



GOVERNMENT OF KIRIBATI

MINISTRY OF FINANCE & ECONOMIC DEVELOPMENT

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Fiscal Strategy for the 2022 Budget & Medium Term Fiscal Strategy

The Fiscal Strategy outlines the major parameters that the Government will use to develop the 2022 Budget. This includes the setting of Fiscal Policy Interventions and Targets that will guide expenditure decisions, and the ceilings to be applied to Ministry operating and personnel budgets. The Fiscal Strategy must ensure that the top priorities of Government can be met in a sustainable way, without compromising the delivery of essential services or the budget in the long run – particularly in an environment where extremely volatile fishing revenues can lead to significant risks.

For 2022, the Government will adopt a medium-term fiscal strategy that establishes high level goals to achieve macro-economic stability in the medium term, consistent with the aspirations in the Kiribati 20 Year vision (KV20), and a Budget Strategy that sets out how the goals are to be achieved in 2022.

Taking account of uncertain, but potentially positive, economic conditions and the need to build resilience to manage fiscal risks, the Government will maintain its commitment to macro-economic stability and target fiscal balance and growth in net worth over the medium term, allowing for supportive fiscal measures to underpin the recovery in the short term.

For 2022, departmental budget ceilings have been set at 2021 levels, adjusted for unavoidable pay rises. Government commitments regarding the Copra Subsidy and unemployment benefit payments will be met. Expenditure proposals above the ceiling will be considered through a New Program Proposal process and prioritized should fiscal space be identified. Cash reserves will be used to meet any funding gaps.

Publication of the 2022 Fiscal Strategy reflects the Government's commitment to improved public financial management and transparency. Publication is consistent with global best-case practice, and is recommended under the International Monetary Fund's (IMF) Public Expenditure and Financial Accountability framework.

Medium Term Fiscal Strategy

KV20 articulates long term goals related to achieving macro-economic stability, including implementing policy settings that will increase Gross Domestic Product (GDP), fisheries revenue contributions, the private sector's share of GDP and protect the real value of the Revenue Equalisation Reserve Fund (RERF) over the long-term.

These goals have been translated into a medium-term fiscal strategy to achieve macro-economic stability and build a resilient, wealthy, healthy and secure nation, through responsible fiscal management by:

1. Growing financial net worth over the medium term, through increasing RERF and cash balances and reducing debt. Where new debt is considered, it must be concessional, with at least a 35 per cent grant component;
2. Achieving budget balance over the medium term consistent with economic conditions and inclusive economic growth, with the aim to fully fund Government consumption and investment from current revenue by:
 - a. Revenue mobilization and diversification
 - b. Improving the efficiency and effectiveness of expenditure (value for money) and government investment
3. Investing in productivity enhancing social and economic infrastructure consistent with KV20 priorities and a proactive climate change response, with the aim to support future sources of growth and improved allocative efficiency; and
4. Structural reforms to diversify the economy and build resilience, with the aim to facilitate a vibrant private sector and create meaningful jobs.

This strategy will be supported by the achievement of two fiscal responsibility ratios, to mitigate fiscal sustainability risks:

1. Departmental expenditure not to exceed 50 per cent of total expenditure; and
2. Maintenance of liquidity cash buffers of at least three months expenditure.

The cash buffer will mitigate revenue volatility and liquidity risks and operate to encourage action to control spending over time, should revenues not grow sufficiently to fully meet expenditure requirements. It allows for the fiscal stance to adjust to economic conditions up to a limit, and will ultimately guard against reserves being fully run-down due to unsustainable spending.

The expenditure ratio will support managing expenditure risks and encourage discipline in government spending, facilitating at least half the annual budget being used for transfers and projects to support improved standards of living country-wide.

The impact of adopting this strategy is that fiscal policy will accommodate changing domestic economic conditions (that is, it will move between deficit and surplus in line with the economic cycle), and economic resilience will be built through prudent fiscal management, investment in productive capacity (social and economic infrastructure) as well as structural reforms that promote efficiency in government spending (well targeted social protection measures, State Owned Enterprise (SOE) reforms etc.) and economic diversification.

The Fiscal Strategy is summarized at [Attachment A](#).

2022 Budget Strategy and Ceilings

The proposed 2022 Budget base case settings take account of the medium-term strategy and how it can be achieved in light of expected economic conditions, fiscal risks and Government policy priorities to be delivered in 2022.

Economic Outlook

The Government uses IMF economic forecasts to underpin the economic assumptions used to develop budget estimates.

According to the latest IMF World Economic Outlook (April 2021), the global economic recovery is strengthening, but there remains high uncertainty around the outlook. The accumulating human toll of the COVID-19 pandemic continues to raise concerns as growing vaccine coverage lifts sentiment.

After an estimated contraction of negative 3.3 per cent in 2020, the global economy is projected to grow at 6 per cent in 2021, moderating to 4.4 per cent in 2022. Risks are skewed to the downside, as economic recoveries diverge across countries and sectors, reflecting variations in pandemic-induced disruptions and policy support.

Consistent with the global experience, the IMF estimates that economic growth has slowed in Kiribati, but is expected to recover through 2021 and 2022.

Early Government action to contain the pandemic, including through travel restrictions, successfully limited the risk of a domestic outbreak but also put strains on economic activity, especially in restaurant and hotel services, transportation, and other business activities. This was partially offset by Government measures to support demand. However, the impact of restrictions on the movement of personnel and materials has delayed planned large investment projects and reform initiatives. Fishing revenues were also softer.

The IMF estimates that Kiribati GDP reduced in real terms by 0.5 per cent in 2020, but will increase by 1.8 per cent in 2021, lifting to 2.5 per cent in 2022, as vaccination rates increase and containment measures ease (leading to increased labour mobility and port activity), investment projects move forward and international demand recovers. Improved global conditions should support positive RERF performance and fishing revenues, all other things being equal.

Risks for Kiribati are skewed to the downside, and relate to the potential impact of a COVID-19 outbreak, the duration of containment measures that limit labour mobility, port activity, and project progress, as well as the impact of global economic conditions on RERF performance and fishing demand.

Inflation is expected to stay constant at around 2 per cent. Nominal GDP is estimated at \$311 million in 2022.

2022 Budget Assumptions

The key assumptions in formulating the 2022 Budget include:

- 2022 economic conditions will be consistent with the IMF forecast of 6 per cent global growth, 2.5 per cent Kiribati growth, and 2 per cent inflation;
- Fishing revenue estimates will be consistent with historic performance;
- RERF dividends will be consistent with the RERF withdrawal policy;
- Revenue volatility will be managed by accessing cash reserves;
- Kiribati will remain COVID-19 free and containment measures will be progressively eased as vaccination rates increase, enabling employment and economic activity to increase and projects to restart and progress, assuming transport connectivity issues can be overcome;
- Government policy commitments to increase the Copra Subsidy and pay unemployment benefits will be met, as will public sector pay rises; and
- Donor budget support payments are conditional on meeting fiscal responsibility and economic reform commitments.

The starting point of the budget strategy is to forecast a realistic revenue envelope that provides a ceiling for expenditure. The base case estimates are summarised in the table at [Attachment B](#). These estimates reflect assumptions at a point in time, and are subject to change.

Revenue Estimates

With the positive global economic outlook, and modest growth expected for Kiribati, it is expected that fisheries revenues and taxation revenues should at least be at a similar level to that achieved in 2020, when economic conditions were not as positive.

A key challenge is the assumption around fishing revenues. Prior year forecasting has significantly under-estimated expected fishing revenues. In 2020, fishing revenues outperformed the estimate by nearly a quarter, resulting in an overall surplus, rather than the expected deficit.

The proposed 2022 Budget base case is for a realistic estimate of fishing revenues, consistent with historic revenue levels, to support a realistic assessment of fiscal space and address Government expenditure priorities.

The new RERF withdrawal framework enables Government to plan for orderly RERF withdrawals to support economic development priorities. Dividends can only be drawn down where the fund's rate of return was over 5 per cent in the previous year, and revenue can only be used for development projects. This rule protects the real value of the fund over time, consistent with KV20 objectives.

The preliminary assessed rate of return for RERF in the most recent completed financial year of 2020 was 5 per cent, before the \$40 million dividend used in the 2021 Budget (1.7 per cent after the \$40 million withdrawal). Since the RERF is to all intents and purposes a form of investment by the government, it is appropriate that the interest income or dividend estimated to be received from this investment in any given year be included as part of the funding revenue envelope for the government budget for that fiscal year. This does not necessarily mean that this amount will be drawn down because it will still be subject to the agreed RERF drawdown policy.

All other revenue estimates are consistent with historical patterns.

Overall, the proposed base case revenue funding envelope is \$298 million, a 7 per cent increase over the 2021 Budget estimate.

Expenditure Estimates

The proposed revenue envelope constrains the amount of expenditure that can be considered. The modest economic growth outlook of 2.5 per cent, and uncertainty around COVID-19 and travel restrictions, suggests a supportive fiscal stance may be appropriate to underpin the recovery, but its scale needs to be consistent with economic conditions and include a path to overall balance or surplus, as conditions improve.

- The departmental expenditure ceiling has been set at the 2021 Budget estimate, adjusted for unavoidable pay rises.

- Government commitments for enhanced social protection through an increase in the Copra Subsidy and unemployment benefit will be met.
- Proposals above the ceiling will need to be justified through a New Project Proposal (NPP) process, to enable them to be prioritised should fiscal space be identified. Where possible, savings should be identified to enable re-prioritisation of expenditure.

Overall, the base case total expenditure is estimated at \$296.7 million, a 6 per cent increase on expenditure compared to 2021.

Fiscal balance

Overall, the base case estimates result in a surplus of \$1.3 million which is 0.4 per cent of GDP.

Both of the fiscal responsibility ratios are met in the base case estimate. Cash reserves at 30 June 2021 were \$241.8 million, providing over nine months of expenditure cover. Proposed departmental expenditure is 47 per cent of total expenditure.

RISKS and Sensitivities

The base case estimates rest on assumptions related to economic activity, expenditure and revenue, especially expected fishing revenues and donor direct budget support payments.

There is a risk that fishing revenues may be less than expected due to lower demand for licenses. Donor support payments are conditional on meeting economic reform milestones, with an estimated \$17.4 million potentially at risk (6 per cent of total revenue).

The risk to the fishing revenue estimate will be mitigated by working with MFMRD to better understand the expected revenue estimates, and to develop a robust fisheries forecasting model that can underpin more certainty in the estimate.

The risk to donor support revenues will in part be mitigated by implementation of the proposed medium term fiscal strategy and progress with economic reform initiatives through the Economic Reform Taskforce, as well as demonstrating fiscal discipline in the 2022 Budget strategy.

A further risk relates to the quality of expenditure, and the long-term sustainability of transfer payments. For example, the current level of the Copra Subsidy at \$4 a kilo, when the world price is less than \$1 a kilo, is unlikely to be affordable in the longer term. It is proposed to undertake more analysis to consider opportunities to improve the efficiency and effectiveness of transfer payments in meeting Government objectives. This may include options to target payments to those most in need, or alternative more efficient delivery mechanisms. In addition, reforms to public financial management and State-Owned Enterprises will continue to be pursued.

The base case estimates have limited scope for new initiatives, or emerging fiscal pressures. This may prove unrealistic. This risk can be mitigated by a rigorous review of departmental expenditure to determine opportunities for reallocation, and the potential to revisit the implementation of the RERF withdrawal rule for high value projects that meet the investment criteria.

The economic outlook assumption is also a risk, and foreign exchange volatility may also impact on the estimates. The healthy cash reserves buffer will support manage these risks.

To mitigate the impact of all of these risks on the budget settings, it will be important to review and revisit assumptions as the budget process progresses.

An analysis of the sensitivity of the estimates in the budget year and outyears is included at Attachment C. In all scenarios, the cash buffer fiscal responsibility ratio is maintained.

2022 Fiscal Strategy

Objective: macro-economic stability to support inclusive economic growth through responsible fiscal management

Medium Term Fiscal Strategy	Annual Budget Strategy	Actions
<p>Increase financial net worth in medium term</p> <p><i>Aim to grow RERF and cash balances and reduce debt</i></p>	<ul style="list-style-type: none"> • Drawdown RERF consistent with draw down policy • Prior year surpluses to contribute to RERF • No new debt, unless concessional, with at least 35% grant component. 	<ul style="list-style-type: none"> • RERF drawdown • Cash management and forecasting improvements
<p>Fiscal balance in medium term</p> <p><i>Aim to fully fund consumption and investment from current revenue by containing expenditure and revenue mobilization, taking account of economic conditions</i></p>	<p><i>Supportive fiscal stance to support COVID-19 recovery</i></p> <ul style="list-style-type: none"> • Target operational balance through expenditure ceilings • Social protection measures in line with commitments • Development expenditure consistent with priorities • RERF dividend to fund development expenditure • Realistic revenue estimates • Fiscal responsibility ratios 	<ul style="list-style-type: none"> • Departmental expenditure ceiling at 2021 level - limit of not more than 50% of total expenditure • Maintain cash buffer of 3 months expenditure • Other government expenditure ceiling at 2021 level • Copra subsidy increase in line with commitments • New Policy/Project Proposal process for prioritization • Savings identification process
<p>Investment in productivity enhancing social and economic infrastructure</p> <p><i>Aim to invest to support future sources of growth and improved allocative efficiency</i></p>	<ul style="list-style-type: none"> • Health - COVID-19 and public health • Education • Utilities – electricity, water and sanitation • Transport connectivity (air, sea and land) to facilitate value add in fisheries and tourism • Improved communication functionality and connectivity • Climate change adaptation – build back better 	<ul style="list-style-type: none"> • Progress existing projects • Maintenance and management of existing investments
<p>Revenue mobilization</p> <p><i>Aim to improve the efficiency and effectiveness of revenue collections, and diversify revenue sources</i></p>	<ul style="list-style-type: none"> • Increase revenue collected through improved revenue administration and potential change in policy settings • Diversification 	<ul style="list-style-type: none"> • Review IMF policy recommendations • Transparency of fishing collections • Donor financing
<p>Value for money expenditure</p> <p><i>Improve the efficiency and effectiveness of government expenditure and investment to achieve Government priorities, including targeted social protection measures, asset maintenance (whole of life project costing) and KV20 goals</i></p>	<ul style="list-style-type: none"> • Targeting and efficiency of social protection programs • SOE reforms to improve the return on investment • PFM reforms • Project planning and costing • Climate change resilience 	<ul style="list-style-type: none"> • Implementation of procurement reforms • Budget performance reporting • SOE reforms • Proactive maintenance provisions • Expenditure reviews • Asset management
<p>Structural reforms</p> <p><i>Aim to facilitate a vibrant private sector, economic diversification and job creation</i></p>	<ul style="list-style-type: none"> • Measures to improve the business climate 	<ul style="list-style-type: none"> • Review competitive neutrality reform options • Business regulations – reduce red tape

2022 Budget Base Case Estimates

Item	2019 Actual	2020 Budget	2020 Actual	% of Bud	2021 Budget	2022 Proposed	Change
	\$	\$	\$	%	\$	\$	%
Total Revenue	285,258,217	223,186,605	248,870,320	112%	279,472,655	298,010,249	7%
Total Domestic Revenue	284,758,222	209,273,942	241,862,014	116%	265,500,677	280,613,613	6%
Fisheries revenue	226,307,228	150,101,000	184,068,815	123%	165,400,000	199,967,000	21%
Taxation revenue	49,440,666	49,016,397	51,649,018	105%	49,996,724	50,175,376	0%
Investment revenue	2,294,377	5,000,000	1,752,240	35%	45,000,000	25,000,000	-44%
<i>RERF dividend</i>	...	...	...	...	40,000,000	23,000,000	-43%
<i>Interest and dividends</i>	2,294,377	5,000,000	1,752,240	35%	5,000,000	2,000,000	-60%
Other Ministries revenue	6,715,951	5,156,545	4,391,942	85%	5,103,953	5,471,237	7%
Total donor budget support	499,995	13,912,663	7,008,305	50%	13,971,978	17,396,636	25%
Total Expenditure	246,464,772	260,114,038	239,130,584	92%	279,425,988	296,682,935	6%
Departmental expenditure	117,501,796	120,044,224	115,432,195	96%	138,666,865	141,127,559	2%
Other government expenditure	33,007,180	72,642,118	56,349,746	78%	63,215,690	61,715,690	-2%
Debt servicing	2,845,228	3,208,838	3,409,452	106%	3,681,769	4,090,104	11%
Local Contribution to Development Fund	93,110,568	64,218,858	63,939,191	100%	73,861,664	89,749,582	22%
<i>Copra Subsidy</i>	...	...	...	...	16,000,000	40,000,000	150%
<i>Unemployment Benefit</i>	...	...	...	...	27,065,911	32,400,000	20%
<i>Projects and grants</i>	...	...	...	...	30,795,753	17,349,582	-44%
Balance	38,793,445	(36,927,433)	9,739,736	>100%	46,667	1,327,314	>100%
Balance as share of GDP	14%	-13%	3%	...	0.02%	0.4%	
Cash reserves estimate	...	...	...	...	241,767,320	243,094,634	1%
Cash reserves expenditure months	...	...	...	...	10	10	
Dept expenditure share of total expenditure	48%	46%	48%	...	50%	48%	
Sensitivity Analysis - impact on balance/reserves							
A Low case Fisheries revenue						(31,672,686)	
Cash reserve months						8	
B No Donor Budget Support						(16,069,322)	
Cash reserve months						9	
C No RERF Dividend (return < 5%)						(21,672,686)	
Cash reserve months						9	
D Expenditure 5% higher						(13,506,832)	
Cash reserve months						9	

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Attachment C

2022 BUDGET FORWARD ESTIMATES AND SENSITIVITY ANALYSIS

Item	2019 Actual	2020 Actual	2021 Budget	2022 Proposed	2023 estimate	2024 estimate	2025 estimate
	\$	\$	\$	\$	\$	\$	\$
Total Revenue	285,258,217	248,870,320	279,472,655	298,010,249	304,529,780	312,789,416	321,040,492
Total Domestic Revenue	284,758,222	241,862,014	265,500,677	280,613,613	287,133,144	295,392,780	303,643,856
Fisheries revenue	226,307,228	184,068,815	165,400,000	199,967,000	204,116,764	208,343,756	212,627,332
Taxation revenue	49,440,666	51,649,018	49,996,724	50,175,376	52,272,739	54,370,102	56,306,129
Investment revenue	2,294,377	1,752,240	45,000,000	25,000,000	25,532,335	27,257,348	29,090,828
<i>RERF dividend</i>	...	...	40,000,000	23,000,000	23,448,734	25,090,145	26,846,455
<i>Interest and dividends</i>	2,294,377	1,752,240	5,000,000	2,000,000	2,083,601	2,167,203	2,244,373
Other Ministries revenue	6,715,951	4,391,942	5,103,953	5,471,237	5,211,306	5,421,575	5,619,566
Total donor budget support	499,995	7,008,305	13,971,978	17,396,636	17,396,636	17,396,636	17,396,636
Total Expenditure	246,464,772	239,130,584	279,425,988	296,682,935	300,693,340	304,738,652	309,402,720
Departmental expenditure	117,501,796	115,432,195	138,666,865	141,127,559	143,950,110	146,829,113	149,765,695
Other government expenditure	33,007,180	56,349,746	63,215,690	61,715,690	58,438,264	58,938,264	60,841,255
Debt servicing	2,845,228	3,409,452	3,681,769	4,090,104	4,055,383	4,021,693	3,946,188
Local Contribution to Development Fund	93,110,568	63,939,191	73,861,664	89,749,582	94,249,582	94,949,582	94,849,582
<i>Copra Subsidy</i>	...	...	16,000,000	40,000,000	40,000,000	40,000,000	40,000,000
<i>Unemployment Benefit</i>	...	...	27,065,911	32,400,000	32,400,000	32,400,000	32,400,000
<i>Projects and grants</i>	...	...	30,795,753	17,349,582	21,849,582	22,549,582	22,449,582
Balance	38,793,445	9,739,736	46,667	1,327,314	3,836,440	8,050,765	11,637,772
Balance as share of GDP	14%	3%	0.02%	0.4%	1%	2%	3%
Cash reserves estimate	...	...	241,767,320	243,094,634	246,931,075	254,981,839	266,619,611
Cash reserves expenditure months	...	...	10	10	10	10	10
Dept expenditure share of total expenditure	48%	48%	50%	48%	48%	48%	48%
Sensitivity Analysis - impact on balance/reserves							
A Low case Fisheries revenue				(31,672,686)	(29,973,984)	(26,580,524)	(23,802,844)
Cash reserve months				8	7	6	5
B No Donor Budget Support				(16,069,322)	(13,560,196)	(9,345,871)	(5,758,864)
Cash reserve months				9	8	8	8
C No RERF Dividend (return < 5%)				(21,672,686)	(19,612,293)	(17,039,380)	(15,208,683)
Cash reserve months				9	8	7	7
D Expenditure 5% higher				(13,506,832)	(11,198,227)	(7,186,168)	(3,832,364)
Cash reserve months				9	9	8	8

Sensitivity Analysis

The base case estimates rest on assumptions related to economic activity, expenditure and revenue, especially expected fishing revenues, donor direct budget support payments, RERF returns and expected dividends, as well as the maintenance of expenditure restraint.

The table above includes estimates on the impact on the overall balance for four scenarios, where the underlying estimate may not hold:

- A. Fishing revenue low case: Fishing revenues are \$31 million lower than expected
- B. No Donor Budget Support: Donors do not pay budget support, due to non-achievement of economic reform milestones

C. No RERF Dividend: rates of return on RERF do not exceed the 5 per cent benchmark for withdrawal of a dividend

D. Expenditure high case: expenditure exceeds the forward estimates by 5 per cent.

Cash reserves are assumed to be available to cover the volatility in the balance. The capacity to do this is assessed using an estimate of how many months expenditure the reserves are able to cover. In all scenarios the fiscal responsibility ration of three months reserve cover is met.

The Chart below illustrates the budget balance from 2019 to 2025.

