GOVERNMENT OF KIRIBATI

GoK(12)DPF.2.1

DEVELOPMENT PARTNERS FORUM

Tarawa, Kiribati
25 – 27 June 2012

AGENDA ITEM 2.1: Medium Term Fiscal Framework (MTFF)

Purpose

1. The purpose of this paper is to update development partners on the implementation of MTFF in Kiribati with related issues being encountered in implementing it.

Background

2. The MTFF is a three-year forecast of both revenue and expenditure for the Recurrent Budget. It was developed in 2010 for the 2011 Budget with the idea to continuously use it for formulating fiscal policy over the medium term. Previous budgets were for a single year. This is part of the fiscal reform with assistance provided by the Technical Consultants funded by the Asian Development Bank (ADB) and supported by the Pacific Technical Advisory Centre (PFTAC).

3. Ministry budgets were constrained for 2011, impacting the efficient operations of Ministries/ Departments. Higher budget bids for 2012 and implementation of the new government's policies have made the 2012 budget a difficult one. The MTFF financial model has been updated in terms of capturing realistic figures for the likely inflow of revenue and indicative expenditure requirements.

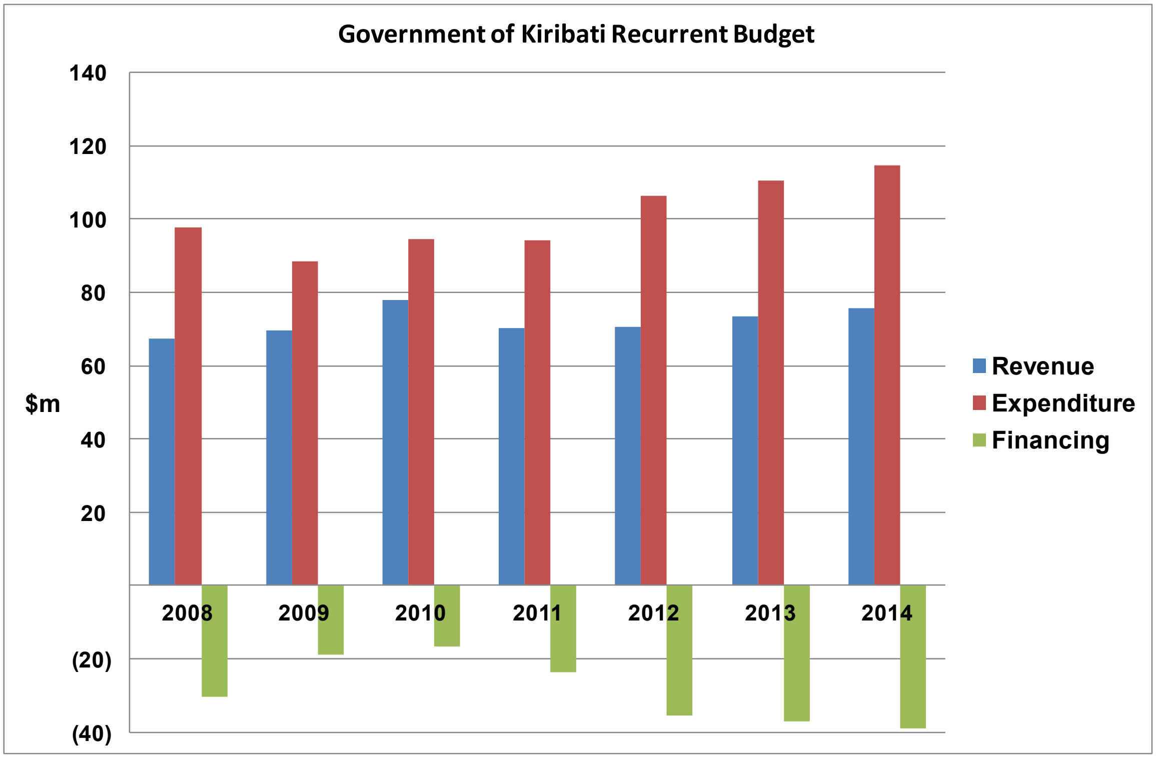
4. Based on the likely revenue inflow and Aggregate Expenditure Ceilings, the level of deficit and the financing is demonstrated by the MTFF. The 2012 MTFF is below:

Government of Kiribati Recurrent Budget Medium Term Fiscal Framework							
$AUD million	**2008 Actual**	**2009 Actual**	**2010 Actual**	**2011 Budget**	**2012 Est.**	**2013 Proj.**	**2014 Proj.**
Revenue	**67.4**	**69.6**	**77.9**	**70.4**	**70.7**	**73.4**	**75.8**
Expenditure							
Ministries	76.1	75.3	70.1	68.7	74.0	75.5	77.0
Grants, subsidies and other	12.8	10.3	13.3	16.5	20.6	21.1	21.5
Debt servicing	8.2	2.9	9.8	1.4	5.4	7.7	10.1
Contributions to Development Fund	0.6	0.0	1.4	7.5	6.2	6.2	6.2
Total Expenditure	**97.7**	**88.6**	**94.6**	**94.2**	**106.3**	**110.4**	**114.8**
Budget Deficit	**(30.32)**	**(19.02)**	**(16.70)**	**(23.79)**	**(35.59)**	**(36.98)**	**(39.00)**
RERF Drawdown	25.0	18.0	17.3	19.7	15.0	15.0	15.0
Required from other sources	**5.3**	**1.0**	**(0.6)**	**4.1**	**20.6**	**22.0**	**24.0**

5. The 2012-14 budget estimates show that revenue is not growing as rapidly as expenditure, reflecting the narrow base for revenue and with the indicative expenditure requirements leading to a growing deficit. The annual drawdown from the Revenue Equalization Reserve Fund (RERF) has been the main source of financing the annual budget deficit, but with the need to use overdraft when the deficit exceeds $15 million. Investment returns for the RERF have been affected by the global financial downturn, and increasing the drawdown would reduce funds available for future generations.

6. As the amount to be financed by borrowing grows, so does the interest on the amount borrowed so Debt Servicing would need to increase rapidly.

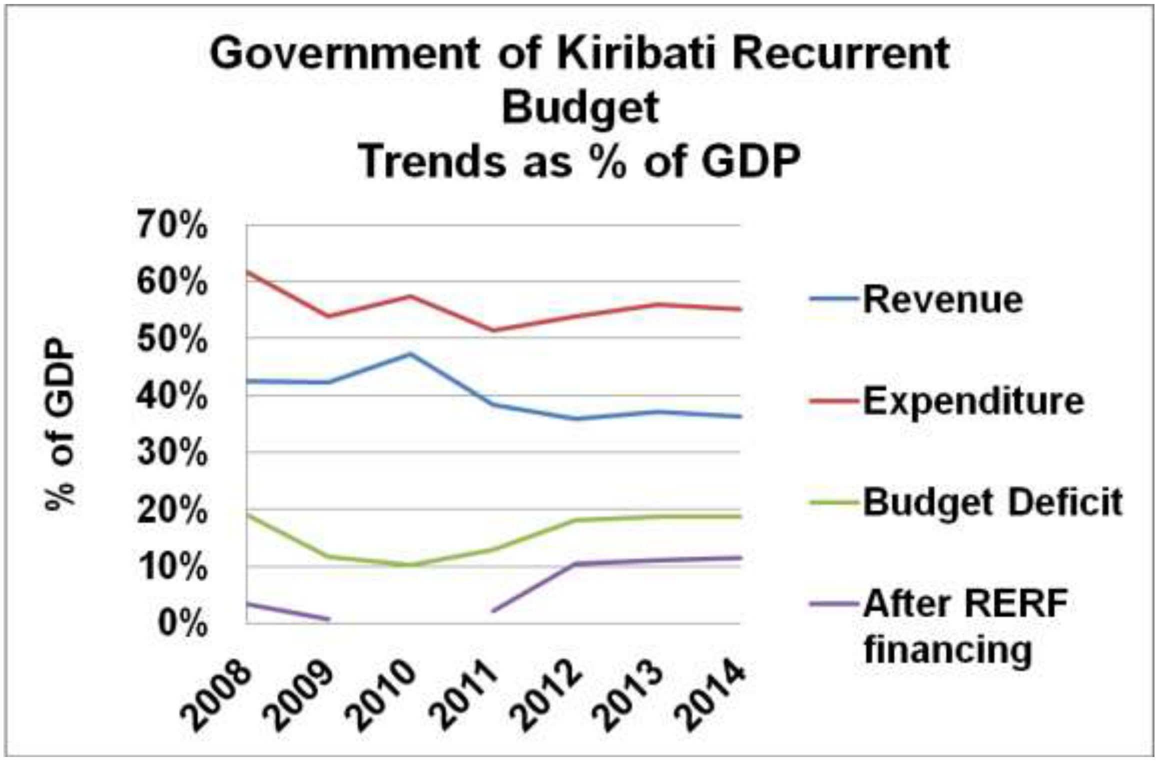
7. The graph hereunder illustrates the historical trend of actual revenue and actual expenditure with the 2012 budget estimates, including the outer years, together with the financing gap.



8. In 2010 revenue grew by 7% which resulted from one off revenue from a fishing boat penalized for fishing without license. There is a very narrow base of revenue – fishing licence fees, personal and corporate income tax and import duty account for around 93% of revenue.

9. The expenditure on the other hand went through a trough from 2009 to 2011. This was due to constraining the budget to deal with the economic crisis. It now needs to increase to reflect that the economy started to improve from 2011 onwards.

10. The trends are also adverse relative to GDP as is shown by the chart. Revenue is falling as a percentage of GDP while Expenditure has fallen, but is now expected to be relatively stable. The lack of revenue growth is the main factor in the rise of the Deficit funding requirement.



11. Given that the RERF is the most important source of financing the budget deficit, technical assistance was provided in determining the sustainable level of drawdown. The recommended drawdown was indicated to be $5,510,000 taking into consideration year 2011 as the base year with the objective of maintaining the RERF in real per capita terms. It thus, gave an indication that with amount of financing required for the 2012 budget and two following years, the RERF nominal value will fall as the proposed drawdown of $15 million is three (3) times the sustainable drawdown.

12. Some activities are underway to reduce spending. The Public Service Office (PSO) is now undergoing a Public Sector Review especially on Performance Management. Starting in 2010, the Ministry of Finance and Economic Development (MFED) embarked on reforming SOEs and so far one SOE has been sold. SOE bailout requests now require a realistic business improvement plan be implemented.

Recommendations:

13. With the narrow revenue base and provision of realistic figures for formulation of relevant polices driven from the MTFF, essential areas to consider are as follows:

   a. Align the Development Budget (reflecting Overseas Development Assistance) with the Recurrent Budget for better allocation of resources to take forward the national priorities.

b. Budget Support to help avoiding the depletion of the RERF for the sake of future generations.
c. Any assistance (concessional loans).