

**Kiribati: 2001 Article IV Consultation—Staff Report and Public Information  
Notice on the Executive Board Discussion**

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 2001 Article IV consultation with Kiribati, the following documents have been released and are included in this package:

- The staff report for the 2001 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on **March 22, 2001** 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 June 8, 2001.** The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF;
- The Public Information Notice (PIN), which summarizes the **views of the Executive Board as expressed during its June 25, 2001 discussion** of the staff report that concluded the Article IV consultation.

Further background documentation prepared by IMF staff for the consultation may be published separately at a later date. The policy of publication of staff reports and other documents by the IMF allows for the deletion of market-sensitive information.

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KIRIBATI

**Staff Report for the 2001 Article IV Consultation**

Prepared by the Staff Representatives for the  
2001 Consultation with Kiribati

(In collaboration with other departments)

Approved by Charles Collyns and Michael Hadjimichael

June 8, 2001

- **The 2001 Article IV consultation discussions were held in Tarawa during March 12–22, 2001.** The team, which comprised Messrs. de Zamaróczy (head), Ma (both APD), and García-Saltos (INS), met with President Tito; Vice-President and Minister of Finance Tinga; other senior officials; members of the National Assembly; and representatives of public enterprises, financial institutions, the private sector, and the donor community.
- **Kiribati's main economic challenges** are: (i) to promote private sector activity in a stable macroeconomic environment in order to foster sustainable growth and employment; and (ii) to make wise use of its marine resources and sizable external assets.
- **At the conclusion of the 1999 Article IV consultation,** Executive Directors welcomed Kiribati's success in maintaining low inflation and in building up external assets. They urged the authorities to scale back the public sector in order to promote private sector activity and thereby to achieve a lasting increase in living standards. Toward this end, they urged the authorities to reduce government expenditure to a sustainable level; improve the composition of expenditure; downsize the civil service; reform public enterprises; and reduce barriers to trade and investment.
- **In 1999–2000, adverse external conditions, policy slippages, and the lack of structural reform led to a weakening in the external and fiscal positions.** The short-term outlook is for continued slow growth with low inflation, and a further deterioration in the external and fiscal positions. For the medium term, timely implementation of fiscal and structural reforms is critical to promote sustainable growth and to enhance the economy's resilience to external shocks.
- **Kiribati has accepted the obligations of Article VIII, Sections 2, 3, and 4, and has consented to the Fourth Amendment to the Fund's Articles of Agreement.** Kiribati maintains an exchange system free of restrictions on payments and transfers for current international transactions. There are no significant restrictions on capital flows.
- **Weaknesses in the statistical database hamper effective surveillance.**

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## I. INTRODUCTION AND BACKGROUND

1. **Kiribati's economic policy is deeply rooted in communally oriented values.** The policy involves extensive reliance on the state for investment, employment, and service delivery. This strategy has managed to provide a stable macroeconomic environment, the build-up of substantial official external assets, and a relatively equitable intra- and inter-generational distribution of income. However, this strategy has also yielded a stagnant economy, with inefficient state-owned enterprises and a small private sector, that has been unable to raise living standards.
2. **Kiribati is one of the least-developed micro-island states in the Pacific region, confronted with daunting physical and economic challenges** (Box 1). Per capita GDP was around US\$500 in 2000. The economy is narrowly based, highly vulnerable to external shocks, and dominated by the public sector. The productive sector is limited, and the only export is copra. The nascent tourism sector does not yet contribute significantly to economic activity. About four fifths of the population operates in the informal sector, which relies on copra production and fishing.<sup>1</sup> Kiribati's social indicators have improved, but present a mixed performance when compared with those of similar economies (Annex I).
3. **Over the last decade, economic expansion has barely kept up with population growth.** Growth faces major constraints, some arising from Kiribati's physical disadvantages and some stemming from policy choices, including a large and ineffective public sector, barriers to investment and trade, and distortionary price controls. For the longer term, the Kiribati archipelago and its 3½ million square kilometer exclusive economic zone (the size of India's land mass) offer growth potential through tourism and enhanced fishing and deep-sea mining, provided sufficient investment is available.
4. **Kiribati is highly dependent on volatile financial inflows, but holds sizable reserves to weather external shocks.** A large share of government spending and of imports is financed from fishing license fees and external grants, which have been unstable. GNP is almost twice the size of GDP, owing to large receipts from fishing license fees, investment income, and seamen's remittances. These inflows, together with external grants, have more than sufficed to finance persistent trade deficits (averaging 60 percent of GDP during the last decade), while allowing Kiribati to accumulate sizable external assets.<sup>2</sup> The latter are held in an overseas trust fund and could be used as a buffer in case of economic distress.

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<sup>1</sup> Boxes 2 and 3 provide a comparison of Kiribati's economy and fiscal structure with those of other small island states.

<sup>2</sup> Because of the unusually large size of Kiribati's GNP compared with its GDP, the question arises as to which is the better aggregate to express ratios in terms of economic activity. Owing to the unstable nature of external financial inflows, the use of GDP is mostly preferred in this report, except in comparisons with other island economies.

### **Box 1. Kiribati's Physical and Economic Challenges<sup>1</sup>**

Kiribati has a population of 85,000, but spreads over an area roughly equal to that of Europe. Most of Kiribati's area is ocean: its land mass amounts to 810 square kilometers, compared to an Exclusive Economic Zone of 3.6 million square kilometers. Kiribati has one of the highest sea-to-land ratios in the world. The vast archipelago of 33 islands reaches 4,000 kilometers from east to west and 2,000 kilometers from north to south. The population is concentrated on the Gilbert Islands, which include Tarawa, the capital island. One-third of the population lives on South Tarawa, where density reaches 1,610 people per square kilometer, while the Phoenix Islands are virtually uninhabited. Kiribati's numerous, small, and low-lying islands heighten its environmental vulnerability, especially to sea-level rises; some islets and bird sanctuaries have already disappeared. A natural disaster on Tarawa could be devastating, as it would affect the entire population and economy.

Transport to, from, and within Kiribati is extremely limited and is primarily by boat. The nearest large markets are 4,000 kilometers away, in Honolulu and Brisbane. There are only six flights a week in and out of the country, all by small plane.<sup>2</sup> Hence distance from and access to external and internal markets presents challenges of a magnitude faced by few other countries. Kiribati's remoteness and dispersion have significant economic and administrative implications. Isolation means that the country is far from the major centers of commerce and finance. Foreign trade is hampered by Kiribati's remote location and irregular supply routes. The development of even a small domestic market is constrained by distances between widely dispersed communities and infrequent internal transport services. Limited domestic market size, combined with large distances from overseas markets, results in a lack of competition; often the domestic market can support only a single supplier or producer. In addition to distance, Kiribati pays high transport costs because of the relatively small volume of cargo, small cargo units, and the need for bulk breaking. Such costs raise the price of exports, thereby reducing their competitiveness and returns. Similarly, high transport costs of imports result in consumer welfare losses.

The resource base is narrow. The arid climate and poor soil offer little potential for agricultural development, except copra. Marine resources are the mainstay of the economy—about 80 percent of households make a living or survive through fishing. The public sector dominates economic activity, while the private sector is small. These factors present challenges to the Government in determining the most appropriate pace and sequencing of policy reforms in areas such as privatization, downsizing and improving the performance of the public sector, and tax and tariff reforms. Smallness of size adds a further dimension to the development challenge when it is compounded by a population that is scattered over long distances. The Government faces diseconomies of scale in providing public goods and services resulting in a relatively larger public sector, which burdens the budget. Not surprisingly the Government relies heavily on taxing imports.

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<sup>1</sup> Based, *inter alia*, on "Small States: Meeting Challenges in the Global Economy," Commonwealth Secretariat/World Bank Joint Task Force, Washington, DC, USA, April 2000.

<sup>2</sup> At the time of the mission, virtually all scheduled flights were suspended for weeks.

## Box 2. Comparing Kiribati and Other Small Island Economies<sup>1</sup>

With few exceptions, most Pacific Island Economies (PIEs) have experienced moderate growth with low inflation over the last few years. Virtually all PIEs were affected by the Asian crisis, with exports and real GDP slowing or contracting in 1997. Most economies recovered in 1998–99, with the exception of Fiji and the Solomon Islands. Reversals in the terms of trade during the second half of the 1990s seem to be the key factor in the relatively high volatility of output growth throughout the region. Although Kiribati's growth rate over the past ten years has exceeded the PIEs' average, the country's relatively higher population growth has resulted in a similarly weak rise of income per capita. In many PIEs unclear property rights and a communal land tenure system appear to increase transaction costs for undertaking agricultural, mining, tourism, and other activities. In some islands (including Kiribati), foreigners may not own land, and face restrictions on entering selected industries. Uncertainties regarding land ownership prevent banks from accepting land as collateral, thus hindering credit extension.

Most of the PIEs are heavily dependent on a few sources of income, and are subject to large external shocks. Financial assistance from developed countries is expected to decline over the medium term. Remittances from overseas, of considerable importance for Tonga, are subject to wide fluctuations. Most PIEs depend on a small number of exports, or related royalties/license fees, including minerals (Solomon Islands), fish (Federated States of Micronesia, Kiribati, Samoa, Solomon Islands, and Tonga), timber (Solomon Islands and Vanuatu), and agricultural commodities (e.g., copra in Kiribati, Republic of Marshall Islands, Samoa, and Vanuatu). Volatility in the price of these exports is an important source of vulnerability. While sharing many similarities with the other PIEs, Kiribati is unusual, in that it holds an exceptionally large stock of net financial assets as a proportion of GDP (Box 6).

### Selected Economic Indicators of Small Island Economies, 1992–98

	Kiribati	Pacific 1/	Caribbean 2/	Others 3/
(Averages in percent per annum, unless otherwise indicated)				
Real GDP growth	2.9	2.0	2.7	4.9
Volatility of real GDP growth 4/	3.5	4.0	2.6	3.3
Real GDP per capita growth	1.1	1.4	2.1	2.8
GNP/GDP	177.1	105.4	96.0	98.3
Population growth	1.7	1.6	0.6	2.1
Inflation	3.2	4.7	2.6	5.5
(Averages in percent of GDP)				
Government revenue	104.9	46.3	24.9	32.8
Government expenditure	107.4	48.1	22.8	40.5
Net foreign direct investment 5/	0.0	3.3	8.8	5.1
Official net resource flows 6/	34.7	6.7	4.4	11.1
International official reserves	675.7	21.9	10.8	12.5

Sources: Data from the national authorities; and Fund staff estimates.

<sup>1</sup> Federated States of Micronesia, Fiji, Republic of the Marshall Islands, Samoa, Solomon Islands, Tonga, and Vanuatu.

<sup>2</sup> Antigua and Barbuda, Bahamas, Barbados, Dominica, Grenada, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines.

<sup>3</sup> Cape Verde, Maldives, and the Seychelles.

<sup>4</sup> Measured as the standard deviation of real GDP growth rates. "Others" excludes Cape Verde.

<sup>5</sup> "Others" excludes Seychelles.

<sup>6</sup> "Pacific" excludes the Federated States of Micronesia and the Republic of the Marshall Islands.

<sup>1</sup> See, Rosales, J., "Macroeconomic Policy and Financial Sector Stability in Pacific Island Countries," paper presented at the *Conference on Financial Sector Stability and Development*, Apia, Samoa, February 2001.

### Box 3. Fiscal Structure in Kiribati and in Other Small Pacific Island Economies

Kiribati's government sector accounts for an unusually large share of the economy. Even when using GNP, rather than GDP, as the base for comparison, the relative size of government spending—while similar to that of the Federated States of Micronesia (FSM) and of the Republic of the Marshall Islands (RMI)—is almost double the corresponding share in other comparable Pacific island economies.

Kiribati is highly reliant on nontax revenue (mainly fishing license fees), which accounts for more than half of total revenue. In contrast to FSM and RMI, which benefit from their association with the United States, the share of external grants in Kiribati is relatively low. With regard to tax revenue, for which domestic output (i.e., GDP) is the relevant base, revenue mobilization in Kiribati is roughly on par with those of comparator countries.

Kiribati, FSM, and RMI all have high levels of current expenditure. Spending on wages is broadly comparable in the three countries, but Kiribati's subsidies to public enterprises are relatively larger. Conversely, Kiribati's spending on health and education is below the regional average, while its development expenditure (even excluding net lending) is much higher than in comparator countries. However, those countries inherited larger stocks of infrastructure from their colonial period, or in connection with U.S. military operations.

#### Fiscal Indicators of Selected Pacific Island Economies

(As percent of GDP/GNP) 1/

	Kiribati 2000	Kiribati 2000	RMI 1999/00	FSM 1999/00	Other Pacific Islands 2/
Total revenue and grants	109	57	65	68	35
Revenue	83	43	23	26	26
Tax	31	16	16	12	21
Nontax	52	27	7	14	5
External grants	26	14	42	42	9
Total expenditure and net lending	116	61	60	69	37
Current expenditure	77	40	52	57	24
Of which: wages and salaries	29	15	18	23	12
Of which: subsidies	5	3	2	3	...
Development expenditure and net lending	39	21	8	12	13
<i>Memorandum items:</i>					
Education expenditure	18	9	21	23	22
Health expenditure 3/	11	6	12	11	13
Government employees per 1,000 people 4/	45	45	30	53	51

Sources: Data provided by national authorities; and Fund staff estimates, including SM/00/266 and SM/00/267.

1/ All columns in percent of GDP, except the second column for Kiribati, which shows percentages of GNP.

2/ Average of the latest five years, for which data are available, for Fiji, Samoa, the Solomon Islands, Tonga, and Vanuatu.

3/ Does not include off-budget expenditure.

4/ For "Other Pacific Islands," average of Fiji, Samoa, and Tonga.

5. **Since 1995 the authorities have pursued an activist fiscal policy, while pursuing, in principle, a medium-term strategy that aims at encouraging private sector development.** This agenda was embodied in their *Medium-Term Strategy for 1997–2000* (MTS), and in its successor, the *National Development Strategy for 2001–03* (NDS), adopted in November 2000 (Box 4). However, progress in implementing these strategies has been limited. Given that the burden of macroeconomic adjustment falls on fiscal policy—for lack of an independent monetary policy—the mission’s recommendations focused on fiscal retrenchment, driven by current expenditure curbing, and on a sustainable levy on external official assets.

#### **Box 4. National Development Strategy for 2001–03**

The *National Development Strategy for 2001–03* (NDS) was prepared by the Government in the second half of 2000 and was considered by the National Assembly in November 2000. NDS aims at achieving the following medium-term objectives: a significant increase in real per capita income; steady growth in employment; enhanced human resource development; higher civil service productivity; stronger links between the public and private sectors; private sector development; and a more competitive and diversified export base.

To achieve the above goals, NDS has the following policy targets:

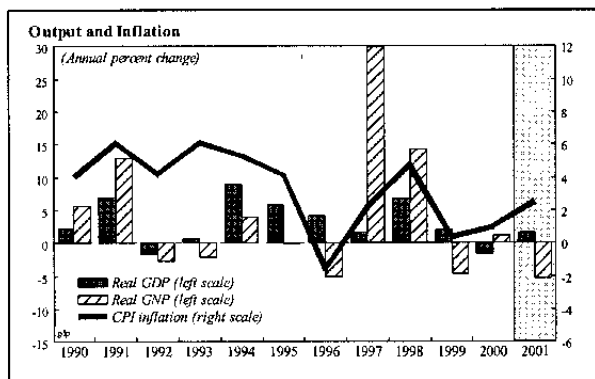
- **Public sector reform:** implementation of output budgeting and performance-based contracts; restructuring of government ministries to focus on core functions; privatization of public enterprises, and for those remaining in the public domain, a more rigorous enforcement of commercial management and budget constraints; and prudent fiscal management;
- **Creating an enabling environment for private sector development:** increased cooperation between the public and private sectors; streamlining of investment approvals and revision of incentives to make them more market friendly; strengthening of the domestic financial system to improve resource mobilization; improvement of access to land for investment and development; and continued reform of taxes and tariffs to remove distortions; and
- **Human resources development:** increased emphasis on basic education, vocational technical training, and primary health care.



## II. RECENT DEVELOPMENTS AND NEAR-TERM OUTLOOK

### A. Economic Developments Since End-1998

6. **Kiribati's economy stagnated and real per capita income shrank between 1998 and 2000.** Real GDP growth averaged only  $\frac{1}{4}$  percent per annum, whereas average population growth was almost 2 percent per annum. This outcome stemmed partly from external factors beyond the Government's control, including adverse climatic conditions that reduced fishing; a plunge in world copra prices; and a drought that hurt copra production. The lackluster growth performance also reflected the continuing inefficiency of the public sector and inappropriate structural policies, which hampered the country's ability to absorb adverse shocks.



7. **Inflation remained subdued in 1999–2000 owing to the weakening of economic activity and the easing of supply problems at the main port.** However, underlying inflation was somewhat higher, as price and margin controls on goods account for 28 percent of the retail price index basket.

8. **The external position deteriorated in 1999–2000.** Exports of new marine products (e.g., bêche-de-mer and seaweed) posted a strong increase, but traditional fish exports fell, owing to unpropitious climatic conditions in the wake of *La Niña*. Imports surged to supply several large domestically financed construction projects, in particular a new Parliament building and 18 junior secondary schools. Meanwhile, fishing license fees dropped by 14 percentage points of GDP (Box 5), while external grants contracted by 21 percentage points of GDP. Mirroring the above developments, the current account plummeted by 28 percentage points of GDP. As a result, the overall external balance was halved between 1998 and 2000. Public external debt remained low and on concessional terms.<sup>3</sup>

9. **The fiscal position weakened significantly in 1999–2000.** With the fall in fishing license fees and in external grants, total revenue and grants slumped by 34 percentage points of GDP between 1998 and 2000. Development expenditure in 2000 declined in line with lower external assistance. However, current government expenditure rose slightly in both years because of increased support to public enterprises and copra producers, and additional

<sup>3</sup> However, in September 2000 the Government requested that a loan from China be transformed into a grant, or at least that service payments that start to fall due in 2001 be deferred. No data were available on private debt but the authorities considered it small.

### **Box 5. Kiribati's Deep-Sea Fishing Sector**

Kiribati is heavily dependent on fishing license fees. In 2000 they represented 51 percent of government revenue and 42 percent of GDP, and they dwarfed exports. Kiribati's exclusive economic maritime zone is comparable to the area of the Caribbean Sea. Kiribati has no commercial fishing capability and relies on other countries for fishing in its territorial waters. The foreign fishing vessels were registered in Japan, Korea, the United States of America (USA), and Taiwan Province of China. Kiribati monitors the catch in several ways including:

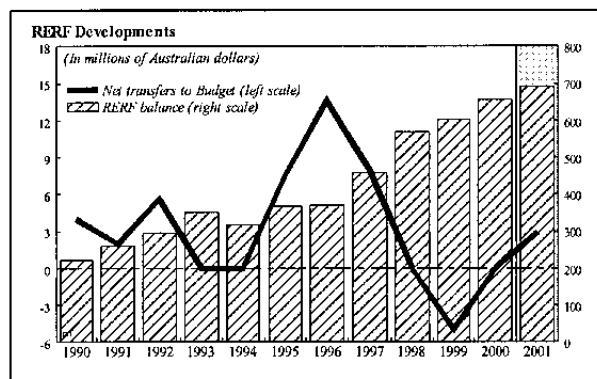
- the use of a satellite tracking system that all licensed boats must carry;
- the placement of Kiribati observers on board randomly selected vessels;
- surveillance flights operated by the air forces of Australia, New Zealand, and the USA; and
- the use of a patrol boat (sponsored by Australia).

The information collected on the location of vessels is fed into a control room in Tarawa, where it is processed for surveillance purposes almost on a real-time basis. The authorities consider that the surveillance is effective and do not think that illegal fishing is a serious problem. For the monitoring of fish stocks, Kiribati relies on the surveillance of the South Pacific Forum's Fishing Agency. In order to manage fish resources in a sustainable manner, the International Western Pacific Management Committee determines quotas for individual states. In 2000, the catch in Kiribati waters slightly exceeded the fishing quota.

Licenses are granted for two months to one year. Under the agreement with the USA, which is negotiated on a multilateral basis with other Pacific Island States in the region, an annual lump sum fee of US\$18 million is paid for all fishing activity. Of this amount 15 percent is shared equally between the participating states and 85 percent is shared according to where the fishing boats operate. Kiribati gets a total of US\$4-5 million a year on average. Fees under bilateral agreements represent 5 percent of the reported value of the catch (moving average of the previous three years' catch), although a recent agreement negotiated with a European Union member country provides for fees of 6 percent of the catch. The outlook for fishing fees in Kiribati in the medium term is somewhat less favorable than in the recent past, owing to the expected return of normal weather conditions. Annual fees are projected by staff to range from \$A 25 million to \$A 28 million based on the average of the last five significant years and the need to avoid possible overfishing. The authorities' estimate for 2001 is smaller, in line with their traditionally conservative fishing revenue projection stance. Over a thousand I-Kiribati work on board foreign fishing boats, an opportunity that provides much-needed employment and remittances (about \$A 12 million a year, exceeding total annual exports).

purchases of goods and services. Reflecting these developments, the overall budget balance swung from a surplus of 19 percent of GDP in 1998 to a deficit of 7 percent of GDP in 2000. The Government financed the deficits by drawing down deposits in the Consolidated, Development, and STABEX Funds.<sup>4</sup>

10. **Despite the external and fiscal deterioration, official international reserves remain comfortable.** Kiribati's reserves stood at \$A 677 million at end-2000 (equivalent to seven years of imports or nine times GDP). They are mainly held in the Revenue Equalization Reserve Fund (RERF—Box 6), which amounted to \$A 658 million at the same time. Notwithstanding the fiscal deterioration, the Government contributed \$A 5 million to the RERF in 1999 and has made no drawdowns since 1997.<sup>5</sup>



11. **The depreciation of the Australian dollar—Kiribati's legal tender—since mid-1997 has improved external competitiveness somewhat.** Kiribati's real effective exchange rate (REER) index in 2000 was 13 percent below the average for 1994–97. There are no data on unit labor costs, but public sector salary scales have remained broadly unchanged since 1995. However, since the major items in the balance of payments (i.e., fishing license fees, external grants, and investment income) are not sensitive to price competitiveness, the impact of changes in the REER is limited.

## B. Near-Term Outlook

12. **The outlook for 2001 is continued slow growth and low inflation (albeit with a modest uptick).** Economic growth is projected to be modest, at 1½ percent. The continuation of unfavorable fishing conditions is expected to be offset by increased government spending, particularly on wages; higher public investment associated with the commencement of several foreign-financed projects; the coming on stream of the new wharf in Betio port; and an improvement in copra production. Inflation is expected to creep up to 2½ percent, as the petroleum price hike is passed through domestically.

<sup>4</sup> The Consolidated Fund is used to finance current expenditure, while the Development Fund finances development expenditure. They are both replenished when there is a budget surplus. The STABEX fund is administered under the Lomé Convention and aims, in the case of Kiribati, at stabilizing the export price of copra, within a given limit of financial assistance.

<sup>5</sup> These reserves were reported as not encumbered.

### Box 6. Revenue Equalization Reserve Fund

- **Origins:** The Revenue Equalization Reserve Fund (RERF) was established by the British colonial administration in 1956 to hold royalties from phosphate mining in trust for the I-Kiribati, anticipating the depletion of the deposits. In 1979, when Kiribati gained independence and the phosphate mine closed, the value of the fund was \$A 68 million. At end-2000, the fund had grown to \$A 658 million (US\$360 million, or nine times GDP).
- **Purpose:** The fund's main objective is to provide sustainable financing of government expenditure for the benefit of current and future generations. The Government's declared policy is to maintain the real per capita value of the RERF in Australian dollars. The National Assembly approves the annual authorized maximum drawdown in the context of the budget debate.
- **Administration:** The fund is administered by a committee of senior government officials who are required to file quarterly reports on the fund's operations with the National Assembly.
- **Management:** The fund is managed by two brokerage firms, which are monitored by a custodian. Comprehensive audits are held periodically. The fund is well diversified, with investments in 22 currencies (25 percent in U.S. dollars, 33 percent in Australian dollars, and 19 percent in both Japanese yen and euros), and evenly split between equities and bonds. During the last five years, the nominal yield of the fund in Australian dollars increased significantly, in part owing to the appreciation of the U.S. dollar. From 1987 to 2000, the financial performance of the fund and the government policy of reinvesting the profits led the per capita value of the fund to grow by 63 percent (in terms of 1995 Australian dollars) and by 25 percent (in terms of 1995 U.S. dollars).

#### Kiribati: Financial Indicators of the RERF, 1987-2000

(In percent, unless otherwise indicated; all figures are averages)

	Nominal Return 1/	Nominal Return 2/	Bond Yields 3/	Real Value Per Capita 4/	
				In \$A	In US\$
1987-1990	6.5	9.5	13.0	3,977	2,862
1991-1995	5.6	12.2	9.1	4,625	3,237
1996-2000	4.2	13.3	6.6	6,219	3,832

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

1/ Includes interest and dividends.

2/ Includes interest, dividends, management fees, and valuation gains.

3/ Australian 10-year maturity government bonds.

4/ Base year: 1995.

**13. The external and fiscal positions are expected to deteriorate further in 2001.**

Fishing activity is projected to remain below the high levels of 1997–98, when *El Niño* boosted the catch in Kiribati's waters. Hence, the current account and the overall balance of payments are projected to worsen, the latter turning negative for the first time in eight years. The budget deficit is expected to exceed 29 percent of GDP, reflecting lower fishing fees and external grants, higher domestically financed development expenditure, and larger subsidies and net lending to public enterprises. The deficit is expected to be financed by depleting the Consolidated, Development, and STABEX Funds (all together, \$A 19 million) and by drawing on the RERF (\$A 3 million, or 3¾ percent of projected 2001 GDP).<sup>6</sup>

**14. The Government's already dominant role in the economy is set to expand.** State-owned enterprises (SOEs) dominate economic activity, but their performance has generally been poor. In contrast, two enterprises jointly owned by the Government and foreign enterprises—Bank of Kiribati (BOK—51 percent owned by an Australian bank) and Telecommunications Services of Kiribati Ltd. (TSKL—49 percent owned by an Australian telecommunications company)—have been profitable. However, the two enterprises' foreign partners are slated to withdraw in 2001. The authorities have identified a new foreign partner for BOK, but intend to take over the foreign partner's share in TSKL and thus to bring the company back to full government ownership. Meanwhile, the Government is planning several new ventures for 2001, including the leasing of an airplane to expand Air Kiribati's operations; the setting up of a copra processing mill; an expansion of the state-owned fishing company's operations; and an extension of telephone links to the outer islands.

### III. POLICY DISCUSSIONS

**15. The discussions focused on the key policy challenge—the achievement of lasting improvements in living standards.** In light of the dim near-term prospects, the mission urged the authorities to rein in the public sector to unfetter the private sector, which is the best vehicle for medium-term sustainable growth. The mission noted that this policy advice was consistent with the Government's own general development strategy, as stated in the newly adopted NDS. While reiterating the policy directions laid out in the NDS, the authorities insisted on the need to implement them cautiously. They were loath to privatize SOEs and to downsize the civil service, citing concerns of political uncertainty and increased unemployment. The comfortable level of international reserves, and still sizable—albeit declining—official development assistance have reduced the authorities' perceived urgency for reform.

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<sup>6</sup> Although the 2001 budget envisages an almost doubling of development expenditure (see the "Budget" column in Table 2), the authorities informed the mission that these new projects would be undertaken only if the required concessional financing was secured. The mission based its projections on discussions in Tarawa with major donors.

### A. The Reform Strategy

16. **Fiscal and structural policies are of central importance in Kiribati, given the absence of domestic monetary policy.** Accordingly, discussions centered on the fiscal and structural reforms needed to promote sustainable development and to enhance the economy's resilience to external shocks. The mission broadly endorsed the *NDS's* focus on public sector reform and prudent fiscal management, and stressed that its timely implementation was critical, noting that progress with the previous *MTS* had been limited. The Minister of Finance had espoused the same strategy in his 2001 budget speech, but acknowledged to the mission that there were differences of opinions within the Government and Parliament on the appropriate pace of reform.

17. **The authorities broadly agreed with the mission's recommendations on fiscal policy but cited constraints in proceeding with structural reforms.** In particular, they remained skeptical of downsizing the public sector and of reducing subsidies to SOEs and copra cutters, stressing the need to maintain social cohesion. They emphasized the following considerations: (i) the social importance of subsidies (especially for copra producers) and of the public provision of goods and services, especially in the outer islands; (ii) the possible unemployment that could result from downsizing and privatization, given the limited absorptive capacity of the small private sector, which might not be able to generate immediately sufficient jobs; and (iii) the key role of the state in promoting investment through the creation of commercial enterprises, which could eventually be privatized. More generally, the authorities insisted on the importance of social cohesion, which required that they build social consensus before proceeding with reforms. These reforms would therefore be undertaken at a pace more suited to Kiribati's cultural environment.

### B. Medium-Term Outlook

18. **The mission presented two medium-term scenarios.** The baseline scenario shows that a continuation of the current policy mix would lead to slow growth and to a decline in real GDP per capita (Annex II); would run against inter-generational equity considerations; and would result in a rapid rise in external debt in terms of GDP. The reform scenario illustrates that, with timely implementation of the reform agenda, real growth of at least 3 percent a year could be achieved over the medium term, implying real GDP per capita growth of 1 percent a year. Owing to the small size of the private sector, growth performance would be initially similar under both scenarios. However, under the reform scenario, growth would not peter out after 2002 (despite the completion of major construction projects), owing to (i) the expansion in private sector activity that would take over skilled workers from the state and deliver products and services more efficiently; and (ii) the positive impact on supply capacity from higher and more productive development expenditure (stemming from redirected current expenditure). Private, rather than publicly owned, enterprises in the marine industry would become the major contributors to growth, and with increased business activity, domestic credit would pick up. Foreign direct investment would also flow in, as a result of reforms in the investment and legal environments and enhanced business opportunities. The authorities broadly agreed with the reform scenario but reiterated the social constraints on reforms.

### C. Fiscal Policy and the Revenue Equalization Reserve Fund

19. **The authorities' three-year budget projections for 2001–03 are not consistent with fiscal retrenchment.** Current expenditure would remain at its recent level of 72 percent of GDP, and development expenditure, at around 44 percent of GDP—in anticipation that sufficient external grants will materialize (see table below). As a result, budget deficits averaging 21 percent of GDP are projected, to be financed by greater drawdowns from the RERF and by concessional loans. The contemplated level of RERF drawdowns would be close to the approved ceiling in the 2001 budget, but would exceed the maximum long-term sustainable level, as estimated by the mission (see Paragraph 24). The authorities noted that projections beyond 2001 were indicative and could be revised for possible policy changes.

20. **The authorities concurred with the mission that taxes and expenditure should be reduced over the medium term to promote private sector growth.** This recommendation is consistent with the authorities' goal of current fiscal balance, which the mission endorsed as a prudent medium-term stance in the face of volatile revenue and the need to use external grants and RERF financing for productive development projects. On the revenue side, the authorities intend to move in the proposed direction, with a planned reduction in personal and company taxes. In order to regain a sustainable fiscal position, and with external grants expected to continue to decline, the mission emphasized that it would be important to start curbing current expenditure, particularly the wage bill and subsidies and net lending to SOEs, and raising more concessional loans for the development budget. Considering these recommendations, and with the aim of serving Kiribati's development needs better, the mission proposed a different medium-term fiscal framework, as shown in the table below (column "Staff Target") and detailed in the reform scenario in Annex II.<sup>7</sup>

21. **The authorities' desire to reduce tax and tariff rates further requires a comprehensive tax policy overhaul.** The tax base is narrow, with the bulk of tax revenue arising from tariffs. Tariff rates are already high (up to 80 percent) and will need to be reduced if Kiribati is to become a member of the Pacific Area Regional Trade Agreement (PARTA).<sup>8</sup> Tariff reductions would benefit the economy by increasing allocative efficiency and helping to attract foreign investment in export-oriented industries (especially nontraditional exports). In these circumstances, the mission made two proposals. First, to broaden the tax base, the authorities should consider a single-rate sales or value-added tax. Second, to lower tariff rates, the authorities should change the import tariff base from an

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<sup>7</sup> Under the recommended fiscal policy mix, current expenditure would fall to about 32 percent of GNP in 2006, broadly in line with the average of 24 percent of GDP for other comparable Pacific Islands, for which GDP is a more meaningful measure of output (Box 3).

<sup>8</sup> With an average tariff of about 19 percent, Kiribati's trade restrictiveness rate is three (of a maximum ten).

f.o.b. to a c.i.f. basis, in line with world practice and conducive to less scope for tax evasion.<sup>9</sup> The authorities indicated that they would consider these recommendations in the context of possible tax and tariff reforms.

<b>Kiribati: Budget Composition, 1995–2006</b> (In percent of GDP)					
	1995–98 Average	1999–2000 Average	2001–03 Budget Estimates	2001 Staff Project.	2006 Staff Target
<b>Revenue and grants</b>	<b>109</b>	<b>114</b>	<b>95</b>	<b>93</b>	<b>75</b>
Tax revenue	26	30	26	28	20
Nontax revenue	47	51	34	41	36
External grants	36	33	35	24	19
<b>Expenditure and net lending</b>	<b>114</b>	<b>120</b>	<b>116</b>	<b>122</b>	<b>87</b>
Current expenditure	72	75	72	82	57
Development expenditure	42	42	44	35	30
Net lending to public enterprises	0	3	0	5	0
<b>Overall balance</b>	<b>-5</b>	<b>-6</b>	<b>-21</b>	<b>-29</b>	<b>-12</b>
<b>Financing</b>	<b>5</b>	<b>6</b>	<b>21</b>	<b>29</b>	<b>12</b>
RERF drawdowns	11	-3	14	4	9
Other government funds 1/	-6	9	1	24	0
External concessional loans	0	0	6	1	3

1/ Consolidated, Development, and STABEX Funds.

22. **The mission supported the authorities' expenditure focus on education and health.** Although expenditure on education and health increased as a proportion of GDP over the last four years, the efficiency of such expenditure needs to be improved. In the face of scarce financial resources, the mission advised continued scrutiny of public expenditure, with a view to making it more efficient and cost-effective, in line with the World Bank's 1998 Public Expenditure Review. In light of serious coastal erosion and solid waste disposal concerns, the mission concurred with the authorities that well-targeted outlays for environmental protection ought to be augmented in the coming years.

23. **Progress has been made in increasing the accountability and transparency of fiscal management.** The authorities indicated that, with donor assistance, they were implementing performance-based budgeting, so as to enhance public expenditure effectiveness. Thus, the 2000 and 2001 budgets included output and performance standards. They recognized, however, that reporting compliance under this scheme had not been satisfactory. The mission suggested that, considering limited administrative capacity, the authorities first concentrate their budget management efforts on selected expenditures and associated performance outcomes, when proceeding with the implementation of performance-based contracts.

<sup>9</sup> Freight is sizable in customs invoicing, given Kiribati's remoteness.



24. **The mission commended the authorities for their continued prudent management of the RERF.** It suggested that the authorities consider bringing in private sector representatives to the RERF Management Committee, which currently comprises only Ministry of Finance officials. Upon the authorities' request, the mission performed an analysis of the long-term maximum sustainable use of the RERF, and recommended that RERF financing of the expected budget deficits not exceed 9 percent of GDP (Annex III). The authorities noted that the authorized level in the budget was higher, but said that they would consider the mission's recommendation. Although larger drawdowns might be envisaged to finance well-designed development projects with high returns, the mission pointed out that concessional loans would likely be available for such projects, which would enable Kiribati to reduce its opportunity costs.

#### **D. Structural Reforms**

##### **Civil service reform**

25. **The mission urged the authorities to start civil service reform in earnest.** The authorities intend to raise the incomes of civil servants—for the first time since 1995—through higher salaries and/or reduced tax rates. The mission proposed that such a move proceed hand in hand with civil service reform, including a downsizing—possibly involving a voluntary departure program.<sup>10</sup> In this connection, the AsDB-sponsored civil service census had shown that not all of the authorized budgetary posts were filled, or were instead filled with temporary staff. The mission argued that in this context new recruitment could be frozen, and once a clear civil service rationalization plan was elaborated and initiated, the envisaged wage increase and tax cuts could be implemented. The authorities indicated that public administration reform was a long-term process and that civil servants' incomes urgently needed to be improved.

##### **Public sector retrenchment**

26. **The mission stressed the need to rein in the public commercial sector.** The mission argued that the public sector should aim at providing core public services, instead of competing with the private sector, especially in commercial or trade activities. The mission welcomed the long-awaited launching of the Private Sector Consultative Committee and urged the authorities to undertake concrete action by, *inter alia*, publishing an initial list of SOEs to be privatized. With the greater competition among private retail outlets in Tarawa, government retail activities could be privatized there, and margin and price controls, gradually phased out. The mission also suggested to start privatizing the large public house stock, rather than to allow an increasing number of government-owned houses to fall into ruin every year for lack of maintenance. The mission also urged the authorities to find a new

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<sup>10</sup> The Asian Development Bank (AsDB) has supported similar programs in the region.

foreign partner for the telecommunications company, TSKL, given the highly technology-intensive nature of its operations. The authorities pointed out that government-owned commercial outlets and margin controls had contributed to supply affordable basic goods in South Tarawa, but also noted that the private sector was now increasingly able to fulfill this role. The housing authority was interested in the suggestion of privatizing some publicly owned dwellings in the framework of its forthcoming supplemental budget request for maintenance. The authorities considered that they had the technical expertise to continue to manage TSKL successfully and that, in order to provide the outer islands with telecommunications infrastructure, it was easier to deal with a public enterprise.

**27. The mission recommended that the authorities review government support to the copra sector.** The mission had extensive discussions with the authorities on the copra sector and noted its sensitive nature, as copra production is one of the few commercial activities practiced on some of the outer islands. Nevertheless, the continued low levels of world copra prices put a sizable burden on the budget, as subsidies to copra cutters are projected to represent 5 percent of GDP in 2001.<sup>11</sup> Thus, the mission recommended that the guaranteed copra price be gradually brought in line with world prices. This step would produce budgetary savings and would also create an incentive for alternative activities on the outer islands, such as seaweed or black pearl farming. The mission also emphasized that the contemplated new copra mill should be privately owned and operated, as this was a typical commercial venture for which the private sector was better equipped. The authorities responded that subsidizing the copra sector was a social rather than an economic decision. As for the copra mill, they intended to hire an experienced foreign miller and to privatize the mill, once it was operating satisfactorily.

#### **Private sector promotion**

**28. Low foreign direct investment highlighted the need for reducing existing barriers to investment.** The major barrier is the prohibition on foreign ownership of land. The mission encouraged the authorities to explore innovative solutions, such as creating zones where foreign investors could own or lease land for, say, 99 years. More generally, procedures for approving foreign investment needed to be streamlined and made more transparent and predictable. The mission welcomed the passage of new land legislation, which clarified land ownership rules in South Tarawa and promoted secure land transactions.

**29. The legal environment needs to be developed to promote private sector activity.** The mission recommended that the authorities update or develop a coherent body of commercial laws (including draft laws on property rights, contracts, secured transactions, payments, and bankruptcy). The authorities noted that the Private Sector Consultative Committee would monitor the business environment and review legislation that affects the private sector.

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<sup>11</sup> World coconut oil (the main use for copra) prices have plummeted by 40 percent since 1996, with only a slight recovery in sight.

### E. Financial Sector Policy

30. **The mission supported the continued use of the Australian dollar as legal tender, as it had strengthened macroeconomic discipline, maintained low inflation, and provided for a liberal exchange regime.**

31. **The mission stressed the need to ease obstacles to financial intermediation.** The bulk of deposits with the two main financial institutions—BOK and Kiribati Provident Fund (KPF—a government-owned pension fund)—are invested overseas, owing to the restriction on foreign ownership of land, which prevents BOK from holding land as collateral, or from redeeming mortgaged buildings on land it cannot own.<sup>12</sup> The mission urged the authorities to explore creative means to alleviate this restriction, including allowing foreign banks to hold land in trust long enough to be able to foreclose it through sale to another local entity. Another major impediment to credit expansion is the lack of domestic investment opportunities. The mission advised against providing partial government guarantees to spur credit, as this could create moral hazard and lead to high fiscal costs. Instead, credit creation should be fostered through structural reforms that promote private sector activity and commercially viable investment projects. The authorities observed that such reforms and transformations would take time.

32. **The mission emphasized that a sound financial system was key to Kiribati's stability.** While BOK is financially sound, as it abides in practice by Australian banking regulations, Development Bank of Kiribati (DBK) and KPF should be strengthened.

- The mission welcomed progress in finding a new majority partner for BOK and the authorities' decision to reduce the Government's share from 49 percent to 25 percent. The mission urged the authorities to wrap up negotiations speedily with the incoming partner to allow for a smooth transition. The mission appreciated the fact that BOK would continue to be managed by a reputable foreign bank on a commercial and fully independent basis.
- The mission noted that the average volume of DBK's loan approvals in 1999–2000 was double the level in 1997–98, reflecting higher lending to the outer islands. However, DBK's nonperforming loan rate had also risen from 7½ percent of its assets in 1998 to around 10 percent in 2000. The mission suggested that DBK could benefit as well from bringing in a foreign partner, to provide expertise, *inter alia*, in credit risk assessment. The mission recommended that government equity injection into DBK in 1999–2000 be considered sufficient and the DBK be free from interference in its lending activities.

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<sup>12</sup> Kiribati was not among the 33 “tax havens” characterized in mid-2000 by the Organization for Economic Cooperation and Development (OECD).

- The mission concurred with KPF's reduction of its guaranteed rate of return from 13½ percent to 11 percent, retroactive to January 1, 1998, which averted the depletion of its reserves. However, KPF's guaranteed rate of return remained unduly high (compared to the return on its assets) and put the onus of keeping KPF afloat on the next generation or on the Government. Accordingly, the mission recommended that KPF's payouts be linked to the actual rate of return on its assets.

33. **Financial institution legislation could help strengthen DBK and KPF, and possibly attract another commercial bank.** Although such legislation—focusing on licensing, supervision, and prudential regulation—was not currently a priority for the authorities, as they had focused on obtaining a new partner for BOK, the mission reminded them that they could request technical assistance from the Pacific Financial Technical Assistance Center (PFTAC) on developing such legislation.<sup>13</sup>

#### F. Data, Technical Assistance, and Other Issues

34. **Fund surveillance of Kiribati has been hampered by weaknesses in virtually all macroeconomic data categories and the lack of regular reporting of core data.** The mission urged the authorities to increase the resources of the National Statistics Office and to request technical assistance (Annex IV). In particular, PFTAC staff had conducted an appraisal mission in September 2000 (Annex V) and had made a number of specific recommendations. The authorities recognized that policy design was more difficult in the absence of macroeconomic data, and they undertook to report core data regularly to the Fund, as had been agreed during the 1999 consultation. Once this reporting is effective, General Data Dissemination Standards could be considered for the reporting of official reserves, for which the basic data seem available and adequate.

35. **The mission recommended that the authorities continue to avail themselves of the technical assistance offered by donors and multilateral organizations.** The mission indicated that the Fund stood ready to consider requests for technical assistance in banking legislation, as well as in tax and tariff policy reform. The Minister of Finance said that the authorities would take this recommendation under advisement.

36. **The authorities consented to the Fourth Amendment to the Fund's Articles of Agreement during the mission and indicated that they would consider authorizing the publication of the 2001 Article IV consultation documents.** The mission invited them to notify the Fund accordingly at their earliest convenience.

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<sup>13</sup> PFTAC is a multidonor-financed entity, for which the Fund serves as executing agency.

#### IV. STAFF APPRAISAL

37. **Kiribati's economic policies reflect the country's communally oriented values that favor social cohesion over individual self-reliance and the "rough and tumble" of the market economy.** This policy involves heavy dependence on the state for investment, employment, and service delivery, and extensive participation of the public in decision making. This strategy has produced a stable macroeconomic environment and the build-up of sizable external assets. However, it has failed to deliver high growth, thus keeping the country one of the least developed among the Pacific Island States.

38. **Since end-1998, unfavorable external conditions, fiscal slippages, and the lack of structural reforms have led to a weakening in Kiribati's external and fiscal positions.** The short-term outlook is for a continuation of slow growth with low inflation and a further deterioration in the external and fiscal balances. While the comfortable level of official external reserves can shelter Kiribati temporarily from external shocks, this buffer should not dull the authorities' sense of urgency for reform.

39. **To achieve sustainable medium-term growth, timely implementation of fiscal consolidation and structural reforms is critical.** The authorities' *National Development Strategy* provides an adequate framework for private sector-led growth with macroeconomic stability. However, progress in implementing the reform agenda has been limited. The authorities need to step up efforts to build a social consensus to proceed with pressing reforms.

40. **To regain a sustainable fiscal position, the authorities must start reducing current expenditure and increasing its efficiency.** Over the medium term, current expenditure should be reined in to offset declining external grants. Reductions in the wage bill and subsidies and net lending to state-owned enterprises and copra cutters are especially important. A curbing of such outlays would allow for tax reductions, which would unfetter the private sector. It would also accommodate additional expenditure on education, health, and environmental protection. However, increasing the efficiency of social expenditure is as critical as bigger outlays are for promoting human resource development. Meanwhile, civil service downsizing would facilitate the expenditure realignment recommended above and would release skilled workers to the private sector.

41. **Kiribati's legal tender, the Australian dollar, has depreciated since mid-1997.** However, the ensuing improvement in external competitiveness has little direct economic incidence, as major foreign income items in the balance of payments are not sensitive to exchange rate changes.

42. **Public enterprise reform and privatization, along with civil service rationalization, should be at the top of the reform agenda.** Unprofitable state-owned enterprises constitute a burden on the budget, compete unfairly with the private sector, and

lead to a misallocation of scarce resources. State-owned enterprises should either face hard budget constraints or should be privatized. The Government should refrain from new commercial ventures that would expand the already dominant role of the public sector.

43. **Barriers to investment need be reduced to boost private sector activity and credit.** Given the scarcity of domestic capital and technological know-how, progress in lowering such barriers is essential to facilitate the entry of foreign investment. Innovative solutions to ease the restriction on foreign ownership of land should be explored, as this restriction deters investment and hampers credit. To enhance economic efficiency, the authorities should progressively replace high tariffs by a broad-based simple indirect domestic tax, and should gradually reduce price and margin controls.

44. **The weakness of the statistical data base has hampered effective macroeconomic policy design, implementation, and Fund surveillance.** The authorities should take advantage of available technical assistance and devote adequate resources and attention to this lingering problem.

44. **The authorities need to notify the Fund about their acceptance of the Fourth amendment to the Fund's Articles of Agreement, as agreed during the discussions.**

45. **It is proposed that Kiribati remain on the 24-month consultation cycle.**

Table 1. Kiribati: Selected Economic and Financial Indicators, 1996–2001

	1996	1997	1998	1999	2000	2001
			Est.	Est.	Est.	Proj.
	(In millions of Australian dollars, unless otherwise indicated)					
<b>Output and prices</b>						
Nominal GDP	64.3	64.5	72.0	74.6	74.2	77.2
Nominal GNP 1/	93.0	119.1	142.4	137.8	141.0	136.9
Real GDP growth (percent change)	4.1	1.6	6.6	2.1	-1.7	1.5
Real GNP growth (percent change)	-5.1	29.8	14.2	-4.7	1.2	-5.3
Inflation (percent change)	-1.5	2.2	4.7	0.4	1.0	2.5
	(In percent of GDP)					
<b>Central government budget</b>						
Total revenue and grants	75.0	125.2	143.6	118.2	109.3	92.9
Revenue	43.3	86.2	96.1	78.8	82.8	68.9
Tax revenue	24.8	26.2	26.1	28.3	30.8	28.3
Nontax revenue	18.5	60.0	70.0	50.4	52.0	40.6
<i>Of which</i> : fishing license fees	9.7	45.7	56.0	42.8	42.0	32.4
External grants	31.7	39.1	47.5	39.4	26.4	24.1
Total expenditure and net lending	110.6	118.9	125.0	123.1	115.9	122.3
Current expenditure	72.5	77.4	71.7	72.3	76.5	82.0
<i>Of which</i> : wages and salaries	30.9	31.3	29.8	29.9	29.0	31.5
subsidies to public enterprises	3.3	8.1	4.7	5.4	5.2	8.0
Development expenditure	38.2	41.5	53.3	50.1	34.4	35.1
Net lending	0.0	0.0	0.0	0.7	5.0	5.2
Overall balance	-35.6	6.4	18.6	-4.9	-6.6	-29.3
Financing:	35.6	-6.4	-18.6	4.9	6.6	29.3
RERF	21.1	12.4	0.0	-6.7	0.0	3.8
Consolidated Fund	14.3	-19.2	-19.6	12.9	4.1	21.9
Development Fund	0.4	0.6	-0.3	-2.7	0.0	2.3
STABEX Fund	0.1	0.1	1.3	1.4	2.5	0.4
External loans, net	-0.3	-0.3	0.0	0.0	0.0	0.9
	(In millions of Australian dollars)					
<b>Financial sector 2/</b>						
Net foreign assets	68.3	92.7	94.8	104.6	112.2	120.0
Domestic credit, net	9.7	10.5	10.2	8.0	10.6	10.0
Other items, net	6.4	-0.6	2.2	2.5	7.6	5.0
Total liabilities	84.3	102.6	107.2	115.0	130.4	135.0
<i>Of which</i> : deposits with Bank of Kiribati 3/	34.6	46.7	45.1	46.9	56.3	60.0
<b>Balance of payments</b>						
Current account balance	-17.5	4.8	28.1	13.0	8.3	3.4
Trade balance	-41.8	-44.1	-42.6	-49.2	-50.1	-53.9
Exports, f.o.b.	6.8	8.4	9.3	13.6	10.0	7.5
Imports, f.o.b.	48.6	52.5	51.9	62.8	60.1	61.4
Services, net	-25.5	-29.7	-28.3	-34.2	-32.5	-32.9
Income, net	31.9	57.6	73.3	71.1	74.9	67.6
Transfers, net	17.9	21.0	25.7	25.3	16.0	22.6
Capital account balance	1.6	-1.0	9.5	-8.4	-4.6	-5.0
<i>Of which</i> : Government	6.2	8.0	12.6	9.0	6.1	7.0
Errors and omissions	16.2	16.1	-5.0	11.2	13.3	0.0
Overall balance	0.4	19.9	32.6	15.7	17.0	-1.6
Official external assets (end of period)	379.1	478.0	602.7	625.3	677.0	692.5
(In years of imports of goods and services)	4.7	5.5	7.0	6.0	6.8	6.8
<i>Of which</i> : Revenue Equalization Reserve Fund	371.8	458.8	570.1	601.4	658.0	692.5
<b>Memorandum items:</b>	(In units as indicated)					
Current account including official grants (in percent of GDP)	-27.1	7.5	39.0	17.4	11.2	4.4
Current account excluding official grants (in percent of GDP)	-58.8	-31.6	-8.5	-22.0	-15.2	-19.7
Official external assets (in millions of US\$)	298.6	311.9	367.8	408.8	369.5	...
External debt (in millions of \$A; end of period)	12.6	12.4	12.3	14.2	14.2	14.7
Per capita nominal GDP (\$A)	814.0	801.0	879.0	894.4	873.4	890.8
Per capita nominal GDP (US\$)	637.3	596.0	553.3	577.4	508.5	...
Real effective exchange rate (percent change) 4/	4.0	-0.4	-8.4	1.7	-7.5	...

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

1/ GDP plus investment income, seamen's remittances, and fishing license fees.

2/ Comprises Bank of Kiribati, Development Bank of Kiribati, and Kiribati Provident Fund.

3/ Includes government deposits.

Table 2. Kiribati: Summary of Central Government Operations, 1996–2001

	1996	1997	1998	1999	2000 Est.	2001	
						Budget	Proj.
(In millions of Australian dollars)							
Total revenue and grants	48.3	80.7	103.4	88.2	81.1	89.3	71.8
Revenue	27.9	55.5	69.2	58.8	61.5	49.4	53.2
Tax revenue	16.0	16.9	18.8	21.1	22.9	21.4	21.8
Nontax revenue	11.9	38.7	50.4	37.6	38.6	28.0	31.3
<i>Of which: fishing license fees</i>	6.2	29.4	40.3	31.9	31.2	21.7	25.0
External grants	20.4	25.2	34.2	29.4	19.6	39.9	18.6
Total expenditure and net lending	71.2	76.6	90.0	91.8	86.0	111.2	94.4
Current expenditure 1/	46.6	49.9	51.6	53.9	56.8	60.6	63.3
<i>Of which: wages and salaries</i>	19.9	20.2	21.5	22.3	21.5	23.7	24.3
subsidies to public enterprises	2.1	5.2	3.4	4.0	3.9	4.5	6.2
Development expenditure 2/	24.6	26.7	38.4	37.4	25.5	50.6	27.1
Net lending 3/	0.0	0.0	0.0	0.5	3.7	0.0	4.0
Budget balance	-22.9	4.1	13.4	-3.7	-4.9	-21.9	-22.6
Financing	22.9	-4.1	-13.4	3.7	4.9	21.9	22.6
RERF	13.6	8.0	0.0	-5.0	0.0	12.6	2.9
Consolidated Fund	9.2	-12.4	-14.1	9.6	3.0	2.4	16.9
Development Fund	0.3	0.4	-0.2	-2.0	0.0	1.3	1.8
STABEX Fund	0.1	0.1	0.9	1.0	1.8	0.0	0.3
External loans, net	-0.2	-0.2	0.0	0.0	0.0	5.6	0.7
(In percent of GDP)							
Total revenue and grants	75.0	125.2	143.6	118.2	109.3	115.6	92.9
Revenue	43.3	86.2	96.1	78.8	82.8	63.9	68.9
Tax revenue	24.8	26.2	26.1	28.3	30.8	27.7	28.3
Nontax revenue	18.5	60.0	70.0	50.4	52.0	36.2	40.6
<i>Of which: fishing license fees</i>	9.7	45.7	56.0	42.8	42.0	28.1	32.4
External grants	31.7	39.1	47.5	39.4	26.4	51.7	24.1
Total expenditure and net lending	110.6	118.9	125.0	123.1	115.9	144.0	122.3
Current expenditure 1/	72.5	77.4	71.7	72.3	76.5	78.4	82.0
<i>Of which: wages and salaries</i>	30.9	31.3	29.8	29.9	29.0	30.8	31.5
subsidies to public enterprises	3.3	8.1	4.7	5.4	5.2	5.8	8.0
Development expenditure 2/	38.2	41.5	53.3	50.1	34.4	65.5	35.1
Net lending 3/	0.0	0.0	0.0	0.7	5.0	0.0	5.2
Budget balance	-35.6	6.4	18.6	-4.9	-6.6	-28.4	-29.3
Financing	35.6	-6.4	-18.6	4.9	6.6	28.4	29.3
RERF	21.1	12.4	0.0	-6.7	0.0	16.3	3.8
Consolidated Fund	14.3	-19.2	-19.6	12.9	4.1	3.1	21.9
Development Fund	0.4	0.6	-0.3	-2.7	0.0	1.7	2.3
STABEX Fund	0.1	0.1	1.3	1.4	2.5	0.0	0.4
External loans, net	-0.3	-0.3	0.0	0.0	0.0	7.3	0.9
<i>Memorandum items:</i>							
(In millions of Australian dollars)							
RERF accrued income 4/	16.5	17.1	20.3	20.6	23.9	22.4	22.4
RERF balance (end of period)	371.8	458.8	570.1	601.4	658.0	682.8	692.5
Consolidated Fund balance (end of period)	3.2	15.5	29.6	20.0	16.9	14.6	0.0
Development Fund balance (end of period)	0.0	-0.4	-0.2	1.8	1.8	0.4	0.0
STABEX Fund balance (end of period)	4.2	4.1	3.2	2.2	0.3	0.3	0.0
Local contribution to development expenditure	5.6	3.1	4.2	8.0	5.9	10.7	8.5

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

1/ Includes spending from the STABEX Fund, mainly as a subsidy to the Copra Society.

2/ Includes the financing of a new government-owned copra mill for a total cost of \$A 4 million, of which three fourths are projected to be spent in 2001, and one fourth, in 2002. The Government's budget only includes \$A 0.6 million of expenditure for this project in 2001.

3/ In 1999 includes \$A 0.5 million contribution to DBK; in 2000 includes \$A 1 million contribution to DBK and \$A 2.7 million of additional equity in Air Kiribati; and in 2001 includes \$A 3.4 million purchase of the shares of Telstra, \$A 3.6 million purchase of a new airplane for Air Kiribati, and \$A 3 million proceeds from the sale of additional BOK equity.

4/ Income for dividends and interest only. Capital gains are excluded.



Table 3. Kiribati: Balance of Payments Summary, 1996–2001

	1996	1997	1998	1999 Est.	2000 Est.	2001 Proj.
(In millions of Australian dollars)						
Current account balance	-17.5	4.8	28.1	13.0	8.3	3.4
Trade balance	-41.8	-44.1	-42.6	-49.2	-50.1	-53.9
Exports, f.o.b.	6.8	8.4	9.3	13.6	10.0	7.5
Imports, f.o.b.	48.6	52.5	51.9	62.8	60.1	61.4
Balance on services	-25.5	-29.7	-28.3	-34.2	-32.5	-32.9
Credit	5.8	5.4	6.4	6.6	6.6	7.0
Debit	31.3	35.1	34.7	40.8	39.1	39.9
Balance on factor income 1/	31.9	57.6	73.3	71.1	74.9	67.6
Credit	33.6	58.7	74.7	72.7	76.7	69.6
Fishing license fees	6.2	29.4	40.3	31.9	31.2	25.0
Investment income	19.7	20.1	23.2	28.5	32.0	30.4
Seamen's remittances	7.7	9.2	11.2	12.3	13.6	14.3
Debit	1.7	1.1	1.4	1.6	1.8	2.0
Balance on current transfers	17.9	21.0	25.7	25.3	16.0	22.6
Credit:	19.0	22.7	27.6	27.4	18.3	25.4
<i>Of which: Government</i>	14.3	17.3	21.7	20.6	13.7	13.0
Debit	1.1	1.7	1.9	2.1	2.3	2.8
<i>Of which: Government</i>	0.0	0.7	0.7	0.7	0.7	0.9
Financial and capital account balance	1.6	-1.0	9.5	-8.4	-4.6	-5.0
Government	6.2	8.0	12.6	9.0	6.1	7.0
Capital transfers	6.1	7.9	12.5	8.8	5.9	5.6
Loans (net)	0.1	0.1	0.1	0.2	0.2	1.5
Direct investment	0.0	0.2	0.0	0.0	0.0	-0.9
Financial institutions	-4.6	-9.2	-3.1	-17.5	-10.7	-11.2
Errors and omissions	16.2	16.1	-5.0	11.2	13.3	0.0
Overall balance	0.4	19.9	32.6	15.7	17.0	-1.6
Change in external assets (increase: -) 2/	-0.4	-19.9	-32.6	-15.7	-17.0	1.6
Revenue Equalization Reserve Fund	-9.9	-8.0	-19.2	-24.4	-21.9	-17.4
Government funds 3/	9.5	-11.9	-13.4	8.7	4.9	19.0
<i>Memorandum items:</i>	(In units as indicated)					
Trade balance (in percent of GDP)	-64.9	-68.4	-59.2	-66.0	-67.6	-69.8
Current account balance (in percent of GDP)	-27.1	7.5	39.0	17.4	11.2	4.4
Current account balance excluding official grants (\$A mill.) (In percent of GDP)	-37.9	-20.4	-6.1	-16.4	-11.3	-15.2
Official external assets (in millions of \$A) 4/ (In years of imports of goods and services)	379.1	478.0	602.7	625.3	677.0	692.5
Foreign reserve assets (in millions of \$A) 5/ (In months of imports of goods and services)	15.7	27.7	42.0	34.4	31.3	12.6
Other assets (in millions of \$A) 6/ (In percent of GDP)	363.4	450.3	560.7	591.0	645.7	679.9
External debt (in millions of \$A) (In percent of GDP)	12.6	12.4	12.3	14.2	14.2	14.7
External debt service (in millions of \$A) (In percent of exports of goods and services)	1.1	1.0	1.5	1.5	1.5	1.1

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/ Excludes valuation changes.

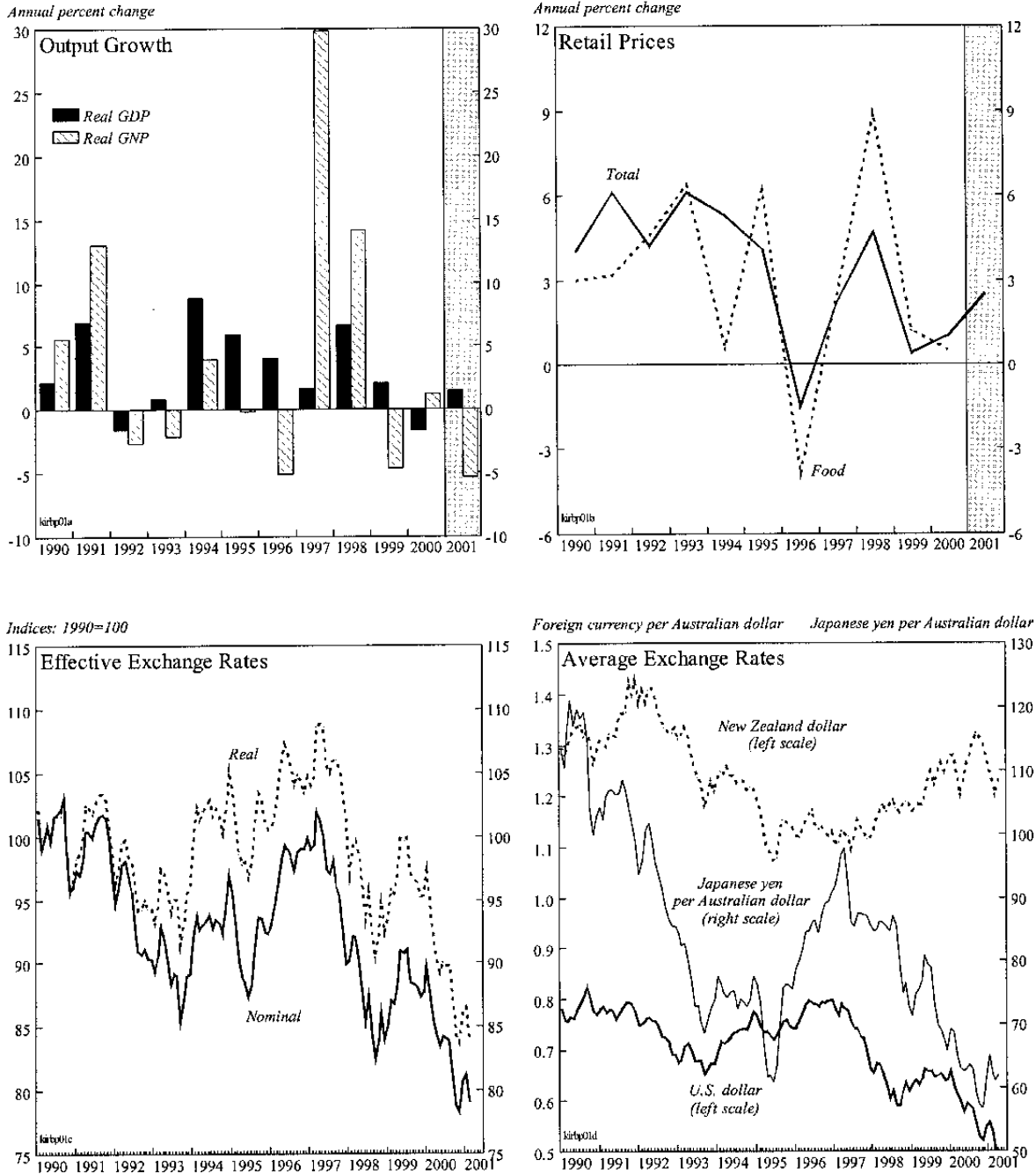
3/ Comprises the Consolidated, Development, and STABEX Funds.

4/ On the basis of market value, excluding valuation changes.

5/ Includes the Consolidated and Reserve Funds, and a small portion of the RERF at the discretion of the Ministry of Finance.

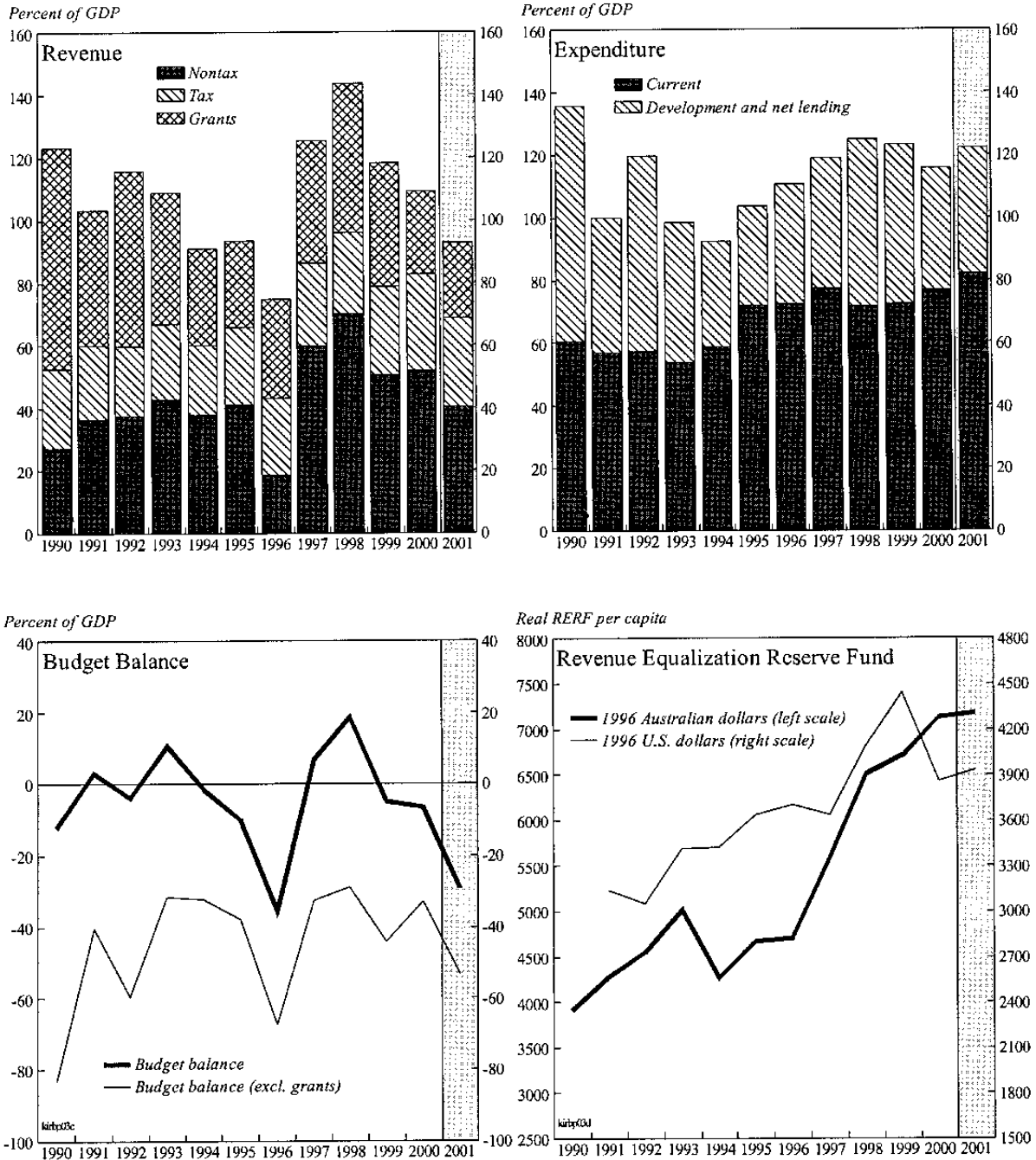
6/ Includes the remaining balance of the RERF and of the STABEX Fund.

Figure 1. Kiribati: Output, Prices, and Exchange Rates, 1990-2001



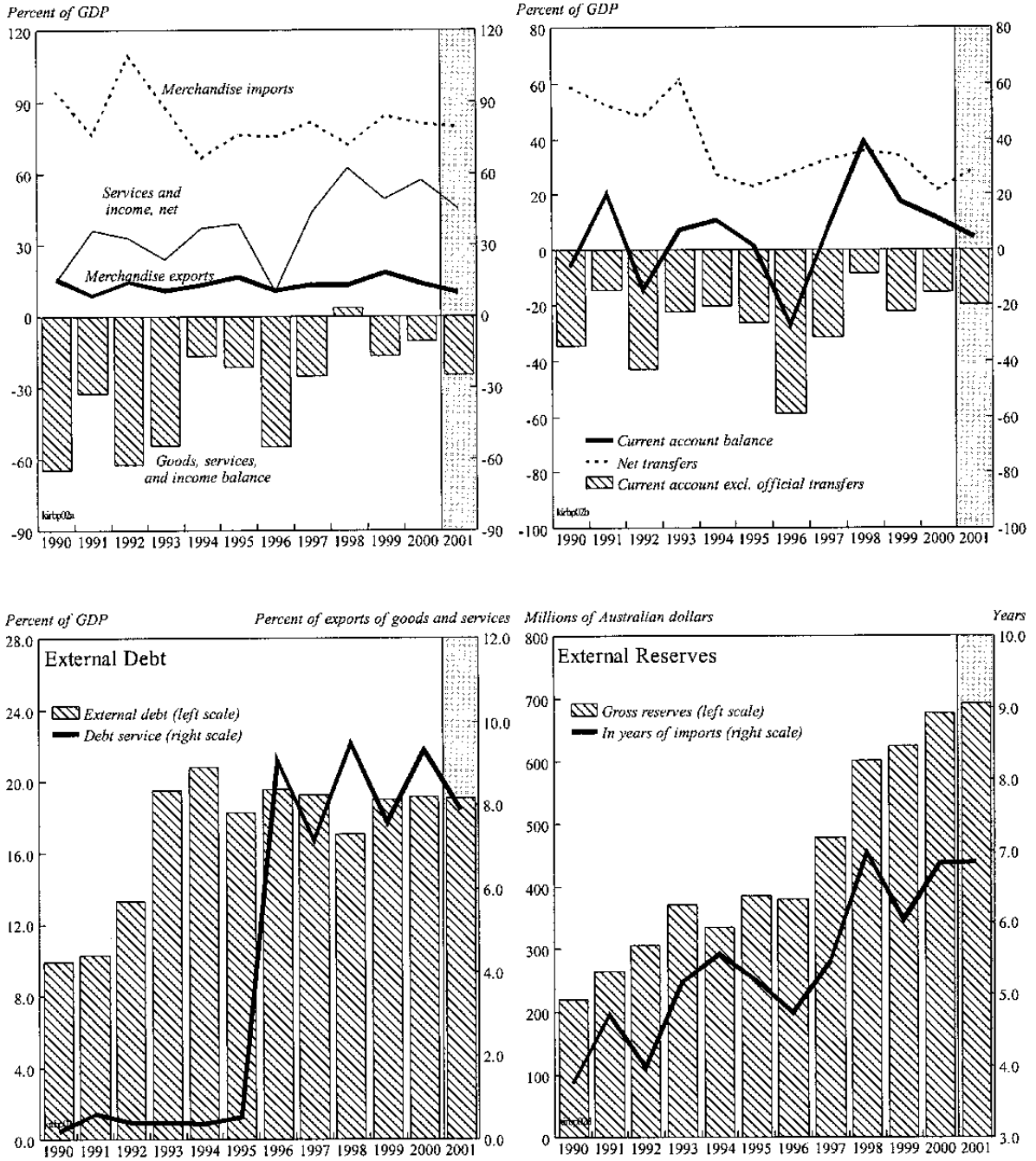
Sources: IMF, Information Notice System; data provided by the Kiribati authorities; and Fund staff estimates and projections.

Figure 2. Kiribati: Central Government Budget, 1990-2001



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

Figure 3. Kiribati: External Developments, 1990-2001



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

## Kiribati: Social and Demographic Indicators, 1988–98

	Kiribati		Same region/income group 1/	
	1988	1998 1/	East Asia and Pacific	Lower-middle income
<b>Population</b>				
Total population, mid-year (millions)	0.1	0.1	1,817.1	886.5
Growth rate (percent)	2.1	1.8	1.1	1.1
Urban population (percent of total)	34.2	35.7	33.9	57.7
<b>Income and prices</b>				
GNP per capita (US\$)	675	1,095	990	1,740
Consumer price index (1995=100)	70.8	105.4	130.3	131.4
<b>Public current expenditures</b>				
Health (percent of GDP)	7.2	11.2	1.7	3.0
Education (percent of GNP)	5.9	10.5	2.9	4.9
<b>Access to safe water (percent of population)</b>				
Total	68	100	84	...
Urban	...	100	89	...
Rural	...	100	82	...
<b>Immunization rate (percent of children under 12 months)</b>				
Measles	54	100	93	89
Diphtheria/Pertussis/Tetanus (DPT)	63	60	93	89
<b>Life expectancy at birth (years)</b>				
Total	55	59	69	68
Male	53	57	67	65
Female	57	62	71	72
Infant mortality (per thousand live births)	65	64 2/	35	35

Sources: Data provided by the Kiribati authorities; and World Bank, *World Development Indicators*, 2000.

1/ 1998 or latest available year prior to 1998.

2/ For Kiribati, figures are for 1987 and 1996, respectively.

### **Kiribati: Illustrative Medium-Term Scenarios, 2001–06**

This Annex presents two medium-term scenarios. First, the baseline scenario (Table II.1) assumes that the current non reforming fiscal and structural policy stance continues over the medium term. Second, the reform scenario (Table II.2) assumes timely implementation of the authorities' *National Development Strategy for 2001–03* (NDS) and of the mission's recommendations.

#### **Baseline scenario (Table II.1)**

Under this scenario, major construction projects<sup>1</sup> in 2002–03 would raise real GDP growth from 1½ percent in 2001 to around 2½ percent a year. However, this upturn would not be sustained. After the completion of the projects, growth is projected to slow to about 1 percent (only half the population growth) by 2005, as decreasing revenue constrains government spending. With private sector activity remaining subdued, there would be no stimulus to offset the post-2003 slowdown. Inflation would be around 2½ percent in 2001–06, in line with projections for Australia, the main trading partner.

Total revenue and grants are expected to decline in terms of GDP, owing to weak growth in fishing license fees and decreasing external grants. Fishing license revenue is assumed to grow in line with world prices for fish, with no significant increases in volume, while external grants are projected to fall from their current level of around 25 percent of GDP to 15 percent of GDP by 2006. Tax revenue is assumed to remain at around 27 percent of GDP. Unchanged expenditure policies would lead to current expenditure remaining at around 75 percent of GDP, with wages accounting for almost half of total current expenditure, and subsidies and net lending to public enterprises remaining high at some 7 percent. Development expenditure would fall to 21 percent of GDP by 2006, in line with lower external grants. This decline would constrain the economy's long-term growth prospects, as the domestic component of development financing would stagnate.

Sizable fiscal deficits (averaging 24 percent of GDP) would ensue under this scenario. With the Consolidated, Development, and STABEX Funds exhausted in 2001, these deficits would have to be financed from increased drawdowns from the Revenue Equalization Reserve Fund (RERF—15 percent of GDP) and increased external concessional loans. The RERF drawdowns would be above the level considered sustainable by the mission (see Annex III). By 2006, the external debt would exceed \$A 50 million.

In 2002, the current account balance would turn into a deficit, owing to higher project-related imports, which would be offset by capital transfers and loans. Thereafter, small current account surpluses would be posted. Export growth would remain weak, as would foreign direct investment. However, over the entire period under review, the overall external balance would remain in surplus, owing to sizable inflows of factor income.

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<sup>1</sup> These are: the sanitation project financed by the Asian Development Bank; the sports stadium financed by China; and the space shuttle base financed by Japan.

### **Reform scenario (Table II.2)**

The reform scenario assumes timely implementation of the NDS's goals of downsizing the public sector, promoting private sector growth, reducing barriers to trade and investment, and investing in human resources development.

Revenue, with respect to GDP, is projected to decline, partly owing to weak growth in fishing license fees, but also reflecting tax reforms aiming at stimulating the private sector. Tax revenue would gradually fall from 28 percent of GDP in 2001 to around 23 percent in 2006. Compared to the baseline scenario, nontax revenue in Australian dollar terms would be approximately the same. Under the reform scenario, it is assumed that external grants would not fall as fast and would remain at around 18½ percent of GDP during 2002-06, as external donors would be supportive of the reform measures.

It is assumed that a downsizing of the civil service starts in 2002. This would enable a steady reduction in the wage bill, from 31½ percent of GDP in 2001 to 22 percent by 2006. Public enterprise reform would also start in 2002. By 2006, subsidies and net lending to these enterprises would be less than half the 2001 level. Development expenditure would fall slightly to 30 percent of GDP in 2006, but this level would be higher than under the baseline scenario, because of higher external grants.

Budget deficits would fall steadily under this scenario to about 12 percent of GDP by 2006. Current expenditure would gradually fall in balance with revenue, while development expenditure would be financed by drawdowns from the RERF (9 percent of GDP, in line with the mission's analysis of the sustainable long-term rate of drawdown), external grants, and concessional external loans.

Despite the completion of the major construction projects, real GDP growth is projected to be 3 percent in 2004-06, due to the growth in private sector activity and the stimulus from development expenditure. This would imply a real per capita GDP growth of 1 percent per annum. Inflation would be about 2½ percent a year (as in the baseline scenario).

Growth is expected to be led by the marine industry, given the large sea resources. Under this scenario, however, it is the private sector that would lead economic activity. Tourism and wholesale and retail trade would be significant areas for increased private sector activity. With improved business opportunities, domestic credit is expected to pick up. Foreign direct investment is anticipated to flow in, owing to reforms in the investment and regulatory environment.

Under this scenario, export growth would improve over time, as the private sector exploits profitable opportunities. Import growth would also pick up somewhat, reflecting higher growth in output and income. The overall external balance would continue to be in surplus.

Table II.1. Kiribati: Baseline Scenario, 2001–06

	2001	2002	2003	2004	2005	2006
	Projections					
(In millions of Australian dollars, unless otherwise indicated)						
Output and prices						
Nominal GDP	77.2	81.5	85.7	89.6	92.7	95.8
Nominal GNP 1/	136.9	145.8	156.4	160.2	165.7	172.1
Real GDP growth (percent change)	1.5	2.8	2.5	2.0	1.0	1.0
Real GNP growth (percent change)	-5.3	3.7	4.5	-0.1	1.0	1.5
Real per capita GDP growth (percent change)	-0.5	0.7	0.5	0.0	-1.0	-1.0
Inflation (percent change)	2.5	2.7	2.7	2.5	2.4	2.3
(In percent of GDP)						
Central government budget						
Total revenue and grants	92.9	86.4	83.0	80.4	78.6	75.8
Revenue	68.9	65.4	64.0	62.4	61.6	60.8
Tax revenue	28.3	28.3	27.8	26.7	26.4	26.2
Nontax revenue	40.6	37.1	36.3	35.7	35.2	34.7
<i>Of which: fishing license fees</i>	32.4	30.6	29.9	29.4	29.0	28.6
External grants	24.1	21.0	19.0	18.0	17.0	15.0
Total expenditure and net lending	122.3	114.3	108.5	102.8	100.5	96.8
Current expenditure	82.0	77.0	75.4	74.7	75.4	74.8
<i>Of which: wages and salaries</i>	31.5	30.5	30.4	30.3	30.3	30.2
<i>subsidies to public enterprises</i>	8.0	6.6	6.3	6.6	6.6	6.5
Development expenditure	35.1	36.0	32.0	27.0	24.0	21.0
Net lending	5.2	1.2	1.2	1.1	1.1	1.0
Budget balance (excluding grants)	-53.4	-48.9	-44.5	-40.4	-38.8	-36.0
Budget balance (including grants)	-29.3	-27.9	-25.5	-22.4	-21.8	-21.0
Financing	29.3	27.9	25.5	22.4	21.8	21.0
Revenue Equalization Reserve Fund	3.8	15.0	15.0	15.0	15.0	15.0
Consolidated Fund	21.9	0.0	0.0	0.0	0.0	0.0
Development Fund	2.3	0.0	0.0	0.0	0.0	0.0
STABEX Fund	0.4	0.0	0.0	0.0	0.0	0.0
External loans, net	0.9	12.9	10.5	7.4	6.8	6.0
(In millions of Australian dollars, unless otherwise indicated)						
Balance of payments						
Current account balance	3.4	-5.3	0.9	3.2	3.0	4.5
Trade balance	-53.9	-58.2	-57.8	-56.6	-58.2	-58.7
Exports, f.o.b.	7.5	7.7	9.3	9.4	8.4	8.6
Imports, f.o.b.	61.4	65.9	67.2	66.0	66.6	67.3
Services, net	-32.9	-32.0	-31.9	-30.9	-31.4	-31.5
Income, net	67.6	72.5	79.4	79.8	82.5	86.3
Transfers, net	22.6	12.4	11.3	10.9	10.1	8.4
Financial and capital account balance	-5.0	14.4	8.4	6.4	7.1	6.0
<i>Of which: Government</i>	7.0	15.6	13.9	11.5	11.1	10.0
Overall balance	-1.6	9.1	9.3	9.6	10.0	10.5
Official external assets (end of period)	692.5	719.6	747.6	776.7	806.9	838.4
(In years of imports of goods and services)	6.8	6.8	7.0	7.4	7.6	7.8
<i>Of which: Revenue Equalization Reserve Fund</i>	692.5	719.6	747.6	776.7	806.9	838.4
Memorandum items:	(In units as indicated)					
Current account balance including official grants (in percent of GDP)	4.4	-6.5	1.1	3.6	3.2	4.7
Current account balance excluding official grants (in percent of GDP)	-19.7	-27.5	-17.9	-14.4	-13.8	-10.3
Official external assets (in millions of US\$)	382.0	394.3	405.6	417.4	432.2	449.1
External debt (in millions of \$A; end of period)	14.7	25.1	33.9	40.4	46.5	52.1
Per capita GDP (\$A)	891.0	921.0	950.0	974.0	987.0	1,001.0

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

1/ GDP plus investment income, seamen's remittances, and fishing license fees.



Table II.2. Kiribati: Reform Scenario, 2001–06

	2001	2002	2003	2004	2005	2006
	Projections					
	(In millions of Australian dollars, unless otherwise indicated)					
Output and prices						
Nominal GDP	77.2	81.5	86.1	90.9	95.9	101.1
Nominal GNP 1/	136.9	151.4	159.4	162.9	170.0	179.7
Real GDP growth (percent change)	1.5	2.8	3.0	3.0	3.0	3.0
Real GNP growth (percent change)	-5.3	7.7	2.5	-0.3	1.9	3.3
Real per capita GDP growth (percent change)	-0.5	0.7	1.0	1.0	1.0	1.0
Inflation (percent change)	2.5	2.7	2.7	2.5	2.4	2.3
	(In percent of GDP)					
Central government budget						
Total revenues and grants	92.9	85.6	82.5	79.5	76.9	75.0
Revenue	68.9	64.6	62.8	60.9	59.4	58.5
Tax revenue	28.3	27.2	25.7	24.2	23.3	22.9
Nontax revenue	40.6	37.5	37.1	36.7	36.1	35.6
<i>Of which: fishing license fees</i>	32.4	30.8	30.2	29.6	28.8	28.0
External grants	24.1	21.0	19.7	18.6	17.5	16.5
Total expenditure and net lending	122.3	107.7	101.7	95.2	93.1	86.8
Current expenditure	82.0	69.5	66.7	62.2	61.1	56.8
<i>Of which: wages and salaries</i>	31.5	28.0	27.0	25.0	24.5	21.9
<i>subsidies to public enterprises</i>	8.0	6.2	5.2	4.7	4.0	3.5
Development expenditure	35.1	37.0	35.0	33.0	32.0	30.0
Net lending	5.2	1.2	0.0	0.0	0.0	0.0
Budget balance (excluding grants)	-53.4	-43.1	-38.9	-34.3	-33.7	-28.3
Budget balance (including grants)	-29.3	-22.1	-19.2	-15.7	-16.2	-11.8
Financing	29.3	22.1	19.2	15.7	16.2	11.8
Revenue Equalization Reserve Fund	3.8	9.0	9.0	9.0	9.0	9.0
Consolidated Fund	21.9	0.0	0.0	0.0	0.0	0.0
Development Fund	2.3	0.0	0.0	0.0	0.0	0.0
STABEX Fund	0.4	0.0	0.0	0.0	0.0	0.0
External loans, net	0.9	13.1	10.2	6.7	7.2	2.8
	(In millions of Australian dollars, unless otherwise indicated)					
Balance of payments						
Current account balance	3.4	-1.7	4.5	5.6	4.2	8.0
Trade balance	-53.9	-58.2	-57.6	-56.1	-57.3	-57.9
Exports, f.o.b.	7.5	7.7	9.8	10.8	10.7	11.6
Imports, f.o.b.	61.4	65.9	67.5	66.9	68.0	69.5
Services, net	-32.9	-32.0	-31.9	-31.0	-31.8	-32.0
Income, net	67.6	78.1	82.0	81.1	83.7	88.7
Transfers, net	22.6	10.4	12.0	11.7	9.5	9.2
Financial and capital account balance	-5.0	15.8	8.9	7.8	9.0	5.4
<i>Of which: Government</i>	7.0	15.8	13.9	11.1	11.9	7.8
Overall balance	-1.6	14.0	14.6	15.2	15.8	16.5
Official external assets (end of period)	692.5	724.5	757.9	792.8	829.2	867.2
(In years of imports of goods and services)	6.8	6.9	7.1	7.5	7.7	7.8
<i>Of which: Revenue Equalization Reserve Fund</i>	692.5	724.5	757.9	792.8	829.2	867.2
Memorandum items:	(In units as indicated)					
Current account balance including official grants (in percent of GDP)	4.4	-2.1	5.2	6.2	4.3	7.9
Current account balance excluding official grants (in percent of GDP)	-19.7	-23.1	-14.5	-12.4	-13.2	-8.6
Official external assets (in millions of US\$)	382.0	395.0	409.2	424.6	444.1	465.1
External debt (in millions of \$A; end of period)	14.7	25.2	33.7	39.7	46.4	49.1
Per capita GDP (\$A)	891.0	921.0	955.0	988.0	1,022.0	1,056.0

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

1/ GDP plus investment income, seamen's remittances, and fishing license fees.

### **Kiribati: Sustainable Annual Drawdowns from the Revenue Equalization Reserve Fund**

This Annex presents an update of the analysis of the sustainable use of the Revenue Equalization Reserve Fund (RERF) presented in the framework of the previous consultation (SM/99/134, Annex II). Specifically, the analysis aims at determining the maximum annual drawdowns from the RERF that would ensure that both current and future generations use a similar level of the RERF's resources (as a percentage of GDP) to finance public expenditure. This would also ensure that the per capita real value of the RERF, expressed in 1996 Australian dollars, would remain constant.

To determine maximum allowable drawdowns over the long run, projections of the real per capita value of the RERF were made out to the year 2050, based on the following conservative assumptions (although it should be borne in mind that significant uncertainty surrounds these projections):

- The end-2000 value of the RERF is used as the starting value for the analysis.
- An annual nominal portfolio rate of return (including interest, dividends, and trading gains) of 6 percent is used. This is somewhat lower than in the previous simulation, owing to expected lower global yields in coming years. This rate is about ½ to 1 percentage point higher than long-term bond yields in Australia and the United States in December 2000, as it includes a small premium on investment in equities (as was the case historically).
- Population growth of 2 percent a year is used (consonant with recent census data), declining to 1½ percent a year after 2020.
- Real GDP growth of 3 percent per annum is projected, in line with the reform scenario outlined in Annex II. (The baseline scenario has a lower long-term growth rate and would thus lead to lower sustainable drawdowns).
- Inflation of 2½ percent per annum is used, consistent with the assumption presented in Annex II (both scenarios).

Under these assumptions, annual drawdowns equivalent to 15 percent of GDP (as approved by Parliament for the 2001 budget) over the long run would erode the real per capita value of the RERF by about 60 percent by 2050 (see "Authorities' scenario" in the table below).

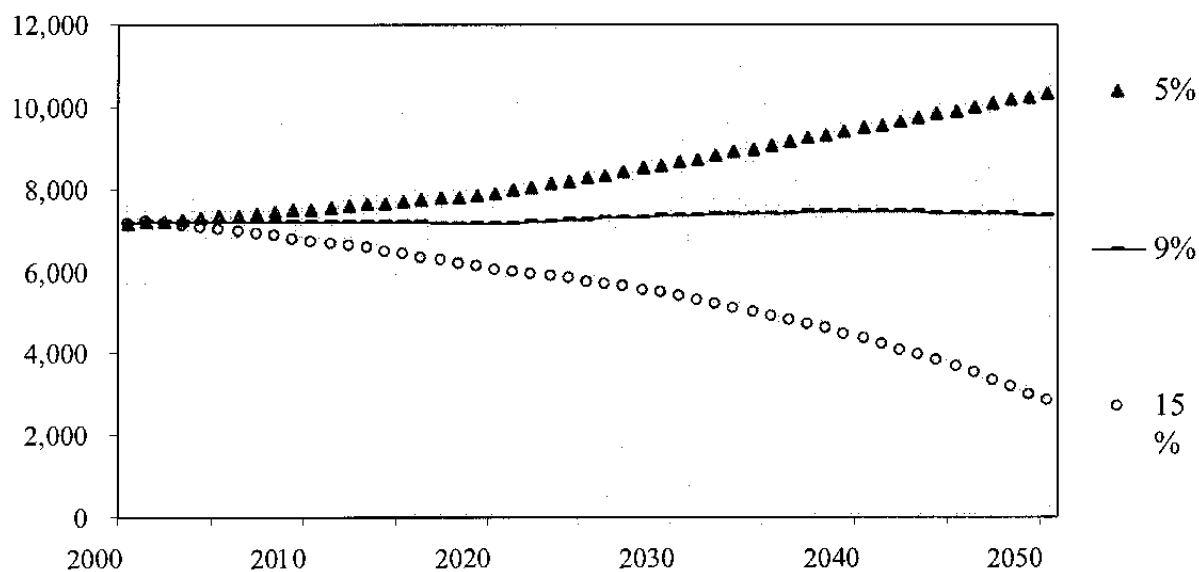
The analysis suggests that the maximum annual drawdowns from the RERF would need not to exceed about 9 percent of GDP to be sustainable over the long term. Such a level would broadly maintain the real per capita value of the RERF through 2050 (see "Sustainable scenario").

The continuation of the historical trend since 1989 of average annual drawings of some 5 percent would result in a 45 percent increase in the real per capita value of the RERF (see “Historical trend scenario”).

**Kiribati: RERF Projections, 2000–50**

	2000 Actual	2020 Project.	2050 Project.	Percent Change 2050/2000
<b>Authorities’ scenario</b> <i>(Drawdowns of 15 percent of GDP)</i>				
RERF per capita (in \$A)	7,745	10,744	10,575	36.5
RERF real per capita (in 1996 \$A)	7,132	6,037	2,833	-60.3
<b>Sustainable scenario</b> <i>(Drawdowns of 9 percent of GDP)</i>				
RERF per capita (in \$A)	7,745	12,715	27,394	253.7
RERF real per capita (in 1996 \$A)	7,132	7,145	7,339	2.9
<b>Historical trend scenario</b> <i>(Drawdowns of 5 percent of GDP)</i>				
RERF per capita (in \$A)	7,745	14,030	38,606	398.5
RERF real per capita (in 1996 \$A)	7,132	7,884	10,342	45.0

**Kiribati: Real Per Capita Value of the RERF, 2000-50**  
(In constant prices of 1996 Australian dollars)



## **Kiribati: Statistical Issues**

### **Outstanding Statistical Issues**

There is no country page for Kiribati in the *International Financial Statistics* (IFS). No data are currently provided to the Fund on a regular basis. Kiribati has few statistical publications, and weaknesses remain in the statistics on government finance, national accounts, and balance of payments. Technical assistance is needed in these areas, including from the Pacific Financial Technical Assistance Center (PFTAC).

#### **1. Real Sector**

Technical assistance in national accounts was provided by the Asian Development Bank (1989), PFTAC (1994 and 2000), and the Statistics Department (STA) (1995). Estimates of GDP at constant prices by industry are available for the period 1979 to 2000; however, the quality of the deflators and of the survey data needs further improvement. There are no expenditure-based estimates of GDP.

The monthly retail price index (1996=100) is produced with a lag of about two months, based on a survey in Tarawa. The weights were updated in 1999 to reflect the 1996 household survey. There are no producer, wholesale, or trade price indices.

#### **2. Government Finance**

Kiribati does not report any government finance statistics (GFS) data to STA for publication in the *GFS Yearbook*. The latest available data based on GFS classification are for 1994, with the data for 1995 under compilation. Previous missions compiled fiscal data for 1996-99. A provisional budget outcome is available for 2000.

#### **3. Balance of Payments**

The latest balance of payments statistics reported by Kiribati are for 2000. The large net errors and omissions in the balance of payments data appear to reflect the underestimation of private transfers, including seamen's remittances and other foreign exchange receipts. Quarterly trade statistics are available with a lag of eight months, while monthly foreign reserves data are available with a lag of about one month. Consistency between the balance of payments data and budget and financial sector data needs improvement.

#### **4. Monetary Accounts**

Kiribati does not report monetary accounts to STA. Quarterly balance sheets are available for Bank of Kiribati, while annual balance sheets are available for Development Bank of Kiribati and the Kiribati Provident Fund.

## Kiribati: Core Statistical Indicators

(As of May 30, 2001)

	Exchange Rates	International Reserves	Reserve/ Base Money	Central Bank Balance Sheet	Broad Money 1/	Interest Rates	Consumer Price Index	Exports/ Imports	Current Account Balance	Overall Government Balance	GDP/ GNP	External Debt/ Debt Service
Date of latest observation	05/30/01	Q4 2000	N/A	N/A	Q4 2000	Q4 2000	12/00	2000	2000	2000	2000	End-2000
Date received	05/30/01	03/15/01	N/A	N/A	03/15/01	03/15/01	03/01	03/01	03/01	03/01	03/01	3/01
Frequency of Data	D	M	N/A	N/A	Q	Q	M	Q	A	A	A	A
Frequency of Reporting	D	V	N/A	N/A	V	V	V	V	V	V	V	V
Source of data	C	A	N/A	N/A	A	A	A	A	A	A	A	A
Mode of Reporting	E	V	N/A	N/A	V	V	V	V	V	V	V	V
Confidentiality	C	D	N/A	N/A	D	D	D	D	D	D	D	D
Frequency of publication	D	N/A	N/A	N/A	N/A	A	M	A	A	A	A	A

1/ Proxied by total deposits with the Bank of Kiribati (sole commercial bank).

**Kiribati: Fund Relations**  
(As of May 31, 2001)

I. **Membership Status:** Joined June 3, 1986; Article VIII.

II. <b>General Resources Account</b>	<b>SDR Million</b>	<b>Percent of Quota</b>
Quota	5.6	100.0
Fund holdings of currency	5.6	100.0

III. <b>SDR Department</b>	<b>SDR Million</b>	<b>Percent of Allocation</b>
Holdings	0.01	...

IV. **Outstanding Purchases and Loans:** None.

V. **Financial Arrangements:** None.

VI. **Projected Obligations to the Fund:** None.

VII. **Exchange Rate Arrangement:** The Australian dollar is legal tender and the domestic currency of Kiribati. Kiribati issues a small amount of coins.

VIII. **Article IV Consultation:** The 1999 Article IV consultation discussions with Kiribati were held in Tarawa during March 23–April 1, 1999. Kiribati is on a 24-month consultation cycle.

IX. **Technical Assistance:** Refer to attached table.

X. **Resident Representative:** None.

**Kiribati: Technical Assistance, 1995–2000**

Source	Purpose	Timing
STA	National accounts compilation and methodology	March–April 1995
PFTAC <sup>1</sup>	Public financial management	April 1996 May 1998
	Sectoral strategies, and official <i>Strategic Development Plan</i>	April and August 1996
	Tax administration	September–Nov. 1996 January–March 1997 July and September 1998 April, June, and September 1999
	Public financial management and <i>Code of Good Practices on Fiscal Transparency</i>	April 2000
	Review of statistical operations	September 2000
World Bank	Public expenditure review	February–March 1997
	Customs tariff and tax reform	May 1997
	Revenue Equalization Reserve Fund investment advice	May 1997

<sup>1</sup> Pacific Financial Technical Assistance Center.

### **Kiribati: Relations with the World Bank Group<sup>1</sup>**

Total commitments: None

IFC investments: None

Kiribati joined the World Bank Group on September 29, 1986. To date, the Bank has not provided any credits to Kiribati and there are no lending activities under consideration at this time. In terms of nonlending economic and sector work, the most recent activities include:

**Tariff Review—1997:** The review recommended a number of changes to the import tariff schedules, essentially to convert tariffs to a c.i.f. basis, to reduce the number of categories, and to rationalize the level of tariffs.

**Support to the management of the Revenue Equalization Reserve Fund (RERF)—1997:** A report on the RERF recommended significant changes to the management of the Fund which would enhance its the growth potential.

**Education Financing and Costs Study—1998:** The review examined various alternatives for development, expansion, and upgrading of the education system.

**Public Expenditure Review—1998:** The review assessed the development effectiveness of public expenditure and related issues of sustainable economic growth, poverty alleviation, fiscal management and expenditure control, governance, and the efficient use of foreign aid flows, and suggested appropriate improvements.

**Public Islands Stakeholder Participation in Development - Kiribati—1998:** The study examined the way in which I-Kiribati social fabric, cultural heritage, and traditions influence the pattern and prospects for development, particularly in terms of social change and economic decision making.

The biennial Regional Economic Report produced by the World Bank continues to provide analysis of the key issues facing Kiribati and other Pacific island member countries. The most recent Regional Economic report, produced in October 1998, focused on enhancing the role of government in Pacific Island Economies.

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<sup>1</sup>Prepared by World Bank staff.



### Kiribati: Relations with the Asian Development Bank<sup>1</sup>

The Asian Development Bank (AsDB) has approved six project loans to Kiribati amounting to US\$14 million, all from Special Fund resources. In addition, technical assistance amounting to US\$7.7 million has been provided for 30 projects. The first loan for Kiribati since 1990 was approved by the AsDB on December 18, 1998 for a Sanitation, Public Health, and Environment Improvement project. The loan for US\$10.2 million is expected to improve the development potential of Kiribati and the health and well being of its population through a sustained program of improvements in water supply, sewerage, solid waste disposal, and environment conservation. The loan is accompanied by two technical assistance grants, totaling US\$1.5 million, to assist the Public Utilities Board (PUB) in the implementation of its restructuring plan and the Ministry of Environment and Social Development (MESD) in carrying out community development and participation initiatives in water, sanitation, and environment conservation.

The AsDB's approach to Kiribati focuses primarily on public sector reforms, infrastructure improvements in Tarawa, and development of the outer islands. In the AsDB's view, the government needs to show a higher commitment to poverty reduction and to more fundamental public sector reform. The AsDB's strategy is to remain engaged in its dialogue for gradual structural changes toward a more efficient public sector and the opening up of the economy to the private sector. This is proposed to be achieved through the AsDB's technical assistance program for strengthening financial and economic management.

Kiribati: AsDB Loan Approvals and Disbursements, 1995–2000  
(In thousands of U.S. dollars)

	1995	1996	1997	1998	1999	2000
Loan approval	8	--	--	10,238	--	--
Loan disbursements	250	-60	--	--	--	1,038
Cumulative disbursements	3,825	3,765	3,765	3,765	3,765	4,803
Cumulative net loan amount	3,825	3,765	3,765	14,003	14,003	14,003
Net loan amount undisbursed	--	--	--	10,238	10,238	9,200
Cumulative principal repayments	105	134	180	227	261	317
Interest payments	36	45	34	32	33	41

Source: Data provided by the AsDB.

<sup>1</sup> Prepared by Asian Development Bank staff.



INTERNATIONAL MONETARY FUND

*Public Information Notice*

EXTERNAL  
RELATIONS  
DEPARTMENT

Public Information Notice (PIN) No. 01/96  
FOR IMMEDIATE RELEASE  
September 21, 2001

International Monetary Fund  
700 19<sup>th</sup> Street, NW  
Washington, D. C. 20431 USA

## **IMF Concludes 2001 Article IV Consultation with Kiribati**

On June 25, 2001, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Kiribati.<sup>1</sup>

### **Background**

Real GDP growth slid in 1999–2000, and real per capita income declined. Growth averaged ¼ percent per annum, well below the population growth of 2 percent. This outturn partly stemmed from adverse external shocks (for example, the onset of *La Niña*, which affected fishing; and a drought and lower world copra prices, both of which hurt the copra sector). Inflation remained subdued in 1999–2000, owing to the weakening of economic activity and the easing of supply problems.

The fiscal position weakened significantly in 1999–2000. Total revenue and grants dropped by 34 percentage points of GDP, owing to a fall in fishing license fees and external grants. Development expenditure declined in line with lower external assistance, but current expenditure rose slightly in both years because of increased support to public enterprises and copra producers, and higher spending on goods and services. The overall budget balance swung from a surplus of 19 percent of GDP in 1998 to a deficit of 7 percent of GDP in 2000. The government financed the deficits by drawing down deposits in the Consolidated, Development, and STABEX Funds.

The external position also deteriorated. The current account deficit (excluding official grants) increased, owing to a larger trade deficit and lower fishing license fees. The trade deficit

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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. 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. This PIN summarizes the views of the Executive Board as expressed during the June 25, 2001 Executive Board discussion based on the staff report.

worsened, due to weaker exports of fish and copra, coupled with increased imports occasioned by major construction projects. The overall surplus halved from \$A 33 million in 1998 to \$A 17 million in 2000.

Despite the external and fiscal deterioration, official international reserves remain comfortable. Kiribati's reserves, which are mainly held in the Revenue Equalization Reserve Fund (RERF), amounted to \$A 677 million at end-2000 (equivalent to seven years of imports or nine times GDP). Notwithstanding the fiscal deterioration, the government contributed \$A 5 million to the RERF in 1999 and has made no drawdowns since 1997. Public external debt remained low, and was on highly concessional terms.<sup>2</sup>

The depreciation of the Australian dollar—Kiribati's legal tender—since mid-1997 has improved external competitiveness. The real effective exchange rate (REER) in 2000 was 13 percent below the average for 1994–97. However, the major items in the balance of payments (fishing license fees, external grants, and investment income) are not sensitive to changes in price competitiveness.

The National Development Strategy for 2001–03, which was considered by the National Assembly in November 2000, focuses on the need to reduce the role of the public sector while encouraging private sector-driven growth. However, progress in implementing reform has been slow. Meanwhile, the government is set to expand its role in the economy through several new ventures, including an expansion of the operations of Air Kiribati and the state-owned fishing company; the setting-up of a copra mill; and the extension of telecom services to the outer islands.

### **Near-Term Outlook**

The near-term outlook is continued slow growth, low inflation, and a deterioration in the fiscal and external positions. Real GDP growth is projected to average 2 percent in 2001–02. The continuation of unfavorable fishing conditions is expected to be offset by increased government spending. With fishing activity projected to remain below the high levels of 1997–98, the current account is projected to worsen. Meanwhile, the budget deficit is expected to increase further, reflecting lower fishing fees and external grants, higher domestically financed development expenditure, and increased support to public enterprises and copra cutters.

### **Executive Board Assessment**

Executive Directors commended Kiribati's record of macroeconomic stability and its success in maintaining a substantial cushion of external reserves to counter shocks and safeguard the

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<sup>2</sup> No data are available on private sector external debt, but it is likely to be small, given the modest size of the private sector.

welfare of future generations. At the same time, Directors observed that unfavorable external conditions, fiscal slippages, and the lack of structural reforms since the end of 1998 have led to a weakening in the country's external and fiscal positions, which needs to be reversed. They considered that the main policy challenge was to achieve a sustained increase in the growth rate. However, Directors recognized that geographical remoteness and a narrow resource base pose significant challenges in this regard, and that the preservation of social cohesion must be a central concern in policymaking.

Against this backdrop, Directors welcomed the adoption in November 2000 of the *National Development Strategy for 2001–03* to encourage private sector activity, human resource development, and economic diversification.

Noting the prospective widening in the fiscal deficit in 2001, Directors regarded fiscal retrenchment as an urgent priority. They noted that fishing license fees and external grants are projected to decline in the medium term. Directors considered that, in order to maintain fiscal balance and preserve external assets, the authorities should curb spending, especially on wages, subsidies—including to copra producers—and lending to state-owned enterprises. They should also redirect outlays to education, health, and environmental protection. On the revenue side, Directors considered that the authorities should broaden the tax base. They welcomed the authorities' ongoing efforts to increase the accountability and transparency of fiscal management.

Directors commended the authorities' prudent management of the Revenue Equalization Reserve Fund (RERF), and urged them to continue to use the resources judiciously to ensure the RERF's long-term viability, and to frame their macroeconomic policies accordingly.

Directors emphasized that public enterprise reform and rationalization of the civil service are key to successful structural reform. Public enterprise reform should include improving management, promoting joint ventures, and privatizing enterprises to the extent possible. Civil service reform would help contain budget spending. They recognized the authorities' concern, however, to avoid undue hardship on personnel released from the public sector, primarily by ensuring the expansion of private sector activity, including through the provision of support for new commercial enterprises.

Noting that foreign direct investment is low, Directors recommended streamlining and making more transparent the relevant procedures, as well as reducing other barriers to investment. They welcomed the passage of new land legislation, which clarified land ownership rules in South Tarawa and promoted secure land transactions. Directors also urged the authorities to explore innovative solutions to ease the restrictions on foreign ownership of land in order to facilitate investment and credit growth. They particularly encouraged the authorities to explore ways to develop tourism and fishing.

Directors noted that the use of the Australian dollar as legal tender has served Kiribati well by providing a framework for macroeconomic discipline, low inflation, and a liberal exchange regime.

Directors noted that surveillance of Kiribati has been hampered by weak data and irregular reporting. They urged the authorities to provide more resources to the National Statistical Office and to supply a set of core data to the Fund on a regular basis.

It is expected that the next Article IV consultation with Kiribati will be held on the 24-month cycle.

**Public Information Notices (PINs)** are issued, (i) at the request of a member country, following the conclusion of the Article IV consultation for countries seeking to make known the views of the IMF to the public. This action is intended to strengthen IMF surveillance over the economic policies of member countries by increasing the transparency of the IMF's assessment of these policies; and (ii) following policy discussions in the Executive Board at the decision of the Board. The Staff Report for the 2001 Article IV Consultation with Kiribati is also available.

**Kiribati: Selected Economic Indicators**

	1996	1997	1998	1999 Est.	2000 Est.	2001 Proj.
(In millions of Australian dollars)						
<b>Output and prices</b>						
Nominal GDP	64.3	64.5	72.0	74.6	74.2	77.2
Nominal GNP 1/	93.0	119.1	142.4	137.8	141.0	136.9
Real GDP growth (percent change)	4.1	1.6	6.6	2.1	-1.7	1.5
Real GNP growth (percent change)	-5.1	29.8	14.2	-4.7	1.2	-5.3
Inflation (percent)	-1.5	2.2	4.7	0.4	1.0	2.5
(In percent of GDP)						
<b>Central government budget</b>						
Total revenue and grants	75.0	125.2	143.6	118.2	109.3	92.9
Total expenditure and net lending	110.6	118.9	125.0	123.1	115.9	122.3
Current expenditure	72.5	77.4	71.7	72.3	76.5	82.0
Development expenditure	38.2	41.5	53.3	50.1	34.4	35.1
Net lending	0.0	0.0	0.0	0.7	5.0	5.2
Budget balance	-35.6	6.4	18.6	-4.9	-6.6	-29.3
(In millions of Australian dollars)						
<b>Financial sector 2/</b>						
Net foreign assets	68.3	92.7	94.8	104.6	112.2	120.0
Domestic credit, net	9.7	10.5	10.2	8.0	10.6	10.0
<b>Balance of payments</b>						
Current account balance	-17.5	4.8	28.1	13.0	8.3	3.4
(In percent of GDP)	-27.1	7.5	39.0	17.4	11.2	4.4
Trade balance	-41.8	-44.1	-42.6	-49.2	-50.1	-53.9
Exports, f.o.b.	6.8	8.4	9.3	13.6	10.0	7.5
Imports, f.o.b.	48.6	52.5	51.9	62.8	60.1	61.4
Services, net	-25.5	-29.7	-28.3	-34.2	-32.5	-32.9
Income, net	31.9	57.6	73.3	71.1	74.9	67.6
Transfers, net	17.9	21.0	25.7	25.3	16.0	22.6
Overall balance	0.4	19.9	32.6	15.7	17.0	-1.6
Official external assets (end of period)	379.1	478.0	602.7	625.3	677.0	692.5
(In years of imports of goods and services)	4.7	5.5	7.0	6.0	6.8	6.8
<i>Of which:</i>						
Revenue Equalization Reserve Fund	371.8	458.8	570.1	601.4	658.0	692.5
<b>Memorandum items</b>						
Official external assets (in millions of U.S. dollars)	298.6	311.9	367.8	408.8	369.5	...
External debt (end of period)	12.6	12.4	12.3	14.2	14.2	14.7
U.S. dollar per Australian dollar (period average)	0.783	0.744	0.629	0.646	0.582	...
Nominal effective exchange rate 3/	97.7	97.4	87.2	88.3	83.5	...
Real effective exchange rate 3/	104.3	104.0	95.2	96.8	89.5	...

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

1/ GDP plus investment income, seamen's remittances, and fishing license fees.

2/ Comprises Bank of Kiribati, Development Bank of Kiribati, and Kiribati Provident Fund.

3/ Data from *Information Notice System*; 1990 = 100; period average.