Kiribati

3

BACKGROUND

If the exclusive economic zone is included, Kiribati has the largest area among PDMCs at 3.5 million square kilometers; but its total land area is only 810 square kilometers. The population of almost 90,000 is heavily concentrated on South Tarawa, where the population density reaches 1,610 persons per square kilometer. Population growth is around 2.4 per cent per year, and unlike some other PDMCs, Kiribati does not have emigration as a safety valve.

A 1999 GDP of US$81 million places Kiribati amongst the smallest economies of the PDMCs. It is also one of the most remote and fragmented. Per capita GDP of around US$900 is one of the lowest of the PDMCs, although GNP is about twice as high as GDP because of the large inflows of investment income from trust funds, revenue from fishing licenses, and workers' remittances. Kiribati's social indicators are also among the lowest in the Pacific Islands. However there has been an increase in life expectancy from 51 years in the late 1970s to 57 years in 1985–90.

The majority of the population are employed in the subsistence sector, and redistribution mechanisms ensure that basic needs for food and shelter are met. Formal employment is dominated by the public sector. Religion continues to play a strong role in social and economic life: the southern islands are predominantly Protestant, while the northern are predominantly Roman Catholic. Religious organizations are heavily involved in education and community development.

Kiribati has been an independent republic since 1979. The President is elected for a four-year term (a maximum of three terms) and is both Head of the Government and Head of State. The President nominates ministers from among the members of the House of Assembly, which constitutes the legislature. The House comprises 39 elected members from 23 constituencies, with at least one member from each inhabited island, and is elected by universal adult suffrage for a four-year term.

Local governments consist of island councils. Councillors are elected by universal adult suffrage for a three-year term. However, island councils are often overshadowed by the power of the Unimane, or Councils of Elders. The judicial structure consists of a High Court, headed by a Chief Justice; Magistrate's Courts; and a Court of Appeal. There is a right of appeal to the Privy Council in London. Although the political system formally reflects Westminster traditions, traditional i-Kiribati values remain firmly embedded in it, with significant consequences for decision making in economic matters.

THE MACROECONOMIC ENVIRONMENT

Economic growth in the 1990s has been relatively rapid. After recording an average annual growth rate in the 1980s of 1.1 percent, real GDP grew at 4.3 percent per year in 1990–95; and at 4.3 percent in 1996. The growth dropped to 1 percent in 1997, before rebounding to 7.3 percent in 1998 because of a large construction project. A more modest rate of 2.3 percent was recorded in 1999 (Table 3.1). Real GDP contracted by an estimated 4 percent in 2000 (ADB 2001).

The acceleration in growth during the 1990s was driven by the public sector. Government services (in constant prices) grew at the average annual rate of 8 percent in 1990–96, and continued to expand during the next two years, before a contraction in 1999. The Government accounted for around 45 percent of monetary GDP (at factor cost) at the end of the period. Output in the small agriculture sector fluctuated markedly from year to year, as did that of the industry sector. Public enterprises continued to play a dominant role, collectively accounting for around 30 percent of GDP. The public sector therefore accounts for about three quarters of monetary GDP at factor cost, and, including island councils, it provides around the same percentage of paid employment.

There are 21 nonfinancial public sector enterprises in Kiribati, with several more planned; these result from the conversion of some Government activities. Seventeen public enterprises have been established as limited liability companies with their own share capital (generally wholly Government-owned), and with general managers reporting to their own boards of directors. However, the overwhelming presence of Government representatives on the boards makes Government policy the decisive factor, and this has prevented commercialization of the companies. There appears to be little understanding of commercial management in the public enterprise sector, and most enterprises continue to perform poorly. The low efficiency of public enterprises, the poor quality of their output, and the Government support squeeze out competing private enterprises. Only two enterprises, operated jointly with the private sector, have achieved reasonable returns on equity, but the cost of their services is high, as they face no competition.

The Government maintained a relatively aggressive fiscal policy stance through much of the 1990s (Table 3.1). The Revenue Equalization Reserve Fund (RERF), which provides overseas investment income equal to about one third of GDP, underwrote recurrent expenditure without jeopardizing the real value of the Fund.[11] The latter increased substantially in 1995–1996 as a result of a large public sector wage rise, increased spending on social services and transport and communication, and higher subsidies to ailing public enterprises. Domestic revenue fluctuated widely due to variations in fishing license fees, and reached an all-time high in 1998. Capital expenditure remained mostly donor funded, and in 1997 was more than three times the historically low 1994 level. The overall balance was in deficit in every year except 1997 and 1998. These deficits were financed by concessional loans and accumulated balances

[11] The RERF reached AUD$570.1 million by the end of 1999.

Table 3.1

Macroeconomic Indicators for Kiribati, 1994–1999

	1994	1995	1996	1997	1998	1999 (est.)
Output and inflation			(in percent)			
Real GDP growth	7.2	3.5	4.3	1.0	7.3	2.3
Change in CPI (end period)	3.9	4.1	-1.5	2.2	4.7	0.4
Central Government Finance	(percent of GDP market prices inc. non-monetary)					
Revenue	60.1	65.8	43.2	84.6	96.5	78.2
External Grants	30.8	27.7	31.7	39.2	47.2	39.1
Current Expenditure	58.6	71.9	77.2	79.6	71.9	84.6
o/w wages	22.4	28.5	30.9	31.3	27.8	32.3
Development Expenditure	33.9	31.9	38.2	39.2	47.2	39.1
Overall Balance (excl. RERF drawdown)	-1.5	-10.2	-40.5	5.1	24.6	-6.4
Money and Credit			(annual percent change)			
Net foreign assets	16.4	24.1	-33.8	14.7	13.7	4.2
Total domestic credit	5.9	-0.3	-1.6	-10.7	-1.7	0.5
Private sector credit	-0.7	1.0	-0.9	5.4	-2.3	-1.3
Broad money	10.1	-0.9	11.7	-3.1	11.1	5.1
Balance of Payments (AUD$m)						
Merchandise Exports	7.1	10.0	6.8	8.4	9.4	12.1
Merchandise Imports	36.1	47.5	48.6	52.5	53.2	62.9
Factor Income (Credit)	41.6	47.4	33.6	58.7	76.9	—
Current Account	1.6	-3.3	-20.9	0.8	21.5	14.2
(In percent of GDP)	2.8	-5.8	-32.0	5.2	34.0	18.8
Official Transfers to Government	3.5	7.3	6.4	7.0	10.4	—
Overall Balance	-1.7	-5.7	-25.3	-3.1	10.3	—
Errors and Omissions	24.1	18.9	13.3	20.5	39.5	—
Overall Balance	22.5	13.2	-12.0	17.4	49.7	—
Gross Reserves	332.4	375.7	375.0	462.5	596.8	617.6
(in years of imports of goods and services)	5.4	5.1	5.0	5.8	7.4	10.6
External public debt (AUD$m)		9.3	12.7	12.9	13.2	13.9
(In percent of GDP)	17.2	20.7	19.5	21.5	19.2	19.7

— Not available

Sources: Government of Kiribati 1999; ADB 2001 in the Consolidated Fund. There was no Government borrowing from the domestic banking system.

The trade balance was in substantial deficit throughout the 1990s, while the current account moved from deficit to surplus largely according to fluctuations in fishing license fees. Gross official reserves, which include RERF, were sufficient for around 10 years of imports; and external debt remained under 22 percent of GDP.

Use of the Australian dollar (AUD$) as legal tender closely links the inflation rate, international competitiveness, and the small financial system to Australian economic developments. The inflation rate was under 5 percent during the 1990s, ranging from –1.5 percent in 1996 to a high of 4.7 percent in 1998. International competitiveness improved with the depreciation of the Australian dollar from 1996. Growth in the broad money supply was erratic in the 1990s, in line with substantial fluctuations in net foreign assets. Domestic credit growth was negative in most years, including credit to the small private sector. Only about one dollar in eight of deposits with the sole commercial bank is lent domestically.

The *Medium Term Strategy* adopted by Government late in 1997 (Republic of Kiribati 1997) identified three key macroeconomic issues. The first was near-static GDP per capita since 1979. The second was finding employment for the growing workforce. The third was the Government's ability to sustain the growth in public services. Five strategies for addressing these issues were proposed:

(i) reduction in the relative size of core Government,
(ii) public enterprise reform,
(iii) facilitation of private sector development,
(iv) encouraging foreign investment, and
(v) ensuring consistency between sectoral and national policies.

In 2000, the basic issues remained, and Government had reaffirmed the relevance of the strategic responses in its *National Development Strategy for 2000–2003* (Republic of Kiribati 2000). The strategy gives priority to increasing the utilization of domestic savings for private investment. The challenge is to accelerate implementation of the various strategies.

THE STRUCTURE OF THE FINANCIAL SECTOR AND INSTITUTIONS

The formal financial system of Kiribati consists of one commercial bank—the Bank of Kiribati (BOK)—the Development Bank of Kiribati (DBK), the Kiribati Provident Fund (KPF), the Kiribati Insurance Corporation, and a national housing authority. There is also a large number of village banks that can be regarded as belonging to the semiformal financial sector (see below). With the exception of BOK, all financial institutions are wholly Government-owned corporations. Kiribati uses the Australian dollar as its currency, which has helped to enforce macroeconomic discipline; it has also eliminated the need for a central bank to conduct monetary and exchange rate policy. There is thus no money market, and interest rates in Australia are used as reference rates. The Government allows free movement of funds into and out of the country.

Total assets of the major financial institutions amounted to AUD$111.4 million in 1999. However most of these assets (around 90 percent) are invested offshore because of the lack of bankable projects. Only 7 percent of the assets of BOK are lent to the domestic market. Almost all KPF and KIC funds are invested and managed offshore.

As the largest financial institution, KPF held 54 percent of total assets of the formal financial system in 1999. KPF was set up under its own Act of Parliament, which does not allow for any lending to local businesses. It has a board consisting of two representatives of the public service, two representatives of employers, and two representatives of employees. Contributions to the fund consist of 6 percent of employed individuals' salaries and an equal amount from employers. Although KPF is responsible to the Minister of Finance, there is no Government interference in the use of funds, which returned an average 12 percent per year during the 1990s.

The second largest financial institution, BOK, held almost 42 percent of total assets in 1999. It was set up under its own Act of Parliament in August 1994, and was a joint venture between the Government of Kiribati (49 percent) and the Westpac Banking Corporation (Westpac) (51 percent), with Westpac providing the management—until September 2000, when Westpac gave one year's notice of its intention to withdraw from Kiribati. At the time of writing, the Government was in negotiation with ANZ to form a new joint venture. Majority foreign ownership of BOK means that it cannot accept land as security for loans.

BOK maintains its head office and two branches on Tarawa, and has one branch on Christmas Island and 23 private agencies distributed over the inhabited islands. There is one branch or agency for every 3,248 people. The private agencies are run by Island treasurers, who handle deposits and withdrawals, but do not lend. Most agencies do not have telephone communication and use radio, ship and mail, so that it is difficult for them to obtain up-to-date information.

DBK was set up in 1987 under the Development Bank of Kiribati Act 1986 as a public service bank. In 1999 it accounted for just under 5 percent of total assets of the financial system.

KIC was established in 1981 and provides life endowment policies and general insurance. Ninety-five percent of the insurance risk is reinsured offshore; almost all income is deposited with BOK.

The National Housing Corporation (NHC) is a statutory body established in 1979 and wholly owned by the Government. Its main role is to administer Government housing for civil servants.

PERFORMANCE OF THE COMMERCIAL BANK

The outstanding features of the Kiribati money supply include the very low level of domestic credit creation, negative claims on Government (net), and the dominance of the level of foreign reserves in determining the money supply.

BOK offers checking accounts, overdraft facilities, term loans, and housing loans. It accepts deposits, exchanges foreign currency, and arranges letters of credit and fund transfers. Most of BOK lending is for consumer loans. These are short-term, high-interest loans that are used to finance social obligations and consumer durables, such as video machines, motor vehicles, and outboard motors. Until 1995, BOK had a statutory monopoly over foreign exchange dealings and commercial banking services in Kiribati.

Interest rates on deposits declined considerably over the 1990s, and were generally zero or negative in real terms (Table 3.2). These low rates result from the monopoly position of BOK and compensate for zero charges on current accounts (of which there are 45,000, with average balances below AUD$100). Lending rates remained unchanged throughout the 1990s, so that the interest spread rose to 8.5 percent. Lending rates for DBK are 12 percent (charged on the balance of the loan). However, DBK does not factor risk into loan pricing on a formal basis.

The financial system is largely unregulated, with most of the controls on activity imposed by the boards of the various institutions. Although this does not appear to be causing any undue difficulty in the management of the financial sector, it does make licensing of new institutions difficult. Moreover, because there is no supervisory authority in Kiribati, there are no published data, or monitoring of risk-weighted ratios, for

Table 3.2

Nominal and Real Returns on Savings and Lending

	Weighted Average Deposit	Average Lending Rates	Nominal Interest Spread	Inflation Rate	Real Savings Rates	Real Lending Rates	Rates in Deposit Rate	Australia Treasury Bill Rates
	(annual percent change)							
1993	3.2	9.7	6.4	5.7	-2.5	4.0	4.76	5.00
1994	4.4	9.7	5.3	3.9	0.5	5.8	5.05	5.69
1995	3.8	9.7	5.9	4.0	-0.2	5.7	7.33	7.63
1996	3.2	9.7	6.4	-2.2	5.4	11.9	6.86	7.02
1997	1.8	9.7	7.9	2.2	-0.4	7.5	5.12	5.29
1998	1.6	9.7	8.1	4.7	-3.1	5.0	4.67	4.84
1999 [a]	1.2	9.7	8.5	2.0	-0.8	7.7	4.72	4.87

a. For 1999, average deposit rates are based only on savings rates.
Source: Government of Kiribati 1999.

financial institutions. It is therefore hard to assess the financial positions of BOK and DBK. DBK in particular has had a large number of nonperforming loans over the years; these are currently being written off the balance sheet, and will be reflected in the future asset position of DBK.

FINANCIAL DEEPENING AND INTERMEDIATION

The demand deposit/GDP ratio increased from 9.6 percent in 1994 to 12.4 percent in 1999, reflecting the growth in accounts below AUD$100 (Table 3.3). The ratio of broad money to GDP declined from 59 to 52 percent during the period, as the demand for savings and time deposits dropped. In consequence, the ratio of narrow money to broad money increased from 17.6 percent in 1994 to 27 percent in 1999. This preference for cash and demand deposits over time deposits reflects the falling nominal deposit rates and the negative real rates on savings, combined with the lack of charges for demand deposits. The preference for demand deposits can also be seen by looking at the relative importance of quasi money to broad money, which has fallen from 82.4 percent in 1994 to 72.7 percent in 1999. Currency in circulation also increased substantially.

COMPETITION

With only one commercial bank, there is virtually no competition in the banking system. KPF and DBK provide very little competition for BOK. Neither KPF nor DBK takes deposits, and DBK is undercapitalized, which limits its ability to lend. DBK has made small loans to existing businesses, which can be secured by a mortgage or guarantee from a Government employee. Two semiformal institutions provide microfinance: credit unions and village banks. In addition, the lack of a money or bond market means that there are few alternative instruments for small savers apart from BOK.

Table 3.3
Monetary Survey and Financial Deepening Statistics, 1994–1999

	1994	1995	1996	1997	1998	1999 (est.)
	(in millions of Australian dollars)					
Money Supply (M3)	31.9	31.7	35.4	31.5	36.9	38.8
Narrow Money (M1)	5.6	7.9	9.9	9.9	9.3	10.6
Currency outside banks	0.4	0.6	0.8	0.8	0.9	1.3
Demand Deposits	5.2	7.3	9.1	9.1	8.4	9.3
Quasi Money	26.3	23.8	25.5	21.6	27.6	28.2
Savings Deposits	7.4	8.6	9.0	8.2	9.7	9.7
Time Deposits	18.9	15.2	16.5	13.4	17.9	18.5
	(in percent)					
Growth of Demand Deposits		40.4	24.7	0.0	-7.7	10.7
Growth of Time Deposits		-19.6	8.6	-18.8	33.6	3.4
	(in percent of GDP)					
Currency in percent of GDP	0.7	1.0	1.3	1.2	1.2	1.7
Demand Deposits in % of GDP	9.6	11.8	14.4	14.0	11.6	12.4
Time Deposits as % of GDP	34.9	24.5	26.0	20.6	24.7	24.6
Narrow Money in percent of GDP	10.3	12.7	15.6	15.2	12.8	14.1
Broad Money in percent of GDP	58.9	51.0	55.8	48.5	50.9	51.7
	(in percent)					
Private Sector Credit (percent of GDP)	4.6	4.5	3.9	6.8	4.7	
Private Sector Credit (percent of total credit)	55.6	63.6	64.1	-28.4	-59.6	
Currency (per cent of broad money)	1.3	1.9	2.3	2.5	2.4	3.4
Narrow Money (percent of broad money)	17.6	24.9	28.0	31.4	25.2	27.3
Quasi Money (percent of broad money)	82.4	75.1	72.0	68.6	74.8	72.7
Demand Deposits (% of narrow money)	92.9	92.4	91.9	91.9	90.3	87.7
Total Domestic Credit/ Banking Assets	12.5	11.6	9.8	-36.9	-12.8	

Sources: Government of Kiribati 1999.

NONBANK FINANCIAL INSTITUTIONS

Development Bank of Kiribati

DBK operates autonomously under its own board, which consists of five members from the public sector and one from the private sector appointed by the Minister of Finance. The Secretary of Finance is the board chairman. DBK's mandate is to provide efficient, customer-focused financial and advisory services using sound banking and management principles; to assist with the development of private sector business; and to improve the living standards of the people of Kiribati.

Although its portfolio has grown at an average 17 percent per year from 1989 to 1998, DBK remains relatively small, with assets of just over AUD$5 million as at 31 December 1999. Funding has come predominantly from ADB and the Government, which has provided annual cash/capital injections, including AUD$2.25 million injected over the past three years, to assist with accelerated business development and the divestment of nonbanking assets. Profitability has been marginal, even including the Government grants (Table 3.4). From 1987 to 1997, DBK incurred large losses, which were accumulated in the balance sheet. It is now severely undercapitalized. DBK's provisioning policy for bad loans is set by its board. International standards are used as a benchmark. Total loans as at December 31, 1998 stood at AUD$3.0 million and the total arrears at that date were 8.75 percent, of which 47 percent were more than 12 months old. In the normal course of events, these would be considered noncollectible.

Government influence on lending has been considerable in the past, particularly in terms of lending to Island councils to aid their development. Most of DBK's lending has been to the service sector and to fishing, although in 1999 there was a substantial increase in lending for fish-processing projects. Since 1997, DBK has strengthened its management in an attempt to improve its performance. It is writing off its nonperforming loans by requesting the Government to buy back the outstanding loans of its publicly owned enterprises, through conversion of loans into equity. In view of the past accumulation of nonperforming loans, prudential guidelines do not appear to be set at international standards.

Table 3.4

Operating Performance and Statistics of Development Bank of Kiribati, 1995–1999

	Actual 1996	Actual 1997	Actual 1998	Forecast 1999
Total Income (AUD$'000)	311	684 [a]	491	596
Total Expenses (AUD$'000)	437	511	637 [b]	622
Net Profit / (Loss) Before Tax (AUD$'000)	(126)	173	(146)	(26)
Total Assets (AUD$'000)	4,104	4,025	4,432	5,082
Share Capital (AUD$'000)	1,600	2,948	3,448	4,121
Shareholders Funds (AUD$'000)	2,448	2,655	3,020	3,683
Provisions for Loan Losses (AUD$'000)	—	43	123	64
Interest Spread (%)	8.4	7.4	8.5	9.1
Earnings Spread (%)				
Loan-related Expenses to Total Expenses (%)	15.3	16.8	13.6	13.8
Staff Expenses to Total Expenses (%)	60.1	46.9	40.5	43.5
Admin. Expenses to Total Expenses (%)	27.9	27.7	24.4	24.1
Shareholders funds/total assets (%)	59.6	65.9	68.1	73.2
Profit / Loss to Av. Shareholders Funds	–5.1	6.5	–4.8	–0.7

— Not available.
a. includes prior period Government revenue grant.
b. includes additional provisions re prior years.
Source: DBK 2000.

Portfolio growth projections of around AUD$2.0 million per year may be achievable, but DBK will need to be wary of growing too quickly and incurring increasing levels of nonperforming loans as a result, especially since DBK does not formally factor risk into its loan pricing (interest is a delicate subject in Kiribati). The major funding for future growth is expected to come from a credit line from the European Investment Bank (EIB). An ongoing New Zealand Overseas Development Assistance (NZODA) program for institutional strengthening and capacity building in DBK is expected to continue for a further two years.

Kiribati Provident Fund

KPF is a statutory corporation. The power to make policy decisions is in the hands of its board, which acts as the trustee for KPF and sets investment guidelines. Under its act, KPF cannot lend to local businesses. The only instruments for investment are offshore stocks and bonds and local buildings. Westpac Investment Management Diversified manages almost 90 percent of the offshore investments, which are 50 percent in bonds and 50 percent in stocks. While leverage is left to fund managers, they must get approval from the board. KPF also owns a commercial building in Bairiki, which is rented to shop owners and has a return of around 13.5 percent per year.

As noted above, returns on KPF investments have averaged 12 percent over the 1990s. Interest is paid to members at the end of the year. KPF will guarantee a loan for land or building for members and will pledge 70 percent of members' KPF holdings as collateral. If a member defaults, the lender will send a claim to KPF for payoff. KPF cannot lend for mortgages directly.

Withdrawal of funds can be made when a member attains the preretirement age of 45, or has to resign from work and does not take alternative employment; reaches the retirement age of 50 years; intends to emigrate without intention of returning; or dies. A lump sum is paid on withdrawal and the employee receives the amount paid in plus accumulated interest. Members are allowed a maximum of three payments. KPL does not pay an annuity, although plans for this are in preparation. Once a member withdraws, he or she can invest the funds in the private sector. The current trend by employees is to opt out of the Government and run businesses, such as truck hire or local stores.

Kiribati Insurance Corporation

Kiribati Insurance Corporation has a monopoly on life and general insurance, and has generated low returns for policyholders. Policy bonuses have been only around 1 percent per year.

National Housing Corporation

The National Housing Corporation (NHC) controls more than one third of the housing stock on South Tarawa. Houses are let at concessional rents to civil servants, and there is little incentive for the private sector to compete. Given the need for additional housing, private sector involvement should be encouraged, perhaps through privatization of NHC and provision of rent allowances to civil servants (ADB 1998).

The Revenue Equalization Reserve Fund

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 people of Kiribati, in order to provide funds for budgetary support and economic development. At independence in 1979, the RERF was valued at AUD$69 million. As the end of 1999, its value had reached AUD$570.1 million.

The RERF is administered by the RERF Committee, which consists of the Minister of Finance (chairman) and five other senior officials. The committee is required to file quarterly and annual operations reports with Parliament, whose approval is necessary for all drawdowns. The Committee is empowered to appoint fund managers; make decisions concerning the auditing and performance review of the funds; and set broad operational guidelines for investment, including currency composition, asset structure, and risk management. The RERF is managed by a custodian company and is well diversified, with around 50 percent of its holdings in US and Australian dollars, and the remainder in a number of currencies. Fifty percent of the portfolio is held in stocks and 50 percent in bonds.

LEGAL AND REGULATORY FRAMEWORK AND SUPERVISION

There is no Financial Institutions Act in Kiribati to define entry and exit standards. Each of the three financial institutions in Kiribati is set up under its own Act of Parliament, which contains prudential aspects. Although there are three major financial institutions (BOK, KDB and KPF), there is no supervisory authority.

DEVELOPMENT OF MONEY, BOND, AND CAPITAL MARKETS

With the Australian dollar as its currency, Kiribati has no independent monetary policy. There are no Government bills or bonds. Since there is only one commercial bank operating, there is no interbank payment system. There are no capital markets in Kiribati. Steps to corporatize and privatize State enterprises are being taken, but the pace is very slow, and it will be a long time before the Government moves to privatization that might include issuing general shares to the public. There is no domestic stock exchange: most businesses other than very small-scale operations are owned by the Government. The small businesses obtain their funds from internal sources and from the extended family.

MICROFINANCE

There is a growing need for microfinance services in Kiribati. While household production can continue to sustain a basic livelihood, there are population pressures on land and limited opportunities to earn cash incomes from formal employment. These limitations are especially severe in the outer islands: the 1996 household income and expenditure (Statistics Office 1996) revealed that incomes in South Tarawa were AUD$268 per fortnight; in Butariki and Onotoa, they were AUD$93 and AUD$10 per fortnight, respectively.

Given the limits to public service expansion and the small private sector, which accounted for only 9 percent of total paid employment in 1995, i-Kiribati have looked for work overseas or engaged in self-employment activities. With Nauru phosphate mining operations coming to a close and with increasing competition in the international market for seamen, greater emphasis must be placed on employment in the informal sector.

It was estimated in the 1990 Census that 3,227 people were engaged in informal sector cash-earning activities. The reported activities include street vendors or hawkers, copra cutters, commercial fishermen, bakers, pastry cooks, sour toddy sellers, other food sellers, and local cigarette sellers (Table 3.5). In 1990, 21,400 people were engaged in informal employment activities if village workers and intermittent sellers are included, while

11,200 were working in the formal employment sector (UNDP 1997). These figures show that there are a substantial number of people engaged in informal sector activities. Men and women were both involved but the ratio was 3 to 1 in favor of men. It is likely that there are more women now participating in informal sector activities, as manifested by the growing number of women sellers at the Bairiki flea market, and the increasing participation of women handicraft sellers at the two handicraft outlets run by the Catholic and Protestant churches. Microfinance can play an important role in supporting further informal sector growth.

Table 3.5

Informal Cash Workers

Activity	Male	Female	Total
1. Street vendors (hawkers)	4	17	21
2. Tree workers (copra cutters)	1,401	235	1,636
3. Commercial fishermen	898	44	942
4. Bakers, pastry cooks	22	210	232
5. Sour toddy sellers	120	9	129
6. Other food sellers	14	28	42
7. Local cigarette sellers	20	205	225
Total	2,479	748	3,227

Source: Adapted from Ministry of Environment and Social Development 1997.

To reduce overcrowding in South Tarawa, the Government plans to implement a resettlement scheme on selected islands, to create income- and employment-generating activities in the outer islands, and to ensure an equitable distribution of service delivery to the outer islands. Microfinance could assist in effective implementation of these strategies. However, it should be coupled with other support services such as business training, marketing, and extension services.

BOK and DBK operate a network of branches and agents to serve people in rural areas (Table 3.6). Despite their wide outreach, BOK services are available mainly to people who have regular sources of income, and both BOK'S and DBK's services to those who have sufficient assets to satisfy the security and equity requirements. DBK's minimum loan of AUD$1,000 is beyond the needs and absorptive capacity of microentrepreneurs, especially of first-time borrowers. Though DBK can lend below the stipulated minimum, this flexibility is rarely exercised: of the total 461 loans extended in 1995 and 1996, it is estimated that only 27, or 6 percent, of the loans released were below AUD$1,000 (Ministry of Environment and Social Development 1997). The financial services offered by the banks are likewise limited. DBK offers only credit services, while BOK offers both credit and savings; but BOK agents (the island councils) can only handle savings and withdrawal transactions; they cannot extend loans, though they may accept loan applications.

Despite the efforts of DBK and BOK to make their services available to all i-Kiribati, it is likely that the majority of the people who are not working and who have limited assets will have difficulty in accessing banking services from the two formal financial institutions. This underscores the need for a microfinance scheme that will accommodate the special financial needs of those who usually fall outside the ambit of formal financial services.

The current providers of microfinance services can be categorized as informal and semiformal. In the informal category is borrowing from friends and relatives and from small-scale

Table 3.6

Banking Sector Outreach

Bank Name	Location of Head Office	Branches	Agents
1. Bank of Kiribati (BOK)	Bairiki (full range of services)	Three: Betio, Bikenibeu & Christmas Island (full range of services)	23 Island Councils (Savings services only and acceptance of loan applications)
2. Development Bank of Kiribati (DBK)	Bairiki (Credit only for development/economic projects)	Christmas Island (credit only)	All islands except four (credit only but approval done at the head office)

Source: Interview with officers, BOK and DBK.

savings and loan schemes. Most often people borrow from relatives or friends for the purpose of meeting personal, family, traditional, and religious obligations. The recipient may pay back in cash or kind.

Savings and lending by a group of fellow employees exists but is not widespread. A group of people from the same office might agree to save a small amount of money every payday, and from this pool of funds lend out to the members of the group or to colleagues at a fixed rate of interest. Loans are small, short-term, and released quickly. Funds are deposited in the bank for equal distribution to the members at the end of the year, including any interest earned. Formalizing the savings and loan activities of workers′ groups and unions means registering them as credit unions, though care is needed to avoid stifling informal initiatives. The Kiribati Credit Union League (KCUL) is pursuing this process.

There are two semiformal institutions providing microfinance services in both urban and rural areas. These are village banks and credit unions. They are regarded as semiformal because they are governed by specific legislation (the Credit Union Act and the Village Bank Act) that requires them to register as financial institutions.

Village Banks

The Government launched the Village Bank Program in June 1995 in support of its development policy, and in response to the popular clamor for microcredit. A total of AUD$460,000 from the Kiribati National Development Fund was allotted for distribution as seed funds to establish village banks. The Rural Planning Unit (RPU) of the Ministry of Home Affairs and Rural Development was designated as overseer of the nationwide implementation of the program. More than 180 village banks were established throughout the outer islands and in the urban and periurban areas of North and South Tarawa.

The Village Bank Program promotes community empowerment, as each bank is owned and managed by the village people themselves, through a committee supported by an Island Project Officer seconded at the Island Council (with minimal supervision by the RPU). The village bank uses a participatory approach: all decisions concerning the affairs of the bank are reached through consensus.

Pursuant to the Village Bank Act, a village bank is authorized to extend loans only to members who are registered as electors in the ward in which a Bank is registered. The act specifically prohibits the provision of credit for the following purposes:

(i) "to pay for or contribute to the costs of any funeral;
(ii) to enable the applicant for the loan or any other person to repay a debt or give a gift or donation;
(iii) to pay for or contribute to the costs of feast, fete or celebration; [or]
(iv) to enable any person to acquire goods for use otherwise than in the course of his business."

Lending operations are governed by the Rules and Guidelines for Village Banks. Over time, modifications have been made to suit the needs of members (Table 3.7). In most rural areas, village banks are the only source of institutional credit.

The village bank scheme has considerable outreach: 23 out of the 24 inhabited islands are covered, as are all the wards in each island, for a total of 182 throughout the country. All members have equal access to loans, depending on the availability of funds. In villages with many households (notably in South Tarawa), funds may not be sufficient to accommodate the financial demands of all households, so that applicants may have to wait for their turn. Providing funds is obviously more of a problem for decapitalized village banks and those with a higher default rate on loans.

The evaluation of the Village Bank Program undertaken in 1997 found that the majority of banks had revolved their seed fund several times over, some more than 12 times within a 20-month period; indeed, some households have borrowed several times. The collateral requirements are easy to comply with, although there have been complaints that women have less access than men.

The Village Bank Program has relied heavily on Government financial support: 95 percent of the village banks have registered an increase in the grants provided to them by the Government

Table 3.7

Village Bank Current Lending Guidelines

Terms and Conditions	Particulars
1. Purpose of loan	For starting or expansion of microenterprises or income-generating projects, or for social development purposes, such as paying school fees, purchase of bikes, and other household assets
2. Loan ceiling	Not to exceed Au$200, but some village banks increased ceiling to Au$500
3. Repayment period	Depending on the amount of loan, ranges from 1 to 8 months
4. Interest rate	Not to exceed 10% per loan term
5. Mode of Payment	Monthly
6. Service Fee	Between Au$0.50 to Au$5
7. Security requirements	In most cases, security/collateral required (e.g. babai pits, house, bike, and other personal assets)

Source: Interview with bank officers, BOK and DBK.

(Table 3.8). The cost of operations is very low, mainly involving sitting allowances and stationery. Some banks undertake fund-raising activities to help meet costs of operation. The better-performing village banks demonstrate the importance of prudent management, sound accounting, proper record keeping, and monitoring of performance, as well as the support of the villagers. A study of highly successful village banks would be useful as a means of identifying best practice. The Village Bank Program progress report of November 1999 (UNDP 1999) concluded that 29 percent of village banks had achieved excellent performance, 38 percent good performance, 22 percent average performance, and 12 percent poor performance.

RPU's technical capacity to administer the Village Bank Program is limited. The staff have little experience or understanding of the principles and best practices of microfinance and microenterprise development. Staff who are involved in the Program are also tasked with other functions. Though progress reports are submitted by the island project officers on a monthly basis, the management information system needs improving. The fundamental question remains whether

Table 3.8
Village Banks' Receipts of Seed Funds

Percentage (%) of Increase or Decrease of Seed Fund since 1995	No. of Village Banks
Decrease: –1 and below	9
Increase: 1–25	52
26–50	48
51–75	27
76–100	18
101–150	14
151–200	9
201–300	4
Total	182

Source: UNDP 1999.

the RPU is the right agency to handle the Village Bank Program, or whether it should be administered by an NGO or by KDB.

Those borrowers engaged in business or livelihood projects generally lack business skills and therefore need access to appropriate support services. In the outer islands, the "copy cat syndrome" prevails, resulting in competition and saturation of the market. There is a need to introduce innovative business ideas, as well as a need to link clients to the market in Tarawa. Funds for technical assistance, especially to conduct training as well as monitoring, are lacking, and the RPU is seeking donor support. RPU has not yet explored any linkages with other support service providers, especially in the area of business training. It would be advisable for RPU to tie up with NGOs and Government agencies like the Small Business Development Centre in extending business training and advice to village bank members. Island project officers could be targeted so that they can more effectively advise village bank members in managing their enterprises or in identifying viable microenterprises. RPU should also seek financial advice from the DBK and BOK as well as technical assistance from the UNDP Pacific Sustainable Microfinance and Livelihoods through Empowerment (SMILE) Program.

Credit Unions

The credit union movement was first introduced into Kiribati in 1986. Credit unions are governed under the 1990 Credit Union Act. They can be formed by any group of 15 or more people who are residents of Kiribati and have a common bond; they must be registered with the Registrar of Credit Unions. The main objectives of credit unions are to promote thrift among members by encouraging savings, either as payment on shares or as deposits, and to provide credit to members for either provident or productive purposes. Each credit union prepares its own bylaws to govern operations. A board of directors is responsible for the general management of the credit union. There are three committees formed in each credit union: the credit committee, the supervisory committee, and the educational committee. Officers provide their services on a voluntary basis; for this reason credit unions have low operating costs.

The Kiribati Credit Union League (KCUL), established in 1995 and housed at the Ministry of Labour and Cooperatives, is the apex organization for credit unions in Kiribati. With the exception of the salary of the general manager, the League is funded by the United Nations Development Programme (UNDP). This funding is now running low, and a proposal has been submitted to the Government for additional funding. Technical assistance, mostly in the form of training, is provided to the KCUL and to individual credit unions by the Credit Union Foundation of Australia and the Hans Seidel Foundation. Concern has been raised that credit unions are duplicating the services of the village banks, especially those that also operate in the outer islands.

The lending guidelines vary for each credit union according to members' agreements. All loans carry a reasonable rate of interest. Collateral and other securities are not required, and the amount of the loan cannot exceed the amount held by the member as shares. Loans are of two types: short-term (six months or less), and long-term (six months or more). Service fees are charged on loans. Policies are set in consultation with the members, and as a result the compliance rate is high.

As of December 1999, there were 82 registered credit unions, of which 49 were active and 33 were inactive; and 48 unregistered credit unions, of which 12 were active and 36 were inactive.

These credit unions cover 19 out of the 23 inhabited islands. Urban-based credit unions (mainly in South Tarawa) are mostly employee-based, covering both civil servants and private employees. Rural-based credit unions are either community-based or family-based, and consist of both working and nonworking people. Those working include teachers, employees at the Island Council, and other civil servants. Credit unions are dominated by men. Total membership is 3,373; 2,186 are members of registered credit unions (1,515 men, 671 women) and 1,187 of unregistered credit unions (724 men, 463 women).

Employee-based credit unions have more assets, and most operate profitably. Costs of operation are minimal since staff are not paid. Most unions have high levels of long-term loans, but within the limits of the members' shares. The number of delinquent loans is very low, since loan repayment is done through payroll deduction.

Community-based unions are at an early stage of development. Most of them registered only in 1998 and 1999 and are not actively lending to members. Their service is more concentrated on savings, and no profits have yet been registered.

LAND OWNERSHIP STRUCTURE

There is considerable lack of clarity over land titles in Kiribati. Work is progressing, but the courts are overcrowded and the validity of many titles is uncertain. Because of the scarcity of land, there are strict controls over transfers. Land cannot be alienated, but it can be bought and sold between Kiribati nationals. Even so, such transactions are subject to the approval of the Land Court, which is a slow process.

Most land is held by indigenous people in accordance with traditional customs of land tenure. It used to be termed native land, but is now more commonly called customary land. In addition to customary land, a small proportion of land is freehold land owned by individual persons or bodies, and a small proportion is owned by the State.

When the Gilbert and Ellice Islands were declared a protectorate of Britain in 1892, the British Crown acquired no proprietary rights to land by virtue of its sovereignty, since the islands were only a protectorate. In 1915, the islands were ceded to Britain as a colony, but subject to existing proprietary rights of the indigenous islanders. From that time onwards, the British Crown acquired ownership of any land in the islands that was not subject to native title. Accordingly, if proprietary rights of islanders become extinct, as happened in Butaritari, the rights of ownership vest in the Crown.

In addition, the Crown Acquisition of Lands Act, enacted in 1956, authorized the colonial administration to acquire, either voluntarily or compulsorily, and either absolutely or for a term of years, any land required for public purposes, subject, however, to the payment of consideration or compensation. Legislation was also enacted in 1959 to enable the colonial Government to purchase or compulsorily acquire agricultural land that had been neglected or not used efficiently. Such land could be made available for settlement by Gilbert Islanders who did not have sufficient land, or sold or given to a local Government council. This power has been rarely used.

At the time of independence, all property owned by the British Crown was transferred to the Republic of Kiribati, and the Crown Acquisition of Lands Act was renamed the State Acquisition of Lands Act.

As a matter of practice, the Government usually leases land, rather than purchasing it. But even with regard to leases, serious differences of opinion have developed between the landowners and the Government as to the appropriate amount of consideration or compensation it should pay for land it acquires. The High Court is authorized to adjudicate disputes about compensation.

Freehold Land

During protectorate times, Gilbert Islanders sometimes sold land to Europeans, to be used for churches, missionary stations, and stores. These titles were recognized by the British Government when the Gilbert Islands became a British colony, but no further sales of land by Gilbert Islanders were permitted. This was intended to protect the indigenous population from loss of its basic physical asset. In 1976, the colonial administration enacted the Non-Native Land (Restriction on Alienation) Act, which enabled the colonial Government, and later, the Kiribati Government, to preempt any freehold land that an owner wished to sell, give away, or lease. As a result, the amounts of freehold land held by individuals in Kiribati today are very small.

Freehold lands can in principle be leased and mortgaged. There is no locally enacted legislation that regulates leases and mortgages of freehold land, but presumably the provisions of the previous English legislation, Property Law Act 1925, (UK) apply in Kiribati, subject to modification for local conditions, by virtue of Laws of Kiribati Act 1989, which recognized English statutes of general application.

Under the Property Law Act 1925 (UK), mortgages of land can be taken out, either by way of a lease of the land to the mortgagee, or by a deed of charge over the land. A deed of charge is simpler, but since the land remains in the ownership and possession of the mortgagor, it is also the more dangerous for the mortgagee, unless there is some efficient and accurate method of publicly recording the deed of charge. If the mortgagor is in default, Property Law Act 1925 (UK) provides that the mortgagee may enter into possession and sequestrate the rentals, or may sell the freehold. But this is subject in Kiribati the Government's right of first refusal under the Non-Native Land (Restriction on Alienation) Act.

Customary Land

Many of the traditional land tenure customs in Kiribati have been recorded in a written document, the Gilbert and Phoenix Land Code, which is annexed as a schedule to the Native Lands Act. Most customary land is held in joint ownership by a family grouping or clan, called *kaainga*, although in some areas it appears that custom also allows for ownership of land by an individual, especially where land was given as a gift to a particular individual.

Attempts were made in protectorate times to register ownership of customary land, but they were very unsuccessful. The first attempt to register ownership of customary land was begun by the Native Land Commission appointed under the terms of the Native Lands Commission Ordinance, 1922. The commission worked until registration of the land in all the islands was completed in 1956. After 1956, under a new Natives Lands Ordinance, this work was taken over, first, by Lands Courts established by the local government council of each island, and then, in 1977, by specially constituted Magistrates Courts (Lands). These courts were authorized to register any title of customary land in any island that had been overlooked by the Native Lands Commission at the time of its registration visit to that island; subsequent transfers of title approved by the Courts; and titles to garden pits, ponds, fish traps, and sea walls constructed subsequent to the registration visit of the Native Lands Commission. The Magistrates Courts could also register native wills, native leases, and native adoptions approved by the Courts. The original registrations by the Native Lands Commission, and those registered subsequently, have been open to considerable dispute; legislation has had to be enacted to declare that, except in Tarawa and Tabiteuea, land registrations are indefeasible and cannot be challenged.

In colonial times, customary land was declared inalienable by sale, lease, or otherwise except to another Gilbert Islander or to the Crown; but later the number of permitted acquirers was expanded to include a local government council, a registered cooperative society, the Housing Corporation, and the National Loans Board.

Leases of customary land are required by legislation to be of two kinds: native leases, which are leases to indigenous i-Kiribati, of an area not exceeding five acres and for a duration not exceeding 21 years (to be approved by a Magistrates Court [Lands]); and nonnative leases, which are all other leases (to be approved by the Minister of Lands). Custom usually permits the occupation of land without a formal lease, if the consent of the landowner is obtained, and in practice, it seems that many customary lands are occupied on that basis.

No provision in the Native Lands Ordinance expressly authorizes the mortgage of customary lands. However, the Native Lands Ordinance provides that title to land acquired by the National Loans Board as security shall not become absolute until the right to redeem the property has been lost. This section seems to contemplate that customary land may be given as security for money loaned by the National Loans Board. It does not indicate, however, how that security is to be given. The Property Law Act

1925 (UK) provides that mortgages of freehold land may be created either by leases until repayment of the loan, or by a deed of charge; and that mortgages of leaseholds may be created by a sublease until repayment of the loan, or a deed of charge. It would seem, therefore, that customary lands, and leases of customary lands, may be mortgaged to the National Loans Board, under the terms of the English legislation.

There is no legislation providing for mortgages or charges to be placed on crops, trees, or livestock. However, because of the climate and poor soil, virtually the only crops of value are coconuts and taro, and the only livestock pigs and poultry.

Disputes

Most disputes arise in relation to customary lands, and concern claims of ownership fragmentation, informal occupations; and absentee owners.

The work of the Native Lands Commission was open to challenges on various grounds. First, the names of owners and the names and/or descriptions of the lands were recorded in the register, but the lands were not surveyed or mapped, and often the boundaries were not precisely defined. Second, the names of all the owners were often not recorded, but only some of them. Third, the names and descriptions were entered as at the time of the visit of the Commission, not as they changed.

After 1956, when the Native Lands Commission was replaced by the Lands Courts established by the local government councils, further discrepancies crept in, because the records were kept by the clerks of the courts, some of whom were not very accurate or efficient. As noted above, to put a stop to the many disputes that continued to arise, the Native Lands Ordinance 1956 was enacted to provide that, except in Tarawa and Tabiteuea, the record of the Commission and of the Land Courts was to be indefeasible, or unchallengeable. In these areas, although the registration cannot directly be challenged, disputes can still arise when that registration record is translated onto the ground, and the boundaries between the pieces of land described in the register have to be determined. Even when boundary marks have been placed, they may deteriorate through natural causes, or be moved by human forces.

Because the atolls of Kiribati are small, and because most land is held jointly by kinship groups that have over the years expanded in size, the amount of land available to members of kinship groups has usually steadily diminished, often becoming economically nonviable. This has been the source of tension and disputes.

Although the Native Lands Ordinance prescribes that leases of native land can only be of two kinds, native leases and nonnative leases , in fact indigenous landowners allow others to occupy portions of their land, especially for house sites, without any lease, but solely as a result of oral agreement. Over time, friction often develops between the landowners and the occupiers, and it becomes difficult to determine their respective rights.

It is not uncommon for some owners of customary lands to leave and live elsewhere, either within Kiribati or overseas. Usually the land is left in the hands of a caretaker, but there is an obvious potential for disputes to arise between the caretaker and the remaining owners or neighbors of the land, or between the absentee landowner or the caretaker and the remaining owners. Such disputes appear to occur frequently. Although the Neglected Lands Act gives the Government power to purchase or compulsorily acquire lands that are not fully utilized, in practice governments are unwilling to use the powers under this Act.

The bodies having power to adjudicate disputes about titles and boundaries of native lands in Kiribati have undergone many changes. During the years of the Native Land Commission, 1922–1956, appeals against its decisions were heard originally by the Resident Commissioner—until 1940, when the post of Chief Land Commissioner was established to deal with appeals. In 1956, Land Courts were set up in each island to take over the work of the Commission, and appeals were taken first to the Resident Commissioner, and then later to the Lands Courts Appeal Panel, with final appeal to the High Court on matters of law. In 1977, the Lands Courts were replaced by Magistrates Courts (Lands) composed of five magistrates. Decisions may be made by a majority of the members of these Courts. Appeals against Magistrates Courts (Lands) are to be determined by a specially constituted High Court, presided over by the Chief

Justice or a judge together with at least four magistrates drawn from the panel of lands magistrates. The decision of a majority of the High Court so constituted shall be final, and there is no further provision for appeal.

KEY CONSTRAINTS ON FINANCIAL SECTOR DEVELOPMENT

The major factor constraining the development of the banking and financial sector in Kiribati is the lack of viable investment opportunities in the private sector to finance at a reasonable risk. The reasons for this are many and varied.

Geographic Fragmentation

The remoteness of Kiribati and its geographic fragmentation are severe constraints on the development of export industries. The country faces high transport costs, both internally and externally. For example, long-line fishing for sashimi tuna is constrained by the transportation problem and the lack of onshore handling facilities (which would need to be developed to international standards). Another example is the salt project on Christmas Island, where high freight costs prevented the development of an export industry. Lack of good transportation systems and the lack of infrastructure (power, water, telecommunications) make it very difficult to develop a tourist industry. The very limited natural resource base and infertile soil constrain agricultural development. Kiribati does, however, possess abundant and extensive ocean resources, principally fish, seaweed, and manganese.

Geographic fragmentation and dispersal also makes cost-efficient service delivery difficult. In particular, the delivery of microfinance services suffers diseconomies of scale in outer islands.

Dominance of Public Enterprises

Private sector development is constrained by more than 20 large public enterprises, with which the private sector cannot compete. The public enterprises receive subsidies from the

Government and loans from BOK (backstopped and underwritten by the Government). Most of them do not have proper and up-to-date accounts, despite being obliged to file accounts every year. Only two public enterprises (which are externally managed) make profits: BOK and Telecom. Nonetheless, the Government remains involved in a wide range of activities: retailing, wholesaling, running hotels, running transportation systems (ships, buses, aircraft), external trade, fishing and seaweed production, food manufacture, fuel supply, housing and telecommunications. Many of these businesses could be run in the private sector; and in all cases the key issue is the poor standard of management and inefficiency of operations.

Although the Government of Kiribati has stated its commitment to public enterprise reform, the pace of change has been very slow and cautious. Commitment to privatization of public enterprises is a big issue politically, and at present, political ownership of privatization is lacking, partly because of a perception that it means wholesale job losses. In addition, the task of privatizing is difficult because of the large debt burdens of some public enterprises, their unattractive balance sheets, and the lack of expertise resulting from a lack of business acumen and experience. There is also the consideration that if public enterprises were privatized, BOK would be unwilling to lend to them because of the loss of the Government guarantee.

Red tape discourages foreign investment: there are only discretionary guidelines, nothing is written down, and procedures are very bureaucratic. High taxes—35 percent for business and withholding taxes on dividends (averaging 20 percent, top rate 35 percent)—also discourage foreign investors. On top of that, foreigners cannot own land and have to negotiate leases.

Many Government regulations lack transparency. There is a need for investment licenses from the Government; procedures for acquiring licenses are heavily bureaucratic; fees for business licenses are quite high; and business owners are required to buy two licenses, one from Tarawa Urban Council and one from Betio council. Businesses must also comply with tax and safety regulations and make contributions to KPF. Generally, the Government is more obstructive than helpful to people wanting to set up businesses. There are no good advisory services, and the Government does not provide research services, which are badly needed, particularly in agriculture.

Public enterprise prices are generally maintained below what the enterprise would need to maintain the service, so maintenance suffers. There is an increasing list of price controls, many of them food items such as rice, which affect both retailer and wholesaler. This limits the growth of the private sector.

The overall public sector (including the civil service) is large, and downsizing would release scarce human resources to the private sector and help foster its expansion. Further, in almost every business in Kiribati, whether private or public, the same people sit on the board, and almost every business has Government involvement. It would be a huge task to have a purely private enterprise in Kiribati of any size, because of the lack of expertise outside the Government.

Cultural Concerns

The communal culture of Kiribati makes business development difficult for two reasons: first, the stock of private or family equity can be depleted by the need to meet family and cultural commitments. Second, the customs of sharing make it very difficult to accumulate assets. A further constraint is that there is a perception among many i-Kiribati people, especially outside Tarawa, that entrepreneurs are "money-hungry people" and that business is not a desirable career. People in the outer islands are especially careful not to be seen to know more than other people do, which acts as a disincentive to training and to success in business. At the same time, knowledge is also seen as a source of power, which should be jealously guarded. As a result, it is hard for prospective business people to get advice and assistance from other business people, or Government or bank staff. It therefore makes it very difficult to introduce schemes such as mentoring (IFC 1998). Finally, also, the profit motive and the egalitarian attitude of the people do not sit comfortably together. Small businesses do not have Government involvement, but can come up against cultural laxity about family's and friends' taking produce from family businesses without payment. For this reason, small businesses often end up incurring losses.

The situation may have improved over the years, since it is now observed that more people are doing business, especially in Tarawa. What is needed is a vigorous awareness and education campaign to teach people how to reconcile culture with business, so that instead of being a deterrent it can help stimulate the development of business. Several studies show that kinship and *wantok* (friends and family networks) actually assisted some entrepreneurs to establish themselves in the earliest phase of economic change.

The constraints faced by women pursuing credit and business opportunities include limited access to credit due to inability to provide collateral or any form of security. BOK and DBK require security in the form of a physical asset or a guarantor, and women have difficulty complying with this requirement because they possess no physical assets or have to have a working husband or a working relative to guarantee the loan. Also, some women are not aware that they can borrow money from the bank. Others would not dare borrow for fear of not being able to repay the loan. The perceived role of women as subservient household workers not engaged in any business activity is an impediment that is slowly changing. There are an increasing number of business women, especially in Tarawa. There is no special credit scheme for women—unlike in Fiji, Vanuatu, and Solomon Islands, where microfinance schemes exclusively target women—and women face discrimination from male-dominated social institutions.[12]

Lack of Business Skills

The low level of education, combined with the ability of many professionals to earn higher salaries overseas, has left Kiribati with a chronic shortage of people with technical

[12] As cited in IFC 1998, "The Tarawa Island Council, for example, which is composed of men, charges some women twice for sites in Bairiki market. They first charge the National Council, now known as the Aia Meaa Ainene Kiribati (Kiribati Women's Federation, or AMAK), $108 per year per market site for women; and they then charge each woman who uses the site an additional $1 per day (a very high annual fee)."

qualifications and business skills. The development of an entrepreneurial class is at an embryonic stage and includes a variety of small-scale ventures, such as bakeries, toddy brewing, piggeries, biscuit making, garment production, furniture making, and commercial fisheries. Retired civil servants are moving into the private sector, but the shortage of people experienced in business is severe. The main activities of the private sector are limited to retailing and a few service industries. These are the main areas DBK lends to, and its portfolio reflects that. DBK also has sectoral allocations for its loans, and it is often difficult to get a loan for start-up businesses outside that allocation system.

Land Tenure Uncertainties

There is widespread and continuing uncertainty about the boundaries of customary land, and about who is entitled to what rights in customary land. These are serious disincentives to investment in customary land. In addition, because land cannot be alienated, it is very difficult for foreign investors to get access to land other than that owned by the Government. There is no accurate system for surveying and recording the boundaries of lands; in small islands with expanding populations and very limited natural resources, this is a constant source of friction and dispute.

No locally enacted legislation expressly provides for the granting of mortgages of freehold land or of customary land or leases of customary land, although English legislation still in force in Kiribati may permit it. There is also no locally enacted legislation that expressly provides for the granting of mortgages or charges over crops, trees, or livestock.

Disputes about ownership and boundaries of native lands are numerous and do not seem to be diminishing. At present, all these disputes can be appealed from the Magistrates Courts (Lands) to the High Court, which is likely to be very expensive for the litigants, and also to cause delays in the resolution of both land disputes and also normal civil and criminal proceedings before the High Court.

RECOMMENDATIONS

Create an environment conducive to private sector development.

There is a need to create an environment in which the private sector can develop, generate economic and employment growth, and thereby stimulate financial sector development.

Reform and "rightsize" the civil service.

A first step in this scenario would be to formulate and implement a civil service reform aimed at reducing the size of public administration while improving its service delivery. In order to allow the Government to concentrate on core functions, churches and NGOs should be encouraged to carry on and further develop their service provision roles in the social and other sectors. It would be more cost effective for the Government to provide additional support to these organizations than to duplicate their efforts.

Privatize some public enterprises.

A second step would be to privatize the commercial activities of those public enterprises that could be efficiently managed by the private sector. This should involve a public education campaign and mitigation of the social consequences of privatization. The remaining public enterprises and corporations should either be operated on commercial principles, by setting prices to cover costs and by providing them with greater autonomy and efficient management, or be closed down. If this is not possible, then the cost of Government policies should be recognized explicitly, and a subsidy should be provided for the enterprises to operate, maintain, and replace their assets in an efficient manner.

Build up an efficient, responsive, and competitive financial system.

As in most PDMCs, Kiribati's economic development has been hampered by the lack of an efficient, competitive, and responsive financial system. Reforms are needed to make the banking sector more competitive. As a first step toward creating another commercial bank, Kiribati should pass a Financial Institutions Act to license financial institutions and define entry requirements in terms of minimum capital requirements and level of experience. A Financial Institutions Act should also spell out conditions under which licenses will be revoked.

In addition, a Financial Institutions Act should set up an independent supervisory authority to license and supervise commercial banks, NBFIs, and other financial institutions such as credit unions or foreign exchange bureaus. These institutions should be able to provide services to compete with BOK. DBK should also be strengthened and adequately capitalized. When the supervisory authority is established, it should put into place systems that will make BOK more transparent and accountable. In addition, the supervisor should make some provision for monitoring the fees and charges of BOK to ensure that these charges bear a reasonable relationship to BOK's costs. Finally, the authority should join the Pacific Islands Prudential Regulation and Supervision Initiative and commit itself to creating more formal and extensive arrangements for closer cooperation and coordination among PDMCs, and to strengthening the domestic regulatory environment in line with international best practices.

Kiribati needs to adopt clear international accounting and auditing standards, in line with internationally accepted standards of accounting for all financial institutions and for the private and public sectors. A modern bankruptcy law and collection procedures are also needed. Collateral should be clearly defined by commercial law, and effective enforcement procedures should be put into place. Accessible and up-to-date registration and information systems on property, credit, and security should also be put in place and the judicial system strengthened.

A simple and clear Companies Act, and efficient mechanisms for company registration and for monitoring compliance by companies, are needed as the basis for corporate capital market development.

Consider participation in a regional stock exchange, when and if it is developed.

If a regional stock exchange facility were developed, a number of issues would arise in relation to its use by investors in Kiribati. Since these are covered in the recommendations section of the previous chapter (The Fiji Islands), they are not repeated here. The same observation applies to the concept of a new regional venture capital fund. The similar issues involved in Kiribati's participation in such a facility are discussed in the first part of this study, *Volume One: The Regional Report*.

Improve the performance of DBK and KPF.

It is recommended that DBK be supported in its efforts to improve performance. In particular, pricing according to risk is a practice that will need to be progressively introduced. It is recommended that KPF develop model investment criteria and members rules on a regional basis.

Promote good savings habits.

The Government, in collaboration with NGOs and traditional leaders, should undertake a vigorous awareness and education campaign on the need to build good savings habits, instill credit discipline, and reconcile culture with business. This is a precondition for microfinance to flourish and is worthy of donor support.

Build capacity in microfinance systems.

The institutional capacity of existing microfinance institutions/providers should be built through the following measures:

(i) Provision of technical assistance to KCUL, RPU, and DBK, with a view to formulating appropriate policies and procedures; setting up management information systems;

improving financial management; developing products; and improving human resource management.

(ii) Provision of computer programs on management information and accounting and reporting systems for village banks and credit unions.

(iii) Linking of the three existing providers to other microfinance providers in the Pacific and overseas for exchange of information and best practices.

(iv) Provision of financial assistance to RPU and KCUL for monitoring, training, and hiring at least two full-time staff members for KCUL.

(v) Establishment of a Village Bank Unit at RPU, with at least one full-time staff member dedicated to handling village banks.

(vi) Training of island project officers and KCUL officers in business and microfinance methods and organization, so that they can train and provide advice to village bank/ credit union committees, as well as provide advice directly to members.

A legal framework to enable NGOs to engage in microfinance should be established. This could be done through an Order authorizing NGOs to accept deposits and extend credit, and to use the profit to build capital and cover costs of operation. Existing laws that may restrict or impede microenterprise development should be reviewed. The Small Business Development Centre could take the lead, with the results presented to various stakeholders to prepare an Action Plan to change/amend legislation or regulations.

The following innovative schemes should be considered. First, DBK should reduce its minimum loan size to AUD$500 and simplify lending requirements, using NGOs to organize clients and do the collection, and also undertaking wholesale lending to NGOs. Second, a credit scheme exclusively targeting urban women in Tarawa should be set up under the administration of DBK in partnership with NGOs. Third, bankers, private individuals, and Government officials with good banking and financial background should be encouraged to provide technical advice to present microfinance providers, through the creation of a Microfinance Task Force.

Resolve disputes over land tenure, and simplify leasing and mortgaging.

Discussions should be held within the Government on the desirability of enacting legislation that both provides for, and regulates, the mortgaging of freehold and customary land, the mortgaging of leaseholds of freehold and customary land, and the mortgaging of crops, trees, and livestock. These discussions should be held in conjunction with others designed to provide a more rapid and enduring system of resolving disputes as to titles and boundaries of customary land. An assessment should be made as to whether further work should be done

(i) to improve the accuracy of the records of the Magistrates Courts (Lands) and the High Court;
(ii) to improve the accuracy of boundaries of customary land;
(iii) to establish a Land Court that does not require the attendance of the Chief Justice;
(iv) to regulate the present licensing of land without leases; and
(v) to enable people to place charges or loans.