodians sufficiently knowledgeable about the specifics of the RERF to be willing and able to bid. In a resource-intensive but critical process, Treasury worked with the targeted global custodians to educate them on the specifics of the RERF, using Treasury's expertise and convening power to get a genuine competition among suitable custodians for the benefit of Kiribati.

<sup>20</sup> While the high management fees were a small aspect of the rationale for changing asset managers, World Bank Treasury estimates that the change in asset managers and restructuring of the portfolio will save the government upwards of A\$1 million per year in RERF management costs. There is potential for additional savings as a result of the request for proposal for custodial services. The review found the fees charged by the incumbent custodian to be the highest among all clients in the World Bank Treasury Reserves Advisory and Management Program (RAMP), and about three times the client average.



strategy by the RERF Investment Committee, and its endorsement by Cabinet, will serve as an indicative trigger for the second operation in the series.

36. **The expected result of these reforms over the medium term is that the RERF portfolio will be implemented and managed in accordance with the investment strategy – and thereby with the redefined purpose and objectives approved by Cabinet, as supported by this operation.**<sup>21</sup> The team will also continue to track the two results indicators established for the previous DPO series, to demonstrate the maintenance of the gains of previous reform actions. These are that RERF portfolio performance is aligned with market benchmarks (with portfolio performance better than 0.25 percent below the benchmark), and that the RERF is managed according to prevailing market standards with reduced costs (with management costs of 0.1 percent of market value or less).

***Prior Action 2: (i) The Recipient, through its Cabinet, has approved a Cash Management Policy, including a new cash target; and (ii) the Recipient, through its Ministry of Finance and Economic Development, has authorized initial transfers of excess cash reserves to an interest-bearing account of the Recipient, in accordance with the Cash Management Policy.***

37. **In recent years, in the context of increased fishing revenue, relatively prudent fiscal management and the changing role of the RERF, the build-up of significant cash reserves has not been fully addressed by the GoK.**<sup>22</sup> The cash held in an at-call, zero-interest account for the recurrent budget is now about nine months of recurrent expenditure, well above the three months of recurrent expenditure that the IMF recommended should be held as a cash buffer. The GoK also has about seven months of recurrent expenditure held in an interest-earning account that can be accessed within 48 hours. This account could fulfil much of the cash buffer role recommended by the IMF, reducing below three months of recurrent expenditure the amount of cash that needs to be held in the at-call account. In addition, there is the equivalent of about four months of recurrent expenditure in an at-call, zero-interest account that holds funds appropriated for the development budget, but not yet expended. The GoK has identified poor cash forecasting and the lack of an agreed cash target for the at-call accounts as contributing factors to this situation. The GoK has estimated that the excess cash it is holding in its at-call accounts is costing it A\$1.8m per annum in foregone interest.

38. **To manage its cash balances more efficiently, the GoK has prepared a cash management policy which sets a cash target and prescribes the transfer of excess cash to interest-bearing accounts.** The policy sets targets of two months of spending for the consolidated fund and development fund to be held at call in local bank accounts, with a range of plus or minus one month. The IMF and World Bank Treasury are also supporting the GoK to determine what additional prudential buffer, if any, is required to ensure sufficient liquidity remains in the local banking system. Cabinet has approved the cash policy along with an implementation plan to gradually transfer excess cash to interest-bearing accounts until the cash target (and any additional prudential buffer) is met. Accordingly, the Minister of Finance has authorized the immediate transfer of A\$22m to the interest-bearing account in Australia, with further monthly transfers scheduled in order to reach the cash target (and any additional prudential buffer). The cash target will be reviewed on a six-monthly basis, and the Ministry of Finance is considering appointing a dedicated officer

<sup>21</sup> This results indicator will be more clearly defined at the time of the second operation in the series, when the content of the investment strategy is known, so key quantitative indicators can be selected from it.

<sup>22</sup> The build-up of reserves is partly a consequence of the GoK's intention to treat the RERF as an endowment fund rather than a stabilization fund. The RERF is treated as the "lender of last resort", so other reserves are needed to provide a buffer against lower than expected fisheries revenue and ensure that the RERF's real value is maintained.



to support the Accountant General in managing the GoK's daily liquidity requirements in line with the policy.

39. **The expected result of this reform is a reduction in the volume of cash reserves above the GoK's liquidity target that are earning zero interest.** If achieved, this will mean that the GoK no longer foregoes such a significant amount of interest on an ongoing basis.

40. **The second operation in the series has, as an indicative trigger, Cabinet approval of an asset management strategy for operating and maintaining major government-owned assets (including schools, health facilities, and roads).** Surveys of the condition of major government-owned assets consistently indicate very poor maintenance, and rough estimates of asset maintenance requirements for sub-sets of major asset classes suggest that the budget allocation for maintenance is a small fraction of what is required. In addition, it is unclear whether current allocations of responsibilities for asset maintenance are appropriate, and whether there are misalignments between appropriation holders, asset maintenance incentives, and asset maintenance responsibilities. Given that the GoK is now expanding its capital investment program, it is critical that these systemic weaknesses are addressed. The GoK is embarking on the preparation of an asset management strategy that will establish a set of principles for asset maintenance, address these questions of the allocation of responsibilities, and set out a plan to increase asset maintenance funding and activities commensurate to what is required. MFAT is providing technical assistance for the work, which will also be informed by the findings IMF's Public Investment Management Assessment (to be published in late 2018). Cabinet approval of the resultant asset management strategy will serve as an indicative trigger for the second operation in the series.

41. **The immediate result expected from this reform is that the budget appropriation for asset maintenance rises towards the target level established in the asset management strategy.** This will provide a basis for more adequate asset management going forward. This results indicator will be defined with a quantitative target once the asset management strategy has been prepared, and more in-depth analysis as to the required sustainable level of maintenance spending is made available.

***Prior Action #3: In accordance with the Kiribati Public Procurement Reform Plan to establish a Central Procurement Unit ("CPU") within the Ministry of Finance and Economic Development, the Recipient has: (i) through its Cabinet, approved the establishment of posts for the staff complement of the new CPU; and (ii) through its Ministry of Finance and Economic Development, appointed a chief procurement officer and procurement officer.***

42. **Procurement has been recognized as an area of significant weakness in public financial management in Kiribati for some time, and the GoK has endorsed a procurement reform plan.** The key problem is that the procurement process lacks the supporting regulations, detailed guidance and context-specific institutional arrangements to support better procurement practice, limiting the GoK's ability to achieve greater efficiency, fairness and transparency in the more than A\$70m of procurements it undertakes each year (a figure that is steadily growing, and increasing in complexity as the GoK looks to make more capital investments). This is especially problematic in a context like Kiribati, where administrative capacity is so scarce. The current procurement legislation dates from 2002 and needs to be updated to better reflect Kiribati's unique circumstances (particularly the thin procurement capacity of line ministries and the major role of SOEs in the economy) as well as recent developments in international best practice (for example, to mandate annual procurement planning, strengthen competition and transparency provisions, and provide for a stronger bidder appeals process). There are



currently no procurement regulations, procedures or standard bidding and contract documents (instead, a variety of different models are in use in different agencies), and no working-level procurement procedures. Aside from reducing the prospects for better procurement practice, this situation adds complexity, thus preventing scarce administrative capacity from being directed to its most effective use. Opportunities for synergy and better value are further lost through decentralized procurement functions in line ministries and SOEs, most of which have very small volumes of procurement and no dedicated procurement resources. In the absence of established annual procurement planning, procurement tends to be transactional (buying quickly using the same process and suppliers as before) rather than strategic.

43. **In 2017, Cabinet approved the Kiribati Public Procurement Reform Plan (KPPRP), which the GoK had prepared with technical assistance from the ADB.** This action was supported in the last DPO series. In the first phase of reforms implemented under the KPPRP, a new Central Procurement Unit (CPU) in MFED has now been established, with the new positions in the CPU approved by Cabinet in the 2018 Establishment Register. Crucially, the CPU will allow for centralization and professionalization of procurement capacity which is currently very thinly spread across the public service. The CPU will carry out all procurements above A\$10,000, and is also expected to reduce the number of smaller procurements carried out by line ministries through consolidating tenders for commonly procured items. MFED has recruited a Chief Procurement Officer and Procurement Officer, and the CPU is now operational. The two positions represent the full locally-funded complement for the CPU for this phase of the procurement reform plan, with the ADB (with MFAT funding) also recruiting two advisory roles to support the unit to carry forward the reforms.<sup>23</sup>

44. **The next major step in the implementation of the KPPRP is the preparation of a revised legislative framework for procurement.** A comprehensive review of the existing Procurement Act 2002 is being undertaken, as well as related legislation on whistleblower protection and corruption. The new legislation will (inter alia) introduce mandatory procurement planning, prescribe full transparency of the procurement process and open bidding, set clear criteria for exclusion of bidders, and establish an independent Bidders Appeal Tribunal. The revised framework should improve transparency and value for money, while making it easier for the local private sector to participate in tenders on a level playing field. With funding from MFAT, the ADB will also provide technical assistance for this work, and the submission of the legislation to Parliament will serve as an indicative trigger for the next operation. Regulations, standard bidding and contract documents, procedural templates and a procurement manual will also be prepared to implement the new legislation.

45. **The expected result of the procurement reform process is improved value-for-money and transparency in public procurement, as indicated by (i) procurement processes over the threshold specified in the new legislation being subjected to competition, and (ii) tender awards being made public as per the provisions of the new legislation.** These results indicators are indicative, and will be revisited (ideally with quantifiable targets) in the next operation when the content of the new legislation and data availability are confirmed (based on the final specifications of the new financial management information system (FMIS) that the GoK is currently scoping with support from the ADB).<sup>24</sup>

<sup>23</sup> The long-term staffing requirement for the CPU envisaged under the KPPRP is two staff for operations and two 'regulatory' staff, responsible for maintaining policy documents and databases as well as training line ministries.

<sup>24</sup> Unfortunately, no baseline data are available to measure the share or value of contracts that are currently subjected to competition, due to this information not being captured under the current FMIS configuration and also the current heavy reliance on paper-based processes.

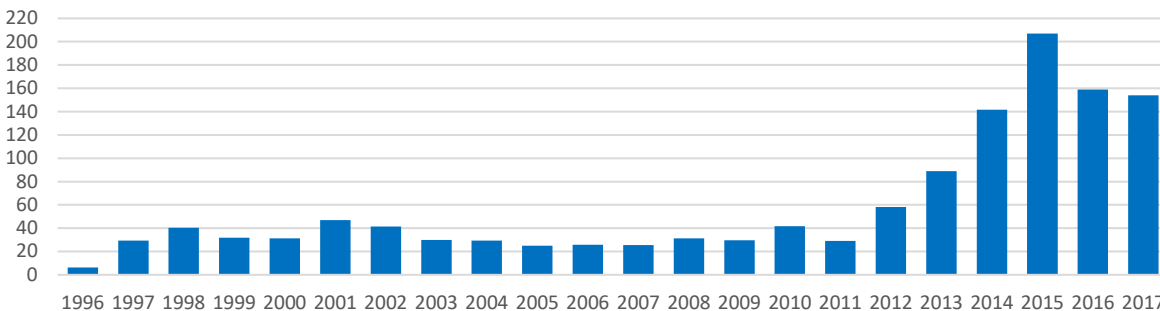


**Pillar 2: Supporting the prospects for inclusive growth by strengthening fisheries sector management and improving access to basic services.**

***Prior Action 4: The Recipient, through its Parliament, has enacted the Fisheries (Amendment) Act 2017, to define Illegal, Unreported and Unregulated (“IUU”) fishing, define serious fishing violations, raise the penalty provisions for serious offenses, and provide for greater transparency, to combat IUU fishing.***

46. **Fisheries are one of Kiribati’s most important assets, and – through the public sector activity that fisheries license fee revenue supports – are the main driver of the economy.** They also provide direct economic benefits through semi-subsistence coastal fisheries and jobs in fishing, processing and transshipment operations. As is clearly recognized in the KDP and KV20, increasing the sustainable returns from fisheries assets – whether license fee revenue to fund public sector activity or direct economic benefits – is critical to inclusive growth in Kiribati. Historically, Kiribati’s fisheries revenues were low and volatile, but a turning point came with the implementation of the VDS in 2012 (Figure 4). The VDS was the result of an accord reached by the Parties to the Nauru Agreement (PNA) to establish limits on the number of fishing days they would sell to purse seine vessels. Effectively, this supply constraint enables PNA members to retain a greater proportion of the tuna catch value in license fees. In previous DPO series, the Bank supported the GoK to reform the management of fisheries resources and fisheries revenue, through the adoption of a National Fisheries Policy in which Kiribati committed to implement the VDS, and the production of a joint annual report on fisheries revenue by MFED and MFMRD (requiring the sharing of disaggregated data on fisheries revenues by MFMRD, which had not occurred previously). The Bank also supported the adoption of a Fisheries Joint Ventures Policy, establishing clear criteria to assess the performance of fisheries joint ventures (through which the GoK hopes to increase domestic value-adding and employment in the sector), on an annual basis. Alongside the RERF reforms, fisheries reforms represent one of the most significant achievements of previous DPO series – though further progress can be made on VDS compliance and expansion.

**Figure 5: Fishing license fee revenues, 1996-2017 (A\$m)**



Source: MFED and MFMRD. Note that there is

47. **The GoK has recently enacted the Fisheries Amendment Act (2017), to define IUU fishing and serious fishing violations, and raise the penalty provisions for serious offences threefold to deter future offenders.** Weaknesses in the previous regulatory framework and compliance evaluation system left Kiribati vulnerable to being identified by the European Commission (EC) as a non-cooperating third country in the fight against IUU fishing, with the EC issuing Kiribati with a ‘yellow card’. The GoK has been working to remedy the identified weaknesses. Through the legislative amendments, Kiribati has defined IUU fishing and serious fishing violations and tripled the maximum penalties, which together should help to deter IUU. The amendments clarify the Minister’s powers and responsibilities with respect to long-term



conservation and sustainable management of marine living resources (the stated fundamental objective of the Act), and also provide for greater transparency and information sharing regarding vessels operating in Kiribati's exclusive economic zone (EEZ), to combat IUU fishing. Amendments were also made to incorporate Kiribati's responsibilities under international law on the conservation and management of fishing resources (including in respect of articles in the United Nations Convention on the Law of the Sea, United Nations Fish Stocks Agreement, and Western Central Pacific Fisheries Convention). The immediate aim of the amendments was to have the 'yellow card' removed – if the identified weaknesses remained unresolved and Kiribati were issued with a 'red card', fish or products made from fish caught in Kiribati's EEZ and by Kiribati-flagged vessels could not be sold in the EU, significantly undermining the attractiveness of Kiribati's EEZ. The EC has conducted a subsequent audit, and although the results are not yet finalized the signs are positive. More broadly, these amendments yield a stronger and more transparent legal framework for fisheries management, in line with the priorities under the National Fisheries Policy.

48. **The legislative amendments supported in the current operation are expected to contribute, among other things, to more transparent management of Kiribati's fisheries assets.** This will be measured as compliance with the requirement to publish all license conditions and the vessels to which they apply on a six-monthly basis, as stipulated under the new legislation.

49. **The indicative trigger for the next operation is Cabinet adoption of a roadmap for the development of the fisheries transshipment subsector.** The GoK has identified the development of fisheries transshipment hubs in Betio and Kiritimati Island as a priority economic growth opportunity. By establishing the required infrastructure and facilities at its ports, Kiribati may be able to encourage vessels to purchase services such as net mending, refueling, restocking of salt and supplies, as well as increase the tuna filleting and processing activity occurring on shore in Kiribati. This would generate employment opportunities and increase Kiribati's share of the value-added from its tuna fisheries. There is already a modest amount of transshipment activity occurring in Kiribati ports, and the roadmap will be important to ensure that GoK can plan appropriately for further growth of the subsector, so that it has the capacity to oversee and monitor transshipment in accordance with its international obligations to combat IUU fishing and in keeping with appropriate social safeguards. The World Bank Pacific Regional Oceanscape Program (PROP) and MFAT are providing technical assistance to support the development of the roadmap, as well as the feasibility analysis and economic, social and environmental assessments that will be used to inform the roadmap.

50. **The results indicator for this trigger is an increase in government transshipment revenue as a proportion of total government revenue from fisheries.** This is a proxy for the share of value captured by the local economy from transshipment, relative to total fishing activity in its EEZ.

***Prior Action 5: The Recipient, through its Cabinet, has approved the introduction of a tariff for residential water use for the three pilot areas of South Tarawa where households are provided with reticulated water 24 hours a day, 7 days a week, a decision critical for the Public Utilities Board to develop and sustain safe water supply services to all of South Tarawa, thereby reducing the associated burden on women and girls.***

51. **Access to safe water is critical to human health and wellbeing.** The provision of safe water and basic sanitation is a significant challenge in Kiribati, with South Tarawa – where population growth is also the most pronounced – the biggest concern. The KDP recognizes that overcrowding and poor hygiene from inadequate water and sanitation are key contributing factors to the prevalence of communicable



diseases in Kiribati – one of the few countries in the world where leprosy is present. Diarrheal diseases in infants and children are also a chronic problem, with girls more likely to be affected than boys.<sup>25</sup> Kiribati has one of the highest rates of infant mortality in the region. While about two thirds of the South Tarawa population are connected to a reticulated water system, water is only supplied up to two hours every 48 hours and at very low pressure. Only 49 percent of the South Tarawa population has access to basic sanitation services (half of which is connected to a sewerage system), and 60 percent of the population report at least occasionally practicing open defecation in the sea.

52. **Stakeholder consultations at the time of the first DPO series suggested that problems with the provision of basic services – including water and electricity – have a large impact on the lives of the poor and especially on women.** A baseline survey carried out by the World Bank earlier this year found that two thirds of households spend more than half an hour a day on water collection tasks, with an average time taken of 55 minutes per day.<sup>26</sup> As well as the time and physical effort spent collecting water, at least one person in the household needs to wait at home during the day to ensure that the family does not miss out when the PUB water is supplied, significantly limiting opportunities for employment outside the home. An observational study and the household survey found that the burden of bulk water collection from community standpipes and shallow wells is generally shared between males and females, but that women tend to be responsible for a larger share of water-related household tasks such as cleaning and washing, and spend a significant amount of time fetching well water for these uses.<sup>27</sup> Focus group research among women in South Tarawa in 2012 also revealed that hygiene is seen as a mother's responsibility, so hygiene-related illnesses in children reflect badly upon women. In addition, anecdotal evidence from pilot sites indicated that mothers had previously denied themselves water in between standpipe supply episodes, to ensure there would be sufficient safe water for their children, which they no longer have to do with their own 24/7 supply.

53. **Water supply and sewage disposal in South Tarawa are the responsibility of the Public Utilities Board (PUB).** Previous DPO series have supported broad SOE governance reforms and the provision of community service obligation (CSO) payments in accordance with clear criteria, as well as specific reforms to improve the financial and operational performance of PUB, all of which have contributed to the turnaround in performance of PUB in recent years. The last DPO also supported the introduction of a lifeline tariff for electricity and a reduction in the household connection fee, to make electricity more affordable to the poor. The focus of this reform process is now increasingly shifting to water, and PUB is working with the World Bank to pilot 24/7 piped water supply in three South Tarawa communities, with each household being provided a lockable outdoor tap.

54. **In January 2018, Cabinet made the historic decision to approve a volumetric water tariff for the three pilot areas in South Tarawa being provided with a 24/7 reticulated supply.** The decision to approve a tariff reverses a longstanding policy that no one should pay for water, and is a bold recognition that expanded water supply services are only viable if consumers bear at least some cost for the water they use. The tariff means that consumers have a strong incentive to conserve water, which is essential in Kiribati. South Tarawa relies on two water lenses that are under severe strain from saltwater intrusion and population growth, and which can reach critically low levels during drought periods. Additional water can only be supplied in significant volumes from desalination plants (with a high fixed cost and time lag),

<sup>25</sup> Based on the findings of ADB (2014), Economic Costs of Inadequate Water and Sanitation, South Tarawa, Kiribati.

<sup>26</sup> The survey was carried out in June 2018 and collected baseline information from 300 households in South Tarawa.

<sup>27</sup> This was observed for stay-at-home mothers as well as women in paid employment.



making it particularly important that there is an efficient mechanism in place to manage demand. Charging a tariff that yields a significant portion of water revenue (alongside CSO payments if needed) also means that PUB's primary accountability for the quality of its water services will be to customers, which is likely to be more effective as a performance incentive than government oversight alone (under the alternative of a 100 percent subsidy).<sup>28</sup> The volumetric tariff design ensures that users pay in accordance with their water consumption.

55. **PUB is now testing its capabilities to manage these new, upgraded water supply services, properly maintain its infrastructure, roll-out billing and customer management systems, and encourage conservation in the use of water through the tariff structure and awareness activity.** Households in the three communities are learning how to manage their water use and to budget for their water bills. Consultations so far with women in the pilot areas suggests that access to 24/7 water has transformed their lives – both in respect of the water collection burden, and by improving their ability to provide water for their families when it is needed. Improvements in skin conditions of children have also been reported.

56. **The next phase of these water reforms is to provide for the eventual upgrade of improved water supply services to all areas of South Tarawa, which will occur after a solar-powered desalination plant has been established to provide the bulk of the water resource.** Analysis of the operation of the pilots, feedback from community consultations, and a willingness to pay survey will enable the GoK and PUB to refine their assessment of the most appropriate pricing structure of the tariff for the full rollout, along with the CSO funding to be provided by GoK. The determination of the tariff for the full rollout will serve as an indicative trigger for the next operation in the series.

57. **The results of these reforms will be measured by the increase in the number of households in South Tarawa with access to reticulated water 24/7, and the share of women in the pilot communities who report that access to safe water 24/7 has had a positive impact on their daily lives.**<sup>29</sup> The water reforms are expected to disproportionately benefit women and girls in several ways: directly, by reducing time spent fetching water for washing and cleaning; and indirectly through improved health outcomes, since there is a higher prevalence of diarrhea and dysentery amongst females, and also because I-Kiribati women are mainly responsible for caring for sick children.

58. **These reforms are also expected to yield significant climate co-benefits.** First, in terms of mitigation, the provision of safe water to all households in South Tarawa that the tariff reforms will facilitate will reduce or even remove the need to burn fuels to boil water, therefore alleviating greenhouse gas emissions that result from burning fuels.<sup>30</sup> Second, in terms of adaptation, South Tarawa's two water lenses are already under strain due to climate change, and water supply is currently severely rationed. Expanded access through 24/7 household taps will significantly increase demand for water, and demand is expected to increase further over time as higher temperatures from climate change increase the need for freshwater per person. The tariff is critical for South Tarawa to adapt to these challenges and ensure that demand can be managed efficiently within the capacity of the water lenses and the new solar-

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<sup>28</sup> Obtaining a significant portion of water supply revenues from a tariff may also increase predictability of funding – and therefore planning capacity – for PUB relative to a CSO-only funding model, since GoK may not have sufficient capacity in the short term to implement a reliable multiyear CSO mechanism.

<sup>29</sup> The exact wording of the results indicator depends on the design of the household questionnaire for the follow-up survey of the pilot sites, which is yet to be finalized.

<sup>30</sup> Almost all households on South Tarawa boil water for drinking using locally sourced wood, coconut residues, kerosene, or propane gas.



powered seawater desalination plant.

***Prior Action 6: The Recipient, through its Parliament, has enacted the Early Childhood Care and Education Act 2017, for the regulation, facilitation and support of early childhood care and education and preschool programs and services at national and local government levels.***

59. **Early childhood care and education (ECCE) is crucial for children’s cognitive, social and psychological development, but has received comparatively little attention and investment in Kiribati to date.** The consequences of this relative neglect are starkly illustrated in the early childhood development results measured by the Kiribati Early Human Capability Index (KeHCI).<sup>31</sup> Across the nine KeHCI domains, the lowest achievements were on early reading, writing, and maths skills: only 52 percent of children could hold a book and turn its page correctly; 27 percent were able to follow the words in a book from left to right; and only 19 percent were able to count to 20. The Early Grade Reading Assessment (EGRA) in 2016 found that only 47 percent of grade 3 students could read with comprehension, while 13 percent had a zero score.<sup>32</sup> School progression is very low, with only 17 percent of children who start primary school finishing it six years later, and only half of those passing the entrance exam to high school. Given both the limited domestic economic opportunities in such a small, remote state, and the existential climate change threats Kiribati faces, a good education and good health are arguably the most important things the GoK can provide I-Kiribati children, to enhance their future livelihood prospects at home and abroad. Access to high-quality ECCE is a crucial foundation for these human capital investments.

60. **The enactment of the Early Childhood Care and Education Act 2017 is a clear signal of the GoK’s recognition of the significance of ECCE and commitment to address existing weaknesses in this sector.** The Act establishes a framework for the regulation of ECCE and preschool services for children of three to under six years old. It establishes a registration and compliance mechanism for the provision of the services, as well as the requirements for the operation of the services. It also facilitates and supports ECCE and preschool programs and services at national and local government levels. In essence, it provides the foundation for establishing and expanding access to quality ECCE and preschool services. To the extent that public resources will be used to support facilities and early childhood educators, the Act provides a basis for the public education sector to secure those resources. This will inevitably have fiscal implications,<sup>33</sup> but without having access to quality ECCE, the public investment currently being made in primary, secondary, tertiary and vocational education is yielding very limited returns.

61. **Building on this new legislative framework, there are a number of next steps the GoK now needs to pursue.** The drafting of regulations for the implementation of the Act is obviously critical, as well as a detailed costing and prioritisation of subsequent steps. Curriculum development for preschool programs is already being supported by UNICEF, with MFAT funding. Programs for upskilling para professionals in

<sup>31</sup> The KeHCI instrument was adapted to the Kiribati context by local stakeholders. It includes different areas of early child development like physical, social and emotional, language, and cognitive development. The national census was completed in 2017 for the population aged 3-5 years, supported by the PEARL program.

<sup>32</sup> The EGRA was completed for a representative sample of grade 1-3 students in Kiribati in 2016, supported by the PEARL program.

<sup>33</sup> A detailed costing is yet to produced (this is a key contribution of the roadmap which will serve as the indicative trigger for the next operation in the series – see paragraph 61). However, the current level of spending on primary education (A\$11m) could provide a useful benchmark. Expanded preschool access and adequate resourcing of preschool teaching could perhaps cost about half that amount on an ongoing basis (say A\$5m or 3 percent of recurrent spending). The main cost is expected to be staffing rather than upfront investment in new facilities.



the preschool sector will also be needed to ensure that quality ECCE and preschool programs are provided. Drawing on the data and pilot experiences generated through the PEARL program, the World Bank will support the GoK to develop a costed roadmap to boost school readiness and improve early grade literacy. The school readiness component will be multi-sectoral, covering the health, nutrition, care and cognitive stimulation components of early childhood development.<sup>34</sup> The early grade literacy component will use the evidence generated by the PEARL Early Grade Reading Intervention to lay out the steps needed to continue the reading program in Year 1 and extend the methodology and technical foundations to Years 2 and 3. The PEARL-supported roadmap will represent the first effort by government and development donors to coordinate funding to priority actions that lay the foundation for sustained improvements in the subsector’s governance and service delivery. This roadmap will thus be particularly significant, because it will support the GoK to start linking ECCE and preschool developments to early grade education, and to ensure that when children enter school, their teachers have the skills and tools to support their literacy acquisition. Cabinet adoption of this roadmap will serve as an indicative trigger for the second operation in the series.

62. **This reform area is expected to result in improvements in early grade literacy.** This would be measured by improved results in reading skills tests for children in pilot schools, compared with the 2016 EGRA baseline. While the ECCE Act is a clear signal of the GoK’s recognition of the significance of ECCE, and a number of donors are providing technical assistance with next steps in its implementation, the dialogue between MFED and the Ministry of Education on government funding for the implementation of the ECCE Act is in its preliminary stages, and represents a significant risk to the achievement of the expected results. The World Bank, through both the DPO dialogue and PEARL engagement, will support this dialogue, helping to mitigate this risk.

**Table 3: DPF Prior Actions and Analytical Underpinnings**

Prior Actions	Analytical Underpinnings
<b>Operation Pillar 1: Strengthening public financial management</b>	
<p><b>Prior action #1:</b> The Recipient, through its Cabinet, has endorsed a set of clear investment objectives for the Revenue Equalization Reserve Fund. <i>Status: Completed</i></p>	<p>IMF Country Report No. 9/196 (Selected Issues Paper I); IMF Monetary and Capital Markets Department technical assistance report, 2011; IMF Country Report No. 15/207 (Box 3); World Bank Treasury RAMP technical assistance reports, particularly recommendations regarding the clarity of investment objectives.</p>
<p><b>Prior action #2:</b> (i) The Recipient, through its Cabinet, has approved a Cash Management Policy, including a new cash target; and (ii) the Recipient, through its Ministry of Finance and Economic Development, has authorized initial transfers of excess cash reserves to an interest-bearing account of the Recipient, in accordance with the Cash</p>	<p>IMF Article IV Report, 2017, regarding efficient use of cash buffers.</p>

<sup>34</sup> The extent to which the roadmap will be able to incorporate these multi-sectoral elements is partly dependent on the extent to which the work of UNICEF and other donors can be integrated. This will be determined on the next mission in late 2018.



Management Policy. <i>Status: Completed</i>	
<b>Prior action #3:</b> In accordance with the Kiribati Public Procurement Reform Plan to establish a Central Procurement Unit (“CPU”) within the Ministry of Finance and Economic Development, the Recipient has: (i) through its Cabinet, approved the establishment of posts for the staff complement of the new CPU; and (ii) through its Ministry of Finance and Economic Development, appointed a chief procurement officer and procurement officer.	Kiribati Public Financial Management Performance Report, 2010; Kiribati Procurement System Review Report, 2016: recommending a comprehensive reform of procurement legislation, regulations, processes and institutions, with the establishment of the Central Procurement Unit included in the first phase of the reform plan.
<b>Operation Pillar 2: Supporting inclusive growth</b>	
<b>Prior action #4:</b> The Recipient, through its Parliament, has enacted the Fisheries (Amendment) Act 2017, to define Illegal, Unreported and Unregulated (“IUU”) fishing, define serious fishing violations, raise the penalty provisions for serious offenses, and provide for greater transparency, to combat IUU fishing. <i>Status: Completed</i>	European Commission, Decision of 21 April 2016, on notifying a third country of the possibility of being identified as a non-cooperating third country in the fight against illegal, unreported and unregulated fishing (2016/C 144/05).
<b>Prior action #5:</b> The Recipient, through its Cabinet, has approved the introduction of a tariff for residential water use for the three pilot areas of South Tarawa where households are provided with reticulated water 24 hours a day, 7 days a week, a decision critical for the Public Utilities Board to develop and sustain safe water supply services to all of South Tarawa, thereby reducing the associated burden on women and girls. <i>Status: Completed</i>	ADB, The Economic Costs of Poor Water and Sanitation South Tarawa, 2014; ADB, Balancing the Burden, 2015, on the disproportionate burden that lack of access to basic water and sanitation imposes on women and children in Kiribati.
<b>Prior action #6:</b> The Recipient, through its Parliament, has enacted the Early Childhood Care and Education Act 2017, for the regulation, facilitation and support of early childhood care and education and preschool programs and services at national and local government levels. <i>Status: Completed</i>	Kiribati Early Grades Reading Assessment, 2016; Kiribati Early Human Capability Index (KIEHCI) survey.

#### 4.3. LINK TO CPF, OTHER BANK OPERATIONS AND THE WBG STRATEGY

63. **The proposed operation is aligned with the priorities identified in the Regional Partnership Framework (RPF) FY17-FY21 (Report #120479).** The first component of the PDO on strengthening public financial management is aligned with focus area 4 of the RPF (strengthening the enablers of growth opportunities – specifically, the development and maintenance of frameworks to improve fiscal management). The second component of the PDO on supporting inclusive growth is aligned with focus



area 1 (fully exploiting the available economic opportunities – specifically, improved management of fisheries), focus area 4 (specifically, increased access to basic services) and focus area 2 (specifically, improving education outcomes). Both components of the PDO are aligned with the twin goals of ending extreme poverty and promoting shared prosperity in a sustainable manner, through the way fiscal management, exploiting available economic opportunities and improving access to basic services contribute to poverty reduction and shared prosperity.

64. **The proposed operation is complemented by a number of other Bank engagements in contributing to achieve the objectives of the RPF.** These include: (i) the World Bank Treasury RAMP, which is helping the GoK improve the governance, management and strategy relating to the RERF; (ii) the Pacific Regional Oceanscape Project (PROP), which is helping the GoK with the management of its fisheries assets; (iii) the Pacific Early Age Readiness and Learning (PEARL) Project, which is helping the GoK with school readiness and early grade literacy; and (iv) the Kiribati Adaptation Project (KAP) III and the South Tarawa Water and Sanitation Project under preparation, which are helping the GoK with providing sustainable access to water.

#### 4.4. CONSULTATIONS AND COLLABORATION WITH DEVELOPMENT PARTNERS

65. **The GoK formulates its national development plans through a consultative process among government stakeholders, civil society and the private sector.** As well as being consulted in its formulation, civil society and the private sector are invited to provide feedback on drafts of the plans and indicates areas that they can support. The planning process also involves widespread consultation with all government ministries and agencies. The consultation process for DPOs in Kiribati occurs through the Economic Reform Taskforce (ERT). The ERT was established prior to the first DPO series, to serve as a forum for consultation, coordination and management of key economic reforms. It is a joint government-donor working group, chaired by the Secretary to Cabinet with the Ministry of Finance and Economic Development serving as the Secretariat, and includes the Secretaries for all relevant government ministries and agencies, as well as representatives of the World Bank, ADB, DFAT and MFAT. The ERT provides a forum for dialogue, progress monitoring, results monitoring, and coordination of technical assistance for budget support-related reforms.

66. **The World Bank has collaborated closely with the ADB, DFAT and MFAT in the preparation of this operation.** In keeping with the established practice in the region, this operation is based on a joint policy matrix agreed between the GoK and this group of development partners. This approach improves the feasibility of reforms by having the GoK and key development partners focus on a small set of reforms, and by coordinating the provision of technical assistance in support of these reforms. This approach also reduces the transaction costs on the GoK, by harmonizing the engagement and procedural aspects of budget support operations. The policy matrix supported by the Bank represents a sub-set of the actions in the joint policy matrix (with the ADB supporting the two additional actions in the joint policy matrix on SOE reform and the preliminary steps in the asset management reform process). With respect to the actions in the joint matrix, the World Bank provides technical assistance on the RERF and education reform areas, the ADB provides assistance on the procurement reform area, and MFAT is the main provider of assistance on the fisheries reform area. The Bank, ADB, MFAT and DFAT work together to provide assistance to PUB, with the Bank and ADB preparing to co-finance the South Tarawa Water and Sanitation Project. In addition, the Bank collaborates closely with the IMF and with the Pacific Financial Technical Assistance Centre (PFTAC) on macro-fiscal policy and PFM issues.



## 5. OTHER DESIGN AND APPRAISAL ISSUES

### 5.1. POVERTY AND SOCIAL IMPACT

67. **Policies supported by the proposed operation are largely expected to have a positive impact on poor people and vulnerable groups.** Strengthening public financial management and safeguarding fiscal sustainability should help ensure that the GoK can maintain public services and public investment in human and physical capital, which tend to be of disproportionate importance to the poor. Improving the financial and operational performance of the RERF is vital to fiscal sustainability in Kiribati. Improving cash management will enable the GoK to increase its interest revenue, expanding public expenditure possibilities. Improving the efficiency of public procurement should contribute to higher quality public spending, again of disproportionate benefit to the poor.

68. **Supporting inclusive growth – through the fisheries and education reforms under the second pillar – is also expected to have a positive impact on poor people and vulnerable groups.** Safeguarding the returns Kiribati obtains from its oceanic fisheries assets – through an appropriate legislative framework – is expected to benefit the poor, primarily through the public services and public investment that sustained higher revenues enable. The revised legislative framework should also directly benefit local operators and those reliant on coastal fisheries for their livelihoods, as it provides a legal basis for the Minister to enforce catch limits and other measures to protect fisheries in Kiribati’s territorial waters.<sup>35,36</sup> Supporting access to quality ECCE services is expected to benefit the poor directly, because of its contribution to better learning outcomes – with the poor typically relying more on their human capital for their livelihood possibilities, because they have limited financial capital.

69. **Introducing a water tariff – which is a prerequisite for the sustainable provision of 24/7 water in South Tarawa – is expected to have positive impacts on poor people and vulnerable groups, but also some negative impacts in the short term.** The 24/7 supply of safe water will improve the quality of life of the people in the communities covered by the pilot and eventual rollout, who currently lack such access to potable water (and by inference, are likely to be in the lower income quintiles). The benefit is expected to be most pronounced for women, who typically bear greater responsibility for the health and wellbeing of children. However, the pilot tariff would result in monthly bills of over \$40 if households fully substituted towards the tap supply (instead of free sources such as well water) and is not in line with the estimated average willingness to pay (A\$12.20 per month, based on the World Bank’s 2018 survey), with only a 35% bill repayment rate in the pilots so far. Although the feedback from communities has been overwhelmingly positive, it is possible that the tariff has had a negative impact on households’ disposable income, depending on the extent to which consumers continue their old habit of boiling water (the cost of which can be as high as A\$118 per household per month according to a recent ADB study). Over time, we would expect households to make a net financial saving as they no longer burn fuel for water treatment. The negative impact in the short term is being mitigated through a PUB awareness program

<sup>35</sup> The Bank’s new PROP engagement will include a focus on supporting the GoK to improve management of coastal fisheries, including the collection of relevant data. As such, PROP will be able to assist the GoK with the practical implementation of the coastal management measures that the new legislation enables.

<sup>36</sup> Local fishing operators will also benefit from stricter penalties for IUU fishing included in the legislative reform, to the extent that they have been competing with IUU fishing operators for the same fisheries resources. This could be quite limited, given that most IUU fishing would occur in Kiribati’s EEZ rather than in coastal waters.



to help consumers understand their water usage, as well as staggered bill payment plans, although we understand that PUB is now starting to disconnect non-payers. In view of the level of non-payment, the Bank has instead encouraged the Ministry of Infrastructure and Sustainable Energy to review the appropriateness of the current pilot tariff. The tariff will be refined for the rollout of 24/7 supply, and the Bank is providing technical assistance to the GoK to support this. The Bank is currently analyzing potential tariff structures for the rollout, with the objective of ensuring that water expenditure is, for standard consumption levels, less than the international benchmark of five percent of household income, and that the overall tariff structure is consistent with willingness to pay (to avoid the cost of boiling lower-quality water, and the time taken to collect it). Based on the Bank's initial analysis, a tariff which resulted in monthly bills of A\$1 for the poorest 30 percent of households, and A\$8 for the next 30 percent, would remain consistent with households' willingness to pay and could be sufficient to cover PUB's operating costs in the future. This analysis will be further refined in consultation with the GoK and PUB. This process will also provide a foundation for a dialogue between the Bank and the GoK on possible complementary social protection arrangements for poor people and other vulnerable groups currently outside Kiribati's formal social safety nets.

## 5.2. ENVIRONMENTAL ASPECTS

70. **Policies supported by the proposed operation are not expected to have any significant direct adverse effects on the environment, forests and natural resources.** In the team's judgment, improving the management of the RERF, improving cash management, reforming public procurement, and supporting access to quality ECCE services are not expected to have any environmental impact. Strengthening the legislative framework for fisheries management to deter IUU fishing is expected to have a positive environmental impact, because IUU fishing undermines the sustainable management of the resource. The introduction of a water tariff accompanying the 24/7 supply of water in pilot areas of South Tarawa is also expected to have a positive environmental impact, because the structure of the tariff is designed to support water conservation – critical given the scarcity of water resources in South Tarawa especially. Increased access to safe water will also reduce the need to burn fuels to boil water, so may improve air quality and reduce emissions in South Tarawa.

71. **Kiribati's institutional capacity for environmental assessment and climate risk management is rated 3.0 according to the latest CPIA, indicating that the legal and regulatory framework are in place for effective environmental assessment system but weak capacity constrains monitoring and enforcement.** The Environment Act 1999 (with 2007 Amendments) and the Environment Regulations 2001 provide the legal and regulatory framework for the country's environmental assessment system. The draft Environmental Regulation 2009 is currently being redrafted to update the processes for environmental impact assessment. The Environment and Conservation Department is responsible for implementation and enforcement. Its capacity remains weak due to staff turnover, inadequate budget allocations to monitoring and enforcement, and a lack of capacity to carry out technical reviews of complex applications. Technical assistance is being provided through sector-specific Bank projects in the relevant reform areas, to help mitigate these institutional capacity weaknesses. For example, in the fisheries sector, the World Bank's PROP project includes an objective to "build the capacity of MFMRD to engage and support sustainable local marine-based resource development and management", and capacity supplementation will also be provided through the provision of a safeguards specialist in the project management unit. With respect to mainstreaming climate change management in national policy, Kiribati is committed to integrating climate risk awareness and responsiveness into its economic and



operational planning frameworks. In vulnerable areas, such as fresh water management and coastal protection, climate risks are integrated into projects and plans. Overall, while administrative capacity for environmental protection in Kiribati is weak, a combination of the existing environmental regulatory framework, the capacity building assistance being provided by the Bank, the nature of the reforms supported in the proposed operation, support the conclusion that the proposed operation is unlikely to lead to significant adverse environmental impacts.

### 5.3. PFM, DISBURSEMENT AND AUDITING ASPECTS

72. **Overall, the fiduciary risk to this operation arising from Kiribati's public financial management framework is assessed as substantial.**

73. **Following the 2010 Public Financial Management Performance Report, the government has worked to strengthen public financial management, with technical assistance from donors.** Information sharing between MFMRD and MFED on the sources of fisheries revenues has improved significantly (a measure supported by the first DPO series). There has been some progress in strengthening expenditure controls, through improved accounting systems and the move toward a more standard budget classification. However, issues remain in relation to the effectiveness of the controls and in reconciling the central accounting system with the separate systems in line ministries. There has been some incorporation of a multi-year perspective in budgeting. The backlog of annual financial statements of the government has been eliminated, and progress has been made in eliminating the backlog for the large SOEs (a measure supported by the previous DPO series). The government has strengthened the transparency of SOE-related financial activities, breaking down transfers to SOEs between CSOs and other transfers. Procurement reforms have also now been initiated (a measure also supported by the current operation). Kiribati's annual budget is made publicly available on the GoK's website once passed by Parliament (with the budget sessions broadcast on public radio).

74. **At the same time, a number of weaknesses highlighted in the 2010 report are yet to be addressed, and in some areas PFM performance has declined.** Previously identified weaknesses that have not been addressed include: (i) revenue estimates in the budget where variations can be in excess of 100 percent – although this is driven by the volatility of fishing license fee revenue; (ii) classification of the budget; (iii) oversight of aggregate fiscal risk from other public sector entities; (iv) competition, value for money and controls in procurement; (v) quality and timeliness of in-year budget reports; (vi) effectiveness of internal controls; and (vii) timeliness and regularity of accounts reconciliation. In addition, the credibility of the expenditure program has declined since the 2010 report, with deviations of more than 10 percent in 2015 and 2016 in aggregate expenditure outturn compared to original budget, and deviations of more than 10 percent in composition of expenditures compared to original approved budget in 2015 and 2016. Again, however, the main driver of these variations is fisheries revenue volatility, which the GoK accommodates by conservative original appropriations, and significant supplementary appropriations if revenues come in ahead of forecasts. Another area of declining performance is the accuracy of the government's financial statements, with the Auditor General providing a disclaimer audit opinion on the 2016 accounts (see below).

75. **External audit functions reasonably well in Kiribati.** The Audit Office is considered to function



well, although it struggles with limited resources and capacity, and its recommendations are not consistently implemented. While audit reports on the government's financial statements are available within eight months of their receipt, there have in the past been delays in the submission of the financial statements to the Audit Office. These delays have now been eliminated. The government's 2016 annual accounts were subject to a disclaimer audit opinion, with the Auditor-General unable to satisfy herself as to the accuracy of the financial statements and thus unable to express an opinion on them. The Auditor General found that there was a variance of A\$709,080 between the total revised budget and the annual account, "the significant amount of which is pervasive and would disclaim the accounts. Because of the error in the revised budget, the net saving for the year should be A\$3,410,965 and not \$2,701,884 as appeared in the annual account." Approximately 50 percent of expenditure is audited annually. There is strong parliamentary scrutiny of the audit reports. Parliament reserves one day per session for debate of the reports and the government is required to table a response to the Public Accounts Committee's recommendations. Parliamentary proceedings are broadcast on public radio, which has wide listenership. Nevertheless, the lack of information on tax expenditures – particularly fishing license fee and tax revenue foregone through fisheries joint venture agreements – limits the extent to which the public is able to scrutinize the full extent of the government's fiscal operations.

76. **Kiribati does not have a central bank or its own national currency.** It has not, therefore, been subject to an IMF Safeguards Assessment. The disbursement measures proposed are that the grant funds disbursed by the World Bank be deposited into a dedicated Local Currency Deposit Account and from it into the budget account of the government and thus available to finance budgeted expenditures. The grant will be disbursed according to IDA disbursement procedures for development policy operations. The full grant amount of US\$5 million equivalent will be disbursed against satisfactory completion of the specified policy actions as listed in Table 3, the government agreement as summarized in the Letter of the Development Policy, and adequacy of the macroeconomic policy framework, 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 Bank. ANZ is a large Australian bank and owns 75 percent of the ANZ Banking Company operating in Kiribati. The government owns the other 25 percent. This is the only commercial bank operating in Kiribati. All investment lending funds to Kiribati which require a Designated Account have used the ANZ.

77. **Flow of funds is subject to the government's regular financial management processes.** Grant proceeds once deposited into a dedicated Local Currency Deposit Account will be transferred into an account of the government available to finance budgeted expenditures, and will thus be subject to the government's regular PFM processes and procedures. As a due diligence measure, within 30 days of receipt of the IDA funds the Recipient will provide, by way of a letter, confirmation to the World Bank that the grant amount has been credited to an account used to finance budgeted expenditures. Disbursement would not be linked to specific purchases. The proceeds of the operation would not be used to finance expenditures excluded under the General Conditions for IDA Financing: Development Policy Financing (General Conditions). If, after being deposited in a government account, the proceeds of the operation are used for excluded expenditures as defined in the General Conditions, IDA will require the Recipient to refund the amount directly to IDA. Any such amounts refunded to IDA shall be cancelled.

78. **As an additional risk mitigation measure, the World 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.** The audit will cover the following: (i) the accuracy of the summary of the transactions of this account, including the accuracy of any 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 funds flow; and (iii) that payments from this dedicated Local Currency Deposit Account were not used for excluded expenditures as defined in the General Conditions and 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 end of the Recipient's financial year in which the grant is disbursed, and will be made publicly available in a timely fashion.

79. **The closing date for the proposed operation is September 30, 2020.**

#### 5.4. MONITORING, EVALUATION AND ACCOUNTABILITY

80. **The ERT provides the structure supporting the monitoring and evaluation of the proposed operation.** Progress against actions and outcomes will be collaboratively tracked, and any necessary remedial actions identified and executed jointly by the members of the ERT. Monitoring and evaluation will be supported by the data provided by relevant government ministries and agencies, donors, and those available from publicly available sources. As far as possible, results indicators rely on data that would be produced anyway or, where it does not, technical assistance has been committed to support the GoK to measure the required indicator.

81. **Grievance Redress.** Communities and individuals who believe that they are adversely affected by specific country policies supported as prior actions or tranche release conditions under a World Bank DPO may submit complaints to the responsible country authorities, appropriate local/national grievance redress mechanisms, or the World Bank's Grievance Redress Service (GRS). The GRS ensures that complaints received are promptly reviewed in order to address pertinent concerns. Affected communities and individuals may submit their complaint to the World Bank's independent Inspection Panel which determines whether harm occurred, or could occur, as a result of World Bank non-compliance with its policies and procedures. Complaints may be submitted at any time after concerns have been brought directly to the World Bank's attention, and Bank Management has been given an opportunity to respond. For information on how to submit complaints to the World Bank's corporate GRS, please visit <http://www.worldbank.org/GRS>. For information on how to submit complaints to the World Bank Inspection Panel, please visit [www.inspectionpanel.org](http://www.inspectionpanel.org).

#### 6. SUMMARY OF RISKS AND MITIGATION

82. **The overall risk rating for the proposed operation is substantial.**

83. **Institutional capacity risks are rated as high, because of the extremely thin capacity of the public sector to implement the reform program and sustain it over time.** Kiribati struggles with thin capacity – with a small number of public servants and external consultants responsible for carrying out a large number of tasks and implementing a large number of reforms. Those with well-developed technical skills and experience are often difficult for the public service to retain, due to the attractive opportunities offered by development partners with local offices or employment overseas. Program implementation



and especially sustainability is constrained by thin capacity, and can be significantly affected whenever public servants or external consultants leave their positions. This risk is mitigated somewhat by: having a relatively strong engagement with government that has been maintained over a number of years and has thus become somewhat institutionalized; selecting a limited number of policy actions; ensuring an alignment between those policy actions and government priorities; having dedicated technical assistance from various development partners to support the implementation of the policy actions; and having regular missions to help maintain the momentum of the program.

**84. Risks relating to sector strategies and policies are rated high, in part because the introduction of a water tariff to help enable the sustainable provision of 24/7 water in South Tarawa may be contested over time, particularly in connection with the impacts on poor people and vulnerable groups.**

The 24/7 supply of safe water will improve the quality of life of the people in the communities covered by the pilot and eventual rollout, who currently lack such access to potable water (and by inference, are likely to be in the lower income quintiles). However, the tariff may have a positive or negative effect on disposable incomes for poor people and vulnerable groups, depending on how fast consumers discontinue their old habit of burning fuel to boil water. Further, although the World Bank's 2018 survey found an average willingness to pay of A\$12.20 for high-quality water, 29 percent of households were not willing to pay anything or were unsure. This suggests a significant risk to PUB's ability to recover the costs of the improved water supply. These risks are being mitigated by the analysis and policy dialogue that will come out of the recently conducted willingness to pay survey and ongoing community consultations through the pilots, which will inform the review of the pilot tariff for the full rollout of 24/7 supply, and will also provide a foundation for a dialogue between the Bank and the GoK on possible complementary social protection arrangements for poor people and other vulnerable groups currently outside Kiribati's formal social safety nets. A further sector policy risk is posed by the preliminary nature of the dialogue between MFED and the Ministry of Education on government funding for the implementation of the ECCE Act, which will have a significant bearing on the achievement of the expected results. The World Bank, through both the DPO dialogue and PEARL engagement, will support this dialogue, helping to mitigate this risk.

**85. The political and governance risk is rated as substantial because the reform program supported by the DPO series includes areas that have tended to be politically sensitive.** These include the management of the RERF, the management of fisheries assets, and the introduction of a water tariff. To mitigate these risks, the dialogue accompanying the proposed operation has focused on reaching shared understandings and taking a step-by-step approach to reforms. Still, there is a large degree to which these political risks cannot be mitigated, because the reforms pertain to Kiribati's key assets, major established interests, or issues of widespread public interest – this makes the reforms potentially very important, but it means they are inherently risky.

**86. The macroeconomic risk is rated as substantial because Kiribati's economic and fiscal situation is inherently volatile and any negative economic or fiscal shock will inevitably detract from the policy focus on the reform program.** A major downturn in fisheries revenues, a major shock to global financial markets that affects the value of the RERF, or an extreme weather event that provides a large negative shock to the economy, would each intensify fiscal pressures and likely divert scarce administrative effort away from the reform program and towards addressing the shock. These are not risks that should necessarily be mitigated, because in any of those events, addressing the impact of the shock would likely be a higher priority than pursuing the reform program. To the extent that it is appropriate to maintain the reform momentum, the strong policy dialogue and technical and financial assistance provided by the group of development partners should serve as mitigating factors. Any stepping back from the GoK's



current fiscal anchors – a balanced budget and sustainable management of the RERF – would also have significant adverse consequences for the macroeconomic outlook. However, the GoK has demonstrated strong commitment to its fiscal anchors to date, including as shown by its recent decision to publish its fiscal strategy as part of the budget process. This risk is further mitigated by the specific engagement of World Bank Treasury on the RERF, and the economic policy dialogue with the GoK, where the Bank and other budget support donors engage regularly on the overall fiscal framework as well as on specific fiscal risks, such as those arising from the wage bill and airline SOE.

87. **A further substantial risk to the operation is posed by environmental and social risks, given Kiribati’s high degree of vulnerability to natural disasters and the effects of climate change.** If Kiribati experiences a natural disaster over the medium term, its macroeconomic stability may be threatened and significant parts of the bureaucracy may have to shift their attention to disaster recovery efforts. This poses a risk to the operation through the adequacy of the macroeconomic framework, and also through the potential diversion of scarce reform effort away from the reforms in the policy matrix. This risk is mitigated somewhat by the selection of a limited number of high priority reforms, but in the event of a major natural disaster it may well be that the reform program is rightly considered a lower priority than disaster response and recovery.

88. **As noted in Section 5.3, the fiduciary risk is rated as substantial.** The 2010 Public Financial Management Performance Report identified a number of significant weaknesses in PFM. While considerable reform work has been undertaken since, resulting in improved performance on some of these areas (such as guidance on budget preparation and timing of budget approval), a number of weaknesses highlighted in the 2010 report are yet to be addressed and in some areas PFM performance has declined, including in relation to aggregate expenditure and revenue outruns. As a risk mitigation measure, within 30 days of receipt of the IDA funds the Recipient will provide, by way of a letter, confirmation to the World Bank that the grant amount has been credited to an account used to finance budgeted expenditures. As an additional risk mitigation measure, the World 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. The audit will be provided to the World 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.

Table 4: Summary Risk Ratings

Risk Categories	Rating
1. Political and Governance	● Substantial
2. Macroeconomic	● Substantial
3. Sector Strategies and Policies	● High
4. Technical Design of Project or Program	● Moderate



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5. Institutional Capacity for Implementation and Sustainability	● High
6. Fiduciary	● Substantial
7. Environment and Social	● Substantial
8. Stakeholders	● Moderate
9. Other	
<b>Overall</b>	● Substantial

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**ANNEX 1: POLICY AND RESULTS MATRIX**

Prior actions and Triggers		Results		
Prior Actions under DPF 1	Triggers for DPF 2	Indicator Name	Baseline	Target
<b>Pillar 1---Program Development Objective 1: Strengthening public financial management with respect to financial and physical assets.</b>				
<b>Prior Action #1.</b> The Recipient, through its Cabinet, has endorsed a set of clear investment objectives for the Revenue Equalization Reserve Fund.	<b>(Indicative) Trigger # 1.</b> The Recipient’s RERF Investment Committee has adopted a revised investment strategy, and the Recipient’s Cabinet has endorsed this investment strategy.	<b>Results Indicator #1:</b> The RERF portfolio is implemented and managed in accordance with the revised investment strategy.	No (2017)	Yes (2021)
<b>Prior Action #2.</b> (i) The Recipient, through its Cabinet, has approved a Cash Management Policy, including a new cash target; and (ii) the Recipient, through its Ministry of Finance and Economic Development, has authorized initial transfers of excess cash reserves to an interest-bearing account of the Recipient, in accordance with the Cash Management Policy.	<b>(Indicative) Trigger # 2.</b> The Recipient’s Cabinet has adopted an asset management strategy for operating and maintaining major government-owned assets.	<b>Results Indicator #2:</b> Cash reserves above the operational cash target that are earning zero interest are reduced.  <b>Results Indicator #3:</b> Budget allocations for asset maintenance and repairs are made in accordance with the asset management strategy.	5.4 months of recurrent spending (Jul 2018)  No (2017)	1 month of recurrent spending (2021 average)  Yes (2021)
<b>Prior action #3:</b> In accordance with the Kiribati Public Procurement Reform Plan to establish a Central Procurement Unit (“CPU”) within the Ministry of Finance and Economic Development, the Recipient has: (i) through	<b>(Indicative) Trigger #3.</b> The Recipient’s Cabinet has submitted the revised legislative framework for procurement to Parliament.	<b>Results Indicator #4:</b> Competitiveness in public procurement is improved through procurement processes being subjected to	No (2017)	Yes (2021)



Prior actions and Triggers		Results		
its Cabinet, approved the establishment of posts for the staff complement of the new CPU; and (ii) through its Ministry of Finance and Economic Development, appointed a chief procurement officer and procurement officer.		competition in accordance with the new legislation. <b>Results Indicator #5:</b> Transparency in public procurement is improved through the online publication of tender award notices in accordance with the new legislation.	No (2017)	Yes (2021)
<b>Pillar 2---Program Development Objective 2: Supporting the prospects for inclusive growth by strengthening fisheries sector management and improving access to basic services.</b>				
<b>Prior Action #4.</b> The Recipient, through its Parliament, has enacted the Fisheries (Amendment) Act 2017, to define Illegal, Unreported and Unregulated (“IUU”) fishing, define serious fishing violations, raise the penalty provisions for serious offenses, and provide for greater transparency, to combat IUU fishing.	<b>(Indicative) Trigger #4.</b> The Recipient, through its Cabinet, has adopted a roadmap for the development of the fisheries transshipment subsector.	<b>Results Indicator #6:</b> A list of all fishing license conditions and the vessels they apply to is published not less than every six months, in accordance with the Fisheries (Amendment) Act 2017.  <b>Results Indicator #7:</b> Transshipment revenue as a proportion of total public revenue from fisheries is increased.	No (2017)  4 percent (2017)	Yes (2021)  8 percent (2021)
<b>Prior Action #5.</b> The Recipient, through its Cabinet, has approved the introduction of a tariff for residential water use for the three pilot areas of South Tarawa where households	<b>(Indicative) Trigger #5.</b> The GoK determines an appropriate pricing structure of the tariff for the full rollout of 24/7	<b>Results Indicator #8:</b> The number of households in South Tarawa with access to reticulated water 24/7 is	(Dec 2017) 0 households	(Jul 2021) 400 households



Prior actions and Triggers		Results		
are provided with reticulated water 24 hours a day, 7 days a week, a decision critical for the Public Utilities Board to develop and sustain safe water supply services to all of South Tarawa, thereby reducing the associated burden on women and girls.	reticulated water in South Tarawa.	increased.  <b>Results Indicator #9:</b> The percentage of women reporting a positive impact on their daily lives resulting from 24/7 access to safe water at home is increased.	(Dec 2017) 0 percent	(Dec 2021) 60 percent
<b>Prior Action #6.</b> The Recipient, through its Parliament, has enacted the Early Childhood Care and Education Act 2017, for the regulation, facilitation and support of early childhood care and education and preschool programs and services at national and local government levels.	<b>(Indicative) Trigger #6.</b> The roadmap for school readiness and early grade reading implementation has been adopted.	<b>Results Indicator #10:</b> The shares of Year 1 and 2 students in pilot schools demonstrating at least some reading comprehension is increased.	14 percent of Year 1 students and 64 percent of Year 2 students (2016)	24 percent of Year 1 students and 70 percent of Year 2 students (a 10 percent improvement) (2021)



**ANNEX 2: FUND RELATIONS ANNEX**

DOCUMENT OF INTERNATIONAL MONETARY FUND AND FOR OFFICIAL USE ONLY

**FOR  
INFORMATION**

FO/DIS/18/122

July 30, 2018

To: Members of the Executive Board  
From: The Acting Secretary  
Subject: [Kiribati—Assessment Letter for the World Bank](#)

Board Action: Executive Directors' information  
Publication: Yes\*  
Questions: Ms. Igan, RES (ext. 34743)

\*If the authorities consent to the publication of this assessment, it may be published by the World Bank.



## Kiribati—Assessment Letter for the World Bank

July 27, 2018

1. **Kiribati has enjoyed relatively strong growth in recent years, propelled by a substantial increase in fishing revenues and major infrastructure projects.** Real GDP grew at an annual average of 5¼ percent in 2015–16. By comparison, the average annual real GDP growth rate for 2000–14 was about 1½ percent. The stronger growth reflects in large part the record-high fishing revenue, which reached almost 80 percent of GDP (up from the historical average of 25 percent). Construction activity driven by donor-financed infrastructure investment also contributed. Real GDP growth is estimated to have moderated to around 3 percent in 2017 and is expected to moderate further to 2¼ percent in 2018, as fishing revenues normalize and several large projects come to completion. Inflation has remained subdued, in line with low inflation in trading partners and international food prices.

2. **Risks to near-term growth are substantial and skewed to the downside.** The favorable weather conditions underpinning strong fishing catches have lasted unusually long. A cyclical reversal could threaten revenues, with implications for the fiscal balance and the current account. Tighter global financial conditions could adversely affect the domestic economy through the exposure of the Revenue Equalization Reserve Fund (RERF) and the Kiribati Provident Fund (KPF). Given Kiribati's high reliance on imported goods, commodity price shocks and exchange rate volatility could have an outsized impact on imports, inflation, and growth.

3. **Kiribati's low-lying atolls are at the forefront of the challenges posed by climate change.** Rising sea levels, storm surge, coastal erosion, and saltwater intrusion jeopardize the country's limited resources and are likely to have a direct impact on potential growth as well as the fiscal position. The costs of mitigating the adverse effects of climate change can partially be met by the operational budget. In this regard, staff recommends that the budget includes an explicit provision for climate change adaptation, up to 2 percent of GDP annually to cover the recurrent costs. Capital projects, however, require continued financial support from donors.

4. **Debt Sustainability Analysis (DSA) indicates that Kiribati remains at high risk of debt distress.** The baseline scenario assumes that fishing revenues remain constant in real terms over the forecast horizon and the government maintains a conservative fiscal stance that adheres to a broadly balanced recurrent budget. Even then, the debt-to-GDP ratios breach the indicative thresholds within the next decade. Sensitivity analyses indicate that public debt is unsustainable under realistic shocks. While the large size of the RERF relative to external debt limits immediate risks, the RERF could be significantly depleted over the longer run in downside scenarios to fishing revenue. Containing the risk of debt distress will require further progress in structural and fiscal reforms, as well as securing grants to finance the country's significant development needs. Government borrowing through concessional loans should be closely monitored to safeguard long-run debt sustainability.



- 5. Prudent management of public resources remains the key policy challenge.** Accommodating Kiribati's considerable public spending needs in a sustainable way requires strengthening the fiscal policy framework. Rolling, multi-year expenditure paths should be laid out transparently to meet the government's development goals. These paths should be consistent with conservative revenue projections and wealth management targets. The framework should also entail achieving a balanced structural budget in the medium term with an appropriately-sized cash reserve buffer to deal with revenue volatility and external shocks. The RERF should be enhanced further as an anchor for long-run fiscal sustainability. Over the long run after the RERF balance achieves a target level, the authorities could consider formulating a rule-based withdrawal mechanism for RERF to support development spending, with the aim to preserve the RERF as an endowment fund that can provide the Kiribati population with a permanent and stable stream of income.
- 6. Strong macroeconomic management capacity and institutions are critical for the effective implementation of a sustainable development strategy.** To this end, the authorities should push forward structural fiscal reforms to address the institutional weakness in tax administration and public financial management. To catalyze donor support, the authorities could usefully consider technical assistance on improving the institutional framework for managing public investment, as well as access to donor financing for climate change adaptation and marine resource preservation.
- 7. A more dynamic private sector would help achieve the goal of inclusive prosperity.** There is limited scope in the public sector to absorb the strong labor force growth. The authorities should maintain the momentum of SOE reforms to create an environment for private-sector-led growth, by further strengthening the commercial mandate of the SOEs and developing a medium-term reform plan for operationally and financially sustainable delivery of electricity, water, and sanitation services. Continued divestment and outsourcing of SOE activities to the private sector will help improve efficiency and strengthen public finances. Further improvement in infrastructure, business environment, and human capital would also support private sector development. This includes promoting air transportation and shipping services, streamlining business licensing process and improving land registration. Building human capital, especially through vocational and technical training, would help Kiribati harness its marine resources. Further development in other domestic sectors including tourism and routine infrastructure maintenance could also offer more employment possibilities.
- 8. Financial deepening to support a dynamic private sector needs to be implemented in a sustainable way.** Facilitating private sector access to credit would be best achieved by removing structural impediments and improving financial education, land access procedures, dispute resolution mechanism and recovery processes. The public financial institutions have supported access to financial services but long-term sustainability of their operations calls for strengthened risk monitoring and addressing deficiencies in financial supervision, including by developing a comprehensive banking regulation framework. The crediting rates for KPF member balances should be more closely linked to its investment returns to ensure its ability to meet its contractual obligations, and the fund's investment strategy should switch to a more conservative one.



9. **Fund relations.** Kiribati is on a 12-month Article IV consultation cycle and has no outstanding purchases or loans and no financial arrangements with the IMF. The last Article IV consultation was concluded by the Executive Board on December 8, 2017.



Table 1. Kiribati: Selected Economic Indicators, 2015–20

	2015	2016	2017		2018		2019		2020	
			Est.	Proj.	Est.	Proj.	Est.	Proj.		
Real GDP (percent change)	10.3	1.1	3.1	2.3	2.4	2.3				
Real GNI (percent change)	19.8	-13.0	2.7	-2.3	2.2	2.6				
Consumer prices (percent change, average)	0.6	1.9	0.4	2.5	2.5	2.5				
Central government finance (percent of GDP)										
Revenue and grants	155.8	137.5	121.8	157.5	132.5	117.8				
Total domestic revenue	110.4	83.0	82.0	71.1	70.3	69.5				
Of which: fishing revenue	92.0	65.0	61.2	50.7	50.0	48.8				
External Grants	45.4	54.6	39.8	86.4	62.2	48.2				
Expenditure and net lending	113.2	127.6	129.5	163.2	138.4	122.5				
Current	60.3	67.8	84.8	72.0	71.7	69.9				
Development	52.9	59.8	44.7	91.1	66.8	52.6				
Recurrent fiscal balance (incl. budget grants)	52.2	18.7	4.4	3.8	6.7	-0.3				
Overall balance 1/	42.6	9.9	-7.7	-5.7	-6.0	-0.3				
Financing	-42.6	-9.9	7.7	5.7	6.0	0.3				
Of which: Revenue Equalization Reserve Fund (RERF)	-22.3	-12.3	0.0	0.0	0.0	0.0				
RERF										
Closing balance (in millions of Australian dollars)	756	868	923	949	976	1033				
Per capita value (in 2006 Australian dollars)	5,481	6,090	6,198	6,135	6,065	5,996				
Cash reserve buffer 2/										
Closing balance (in millions of Australian dollars)	133	145	126	138	160					
Balance of payments										
Current account including official transfers (in millions of US dollars)	79.1	35.3	17.7	34.6	15.0	3.8				
(In percent of GDP)	46.7	19.4	9.0	16.9	7.1	1.7				
External debt (in millions of US dollars)	32.5	41.1	51.7	60.4	69.3	77.8				
(In percent of GDP)	19.9	22.9	26.3	29.8	32.8	35.5				
External debt service (in millions of US dollars)	0.6	0.7	1.2	0.8	2.3	3.2				
(In percent of exports of goods and services)	3.9	3.7	5.9	3.9	10.0	9.5				
Exchange rate (A\$/US\$ period average)	1.3	1.3	...	...	...	...				
Memorandum item:										
Nominal GDP (in millions of US dollars)	181.7	197.3	204.5	211.0	220.0	227.3				

Sources: Data provided by the Kiribati authorities; and Fund staff estimates and projections.  
1/ Overall balance in the table is different from official budget because loans are classified as financing.  
2/ Cash reserve buffer includes the government's custodian account and cash account.



**ANNEX 3: LETTER OF DEVELOPMENT POLICY**



**GOVERNMENT OF KIRIBATI  
MINISTRY OF FINANCE & ECONOMIC DEVELOPMENT**  
Phone: (686) 74021806 Address: PO Box 67, Tarawa, Kiribati

Date: 1 October 2018

Mr. Jim Young Kim  
President  
The World Bank  
Washington, D.C., 20433

Dear President Kim

**Re: Letter of Development Policy**

In June 2018 this government launched Kiribati Vision 20 (KV20), which sets out our vision for a wealthier, healthier and peaceful Kiribati over 2016-2036. The KV20 is a blueprint for sustainable and inclusive economic growth, focusing on the key sectors of fisheries and tourism, as well as developing human capital, investing in infrastructure, and promoting good governance.

Since taking office in 2016, this government has made significant strides to delivering on the KV20 ambition. We have increased direct economic support to the rural population through doubling the copra price, introduced fee-free education for forms 4, 5 and 6, and reduced the cost of access to electricity in South Tarawa. We have also delivered on our commitments to improve the pay and working conditions for public servants, and invested in better transport and telecommunications links within Kiribati and internationally.

Importantly, these initiatives have been fully funded within the government's revenue envelope. Macroeconomic stability is a critical foundation for our economic growth targets, and prudent and sustainable fiscal management is a key priority for this government. As described in the Fiscal Strategy for the 2019 Budget, the first Fiscal Strategy to be made publicly available in Kiribati, the government is committed to running at least a balanced budget in 2019 and over the medium term.

Our government has been working closely with the World Bank and other development partners to deliver on the KV20 objectives, both in terms of project investments and the policy reform agenda. Allow me to highlight some of our policy reform priorities and recent achievements in more detail below.

The Revenue Equalisation and Reserve Fund (RERF) is one of Kiribati's most important assets and it is critical that it is managed effectively to provide benefits to both present and future generations. Since the current government took office in March 2016, the RERF value has increased by \$278.8 million to reach \$1.023 billion at the end of August 2018—two years ahead of the KV20 target of \$1 billion by 2020. In addition, this government has realised a number of management reforms, including implementation of new asset managers and the appointment of a new custodian through a competitive selection process. Cabinet recently approved the adoption of a clear set of objectives for the management of the RERF to maintain the real value of the fund while using a portion of RERF returns to finance development projects. World Bank technical assistance has been a valuable input throughout this process, and we continue to work with the World Bank team on implementing the new management objectives.



High fisheries revenue in recent years has allowed Kiribati to accumulate significant cash reserves, which can now replace the traditional revenue stabilisation role of the RERF. Cabinet recently adopted a Cash Management Policy to ensure that these significant cash reserves are managed as efficiently as possible while still meeting the liquidity needs of the government and the banking system.

Another public financial management priority is improving transparency and value for money in procurement. 2018 saw the establishment of a new Central Procurement Unit in the Ministry of Finance and Economic Development, and we look forward to working closely with the Asian Development Bank and New Zealand to continue implementing the Kiribati Public Procurement Reform Programme in 2019.

The dramatic increase in fisheries revenue that Kiribati has experienced in recent years serves to demonstrate the transformational potential of our marine resources. It is vitally important that both our EEZ and our inshore fisheries are managed sustainably for the benefit of current and future generations of I-Kiribati. To that end, we have amended our Fisheries Act to define Illegal, Unregulated and Unreported fishing in line with international practice, and increase the penalties for fishing violations in our EEZ and in our coastal waters. We are also committed to increasing value-added and job creation from our EEZ, and are exploring the development of fisheries transshipment hubs to support satellite services in Betio and Kiritimati.

Our vision for a healthy and wealthy Kiribati cannot be achieved without improved infrastructure and services. Access to safe drinking water is a particular challenge in South Tarawa, where the water lenses are coming under increased strain from climate change and population growth. This government is particularly mindful of how access to safe drinking water improves the health and wellbeing of women and children, as well as men. With the support of the World Bank and other development partners, we are working on climate-proof solutions to expand access to potable water. Our Public Utilities Board is piloting 24/7 piped water to 400 households, with plans to roll out to all of South Tarawa in the coming years. Cabinet has approved a tariff for the pilot 24/7 water service, to incentivize water conservation and customer service. We are also working with the New Zealand Government to strengthen our asset management and maintenance systems, to ensure that our infrastructure delivers to its expected service standard over its whole economic life.

Last but not least, our government is committed to ensuring all I-Kiribati receive a high-quality education and have access to decent employment. Our fee-free policy for senior secondary education is an important milestone towards this aspiration, and the new Early Childhood Care and Education Act signals our commitment to improve quality and access to early education for all I-Kiribati children.

This government welcomes the World Bank's continued engagement and assistance in support of the government's reform priorities. The previous four budget support operations have helped the government build a strong partnership with the World Bank and other development partners, and to develop a shared vision on priority reforms. The government looks forward to the World Bank's continued active engagement in Kiribati and its support for the country's ongoing reform agenda.

Yours sincerely

**Hon. Dr Teuea Toatu**  
**Minister for Finance and Economic Development**



**ANNEX 4: ENVIRONMENT AND POVERTY/SOCIAL ANALYSIS TABLE**

Prior Actions	Significant positive or negative environment effects	Significant poverty, social or distributional effects positive or negative
<b>Operation Pillar 1: Strengthening public financial management</b>		
<b>Prior action #1:</b> The Recipient, through its Cabinet, has endorsed a set of clear investment objectives for the Revenue Equalization Reserve Fund.	No	Yes – positive (indirect)
<b>Prior action #2:</b> (i) The Recipient, through its Cabinet, has approved a Cash Management Policy, including a new cash target; and (ii) the Recipient, through its Ministry of Finance and Economic Development, has authorized initial transfers of excess cash reserves to an interest-bearing account of the Recipient, in accordance with the Cash Management Policy.	No	Yes – positive (indirect)
<b>Prior action #3:</b> In accordance with the Kiribati Public Procurement Reform Plan to establish a Central Procurement Unit (“CPU”) within the Ministry of Finance and Economic Development, the Recipient has: (i) through its Cabinet, approved the establishment of posts for the staff complement of the new CPU; and (ii) through its Ministry of Finance and Economic Development, appointed a chief procurement officer and procurement officer.	No	Yes – positive (indirect)
<b>Operation Pillar 2: Supporting inclusive growth</b>		
<b>Prior action #4:</b> The Recipient, through its Parliament, has enacted the Fisheries (Amendment) Act 2017, to define Illegal, Unreported and Unregulated (“IUU”) fishing, define serious fishing violations, raise the penalty provisions for serious offenses, and provide for greater transparency, to combat IUU fishing.	Yes – positive	Yes – positive (indirect)
<b>Prior action #5:</b> The Recipient, through its Cabinet, has approved the introduction of a tariff for residential water use for the three pilot areas of South Tarawa where households are provided with reticulated water 24 hours a day, 7 days a week, a decision critical for the Public Utilities Board to develop and sustain safe water supply services to all of South Tarawa, thereby reducing the associated burden on women and girls.	Yes – positive	Yes – positive and negative (direct)



<p><b>Prior action #6:</b> The Recipient, through its Parliament, has enacted the Early Childhood Care and Education Act 2017, for the regulation, facilitation and support of early childhood care and education and preschool programs and services at national and local government levels.</p>	<p>No</p>	<p>Yes – positive (direct)</p>
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