

# The Kiribati economy— performance and prospects

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The economy of Kiribati has shown very slow growth since the country achieved independence in 1979, with real GDP per capita today being little different from its level twenty years ago. Performance has been affected by the size and inefficiency of the public sector, by the country's limited export base, and by the lack of a dynamic private sector presence. Nevertheless, conservative macroeconomic management and a significant level of external reserves have helped the Kiribati government to maintain fiscal and external balance over the years. There are some immediate problems posed by declining copra prices and uncertainties surrounding future fisheries returns, however, there are some hopeful signs for export growth, especially in tourism. The current National Development Strategy is consistent with a development path that is environmentally, socially and culturally sustainable, but it remains to be seen whether its good intentions can be translated into action.

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The 33 islands that comprise the Republic of Kiribati are scattered over a vast area of the Pacific Ocean, equal to about half the size of the Australian continent. The widely dispersed nature of its territory, together with the small size of its economy and its limited range of exportable commodities, have presented the government of Kiribati with difficult problems of economic management. At the same time, the political stability, social cohesion and cultural resilience of the I-Kiribati have made the task of formulating and implementing economic policy considerably easier than it might otherwise have been; over the period since independence in 1979, these characteristics have provided a sound foundation upon

which the present-day economic, social and cultural life of the country has been built.

Nevertheless the seriousness of the problems which have affected the Kiribati economy over recent years should not be underestimated. They have resulted in a situation in which some economic and social indicators remain relatively poor compared to regional standards, and they continue to give rise to uncertainties concerning the country's economic future. Kiribati also faces some very worrying environmental, health and urban management problems which will only be exacerbated by trends in the size, composition and location of the population that can be expected to occur over the next couple of decades.

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Here we review the performance of the Kiribati economy over the last 5–10 years and highlight some of the obstacles to economic growth which have been encountered over this period. The paper begins by outlining the structure of the economy of Kiribati, and goes on to consider recent trends in GDP, government revenue and expenditure, balance of payments, employment levels and other variables. We then discuss the national development strategies that have been pursued by the government in the recent past, and summarise the essential features of the current Medium Term Strategy covering the years 2000–2003. The paper concludes with a detailed assessment of five major issues of concern to the formulation of economic policy at the present time: public sector reform, expanding the private sector, export market development, human resource development and sustainability.

### Structure of the economy

The total land area of the Republic of Kiribati is only 810.5 square kilometres. It comprises 33 islands, mostly low-lying coral atolls, scattered throughout an exclusive economic zone (EEZ) of 3.5 million square kilometres which lies both north and south of the equator and just west of the International Date Line. The population is now just over 90,000 and GDP is just under A\$80 million. In terms of GDP per capita, Kiribati, at US\$702 per head in 1998, ranks lowest amongst the five least-developed Pacific island countries.<sup>1</sup>

The structure of the Kiribati economy reflects the country's narrow resource base and its heavy reliance on government activity. It is a striking fact that the services sector accounts for about three-quarters of GDP (World Bank 2000). Agriculture and fisheries contribute about 10 per cent of measured GDP, with copra, fishing and seaweed being the main sources of cash income.<sup>2</sup> The private sector comprises a relatively small proportion of the economy,

and industrial activity is negligible. The majority of the population relies on household production as their primary source of food and shelter.

The large subsistence sector means correspondingly that levels of formal employment are relatively low. Just less than 20 per cent of the adult population of working age are in paid employment; almost all of the remainder are engaged in village work. The 1995 census (the most recent for which published data are available) indicates that of the formally employed workforce in that year, 39 per cent worked for the central government, 26 per cent for public enterprises, and 12 per cent for island councils, giving an aggregate proportion of total employment accounted for by the public sector of 77 per cent. More recent estimates indicate little change in these proportions. Thus, the Kiribati economy is dominated by government activity and hence its economic performance and prospects are very heavily influenced by government decisions and actions.

Because of the small size of the cash economy in Kiribati, the proportion of government finance derived from taxation is low, at just over 20 per cent of revenue. The principal sources of non-tax revenues are royalties paid by countries fishing in the EEZ, and interest and dividends on the Revenue Equalisation Reserve Fund (RERF). This fund, which was established by the British colonial administration in 1956 on the basis of Banaban phosphate revenues, is held entirely offshore. Thanks to prudent management and favourable investment markets, it has grown steadily over the years. It has continued to provide a fiscal buffer in the framing of Kiribati budgetary policy, and has acted as a stabilising influence in helping the government to deal with internal and external variability. Essentially, fiscal policy in Kiribati has involved using domestic taxes and revenues to cover recurrent expenditure, with drawdowns from the RERF to cover shortfalls. The capital budget relies mainly on external assistance

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via multilateral agency loans and direct grants from donor countries.

In the external sector, Kiribati shows a deficit on merchandise and services trade, but this is offset by a positive balance on external income from factors of production and a net credit on current transfers. Thus in general the balance on external account has been satisfactory. However, export income is subject to considerable variability due to fluctuations in prices and volumes of copra and fisheries products from year to year. Again, prudent use of the RERF has continued to provide a buffer against these uncertainties in the external account.

Kiribati uses the Australian dollar as its currency. While this means that the government need not concern itself with monetary policy, it also means that the country's international competitiveness is not reflected in the exchange rate for its currency, and also that its domestic inflation rate is linked to that in Australia. The financial sector is rudimentary and, like the rest of the economic system, is dominated by government; the Bank of Kiribati is jointly owned by the Kiribati government and the Australian bank Westpac, and all other financial institutions, including the Development Bank, the Kiribati Provident Fund and the Kiribati Insurance Corporation, are wholly government-owned.

The government has invested heavily in public-sector commercial enterprises (PSCs). There are now 27 such businesses established in a variety of areas including export/import activities, housing, manufacturing, tourism, banking, transport, communications, public utilities and energy. Of these only the joint venture companies—The Bank of Kiribati and Telecom Service Kiribati Limited—have achieved a higher net return to the government than that earned by the RERF. The rest have performed poorly and, in addition, because they compete in markets where private firms might otherwise gain a foothold, they have tended to act as a deterrent to new investment in these markets.

A significant problem in the structure of the Kiribati economy is the inadequacy of its economic infrastructure. The dispersed geography presents very great difficulties for developing efficient domestic transport and communications facilities. Air and shipping services, especially to the remoter islands, tend to be unreliable and costly. In South Tarawa, basic services of water, sanitation and other infrastructure facilities are unable to meet the demands caused by increasing population pressure. These problems severely compromise the country's capacity to provide appropriate support services, for example for commercial enterprises seeking to establish themselves in Kiribati, thus affecting the attractiveness of this Pacific nation as a location for direct foreign investment.

Turning now to demographic characteristics, an overview of the Kiribati population can be gained by considering the results of the 1995 census (Demmke et al. 1998). The estimated population in that year was about 81,000, of whom more than 40 per cent lived in South Tarawa, where the density was as high as 1,800 people per square kilometre. Of the adult population of about 48,000, 84 per cent were economically active, but, as noted above, only 8,000 (fewer than 20 per cent) were employed in the cash economy. The age distribution reveals a very young age structure, with 41 per cent of the population being less than 15 years of age in 1995. At a population growth rate of 2.5 per cent per annum there would be a doubling of the population in 28 years, although the population growth rate in the period since 1995 has in fact been lower than this, at about 1.8 per cent per annum.

Any account of the structure of the Kiribati economy should recognise the cultural underpinnings of Kiribati society. The I-Kiribati have developed a cultural system which fosters independence and self-reliance while at the same time subordinating individual ambition to the collective needs of family and community. This culture of

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cooperation and sharing makes for effective use of the limited resources provided by the country's island environment. It also contributes to the workability of political processes and to a community relatively free of the sorts of social tensions that are common in other countries. This cultural and social cohesion facilitates the task of economic management in Kiribati.

In summary, the economy of Kiribati is characterised by a high level of government expenditure, a large public enterprise sector, a small formal private sector with limited competition and low levels of cash employment, but a substantially stable budgetary and external position. The small

size of the domestic market and the limited opportunities for export growth mean that diseconomies of scale are widespread, militating against the achievement of efficiency in agriculture, industry and the services sector.

## Recent trends

The growth performance of the Kiribati economy has been sluggish over the years since independence. Real GDP per head has fluctuated over this period without showing any consistent upward trend. During the 1990s, there was a period of accelerated growth, due primarily to expansionary

Table 1 Kiribati: GNP and GDP aggregates, 1995–2001

	1995	1996	1997	1998	1999 <sup>E</sup>	2000 <sup>E</sup>	2001 <sup>P</sup>
	(A\$ million)						
GNP at market prices	107.7	96.2	123.0	145.2	137.8	143.5	139.2
GDP at market prices	62.1	64.3	64.9	72.4	75.5	76.7	79.8
GDP at factor cost	52.4	54.4	54.7	60.4	..	..	..
Real GDP (at 1995 prices)	62.1	64.8	64.3	69.0	70.7	69.5	70.5
Real GDP growth (percentage change)	6.5	4.1	-0.8	7.3	2.5	-1.7	1.5
	(A\$ per head)						
GNP per capita <sup>a</sup>	1,343	1,178	1,480	1,717	1,600	1,637	1,563
GDP per capita <sup>a</sup>	775	788	781	856	877	875	894
Real GDP per capita (at 1995 prices)	775	790	766	803	805	776	771
Real GDP per capita growth (percentage change)	4.1	1.9	-3.1	4.8	0.2	-3.6	-0.6
GDP contribution by sector (per cent)							
Agriculture	5.0	5.6	3.6	5.1	4.9	..	..
Commerce and industry	24.3	22.0	24.9	23.2	25.5	..	..
Government	40.3	44.2	43.0	43.2	39.7	..	..
Marine resources	5.8	5.7	4.5	4.5	4.5	..	..
Transport and communications	16.9	14.8	14.7	13.5	13.5	..	..
Tourism	3.3	3.7	4.2	4.0	3.2	..	..
Utilities and construction	4.4	4.0	5.2	6.5	8.8	..	..
Total	100.0	100.0	100.0	100.0	100.0		

<sup>E</sup> estimated

<sup>P</sup> projected

<sup>a</sup> Calculated using population estimates revised following the 2000 census (see Table 5).

Source: Compiled from data supplied by the Government of Kiribati and from International Monetary Fund and Asian Development Bank estimates.

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government spending from 1994 to 1998. But from 1998 to 2000, a fall in fishing licence fees, a weakening copra price, lowered output of both copra and fisheries, and a decline in construction activity (following completion of several major projects including the new port in Betio and the new Parliament House), reduced growth in real GDP, such that between 1999 and 2000 real GDP per capita is estimated to have fallen by almost 4 per cent. Table 1 shows the trends in the main GDP aggregates in the period since 1995. Wide fluctuations in per capita GDP are apparent.

The dominance of government activity in the economy of Kiribati is indicated in the data on sectoral composition of GDP (Table 1). Some 40 per cent of GDP is accounted for by government ministries, with further public expenditures included under other sectoral classifications via the PSCEs which operate in almost all sectors of the economy. The sectoral proportions have fluctuated over the

period from 1995, but have shown no clear trend. Certainly there is no sign of any downward movement in the proportion of GDP accounted for by the public sector.

The overall structure of the Kiribati budget was noted above; trends in principal budget items from 1996 to the present are shown in Table 2. Tax receipts, which comprise roughly one third direct and two-thirds indirect taxes, have grown steadily in nominal terms over the period shown. Non-tax receipts, on the other hand, have fluctuated markedly, due particularly to variability in revenues from the sale of fishing licences, which peaked at around A\$40 million in 1998. Current outlays have risen in nominal terms in each of the years shown, but development expenditure has fallen away since 1998, reflecting a reduction in external assistance. The budget balance has moved from deficit to surplus and back again. The budget surplus reached a peak of A\$13.4

Table 2 Kiribati: budget summary, 1996–2001 (A\$ million)

	1996	1997	1998 <sup>E</sup>	1999 <sup>E</sup>	2000 <sup>E</sup>	2001 <sup>P</sup>
Revenue						
Tax	15.9	17.0	18.8	21.1	22.9	22.3
Non tax	11.9	38.6	50.4	37.6	38.6	31.3
External development grants	20.4	25.2	34.2	29.4	19.6	18.6
Total revenue and grants	48.2	80.8	103.4	88.1	81.1	72.2
Expenditure						
Current	46.6	49.9	51.6	53.9	56.8	63.3
Development	24.5	26.8	38.4	37.4	25.5	27.1
Net lending	-	-	-	0.5	3.7	4.0
Total expenditure and net lending	71.1	76.7	90.0	91.8	86.0	94.4
Balance						
Surplus/deficit	(22.9)	4.1	13.4	(3.7)	(4.9)	(22.2)
financed by						
RERF	13.6	8.0	-	(5.0)	-	2.5
Consolidated Fund	9.2	(12.4)	(14.1)	9.7	3.1	16.9
Other <sup>a</sup>	0.1	0.3	0.7	(1.0)	1.8	2.8

<sup>E</sup> Estimated

<sup>P</sup> Projected

<sup>a</sup> Including Development Fund, STABEX Fund and net external loans.

**Source:** Calculated from data supplied by Government of Kiribati and from IMF estimates and projections.

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million in 1998 (19 per cent of GDP), subsequently falling to a deficit of A\$4.9 million (6 per cent of GDP) in the year 2000 (Table 2). Despite these recent budget deficits, the government did not call upon a drawdown from the RERF in any of the years between 1997 and 2000, and indeed was able to add A\$5 million to the fund out of the 1999 Budget (as indicated in Table 2, a drawdown from the RERF may be made in 2001). The deficits have been financed through the Consolidated Fund (which essentially reflects earlier surpluses carried forward), and by other means.

A closer look at movements in the RERF between 1995 and 2000 is provided in Table 3. The Fund has been handled by two fund managers, augmented recently by a third. Its portfolio valuation measured in Australian dollars has increased rapidly in the last two years thanks particularly to the depreciation of the Australian currency. The government's policy in regard to the Fund has been to limit drawdowns so that the real capital value of the fund is not eroded, allowing the interest and dividend income to be used for budgetary stabilisation, especially in times of external pressure. At present the annual drawdown approved by Parliament is set at 15 per cent of GDP. In

fact, the actual annual drawdowns since 1989 have averaged only about 5 per cent of GDP and as noted earlier there were no withdrawals at all from the Fund between 1997 and 2000. Nevertheless, increasing uncertainties facing the formulation of fiscal policy in Kiribati suggest that the Fund is likely to be required to play a significant role in managing the budget in the future as it has at any time in the past, and therefore that a conservative approach to its management will continue to be appropriate.

On the external account, whilst exports have fluctuated in value because of variations in both volume and price, imports have continued to climb (Table 4). The current account balance improved through to 1999 thanks again to increasing fishing licence revenues, but has deteriorated in 2000 because of a decline in traditional fish exports, and a contraction in fishing fees and external grants. Copra continues as the country's single most important export commodity. The copra price to growers is subsidised by government, both to maintain returns when the world price is low and to equalise freight costs from the outer islands. Maintaining the subsidy has been difficult in the last year or so because of declining world prices; a continuation of the subsidy in future needs a careful review, on

Table 3 Kiribati: movements in Revenue Equalisation Reserve Fund, 1995–2000 (A\$ million)

	1995	1996	1997	1998	1999	2000
Opening valuation at 1 January	311.93	367.9	371.8	458.9	570.1	601.5
Deposits	-	-	-	-	5.0	-
Net income to Fund <sup>a</sup>	20.5	22.0	36.9	72.0	54.5	58.9
Drawdown	(3.5)	(5.6)	(8.0)	-	-	-
Apparent net portfolio gains/losses	39.0	(12.5)	58.2	39.2	(28.1)	(2.4)
Closing valuation at 31 December	367.9	371.8	458.9	570.1	601.5	658.0
Interest and dividend rate of return (per cent per annum)	4.0	4.5	4.6	4.4	3.6	4.0

<sup>a</sup> Includes interest, dividends, realised currency and capital gains and losses, and fund management expenses.

Source: Calculated from data supplied by Government of Kiribati.

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account both of its adverse incentive effects and of the likely phasing out of the STABEX fund in the future.<sup>3</sup>

The size of the employed workforce jumped almost 35 per cent over the two years from 1996 to 1998 (Table 5); this increase was due partly to the expansion of government

expenditure noted earlier which fed through particularly to the PSCEs, and partly to a rise in private sector employment. However, the proportion of employment accounted for by the private sector remains uncomfortably low.

Table 6 lists some social indicators which compare Kiribati with the averages

Table 4 Kiribati: external trade balance, 1995–2001 (A\$ million)

	1995	1996	1997	1998	1999 <sup>E</sup>	2000 <sup>E</sup>	2001 <sup>P</sup>
Merchandise trade							
Exports f.o.b.	10.4	6.9	8.4	9.4	12.1	10.0	7.5
Imports f.o.b.	(47.5)	(48.6)	(52.5)	(53.2)	(62.9)	(60.1)	(61.4)
Net services	(21.4)	(20.0)	(22.1)	(22.6)	(23.0)	..	..
Net factor income <sup>a</sup>	45.6	31.9	57.7	75.4	87.0	74.9	67.6
Net current transfers	9.7	8.8	9.3	12.4	14.0	..	..
Current account balance	(3.3)	(20.9)	0.8	21.5	27.2	..	..
Current account balance as per cent of GDP	-5.3	-32.6	1.2	29.7	36.0	..	..
Ratio of exports to imports	0.22	0.14	0.16	0.18	0.19	0.17	0.12

<sup>E</sup> estimated

<sup>P</sup> projected

<sup>a</sup> Including fishing licence revenue and net remittances.

Source: Calculated from data supplied by Government of Kiribati and from IMF estimates and projections.

Table 5 Kiribati: employment, 1995–99

	1995	1996	1997	1998	1999 <sup>P</sup>
Population <sup>a</sup>	80,169	81,612	83,081	84,577	86,099
Formal employment (no.)	6,795	6,462	8,152	8,663	8,592
Formal employment as proportion of total population (per cent)	8.5	7.9	9.8	10.2	10.0
working-age population (per cent)	16.4	14.7	18.2	18.9	18.3
Formal employment by sector (per cent)					
Civil service	53.6	71.0	59.4	54.5	55.1
Public enterprises	25.5	15.2	21.2	21.5	21.6
Private sector	20.9	13.8	19.5	24.0	23.3
Total	100.0	100.0	100.0	100.0	100.0

<sup>P</sup> provisional.

<sup>a</sup> Calculated on the basis of a revised estimate of the 1995–2000 population growth rate derived from the 2000 census.

Source: Data supplied by Government of Kiribati.

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Table 6 Selected social indicators: Kiribati and all Pacific countries, approximate annual averages, 1995–2000

	Kiribati	All Pacific countries <sup>a</sup>
Population growth rate (per cent per annum)	1.8	2.2
Population density (inhabitants per km <sup>2</sup> )	112	14
Urban population (per cent)	37	24
Average household size (no.)	6.5	..
Median age (years)	19.8	20.2
Crude birth rate (per '000 inhabitants)	33.1	32.5
Crude death rate (per '000 inhabitants)	8.4	9.3
Crude net migration rate (per '000 inhabitants)	-	-1.1
Total fertility rate (no.)	4.5	..
Infant mortality rate (per '000 live births)	62	..
Life expectancy at birth (years)	61.5	..

<sup>a</sup> Includes all the countries of Melanesia, Micronesia and Polynesia.

Source: Secretariat of the Pacific Community, 2000. *Oceania Population 2000*, Demography/Population Programme, Secretariat of the Pacific Community, Noumea.

taken across all Micronesian, Melanesian and Polynesian Pacific nations. Time series data on these indicators are difficult to obtain, so the best available data representative of the years between 1995 and 2000 are shown. Despite the crowding in South Tarawa, Kiribati has the lowest population density of all the Micronesian countries, and the second lowest degree of urbanisation.<sup>4</sup> Birth and death rates and other demographic indicators are broadly comparable with other countries of the region. Most of these indicators have shown significant improvement over the long term; for example, infant mortality has fallen from more than 100 per thousand live births in 1970 to under 60 today, whilst life expectancy has risen from 52 to 62 years over the same period (World Bank 2000). Nevertheless, problems with clean water supply, sanitation and waste-disposal, combined with relatively low public expenditure on health per head of population (just over A\$100 per head per annum in 1998), continue to affect adversely

the health and welfare of the I-Kiribati, and seriously constrain potential improvement in social indicators in the future.

### National Development Strategies

Processes for national development planning have been in place in Kiribati since independence. During the 1980s and 1990s, development plans were drawn up containing lists of projects and proposals for achieving national development targets.<sup>5</sup> This sort of old-style development planning gave way in the mid 1990s to a more strategic approach. The National Development Strategy of 1996, covering the period 1996–1999, was followed by the Medium Term Strategy for 1998–2000 prepared in 1997 (Kiribati, Ministry of Finance and Economic Planning 1996, 1997). These documents marked a departure from previous plans. They aimed to provide a policy framework within which objectives such as fostering private sector investment and promoting

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economic growth could be pursued. Attention was focused particularly on reducing the relative size of government to enable the private sector to expand, and on reform of public enterprises. Whilst these prescriptions had been put forward in earlier planning exercises (see, for example, Fairbairn 1992:37–8), the difference now was that a more flexible and more holistic approach was being adopted, with the government's role oriented towards providing social services and infrastructure, and establishing an enabling climate for new investment. Strategies to encourage business, to provide better water, sanitation, transport, communications and energy services, to promote human resource development, and to foster community and social life were spelt out.<sup>6</sup>

This same approach, as well as many of the policy proposals, are carried forward into the current National Development Strategy, prepared in 2000 and covering the period 2000–2003. In keeping with the current fashion, this document begins with a vision statement which paints a rosy picture of the hoped-for state of the economy in 2005.

By 2005 Kiribati will have achieved a significant increase in real per capita incomes, along with steady growth in employment. Within the region, Kiribati will be among the leading countries in gaining improvements in education, health, environmental protection and social indicators. Public sector reforms will have raised productivity of the civil service, together with customer service standards and managerial accountability. Through structural reform, Kiribati will have established an effective enabling environment to sustain the significant growth which it aims to achieve in private sector output and employment (Kiribati, Ministry of Finance and Economic Planning 2000:3).

The document spells out 'strategic outcomes' for the nearer term (2000–2003) which will create the 'enabling environment'

for the realisation of the vision. Presenting these outcomes is seen as important for mobilising public support and for providing a framework to guide the functions of the various government ministries. The strategic outcomes comprise

- a sound macroeconomic framework
- stronger linkages between public and private sectors
- private sector development and employment creation
- a more competitive and diversified export base
- an enhanced capacity for human resource development
- stronger international linkages.

To achieve these outcomes, the strategy envisages a continuation of a conservative fiscal policy and a number of structural reforms. The program for carrying forward reform of the public sector involves introduction of performance management and sectoral planning systems, and a restructuring of ministries and public enterprises, in an effort to improve the efficiency with which core government functions and broader publicly-provided outputs are delivered. Measures to streamline the country's underdeveloped financial sector are proposed, as a means towards increasing the flow of savings into domestic investment.

The strategy sees employment creation as one of the highest priority areas in the 2000–2003 period. It is acknowledged that sustainable jobs growth must come from expansion of the private sector; key initiatives in this respect are the creation of a positive investor-friendly business climate, and strengthening the participation of the private sector in planning and policy, together with a carry-forward of earlier (largely unsuccessful) efforts to commercialise further the PSCEs. In the latter respect, the removal of subsidies, loan guarantees and other concessions to these enterprises will be pursued, with the aim of creating a level playing field for all enterprises operating in Kiribati, whether government or

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privately owned. Tourism will be particularly targeted as a potential avenue for new investment.

In terms of infrastructure, the 2000–2003 strategy makes some modest proposals to improve transport and communications, including upgrading of the two airports which receive international traffic, improving the telephone system and corporatising the Post Office. More far-reaching proposals are put forward to improve the quality and availability of water supplies and to expand the coverage of the sewerage and sanitation system, especially in South Tarawa, although the strategy document does not spell out how these plans are to be realised.

Social infrastructure and services make up a significant component of the 2000–2003 strategy, in keeping with the government's strong commitment to improving the human resource development of the country. Action to be taken will include a full implementation of the junior secondary school program and a strengthening of teacher qualifications and skills, both carried forward from the 1996–1999 Medium Term Strategy. More generally the strategy document recognises the importance of improving educational quality as a key element in achieving better educational outcomes, and most of the educational initiatives proposed, including curriculum development and improved teacher training, are aimed in this direction. In health, priority strategies include improving the quality of medical services, increasing cost recovery, and continuing to strengthen linkages with community organisations to enhance the operation of the primary health care system.

It is clear that the most recent National Development Strategy represents a continuation of the essential elements of earlier strategies, especially the fundamental structural issues of public sector reform, private sector growth and human resources development, but repackaging them in the

light of shortcomings in achievement of earlier planning objectives. Next, we draw out what might be seen as the major issues facing the strategic development of economic policy in Kiribati over the forthcoming period, in the light of successes and failures in policymaking to date, and in a planning context where future uncertainties abound.

### The major issues

The continuing slow pace of economic growth in Kiribati and the relentless increase in the working-age population indicate that the problem of labour absorption will remain one of the most critical questions facing policymakers in Kiribati in the foreseeable future. The domestic economy simply does not have the capacity to absorb the numbers of workers potentially coming onto the labour market over the next few years. The limited size of the domestic market indicates that job creation and growth in real per capita incomes in Kiribati will have to come importantly from export development. Moreover, the relatively low level of domestic savings places a constraint on the local supply of investment funds, such that higher rates of economic growth are unlikely to be achievable without the participation of at least some level of foreign direct investment.

At the same time, whilst fostering material growth in Kiribati is an important objective, it must be seen in a wider perspective. It has to be noted that successive governments in Kiribati have not pursued elusive development goals, but have built on a household production system and a set of evolved cultural values which have supported the country over many centuries. As the Asian Development Bank has observed, several other countries in the region have tried to progress too rapidly, with adverse economic and social consequences. In Kiribati, on the other hand, a more prudent development path has been followed. Thus,

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the Bank concludes, a continuation of this 'modest approach to development should enable the country to avoid some of the more serious problems now facing its neighbours' (ADB 1998:4).

Nevertheless, however the balance of development objectives is struck, there are a number of critical considerations which arise in any assessment of the performance and prospects for the Kiribati economy. They can be grouped under the following five headings.

### Public sector reform

Reducing the size of the public sector and improving the efficiency of service delivery have been recurring themes in Kiribati government policy, with little progress made in achieving either. However there may be some cause for hope that current processes aimed at improving public sector management may yield some fruit, provided problems of performance reporting and monitoring of output agreements can be overcome.<sup>7</sup> Some fiscal reforms are also in prospect, with proposals to cut personal income tax and company taxes as a means of boosting the private sector. However, the stimulus effects of personal income tax cuts would be likely to be relatively small and would benefit only a small proportion of the population, whilst it would seem to make more sense, if it is thought that present corporate tax levels are too high, to provide specifically targeted tax incentives for the business sector rather than a general reduction in company tax.

The future of the PSCEs remains a thorny problem. As noted earlier, most have performed very poorly, and past efforts to improve their efficiency and competitiveness, whether by restructuring their Boards of Directors, changing managers, introducing new management systems, or by other means, have had little success. Yet wholesale privatisation is hardly the answer, not least because none of the unprofitable enterprises

is a particularly attractive proposition to a private investor. Aware of this problem, the government has adopted a policy of persisting with attempts to improve the PSCEs' performance before contemplating offering them for sale. However, an alternative and more pro-active approach might be for the government to offer a challenge to a potential private partner to come into a given PSCE as a joint venture with the government, with the specific task of bringing in the expertise necessary to turn the business around. Such an approach could attract, for example, a foreign company with access to the necessary skills which might be willing to take a limited position in such an enterprise, knowing that government backing and cooperation would be assured via a joint venture arrangement.

Overall, reform of the public sector is an issue that has to be handled with care. Simplistic calls for slashing the size of government are counterproductive, since there is as yet no capacity for the private sector to absorb the resulting redundancies, and the social consequences of too-rapid a downsizing of the public service would be likely to be serious. Yet a reduction in the relative size of the public sector is both desirable and feasible in the medium term and properly remains an objective of government, as a means to reduce the budgetary burden of the civil service wage bill and to improve efficiency. In the current National Development Strategy, the public sector reform objective is referred to as one of 'right-sizing' government, though judgments as to what constitutes 'right' differ both within government and beyond.<sup>8</sup>

### Expanding the private sector

The corollary to a strategy of limiting the growth of the public sector is the parallel strategy of allowing the private sector to expand. There are, not surprisingly, differing views within the government as to how much scope can or should be provided to private

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enterprise within the Kiribati economy, especially in taking over functions presently performed within the public sector. Suffice it to say that experience to date provides no confidence that government can go it alone, but that any shift in the public/private sector balance is likely to be gradual.

In regard to the expansion of small to medium-scale enterprise financed domestically, the role of the Development Bank of Kiribati in mobilising funds remains essential. Its loans are small, reflecting the small scale of the businesses involved, with an average loan size of A\$4,000–5,000. Its activities are complemented by those of the village banks, which are financed via a government project and which can lend up to A\$500 for any purpose. At present there is a gap between this maximum and the minimum of A\$2,000 which can be lent by the Development Bank. It would seem desirable for the village banks to grow (at least those which have been operating successfully) so that they can fill this gap over time.

The government recognises that more substantial private-sector investment will have to come from the inflow of foreign capital, and the current National Development Strategy seeks to smooth the way for encouraging foreign direct investment whilst maintaining an adequate level of scrutiny over proposed projects. Notwithstanding the small size of the Kiribati economy, there are a number of potentially attractive avenues for foreign investment which could be developed. It seems clear, however, that the biggest single deterrent to foreign investors in most sectors is likely to be inadequate infrastructure, particularly in regard to transport and communications, but also in energy, water supply, sewerage and drainage, waste disposal and other infrastructure services.

In regard to transport, a fundamental requirement is for a more reliable international air service for passengers and freight. Very few foreign companies could contemplate setting up in Kiribati while the present level

of uncertainty surrounds air transport in and out of the country. Solutions to this problem, for example via a sub-regional airline or a joint arrangement with a reliable international carrier, need to be urgently sought. The second transport requirement, for businesses dealing with the outer islands, is more adequate air and sea transport within the country itself. The enormous difficulties of providing such services has to be acknowledged; nevertheless better domestic transport provision remains an essential prerequisite for many potential foreign investment projects. Similar remarks can be made about international and domestic telecommunications, although in this area greater progress has been made to date.

Many potential foreign investment projects, whether set up as independent enterprises or as joint ventures with local participation, will wish to establish in the capital Tarawa. The present level of provision of basic services of water supply, sewerage and waste disposal is such as to act as a deterrent to the establishment of such businesses. It has to be recognised that improvement of these infrastructure services benefits not just the inhabitants of Tarawa but is likely to be a necessary prerequisite to the siting of new foreign businesses in the capital. Fortunately, some progress is being made in this area; most importantly, the ADB is financing a Sanitation, Public Health and Environment (SAPHE) project via a loan of A\$10.2 million approved in December 1998, and this project should lead to material improvements in hygiene, public sanitation and water conservation (ADB 2000). Nevertheless, much more will still be required if the 'investor-friendly' environment hoped for in the National Development Strategies is ever to be realised.

**Export market development**

Kiribati has only a very limited range of export commodities. In one respect this could be interpreted as a virtue because it concentrates attention on just a few

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opportunities and avoids the problem of spreading development too thinly. Be that as it may, the outlook for growth in the volume and value of Kiribati's exports is by no means as gloomy as might be suggested by the small range of exportable products available.

Turning first to agriculture, the future of copra exports remains uncertain. It may be that yields will be improved through the introduction of new varieties to replace aging tree stock, but future price trends are difficult to predict. It may also be that a locally-established copra mill could add value to the raw product prior to export, or that a coconut sawmilling industry using old and unproductive trees to produce timber for furniture and construction might be developed. Overall, however, despite the fundamental role that copra has played in the development of the economy and in the lives of the I-Kiribati, it seems unlikely that it will retain its pre-eminence in the export sector over the long term.

Seaweed, on the other hand, has proved a successful venture with considerable export potential. On the islands with lagoons people are committing to the production of seaweed, and the commercial prospects appear bright. New strains are being sought which will be suitable to the handful of islands that do not have lagoons, and must therefore grow the seaweed in the sea. One of the reasons for the success of the seaweed project is that it does not require much equipment—the seaweed grows on ropes placed under the water's surface, is harvested and laid out to dry in the sun, and can be stored in the sand. It is a good example of the use of appropriate technology to produce a marketable product in an ecologically sustainable way. There may also be scope in due course for some value adding via a local processing plant.

Turning to commercial fishing, we note that so far government investment in this industry has not been successful. It remains to be seen whether the recent merger of Te

Mautari Limited, which was set up in 1981 to develop the offshore tuna fishery, and the Outer Islands Fisheries Project, which supplies local markets, will improve matters. Private ventures, for example involving pet fish, sharkfin and *bêche-de-mer*, have fared better. There remains considerable untapped potential in the fisheries sector, especially when it is realised that a catch worth an estimated A\$800 million is taken each year by foreign vessels fishing in Kiribati waters.<sup>9</sup> There appears to be some interest in further development of commercial fishing activities aimed at the export market, but the government is cautious about making any large-scale investment in this area. Other marine resources with export potential include cultured pearls, at present the subject of a development project<sup>10</sup> which, if successful, could lead to the establishment of small-scale farms on certain islands, and could also attract foreign interest.

An industry with significant export potential is tourism, especially on Kiritimati in the Line Islands and also on Tarawa and some of the outer islands of the Gilberts. There has been some expansion in visitor accommodation and tourist facilities over the past few years, and visitor numbers grew by about 8 per cent per year between 1995 and 1999. However the total number of visitors remains very small (5,300 in 1999). The 2000–2003 strategy document recognises the substantial potential for tourism in Kiribati, especially in drawing visitors to Kiritimati from North America and elsewhere via Hawaii; realisation of this potential will require substantial investment and coordinated planning. Large-scale tourism projects will inevitably require foreign direct investment, which may need to be linked to government provision of specified infrastructure before they could become feasible. In addition there is scope for the development of small-scale, locally-provided services in parallel with the growth of a larger-scale tourism industry, for example in offering

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services such as boat hire, restaurants, shopping and so on; the Development Bank of Kiribati could have a role in financing such enterprises.

Tourism development in Kiribati is likely, at least in the first instance, to be of the low-volume high-yield variety, with a focus on eco-tourism and cultural tourism. To its credit the National Development Strategy recognises the threats that unrestrained tourism development can pose to environmental, social and cultural values; the government wishes to ensure that whatever tourism development occurs will do so according to strict guidelines, so that it does not affect the ecological or cultural integrity of the country. To translate this wish into reality will require careful planning; a tourism sector feasibility study could be a useful step in this direction.

Finally it might be noted that these tourism developments are most likely to occur in the east of the country, in the areas where Kiribati's most productive fishing grounds also happen to lie. There might thus be some complementarity between the tourism and fisheries industries, for example in the development of infrastructure. More generally, if the principal future locus of economic dynamism in Kiribati were to shift eastwards as the tourist and fishing industries grew, it may foreshadow a relocation of the administrative centre of the country in that direction.

### Human resource development

The government of Kiribati has always given very high priority to human resource development as an essential component of development strategies, no doubt reflecting a basic need felt across the whole community for improvements in access to education and health services. In regard to education, significant progress has been made.<sup>11</sup> Primary schooling is now universal, and the Junior Secondary Schools program, initiated in 1998, is now well on the way to achieving its aim of

universal access to basic secondary education for all I-Kiribati. The majority of the secondary schools in the country are operated by the churches, although government provides some teachers and other facilities to these schools as well as running the state schools. Some external assistance has been received for education: Australia and New Zealand have provided educational aid and the US Peace Corps is active in areas such as teacher training. But so far no loan projects in the education sector have been generated through the multilateral agencies.

Several significant problem areas can be highlighted in the further development of the education sector in Kiribati. First, there is a serious shortage of teachers, despite the efforts of the Kiribati Teachers College (which trains mainly primary-school teachers) and the University of the South Pacific Centre (which provides programs leading to degrees and whose graduates are therefore capable of teaching at secondary level). A second and related issue is the matter of educational quality. It is well established that one of the most significant constraints on educational development in less-developed countries is the quality of the educational services provided, measured in terms of the supply of properly trained teachers, appropriate curricula, adequate textbooks, teaching materials, and so on.<sup>12</sup> The National Development Strategy clearly recognises the urgent need to upgrade educational quality at all levels of the system in Kiribati, and accords it a strong priority in forward plans, although progress is inevitably likely to be slow.

A further problem concerns the progression of qualified students beyond Form 3, that is, beyond the junior secondary level. Because of shortages of places, a number of qualified students are unable to proceed to higher secondary study, with a resulting loss of potentially well-trained school-leavers capable of filling skill shortages in the workforce. Opportunities are forgone not only in the academic stream;

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there is a potential also to provide further vocational training for those completing Form 3. Such training could be particularly effective if it were linked to the areas of industry development mentioned earlier that are emerging as the principal avenues for the future growth of the Kiribati economy.

In the area of health, priority has been given to primary health care in recent years, with progress being made despite the difficulties of recruiting qualified medical staff. This priority is to be strengthened in the forthcoming period, with emphasis on preventive programs and reproductive health. Curative services will be maintained and rationalised. Whilst there may be some scope for limited cost recovery in the provision of medical services where no external public benefits are involved, the cost of health services will continue to have to be borne by government, and indeed there are strong arguments for continuing to allow free or almost free access to basic health care. Further, it should be recognised that infrastructure expenditure outside of the health budget, for example on water supply, sanitation and waste disposal, is likely to have a significant impact in improving the health status of the I-Kiribati.

**Sustainability**

In a sense, the idea of sustainable development brings together many of the issues discussed above.<sup>13</sup> Certainly a core element of sustainable development is improvement in material living standards. But the notion of sustainability widens the development paradigm to include a concern for such aspects as the distributional consequences of growth, the quality of life, and the broader social, environmental and cultural ramifications of the development process. The National Development Strategies for Kiribati have been aware of the significance of these elements in the framing of development policy, and the balance of development objectives which the country has pursued in the past and which

still guide policy formation reflects the broad scope of the government's thinking. Several significant issues deserve further attention.

First, the institutional structures and systems of governance which are an essential underpinning of a free and democratic society are well established in Kiribati (for an overview, see Macdonald 1996). The country's Constitution provides for effective political representation and public participation, and for transparency and accountability of government. It also protects human rights and the rule of law. Property rights, especially rights over land, are determined by legal principles and by customary usage. This is not to say, however, that all systems work smoothly. In particular, reference is often made to the fact that difficulties in the leasing of land or the transfer of title to land have been an important constraint on development projects in several parts of the country, and especially in the capital where pressure on land resources is acute. Further progress in removing these obstacles will be necessary in the present planning period if sustainable growth is to be achieved.

Turning to environmental aspects, we may divide the problems facing Kiribati into those shared in common with other countries, and those which are specific to Kiribati. Principal amongst the former is the threat posed by climate change. Hoegh-Guldberg et al. (2000) note that coral bleaching caused by warming of the Pacific Ocean is likely to have a number of adverse consequences for the region, including damage to fisheries, impacts on tourism, and increased coastal erosion. In addition, the effects of rising sea-levels on low-lying atolls such as those of Kiribati will, if realised, be disastrous. The major environmental problems facing the Kiribati government over which it can hope to exercise some control are those associated with increasing population pressure on South Tarawa. Solutions to these problems lie partly in implementing the sorts of infrastructure improvements discussed above, and partly in

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efforts to halt or reverse the population drift from the outer islands to the capital. The creation of more employment opportunities in the islands would greatly help in stemming the exodus. Island Councils could perhaps be more effective here, and in addition some of the newer commercial opportunities now opening up, such as seaweed production, can be expected in due course to generate productive work for remote communities. The Development Bank of Kiribati is also trying to encourage decentralised development through its lending policy, and around 56 per cent of the total value of its loans is now located on the outer islands. The completion of junior secondary schools serving every island should also help to reduce the urban drift over time.

Cultural development is increasingly being seen as an integral part of sustainable human development.<sup>14</sup> In the case of Kiribati, sustainability would imply maintenance of the essential cultural values of the I-Kiribati which have remained unchanged over many centuries. But, as Tisdell (2000:3) has noted, the 'communal ethic of Kiribati...is to some extent in conflict with the Western ethic promoting competition and the pursuance of self-interest'. There is no doubt that some development paths which Kiribati could follow would involve the rapid diffusion of values inimical to its traditional community-based system, and could therefore pose a threat to its social and cultural stability. Other paths can be envisaged, however, which seek to reap the fruits of development without compromising cultural integrity. The clear tenor of the National Development Strategies is that paths of the latter type are the only ones which will be contemplated.

## Conclusion

The economy of Kiribati faces some immediate problems caused by continued slow growth, a possible upturn in inflation and some deterioration in the fiscal position

and the external outlook. In these circumstances the maintenance of a sound macroeconomic framework is essential as a basis on which future improvements in growth performance can be built. The government's current National Development Strategy spells out its intention to work towards a balanced budget, a balance on external account, and relative price stability, in order to promote confidence amongst the international community—including donors and potential business investors—and to support the growth of a more vigorous private sector.

In this article we have pointed to some of the strengths and weaknesses in the country's economic framework. On the positive side, we have drawn attention to Kiribati's social and political stability, its record of responsible macroeconomic management, the healthy state of its reserves, and the existence of some potential for development of its export base. On the other hand we have also pointed to the continuing difficulty of containing growth in the public sector, the urgent need for effective reform of the PSCs, and the obstacles to new private investment projects, especially those posed by inadequacies in the country's infrastructure.

Nevertheless, despite the problems and uncertainties, the basic stability of the Kiribati economy and the determination of its government to embrace a sustainable development path provide some reassurance in any assessment of Kiribati's current outlook. Indeed, they give cause for longer-term optimism about the country's future. What remains to be seen in the nearer term is whether the good intentions of the present development strategy can be translated into purposeful action.

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## Notes

- <sup>1</sup> In ascending order of 1998 GDP per capita, these countries are Kiribati, Solomon Islands (US\$926), Samoa (US\$1,060), Tuvalu (US\$1,157) and Vanuatu (US\$1,231) (UNDP 1999).
- <sup>2</sup> This figure rises to more than 20 per cent if the imputed value of subsistence production is included, as appears to be the case in the data presented in World Bank (2000).
- <sup>3</sup> This fund was originally established to assist African, Caribbean and Pacific countries to stabilise their export earnings, particularly from trade in primary products with the European Union.
- <sup>4</sup> The average population density in Micronesia in 2000 was about 161 per square kilometre, with a level of urbanisation of 48 per cent (Secretariat of the Pacific Community 2000).
- <sup>5</sup> For some discussion of these plans, see Pollard (1987), Tabai (1987), Browne and Scott (1989), Fairbairn (1992).
- <sup>6</sup> For discussion of the 1996 National Development Strategy and the Medium Term Strategy of 1997, see Tito (1997), ADB (1998), ESCAP (2000), Tisdell (2000).
- <sup>7</sup> An AusAID project valued at A\$1.64 million over 1997–2000 has helped in this respect, through improvements in government budgeting systems and planning (see AusAID 2001:16).
- <sup>8</sup> Not surprisingly the IMF remains a vigorous advocate of reduction in the size of the public sector in Kiribati (IMF 1999), despite problems that have arisen in some other countries where hindsight suggests a policy of cutting public expenditure has been too rapidly implemented.
- <sup>9</sup> This estimate was made by officials in the Ministry of Natural Resources Development.
- <sup>10</sup> This project is being carried out under the auspices of the Australian Centre for International Agricultural Research (ACIAR).
- <sup>11</sup> The importance placed by the I-Kiribati on education is reflected in the high proportion (8.3 per cent) of the average household budget devoted to school-related expenditures on behalf of children (Kiribati, Statistics Office 1996). For an overview of the education

system in Kiribati, see National Office of Skills Recognition (1995).

- <sup>12</sup> For a discussion of these issues from a regional perspective, see Gannicott and Throsby (1992).
- <sup>13</sup> For an account of sustainable development strategies in a Pacific island context, see the essays collected in Overton and Scheyvens (1999).
- <sup>14</sup> For a discussion of the role of culture in sustainable development, see the report of the United Nations World Commission on Culture and Development (WCED 1995). For an account of I-Kiribati culture, see Bataua et al. (1985).

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### Acknowledgments

I am grateful to Helen Bowers, Hans Guldberg, Tiimi Kaiekieki, Betarim Rimon, Kietu Tabwebweiti, Tukabu Tauati, Tukabu Tereroko, Tekena Tiroa, Clem Tisdell and Teuea Toatu for discussions and for supplying me with material. None of these is responsible for the views expressed in this paper.