



GOVERNMENT OF KIRIBATI

GoK(12)DPF.06

DEVELOPMENT PARTNERS FORUM

Tarawa, Kiribati
25 – 27 June 2012

AGENDA ITEM 6: Kiribati Economic Reform Dialogue.

9:

Priorities and Process

-----**DRAFT FOR DISCUSSION PURPOSES ONLY**-----

Prepared for the Government of Kiribati by a joint team comprising Ministry of Finance and Economic Development, World Bank, and AusAID staff.

Executive Summary

This document is intended to begin a discussion. The Ministry of Finance and Economic Development (MFED) has requested World Bank and AusAID advice on 1) actions from within its existing ambitious program of economic reforms that are likely to have the greatest impact on economic development progress, and 2) options for establishment of a coordination mechanism including donors and Government to ensure that efforts towards progress in important areas are being prioritized, progress is being tracked, and sufficient international assistance in being provided.

This document is not intended to replace or override existing planning documents, nor is it intended to be a “new plan” – rather, it is intended to provide an assessment of relative priorities within the priorities already established by the Government, and inform an ongoing discussion within GoK and with development partners to achieve shared goals.

a) Economic Reform Priorities

The Government’s current economic reform priorities are sound. Taking account of the Kiribati context (including unique geography and capacity constraints), immediate challenges, and existing reform priorities, strategies and plans we identify three areas of opportunity for Kiribati. These areas of opportunity and the broad steps required to see them realized are outlined in the following diagram. The Amajority of the listed actions are underway and are reflected in the forthcoming KDP 2012-15.

Potential Areas of Opportunity		
Ensuring efficiency and sustainability in Government finances is vital given existing challenges and the likely large ongoing role of Government in the economy.	Expanding economic opportunities is vital given the young and growing population.	Making the most of aid is vital given the large share of public expenditure and economic activity accounted for by donor flows
<ul style="list-style-type: none"> • Fiscal sustainability: Understanding longer-term fiscal sustainability challenges facing Kiribati, given trends in expenditure, revenue, and use of the RERF. (NEW) • Revenues: Administrative and policy tax reform in the context of declining tariff revenues, improving RERF management, and managing volatility from fishing revenues. (*, KDP) • Expenditure: Reducing the fiscal burden of SOEs and improving performance, strengthening expenditure control to underpin better planning and financial management. (*, KDP) 	<ul style="list-style-type: none"> • Accessing foreign labour markets: New courses and improved standards at MTC / FTC, KIT, KSON. Maximise Kiribati participation in regional seasonal workers programs and expand into health and aged care sector. (*, KDP) • Infrastructure for growth and jobs: Timely execution of infrastructure projects in roads, aviation, and telecommunications for a better business environment. Ensure local job and contracting opportunities are maximised during construction and ongoing maintenance. (*, KDP) • Protecting outer-island livelihoods. Review existing mechanisms for supporting outer island economic development (eg copra subsidy 	<ul style="list-style-type: none"> • Better predictability of aid and alignment with Government priorities. Improving the reporting of project flows and execution for a more complete development budget. Over time, moving towards increased use of government systems to ensure alignment with policy goals. (*) • Better donor coordination. Simple steps to reduce the current administrative burden on Government imposed by large numbers of projects. (New)

	scheme), and reform policy to protect outer island livelihoods at lower fiscal and economic costs. (NEW)	
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* = Currently underway, or planned to be started soon

KDP = reflected in draft KDP 2012-15

New = New activity

Specific reform actions need to be identified. To facilitate useful discussion and coordination, it is necessary to identify the specific and measurable policy actions that are being pursued to give effect to the broad objectives outlined above. Specific priority policy measures to achieve the objectives listed above are listed in the following table. The majority of these policy actions are already being undertaken by GoK, often with donor assistance.

Potential Priority Actions		
Short-term	Medium-term	Expected Results
Efficiency and Sustainability in Government Finances		
Expenditure analysis work carried out by World Bank to assess linkages between current policy priorities and existing expenditure. New activity.	Process and budget allocation changes to improve alignment between resourcing and policy priorities.	Improved quality of public expenditure, leading to greater progress towards improved social indicators and effective implementation of economic reform efforts.
Implementation of a new tax IT system and compliance measures to increase taxation revenue. Existing MFED activity, with PFTAC and AusAID assistance.	Tax policy changes to substitute for declines in revenue due to required tariff reductions under PICTA.	Reductions in customs revenue are offset by increases in domestic revenue through successful implementation of tax changes.
Appointment of an investment advisor to assist in the implementation of improvements in RERF asset allocation and management. Would also examine current GoK use of overdraft mechanisms for financing cash and revenue shortfalls and alternative options. Existing MFED activity. Donor assistance required.	Agreement between GoK and DPs on updated policy rules for drawdowns of RERF, based on realistic fiscal forecasts, expected aid support, and demographic changes. Reduced reliance on expensive commercial overdraft facilities.	Sustainability of Government finances is improved and returns from RERF investments increase.
Preparation of National Fisheries Policy and accompanying Institutional Strengthening Program to support policy implementation. Existing MFMRD activity.	Coordinated implementation of the Institutional Strengthening Program, with required support from regional organisations and DPs.	Increased and more stable revenue from offshore fisheries, within sustainable catch limits
Introduction of policy reforms requiring MFED to provide advice to Cabinet on fiscal and economic impacts prior to the finalization of any Joint Venture arrangements. New activity.		Fiscal risks associated with Joint Ventures are reduced and outcomes improved.
Cabinet endorsement of the SOE Act and the Reform Strategy (2012). Existing Activity with ADB support.	Government divests commercial SOEs currently imposing greatest fiscal drain. Steps are taken towards improved commercial management of SOEs remaining under state ownership.	SOEs performing commercial roles are divested, reducing fiscal drain and creating space for private sector growth. The quality of services improves and prices are reduced.

Implementation of the upgraded Attaché accounting system in central and line ministries. Planned MFED activity with ADB / AusAID support.	Broader measures to achieve improved budget execution and a closer alignment between budgets and Ministry and Government plans.	Improved quality of public spending through better planning and closer links to policy priorities.
Expanding Economic Opportunities		
The Infrastructure steering committee meets regularly to assess progress in implementation of major infrastructure projects in roads, telecommunications, aviation, and water. Planned activity.	Introduction of competition into the telecommunication sector. Timely progress against key project milestones.	Improvements in telecommunications quality and affordability. Improved road, aviation, and water infrastructure.
Engagean advisor to provide recommendations for reform of the copra subsidy scheme and other mechanisms for protecting livelihoods on the outer islands, and identify additional options for ensuring cash incomes to rural workers. New activity.	Implementation changes to improve the efficiency and effectiveness of policies to protect outer-island livelihoods.	Incomes of rural workers are maintained while overall economic and fiscal costs of subsidies are reduced.
Improving quality and range of training opportunities at MTC - FTC, KIT, and supporting efforts to maximise Kiribati's participation in regional seasonal workers schemes. Specific actions to be determined.	MLHRD researches and identifies new labour market access arrangements to increase the number of I-Kiribati working abroad in the skilled trades and the professional services sectors.	Increased numbers of I-Kiribati participating in proven migration opportunities, while expanding access to new opportunities.
Making the Most of Aid		
Donors move to provide accurate reporting of projected and actual expenditure for at least 75 percent of aid flows. New activity.	Donors work with GoK to ensure that larger proportion of donor financing makes use of Government systems.	Aid flows are more predictable and better aligned with Government priorities, facilitating improvements in planning and greater effectiveness in public expenditure.
Development partners consistently provide mission calendars to MFED (NEPO), increase use of joint missions, and avoid missions during busy periods, including during the late stages of the budget process. New activity.		Reduced capacity strain of MFED, allowing more time for staff to implement reforms and carry out core business.

b) Proposed Process

To ensure good coordination between donors and Government on the implementation of these or alternative priorities and the regular tracking of progress, we suggest a regular process where priorities are agreed, progress is tracked, and key actions for donors and government are updated as reforms are achieved. Based on consultation with development partners and Government, we propose the following process for consideration and feedback:

1. Following consultation in January – March 2012, GoK and donors agree to a set of agreed reform priorities, informed by the ideas presented in the analysis above. A very short Economic Reform Framework document (1-2) pages, listing agreed priority actions and timeframes for their implementation is produced.

2. A regular Dialogue Meeting is held (twice per year) between the GoK and Development Partners (DPs) to discuss progress of implementing the reforms and activities identified in the Economic Reform Framework, any emerging issues, gaps in development partner assistance and ways to improve effectiveness. GoK chairs, but with administrative support from a rotating development partner.
3. Each year a joint GoK-DP mission, with sufficient economic capacity, would review progress towards successful implementation of the Economic Reforms. It would provide recommendations for updating the Economic Reform Framework.
4. The Economic Reform Framework is updated by the GoK with support from Development Partners and based on the findings from the Annual Review, and subsequent discussions.

1. Background and Purpose

The Government of Kiribati (GoK) has asked the World Bank and AusAID to work with the Ministry of Finance and Economic Development to identify economic reform priorities. This is intended to ensure progress against key constraints to economic development. The GoK is already engaged in an extensive program of economic reform, supported by various development partners. GoK believes, however, that the pace of progress could be accelerated through: 1) the identification of key economic reform actions that are likely to have the greatest impact on economic development progress, 2) sequencing of reform efforts to achieve maximum impact, and 3) the establishment of a coordination mechanism including donors and Government to ensure that efforts towards progress in important areas are being prioritized, progress is being tracked, and sufficient international assistance is being provided. Accordingly, in this document we present: 1) potential priority areas for economic reform effort, based on an overall assessment of economic prospects and constraints, and a review of existing planning documents, and 2) proposals for a joint Government-donor coordination mechanism to ensure that progress is being tracked and sufficient assistance provided for the achievement of these priorities.

This document is not intended to replace or override existing planning documents, such as the Kiribati Development Plan, Ministry Annual Plans, the Public Finance Management Reform Plan, or any other official strategies. Rather, this document is intended to provide an assessment of relative priorities within the priorities already established through government. Where clear gaps exist, however, this document identifies potential additional reform initiatives for consideration by the Government. Through the narrowing of priorities for economic reform, the GoK hopes to focus the attention of donors and its own reform efforts in ways that achieve the greatest impact with inevitably limited resources.

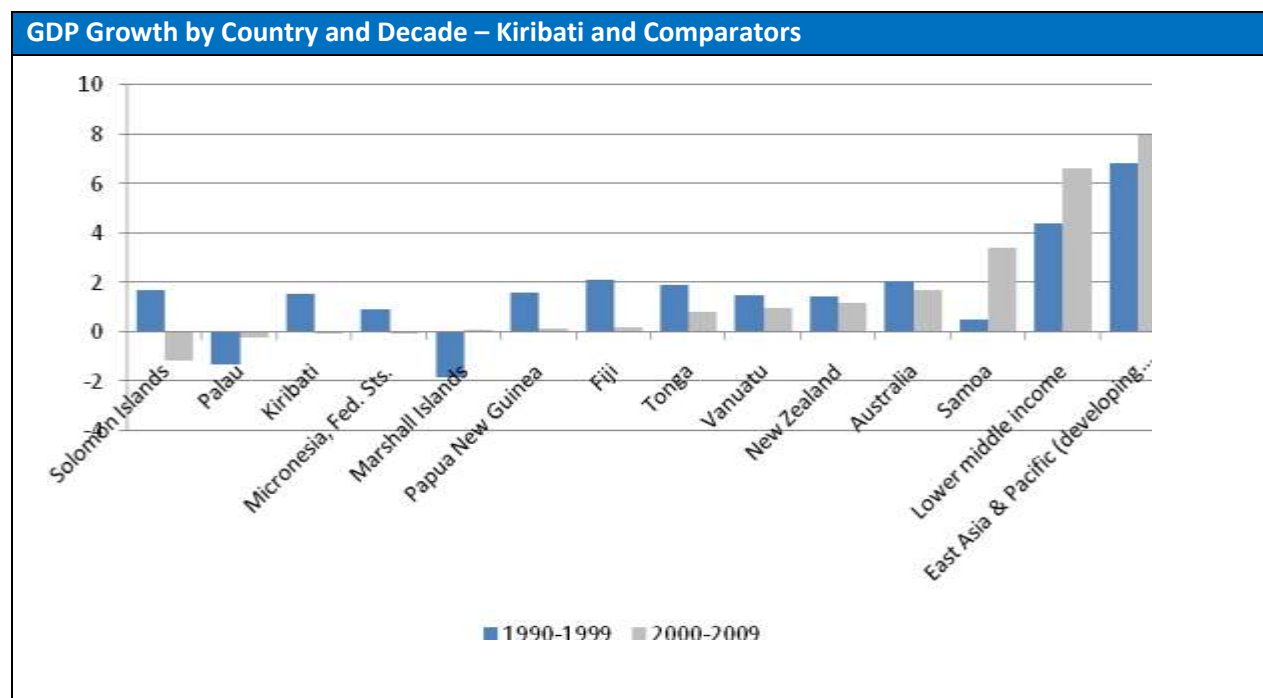
In this document, we identify priorities for reform and suggest a process by which progress in these areas could be assured. In the second section of this document, we provide a brief overview of the current shape of the economy. In section three we identify key areas of opportunity and the initiatives that could be pursued to see them realized. In section four, we outline a proposed process by which coordinated progress against planned reform measures could be pursued.

This document is an early draft for discussion. It has been prepared by a joint team comprising MFED, World Bank and AusAID officials during a visit in December 2011. The team met with various government agencies and donors, and is grateful for their advice. From this point, the team will seek feedback from Government on whether the appropriateness of suggested reform priorities and the suggested coordination mechanism. This document will then be updated, and discussed with donors at the meeting in March 2012 alongside broader consultations on the Kiribati Development Plan 2012-15.

2. Economic Context

There is a pressing need for improved economic conditions and expanded economic opportunities in Kiribati. With GNI per capita of about \$2,000 Kiribati is one of the poorer countries in the Pacific. One fifth of the population lives below the national poverty line, particularly in the outer islands and parts of the main urban settlements in Tarawa. While improvements have been made in the provision of health and education, concerns remain, regarding the quality of education, while some health indicators remain

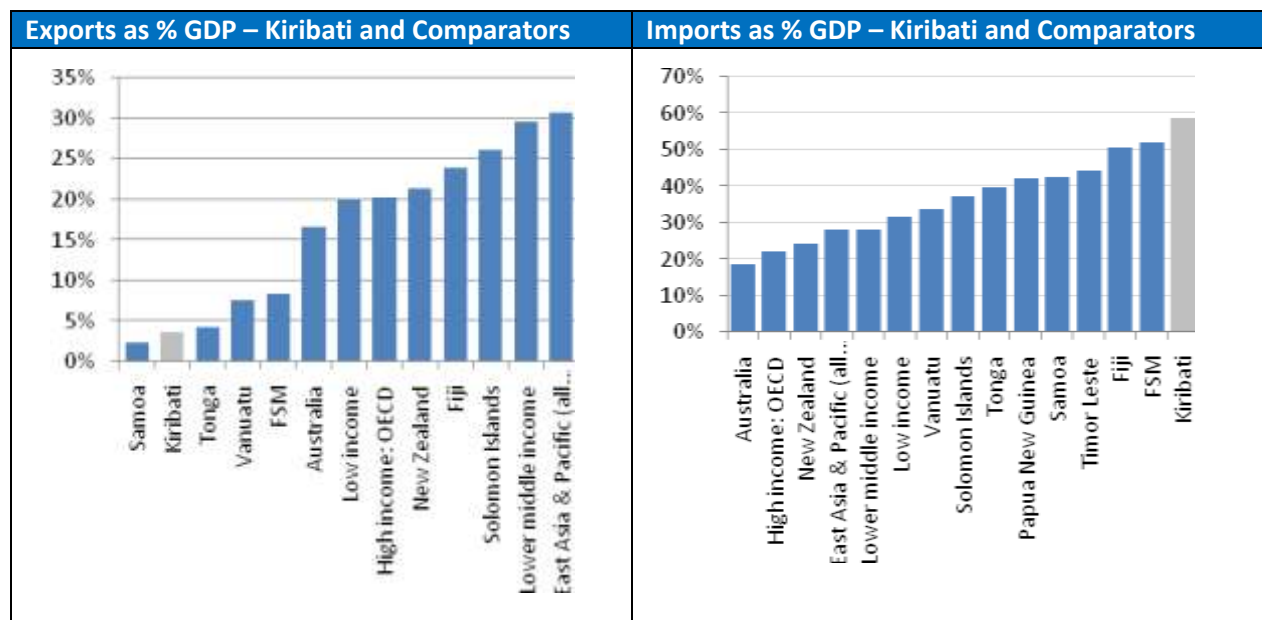
very poor. Most of the population does not have access to basic infrastructure. A shortage of economic opportunities is a major concern given the young and growing population, pressure on traditional subsistence systems, and rapid growth in urban areas. With low historic rates of economic growth, it is clear that new approaches are needed to ensure Kiribati is able to provide necessary services and public goods to its people, and create opportunities for the next generation of I-Kiribati.



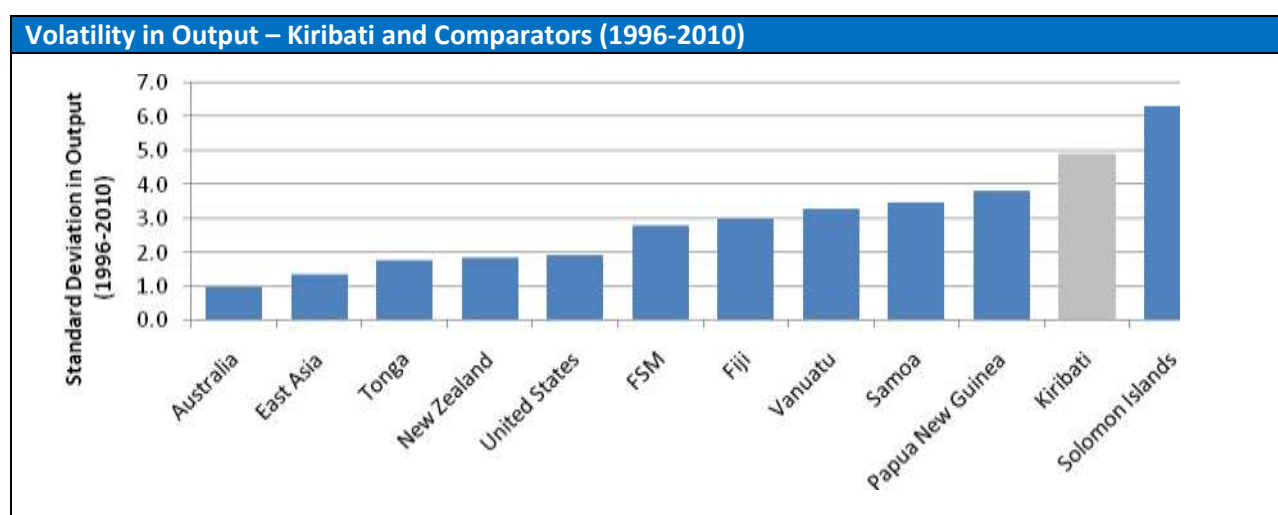
Geographical factors exert a determining influence on the economy of Kiribati. Low rates of growth in Kiribati are substantially explained by geographic factors. Kiribati is unique in the extent to which its population is dispersed, and faces similar disadvantages to other Pacific Island Countries (PICs) in terms of its distance smallness and distance to major markets. Kiribati is composed of 33 islands spread over 3.5 million square kilometers. The population of about 100,000 people lives on 20 coral atolls. The capital, South Tarawa, is about 4,000 kilometers from Australia, Hawaii, and New Zealand. Due to the small geographical area of population centres and their low elevation, Kiribati is also extremely vulnerable to natural disasters. These geographical factors have exerted a long-term influence over the economy of Kiribati, through several channels.

The costs of doing business are high and the private sector is small. Because of the smallness and dispersal of the population, it is difficult for firms to achieve economies of scale in production for local markets. Smallness also increases the costs and reduces the availability of public goods (roads, telecommunications, water, and electricity) required to operate businesses. Consequently, it is difficult for local firms to produce at costs that are competitive against imports, which are typically produced in larger volumes for large, international markets. Other small countries have overcome the difficulties of smallness by exporting to larger foreign markets, but this is difficult for Kiribati firms, due to the costs of distance, with local firms facing very high transport costs involved in shipping goods or providing services to major foreign markets. These disadvantages are reflected in economic indicators. The Chamber of Commerce estimates that there are only 200 businesses currently operating in Kiribati, and very few

successful exporters. Imports (around 50percent of GDP) vastly outstrip exports (of around only 3percent of GDP).



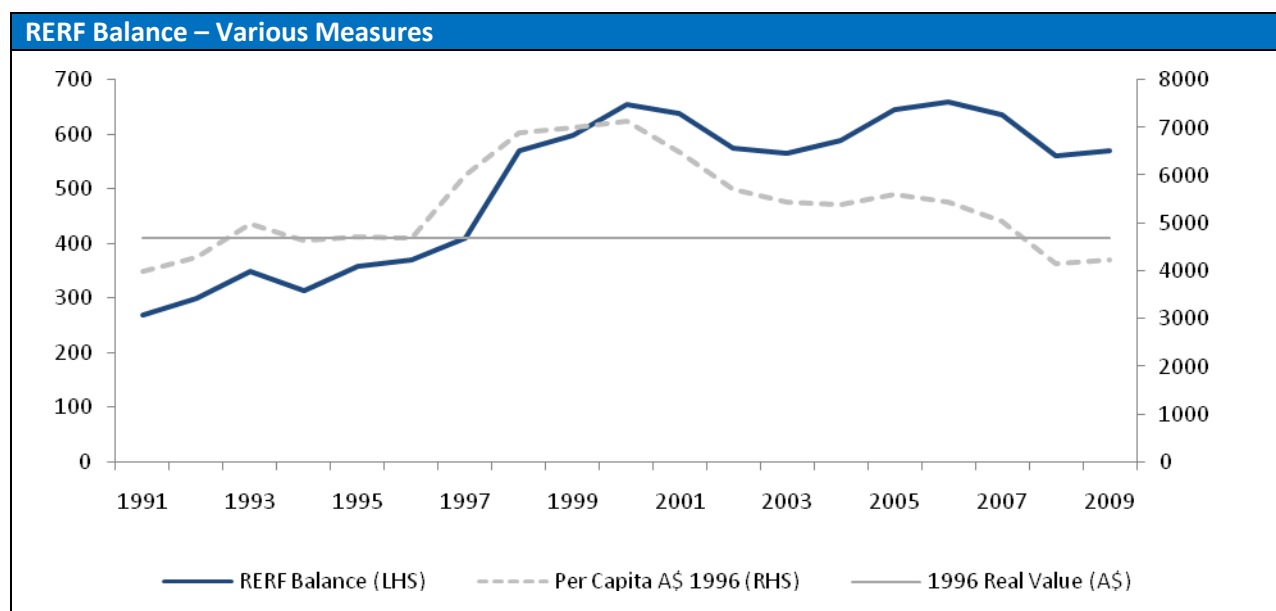
Due to high costs of private-sector activity, the economy is undiversified and exposed to volatility. Local production is concentrated in copra, seaweed, and fishing – all of which are vulnerable to whether conditions or international price movements. Highly volatile fishing license fees, aid flows, and remittances are key sources of income and are relied on to finance the structural trade deficit. Due to heavy dependence on imported food and fuel, Kiribati is also heavily exposed to changes in international commodity prices, which flow throughout the economy and cause broader price inflation.



There are important weaknesses in the management of publicfinances. With limited prospects for private sector development, the Government constitutes a large proportion of the economy – with government expenditure equal to 80 percent of GDP, and nearly half of this financed by aid. The efficiency and sustainability of current public spending is questionable, however. Kiribati faces major

constraints in the management of public resources due to severe capacity constraints within Government and the additional challenges imposed by exposure to revenue volatility. Weaknesses in the budget process, public financial management systems, and public sector planning processes lead to some wastage in the use of public resources. The efficiency of the 24 SOE operations is questionable, with telecommunications and electricity costs in Kiribati the highest in the Pacific and coverage very limited. Many SOEs also represent a significant drain on public finances, through both implicit and explicit subsidies. A substantial proportion of donor expenditure is not accurately recorded on the budget and there are weaknesses in donor reporting, impeding planning processes and macroeconomic management.

The overall sustainability of public finances is questionable. Kiribati has been running consecutive budget deficits, averaging 12 percent of GDP for the past decade. These deficits have been financed through RERF draw-downs and concessional loans. In the long-run, Kiribati's current reliance on draw-downs from the RERF is unsustainable. On current trends, the RERF will be reduced to a third of its current value by 2030. The implementation of the PICTA free trade agreement is likely to further erode the revenue-base through reductions of tariff income if planned tax changes are not introduced. This would see accelerated draw-downs from the RERF and its earlier depletion.



3. Economic Opportunities and Reform Priorities

Despite the constraints and challenges faced by Kiribati, there are important opportunities for improved living standards and increased economic opportunities. In this section we briefly outline three key areas of opportunity that the GoK may wish to pursue through its economic development efforts. These areas of opportunity have been identified through consultation with Government and development partners and on the basis that they could realistically be realized despite: 1) immutable geographical disadvantages, and 2) existing capacity and resource constraints. The three areas of opportunity and the priority reforms required for their realization are shown in the figure below.

Potential Areas of Opportunity		
Ensuring efficiency and sustainability in Government finances is vital given existing challenges and the likely large ongoing role of Government in the economy.	Expanding economic opportunities is vital given the young and growing population.	Making the most of aid is vital given the large share of public expenditure and economic activity accounted for by donor flows
<ul style="list-style-type: none"> • Fiscal sustainability: Understanding longer-term fiscal sustainability challenges facing Kiribati, given trends in expenditure, revenue, and use of the RERF. (NEW) • Revenues: Administrative and policy tax reform in the context of declining tariff revenues, improving RERF management, and managing volatility from fishing revenues. (*, KDP) • Expenditure: Reducing the fiscal burden of SOEs and improving performance, strengthening expenditure control to underpin better planning and financial management. (*, KDP) 	<ul style="list-style-type: none"> • Accessing foreign labour markets: New courses and improved standards at MTC / FTC, KIT, KSON. Maximise Kiribati participation in regional seasonal workers programs and expand into health and aged care sector. (*, KDP) • Infrastructure for growth and jobs: Timely execution of infrastructure projects in roads, aviation, and telecommunications for a better business environment. Ensure local job and contracting opportunities are maximised during construction and ongoing maintenance. (*, KDP) • Protecting outer-island livelihoods. Review existing mechanisms for supporting outer island economic development (eg copra subsidy scheme), and reform policy to protect outer island livelihoods at lower fiscal and economic costs. (NEW) 	<ul style="list-style-type: none"> • Better predictability of aid and alignment with Government priorities. Improving the reporting of project flows and execution for a more complete development budget. Over time, moving towards increased use of government systems to ensure alignment with policy goals. (*) • Better donor coordination. Simple steps to reduce the current administrative burden on Government imposed by large numbers of projects. (New)

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KDP = reflected in draft KDP 2012-15

New = New activity

Areas of opportunity have been identified on the basis to which they would contribute to substantially improved standards of living over the medium-term. Reflecting requests that this work focus on strategic priorities, we have identified a range of actions that could be pursued to achieve immediate progress against goals with long-term importance. While identified priority actions may be incremental and very specific, they are intended to provide a basis for broader changes to propel substantial increases in the quality of life of I-Kiribati over the medium term. Generally, priority actions are already being pursued by the Government, often with international assistance.

3.1 Ensuring efficiency and sustainability in Government finances

Given limited prospects for export-driven growth, public spending is likely to continue to comprise a large proportion of the economy. Achievable expansions in the private sector may change the balance between public and private sector in Kiribati. But it is reasonable to expect that the public sector, substantially financed by aid, will constitute a large proportion of the economy for the foreseeable future.

Improving efficiency and sustainability in public finances will underpin broader development progress. Given that public resource use will continue to have a large impact on incomes, access to services, and opportunities for I-Kiribati, improving public finances is a key challenge. Maintaining overall macroeconomic stability and ensuring that public expenditure is directed towards the highest social and economic development priorities is vital. Achieving this requires government and donors to a) come to grips with key medium-term issues of resource availability and allocation, b) take action to protect existing revenue sources, and c) take immediate steps to strengthen the efficient delivery of services at the level of line agencies.

A) Government and development partner need to address strategic issues in resource availability and allocation. Kiribati faces severe challenges in meeting its public resource requirements over the medium-to-long term. Firstly, the overall sustainability of Government finances remains a key concern of Ministers and officials. Analysis is needed to assess the likely current trajectory of expenditure and revenues, given expected economic developments, the likely impact of possible reforms, and demographic shifts. Such analysis could inform discussions regarding the management of the RERF and medium-term requirements for donor support. Secondly, while recent work on strengthening planning processes and developing a Medium-Term Fiscal Framework is likely to contribute to improvements in resource allocation and use, it seems clear that use of public resources could be better aligned with policy priorities. Expenditure analysis work could be undertaken to assess the extent to which existing allocations reflect policy goals, in terms of trends over time, and allocations to Ministries, sectors, and specific inputs. The results of such analysis could be useful in informing better targeting of government expenditure through future budgets.

	Short-term	Medium-term	Expected Results
1)	Expenditure analysis work carried out by World Bank to assess linkages between current policy priorities and existing expenditure. New activity.	Process and budget allocation changes to improve alignment between resourcing and policy priorities.	Improved quality of public expenditure, leading to greater progress towards improved social indicators and effective implementation of economic reform efforts.

B) The Government recognises that domestic revenue, the RERF, and fishing license incomes need to be protected. Key government priorities to strengthen and protect government revenues include:

- **Ensuring sustainable management of the RERF.** Due to the impacts of the Global Food and Fuel and Economic Crises, the capital value of RERF investments has declined, while draw-downs have accelerated. IMF TA has identified several options to improve the management of the existing investment portfolio, and these could be implemented. But it seems unlikely that the asset value of the RERF can be maintained given current expenditure trends. Options need to be considered to return to a sustainable level of draw-downs, probably through some combination of reduced Government expenditure, increased donor support to the recurrent budget, or additional donor-financed capital injections to the RERF. Such reforms would be likely to require donors and GoK reaching agreement on sustainable draw-down rates over the medium-term.
- **Maximizing fishing license revenues while managing volatility.** Fishing license income comprised almost half of Government revenue in 2010. There is a common perception that Kiribati could be doing more to maximize income from this resource through better licensing arrangements and enforcement regimes. Existing and planned joint-venture arrangements may provide opportunities for

Kiribati to capture a greater share of revenue benefits, but it remains unclear if Kiribati has gained any benefit from Joint Venture arrangements given associated tax concessions and limited local economic impact. There is also a clear need to manage volatility in revenue flows: shortfalls from projections during 2011 contributed to a larger-than-expected fiscal deficit and there is uncertainty about future revenue flows. Options could be developed for managing fishing license volatility through hedging of exposure to currency risk, and more general fiscal smoothing mechanisms.

- **Tax administration and policy changes to prepare for the impact of free trade agreements.** The implementation of free trade agreements is likely to have a substantial impact on revenues through the erosion of tariff incomes. To prepare for this impact, the GoK has already prepared a range of policy and administrative changes.¹ Implementation of these changes has been held up, however, due to the inadequacy of existing IT systems to support such changes. MFED officials are now considering the Data Torque system, and will be travelling to Samoa, Tonga and New Zealand to learn more before committing to a system update.

	Short-term	Medium-term	Expected Results
2)	Implementation of a new tax IT system and compliance measures to increase taxation revenue. Existing MFED activity , with PFTAC and AusAID assistance. .	Tax policy changes to substitute for declines in revenue due to required tariff reductions under PICTA.	Reductions in customs revenue are offset by increases in domestic revenue through successful implementation of tax changes.
3)	Appointment of an investment advisor to assist in the implementation of improvements in RERF asset allocation and management. Would also examine current GoK use of overdraft mechanisms for financing cash and revenue shortfalls and alternative options. Existing MFED activity. Donor assistance required.	Agreement between GoK and DPs on updated policy rules for drawdowns of RERF, based on realistic fiscal forecasts, expected aid support, and demographic changes. Reduced reliance on expensive commercial overdraft facilities.	Sustainability of Government finances is improved and returns from RERF investments increase.
4)	Preparation of National Fisheries Policy and accompanying Institutional Strengthening Program to support policy implementation. Existing MFMRD activity.	Coordinated implementation of the Institutional Strengthening Program, with required support from regional organisations and DPs.	Increased and more stable revenue from offshore fisheries, within sustainable catch limits
5)	Introduction of policy reforms requiring MFED to provide advice to Cabinet on fiscal and economic impacts prior to the finalization of any Joint Venture arrangements. New activity.		Fiscal risks associated with Joint Ventures are reduced and outcomes improved.

C) There is scope to improve outcomes from public expenditure. Immediate measures could be pursued to improve the quality of public expenditure and support more efficient use of public resources at the line level. Such measures include:

- **Reducing fiscal drain from poorly performing state-owned enterprises.** Poorly performing SOEs are responsible for poor quality economic infrastructure and a major fiscal cost (approximately 5

¹PFTAC proposed: A value-added tax (VAT); a presumptive tax; and a single ad valorem tax on imports from non Pacific countries; simplified personal income tax (PIT); single rate of corporate income tax (CIT).

percent of GDP or 7 percent of total recurrent expenditure in 2010, excluding the impact of tax concessions and non-compliance) through explicit or implicit subsidies. The GoK is strongly committed to privatizing or otherwise improving the performance of several SOEs and has been making significant progress, despite the contentious and difficult nature of the reforms. A key priority is to ensure that measures are being taken to improve performance of those SOEs currently imposing the largest economic and fiscal costs. Communicating the rationale for the proposed changes to the public is also very important and an area where donor assistance may be required.

- **Improving expenditure control.** While a broad range of reforms are being addressed through the Public Finance Management Roadmap and various associated Technical Assistance, technology and system improvements to achieve better expenditure control remain a key priority. Weak expenditure control undermines planning efforts and the tracking of expenditure against budgets. It contributes to cash-flow problems, and the accumulation of arrears at the level of line ministries. Relatively simple improvements to the existing attaché system would allow better expenditure tracking throughout the year, strengthened cash management, and assist Line Ministries in managing their budgets.

	Short-term	Medium-term	Expected Results
6)	Cabinet endorsement of the SOE Act and the Reform Strategy (2012). Existing Activity with ADB support.	Government divests commercial SOEs currently imposing greatest fiscal drain. Steps are taken towards improved commercial management of SOEs remaining under state ownership.	SOEs performing commercial roles are divested, reducing fiscal drain and creating space for private sector growth. The quality of services improves and prices are reduced.
7)	Implementation of the upgraded Attaché accounting system in central and line ministries. Planned MFED activity with ADB / AusAID support.	Broader measures to achieve improved budget execution and a closer alignment between budgets and Ministry and Government plans.	Improved quality of public spending through better planning and closer links to policy priorities.

3.2 Expanding economic opportunities

Creating economic opportunities is vital for standards of living and social cohesion. With a young and growing population, a key priority for incomes, social outcomes, and stability is the creation of economic opportunities. This is likely to require an improved domestic business environment and increased access to offshore labour markets.

Priorities for generation of economic opportunities reflect the Kiribati context and Government strategies. Kiribati is currently a difficult place to do business. There are many barriers to private sector development and the creation of local jobs, and much that could be done to improve the business environment. With inevitable constraints on Government reform capacity, it is important that efforts focus on the most important constraints. Investment projects to improve existing infrastructure are a key priority, as they will both improve general business conditions, and create a direct source of demand for services and labour with broader flow-on impacts across the economy. However, the small size and isolation of the economy, and its vulnerability to climate change, are likely to constrain the viable range of private sector opportunities, even under ideal infrastructure, policy, and regulatory settings. Improving access to foreign labour market opportunities is therefore also vital.

A) Improving infrastructure will support local livelihoods. Improvements in the operation of existing utilities and the provision of improved basic infrastructure could substantially reduce the costs of

economic activities, opening up new opportunities for businesses serving domestic markets. The infrastructure investments also represent an important opportunity for job creation during both the construction phase, and through ongoing maintenance. Given the small size of the private sector and skilled labour market, taking advantage of these opportunities will not be automatic, and will require a concerted effort by government and donors. Careful management and implementation of major donor projects in infrastructure (roads, airport improvements, and telecommunications liberalization) is therefore vital not only to ensure good returns from substantial donor and Government investments of resource and capacity, but also to facilitate improved livelihoods.

B) Reforming policies to provide rural livelihoods. The existing copra subsidy scheme is inefficient and imposes substantial fiscal costs on Government. At the same time, it is likely that some form of policy mechanism is required to maintain economic opportunities for rural workers. With outer-island livelihoods a core concern of Government, work is needed to consider other options for providing cash income and employment on other islands in an efficient way and at an affordable cost.

	Short-term	Medium-term	Expected Results
8)	The Infrastructure steering committee meets regularly to assess progress in implementation of major infrastructure projects in roads, telecommunications, aviation, and water. Planned activity.	Introduction of competition into the telecommunication sector. Timely progress against key project milestones.	Improvements in telecommunications quality and affordability. Improved road, aviation, and water infrastructure.
9)	Engage an advisor to provide recommendations for reform of the copra subsidy scheme and other mechanisms for protecting livelihoods on the outer islands, and identify additional options for ensuring cash incomes to rural workers. New activity.	Implementation changes to improve the efficiency and effectiveness of policies to protect outer-island livelihoods.	Incomes of rural workers are maintained while overall economic and fiscal costs of subsidies are reduced.

C) Foreign labour markets are a critical source of employment and income for I-Kiribati families, and further opportunities could be pursued through addressing both supply and demand side constraints. Regardless of infrastructure development and other measures to improve the domestic business environment, the capacity of the economy to generate quality jobs is likely to remain limited due to constraints of size, geography, and limited public resources and capacity. In this context, labor mobility can generate important benefits, both through generating economic opportunities for migrant workers, and remittance flows that can benefit the local economy through the creation of increased domestic demand and government revenues. Currently there are an estimated 1,500 I-Kiribati working abroad, mainly as seafarers but also through the regional seasonal workers scheme, on fishing vessels, and through other private means. Our estimates suggest that these workers, which account for 1.5% of the population generate over 7% of GNI. The following key measures may represent key priorities to ensure improved opportunities for I-Kiribati in international labor markets:

- **Further strengthening local training opportunities for proven opportunities.** Kiribati has performed well in providing world-class training opportunities for international labour. Gains to date could be further consolidated by: 1) achieving further advances in the quality and range of training opportunities provided by the Marine Training Centre (MTC), and expand certification levels to Officer and beyond, 2) improving the standards of fisheries training in order to take advantage of local crewing stipulations, and 3) supporting efforts to maximise Kiribati's participation in regional

seasonal workers schemes, through preparatory training and forging direct industry linkages with horticultural companies.

- **Pursuing new opportunities.** To create new opportunities for international employment, participation of I-Kiribati in a broader range of international jobs could be pursued. This could involve: 1) supporting I-Kiribati participation in international health care and aged care labour markets through improved training arrangements and access agreements, and 2) pursuing short-term work attachment programs in large neighbouring countries in skilled trades and the professional services sector.

	Short-term	Medium-term	Expected Results
10)	Improving quality and range of training opportunities at MTC - FTC, KIT, and supporting efforts to maximise Kiribati's participation in regional seasonal workers schemes. Specific actions to be determined.	MLHRD researches and identifies new labour market access arrangements to increase the number of I-Kiribati working abroad in the skilled trades and the professional services sectors.	Increased numbers of I-Kiribati participating in proven migration opportunities, while expanding access to new opportunities.

3.3 Making the most of aid

Even with substantial improvements in revenue management, increased labor mobility, and expanded domestic economy opportunities, Kiribati is likely to continue to rely on aid. In 2010, aid accounted for around 50 percent of total public spending, and more than a third of GDP. Economic growth over the medium-term is expected to be driven by large donor-funded investment projects, and aid flows are likely to very substantially increase as climate change adaptation commitments become available from major donors. Recognition of the likely long-term nature of aid support to Kiribati increases the importance of improved predictability, strengthened reporting, increased use of country systems, and other simple measures to improve alignment and reduce the existing administrative burden on government.

A) Improved predictability of aid flows and alignment with Government priorities could deliver important benefits. The 2010 PEFA assessment notes significant weaknesses in reporting of the allocations and actual expenditure of donors. Inadequate reporting of donor project spending undermines Government planning efforts, with a substantial share of total public resource use not being adequately recorded in the budget. The PEFA also notes the low overall share of donor expenditure making use of country systems. In the short term, donors could increase efforts to ensure that aid flows are adequately reported and recorded in budget documents. In the longer-term, donors could work with Government to ensure that a greater proportion of overall aid flows are channeled through country systems, improving alignment with Government priorities, and increasing the local economic impact of aid expenditure.

	Short-term	Medium-term	Expected Results
11)	Donors move to provide accurate reporting of projected and actual expenditure for at least 75 percent of aid flows. New activity.	Donors work with GoK to ensure that larger proportion of donor financing makes use of Government systems.	Aid flows are more predictable and better aligned with Government priorities, facilitating improvements in planning and greater effectiveness in public expenditure.

B) Simple measures to improve donor coordination could have a major impact. Central agencies and key line ministries report that a very substantial proportion of available capacity is expended through

servicing various donor requests. In an environment of extremely thin capacity, donor demands may have substantially supplanted capacity to carry out everyday functions and implement priority reforms within key agencies. Government has suggested several measures by which coordination could be improved to reduce capacity strains on staff, including increased use of joint missions, and the identification of particularly busy time during which visits should be avoided.

	Short-term	Medium-term	Expected Results
12)	Development partners consistently provide mission calendars to MFED (NEPO), increase use of joint missions, and avoid missions during busy periods, including during the late stages of the budget process. New activity.		Reduced capacity strain of MFED, allowing more time for staff to implement reforms and carry out core business.

4. Possible Coordination Process

To ensure good coordination between donors and Government on the implementation of these or alternative priorities and the regular tracking of progress, we suggest a regular process where priorities are agreed, progress is tracked, and key actions for donors and government are updated as reforms are achieved. Based on consultation with development partners and Government, we propose the following process for consideration and feedback:

1. Following consultation, GoK and donors agree to a set of agreed reform priorities, informed by the ideas presented in the analysis above. A very short Economic Reform Framework document (1-2) pages, listing agreed priority actions and timeframes for their implementation would be produced.
2. A regular Dialogue Meeting is held (twice per year) between the GoK and Development Partners (DPs) to discuss progress of implementing the reforms and activities identified in the Economic Reform Framework, discuss any emerging issues, identify gaps in development partner assistance and ways to improve effectiveness. GoK could be represented by members of the Development Coordination Committee, to ensure broader alignment with other coordination processes. All key donors to be represented by sufficiently senior officials, and the Dialogue Meeting to occur in Kiribati. Regular meetings between donors in country and Gokwill continue to occur on an as-needed basis.
3. The Dialogue Meeting to be chaired by the GoK, but with a rotating DP providing logistical and administrative assistance.² A different DP each year would support the GoK in organising two Economic Dialogue Meetings, including through liaising with development partners, preparing background materials, and taking responsibility for logistical arrangements.
4. Each year a joint GoK-DP mission, with sufficient economic capacity, would review progress towards successful implementation of the Economic Reforms. It would provide recommendations on

² For instance, and as suggestions only, the DP “Co-Chair” could be the broker between DPs and GoK in determining the agenda, supporting with meeting arrangements, assist with taking minutes and updating the Economic Reform Framework.

where to update the Economic Reform Framework. The Annual Review team may be tasked to conduct discrete research into particular issues.

5. On an annual basis, the Economic Reform Framework is updated by the GoK with support from the DP “co-chair”. The update will be based on the findings from the Annual Review, and from discussions held at the Economic Dialogues.
6. At each of the Economic Dialogue Meetings, practical efforts to improve development coordination in this sector will be pursued. For instance:
 - a. Development Partners may be asked to submit in a common template their planned missions and analytical work for the next six months
 - b. Development Partners may be advised about timeframes and processes for submitting ODA information to the GoK for budget preparation.

