



# KIRIBATI

## 2014 ARTICLE IV CONSULTATION—STAFF REPORT; PRESS RELEASE; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR KIRIBATI

May 2014

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2014 Article IV consultation with Kiribati, the following documents have been released and are included in this package:

- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on May 16, 2014, following discussions that ended on March 15, 2014, with the officials of Kiribati on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on May 5, 2014.
- An **Informational Annex** prepared by the IMF.
- A **Debt Sustainability Analysis** prepared by the staffs of the IMF and the World Bank.
- A **Press Release** summarizing the views of the Executive Board as expressed during its May 16, 2014 consideration of the staff report that concluded the Article IV consultation with Kiribati.
- A **Statement by the Executive Director** for Kiribati.

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# KIRIBATI

## STAFF REPORT FOR THE 2014 ARTICLE IV CONSULTATION

May 5, 2014

### KEY ISSUES

Kiribati's key economic challenges are to reduce large structural fiscal imbalances and increase growth and employment opportunities, while facing obstacles posed by remoteness, lack of scale, vulnerabilities to external shocks and climate change.

The significant fiscal consolidation envisaged by the authorities will help stabilize Kiribati's sovereign wealth fund (the Revenue Equalization Reserve Fund, or RERF) in real per capita terms. This stabilization effort would also require that fishing license fees remain close to recent exceptionally high levels, with windfall incomes relative to the conservative budgeted baseline saved. In the event of weaker fishing license fee revenues, a more ambitious adjustment in the non-fishing budget would be needed.

The small private sector share in the economy due to remoteness and weaknesses in business climate constrains growth and puts strain on public finances. Continuing the fiscal and structural reform program is essential. Climate change brings additional risks and fiscal costs.

#### Main Recommendations:

- Continue fiscal reforms designed to deliver fiscal consolidation and improved public financial management. Seek to maintain fishing license fees above the current conservative budget baseline, with windfalls saved to strengthen RERF balances. If fishing license fee windfalls cannot be sustained, explore other options to further strengthen fiscal balances.
- Continue reforms of state-owned enterprises (SOEs).
- Facilitate growth through improving the business climate and infrastructure, including through streamlining government services.

Approved By  
**Hoe Ee Khor and Peter Allum**

Discussions were held in Kiribati. The mission met with President Anote Tong, Minister of Finance Mr. Murdoch, Secretary of Finance Mr. Elli, other senior government officials and representatives from public enterprises and the private sector. The mission also participated in the Development Partner Forum organized by the government. The team comprised of Mr. Dodzin (Head), Mr. Bai, Mr. Cabezon, and Ms. Rauqueuqe (all APD). The World Bank and AsDB teams led by Mr. Haque and Mr. Lotele, and Mr. Choi (ED office) also joined the policy discussions.

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## BACKGROUND

**1. Smallness, remoteness and climate change risks combine to impede growth and fiscal sustainability in Kiribati** (Figure 1). Given its narrow production and export base, Kiribati continues to heavily rely on fishing license fees revenues, official transfers and workers' remittances to finance its structural trade deficit. There has been some pick-up in private sector activity with the commencement of key donor funded projects, even though the public sector still dominates the economy. Climate change risks provide further challenges for the country's already limited infrastructure and administrative resources.

**2. Fiscal outcomes have been dominated by volatile fishing license revenues, which have been unusually high in the last two years** (Figure 2). Government cleared its expensive commercial debt in 2012, which have helped with containing previously large spending outlays. Problematic SOEs and overruns on copra subsidy payments have continued to be a drag on the budget. On the revenue side, non-compliance dented government's tax revenue collections, even as high fishing license fees allowed the government to bolster the value of the Revenue Equalization Reserve Fund (RERF)<sup>1</sup> in 2013. The high financing demands placed on the country's sovereign wealth fund (SWF) via large and excessive current fiscal deficits over the years have significantly reduced the RERF real per capita value which is now significantly below its 2000 level.

**3. Government's reform program to address the country's fiscal and structural challenges continues, with the support of the donor community.** Key reforms to public financial management, tax systems, SOEs and the private sector are ongoing, in line with IMF advice. Significant progress has been made in SOE reform and work is underway to implement the recently-approved fisheries policy, and improve cash and debt management. Based on this reform progress, the World Bank has provided budget support for 2014 and further donor budget support is envisaged based on the continued progress of the reform agenda. The reforms are consistent with the IMF advice provided during the previous Article IV consultations and staff visits.<sup>2</sup>

**4. The IMF has been actively involved in all relevant aspects of the government-led reform program in coordination with the World Bank, AsDB, AusAid and other development partners.** The Fund has provided macroeconomic, fiscal, and debt sustainability assessments and projections.

<sup>1</sup> The Revenue Equalization Reserve Fund (RERF) is a sovereign wealth fund established in 1956 and capitalized using phosphate mining proceeds before phosphate deposits were exhausted in 1979. It is one of the main sources of fiscal income and budget financing for Kiribati.

<sup>2</sup> Staff conducted Article IV consultation and a staff visit in 2013. Both missions were conducted jointly with the World Bank and AsDB teams. The main recommendations of the consultation and the staff visit included: conducting a medium-term fiscal adjustment to ensure fiscal sustainability and to preserve the value of the RERF; continuing the structural reform agenda, including reform of the SOEs; executing authorities plan to strengthen the tax revenue, including through the introduction of the value added tax (VAT); streamlining inefficient subsidies; carrying on measures to promote private sector development through improving the business climate and infrastructure, and facilitating the development of the marine sector. The authorities advanced on most fronts as discussed in this staff report. Some areas, such as reforms of copra subsidies and public utilities remain to be addressed fully.

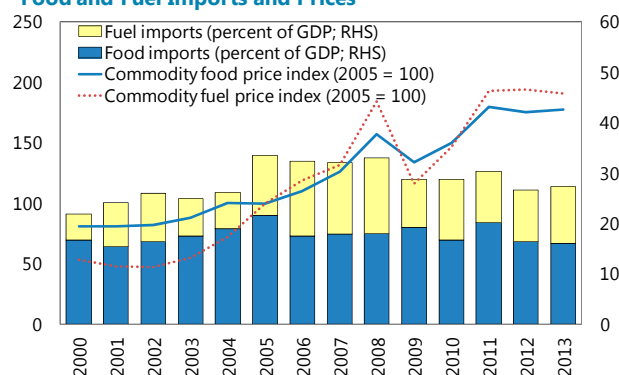
IMF experts from headquarters and PFTAC have provided TA in the area of public financial management, management of the RERF and the Kiribati Pension Fund (KPF), national accounts, government finance, and external statistics.

## OUTLOOK

**5. In 2013, the economy experienced its third year of consecutive economic growth on account of donor projects and increased private sector activity.** Construction activities related to the sea-port and private sector projects drove last year's growth outcome. Consumer and business confidence has improved with the commencement of the road project in 2014 and the anticipated positive spillover to the retail, wholesale and service-related sectors. Increased spending related to the donor projects is expected to raise inflation to about 2.5 percent in 2014, after a subdued 2013 outturn of 0.8 percent, due to moderate commodity prices.

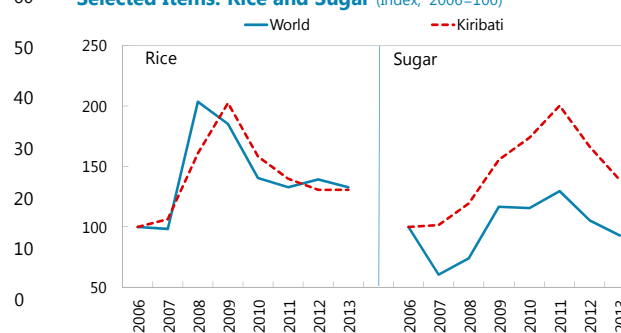
**6. Kiribati's external position, while in deficit, continues to be sustained by a steady flow of official capital transfers and recently also by high fishing license fees.** While the trade balance deteriorated slightly as a result of increased import demand associated with the donor infrastructure projects in 2013, positive balances in the income and transfers categories kept the current account deficit similar to 2012 levels. Moderate commodity prices also helped contain spending on imports. Notably, higher-than-expected fishing license revenues allowed the government to shore up the value of the RERF and favorable yields for Australian assets ensured steady income flows on Kiribati's SWF.

**Food and Fuel Imports and Prices**



Sources: IMF WEO; and staff calculations.

**International Price Index and Domestic Price Index on Selected Items: Rice and Sugar (Index, 2006=100)**



Sources: IMF, Primary Commodity Price System, Kiribati National Statistical Office and IMF Staff Estimates.

**7. Recent and planned key improvements to infrastructure should strengthen the growth momentum into the medium term.** Apart from creating jobs, the growth dividend to ongoing infrastructure projects includes improving the climate for increased investment and business activities.

**8. Risks to the near-term outlook are balanced** (see risk assessment matrix). While the positive impact of domestic public works may be larger than presently envisaged, a further softening in the external environment and volatile commodity prices present downside risks to growth. In addition,

volatile fishing licenses represent a real risk to stability of fiscal revenues. In the long term, the country's vulnerability to climate change and natural disasters presents risks to growth prospects.

### Box 1. Kiribati: Seamen Employment and Remittances

**Seafaring provides an important source of employment and remittances for Kiribati, which both having exhibited clear downward trends in recent years.** While remaining sizable, employment fell

sharply during the global financial crisis. As of December 2013, there were about 1008 Kiribati seamen on board, compared to 1452 in 2006. Over the period, seamen remittances fell by about 4 percent of GDP, and stood at 6 percent of GDP in 2013. The depreciation of the U.S. dollars over the past few years has also had a negative impact on the Australian dollar value of seamen remittances (see the figure below).

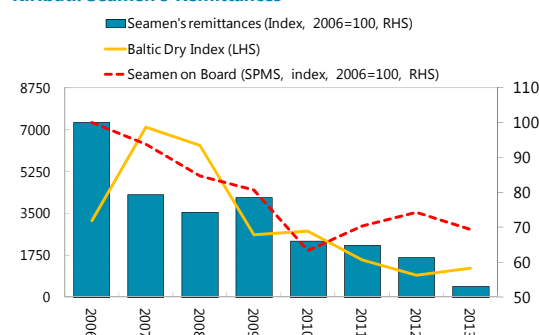
**The recovery in world trade from the global crisis did not produce a corresponding recovery in seamen employment for a number of structural reasons.** The

shipping industry continues to suffer from low profitability and overcapacity. In addition, the increasing size of ships and automation of ship operations have reduced the demand for seamen.

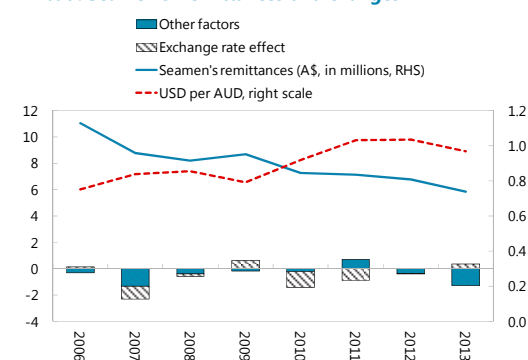
**Kiribati seamen are trained in the Kiribati Marine Training Center, which is considered one of the best vocational training institutes in the region.**

Nevertheless, seamen from Kiribati have become less competitive compared with those from the South and South-east Asian countries because of higher transport costs and longer visa processing times. Addressing these obstacles would help maintain the seamen profession as an important source of employment, training, and national income.

Kiribati: Seamen's Remittances



Kiribati: Seamen's Remittances and changes



## POLICIES TO ACHIEVE FISCAL SUSTAINABILITY AND PROMOTE LONG-TERM GROWTH

*Key policy challenges are to reduce structural fiscal imbalances and increase growth opportunities, in particular for private sector growth. These challenges are interconnected because private sector growth is vital for reducing the fiscal burden. Improving the business climate and implementation of remaining SOE reforms are vital. Enhancing access to finance for viable business projects, while maintaining adequate financial risk management is also important.*

## A. Fiscal Policy

*Main policy challenges in the fiscal area include the implementation of the planned reforms to improve fiscal outcomes and fiscal frameworks. Ensuring the sustainability of the RERF needs to remain among the main objectives.*

- 9. The government continued to make improvements into its public financial management framework.** It has strengthened the process for debt and guarantees approval and substantially reduced the exposure to SOE guarantees. For 2014, the government incorporated into the budget the subsidies called community service obligations (CSOs) in the amount of 1.7 percent of GDP to account more transparently for SOE-related budget costs. Next year, with the planned national elections, spending restraint will become even more important.
- 10. The VAT has been introduced on April 1 as planned.** The initial implementation phase is expected to involve some challenges. The required documentation for submitting VAT returns may yield additional revenue benefits through strengthening compliance. In this regard, the authorities are encouraged to continue to make the relevant technological investment and training to allow for an easing into this transitional phase.
- 11. Fiscal adjustment should continue with the excess revenues from fishing license fees saved in the medium-term while maintaining essential expenditures and investments in infrastructure, health, and education at sufficient levels.** The report considers two main scenarios given the uncertainty and volatility of fishing licenses (see Box 2 for details).
- 12. Following the framework of the 2013 Article IV report the baseline (or lower fishing license fees) scenario** assumes a conservative path for fishing license fees, which would return to the levels of about 22 percent of GDP for 2014. This scenario also corresponds with the authorities' budget assumptions and incorporates their current commitment to reforms, with estimated fiscal consolidation of more than 10 percent of GDP by 2019 and additional adjustment in the longer term. Despite significant consolidation effort, the RERF per capita balance continues to decline. Stabilization of the RERF in this case would require a challenging further fiscal adjustment. The stabilization of the RERF per capita value around 2023 would require narrowing the current fiscal balance to about 3½ percent of GDP. In addition stronger fiscal adjustment would lead to lower GDP growth compared to the baseline scenario.
- 13. The higher fishing license fees scenario assumes that these fees will remain high at close to 2012–13 levels.** This outcome, if it materializes, would largely eliminate the need for additional fiscal consolidation to stabilize the RERF above the level assumed in the baseline. However, it would be important to save these windfall license fees to strengthen RERF balances, rather than to finance additional spending. Stronger RERF balances would sustain a higher long-term current fiscal deficit of about 4½ percent of GDP in the longer run.
- 14. Further improving budgeting mechanisms around generation and use of sustainable fishing license fees are important.** License fees have been volatile and are currently difficult to project with confidence. To strengthen budget planning and cash management, improvements in the

timely exchange of information about the performance of the various components of fishing license revenues between key ministries and the Ministry of Finance would be important.

**15. Restructuring the copra subsidy scheme and improving operational efficiency at the Public Utilities Board (PUB) remain outstanding issues to reduce fiscal costs.** The government plans to make further steps towards enhancing revenue collections by introducing more modern meter equipment and improving operations of the PUB with the assistance of the World Bank.

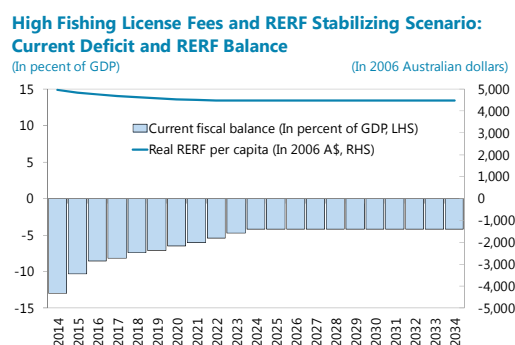
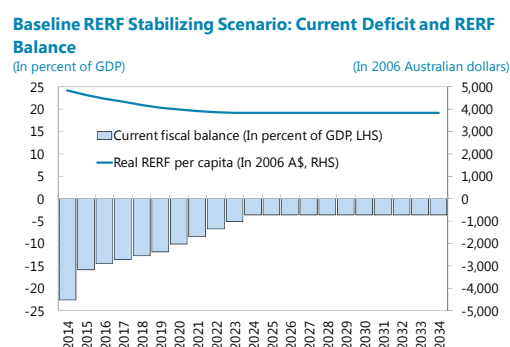
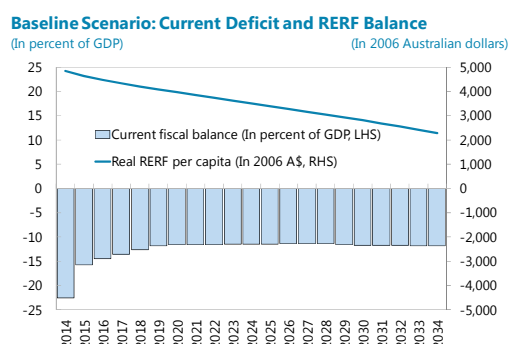
### Box 2. Kiribati: Ensuring Fiscal Sustainability

- **The baseline scenario** assumes conservative fishing license revenues and incorporates the authorities' current commitments to reform. It takes into account the recent introduction of value added and excise taxes, and assumes that current expenditures will grow more slowly than nominal GDP in the medium and longer term. This scenario also incorporates donor budget support of A\$25 million under the reform program in 2014–16. Under this scenario, the current fiscal deficit will be reduced from 22½ percent of GDP in 2014 to 11.8 percent of GDP in 2019 and stabilize at this level in the longer run. The RERF drawdown would be reduced from 14½ percent of GDP to 11.8 percent of GDP correspondingly. Despite the significant narrowing of the current fiscal deficit by more than 10 percent of GDP, the RERF per capita value does not stabilize and declines by more than 40 percent by 2030 compared to the projected 2014 level.

- **The baseline stabilizing RERF per capita value scenario** incorporates additional fiscal measures to stabilize the RERF per capita values by 2023–24 at about A\$3,900 in constant terms. Under this scenario, the current fiscal deficit has to narrow significantly to about 3.8 percent of GDP on average in 2023–30. Such stabilization will be difficult to achieve. It requires narrowing the current fiscal deficit by more than 8 percent of GDP in the long run.

- **The high fishing license fees and stabilizing RERF per capita value scenario**, assumes higher fishing license fees revenues and also some fiscal measures to stabilize RERF per capita values by 2023–24, at about A\$4,500 in constant terms. Owing to the high fishing license revenue, the required fiscal consolidation scale to stabilize the RERF balance is smaller than the baseline scenario, with the current fiscal deficit narrowing to 4.2 percent of GDP in the long run.

- **Under all of the above scenarios, Kiribati is projected to remain at high risk of external debt distress.** This reflects a projected from grant to debt financing for large infrastructure needs (Supplement I).



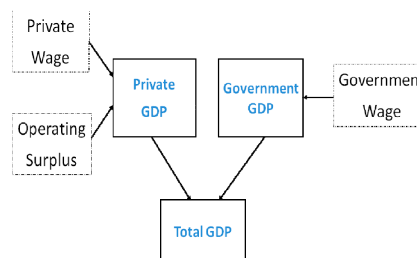
**16. The government's financing plans include mainly project and budget support grant financing in the near term.** Over the medium-term the government is also expected to access the concessional financing on IDA like terms (for details see Box 1 of the DSA Annex). The policy of avoiding non-concessional debt financing of the recurrent budget should continue.



### Box 3. Linkages Between the Government Sector and Growth and Fiscal Multipliers in Kiribati

**Due to small size and diseconomies of scale in Kiribati, the government sector plays a significant role for growth and employment prospects.** In 2013, total government current spending accounted close to 60 percent of GDP, and government sector for more than 28 percent of GDP. Government employees represented 21.5 percent of total employment and 42 percent of formal employment. Therefore, evaluating the impact of fiscal policies on growth and the overall economy is critical for the design of macroeconomic policies.

**This box briefly presents a practical framework that incorporates the two-way linkages between government spending and real GDP growth and allows estimating the impact of fiscal policy on the economy, including through evaluating fiscal multipliers.**<sup>1</sup> In this framework, GDP on the production side is conceptually divided into government GDP and private GDP. The government GDP mainly consists of wages of public employees; the private sector follows an augmented Cobb-Douglas production function. The impact of government sector on GDP is evaluated through the influence of government taxation and spending which critically depends on consumption, saving and investment decisions by the government, domestic residents, and foreigners, and on their shares of spending on domestic versus imported goods. The parameters are calibrated, with estimation procedures taking into data limitations.



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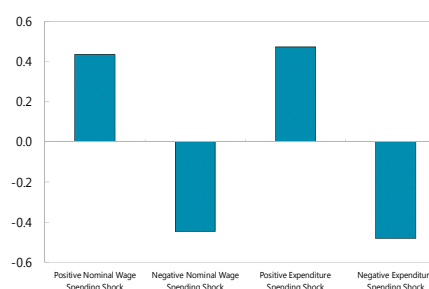
**We simulated different scenarios, including nominal wage shock and public expenditure shock scenarios.**

Then we calculated the corresponding fiscal multipliers under each scenario. The fiscal multipliers are defined as the ratio of a change in GDP output ( $\Delta Y$ ) to a discretionary change in government spending ( $\Delta G$ ). Here GDP is in real terms, so the multiplier means the effect of a \$1 increase in spending on the real GDP level. Regarding the time frame, we focus on the impact multipliers, which are defined as  $\Delta Y(t)/\Delta G(t)$ , where  $t$  denotes the year fiscal multipliers are examined.

**The simulation results show that different spending shocks have different multipliers.** As the shares of imported goods and services in household consumption and government expenditure are high in Kiribati, the stimulus effects of expansionary fiscal policy on domestic GDP are limited, and fiscal multipliers are relatively lower compared with economies with more developed domestic industries. Under a positive nominal public wage shock, the impact multiplier is 0.44, while the multiplier under a positive public expenditure is 0.47<sup>2</sup>, which implies that expansionary fiscal policy's stimulus effect on GDP growth is limited in Kiribati.

Combining the above calculated fiscal multipliers with budgeted current and development expenditure data, this framework also allows us to better project GDP growths, which is 3.0 in 2014 and 2.7 in 2015, as shown in the SEI table.

Impact Multipliers in Kiribati



<sup>1</sup> For more details, please see the book chapter: "Growth and Fiscal Multipliers in Small States – the Case of Pacific Island Countries", forthcoming.

<sup>2</sup> It is worth noting that development expenditure's impact multiplier is even lower (our estimate is 0.05–0.1, as most development expenditures are spent on imported goods and services in Kiribati). However, if development expenditure can increase productivity, the long-term fiscal multiplier would be higher.

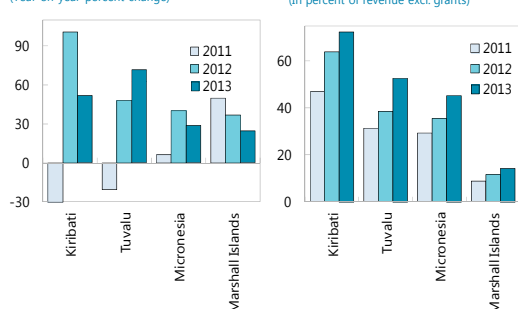
### Box 4. Regional Arrangement for Fishing License Fees

Fishing license fees are a major source of revenue for several microstates in the Pacific (in particular Kiribati, Micronesia, Marshall Islands, and Tuvalu). Since 2011, fishing license revenue has increased significantly, at an average rate above 30 percent during 2011–13. A large share of this increment is attributed to the implementation of minimum fishing license fees under the Parties to the Nauru Agreement (PNA).

The PNA is a regional agreement among member countries' to coordinate the management of marine resources. The Agreement was initially established in 1982 among eight Pacific island countries<sup>1</sup>, although it took several years until it reached its current form. This agreement sought to strengthen the bargaining power of license-issuing countries and regional control to address illegal fishing.

**Selected Members of the Nauru Agreement: Fishing License Fees Revenues**

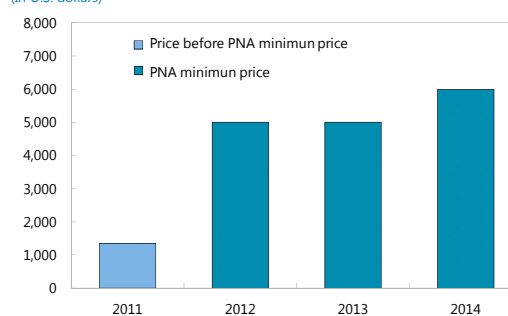
(Year-on-year percent change)



Note: Includes countries heavily dependent on fishing license fees.  
Sources: IMF, Asian-Pacific Small States Monitor, April, 2014.

**Parties of Nauru Agreement: Vessel Fishing Day Price**

(In U.S. dollars)



Sources: PNA and Pacific Islands Forum Fisheries Agency.

In 2007, PNA members introduced a new mechanism, the vessel day scheme (VDS), to increase the PICs' bargaining power and ensure sustainability of its marine resources. Instead of only setting a limit on the number of vessels in the region as was done previously, the new scheme also limited the total number of fishing days (limits both number of days and number vessels). Under the VDS, Nauru Agreement members jointly consented to allocate a fixed number of transferable fishing days for their combined Exclusive Economic Zones (EEZs), apportioned to members according to the individual sizes of their EEZs and historical catch. The fishing companies pay a flat fee per vessel per day with adjustment for the size of the vessel.<sup>2</sup>

The PNA members further strengthened the VDS in 2011 by introducing a minimum fee for fishing per vessel day. The minimum fee was set at US\$5,000 effective in 2012 and raised to US\$6,000 effective January 2014. In addition, the current practice includes revisions of total fishing days for the combined EEZs of the parties and annual revisions of the VDS minimum prices.

Sources: IMF, Asia & Pacific Small States Monitor April 2014; and PNA and Pacific Island Forum Fisheries Agency.

<sup>1</sup> The members of the Nauru Agreement are: Kiribati, the Marshall Islands, Micronesia, Nauru, Palau, Papua New Guinea, Solomon Islands, and Tuvalu.

<sup>2</sup> Large vessels pay a price of 1.5 times the standard fee.

## B. State-owned Enterprises Reforms

**17. Staff supports the extensive SOE reforms undertaken by the government with the assistance of the AsDB.** The closures of underperforming SOE have significantly reduced fiscal risks, including through the reduction of outstanding government guarantees. Government plans for the near term include privatizing certain enterprises and effectively implementing key provisions of the new SOE Act, particularly in the areas of SOEs' strategies formulation and financial reporting. Measures towards commercialization of SOEs and improving the operational efficiency of some others are all steps in the right direction. Nevertheless, realistic expectations need to be made about the commercial viability of those public enterprises that fulfill social mandates, including the shipping company that services the outer and dispersed smaller islands. Adequately complying with the government's debt and guarantee policy as well as enhancing the oversight and accountability according to the recently introduced SOE Act should contain these fiscal risks.

### Authorities' Views

**18. The government is committed to the SOE reform agenda.** The authorities indicated that visible success in SOE reforms has increased the community's buy-in for other public sector reorganization policies pursued by the government.

**19. The authorities acknowledge that even with privatization of some public enterprises, structural factors impede private sector activities.** Lack of management expertise and the unavoidable cost disadvantages of geography and diseconomies of scale mean that government will continue to tolerate some loss-making by key public enterprises.

## C. Increasing Private Sector Growth Opportunities

**20. The private sector in Kiribati remains small, limited by its market size, poor connectivity and high transport costs.** Since the combined cost impact of smallness and distance effectively undermine competitiveness, private sector activities that have grown in Kiribati are concentrated around imports distribution/retailing; meeting the demands for the public sector and associated projects; fishery related activities, and niche tourism.

**21. Proceeds from access to Kiribati's fishing waters and seamen remittances continue to be a large part of the country's national income.** Despite the positively high fishing license fee receipts in the recent past, the value of fish caught in Kiribati waters far exceeds fishing license fees and total Kiribati GDP. Kiribati must continue to encourage investment in onshore marine processing of its fish resources in order to fully realize its fisheries industry's potential. Recently, Kiribati seamen employment has been flat, as technological improvements to ships and high transport costs have cut into the demand for seafarers.

## Staff Views

**22. Reducing high unemployment should be among priorities.** According to the 2010 Census, the unemployment rate exceeds 30 percent. Given the ample challenge of creating jobs and raising economic growth, facilitating the mobility of Kiribati workers under existing arrangements can be further strengthened. Temporary migration programs for low-skill labor are quite attractive for PIC workers who are skilled at agriculture and fisheries and lack the professional qualifications to permanently migrate. The government has rightly encouraged training in technical areas for which there is external demand at its various education institutes.

**23. Exploiting opportunities and addressing constraints within existing areas of advantage are vital.** Ongoing infrastructure projects and the consequent demand and inflow of foreign workers have been met by growth in the retail and accommodation sectors, apart from greater awareness for Kiribati's niche-tourism potential. With the completion of these projects, improvements to public service delivery should also encourage confidence and increased private sector activity. On constraints, seamen recruitment and fishing industry stakeholders have raised the issue of high airfares and air freight charges as an unnecessary additional cost to doing business.

**24. With its vast marine resources, developing fisheries further appears to be most promising.** Kiribati's marine resources are quite significant that rents can be gained in spite of the inherent high cost structures. Government's planned development of Christmas Island, with a particular focus on fisheries, should raise job opportunities and help promote increased private sector activities. Even so, government is encouraged to continue to carefully analyze offers for joint ventures in developing its marine resources and promptly address concerns about the difficulties local fishermen face in accessing formal funding, if locals are to meaningfully participate in this key industry.

**25. Calling for modification, including increasing quotas, to existing regional seasonal worker schemes may be beneficial.** The assistance of regional governments is being sought to increase opportunities to work abroad, including increasing country quotas through seasonal worker schemes. Going forward, the authorities are encouraged to find avenues for directing graduates from its local educational institutions to some modified system of the seasonal worker scheme offered by both Australia and New Zealand in order to increase job opportunities and sustain growth and macroeconomic stability into the medium term.

**26. Ongoing infrastructure projects should support private business growth, outside of improving the business climate.** Improvements to strategic infrastructure such as the port and roads, and planned airport works should partly improve ease of doing business and cost competitiveness. In addition, government is advised to scale back red tape associated with the need for multiple business permits from town councils and various government agencies.

## Authorities' Views

**27. The authorities acknowledged the benefits of supporting the private sector and viable industries.** The government noted that with the exit of SOEs from certain wholesaling/retailing roles, the private sector promptly took over those functions, indicative of the willingness to do business. Improvements to telecommunications should also encourage other private sector entrants.

**28. Government continues to support labor migration.** Workers' remittances have been a dependable source of foreign exchange and income for Kiribati. However, the authorities are aware of other regional governments' concerns for making jobs available first to their citizens given the uncertain global economic environment.

## D. Financial Sector

### Background

**29. Formal financial sector lending remains limited.** The country's weak property rights and investor protection regimes preclude credit expansion. Between the country's only commercial bank and the Development Bank of Kiribati (DBK), accessing credit is relatively expensive. In addition, high spreads have kept lending profitable. Since government cleared much of its commercial borrowing in 2012, household credit has risen to largely take up that slack. Credit expansion to the agriculture, forestry and fisheries and construction sectors have been brisk, in particular after reducing public sector bank borrowing since 2010.

**30. The Kiribati Provident Fund's (KPF) small loans scheme (SLS) continues to grow.** Increased demand for credit has seen the SLS expand to around A\$11 million.<sup>3</sup> While the KPF's overseas investment income performed resiliently last year, the Fund must be watchful of nonperforming loans.

### Staff's Views

**31. Further improving the accessibility of land may create new opportunities for viable credit.** Given its small size, lending opportunities for financial industry players are quite thin. Hence, developing Kiribati's land market, by strengthening dispute resolution mechanisms and improving its land registry should assist with banks' collateral recovery.

Kiribati: Outstanding Banking Loans, 2007–13

	2007	2008	2009	2010	2011	2012	2013
	(In millions of Australian dollars)						
DBK	8.9	9.1	9.4	9.1	9.0	8.7	8.9
ANZ	32.9	49.9	48.9	36.3	40.0	31.4	38.0
Government, SOE and other	20.1	34.0	36.9	31.7	25.3	17.7	16.8
Private sector	11.9	14.8	11.3	4.0	11.4	10.1	10.3
Households	0.9	1.1	0.7	0.6	3.2	3.6	10.9
Total Loans	41.8	59.0	58.3	45.4	49.0	40.2	46.9
	(In percent of GDP)						
DBK	6.0	5.7	5.8	5.5	5.4	5.2	5.1
ANZ	22.4	31.1	30.1	22.1	23.9	18.6	21.7
Government, SOE and other	13.7	21.2	22.7	19.3	15.1	10.5	9.6
Private sector	8.1	9.2	7.0	2.5	6.8	6.0	5.9
Households	0.6	0.7	0.4	0.4	1.9	2.1	6.2
Total Loans	28.4	36.8	35.8	27.7	29.3	23.8	26.7

Source: Data provided by the Kiribati authorities.

**32. Capacity constraints mean that operational and lending standards and risk management strategies must be tightened.** In the absence of a financial system regulator, the country's nonbank financial institutions often have relatively high NPLs and low-asset quality, contributing to financial risks. For the KPF in particular, returning to a positive funding position is

<sup>3</sup> A member may borrow up to 35 percent of accrued balances for a maximum two years.

important for its long term sustainability as a pension fund as most retirees take lump-sum withdrawals. The KPF also must monitor vigilantly its financing of physical assets acquisition by SOEs, given the past poor financial track record of SOEs.

### Authorities' Views

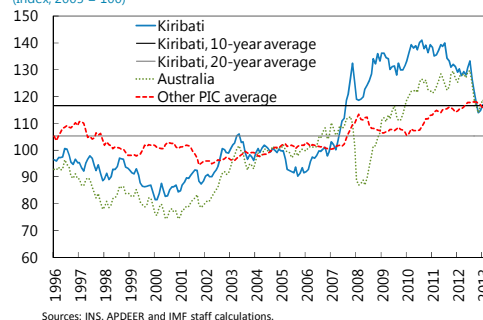
**33. The authorities broadly concurred with staff views.** Since the country's economic base will hardly support additional market players, the authorities recognize that addressing current impediments to increased financial intermediation and strengthening lending practices and investment strategies will help ensure financial system stability.

## E. Exchange Rate Assessment

**34. The Australian dollar circulates as legal tender.** Kiribati has accepted the obligations under Article VIII of the Fund's Articles of Agreement and maintains an exchange system free of restrictions on the making of payments and transfers for current international transactions.

**35. Reflecting the weakness of the Australian dollar and some global commodity prices, the real effective exchange rate (REER) is close to its long run average.** This depreciation of the REER reduces potential risks of overvaluation. That said, precise estimates of exchange rate valuation are difficult for Kiribati. CGER-like analysis is currently neither feasible nor meaningful for Kiribati given the data limitations. In addition, given its narrow production base, the real exchange rate plays a limited role in BOP performance, which is driven more by exogenous factors affecting fishing license fees and donor flows.

**Kiribati: Real Effective Exchange Rate**  
(Index, 2005 = 100)



**36. The use of the Australian dollar as the official currency remains appropriate.** It has provided a strong nominal anchor, given Kiribati's close linkages with Australia and in light of its limited capacity to conduct its own monetary policy. The reforms aimed at boosting private sector growth discussed above will be crucial to improving and maintaining competitiveness. The current account deficit in relation to GDP is largely driven over the medium term by fiscal policy. Consistent with this, the projected fiscal consolidation in the coming years will also be important to help narrow the trade deficit.

## STAFF APPRAISAL

**37. Kiribati has made significant strides since starting the government-led reform program supported by the donor community.** Key policy challenges include the steady implementation of planned fiscal and structural reforms with the aim of eventually stabilizing the RERF per capita balance and improving growth prospects, and facilitating the development of the private sector through improving infrastructure and enhancing business climate conditions.

- 38. Fiscal adjustment should aim at stabilizing the RERF in real per capita terms over the medium term.** This will require determined implementation of the currently planned fiscal consolidation efforts, while ensuring adequate investment in the priority areas of infrastructure, health and education. The authorities should seek to boost fishing license fees above the current conservative baseline, with additional receipts saved to replenish the RERF. In the event that fishing license fees cannot be sustained at recent high levels, the authorities should explore options for further strengthening other aspects of budget performance to ensure longer-term fiscal sustainability.
- 39. The government made impressive progress with SOE reforms.** These reforms should continue, including through the implementation of the SOE Act and planned privatization and reforms in the telecommunication and infrastructure sectors. The problems with underperforming SOEs, in particular the PUB, need to be addressed. Government intentions to tackle the inefficient copra subsidy system and reform related enterprises are welcome.
- 40. We commend the authorities on introducing the VAT this year.** The challenge now is to ensure robust implementation. Ensuring adequate compliance for other major taxes is also very important, and the authorities need to maintain resources in this area.
- 41. The private sector is critical for lifting growth prospects for Kiribati and reducing high unemployment.** We welcome plans to develop fisheries infrastructure on Christmas Island with the assistance of the EU. High transport costs, including airfares, present a big hurdle for doing business in Kiribati and the efforts to address these with the help of the regional and donor communities are welcomed. Expanding opportunities to work abroad, including for qualified graduates, would help increase employment and build human capital.
- 42. Improving access to credit for viable private sector projects while ensuring robust risk management is important.** Introducing modern banking technologies such as payment through mobile phones would help improve financial inclusion through facilitating access to financial accounts and transactions, including paying utility tariffs. At the same time appropriate risk management procedures need to be maintained. Also, the pension fund needs to return to a positive net funding position.
- 43. It is recommended that the next Article IV consultations continue to take place on a 12-month cycle in light of ongoing structural challenges and vulnerabilities and government reforms that require close involvement of the IMF.**

## Risk Assessment Matrix <sup>1/</sup>

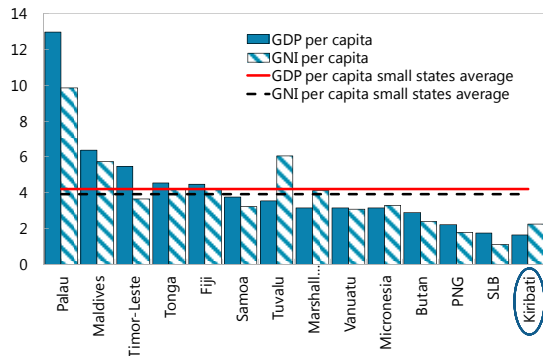
Sources of Risks	Likelihood	Potential Impact
Fiscal sustainability risks	<b>Medium</b> Declining reform momentum and political will would lead to delay in delivering the necessary fiscal and structural reforms and impede fiscal adjustment.	<b>High</b> Lack of progress in tax and expenditure reforms would lead to continuous unsustainable deficits and eventual depletion of the RERF in the longer run.
Protracted slowdown in advanced and emerging economies	<b>Medium (except Europe) High (Europe)</b> Advanced economies: larger than expected deleveraging or negative surprises on potential growth. Emerging markets: earlier maturing of the cycle and incomplete structural reforms leading to prolonged slower growth. As a result of stalled or incomplete delivery of policy commitments at the national or Euro area level, or adverse developments in some peripheral countries, financial stress could re-emerge and bank-sovereign-real economy links re-intensify.	<b>Medium</b> The decline in global returns and valuations would have a negative impact on RERF assets. Also, fishing license fees and seamen's remittances could be negatively affected if global demand for fish and shipping grows at a slower pace of growth. The adverse impact would be somewhat mitigated by its limited direct exposure to the Euro area. and proximity to the growing Asia and Pacific economies
Financial Risks Financial stress in the Euro area re-emerges triggered by stalled or incomplete delivery of national and euro area policy commitments	<b>Medium</b> Financial stress in the Euro area re-emerges triggered by stalled or incomplete delivery of national and euro area policy commitments Risks to financial stability from incomplete regulatory reforms: delays, dilution of reform, or inconsistent approaches (medium-term)	<b>Medium</b> Declining growth prospects could impinge on global asset valuations and negatively affect the value of the RERF assets. The adverse impact would be somewhat mitigated by its limited direct exposure to the Euro area
Fluctuations in commodity prices.	<b>Medium</b> Sustained decline in commodity prices triggered by deceleration of global demand and coming-on-stream of excess capacity (medium-term)	<b>Medium</b> Decline in commodity prices would be favorable to Kiribati since it will reduce the value of imports. At the same time commodity price increase would work in opposite direction.
Geopolitical risks.	<b>Low</b> Disruptions triggered by geopolitical incidents in East Asia (financial flows and supply chain)	<b>Low</b> Fishing license fees may be affected by the disruption of shipping.
<p>1/ The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (that is, which is the scenario most likely to materialize in the view of IMF staff). The relative likelihood of risks listed is the staff's subjective assessment of the risks surrounding this baseline. The RAM reflects staff's views on the source of risks and overall level of concerns as of the time of preparation of this document.</p>		



**Figure 1. Kiribati: The Setting in a Cross-Country Context**

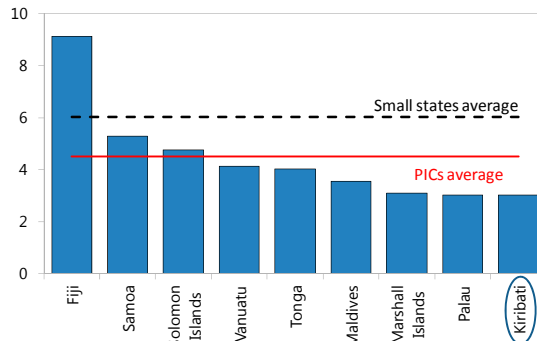
*Kiribati is one of the lowest earning...*

**Per Capita Income, 2012**  
(In thousands of U.S. dollars)



*...and the most remote islands among small states.*

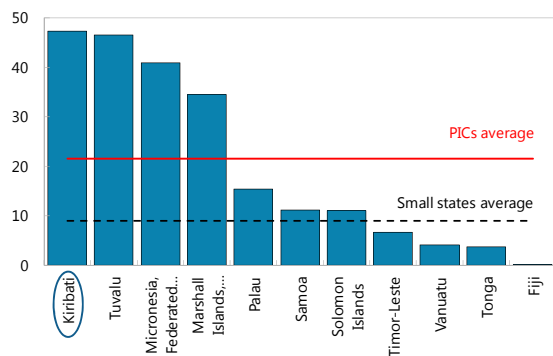
**Liner Shipping Connectivity Index, 2005-2012**



Note: A smaller number indicates lower connectivity/high transportation costs. Countries with maximum connectivity=100. Non-small states mean= 26.1.

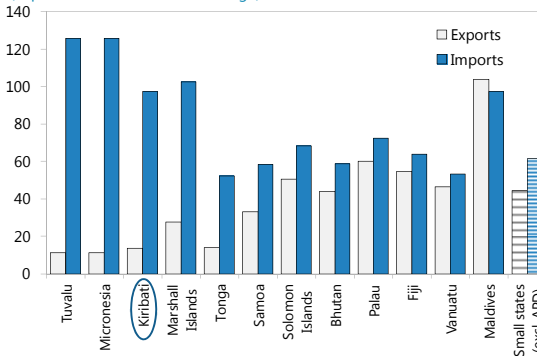
*The country relies heavily on foreign aid...*

**External Grants, 2012**  
(In percent of GDP)



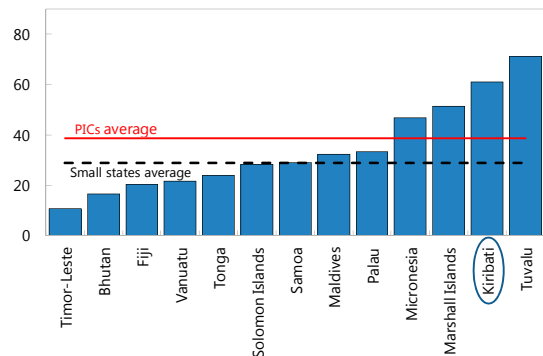
*...to finance its large development needs, which are contributing to import demand.*

**Trade Balance of Goods and Services**  
(In percent of GDP, 2007-12 average)



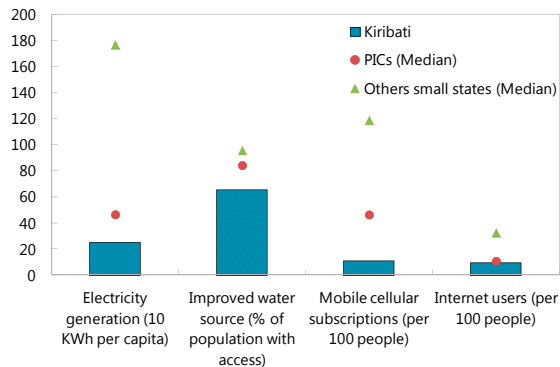
*Public sector is dominant due to the economy's narrow production base and constraints to private sector development...*

**Current Government Expenditure, 2012**  
(In percent of GDP)



*... including weak infrastructure.*

**Infrastructure Indicators, 2012**



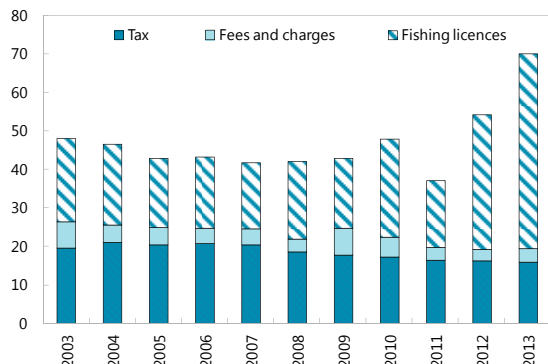
**Figure 2. Kiribati: Fiscal Dynamics**

Fishing license revenues amount to about half of total revenue and were high in the last two years...

...and have been volatile.

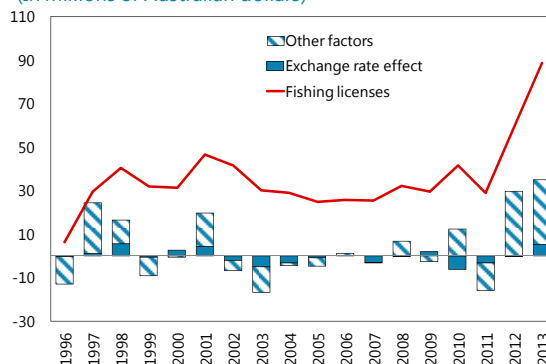
**Revenue**

(In percent of GDP)



**Fishing License Fees and Their Changes**

(In millions of Australian dollars)



Current expenditures are high as a share of GDP...

...and fiscal balance tends to drive the current account.

**Current Expenditure**

(In percent of GDP)



**Drivers of the Current Account Balance**

— Current account balance + capital grants (in percent of GDP)  
 - - - Overall fiscal balance (in percent of GDP)  
 - - - Change in REER (in percent, y/y)

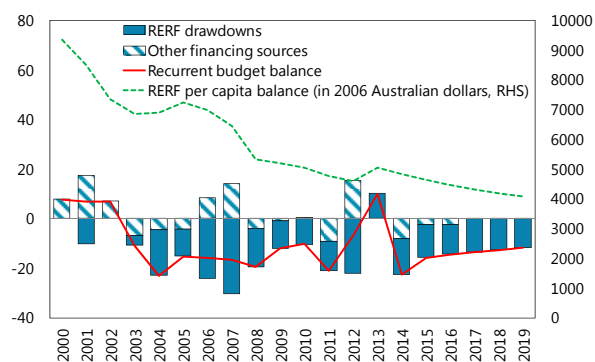


REER drawdowns finance most of the current fiscal deficit...

... and high fishing license revenue outcomes will improve the REER dynamics.

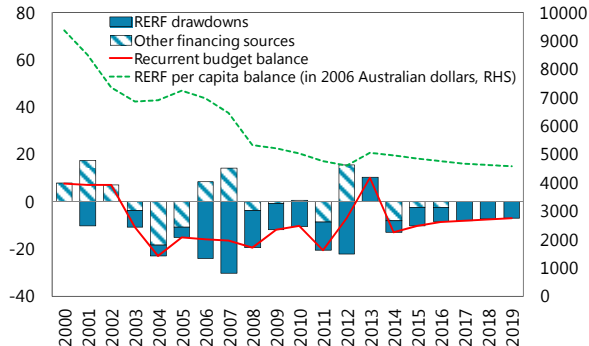
**Fiscal Deficit and Financing: Baseline Scenario**

(In percent of GDP)



**Fiscal Deficit and Financing: High Fishing License Fees and REER Stabilization Scenario**

(In percent of GDP)



Sources: Kiribati authorities; and Fund staff estimates.

**Table 1. Kiribati: Selected Economic Indicators, 2009–15**

Nominal GDP (2011): US\$172.7 million  
 Nominal GNI (2011): US\$236.1 million  
 Main export products: fish and copra

GDP per capita (2011): US\$1,670  
 Population (2011): 103,365  
 Quota: SDR 5.6 million

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

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

1/ Assumes conservative path for fishing license fees in 2014 and onwards. Higher fishing license fees at the level of A\$60 million would imply a current deficit of 13 percent of GDP in 2014.

2/ Current balance excludes grants and development expenditure.

3/ The Australian dollar circulates as legal tender.

4/ Index, 2005=100.

Table 2. Kiribati: Summary of Central Government Operations, 2009–19

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
				Est.				Proj.			
(In millions of Australian dollars)											
Total revenue and grants	115.4	119.0	103.7	152.8	197.9	155.2	163.9	161.6	152.5	145.7	146.4
Revenue	69.6	78.4	61.9	91.3	122.6	72.4	79.8	82.9	86.3	90.0	93.7
Tax revenue	28.7	28.3	27.3	27.4	27.8	24.4	30.4	32.2	34.3	36.5	38.8
<i>Of which:</i> Personal income tax	6.2	6.1	6.1	7.2	7.1	5.6	5.9	6.2	6.5	6.8	7.1
Company tax	7.0	7.3	5.7	4.7	4.6	4.8	5.0	5.6	6.3	7.0	7.7
Import duties	15.5	14.8	15.4	15.4	16.1	...	...	...	...	...	...
VAT & Excise	...	...	...	...	...	14.0	19.4	20.2	21.4	22.7	24.0
Other taxes (hotel)	0.1	0.1	0.1	0.1	0.0	0.0	0.1	0.1	0.0	0.0	0.0
Nontax revenue	40.8	50.1	34.6	64.0	94.8	48.0	49.4	50.7	52.1	53.5	54.9
<i>Of which:</i> Fishing license fees	29.5	41.7	29.1	58.8	88.6	42.2	43.3	44.3	45.4	46.6	47.7
Other	11.3	8.4	5.6	5.1	6.2	5.8	6.1	6.4	6.6	6.9	7.2
External grants	45.8	40.6	41.9	61.5	75.3	82.8	84.2	78.7	66.1	55.7	52.7
Total expenditure	134.9	139.7	139.3	164.2	179.9	203.0	203.6	201.4	192.9	187.3	187.0
Current expenditure	89.1	95.2	97.0	103.0	104.9	114.2	110.5	112.5	115.5	118.5	121.6
<i>Of which:</i> Wages and salaries	40.2	44.4	45.8	47.9	52.1	53.4	54.5	55.5	56.7	57.8	58.9
Subsidies to public enterprises 1/	5.8	6.3	8.5	6.8	9.8	13.5	12.5	11.5	11.5	11.5	11.5
Other current expenditure	43.1	44.6	42.7	48.4	42.9	47.3	43.5	45.4	47.3	49.2	51.1
Repayments	1.5	8.4	1.1	1.0	2.2	8.9	1.0	1.0	0.0	0.5	0.0
Interest payments	1.4	1.4	2.7	6.2	0.8	0.8	0.9	1.5	1.6	2.1	2.2
Others	40.1	34.8	39.0	41.2	40.0	37.6	41.6	42.9	45.7	46.6	48.9
Development expenditure 2/	45.8	44.5	42.2	61.2	75.0	88.8	93.1	88.9	77.4	68.8	65.5
Net lending	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Current fiscal balance 3/	-19.5	-16.8	-35.1	-11.7	17.7	-41.8	-30.8	-29.6	-29.1	-28.6	-27.9
Overall balance 4/	-19.5	-20.8	-35.5	-11.4	18.0	-47.8	-39.7	-39.8	-40.4	-41.7	-40.7
Financing	19.5	20.8	35.5	11.4	-18.0	47.8	39.7	39.8	40.4	41.7	40.7
Revenue Equalization and Reserve Fund (RERF)	18.0	17.3	19.7	37.5	-17.7	26.8	25.8	24.6	29.1	28.6	27.9
Project loans (net)	-0.9	4.0	0.4	-0.3	-0.3	6.0	8.9	10.2	11.2	13.1	12.8
Commercial borrowing	-2.1	-0.5	15.4	-25.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Budget support	...	...	...	...	0.0	15.0	5.0	5.0	...	...	...
(In percent of GDP)											
Total revenue and grants	70.9	72.5	62.0	90.4	112.9	83.9	84.1	78.9	70.9	64.6	62.0
Revenue	42.7	47.8	37.0	54.0	69.9	39.1	40.9	40.5	40.2	39.9	39.7
Tax revenue	17.7	17.2	16.3	16.2	15.9	13.2	15.6	15.7	15.9	16.2	16.4
<i>Of which:</i> Personal income tax	3.8	3.7	3.6	4.2	4.0	3.0	3.0	3.0	3.0	3.0	3.0
Company tax	4.3	4.5	3.4	2.8	2.6	2.6	2.6	2.8	2.9	3.1	3.3
Import duties	9.5	9.0	9.2	9.1	9.2	...	...	...	...	...	...
VAT	...	...	...	...	...	7.6	9.9	9.9	10.0	10.1	10.2
Other taxes (hotel)	0.1	0.0	0.0	0.0	0.0	0.0	0.1	0.0	0.0	0.0	0.0
Nontax revenue	25.1	30.5	20.7	37.9	54.0	25.9	25.3	24.8	24.2	23.7	23.3
<i>Of which:</i> Fishing license fees	18.1	25.4	17.4	34.8	50.5	22.8	22.2	21.7	21.1	20.7	20.2
<i>Of which:</i> other	7.0	5.1	3.3	3.0	3.5	3.1	3.1	3.1	3.1	3.1	3.0
External grants	28.1	24.7	25.0	36.4	43.0	44.8	43.2	38.4	30.8	24.7	22.3
Total expenditure	82.8	85.2	83.2	97.2	102.6	109.7	104.5	98.3	89.7	83.1	79.3
Current expenditure	54.7	58.0	58.0	61.0	59.8	61.7	56.7	54.9	53.7	52.6	51.5
<i>Of which:</i> Wages and salaries	24.7	27.0	27.4	28.3	29.7	28.8	27.9	27.1	26.4	25.6	25.0
Subsidies to public enterprises 1/	3.6	3.8	5.1	4.0	5.6	7.3	6.4	5.6	5.4	5.1	4.9
Other current expenditure	26.5	27.2	25.6	28.6	24.5	25.5	22.3	22.2	22.0	21.8	21.7
Repayments	0.9	5.1	0.7	0.6	1.3	4.8	0.5	0.5	0.0	0.2	0.0
Interest payments	0.9	0.8	1.6	3.7	0.5	0.4	0.5	0.7	0.8	0.9	0.9
Others	24.7	21.2	23.3	24.4	22.8	20.3	21.4	20.9	21.2	20.7	20.7
Development expenditure	28.1	27.1	25.2	36.2	42.8	48.0	47.8	43.4	36.0	30.5	27.7
Net lending	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Current fiscal balance (excl. grants)	-12.0	-10.2	-21.0	-6.9	10.1	-22.6	-15.8	-14.5	-13.6	-12.7	-11.8
Overall balance	-12.0	-12.7	-21.2	-6.7	10.3	-25.8	-20.4	-19.4	-18.8	-18.5	-17.2
Financing	12.0	12.7	21.2	6.7	-10.3	25.8	20.4	19.4	18.8	18.5	17.2
RERF	11.1	10.5	11.8	22.2	-10.1	14.5	13.2	12.0	13.6	12.7	11.8
Project loans (net)	-0.6	2.4	0.2	-0.2	-0.2	3.2	4.6	5.0	5.2	5.8	5.4
Commercial borrowing	-1.3	-0.3	9.2	-15.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Budget support	...	...	...	...	0.0	8.1	2.6	2.4	...	...	...
Memorandum items:											
RERF balance (in millions of Australian dollars)	571	581	579	581	668	666	668	673	681	690	701
RERF balance (in percent of GDP)	351	354	346	344	381	360	343	329	317	306	297
Real per capita value (in 2006 A\$)	5209	5040	4759	4592	5058	4837	4643	4472	4326	4192	4075
Nominal GDP	163	164	167	169	175	185	195	205	215	225	236
Real GDP (percentage change)	-0.7	-0.5	2.7	2.8	2.9	3.0	2.7	2.5	2.4	2.3	2.1

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

1/ Includes subsidies to copra production.

2/ Development expenditure equals grants plus loans for development projects.

3/ Current balance excludes grants and development expenditure (see footnote 2 above)

4/ Overall balance in the table is different from official budget because loans are classified as financing.

Table 3. Kiribati: Medium-Term Projections, 2009–19

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
				Est.	Proj.						
<b>Real sector</b>											
Real GDP (percentage change)	-0.7	-0.5	2.7	2.8	2.9	3.0	2.7	2.5	2.4	2.3	2.1
Inflation (period average)	9.8	-3.9	1.5	-3.0	-1.5	2.5	2.5	2.5	2.5	2.5	2.5
Nominal GDP at market prices (in millions of A\$)	162.8	164.1	167.3	169.0	175.4	185.1	194.9	204.8	215.0	225.4	235.9
<b>Government finance</b>											
	(In percent of GDP)										
Total revenue and grants	70.9	72.5	62.0	90.4	112.9	83.9	84.1	78.9	70.9	64.6	62.0
Revenue	42.7	47.8	37.0	54.0	69.9	39.1	40.9	40.5	40.2	39.9	39.7
External grants	28.1	24.7	25.0	36.4	43.0	44.8	43.2	38.4	30.8	24.7	22.3
Total expenditure and net lending	82.8	85.2	83.2	97.2	102.6	109.7	104.5	98.3	89.7	83.1	79.3
Current expenditure	54.7	58.0	58.0	61.0	59.8	61.7	56.7	54.9	53.7	52.6	51.5
<i>Of which: Wages and salaries</i>	24.7	27.0	27.4	28.3	29.7	28.8	27.9	27.1	26.4	25.6	25.0
Development expenditure	28.1	27.1	25.2	36.2	42.8	48.0	47.8	43.4	36.0	30.5	27.7
Overall balance	-12.0	-12.7	-21.2	-6.7	10.3	-25.8	-20.4	-19.4	-18.8	-18.5	-17.2
RERF balance (end of period; in millions of A\$)	571	581	579	581	668	666	668	673	681	690	701
Real per capita balance (in 2006 A\$)	5209	5040	4759	4592	5058	4837	4643	4472	4326	4192	4075
<b>Balance of payments</b>											
	(In percent of GDP)										
Current account balance	-23.3	-16.9	-32.2	-26.3	-27.4	-53.4	-53.4	-49.3	-41.3	-35.4	-31.7
Trade balance	-49.7	-46.0	-48.2	-58.0	-58.2	-58.8	-56.6	-51.5	-44.3	-37.7	-33.5
Balance on services	-34.0	-30.3	-34.6	-41.8	-41.6	-41.4	-40.8	-39.9	-39.1	-38.0	-36.9
Balance on factor income	41.9	40.8	33.7	49.9	64.9	35.8	35.2	33.8	34.9	33.7	32.5
Balance on current transfers	18.5	18.7	16.8	23.6	7.5	11.0	8.8	8.3	7.2	6.6	6.1
<b>External debt (in millions of US\$; end of period)</b>											
External debt	14.3	18.4	14.2	14.1	13.6	18.7	26.4	35.2	44.8	55.9	67.0
(In percent of GDP)	9.8	11.3	8.4	8.0	8.6	11.4	15.6	20.1	24.6	29.6	34.3
External debt service	1.0	0.6	0.6	0.6	0.5	0.5	0.6	0.7	0.8	0.8	1.0
(In percent of exports of goods and services)	4.8	3.2	2.8	3.0	3.0	3.1	3.2	3.4	3.7	3.9	4.2

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

Table 4. Kiribati: Balance of Payments, 2009–19

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
						Est.				Proj.			
(In millions of Australian dollars)													
Current account balance	-28.6	-32.3	-37.9	-27.6	-53.9	-44.5	-48.1	-98.9	-104.0	-101.0	-88.7	-79.7	-74.7
Trade balance	-71.5	-79.1	-80.9	-75.4	-80.6	-98.0	-102.1	-108.9	-110.3	-105.4	-95.3	-84.9	-79.0
Exports, f.o.b.	12.1	8.8	8.0	4.2	8.3	6.8	7.2	7.7	8.4	9.1	9.8	10.7	11.6
Imports, f.o.b.	83.6	87.9	88.9	79.7	88.9	104.8	109.2	116.6	118.7	114.5	105.1	95.6	90.6
Balance on services	-49.0	-56.4	-55.3	-49.7	-57.9	-70.6	-72.9	-76.6	-79.5	-81.8	-83.9	-85.6	-87.0
Credit	12.8	13.9	15.3	13.6	12.3	10.9	11.2	11.9	12.6	13.4	14.3	15.2	16.1
Debit	61.8	70.2	70.6	63.3	70.2	81.4	84.2	88.5	92.2	95.2	98.2	100.7	103.1
Balance on factor income 1/	63.7	75.2	68.2	66.9	56.4	84.3	113.8	66.2	68.6	69.1	75.1	75.9	76.8
Credit	66.9	79.1	72.2	80.8	62.9	91.6	121.6	74.5	77.6	78.7	85.3	86.9	88.5
Fishing license fees	25.4	32.2	29.5	41.7	29.1	58.8	88.6	42.2	43.3	44.3	45.4	46.6	47.7
Investment income	30.0	34.2	21.6	23.2	23.2	22.3	22.4	21.8	23.4	23.3	28.7	29.0	29.4
Remittances	11.0	11.1	11.7	10.7	10.7	10.4	10.5	10.5	10.8	11.0	11.1	11.2	11.2
Debit	3.1	4.0	4.0	13.9	6.5	7.3	7.8	8.4	8.9	9.6	10.2	11.0	11.7
Balance on current transfers	28.2	28.0	30.0	30.6	28.2	39.8	13.2	20.4	17.2	17.0	15.4	14.8	14.5
Credit	32.5	32.5	34.5	34.9	32.6	44.6	18.4	25.9	23.0	23.2	21.9	21.5	21.5
Of which: Government	26.2	26.3	26.0	31.1	32.4	44.9	16.6	21.9	19.0	18.9	17.6	17.1	16.9
Debit	3.6	3.8	3.5	4.0	4.6	4.9	5.1	4.9	5.1	5.3	5.5	5.7	5.9
Of which: Government	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial and capital account balance	21.1	1.9	10.7	6.1	11.2	27.8	86.5	92.8	100.6	98.6	87.2	79.1	75.2
Government	8.2	9.2	11.5	6.4	10.9	17.8	57.9	64.2	71.3	66.9	56.7	48.5	45.2
Capital transfers	10.4	9.9	12.4	6.8	10.5	18.1	58.1	58.2	62.4	56.7	45.5	35.4	32.4
Loans (net)	-2.3	-0.7	-0.9	-0.4	0.4	-0.3	-0.3	6.0	8.9	10.2	11.2	13.1	12.8
Direct investment	0.4	0.4	0.4	-0.2	0.3	1.3	9.0	1.3	1.3	1.3	1.3	1.3	1.3
Financial institutions 2/	12.6	-7.7	-1.2	0.0	0.0	5.8	19.7	27.3	28.0	30.4	29.1	29.3	28.7
Errors and omissions	-2.6	21.5	25.1	32.8	24.7	2.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	-10.0	-9.0	-2.2	11.3	2.7	-16.7	38.4	-6.1	-3.4	-2.4	-1.5	-0.6	0.5
Change in external assets (increase -) 3/	10.0	9.0	2.2	-11.3	-2.7	16.7	-38.4	6.1	3.4	2.4	1.5	0.6	-0.5
Revenue Equalization Reserve Fund	16.8	-7.8	-2.3	-10.5	-1.9	16.7	-38.4	6.1	3.4	2.4	1.5	0.6	-0.5
Government funds 4/	-6.7	16.8	4.5	-0.8	-0.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
(In percent of GDP)													
Current account balance	-19.4	-20.1	-23.3	-16.9	-32.2	-26.3	-27.4	-53.4	-53.4	-49.3	-41.3	-35.4	-31.7
Trade balance	-48.5	-49.3	-49.7	-46.0	-48.2	-58.0	-58.2	-58.8	-56.6	-51.5	-44.3	-37.7	-33.5
Exports, f.o.b.	8.2	5.5	4.9	2.6	5.0	4.0	4.1	4.2	4.3	4.4	4.6	4.7	4.9
Imports, f.o.b.	56.7	54.7	54.6	48.6	53.1	62.0	62.3	63.0	60.9	55.9	48.9	42.4	38.4
Balance on services	-33.2	-35.1	-34.0	-30.3	-34.6	-41.8	-41.6	-41.4	-40.8	-39.9	-39.1	-38.0	-36.9
Credit	8.7	8.6	9.4	8.3	7.4	6.4	6.4	6.4	6.5	6.6	6.6	6.7	6.8
Debit	41.9	43.8	43.4	38.6	42.0	48.2	48.0	47.8	47.3	46.5	45.7	44.7	43.7
Balance on factor income 1/	43.2	46.8	41.9	40.8	33.7	49.9	64.9	35.8	35.2	33.8	34.9	33.7	32.5
Credit	45.4	49.3	44.4	49.2	37.6	54.2	69.3	40.3	39.8	38.4	39.7	38.5	37.5
Fishing license fees	17.2	20.1	18.1	25.4	17.4	34.8	50.5	22.8	22.2	21.7	21.1	20.7	20.2
Investment income	20.4	21.3	13.3	14.1	13.9	13.2	12.8	11.8	12.0	11.4	13.3	12.9	12.5
Remittances	7.5	6.9	7.2	6.5	6.4	6.2	6.0	5.7	5.6	5.4	5.2	5.0	4.8
Debit	2.1	2.5	2.4	8.5	3.9	4.3	4.5	4.5	4.6	4.7	4.8	4.9	5.0
Balance on current transfers	19.1	17.4	18.5	18.7	16.8	23.6	7.5	11.0	8.8	8.3	7.2	6.6	6.1
Credit	22.0	20.2	21.2	21.3	19.5	26.4	10.5	14.0	11.8	11.3	10.2	9.5	9.1
Debit	2.4	2.4	2.2	2.4	2.7	2.9	2.9	2.7	2.6	2.6	2.6	2.5	2.5
Financial and capital account balance	14.3	1.2	6.6	3.7	6.7	16.4	49.3	50.1	51.6	48.2	40.6	35.1	31.9
Government	5.5	5.7	7.1	3.9	6.5	10.6	33.0	34.7	36.6	32.7	26.4	21.5	19.1
Capital transfers	7.1	6.2	7.6	4.1	6.3	10.7	33.2	31.4	32.0	27.7	21.2	15.7	13.7
Loans (net)	-1.5	-0.4	-0.6	-0.3	0.2	-0.2	-0.2	3.2	4.6	5.0	5.2	5.8	5.4
Direct investment	0.2	0.2	0.2	-0.1	0.2	0.8	5.1	0.7	0.7	0.6	0.6	0.6	0.6
Financial institutions 2/	8.5	-4.8	-0.7	0.0	0.0	3.5	11.2	14.8	14.4	14.8	13.6	13.0	12.2
Errors and omissions	-1.7	13.4	15.4	20.0	14.8	1.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	-6.8	-5.6	-1.3	6.9	1.6	-9.9	21.9	-3.3	-1.8	-1.2	-0.7	-0.3	0.2
Change in external assets (increase -) 3/	6.8	5.6	1.3	-6.9	-1.6	9.9	-21.9	3.3	1.8	1.2	0.7	0.3	-0.2
Revenue Equalization Reserve Fund	11.4	-4.9	-1.4	-6.4	-1.1	9.9	-21.9	3.3	1.8	1.2	0.7	0.3	-0.2
Government funds 4/	-4.6	10.5	2.8	-0.5	-0.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0

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

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

2/ Including errors and omissions for projections.

3/ Excludes valuation changes.

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





# KIRIBATI

## STAFF REPORT FOR THE 2014 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

May 2, 2014

Prepared By

The Asia and Pacific Department  
(In Consultation with Other Departments)

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## FUND RELATIONS

(As of March 31, 2014)

**Membership Status:** joined June 3, 1986; accepted Article VIII.

<b>General Resources Account:</b>	SDR Million	Percent Quota
Quota	5.60	100.00
Fund holdings of currency	5.60	100.02
Reserve position in Fund	0.00	0.08

<b>SDR Department:</b>	SDR Million	Percent Allocation
Net cumulative allocation	5.32	100.00
Holdings	5.39	101.29

**Outstanding Purchases and Loans:** None.

**Financial Arrangements:** None.

**Projected Obligations to Fund:** None.

**Implementation of HIPC Initiative:** Not Applicable.

**Implementation of Multilateral Debt Relief Initiative (MDRI):** Not Applicable.

**Exchange Rate Arrangement:** The Australian dollar circulates as legal tender.

### **Article IV Consultation:**

The 2014 Article IV consultation discussions with Kiribati were held in Tarawa during March 3–15, 2014. Kiribati is on a 12-month consultation cycle.

### **Technical Assistance (TA), 1995–2011:**

STA, LEG, MCM, FAD, and PFTAC have provided TA on statistics, tax administration and policy, budget management, Revenue Equalization Reserve Fund (RERF) and Pension Fund (KPF) management, financial sector reform and supervision, and combating financial crime and financial system abuse.

**Resident Representative:** The resident representative office in the Pacific Islands was opened in September 2010 in Suva, Fiji. Mr. Yongzheng Yang is the Resident Representative.

## RELATIONS WITH THE PACIFIC FINANCIAL TECHNICAL ASSISTANCE CENTRE (PFTAC)<sup>1</sup>

(As of 22 April, 2014)

During the current funding cycle (May 2011 to May 2014), PFTAC assistance to Kiribati has included 28 advisory missions. Kiribati also sent 11 officials to regional seminars and workshops.

### **Tax Administration and Policy**

Kiribati implemented VAT on April 1<sup>st</sup> 2014 with support from PFTAC and Australian Department of Foreign Affairs (DFAT). Appropriate steps were taken in the lead up to implementation with a strong focus on community outreach and this has ensured that there is a good relationship between the tax administration and business. Notwithstanding this work, it is likely that there will be some initial implementation issues but it is likely that these issues will be resolved within the first quarter of operation. The authorities intend to maintain a high level of community outreach in the first quarter of VAT operation to foster greater understanding and promote compliance.

The Taxation Division implemented its new IT system, the Revenue Management System (RMS), in December 2013. The system is used widely throughout the Pacific and is reliable and robust. Key Business Users attended intensive user acceptance testing in New Zealand and there is now a reasonable understanding of the operating system. However, effective implementation of the system will be a significant risk to the authorities and special care should be taken to ensure that data integrity is a high priority.

DFAT continues to support Kiribati with funding for a tax adviser and a new adviser will commence a two year assignment in May 2014. The authorities have signaled that the adviser will be required to oversee the new VAT and IT systems and also take a lead role in developing and implementing a presumptive tax for small micro business and income tax self assessment. PFTAC will provide ongoing support to the authorities and the adviser.

### **Public Financial Management (PFM)**

An August 2011 mission to Kiribati assisted the Ministry of Finance in prioritizing its PFM reform activities (RBM 1.2), and provided a framework for the current joint AusAid/AsDB long-term TA. Prior to the inception of that TA, two PFTAC/IMF missions worked with the Ministry of Finance officials to modify their chart-of-accounts (RBM 1.4) to capture more information on donor-funded projects, to

<sup>1</sup> PFTAC in Suva, Fiji is a multi-donor TA institution, financed by IMF, AsDB, AusAID, and NZAID, with the IMF AS Executing Agency. The Centre's aim is to build skills and institutional capacity for effective economic and financial management that can be sustained at the national level. Member countries are: Cook Islands, Federated States of Micronesia, Fiji, Kiribati, Marshall Islands, Nauru, Niue, Palau, Papua New Guinea, Samoa, Solomon Islands, Tokelau, Tonga, Tuvalu, and Vanuatu.

improve the integration of planning and budgeting (RBM 1.5), and to provide options for better cash and debt management (RBMs 1.3 & 1.6). In addition, PFTAC's PFM Advisors participated in the August 2012 AsDB/AusAid Technical Assistance inception mission, and a concurrent donor forum. During 2013 several missions were conducted with multiple focuses including training budget analysts (RBM 1.5) in the National Economic Planning Office (NEPO), supporting the Team Leader of the joint Australia/ADB Treasury Reform TA (RBM 1.4), and assisting the authorities to develop an improved debt/cash management policy (RBMs 1.3 & 1.6) with support from IMF's APD and MCM Divisions. PFTAC PFM Advisors have also participated in interview/CV review teams for both Australian and EU-funded TA.

PFTAC is ready to provide additional technical support on budget preparation, cash/debt management, and other aspects of budget execution. Officials from Kiribati have regularly participated in PFTAC's regional PFM events, including the November 2011 MTB workshop, the July 2012 PEFA Workshop, the Strategic Development Program Workshops (with Australia DOFD), and the PIFMA Heads meetings.

### **Financial Sector Regulation and Supervision**

In August 2003, the PFTAC advisor and an IMF legal expert visited Kiribati to conduct consultations with industry and government officials on a Financial Institutions Bill that had been drafted in July 2002. Responses to comments raised by the authorities, together with appropriately amended draft legislation, were forwarded to the authorities in December 2003 for action.

To date there has been no further progress on the draft Financial Institutions Bill or the previously drafted Anti-money Laundering Legislation. The PFTAC advisor makes periodic contact with the Ministry of Finance regarding the status of the draft legislation.

### **Economic and Financial Statistics**

GDDS metadata was first published on the IMF website in April 2004 and subsequently updated in March 2013, following assistance by PFTAC. The BOP compiler benefited from training provided in regional courses in 2005 and 2010. PFTAC provided TA on balance of payments in 2008, 2010 and 2012, improving compilation methods and use of source data, as well as providing training, and helping with the transition to BPM6. Starting from 2012, TA on BOP has been provided by the IMF JSA project on external sector statistics.

PFTAC has provided regular TA on national accounts since 2008, assisting the authorities in making significant improvements in methodology and use of source data. Beginning in 2012, PFTAC has increased its TA with the development of an expenditure measure of GDP and with the preparation of statistical procedures for the incorporation of upcoming VAT data. However, progress has been slow due to resource and capacity constraints. The NA compiler benefited from regional courses in 2009, 2012 and 2013. PFTAC also sponsored a one-month attachment for the BOP compiler with Statistics New Zealand in May 2009.

## **Macroeconomic Analysis**

Two missions in 2011 provided assistance in building capacity related to basic forecasting techniques, using the medium-term fiscal framework developed as part of ADB assistance, and assessing sustainable levels of drawdowns from Kiribati's Reserve Equalization Reserve Fund. A regional financial programming workshop held jointly in 2012 by PFTAC and the Singapore Regional Training Institute provided training in financial programming techniques to two economists of the Ministry of Finance and Economic Development.

## BANK-FUND COLLABORATION

### A. World Bank-IMF Collaboration

(As of April 15 2014)

The Fund and the Bank teams maintain close cooperation in various areas and consult frequently. During the current cycle, the Bank staff has joined the IMF missions, including IMF staff visits and the 2014 Article IV mission. The IMF staff and the World Bank staff maintained continuing close dialogue on economic developments and all aspects of the government reform program.

During the current cycle, the teams have produced a Joint DSA. The IMF team provided analysis and advice on the overall macroeconomic and fiscal framework, including fiscal and RERF sustainability. The IMF and World Bank have also been engaged in provision of technical assistance and advice in public financial management and debt management and policy. The Fund also provided technical assistance on pension fund and insurance company management, and on statistical issues, including Government Finance Statistics and Balance of Payments. The Bank has been engaged in various infrastructure projects, including road rehabilitation, airport improvement, solar energy, and adaptation to climate change. Bank staff provided technical assistance on government expenditures, reforms of copra subsidy and import levy fund, liberalization of telecommunication sector, management of RERF assets, and social protection issues. During this cycle the Bank has continued to work closely with the government on the comprehensive program of priority economic reforms, and supported coordination of donor TA around the reform agenda. Reforms identified through this process are now being supported under joint donor budget support, coordinated by the World Bank, with the first tranche disbursed in January 2014.

The IMF and World Bank teams will continue close cooperation going forward, in particular in the context of the government reform program. As agreed earlier, the Fund will continue to lead on macro issues, in particular overall macroeconomic framework, including in the medium-and-longer term, and the Bank on macro-critical structural reform issues.<sup>1</sup> The Fund and the Bank staff will also continue to cooperate with regard to follow up TA, including on the RERF management and public financial and debt management.

### B. Relations with the World Bank Group<sup>2</sup>

Kiribati became a member of the World Bank Group in 1986.

On March 1, 2011, the World Bank's Board of Executive Directors discussed the first Country Assistance Strategy (CAS) for Kiribati, which had previously been covered by a Pacific Islands

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<sup>1</sup> See 2011 Article IV report, Annex III on Bank-Fund collaboration.

<sup>2</sup> Prepared by the World Bank staff.

Regional Engagement Framework. The CAS is structured around the themes of: (i) addressing the existential threat posed by climate change; and, (ii) mitigating the effects of geographic isolation.

The CAS anticipates a significantly expanded program of advisory and financial support for Kiribati. Consistent with Kiribati's limited repayment capacity highlighted in the DSA, it is anticipated that IDA financing will be provided on 100-percent grant terms. IDA grants and trust fund investments of as much as US\$50 million are anticipated over the four year CAS period from FY2011 to FY2014. Such a program of investments is intended to build a foundation for the World Bank to play a more substantive role, in close collaboration with the IMF and other donor partners, in a coordinated economic policy dialogue with the Government of Kiribati.

Key components of proposed World Bank Group engagement include:

- Climate change adaptation and building resilience against shocks is at the core of Bank engagement in Kiribati. The Bank, with trust fund financing, has been supporting climate change mitigation since 2003 through the Kiribati Adaptation Program (KAP), with activities including seawall construction, mangrove planting, and water conservation and supply. Beyond climate change adaptation, the Bank is committed to accelerating efforts to address wider issues of vulnerability in Kiribati, including accessing trust fund resources to improve renewable energy generation to reduce reliance on volatile imported diesel, and to support the transport of food to remote outer islands.
- Mitigating the effects of geographic isolation. Given Kiribati's remoteness, the Bank anticipates scaling up support for climate friendly infrastructure investments. A South Tarawa road improvement investment of US\$24m in IDA and TF financing— undertaken jointly with the AsDB—was approved by the Board on March 1, 2011, with the Kiribati CAS. The Bank has also mobilized significant grant resources with New Zealand and other partners, to help bring Kiribati airports—a vital link with the outside world—up to international safety standards.
- Supporting economic reform and regional integration. An expanded program of investments has provided a foundation for a more substantive engagement by the Bank Group in a coordinated economic policy dialogue in Kiribati. The World Bank has supported Government in developing the Economic Reform Plan and disbursed US\$5.2 million of budget support in March, 2014 in support of policy reforms included in this plan. The second operation in the programmatic series of two operations is currently being prepared in close consultation with Government and other donors. The Bank Group is supporting government efforts to open the telecoms market to new private investments. As well as the direct benefits, telecoms reform has elsewhere in the Pacific proven to be especially successful in building public support and momentum for reform more broadly. The Bank and IFC will cooperate closely in supporting other potential SOE transactions, following the successful introduction of private participation in the management of the Otintaai hotel. As well as domestic reform, the Bank Group continues to support efforts by Kiribati and other Pacific Island countries to gain benefits from greater regional integration, including participation in temporary labor migration schemes established by New Zealand and Australia and anticipated analytical and investment support to help countries improve management and returns from pelagic and deep-sea fishery resources.

## RELATIONS WITH THE ASIAN DEVELOPMENT BANK<sup>1</sup>

The Asian Development Bank has approved eight project loans to Kiribati amounting to US\$34.7 million, all from Asian Development Fund (ADF) resources since Kiribati joined the AsDB in 1974. In addition, TA amounting to US\$18.4 million has been provided for 40 projects. The latest AsDB loan to Kiribati, for South Tarawa Sanitation Improvement Sector project, was approved in October 2011. The AsDB most recently approved an US\$0.8 million TA grant for enhancing economic competitiveness through SOE reform in October 2013.

In line with the broad objective of the Kiribati Development Plan, 2012–15, which focused on enhancing economic growth for sustainable development, ADB's program aims to reduce poverty and promote economic opportunity by improving public financial management and delivering sustainable infrastructure services. As many of the infrastructure services are provided by state-owned enterprises, improving corporate governance arrangements and the commercial focus of these enterprises is a key objective of ADB's support to the government's structural reform program. Technical assistance provided through the Economic Management and Public Sector Reform program helped strengthen state owned enterprise governance. ADB's support has also helped Kiribati move toward a number of Millennium Development Goals. In October 2011, ADB approved a loan for the South Tarawa Sanitation Improvement Sector Project, which aims to improve sanitation and hygiene practices in South Tarawa and increase access to sanitation from 64 percent to 80 percent by 2019. The Road Rehabilitation Project, approved in December 2010, will rehabilitate 32.5 kilometers of main roads and about 8 kilometers of feeder roads. Cofinanced by the Government of Australia, the World Bank and the Pacific Regional Infrastructure Facility, the project will improve socioeconomic conditions for the people of South Tarawa.

<b>Kiribati: Loan, Grant and Technical Assistance Approvals (2007–13)<sup>1/</sup></b>						
	2007	2008	2009	2010	2012	2013
<b>Loan Approvals</b>						
Number	0	0	0	1	1	0
Amount (US\$m)	0	0	0	12	7.56	0
<b>Grant Approvals</b>						
Number	0	0	0	0	0	0
Amount (US\$m)	0	0	0	0	0	0
<b>TA Approvals</b>						
Number	0	1	2	2	1	2
Amount (US\$m)	0	0.8	0.85	0.2	0.8	1
1/ Prepared by the Asian Development Bank Staff.						

<sup>1</sup> Prepared by the Asian Development Bank Staff.

## STATISTICAL ISSUES

<b>Assessment of Data Adequacy for Surveillance</b>	
(As of April 1, 2014)	
<b>General:</b> Data provision has some shortcomings, but is broadly adequate for surveillance. Balance of Payments data are the most affected area.	
<b>National Accounts:</b> With PTFAC assistance GDP estimates have improved. Two TA missions took place in 2013 to improve national account data and produce revised estimates through 2012. However, further capacity building would be needed to continue to improve the quality of GDP estimates. So far, estimates are limited to Gross Domestic Product (GDP) at current and constant 06 prices, using the production approach. Work is ongoing on the expenditure-based GDP estimates.	
<b>Price statistics:</b> The monthly retail price index (1996=100) is produced with a short lag (about a month), based on a survey in South Tarawa (a national index is not available). There are no producer, wholesale, or trade price indices.	
<b>Government finance statistics:</b> A Government Finance Statistics mission took place in October 2013 to set up the reporting framework for GFS for the budgetary central government and to expand coverage towards other sectors. In addition, the mission aimed to review sources for financial transactions and a financial balance sheet. While a complete review of government units, statutory extra budgetary units, and state-owned enterprises (SOE) was completed, a gap still remains regarding donor-financed project funds.	
<b>Monetary statistics:</b> The balance sheets of all the financial institutions (Bank of Kiribati, Development Bank of Kiribati, Kiribati Provident Fund, and Kiribati Insurance Corporation) are available with lags, but the consolidated balance sheet of the financial sector is not available. Data on interest rates are reported with a long lag.	
<b>Balance of payments:</b> The quality of the data is improving, there is extensive work ahead. STA conducted two missions since early 2013. The mission revised the BOP estimates up to 2012 and the implementation of IIP under BPM6. As in the case of GDP data, it has been suggested the need for further statistical capacity building. There still remain some shortcomings in non-trade external statistics collection.	
<b>DATA STANDARDS AND QUALITY</b>	
Kiribati has been a participant in the General Data Dissemination System (GDDS) since 04.	No data ROSC are available.
<b>REPORTING TO STA (OPTIONAL)</b>	
No data are currently reported to STA for publication in the <i>Government Finance Statistics Yearbook</i> , the <i>Balance of Payments Statistics Yearbook</i> or in the IFS.	



**Kiribati: Table of Common Indicators Required for Surveillance**

	<b>Date of latest observation</b>	<b>Date received</b>	<b>Frequency of Data</b>	<b>Frequency of Reporting/7</b>	<b>Frequency of publication/7</b>
Exchange Rates	4/1/14	4/1/14	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities /1	NA	NA	NA	NA	NA
Reserve/Base Money	NA	NA	NA	NA	NA
Broad Money	NA	NA	NA	NA	NA
Central Bank Balance Sheet	NA	NA	NA	NA	NA
Consolidated Balance Sheet of the Banking System	NA	NA	NA	NA	NA
Interest Rates /2	3/31/14	4/3/14	A	A	I
Consumer Price Index	1/14	3/15/14	M	Q	Q
Revenue, Expenditure, Balance and Composition of Financing/3 - General Government /4	12/31/13	3/10/14	A	A	I
Stocks of Central Government and Central Government-Guaranteed Debt /5	12/31/13	3/10/14	A	A	I
External Current Account Balance	12/31/12	3/10/14	A	A	I
Exports and Imports of Goods and Services	12/31/12	3/10/14	A	A	I
GDP/GNP	12/31/12	3/10/14	A	A	I
Gross External Debt	12/31/13	3/10/14	A	A	I
International Investment Position /6	12/31/12	3/10/14	A	A	I

1/ Any reserve assets that are pledged or otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency but settled by other means as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency but settled by other means.

2/ Both market-based and officially-determined, including discounts rates, money market rates, rates on treasury bills, notes and bonds.

3/ Foreign, domestic bank, and domestic nonbank financing.

4/ The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.

5/ Including currency and maturity composition.

6/ Includes external gross financial asset and liability positions vis-à-vis nonresidents.

7/ Daily (D); weekly (W); monthly (M); quarterly (Q); annually (A); irregular (I); and not available (NA).



# KIRIBATI

## STAFF REPORT FOR THE 2014 ARTICLE IV CONSULTATION— DEBT SUSTAINABILITY ANALYSIS<sup>1</sup>

May 13, 2014

Approved By  
**Hoe Ee Khor and Peter Allum,**  
**(IMF) and Jeffrey Lewis and**  
**Sudhir Shetty, (IDA)**

Prepared by the Staff of the International Monetary Fund  
and the World Bank.

*Kiribati continues to be at high risk of debt distress according to this update of the debt sustainability analysis (DSA)<sup>2</sup>. Although unusually high fishing license fees improved the fiscal position recently, containing the risk of debt distress will require prudent financing by continuing to secure grants to support the country's large development needs, and implementing fiscal and structural reform agenda that would ensure fiscal sustainability and raise long-term growth. In particular,, it is important to pursue fiscal consolidation by continuing to contain and improve quality of expenditures, as well as through revenue enhancing measures.*

### Background

**Kiribati is one of the most remote Pacific microstate consisting of quite dispersed 31 islands.**

The export and production bases are narrow and limited to copra, seaweed and fishing. The revenue base is very volatile, with fishing license fees making up about 60 percent of government revenues during 2003–13. Kiribati's sovereign wealth fund—the Revenue Equalization Reserve Fund (RERF)—is a major source of financing and a cushion against risks. Climate change and pressures on infrastructure raise additional challenges. The country relies heavily on foreign aid to finance its large development needs.

<sup>1</sup> The DSA has been produced in consultation with the Asian Development Bank (AsDB). This DSA is based on the common standard LIC DSA framework. Under the Country Policy and Institutional Assessment (CPIA), Kiribati is rated as a weak performer, and the DSA uses the indicative threshold indicators on the external public debt for countries in this category: 30 percent for the present value (PV) of debt-to-GDP ratio; 100 percent for the PV of debt-to-exports ratio; 200 percent for the PV of debt-to-revenue ratio; 15 percent for the debt service-to-exports ratio; and 18 percent for the debt service-to-revenue ratio.

<sup>2</sup> The results of the current debt sustainability analysis remain in line with the 2013 DSA. The DSA analysis shows that as a result the expected debt build-up the sizable and protracted breach of DSA thresholds is likely in 2020s. The main changes in assumptions are an increase in the discount rate (from 3 to 5 percent) according to the new DSA guidance, inclusion of the scenario with higher fishing license revenues; higher realized fishing license fees in 2013, and higher projected disbursements from donors to support the ongoing reform program and address large infrastructure needs. Despite increase in the nominal debt, the NPV of debt remains at the levels similar to 2013 DSA.

**Although fiscal accounts improved in the last two years mainly due to unusually high fishing license fees revenue, such fees remain volatile and Kiribati continues to face the challenge of reducing structural fiscal imbalances.** Large overall fiscal deficits over the last decade (about 13 percent of GDP on average) have resulted in substantial drawdowns of the RERF—the main source of deficit financing.<sup>3</sup> The RERF assets dropped to 380 percent of GDP in 2013 from 565 percent of GDP in 2000.

**As of end-2013, public domestic debt accounted for 4⅓ percent of GDP, while gross public external debt is estimated at about 8⅓ percent of GDP.** Domestic debt includes the publicly guaranteed debt of the state-owned enterprises (SOEs). As of end-2013, all external public debt consisted of concessional loans.

**The medium-term macroeconomic outlook points to moderate growth.** The economy is estimated to have grown by about 2.9 percent in 2013. Donor-financed road and airport projects are expected to continue supporting growth and construction activities over the medium term. Kiribati continues to be vulnerable to external shocks from volatile fishing license revenues, and from financial exposure of its sovereign wealth fund and pension fund.

## The Baseline Scenario

**The baseline scenario incorporates government reform plans and assumes projections for fishing license fees based on historical averages. The assumptions of this DSA are:** (The macroeconomic assumptions underlying the baseline scenario are presented in Box 1.) These projections imply that the fiscal deficit would exceed 25 percent of GDP in 2014 and gradually decline to about 14 by 2030, reflecting government commitment to reforms. It is assumed that the deficit will be partially financed by US\$6–12 million of external loans each year in the medium term and about US\$15 million each year in the longer term to finance large infrastructure and other development needs, as well as to address the adverse impact of climate change. The remaining financing gap is met through drawdowns of the RERF, without additional domestic borrowing. Annual drawdown from the RERF is projected to be 12¾ percent of GDP on average in the medium term and about 12 percent of GDP on average during 2020–34. As a result, the RERF real per capita balance will continue to decline.

## External Debt Sustainability Analysis

**The external DSA indicates Kiribati is at high risk of debt distress, in line with the conclusion of the previous DSA from the 2013 Article IV consultation.** The present value (PV) of external debt increases significantly due to loan disbursements. There is a sizable and protracted breach of the PV of debt-to-exports ratio threshold and of the PV of the debt to GDP ratio around 2026. (The exports and revenues related to exports decline as a ratio to GDP because the economy growth outpaces the growth of fishing licenses, which comprise the main share of exports.) The PV of

<sup>3</sup> The RERF is a wealth fund established in 1956 and was capitalized using phosphate mining proceeds before phosphate deposits were exhausted in 1979.

external debt-to-GDP ratio will increase from 5½ percent of GDP in 2013 to 30 percent of GDP in 2026, and reach over 100 percent of exports starting from 2026.

### Box 1. Macroeconomic Assumptions Under the Baseline Scenario

- GDP growth and population. The economy is expected to grow at about 2½ percent in the medium term (until 2019), supported by donor-financed projects. Over the longer term (until 2034 and thereafter) the growth will moderate to 1.9 percent. Population growth is expected to moderate somewhat from 2.2 percent in 2011 to 1.8 percent in the long run.
- Fishing license fees revenue are projected conservatively at around A\$42 million in 2014 and to remain constant in real terms.<sup>1</sup>
- With the completion of major grant-financed infrastructure projects, aid flows in the form of grants are expected to decline gradually from 44 percent of GDP in 2014 to around 22 percent of GDP in 2019 and to about 20 percent in the longer term, assuming that the government's implementation of reforms encourages continuing support from the main donors (AusAID, New Zealand AID, Japan, and Taiwan Province of China).<sup>2</sup> Access to the IDA-type grant financing is expected to be about US\$25 million per year during 2014–15 to finance both budget support and large infrastructure projects, including road rehabilitation, airport improvement, and others.
- New external loan disbursements are assumed to average about 5 percent of GDP over the medium and long terms. Government is expected to access multilateral financing with IDA-like terms at the level of about US\$8 million by 2017, increasing gradually to US\$10 million annually by 2020. In addition other bilateral concessional loans are expected to provide financing for US\$2–5 million a year. These loans and other investments will be needed to support large development needs in infrastructure, health and education, as well as to adapt to the adverse impact of climate change.<sup>3</sup>
- FDI flows experienced a substantial increase in 2013 because of the additional investments in the fishing joint venture. Thereafter they will continue at a positive level of about ½ percent of GDP per year reflecting additional investment in fishing and marine sectors as a result of the reforms.
- The overall fiscal deficit will be reduced gradually to around 17 percent of GDP by 2019 and to 14 percent of GDP in the long run, reflecting the government's commitment to reforms. The RERF drawdowns would be reduced correspondingly. Nevertheless, the RERF per capita value in real terms would not stabilize and would decline substantially by 2034 compared to the 2011 level. (The nominal rate of the annual return on RERF is assumed to be 5½ percent in the long term.)
- The current account deficit will narrow in the medium term, reflecting a decrease in the fiscal deficit. The trade deficit follows a similar trend.

<sup>1</sup> The average of fishing license fees over 2000–10 was \$41.6 million.

<sup>2</sup> The RERF is invested in the mix of equities and bonds. The long run average historical return on RERF over 2003–13 was 5.2 percent.

<sup>3</sup> The long-run amount of grants is assumed somewhat lower than in the 2013 DSA, reflecting larger front loading of infrastructure projects based latest information.

**Stress tests indicate that the country's debt path is vulnerable to shocks to financing terms and to exports.** The PV of debt to export ratio and the PV of debt to GDP ratio thresholds are breached under the extreme stress test scenario, including a scenario which assumes the interest rate on new borrowing is 200 basis points higher than in the baseline.<sup>4</sup>

### ***Public Debt Sustainability Analysis***

**Public debt analysis paints a similar picture.** Under the baseline scenario, the PV of total public debt is projected to increase to above 30 percent of GDP by 2026, driven mainly by external borrowings. Public debt sustainability is vulnerable to shocks as well. Under the most extreme stress test scenario—real GDP growth being one standard deviation, temporarily lower in the next two years—the PV of debt reaches about 55 percent of GDP by 2024 and 77 percent of GDP by 2034, breaching the threshold of 40 percent in 2020.

### **High Fishing License Fees and RERF Stabilization Scenario**

**The high fishing license fee scenario considers a situation where the high level of fishing license fees observed in 2012–13 will continue in the future, and additional measures to contain expenditure in the longer run.** Under this scenario it would be possible to stabilize the real per capita value of the RERF at about A\$4500 in 2034 and the debt distress level is still at high risk.

**This scenario assumes that fishing license fees will be A\$60 million in 2014 and growing at 2½ percent afterwards.** Current government expenditure follows similar path to the baseline scenario, declining to 51 percent of GDP by 2023 and 45½ percent by 2030. The rest of the assumptions are identical to the baseline scenario. In the medium term, fishing license fees will be around 30 percent of GDP compared to 20 percent of GDP in the baseline scenario. In the long run this revenue will be about 25 percent of GDP compared with the 17 percent of GDP under the baseline scenario. The likelihood of having high fishing license fees revenues depends on the continuity of the current fishing license scheme implemented by PNA and the catch volume, which is dependent on the migratory patterns of fish stocks.

**Nevertheless, in the high fishing license fee scenario, the PV of total public debt is projected to increase to around 35 percent of GDP over the long term** as loan disbursements will still be needed to support large infrastructure needs, Therefore under this scenario Kiribati will continue to be at high risk of debt distress. The low response of the PV debt-to-GDP ratio is explained in part by the fact that fishery companies that purchase the fishing license have limited integration in the domestic economy. While the PV of external debt-to-GDP also presents similar levels as in the baseline scenario, the external debt-to-exports improves and stays far below the threshold<sup>5</sup>.

<sup>4</sup> As a measure of sustainability, fishing license fees are included in the export ratio.

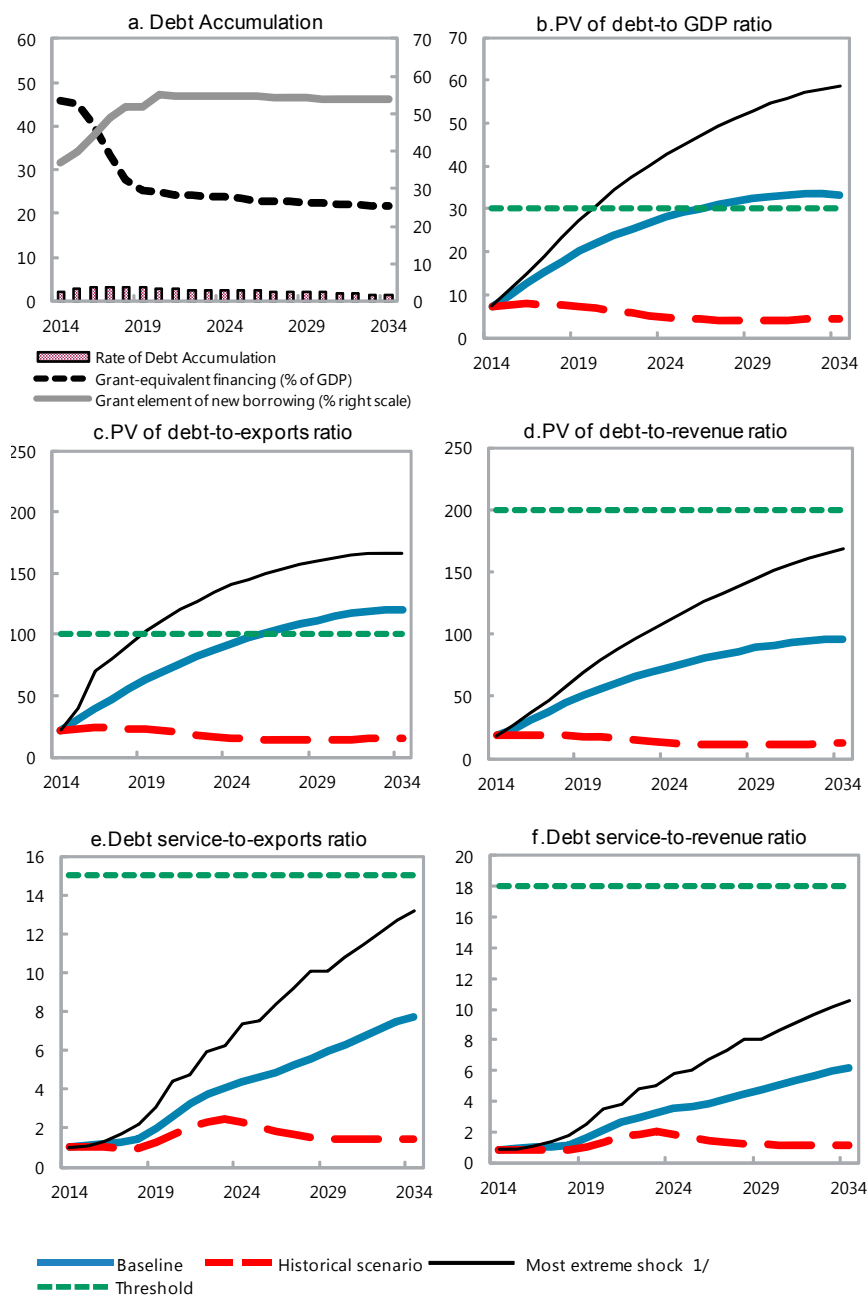
<sup>5</sup> Fishing license fees are included in the denominator of the ratio as they contribute to generate inflows that can be used to pay debt service.

## Conclusions

**Kiribati continues to be at high risk of debt distress.** To narrow fiscal imbalances and stabilize the real per capita RERF value in the context of pressing capital investment needs, it is imperative for the authorities to pursue fiscal consolidation through revenue measures and improving the quality of expenditure. Structural reforms to improve the business climate and promoting private sector growth are also critical to reduce the fiscal burden.

**The authorities broadly agreed with this assessment.** They indicated the commitment to preserving the value of the RERF through the fiscal and structural reform programs supported by the donor community. The government has recently introduced value added and excise taxes and is keen to improve tax administration. They are also committed to controlling expenditure by reforming SOEs and rationalizing the administrative costs and public wages.

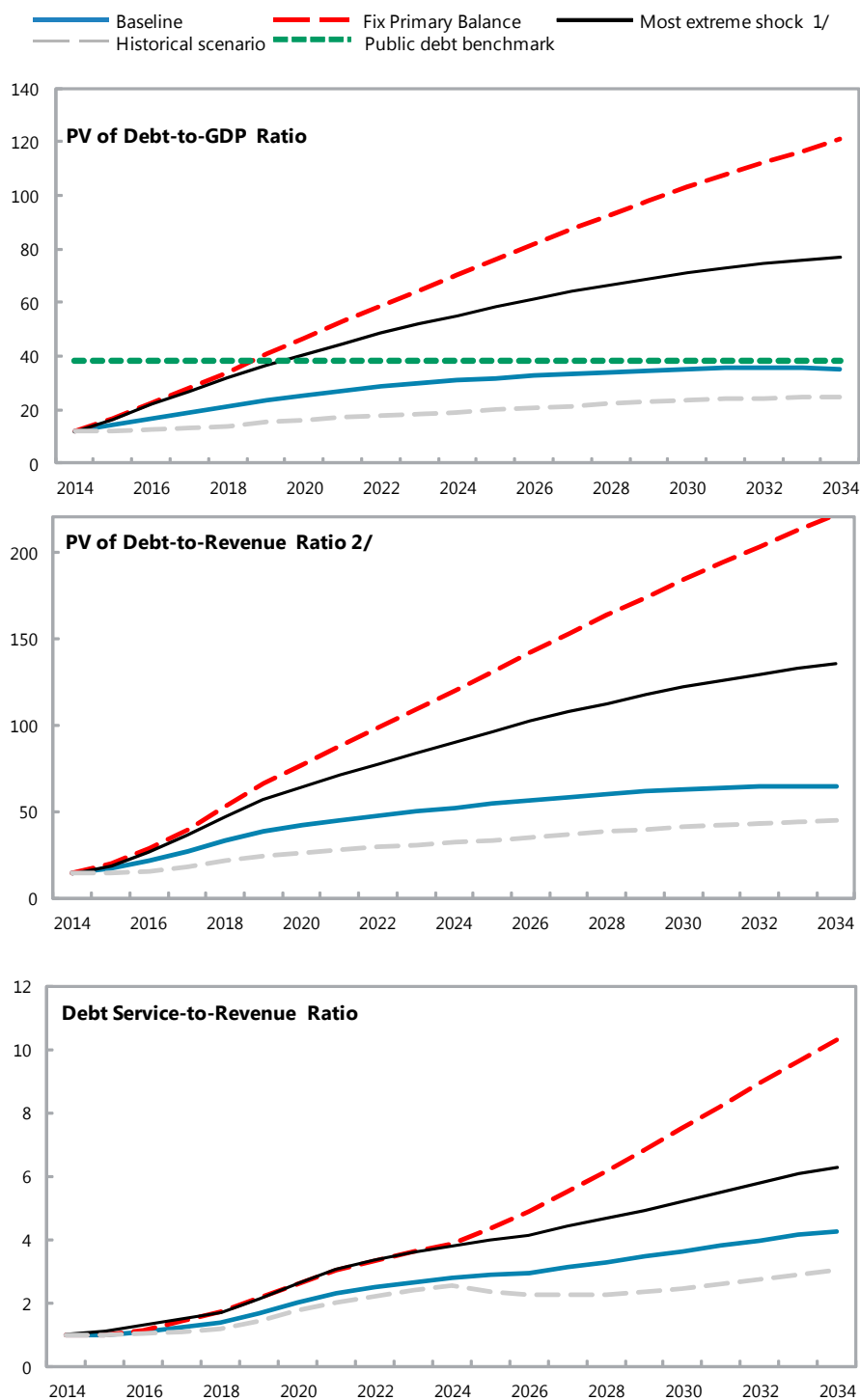
**Figure 1. Kiribati: Indicators of Public and Publicly Guaranteed External Debt Under Alternatives Scenarios, 2014–34 1/**



Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio on or before 2024. In figure b. it corresponds to a loan terms shock; in c. to a Exports shock; in d. to a loan terms shock; in e. to a loan terms shock and in figure f. to a loan terms shock.

**Figure 2. Kiribati: Indicators of Public Debt Under Alternative Scenarios, 2014–34 1/**



Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio on or before 2024.

2/ Revenues are defined inclusive of grants.



**Table 1. Kiribati: Public Sector Debt Sustainability Framework,  
Baseline Scenario, 2011–2034**  
(In percent of GDP, unless otherwise indicated)

	Actual			Average <sup>5/</sup>	Standard Deviation <sup>5/</sup>	Estimate					Projections			
	2011	2012	2013			2014	2015	2016	2017	2018	2019	2014-19 Average	2024	2034
<b>Public sector debt 1/</b>	29.2	11.6	13.3			15.9	19.9	24.1	28.4	33.2	37.8		53.3	62.3
<i>of which: foreign-currency denominated</i>	8.4	8.0	8.6			11.4	15.6	20.1	24.6	29.6	34.3		50.5	60.5
Change in public sector debt	-2.9	-17.5	1.7			2.6	4.0	4.2	4.3	4.8	4.6		2.4	-0.3
Identified debt-creating flows	20.4	6.2	-9.4			25.3	19.7	18.7	17.9	17.5	16.1		13.8	10.9
Primary deficit	19.1	6.3	-10.9	9.9	9.4	25.2	19.7	18.8	18.1	17.8	16.4	19.4	15.2	13.5
Revenue and grants	62.0	90.4	112.9			83.9	84.1	78.9	70.9	64.6	62.0		58.9	54.4
<i>of which: grants</i>	25.0	36.4	43.0			44.8	43.2	38.4	30.8	24.7	22.3		20.9	19.5
Primary (noninterest) expenditure	81.2	96.7	102.0			109.1	103.9	97.7	89.1	82.5	78.4		74.1	68.0
Automatic debt dynamics	1.3	-0.1	1.4			0.1	0.0	-0.1	-0.3	-0.4	-0.3		-1.3	-2.0
Contribution from interest rate/growth differential	1.3	-0.1	0.1			0.0	-0.1	-0.2	-0.4	-0.5	-0.5		-1.1	-1.6
<i>of which: contribution from average real interest rate</i>	2.1	0.7	0.4			0.3	0.3	0.2	0.2	0.1	0.2		-0.1	-0.5
<i>of which: contribution from real GDP growth</i>	-0.9	-0.8	-0.3			-0.4	-0.4	-0.5	-0.6	-0.6	-0.7		-0.9	-1.2
Contribution from real exchange rate depreciation	0.0	0.0	1.3			0.1	0.1	0.1	0.1	0.1	0.2		...	...
Other identified debt-creating flows	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	-0.7
Privatization receipts (negative)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	-0.7
Recognition of implicit or contingent liabilities	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0
Debt relief (HIPC and other)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0
Residual, including asset changes	-23.3	-23.7	11.1			-22.7	-15.8	-14.4	-13.5	-12.6	-11.6		-11.5	-11.2
<b>Other Sustainability Indicators</b>														
<b>PV of public sector debt</b>						11.8	14.1	16.6	18.9	21.4	23.7		30.8	35.2
<i>of which: foreign-currency denominated</i>	...	...	5.4			7.3	9.9	12.6	15.1	17.7	20.2		28.0	33.4
<i>of which: external</i>	...	...	5.4			7.3	9.9	12.6	15.1	17.7	20.2		28.0	33.4
PV of contingent liabilities (not included in public sector debt)	...	...	...			...	...	...	...	...	...		...	...
Gross financing need 2/	21.5	7.0	-10.0			26.1	20.6	19.7	19.0	18.7	17.4		16.8	15.8
PV of public sector debt-to-revenue and grants ratio (in percent)	...	...	9.0			14.0	16.8	21.0	26.7	33.1	38.2		52.2	64.6
PV of public sector debt-to-revenue ratio (in percent)	...	...	14.5			30.0	34.6	41.0	47.1	53.6	59.7		80.9	100.8
<i>of which: external 3/</i>	...	...	7.7			18.6	24.2	31.1	37.5	44.4	50.9		73.5	95.6
Debt service-to-revenue and grants ratio (in percent) 4/	3.7	0.7	0.7			1.0	1.0	1.1	1.2	1.4	1.7		2.8	4.3
Debt service-to-revenue ratio (in percent) 4/	6.3	1.2	1.2			2.1	2.1	2.1	2.2	2.2	2.6		4.3	6.7
Primary deficit that stabilizes the debt-to-GDP ratio	22.0	23.9	-12.6			22.7	15.8	14.6	13.8	13.0	11.8		12.8	13.8
<b>Key macroeconomic and fiscal assumptions</b>														
Real GDP growth (in percent)	2.7	2.8	2.9	1.6	3.2	3.0	2.7	2.5	2.4	2.3	2.1	2.5	1.9	1.9
Average nominal interest rate on forex debt (in percent)	0.8	0.9	1.2	0.9	0.1	1.1	1.1	1.1	1.0	1.0	1.5	1.1	1.1	0.9
Average real interest rate on domestic debt (in percent)	10.7	3.5	12.8	10.0	4.8	8.6	8.7	8.9	9.0	9.1	9.3	8.9	8.2	7.0
Real exchange rate depreciation (in percent, + indicates depreciation)	0.0	-0.2	17.2	0.3	13.6	1.2	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	-0.8	-1.7	0.8	0.8	2.9	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5
Growth of real primary spending (deflated by GDP deflator, in percent)	0.7	22.6	8.5	4.5	8.5	10.1	-2.2	-3.6	-6.6	-5.3	-2.8	-1.7	1.0	1.1
Grant element of new external borrowing (in percent)	...	...	...	...	...	36.9	40.0	43.8	49.1	51.7	51.7	45.5	54.7	54.0

Sources: Country authorities; and staff estimates and projections.

1/ Gross public sector debt

2/ Gross financing need is defined as the primary deficit plus debt service plus the stock of short-term debt at the end of the last period.

3/ Revenues excluding grants.

4/ Debt service is defined as the sum of interest and amortization of medium and long-term debt.

5/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

6/ Includes RERF financing. For 2014-16 also includes expected donor budget support.

**Table 2. Kiribati: Sensitivity Analysis for Key Indicators of Public Debt 2014–34**

	Projections							
	2014	2015	2016	2017	2018	2019	2024	2034
<b>PV of Debt-to-GDP Ratio</b>								
<b>Baseline</b>	12	14	17	19	21	24	31	35
<b>A. Alternative scenarios</b>								
A1. Real GDP growth and primary balance are at historical averages	12	12	12	13	14	15	19	25
A2. Primary balance is unchanged from 2014	12	17	22	28	34	41	70	121
A3. Permanently lower GDP growth 1/	12	14	17	21	24	28	44	81
<b>B. Bound tests</b>								
B1. Real GDP growth is at historical average minus one standard deviations in 2015-20	12	16	22	27	32	37	55	77
B2. Primary balance is at historical average minus one standard deviations in 2015-201	12	14	16	18	21	23	30	35
B3. Combination of B1-B2 using one half standard deviation shocks	12	13	14	18	22	26	39	55
B4. One-time 30 percent real depreciation in 2015	12	17	18	19	21	22	25	25
B5. 10 percent of GDP increase in other debt-creating flows in 2015	12	19	21	24	26	29	36	39
<b>PV of Debt-to-Revenue Ratio 2/</b>								
<b>Baseline</b>	14	17	21	27	33	38	52	65
<b>A. Alternative scenarios</b>								
A1. Real GDP growth and primary balance are at historical averages	14	14	16	18	21	24	32	44
A2. Primary balance is unchanged from 2014	14	20	28	40	53	66	120	222
A3. Permanently lower GDP growth 1/	14	17	22	29	37	44	73	139
<b>B. Bound tests</b>								
B1. Real GDP growth is at historical average minus one standard deviations in 2015-20	14	19	26	36	47	57	90	135
B2. Primary balance is at historical average minus one standard deviations in 2015-201	14	16	20	26	32	37	51	64
B3. Combination of B1-B2 using one half standard deviation shocks	14	15	17	25	33	40	65	98
B4. One-time 30 percent real depreciation in 2015	14	20	23	27	32	36	42	46
B5. 10 percent of GDP increase in other debt-creating flows in 2015	14	23	27	33	41	46	60	71
<b>Debt Service-to-Revenue Ratio 2/</b>								
<b>Baseline</b>	1	1	1	1	1	2	3	4
<b>A. Alternative scenarios</b>								
A1. Real GDP growth and primary balance are at historical averages	1	1	1	1	1	1	3	3
A2. Primary balance is unchanged from 2014	1	1	1	1	2	2	4	10
A3. Permanently lower GDP growth 1/	1	1	1	1	1	2	3	7
<b>B. Bound tests</b>								
B1. Real GDP growth is at historical average minus one standard deviations in 2015-20	1	1	1	1	2	2	4	7
B2. Primary balance is at historical average minus one standard deviations in 2015-201	1	1	1	1	1	2	3	4
B3. Combination of B1-B2 using one half standard deviation shocks	1	1	1	1	1	2	3	6
B4. One-time 30 percent real depreciation in 2015	1	1	1	1	2	2	4	6
B5. 10 percent of GDP increase in other debt-creating flows in 2015	1	1	1	1	1	2	3	5

Sources: Country authorities; and staff estimates and projections.  
1/ Assumes that real GDP growth is at baseline minus one standard deviation divided by the square root of the length of the projection period.  
2/ Revenues are defined inclusive of grants.

**Table 3a. Kiribati: External Debt Sustainability Framework, Baseline Scenario, 2011–34 1/**  
(In percent of GDP, unless otherwise indicated)

	Actual			Historical Average	Standard Deviation	Projections							2014-2019		2020-2034	
	2011	2012	2013			2014	2015	2016	2017	2018	2019	Average	2024	2034	Average	
<b>External debt (nominal) 1/</b>	<b>8.4</b>	<b>8.0</b>	<b>8.6</b>			<b>11.4</b>	<b>15.6</b>	<b>20.1</b>	<b>24.6</b>	<b>29.6</b>	<b>34.3</b>			<b>50.5</b>	<b>60.5</b>	
<i>of which: public and publicly guaranteed (PPG)</i>	8.4	8.0	8.6			11.4	15.6	20.1	24.6	29.6	34.3			50.5	60.5	
Change in external debt	-2.9	-0.4	0.7			2.8	4.2	4.4	4.5	5.0	4.7			2.5	-0.2	
Identified net debt-creating flows	30.6	25.4	22.5			52.5	52.4	48.3	40.2	34.3	30.5			31.4	31.4	
<b>Non-interest current account deficit</b>	<b>32.2</b>	<b>26.2</b>	<b>27.3</b>	<b>24.3</b>	<b>6.8</b>	<b>53.3</b>	<b>53.3</b>	<b>49.2</b>	<b>41.1</b>	<b>35.1</b>	<b>31.3</b>			<b>32.5</b>	<b>33.2</b>	32.6
Deficit in balance of goods and services	65.4	65.0	49.3			77.4	75.2	69.8	62.2	55.0	50.1			47.8	44.7	
Exports	29.7	45.3	61.0			33.4	33.0	32.6	32.4	32.1	32.0			30.4	27.8	
Imports	95.1	110.2	110.3			110.8	108.2	102.4	94.6	87.1	82.1			78.2	72.5	
Net current transfers (negative = inflow)	-16.8	-23.6	-7.5	-19.8	6.2	-11.0	-8.8	-8.3	-7.2	-6.6	-6.1			-8.8	-8.8	-8.8
<i>of which: official</i>	-18.8	-25.6	-9.8			-13.3	-11.2	-10.7	-9.6	-9.0	-8.6			-11.2	-11.2	
Other current account flows (negative = net inflow)	-16.4	-15.2	-14.5			-13.0	-13.1	-12.3	-14.0	-13.3	-12.7			-6.4	-2.7	
<b>Net FDI (negative = inflow)</b>	<b>-0.2</b>	<b>-0.8</b>	<b>-5.1</b>	<b>-0.8</b>	<b>1.5</b>	<b>-0.7</b>	<b>-0.7</b>	<b>-0.6</b>	<b>-0.6</b>	<b>-0.6</b>	<b>-0.5</b>			<b>-0.7</b>	<b>-1.2</b>	-0.9
<b>Endogenous debt dynamics 2/</b>	<b>-1.4</b>	<b>0.0</b>	<b>0.3</b>			<b>-0.2</b>	<b>-0.2</b>	<b>-0.2</b>	<b>-0.3</b>	<b>-0.3</b>	<b>-0.2</b>			<b>-0.3</b>	<b>-0.6</b>	
Contribution from nominal interest rate	0.1	0.1	0.1			0.1	0.1	0.2	0.2	0.2	0.4			0.5	0.5	
Contribution from real GDP growth	-0.3	-0.2	-0.2			-0.3	-0.3	-0.4	-0.5	-0.5	-0.6			-0.9	-1.1	
Contribution from price and exchange rate changes	-1.2	0.1	0.5			...	...	...	...	...	...			...	...	
<b>Residual (3-4) 3/</b>	<b>-33.5</b>	<b>-25.9</b>	<b>-21.9</b>			<b>-49.7</b>	<b>-48.2</b>	<b>-43.9</b>	<b>-35.7</b>	<b>-29.3</b>	<b>-25.8</b>			<b>-28.9</b>	<b>-31.7</b>	
<i>of which: exceptional financing</i>	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0			0.0	0.0	
PV of external debt 4/	...	...	5.4			7.3	9.9	12.6	15.1	17.7	20.2			28.0	33.4	
In percent of exports	...	...	8.9			21.8	30.1	38.5	46.6	55.2	63.3			92.0	120.0	
<b>PV of PPG external debt</b>	<b>...</b>	<b>...</b>	<b>5.4</b>			<b>7.3</b>	<b>9.9</b>	<b>12.6</b>	<b>15.1</b>	<b>17.7</b>	<b>20.2</b>			<b>28.0</b>	<b>33.4</b>	
<b>In percent of exports</b>	<b>...</b>	<b>...</b>	<b>8.9</b>			<b>21.8</b>	<b>30.1</b>	<b>38.5</b>	<b>46.6</b>	<b>55.2</b>	<b>63.3</b>			<b>92.0</b>	<b>120.0</b>	
<b>In percent of government revenues</b>	<b>...</b>	<b>...</b>	<b>7.7</b>			<b>18.6</b>	<b>24.2</b>	<b>31.1</b>	<b>37.5</b>	<b>44.4</b>	<b>50.9</b>			<b>73.5</b>	<b>95.6</b>	
<b>Debt service-to-exports ratio (in percent)</b>	<b>1.0</b>	<b>0.7</b>	<b>0.5</b>			<b>1.0</b>	<b>1.1</b>	<b>1.2</b>	<b>1.3</b>	<b>1.4</b>	<b>2.0</b>			<b>4.4</b>	<b>7.7</b>	
<b>PPG debt service-to-exports ratio (in percent)</b>	<b>1.0</b>	<b>0.7</b>	<b>0.5</b>			<b>1.0</b>	<b>1.1</b>	<b>1.2</b>	<b>1.3</b>	<b>1.4</b>	<b>2.0</b>			<b>4.4</b>	<b>7.7</b>	
<b>PPG debt service-to-revenue ratio (in percent)</b>	<b>0.8</b>	<b>0.6</b>	<b>0.5</b>			<b>0.9</b>	<b>0.9</b>	<b>1.0</b>	<b>1.0</b>	<b>1.1</b>	<b>1.6</b>			<b>3.5</b>	<b>6.2</b>	
Total gross financing need (Millions of U.S. dollars)	55.8	45.1	38.2			87.0	90.2	86.4	75.0	66.7	61.7			80.5	128.4	
Non-interest current account deficit that stabilizes debt ratio	35.1	26.7	26.6			50.5	49.1	44.7	36.6	30.2	26.5			30.0	33.4	
<b>Key macroeconomic assumptions</b>																
Real GDP growth (in percent)	2.7	2.8	2.9	1.6	3.2	3.0	2.7	2.5	2.4	2.3	2.1	2.5	1.9	1.9	1.9	
GDP deflator in US dollar terms (change in percent)	11.4	-1.4	-5.7	5.2	7.8	-6.1	0.9	1.2	1.3	1.5	1.2	0.0	2.5	2.5	2.5	
Effective interest rate (percent) 5/	0.8	0.9	1.2	0.8	0.2	1.1	1.1	1.1	1.0	1.0	1.5	1.1	1.1	0.9	1.1	
Growth of exports of G&S (US dollar terms, in percent)	-6.2	54.3	30.8	13.7	23.0	-47.1	2.4	2.7	2.9	3.1	2.9	-5.5	3.4	3.6	3.4	
Growth of imports of G&S (US dollar terms, in percent)	25.0	17.5	-2.9	9.1	16.7	-2.8	1.2	-1.8	-4.1	-4.4	-2.6	-2.4	3.6	3.7	3.5	
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	36.9	40.0	43.8	49.1	51.7	51.7	45.5	54.7	54.0	54.4	
Government revenues (excluding grants, in percent of GDP)	37.0	54.0	69.9	...	...	39.1	40.9	40.5	40.2	39.9	39.7		38.1	34.9	37.1	
Aid flows (in Millions of US dollars) 7/	43.2	63.7	73.0	...	...	79.0	81.7	77.1	66.4	58.5	55.4		63.7	88.4		
<i>of which: Grants</i>	43.2	63.7	73.0	...	...	73.5	73.5	67.9	56.4	47.0	43.9		50.7	73.4		
<i>of which: Concessional loans</i>	0.0	0.0	0.0	...	...	5.5	8.2	9.2	10.0	11.5	11.5		13.0	15.0		
Grant-equivalent financing (in percent of GDP) 8/	...	...	...	...	...	46.0	45.1	40.7	33.4	27.8	25.3		23.8	21.7	23.1	
Grant-equivalent financing (in percent of external financing) 8/	...	...	...	...	...	95.6	94.0	93.3	92.3	90.5	90.0		90.8	92.2	91.0	
<b>Memorandum items:</b>																
Nominal GDP (Millions of US dollars)	172.7	175.1	169.8			164.3	170.3	176.7	183.4	190.4	196.7			243.1	375.7	
Nominal dollar GDP growth	14.5	1.4	-3.0			-3.3	3.7	3.8	3.8	3.8	3.3	2.5	4.4	4.4	4.4	
PV of PPG external debt (in Millions of US dollars)	...	...	8.5			11.9	16.8	22.1	27.5	33.6	39.6			68.0	125.3	
(PVt-PVt-1)/GDPt-1 (in percent)	...	...	...			2.0	3.0	3.1	3.1	3.3	3.2	2.9	2.5	1.3	2.2	
Gross workers' remittances (Millions of US dollars)	11.0	10.8	10.2			9.3	9.5	9.5	9.5	9.5	9.4			13.7	21.2	
PV of PPG external debt (in percent of GDP)	...	...	5.1			6.9	9.4	11.9	14.3	16.9	19.3			26.5	31.6	
PV of PPG external debt (in percent of exports)	...	...	8.1			18.7	25.7	33.1	40.2	47.8	55.1			77.6	99.8	
Debt service of PPG external debt (in percent of exports)	...	...	0.5			0.9	0.9	1.0	1.1	1.2	1.7			3.7	6.4	

Sources: Country authorities; and staff estimates and projections.

1/ Includes both public and private sector external debt.

2/ Derived as  $[r - g - \rho(1+g)] / (1+g+\rho+g\rho)$  times previous period debt ratio, with  $r$  = nominal interest rate;  $g$  = real GDP growth rate, and  $\rho$  = growth rate of GDP deflator in U.S. dollar terms.

3/ Includes exceptional financing; changes in gross foreign assets; and valuation adjustments. For projections also includes contribution from price and exchange rate changes.

The large residual is explained by changes in the RERF and capital grants not included in current transfers. These capital grants account around 30 percent of GDP, see BOP table.

4/ Assumes that PV of private sector debt is equivalent to its face value.

5/ Current-year interest payments divided by previous period debt stock.

6/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

7/ Defined as grants, concessional loans, and debt relief.

8/ Grant-equivalent financing includes grants provided directly to the government and through new borrowing (difference between the face value and the PV of new debt).

**Table 3b. Kiribati: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2014–34**

(In percent)

	Projections							
	2014	2015	2016	2017	2018	2019	2024	2034
<b>PV of debt-to GDP ratio</b>								
<b>Baseline</b>	7	10	13	15	18	20	<b>28</b>	33
<b>A. Alternative Scenarios</b>								
A1. Key variables at their historical averages in 2014-2034 1/	7	8	8	8	7	7	<b>5</b>	4
A2. New public sector loans on less favorable terms in 2014-2034 2	7	11	15	19	23	27	<b>43</b>	59
<b>B. Bound Tests</b>								
B1. Real GDP growth at historical average minus one standard deviation in 2015-2016	7	10	14	16	19	22	<b>30</b>	36
B2. Export value growth at historical average minus one standard deviation in 2015-2016 3/	7	12	18	20	23	26	<b>33</b>	36
B3. US dollar GDP deflator at historical average minus one standard deviation in 2015-2016	7	10	13	16	19	22	<b>30</b>	36
B4. Net non-debt creating flows at historical average minus one standard deviation in 2015-2016 4/	7	8	9	11	14	16	<b>24</b>	32
B5. Combination of B1-B4 using one-half standard deviation shocks	7	7	6	9	11	14	<b>22</b>	32
B6. One-time 30 percent nominal depreciation relative to the baseline in 2015 5/	7	14	18	21	25	29	<b>40</b>	47
<b>PV of debt-to-exports ratio</b>								
<b>Baseline</b>	22	30	39	47	55	63	<b>92</b>	120
<b>A. Alternative Scenarios</b>								
A1. Key variables at their historical averages in 2014-2034 1/	22	23	24	24	23	22	<b>15</b>	16
A2. New public sector loans on less favorable terms in 2014-2034 2	22	33	46	59	72	85	<b>140</b>	211
<b>B. Bound Tests</b>								
B1. Real GDP growth at historical average minus one standard deviation in 2015-2016	22	30	38	46	55	63	<b>92</b>	120
B2. Export value growth at historical average minus one standard deviation in 2015-2016 3/	22	40	70	81	92	102	<b>140</b>	166
B3. US dollar GDP deflator at historical average minus one standard deviation in 2015-2016	22	30	38	46	55	63	<b>92</b>	120
B4. Net non-debt creating flows at historical average minus one standard deviation in 2015-2016 4/	22	25	27	35	43	51	<b>80</b>	114
B5. Combination of B1-B4 using one-half standard deviation shocks	22	20	18	26	34	42	<b>71</b>	109
B6. One-time 30 percent nominal depreciation relative to the baseline in 2015 5/	22	30	38	46	55	63	<b>92</b>	120
<b>PV of debt-to-revenue ratio</b>								
<b>Baseline</b>	19	24	31	38	44	51	<b>74</b>	96
<b>A. Alternative Scenarios</b>								
A1. Key variables at their historical averages in 2014-2034 1/	19	19	19	19	19	18	<b>12</b>	13
A2. New public sector loans on less favorable terms in 2014-2034 2	19	27	37	47	58	69	<b>112</b>	168
<b>B. Bound Tests</b>								
B1. Real GDP growth at historical average minus one standard deviation in 2015-2016	19	25	34	41	48	55	<b>80</b>	104
B2. Export value growth at historical average minus one standard deviation in 2015-2016 3/	19	29	44	51	58	64	<b>88</b>	103
B3. US dollar GDP deflator at historical average minus one standard deviation in 2015-2016	19	25	33	40	48	55	<b>79</b>	103
B4. Net non-debt creating flows at historical average minus one standard deviation in 2015-2016 4/	19	20	22	28	35	41	<b>64</b>	91
B5. Combination of B1-B4 using one-half standard deviation shocks	19	16	15	22	29	35	<b>59</b>	91
B6. One-time 30 percent nominal depreciation relative to the baseline in 2015 5/	19	34	44	53	63	72	<b>105</b>	136

**Table 3b. Kiribati: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2014–34 (concluded)**  
(In percent)

	Projections							
	2014	2015	2016	2017	2018	2019	2024	2034
<b>Debt service-to-exports ratio</b>								
<b>Baseline</b>	1	1	1	1	1	2	4	8
<b>A. Alternative Scenarios</b>								
A1. Key variables at their historical averages in 2014-2034 1/	1	1	1	1	1	1	2	1
A2. New public sector loans on less favorable terms in 2014-2034 2	1	1	1	2	2	3	7	13
<b>B. Bound Tests</b>								
B1. Real GDP growth at historical average minus one standard deviation in 2015-2016	1	1	1	1	1	2	4	8
B2. Export value growth at historical average minus one standard deviation in 2015-2016 3/	1	1	2	2	2	3	6	11
B3. US dollar GDP deflator at historical average minus one standard deviation in 2015-2016	1	1	1	1	1	2	4	8
B4. Net non-debt creating flows at historical average minus one standard deviation in 2015-2016 4/	1	1	1	1	1	2	4	7
B5. Combination of B1-B4 using one-half standard deviation shocks	1	1	1	1	1	2	3	7
B6. One-time 30 percent nominal depreciation relative to the baseline in 2015 5/	1	1	1	1	1	2	4	8
<b>Debt service-to-revenue ratio</b>								
<b>Baseline</b>	1	1	1	1	1	2	3	6
<b>A. Alternative Scenarios</b>								
A1. Key variables at their historical averages in 2014-2034 1/	1	1	1	1	1	1	2	1
A2. New public sector loans on less favorable terms in 2014-2034 2	1	1	1	1	2	2	6	11
<b>B. Bound Tests</b>								
B1. Real GDP growth at historical average minus one standard deviation in 2015-2016	1	1	1	1	1	2	4	7
B2. Export value growth at historical average minus one standard deviation in 2015-2016 3/	1	1	1	1	1	2	4	7
B3. US dollar GDP deflator at historical average minus one standard deviation in 2015-2016	1	1	1	1	1	2	4	7
B4. Net non-debt creating flows at historical average minus one standard deviation in 2015-2016 4/	1	1	1	1	1	1	3	6
B5. Combination of B1-B4 using one-half standard deviation shocks	1	1	1	1	1	1	3	5
B6. One-time 30 percent nominal depreciation relative to the baseline in 2015 5/	1	1	1	1	2	2	5	9
<i>Memorandum item:</i>								
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	50	50	50	50	50	50	50	50

Sources: Country authorities; and staff estimates and projections.

1/ Variables include real GDP growth, growth of GDP deflator (in U.S. dollar terms), non-interest current account in percent of GDP, and non-debt creating flows.

2/ Assumes that the interest rate on new borrowing is by 2 percentage points higher than in the baseline, while grace and maturity periods are the same as in the

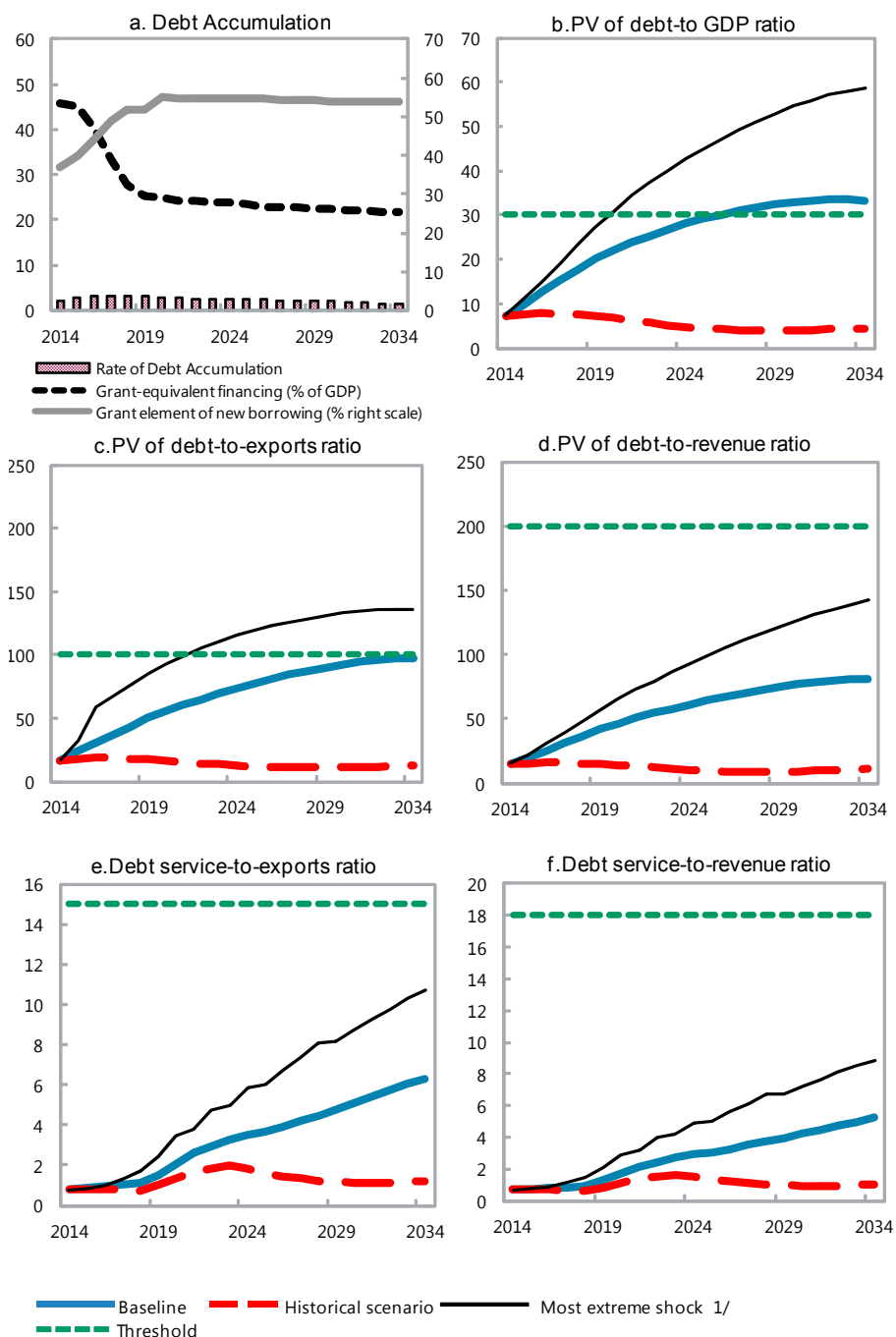
3/ Exports values are assumed to remain permanently at the lower level, but the current account as a share of GDP is assumed to return to its baseline level after an offsetting adjustment in import levels).

4/ Includes official and private transfers and FDI.

5/ Depreciation is defined as percentage decline in dollar/local currency rate, such that it never exceeds 100 percent.

6/ Applies to all stress scenarios except for A2 (less favorable financing) in which the terms on all new financing are as specified in footnote 2.

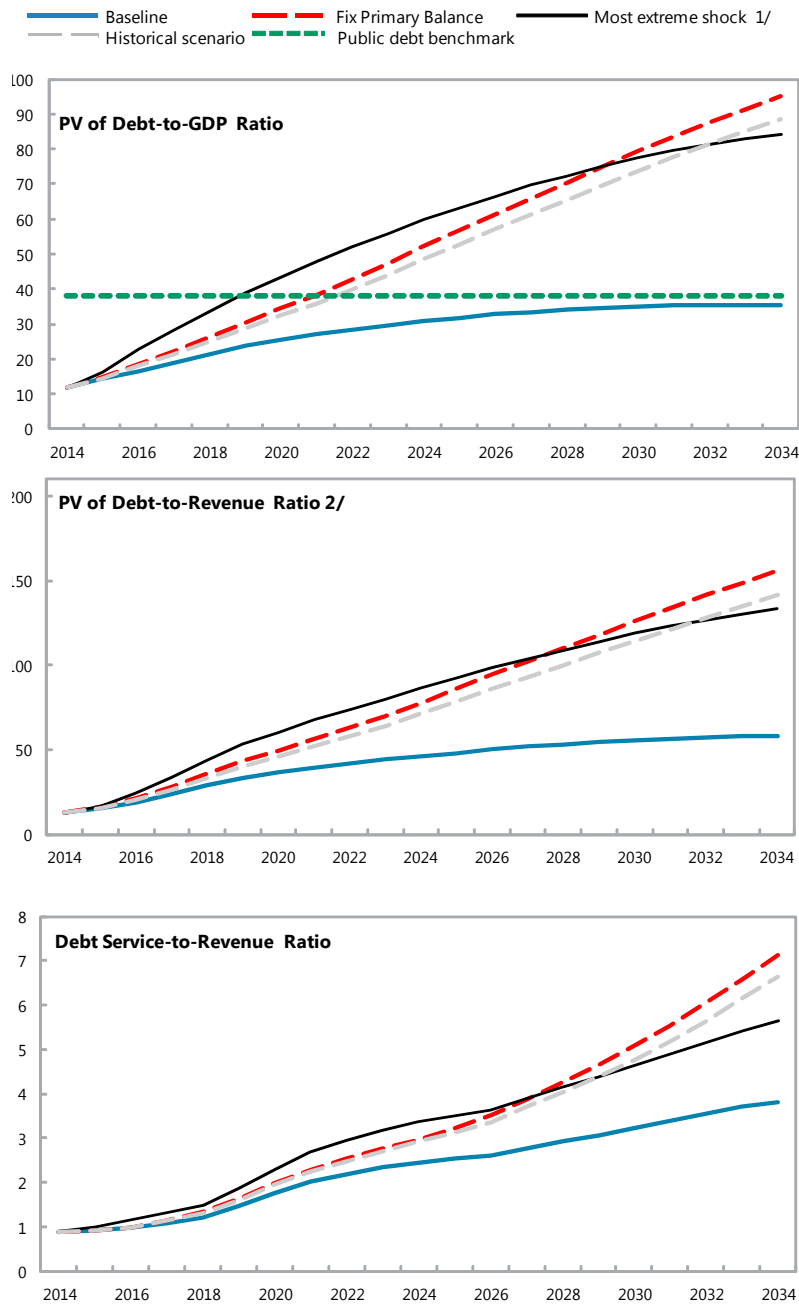
**Figure 3. Kiribati High Fishing License Fee and RERF Stabilization Scenario: Indicators of Public and Publicly Guaranteed External Debt under Alternatives Scenarios, 2014–34 1/**



Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio on or before 2024. In figure b. it corresponds to a Terms shock; in c. to a Exports shock; in d. to a Terms shock; in e. to a Terms shock and in figure f. to a Terms shock

**Figure 4. Kiribati Fishing License Scenario: Indicators of Public Debt Under Alternative Scenarios, 2014–34 1/**



Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio on or before 2024.

2/ Revenues are defined inclusive of grants.

**Table 4. Kiribati: Public Sector Debt Sustainability Framework,  
High Fishing License Fees and Stabilization RERF Scenario, 2011–2034**  
(In percent of GDP, unless otherwise indicated)

	Actual			Average \$/	Standard Deviation \$/	Estimate					Projections					
	2011	2012	2013			2014	2015	2016	2017	2018	2019	2014-19 Average	2024	2034	2020-34 Average	
<b>Public sector debt 1/</b>	29.2	11.6	13.3			15.9	19.9	24.1	28.4	33.2	37.8				53.3	62.3
<i>of which: foreign-currency denominated</i>	8.4	8.0	8.6			11.4	15.6	20.1	24.6	29.6	34.3				50.5	60.5
Change in public sector debt	-2.9	-17.5	1.7			2.6	4.0	4.2	4.3	4.8	4.5				2.4	-0.3
Identified debt-creating flows	20.4	6.2	-9.4			15.7	14.2	12.7	12.5	12.2	11.4				6.5	3.2
Primary deficit	19.1	6.3	-10.9	9.9	9.4	15.6	14.3	12.9	12.8	12.6	11.7	13.3			7.9	5.8
Revenue and grants	62.0	90.4	112.9			93.5	93.5	88.0	79.8	73.3	70.6				66.7	60.9
<i>of which: grants</i>	25.0	36.4	43.0			44.8	43.2	38.4	30.8	24.7	22.3				20.9	19.5
Primary (noninterest) expenditure	81.2	96.7	102.0			109.1	107.7	100.9	92.6	85.9	82.3				74.6	66.7
Automatic debt dynamics	1.3	-0.1	1.4			0.1	0.0	-0.1	-0.3	-0.4	-0.3				-1.3	-2.0
Contribution from interest rate/growth differential	1.3	-0.1	0.1			0.0	-0.1	-0.2	-0.4	-0.5	-0.5				-1.1	-1.6
<i>of which: contribution from average real interest rate</i>	2.1	0.7	0.4			0.3	0.3	0.2	0.2	0.1	0.2				-0.1	-0.5
<i>of which: contribution from real GDP growth</i>	-0.9	-0.8	-0.3			-0.4	-0.4	-0.5	-0.6	-0.6	-0.7				-0.9	-1.2
Contribution from real exchange rate depreciation	0.0	0.0	1.3			0.1	0.1	0.1	0.1	0.1	0.2				...	...
Other identified debt-creating flows	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0				0.0	-0.7
Privatization receipts (negative)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0				0.0	-0.7
Recognition of implicit or contingent liabilities	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0				0.0	0.0
Debt relief (HIPC and other)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0				0.0	0.0
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0				0.0	0.0
Residual, including asset changes 6/	-23.3	-23.7	11.1			-13.1	-10.3	-8.5	-8.2	-7.4	-6.8				-4.2	-3.5
<b>Other Sustainability Indicators</b>																
<b>PV of public sector debt</b>			101			11.8	14.1	16.6	18.9	21.4	23.7				30.8	35.2
<i>of which: foreign-currency denominated</i>			5.4			7.3	9.9	12.6	15.1	17.7	20.2				28.0	33.4
<i>of which: external</i>			5.4			7.3	9.9	12.6	15.1	17.7	20.2				28.0	33.4
PV of contingent liabilities (not included in public sector debt)																
Gross financing need 2/	21.5	7.0	-10.0			16.4	15.1	13.7	13.6	13.5	12.7				9.5	8.2
PV of public sector debt-to-revenue and grants ratio (in percent)			9.0			12.6	15.1	18.9	23.7	29.2	33.6				46.2	57.8
PV of public sector debt-to-revenue ratio (in percent)			14.5			24.1	28.1	33.5	38.5	44.0	49.2				67.2	85.1
<i>of which: external 3/</i>			7.7			15.0	19.7	25.3	30.7	36.5	41.9				61.0	80.7
Debt service-to-revenue and grants ratio (in percent) 4/	3.7	0.7	0.7			0.9	0.9	1.0	1.1	1.2	1.5				2.5	3.8
Debt service-to-revenue ratio (in percent) 4/	6.3	1.2	1.2			1.7	1.7	1.7	1.8	1.8	2.2				3.6	5.6
Primary deficit that stabilizes the debt-to-GDP ratio	22.0	23.9	-12.6			13.0	10.3	8.6	8.4	7.8	7.1				5.5	6.1
<b>Key macroeconomic and fiscal assumptions</b>																
Real GDP growth (in percent)	2.7	2.8	2.9	1.6	3.2	3.0	2.7	2.5	2.4	2.3	2.1	2.5	1.9	1.9	1.9	1.9
Average nominal interest rate on forex debt (in percent)	0.8	0.9	1.2	0.9	0.1	1.1	1.1	1.1	1.0	1.0	1.5	1.1	1.1	0.9	1.1	1.1
Average real interest rate on domestic debt (in percent)	10.7	3.5	12.8	10.0	4.8	8.6	8.7	8.9	9.0	9.1	9.3	8.9	8.2	7.0	7.5	7.5
Real exchange rate depreciation (in percent, + indicates depreciation)	0.0	-0.2	17.2	0.3	13.6	1.2										
Inflation rate (GDP deflator, in percent)	-0.8	-1.7	0.8	0.8	2.9	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5
Growth of real primary spending (deflated by GDP deflator, in percent)	0.7	22.6	8.5	4.5	8.5	10.1	1.4	-4.0	-6.0	-5.1	-2.2	-1.0	0.1	0.8	0.5	0.5
Grant element of new external borrowing (in percent)						36.9	40.0	43.8	49.1	51.7	51.7	45.5	54.7	54.0		

Sources: Country authorities; and staff estimates and projections.

1/ [Indicate coverage of public sector, e.g., general government or nonfinancial public sector. Also whether net or gross debt is used.]

2/ Gross financing need is defined as the primary deficit plus debt service plus the stock of short-term debt at the end of the last period.

3/ Revenues excluding grants.

4/ Debt service is defined as the sum of interest and amortization of medium and long-term debt.

5/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

6/ Includes RERF withdrawals and budget supports not included in grants.



**Table 5. Kiribati: External Debt Sustainability Framework, Baseline Scenario, 2011–34 1/**  
(In percent of GDP, unless otherwise indicated)

	Actual				Historical <sup>6/</sup> Standard <sup>6/</sup>		Projections						2014-2019		2020-2034	
	2010	2011	2012	2013	Average	Deviation	2014	2015	2016	2017	2018	2019	Average	2024	2034	Average
<b>External debt (nominal) 1/</b>	<b>11.3</b>	<b>8.4</b>	<b>8.0</b>	<b>8.6</b>			<b>11.4</b>	<b>15.6</b>	<b>20.1</b>	<b>24.6</b>	<b>29.6</b>	<b>34.3</b>		<b>50.5</b>	<b>60.5</b>	
<i>of which: public and publicly guaranteed (PPG)</i>	11.3	8.4	8.0	8.6			11.4	15.6	20.1	24.6	29.6	34.3		50.5	60.5	
Change in external debt	1.5	-2.9	-0.4	0.7			2.8	4.2	4.4	4.5	5.0	4.7		2.5	-0.2	
Identified net debt-creating flows	15.4	30.6	25.4	22.5			42.9	43.1	38.9	30.5	24.5	20.7		15.4	10.9	
<b>Non-interest current account deficit</b>	<b>16.8</b>	<b>32.2</b>	<b>26.2</b>	<b>27.3</b>	<b>24.3</b>	<b>6.8</b>	<b>43.7</b>	<b>43.9</b>	<b>39.7</b>	<b>31.3</b>	<b>25.4</b>	<b>21.5</b>		<b>16.4</b>	<b>12.7</b>	15.7
Deficit in balance of goods and services	50.9	65.4	65.0	49.3			67.8	65.9	60.6	53.3	46.2	41.6		37.0	33.7	
Exports	36.3	29.7	45.3	61.0			43.0	42.3	41.8	41.3	40.9	40.5		38.2	34.2	
Imports	87.1	95.1	110.2	110.3			110.8	108.2	102.4	94.6	87.1	82.1		75.2	68.0	
Net current transfers (negative = inflow)	-18.7	-16.8	-23.6	-7.5	-19.8	6.2	-11.0	-8.8	-8.3	-7.2	-6.6	-6.1		-8.8	-8.8	-8.8
<i>of which: official</i>	-20.6	-18.8	-25.6	-9.8			-13.3	-11.2	-10.7	-9.6	-9.0	-8.6		-11.2	-11.2	
Other current account flows (negative = net inflow)	-15.4	-16.4	-15.2	-14.5			-13.0	-13.1	-12.6	-14.8	-14.3	-14.0		-11.7	-12.2	
<b>Net FDI (negative = inflow)</b>	<b>0.1</b>	<b>-0.2</b>	<b>-0.8</b>	<b>-5.1</b>	<b>-0.8</b>	<b>1.5</b>	<b>-0.7</b>	<b>-0.7</b>	<b>-0.6</b>	<b>-0.6</b>	<b>-0.6</b>	<b>-0.5</b>		<b>-0.7</b>	<b>-1.2</b>	-0.9
<b>Endogenous debt dynamics 2/</b>	<b>-1.5</b>	<b>-1.4</b>	<b>0.0</b>	<b>0.3</b>			<b>-0.2</b>	<b>-0.2</b>	<b>-0.2</b>	<b>-0.3</b>	<b>-0.3</b>	<b>-0.2</b>		<b>-0.3</b>	<b>-0.6</b>	
Contribution from nominal interest rate	0.1	0.1	0.1	0.1			0.1	0.1	0.2	0.2	0.2	0.4		0.5	0.5	
Contribution from real GDP growth	0.0	-0.3	-0.2	-0.2			-0.3	-0.3	-0.4	-0.5	-0.5	-0.6		-0.9	-1.1	
Contribution from price and exchange rate changes	-1.6	-1.2	0.1	0.5			...	...	...	...	...	...		...	...	
<b>Residual (3-4) 3/</b>	<b>-13.9</b>	<b>-33.5</b>	<b>-25.9</b>	<b>-21.9</b>			<b>-40.0</b>	<b>-38.9</b>	<b>-34.4</b>	<b>-25.9</b>	<b>-19.5</b>	<b>-16.0</b>		<b>-12.9</b>	<b>-11.1</b>	
<i>of which: exceptional financing</i>	0.0	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
PV of external debt 4/	...	...	...	5.4			7.3	9.9	12.6	15.1	17.7	20.2		28.0	33.4	
In percent of exports	...	...	...	8.9			17.0	23.4	30.1	36.5	43.4	49.9		73.3	97.4	
<b>PV of PPG external debt</b>	...	...	...	<b>5.4</b>			<b>7.3</b>	<b>9.9</b>	<b>12.6</b>	<b>15.1</b>	<b>17.7</b>	<b>20.2</b>		<b>28.0</b>	<b>33.4</b>	
In percent of exports	...	...	...	<b>8.9</b>			<b>17.0</b>	<b>23.4</b>	<b>30.1</b>	<b>36.5</b>	<b>43.4</b>	<b>49.9</b>		<b>73.3</b>	<b>97.4</b>	
In percent of government revenues	...	...	...	<b>7.7</b>			<b>15.0</b>	<b>19.7</b>	<b>25.3</b>	<b>30.7</b>	<b>36.5</b>	<b>41.9</b>		<b>61.0</b>	<b>80.7</b>	
<b>Debt service-to-exports ratio (in percent)</b>	<b>0.9</b>	<b>1.0</b>	<b>0.7</b>	<b>0.5</b>			<b>0.8</b>	<b>0.9</b>	<b>0.9</b>	<b>1.0</b>	<b>1.1</b>	<b>1.5</b>		<b>3.5</b>	<b>6.3</b>	
<b>PPG debt service-to-exports ratio (in percent)</b>	<b>0.9</b>	<b>1.0</b>	<b>0.7</b>	<b>0.5</b>			<b>0.8</b>	<b>0.9</b>	<b>0.9</b>	<b>1.0</b>	<b>1.1</b>	<b>1.5</b>		<b>3.5</b>	<b>6.3</b>	
<b>PPG debt service-to-revenue ratio (in percent)</b>	<b>0.7</b>	<b>0.8</b>	<b>0.6</b>	<b>0.5</b>			<b>0.7</b>	<b>0.7</b>	<b>0.8</b>	<b>0.9</b>	<b>0.9</b>	<b>1.3</b>		<b>2.9</b>	<b>5.2</b>	
Total gross financing need (Millions of U.S. dollars)	26.0	55.8	45.1	38.2			71.2	74.2	69.8	57.1	48.1	42.4		41.5	51.2	
Non-interest current account deficit that stabilizes debt ratio	15.3	35.1	26.7	26.6			40.9	39.7	35.3	26.8	20.4	16.7		13.9	12.9	
<b>Key macroeconomic assumptions</b>																
Real GDP growth (in percent)	-0.5	2.7	2.8	2.9	1.6	3.2	3.0	2.7	2.5	2.4	2.3	2.1	2.5	1.9	1.9	1.9
GDP deflator in US dollar terms (change in percent)	19.4	11.4	-1.4	-5.7	5.2	7.8	-6.1	0.9	1.2	1.3	1.5	1.2	0.0	2.5	2.5	2.5
Effective interest rate (percent) 5/	0.8	0.8	0.9	1.2	0.8	0.2	1.1	1.1	1.1	1.0	1.0	1.5	1.1	1.1	0.9	1.1
Growth of exports of G&S (US dollar terms, in percent)	32.7	-6.2	54.3	30.8	13.7	23.0	-31.8	2.0	2.4	2.6	2.8	2.5	-3.3	3.2	3.4	3.2
Growth of imports of G&S (US dollar terms, in percent)	5.6	25.0	17.5	-2.9	9.1	16.7	-2.8	1.2	-1.8	-4.1	-4.4	-2.6	-2.4	2.8	3.4	3.1
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	...	36.9	40.0	43.8	49.1	51.7	51.7	45.5	54.7	54.0	54.4
Government revenues (excluding grants, in percent of GDP)	47.8	37.0	54.0	69.9			48.7	50.3	49.6	49.1	48.6	48.3		45.8	41.3	44.5
Aid flows (in Millions of US dollars) 7/	37.3	43.2	63.7	73.0			79.0	81.7	77.1	66.4	58.5	55.4		63.7	88.4	
<i>of which: Grants</i>	37.3	43.2	63.7	73.0			73.5	73.5	67.9	56.4	47.0	43.9		50.7	73.4	
<i>of which: Concessional loans</i>	0.0	0.0	0.0	0.0			5.5	8.2	9.2	10.0	11.5	11.5		13.0	15.0	
Grant-equivalent financing (in percent of GDP) 8/	...	...	...	...			46.0	45.1	40.7	33.4	27.8	25.3		23.8	21.7	23.1
Grant-equivalent financing (in percent of external financing) 8/	...	...	...	...			95.6	94.0	93.3	92.3	90.5	90.0		90.8	92.2	91.0
<b>Memorandum items:</b>																
Nominal GDP (Millions of US dollars)	150.9	172.7	175.1	169.8			164.3	170.3	176.7	183.4	190.4	196.7		243.1	375.7	
Nominal dollar GDP growth	18.8	14.5	1.4	-3.0			-3.3	3.7	3.8	3.8	3.8	3.3	2.5	4.4	4.4	4.4
PV of PPG external debt (in Millions of US dollars)	...	...	...	8.5			11.9	16.8	22.1	27.5	33.6	39.6		68.0	125.3	
(PVt-PVt-1)/GDPT-1 (in percent)	...	...	...	...			2.0	3.0	3.1	3.1	3.3	3.2	2.9	2.5	1.3	2.2
Gross workers' remittances (Millions of US dollars)	9.9	11.0	10.8	10.2			9.3	9.5	9.5	9.5	9.5	9.4		13.7	21.2	
PV of PPG external debt (in percent of GDP)	...	...	...	5.1			6.9	9.4	11.9	14.3	16.9	19.3		26.5	31.6	
PV of PPG external debt (in percent of exports)	...	...	...	8.1			15.0	20.7	26.7	32.5	38.7	44.7		63.8	83.7	
Debt service of PPG external debt (in percent of exports)	...	...	...	0.5			0.7	0.8	0.8	0.9	1.0	1.4		3.0	5.4	

Sources: Country authorities; and staff estimates and projections.

1/ Includes both public and private sector external debt.

2/ Derived as  $[r - g - \rho(1+g)] / (1+g+\rho+gp)$  times previous period debt ratio, with  $r$  = nominal interest rate;  $g$  = real GDP growth rate, and  $\rho$  = growth rate of GDP deflator in U.S. dollar terms.

3/ Includes exceptional financing; changes in gross foreign assets; and valuation adjustments. For projections also includes contribution from price and exchange rate changes.

Large residual is mostly explained by RERF changes and capital grants.

4/ Assumes that PV of private sector debt is equivalent to its face value.

5/ Current-year interest payments divided by previous period debt stock.

6/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

7/ Defined as grants, concessional loans, and debt relief.

8/ Grant-equivalent financing includes grants provided directly to the government and through new borrowing (difference between the face value and the PV of new debt).



INTERNATIONAL MONETARY FUND



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International Monetary Fund  
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### **IMF Executive Board Concludes 2014 Article IV Consultation with Kiribati**

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

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

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

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

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

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

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

### **Executive Board Assessment<sup>2</sup>**

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

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

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

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

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

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

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

### Kiribati: Selected Economic Indicators, 2009–15

	2009	2010	2011	2012	2013	2014	2015
				Est.		Proj.	
Nominal GDP (2011): US\$172.7 million	GDP per capita (2011): US\$1,670						
Nominal GNI (2011): US\$236.1 million	Population (2011): 103,365						
Main export products: fish and copra	Quota: SDR 5.6 million						
Real GDP (percent change)	-0.7	-0.5	2.7	2.8	2.9	3.0	2.7
Real GNI (percent change)	-4.0	-1.3	-2.4	15.3	13.2	-15.2	2.3
Consumer prices (percent change, average)	9.8	-3.9	1.5	-3.0	-1.5	2.5	2.5
Consumer prices (percent change, end of period)	-1.3	-1.9	-0.8	-3.9	0.8	2.5	2.5
Central government finance (percent of GDP)							
Revenue and grants	70.9	72.5	62.0	90.4	112.9	83.9	84.1
Total domestic revenue 1/	42.7	47.8	37.0	54.0	69.9	39.1	40.9
Grants	28.1	24.7	25.0	36.4	43.0	44.8	43.2
Expenditure and net lending	82.8	85.2	83.2	97.2	102.6	109.7	104.5
Current	54.7	58.0	58.0	61.0	59.8	61.7	56.7
<i>Of which: wages and salaries</i>	24.7	27.0	27.4	28.3	29.7	28.8	27.9
Development	28.1	27.1	25.2	36.2	42.8	48.0	47.8
Current balance 2/	-12.0	-10.2	-21.0	-6.9	10.1	-22.6	-15.8
Overall balance	-12.0	-12.7	-21.2	-6.7	10.3	-25.8	-20.4
Financing	12.0	12.7	21.2	6.7	-10.3	25.8	20.4
Revenue Equalization and Reserve Fund (RERF)	11.1	10.5	11.8	22.2	-10.1	14.5	13.2
Other	0.9	2.1	9.5	-15.4	-0.2	11.3	7.1
RERF							
Closing balance (in millions of US\$)	512	576	586	607	600	587	580
Closing balance (in millions of A\$)	571	581	579	581	668	666	668
Per capita value (in 2006 A\$)	5,209	5,040	4,759	4,592	5,058	4,837	4,643
Balance of payments (in millions of US\$)	-	-					
Current account including official transfers	-29.6	-25.4	-55.7	-46.1	-46.5	-87.8	-90.9
(In percent of GDP)	-23.3	-16.9	-32.2	-26.3	-27.4	-53.4	-53.4
External debt (in millions of US\$)	14.3	18.4	14.2	14.1	13.6	18.7	26.4
(In percent of GDP)	9.8	11.3	8.4	8.0	8.6	11.4	15.6
External debt service (in millions of US\$)	1.0	0.6	0.6	0.6	0.5	0.5	0.6
(In percent of exports of goods and services)	4.8	3.2	2.8	3.0	3.0	3.1	3.2
Exchange rate (A\$/US\$ period average) 3/	1.3	1.1	1.0	1.0	1.0	...	...
Real effective exchange rate (period average) 4/	130.5	132.5	138.0	134.2	126.1	...	...
Memorandum item:							
Nominal GDP (in millions of Australian dollars)	162.8	164.1	167.3	169.0	175.4	185.1	194.9
Nominal GDP (in millions of US dollars)	127.0	150.9	172.7	175.1	169.8	164.3	170.3

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

1/ Assumes conservative path for fishing license fees in 2014 and onwards. Higher fishing license fees at the level of A\$60 million would imply a current deficit of 13 percent of GDP in 2014.

2/ Current balance excludes grants and development expenditure.

3/ The Australian dollar circulates as legal tender.

4/ Index, 2005=100.

**Statement by Jong-Won Yoon, Executive Director for Kiribati  
and Mr. Wonjin Choi, Advisor to Executive Director  
May 16, 2014**

We would like to thank staff for the 2014 report and the close collaboration with the authorities. We welcome the past assistance of the IMF and the rigorous monitoring of the economy in Kiribati that has been associated with their visits. We thank the IMF and donors they are working with for their forthright views and opinions and analysis of the economic situation. We also welcome staff's proposal to maintain the 12 month Article IV consultations cycle for Kiribati.

**Economic Context**

Kiribati consists of 33 small islands in the mid-Pacific Ocean, mainly coral atolls with a distance of 4,500km between the eastern and western economic zones comparable with the distance between the east and west coast of Australia and the United States. 56 percent of the population of approximately 110,000 are located on the islands of South Tarawa and Betio with high patterns of migration from outer islands. The remaining 44 percent of the population are spread across 22 other inhabitable islands. High transaction costs between the outer islands and South Tarawa due to isolation and poor infrastructure affects the development of the productive sectors on the outer islands.

Most of South Tarawa is less than three meters above sea level which means that the country is highly vulnerable to climate change. Latest meteorological reports suggest the tropical Pacific Ocean has warmed steadily in recent months, with large warm anomalies in the ocean sub-surface and increasingly warm sea surface temperatures. These trends suggest that there is a 70 percent likelihood that an El Nino-Southern Oscillation (ENSO) event will occur in July this year. The implications for Kiribati are that it will be subjected to abnormally higher levels of rainfall with potential flooding.

**Economic Outlook**

Economic growth has strengthened and will likely remain strong due to major infrastructure projects commencing over the next few years. A roads rehabilitation project, the airport terminal renovation and a water and sanitation rehabilitation project are several major donor funded projects to get underway over the next few years. The actual lasting impact on the domestic economy may remain modest as all materials, specialist machinery, and most of the construction staff will need to be sourced from abroad. GDP growth will strengthen to around 3.0 percent and inflation will become positive rising to 2.5 percent in 2014 with the introduction of the VAT in April 2014. Fishing revenues strengthened in 2012 and 2013, but are expected to remain volatile as the number of day licenses sold depends on migratory tuna stocks, which remain sensitive to climatic conditions and changes in water temperature. The complete abolition

of commercial fishing in the Phoenix Islands Protected area at the end of 2014 will provide some protection to fish stocks which are threatened by higher catches but will also lead to a decline in fishing revenue in 2015.

### **Fiscal Policy**

Company tax revenues fell in 2012 alongside an increase in noncompliance. However, a small increase in company taxes of 4.6 percent occurred in 2013. Fisheries revenue rose to a record 89.8 million AUD and as a result, the current fiscal balance is forecast to reach 19.4 percent of GDP in 2013. The Revenue Equalization Reserve Fund (RERF), Kiribati's sovereign wealth fund, has significant financial assets amounting to around 370 percent of GDP in 2013. These funds were accumulated from phosphate mining at the time of independence in 1979. Current projections suggest the RERF will undergo a gradual depletion without policy change over the next couple of decades. Thus, Kiribati's overriding fiscal goal remains to protect the value of the RERF. The staff projections suggest that the withdrawals from the RERF should be limited to less than 12 million AUD annually to stabilize the RERF over a period of 8-9 years. Our authorities remain committed to prudent macroeconomic policies, but achieving this target will be difficult.

The introduction of the VAT and excise taxes will put Kiribati on a more equal footing with the tax structures of other Pacific nations and ensures that Kiribati complies with the provisions of the trade agreement PACER Plus which promotes free trade in the Pacific region. The introduction of the VAT along with excise tax and the abolition of customs duty will see overall taxation levels declining in 2014 (mainly due to lags in the collection of VAT) but in 2015 taxation revenue is expected to significantly rise. The World Bank has provided budget support of 5.8 million AUD in 2014 and the Asian Development Bank has offered 3 million USD in budget support to ease adjustment. Other donors have also displayed some interest in the provision of budget support in 2014 and 2015.

Ongoing support remains contingent on future policy action. Donor partners, including the IMF, have agreed on a policy reform matrix that identified key reforms. These reforms have been carefully prioritized to reflect the capacity constraints on the Kiribati Government and were supported through the provision of extensive technical assistance from a range of sources. The programmatic series of Kiribati Economic Reform Operations supports three key elements, including increasing revenues; improving the management of public assets and liabilities; and expanding private sector opportunities. Tax reform that includes steps to improve compliance has been an integral part of the reform. Financial reforms, SOE reform, and improved guidance around management of the RERF have also occurred. Subsidy reforms are under consideration to the copra purchasing scheme. This subsidy provides an important safety net for subsistence populations on the outer islands but remains expensive with 7 percent of total expenditure being outlaid in 2013. However, the Government of Kiribati believes that income

generating schemes such as the copra price subsidy go a long way towards stemming the drift of population from the outer islands to South Tarawa where population pressures are intense. The World Bank has provided assistance to improve the efficiency of the copra price subsidy through recommendations such as the merger of the two main organisations involved. Technical assistance has been provided on centralized debt management guidelines to establish policy criteria around any additional borrowing which the government has agreed to. Departments and SOEs now face new limitations on their ability to independently incur debt or invoke government guarantees through a requirement for formal Cabinet approval.

### **State Owned Enterprise Reform**

Kiribati's SOEs were originally set up to provide commercial services so as to meet public policy objectives. However, governance, sustainability and accountability have been long standing issues in the management of SOEs in Kiribati. Several SOEs have been privatized, with plans for more in the future, opening the potential for increased private sector engagement. The import trading company was sold and the first PPP has been developed between the Government and the owners of the former state owned hotel, the Otintaai Hotel. The Government is examining other asset sales and in 2013 approved a Bill opening the telecommunications industry to competition. The Government has sought expressions of interest in operating the national telecommunications company. For other SOEs with a social mandate, the concentration will be on providing effective subsidies and ensuring their commercial viability. Shipping is one area that the Government has focused its attention on, with a view to encouraging private sector involvement. Our authorities are working with the ADB on a comprehensive review of the SOEs, aimed at improving financial transparency through improved management or sale. An SOE Bill was passed in May 2013 establishing a strengthened legal framework covering independence, governance, financial reporting, and the management of SOEs. The emphasis has been on improving the commercial performance of the SOEs. Arrears on inter-SOE debt and debt to Government Ministries as well as loans to the commercial bank have been catalogued and are being cleared, including those between the Public Utilities Board and Kiribati Oil. The Ministry of Finance has also increased its supervision and oversight to carefully monitor debt management.

### **Private Sector Growth**

Growth in the private sector will be important to reduce the social cost of fiscal adjustment, given high unemployment and relatively low annual income. The rapid population growth in South Tarawa has created a growing private sector, although most businesses remain small, informal, and largely family run. Improved urban planning, given rising population density and clarity around lack of formal land title, could encourage investment. Kiribati authorities have finalised a National Private Sector Development Strategy to progress private sector initiatives.



The authorities have worked for many years to encourage local participation in the fishing industry – the nation’s primary economic resource. A range of joint ventures and employment agreements have been trialled in an attempt to overcome a chronic lack of capital. The Government completed a National Fishing Policy in 2013 to strengthen the sustainable management of fisheries resources and maximize license revenue income. Kiribati has received international direct investment in a new fish processing plant, which offers a promising opportunity for Kiribati to earn more from its fishery resource. The factory will provide employment and exposure to international management practice. The authorities are in negotiations with Fiji to open the air route to competition. Lack of a second airline to Kiribati from Fiji inhibits the growth of important fishing exports due to the limited capacity of the airline.

### **Labor Mobility and Foreign Policy**

With official unemployment rates of over 30 percent, Kiribati sees global integration as its primary avenue towards economic development. The Government has placed a large emphasis on providing the population with the education and skills necessary to capitalize on employment opportunities abroad with a greater emphasis on technical qualifications that are internationally recognised. For instance, the Marine Training Centre in Kiribati is an internationally recognised institution which has provided qualifications for I-Kiribati seafarers to be sent abroad for nearly fifty years. The local technical institute is also supporting this trend to align training schemes with Australian educational standards. This should allow local tradesmen to migrate to meet skill shortages in Australia and New Zealand. New Zealand and Australia also attract seasonal workers from Kiribati, which adds to remittance flows. The Government is attempting to improve basic skills such as financial literacy to boost the numbers of seasonal workers abroad.

Growth to a large extent in Kiribati depends on the fortunes of the fishing industry which accounted for 70 percent of revenue in 2013. The ENSO event expected in July will also mean better conditions for fishing as fish stocks normally rise with ENSO in Kiribati. However, the fishing industry is highly volatile and therefore highly unpredictable with fiscal revenues from fishing in Kiribati fluctuating from 29 million AUD in 2011 to 90 million AUD in 2014. World events such as the Global Financial Crisis also add to the challenges with a sudden downturn for employment of seafarers and commensurate effects on remittances one end result. The world price of rice, a staple commodity, also affects the inflation rate. Exchange rate variations also have an impact on revenue. The Australian dollar is the currency in Kiribati and revenue from fishing contracts, normally written in US dollars, will fluctuate with movements in the Australian dollar. Kiribati is one of the Parties to the Nauru Agreement (PNA) which implements measures to maintain sustainable tuna fisheries and minimise the impact on bycatch species. Regional agreements such as these assist in the management and the revenue streams for the industry.