



Kiribati's Political Economy and Capacity Development

Asian Development Bank

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Kiribati's Political Economy and Capacity Development

Asian Development Bank

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Acronyms

ADB	–	Asian Development Bank
AusAID	–	Australian Agency for International Development
FIC	–	Foreign Investment Commission
IAD	–	institutional analysis and development
IFC	–	International Finance Corporation
KIT	–	Kiribati Institute of Technology
MFED	–	Ministry of Finance and Economic Development
PSO	–	Public Service Office
US	–	United States
USP	–	University of the South Pacific

Note

In this report, “\$” refers to Australian dollars unless otherwise specified.

Foreword

Development partners have increasingly recognized the important role of political economy in a country's growth and development. The political economy's impact is even more pronounced in fragile states and in the small communities of the Pacific islands.

At the request of the Government of Kiribati, the Asian Development Bank (ADB) funded a study of the political economy of the country's state-owned enterprise (SOE) reform. After reviewing approaches and methodologies to examine the political economy, one approach was selected and tried in the Kiribati case study. This study reveals how the prioritization, sequencing, and nature of SOE reform is greatly influenced by the political economy. Technical and professional advice and assistance in support of SOE reform are commonly insufficient in the Pacific islands. Greater account has to be taken for social, cultural, and political influences. A reform program built on the realities of the prevailing political economy will likely differ greatly from a program based on professional considerations alone. The lack of assessments of political economy could well be one major reason why earlier reform efforts have not succeeded.

The Kiribati SOE reform case study stands as a good-practice example for SOE- and other reform programs in the Pacific. The study was undertaken by Professor Ron Duncan under the guidance of ADB's South Pacific Regional Office in Suva, Fiji.

Introduction

This paper reports the results of an investigation into the social, economic, political, and institutional factors that encourage or impede inclusive economic development in Kiribati and hamper the capacity development needed to overcome obstacles to that development. Much of the information on which this report is based was collected in discussions in South Tarawa in January and April 2007.

The institutional analysis and development (IAD) framework of Ostrom et al (2001) served as the analytical framework for the investigation. This framework, which was developed by researchers from the Workshop in Political Theory and Policy Analysis at Indiana University in the United States, is an effective way to explain group behavior that influences a country's economic development.

The investigation centers on the reasons for the difficulties the Government faces when it tries to privatize public enterprises and develop the private sector. Reforms in these areas have concerned various development partners of Kiribati for many years. They have also been, and still are, primary objectives of the Government, as stated in national development plans and related documents and speeches. However, little or no progress has been made in achieving these objectives.

The next section gives an overview of the IAD framework, which is used in the following section to examine the social, economic, political, and institutional factors that have stymied privatization and private sector development in Kiribati. The section after that looks into various measures that could encourage capacity building and economic reforms. The final section sums up the outlook for reform in Kiribati and recommends ways to improve the outcomes of development partner projects and programs in the country.

In the appendix, the IAD methodology is used to develop a capacity-building framework for technical assistance to improve the availability of accurate and up-to-date financial information for a multiyear budgeting framework for Kiribati.

The Institutional Analysis and Development Framework

The institutional analysis and development (IAD) framework is based on the assumption that most problems in development arise because people cannot take the necessary collective action. The delivery of public goods and the effective management of common-pool resources in a society require collective action by that society. However, societal incentives or rules of behavior may provide weak or perverse incentives to individuals and groups to act collectively for their common good, thereby adversely affecting the delivery of public goods and the management of common-pool resources.

Public goods are goods or services from which no consumers can be excluded; consumption by some consumers does not make them any less available to other consumers (i.e., nonrivals in consumption). Further, an individual's consumption is not affected by his or her contribution to the production of the good or service. Thus, there is an incentive to "free ride" if the good or service is provided privately. National defense, security, fire services, public parks, and basic research are examples of public goods that are best provided by government.

Common-pool resources are similar to public goods in that their consumption by individuals is difficult to prevent. But an individual's consumption of these resources subtracts from the amount available to others (i.e., rivals in consumption). Natural resources such as ocean fisheries, for which exclusion is difficult or cannot be enforced for lack of property rights, are examples of common-pool resources. Traditional communities have informal measures for defining and enforcing property rights over natural resources such as fisheries

and forests. What may appear to be common-pool or open-access resources could be subject to such traditional measures. If traditional authority structures have broken down, however, the associated rules may not be enforced. Governments in the Pacific and elsewhere have often taken over the management of natural resources from traditional communities, but have not put in place effective rules of use and enforcement. As a result, such resources could develop into common-pool resources and become examples of what are referred to as the “tragedy of the commons.”¹

Government budgets are treated as common-pool resources when government expenditure is appropriated by politicians for their own use or that of their constituents, instead of being used to provide public goods to benefit society. This behavior appears to be widespread in the Pacific. Politicians are often elected because of the benefits they promise to deliver to the clan, not because of policies that will improve the welfare of all citizens. A form of this behavior is government willingness to fund losses of public enterprises without demanding better performance from them. Such an attitude on the part of government encourages irresponsible behavior by the management and staff of public enterprises—a form of moral hazard.

Problems in carrying out collective action can occur when there is incomplete information, asymmetry in the amount of information held by the parties involved, or lack of stakeholder motivation. Any of these difficulties can generate incentives that prevent individuals from getting together to resolve the collective-action problem. These perverse incentives lead to rent seeking, free riding, and principal-agent problems. Ostrom et al (2001, 243) comment:

Our theoretical findings demonstrate that applying the concept of ownership and sustainability to actual development cooperation relationships is, in practice, quite difficult. Our analysis shows that motivational and informational problems in aid are very deeply embedded...no type of development cooperation is free from powerful perverse incentives.

In adapting their IAD framework to examine the performance of the Swedish International Development Cooperation Agency, Ostrom et al (2001) asked the following questions when evaluating completed projects:

- (i) What collective-action problem(s) led to the undersupply of public goods or the overharvesting of common-pool resources?

¹ This occurs when individuals, acting independently in their own short-term interest, ultimately destroy a shared resource even when it is clear that it is not in anyone's long-term interest.

- (ii) What incentive problems led to the lack of effective collective action?
- (iii) Did changes made in the “rules-in-use” result in disincentives to performance?

The IAD framework and similar questions can be used to analyze the need for and the type of development assistance that should be provided.

As Ostrom et al (2001) correctly point out, it is difficult, if not impossible, to change the characteristics of goods and services and the nature (culture) of a community. Changing the incentives (e.g., institutions or rules-in-use) for the people involved is usually the only way to achieve a different outcome. As they also point out, any transformation of the rules-in-use must take into account the characteristics of the community as well as its physical, economic, political, and social circumstances. Most importantly, it must be understood that those advantaged by the status quo will resist any changes in the rules that do not benefit them. Aid agencies should be careful not to reinforce perverse incentives or weaken government incentives to find better policies and institutions.

According to Ostrom et al (2001), a project or program should be appraised, and its implementation evaluated and analyzed, in the following sequence: context, action arenas, incentives, interactions, and outcomes.

Context refers to the physical situation associated with the project or the problem to be addressed, the attributes of the community, and the rules-in-use. The following questions should be asked in this regard:

- (i) What is the culture and history of the community, its social and political characteristics, and the level and distribution of its assets?
- (ii) How effective is the community at organizing itself?
- (iii) What is the underlying reason for the collective-action problem?
- (iv) Is the problem the undersupply of public goods or excessive use of a common-pool resource?

Action arenas refer to the various parties involved in the project or in the situation giving rise to consideration of development assistance, and how those parties interact with each other. How they interact will depend greatly on the incentives to which they are responding. The incentives, or rules, can be monetary or nonmonetary. Cultural norms may be critical in determining behavior.

Perverse incentives lead to motivational problems in contributing effectively to collective action. Motivational problems can arise because (i) the power relations between groups are asymmetric, and those holding the upper hand resist any change that could increase productivity because it may mean they will

suffer a loss; or (ii) there is missing information or asymmetry in information between parties. If the missing or asymmetric information is about the actions of actors, moral hazard may result. If it is about the characteristics of actors, there may be adverse selection: inferior individuals or inputs are chosen. The missing information may relate to actions that could be taken, links between actions and outcomes, and payoffs from actions—e.g., the benefits and costs of privatization and public sector reform.

Application of the IAD Framework to Economic Reforms

Two reforms that have been proposed and attempted in Kiribati, with little or no progress—the privatization of public enterprises and the promotion of the private sector—are examined in this section by means of the institutional analysis and development (IAD) framework.²

Discussions in Kiribati were used in an attempt to understand the reasons for the lack of progress. Although consideration was limited to these two areas, the political economy issues identified in the discussions are believed to affect all areas of government and economic development. The lessons from this exercise should therefore be generally applicable to an evaluation by development partners of how best to assist Kiribati in building capacity for development.

The political economy in which the privatization of public enterprises and private sector development are being considered is discussed in the following sections. The section on context scrutinizes the economic, political, cultural, and social situation as it affects public enterprises and the private sector. The succeeding section examines the actors in these various arenas and the incentives that appear to determine their behavior. This section is followed by an assessment of how the incentives can be adapted or changed to make the desired reforms possible.

² According to the Government of Kiribati's *National Development Strategy 2002–2003* (2001), public sector reform was a key structural issue to be addressed, as was “creating an enabling environment for private sector development.”

Context

The Asian Development Bank (ADB) in its *2002 Pacific Islands Economic Report* on Kiribati (ADB 2002) reported that there were 32 public enterprises in the country. Information about the number of public enterprises varies, depending on how public enterprise is defined—such as whether joint ventures between government and private enterprises are included. Whatever the correct number may be, it is relatively large. Most importantly, public enterprises occupy most of the economic space usually occupied by the private sector. They incur losses and require government subsidies or government-guaranteed loans to stay liquid. Debts owed them (including debts by ministries and other public enterprises) often go unpaid, and the situation appears to be getting worse.

With public enterprises so pervasive in the Kiribati economy, attempts to promote the private sector make little sense if public enterprises are not privatized at the same time. Public enterprises are even said to be expanding their activities into sectors in which the few private enterprises are operating (such as retail hardware). The private sector has complained about such expansion to government, but with little helpful response. It was unclear from discussions with government officials whether they understood the notion of the public sector, in the form of public enterprises, crowding out private enterprise.

Control of prices of goods and services is widespread. But the quality of goods and services provided by public enterprises is not monitored. There seems to be little transparency in public enterprise accounts and government subsidies, and little effort by government to make public enterprises more efficient. Obvious overmanning, for example, is seldom addressed. As noted in ADB's *2002 Pacific Islands Economic Report*, jobs in the public service and the public sector, which account for more than two-thirds of wage employment, are seen as a means of supporting community income, given the relatively low number of formal jobs. With their large share of the formal workforce, public sector employees are a strong political force. One respondent referred to public enterprises as “an extension of the government.” It seems that public enterprises and control of the prices they charge are an essential part of government efforts to satisfy society's demand that government meets all their needs.

There has been no attempt to corporatize public enterprises to improve their efficiency. Corporatization would be unlikely to improve their performance, at any rate, because a basic reason for their poor performance is interference in their operations by government and individual politicians, and the widely accepted view that the enterprises are to serve socioeconomic objectives. Since the interference is likely to continue as long as government has an ownership role, corporatization seems futile. Around the world, corporatization has not proven to be the cure-all it was once thought to be.

Public enterprises also appear to be a part of the climate of patron–client politics in Kiribati.³ Public enterprises are under various ministries and the ministers appoint their board members.⁴ The board members, according to respondents, are primarily political appointees, often from the ministers’ constituencies. Knowledge of or expertise in the activities of the public enterprise evidently has little bearing on the appointments. Any move to make more appropriate appointments or to improve corporate governance in public enterprises is likely to meet with considerable resistance.

The Government offered for sale several public enterprises in the early 1990s. All the offers fell through because of conditions, largely related to employment, that were imposed on the sale by the Government. The privatization attempts were eventually called off by a new administration that took office on an anti-privatization platform. A related cultural factor was said to be the unwillingness of I-Kiribati to work for individuals, which is seen to be demeaning. Moreover, individualism is frowned upon in the highly egalitarian society. Indeed, there appears to be no shortage of explanations for the dearth of private sector activity.

Some respondents nonetheless maintained that circumstances have changed, and future attempts at privatization would surely have different outcomes. They argued that the present government is much more serious about privatization, and that the issue is being discussed in a much more positive light, even at the grassroots. Tactics meant to raise alarm with claims of jobs being lost will no longer work, they said. The inefficiency and economic and social costs of loss-making public enterprises are now more widely recognized. The large numbers of young people who have studied, trained, and worked overseas are better informed.

While foreign investors have been kept out of certain activities reserved for local investors and public enterprises, some respondents suggested that this is no longer an issue. Yet laws regulating foreign investment, including those prescribing approval procedures and the list of restricted activities, are still in place.

Foreign investment policy was relaxed with the entry of the Fiji Islands company Punjas into the wholesale and retail trade in 2004/05, apparently helped along by the financial problems of the public enterprise wholesaler–retailer resulting from the proliferation of small roadside stores. Respondents noted that there was opposition at first to the entry of Punjas from locals who feared that bringing in foreign capital and workers would take jobs from them. But the opposition is said to have died down. The lower-priced Punjas goods have been positively received, and the company seems to be doing well. The public

³ According to an index of patron–client politics in the Pacific constructed by Duncan and Hassall (2007), Kiribati and the Federated States of Micronesia are the two Pacific states where patron–client politics is most prevalent.

⁴ Board members are appointed for up to 3 years and receive “sitting” allowances: \$50 per day for members and \$55 per day for the chairperson.

enterprise wholesaler–retailer, Bobotin Kiribati Limited, remains in business, however, partly because it is responsible for seeing to it that the outer islands are adequately stocked with basic foodstuffs in emergencies.

The Government reportedly opened the trading of seaweed to the private sector in 2003.⁵ Before that, the public enterprise Atoll Seaweed, under the Ministry of Fisheries and Marine Resource Development, was the sole purchaser of seaweed. Like copra trading, seaweed trading is regarded as an activity of socioeconomic importance. The Government consequently sets the price of seaweed at a level above the world price and has subsidized Atoll Seaweed since it started operations. In these circumstances, the private sector is unlikely to be interested in purchasing and exporting the product. It is no surprise, therefore, that no licenses other than those to Atoll Seaweed have been issued.

There are two mobile phone providers, both government-owned and notionally in competition: Telecom Services Kiribati Limited and Television Kiribati Limited. Negotiations with the Irish mobile phone company Digicel have apparently taken place, and approval is said to be only a matter of months away. The prospective entry of Digicel was claimed to have already led to improved services by the government monopoly telecommunications enterprises, lending credence to the idea that even the threat of competition can improve the performance of public enterprises.

Government support for the privatization of public enterprises appears to be significant. There is support for privatization and promotion of the private sector, backed by logical arguments in favor of market development, at senior bureaucratic levels in key ministries such as finance and economic development; commerce, industry, and cooperatives; and communication, transport, and tourism development. Moreover, the president appears committed to the reforms. On balance, the reforms appear to be as welcome as can be expected in the circumstances. However, significant skepticism about the likelihood of their success must be acknowledged.

The cultural ethos of egalitarianism is very strong in Kiribati society—so strong that working for the government is preferred to working for private businesses, which is seen as helping individuals raise themselves above the rest of the community. External signs of success, such as ownership of big houses and new cars, are also frowned upon. The culture is described as paternalistic, very conservative, collectivist, and consensual (Sofield 2002). The needs of the community are placed ahead of the needs of the individual. In this respect, Kiribati society is unlike Polynesian and Melanesian societies, where chiefly, or “big

⁵ According to a Ministry of Fisheries and Marine Resource Development report on its first 6 months of activities in 2007, however, Atoll Seaweed was holding the only license for seaweed purchases.

man,” authority is much more important. Within Kiribati village communities, consensus reached in discussions in *maneaba* (the village meeting house) must be respected.

The elders of the village and clan have considerable moral authority. Their influence on island affairs has dwindled, however, as younger, better-educated leaders, such as those coming from the churches, have gained more voice. *Maneaba* can be found in disrepair and being used to store copra, respondents noted.

Several possible reasons exist for the diminished role of village meetings and the consensus they generate. People may be looking outside the village for opportunities and leadership. This divergence in viewpoint may derive in part from increased education and travel. People may be less dependent on a collectivist lifestyle and more willing to rely less on government. Generating collective action within communities to overcome collective-action problems could also be at risk.

As in other Pacific island societies, reciprocity is an important aspect of culture in Kiribati, where it is called *bubuti*.⁶ The roots of the practice of sharing in many traditional societies are said to go back to a time when food harvesting was often opportunistic and storage was difficult. In these circumstances, it is rational to share resources in anticipation of having the favor returned. This practice may not be so necessary today, given the availability of storage and savings facilities. As Jared Diamond (2005) observed, however, “the values to which people cling most stubbornly under inappropriate conditions are those values that were previously the source of their greatest triumphs over adversity.”

With the rapid rural–urban migration taking place in the Pacific countries, and increasing familiarity with market-based societies and their emphasis on individualism and individual wealth creation, more indigenous people are becoming entrepreneurial and starting their own businesses. But the culture of sharing still holds sway and poses a significant hindrance to such activities. Respondents remarked that *bubuti* was indeed a significant obstacle to the development of indigenous businesses because people with wealth are expected to share it with their extended families in various ways—by not charging relatives for goods and services provided, for example, or by supporting their relatives’ children and sending them through school.

The people of Kiribati were described as very conservative. Heavily dependent on government, they also seem to be strongly risk-averse. Such risk aversion is understandable in a country in which the environment is very fragile and life is precarious.

⁶ A request from a relative or friend that one normally cannot refuse without damaging the relationship.

The private sector is very small and is made up for the most part of passenger buses, small retail stores, fish and vegetable marketing and food stalls, secondhand clothing shops, travel agencies, hardware stores, and exporters of tropical aquarium fish and other marine products. Growth is evident in the profusion of small passenger buses that transport people around South Tarawa, even though prices are controlled. The private sector is also involved in interisland shipping, mostly operated by churches and villages. This form of private sector participation could be another sign of the collectivist bent of the society, which favors private enterprises run cooperatively over those run by individuals.

Land sales are allowed only between I-Kiribati, and then only with the consent of the Land Court, which imposes the following strict conditions: (i) the land to be sold must be surplus to the needs of the seller and the seller's family, (ii) the buyer must have a genuine need, and (iii) there must be no other suitable land on the island.

Christian churches wield influence, but entertain no apparent antagonism toward private business. In fact, the main Protestant church organization and the Catholic Church have their own business enterprises. Protestant churches own a shipping line and a Mitsubishi dealership. The churches and villages are spheres of collective action that could spur private enterprise in Kiribati. However, the risks of inferior management and poor governance are high in cooperatives.

Actors, Action Arenas, and Incentives

Various actors and action arenas in Kiribati are relevant to privatization and promotion of the private sector. Foremost is government, which depends on an electorate with a strong preference for public enterprises and employs most of those holding jobs in the formal sector. Public sector employees are clearly a major political force. Those working for public enterprises are likely to resist privatization for fear of losing their jobs. Public enterprise employees and public servants have little practical knowledge of private sector operations, and their communal culture, risk aversion, egalitarianism, and disapproval of individualism make them hostile to the idea of free markets.

The current president is a primary actor. Kiribati has a mixed presidential–parliamentary system, in which the president is elected to a 4-year term. The cabinet is chosen by the president from among sitting members of parliament from the ruling party. In any reform efforts, the president must carry with him his cabinet, party members, and coalition members. The numerical strength of the ruling party fortifies the position of the current president. His stated decision not to run for a third and final term may give him more freedom to act, but he

still must carry his party members with him, and they will be concerned with reelection.

As reiterated in the discussions, the politicians are strongly beholden to their constituencies and are expected to give them jobs. Ministers are expected to appoint their constituents to public enterprise boards and the public service. Politicians are also expected to look after the people's "every needs." One respondent compared this situation with that in Samoa, where members of parliament often also have strong authority in the village. Thus, what is decided in parliament can be more easily enforced among individuals and in the villages.

Cabinet ministers in Kiribati have considerable discretionary power, enabling them to provide support to their constituencies. A more efficient public service, good governance of public enterprises, an effective land rights system, or regular auditing of the accounts of ministries and public enterprises would reduce this discretionary power and may be resisted by the ministers for that reason. Even members of island councils have considerable discretionary powers—to issue licenses for businesses, receive "sitting" allowances for visits to proposed business sites, and set some prices (such as bus fares)—which they will loath to relinquish.

The management and board of directors of public enterprises are also likely to oppose privatization and private sector development in concert with their employees and politicians. Public enterprise management and board appointees are mostly drawn from ministers' constituencies and are usually influential in their communities. The sitting fee of \$50 a day that board members receive is most likely an important source of income (especially compared with a week's good income from fishing of \$100–\$200).

The private sector is a stakeholder in privatization and private sector development, but is a very small part of the economy with little political leverage. Unlike most Pacific island countries, Kiribati has few branches of overseas firms. The middle class, which usually generates wealth through private sector activity and has a vested interest in the development of the private sector, is small. The few areas of individual private sector activity in Kiribati, such as operation of the buses that are the principal form of land transport, were largely developed by retired senior public servants who are likely to support continued dependence on public enterprises.

Private business development is clearly faced with significant obstacles. Public enterprises have a monopoly in most areas of the economy that might attract the private sector. Price controls are another impediment. Foreign investors must apply to and be vetted by the Foreign Investment Commission (FIC), which can approve investment plans for up to \$250,000 in capital. Larger investments are referred to the cabinet. Investments that could conflict with established domestic

enterprises or affect the use of lands or other natural resources by nationals are dealt with individually by the FIC, but are not encouraged (United States [US] Department of State 2006). Neither the United Nations Conference on Trade and Development nor the US Commerce Department's Bureau of Economic Analysis reported any foreign direct investment inflows into Kiribati in 2003 and 2004 (US Department of State 2006).

The community must accept public enterprise and private sector reforms. But acceptance will not come easy in this risk-averse society that frowns upon individualism and looks to government so comprehensively to provide goods and services.

The communal system, with its strong clan loyalties, presents difficulties for the establishment of a market economy because markets depend heavily on transactions between parties who do not know each other. The close clan ties and the long-standing distrust of unfamiliar groups, particularly foreigners, mean that there is little of the kind of widespread trust (social capital) that is needed in a market economy.

Analysis

The collective-action problem that appears to make Kiribati unwilling to privatize public enterprises and promote the private sector is the societal belief that benefits gained from dependence on government outweigh their private costs. Government resources—the revenues earned from investments of the Revenue Equalisation Reserve Fund, tuna-fishing license fees, and donor aid—are seen as a common-pool resource. The collective-action problem is sustained in part by the pervasive patron–client politics between politicians and their constituencies. Perverse incentives affect society; public servants; the management, boards of directors, and staff of public enterprises; politicians; and members of the island councils. Given the present rules-in-use, can the expectations of society, or the behavior of politicians and public enterprises, change?

“State capture” by the elite does not appear to be a significant issue in Kiribati. Patron–client politics to achieve political office is pervasive, but does not seem to result in huge gains by a few at the expense of the rest of society. The political importance of maintaining widespread government distribution of the common-pool resource seems to curb elite capture.

If the collective-action problem is to be overcome, individuals and politicians must see that the benefits of collective action to bring about reforms outweigh the cost to them as individuals. Unfortunately, the cost to individuals of giving up their dependence on government is obvious, while the benefits of economic

reform in terms of more jobs, higher incomes, and improved public services are highly uncertain.

Given the very limited state of development of the private sector in Kiribati, the prospects for its accelerated development are not promising. Why would investors be interested in Kiribati? Where will the capital needed to take over public enterprise activities come from? The general antipathy toward foreign investors amplifies the difficulties of attracting foreign investment. However, one may speculate about the opportunities that may arise if public enterprises are privatized and an environment more conducive to foreign as well as local investment develops, the difficult choices and decisions will have to be made by those who are willing to take risks and invest in entrepreneurial activities.

Despite widespread resistance to economic reform, the situation is not altogether hopeless. There are encouraging signs, including the acceptance of the Fiji Islands wholesaler–retailer Punjas and the ongoing discussions for the entry of the mobile phone company Digicel into the Kiribati market. In both cases, the lower prices and better quality of goods and services provided as a result of the introduction of competition are crucial. In the case of Punjas, lower prices have already reaped approval. The proposed introduction of Digicel may also encounter relatively trouble-free acceptance from most I-Kiribati, who are well aware of the high cost and poor quality of telephony services from the government monopoly enterprises. The opening of other markets to competition and privatization of public enterprises will need to be supported by similar public appreciation of the lower prices, better quality, and other benefits of market competition.

A privatization strategy is being prepared by the Ministry of Commerce, Industry and Cooperatives for presentation to the cabinet. A summit of stakeholders has already been held and the ministry plans further discussions with stakeholders. The draft document appears to be comprehensive and sensible. The document must be finalized quickly and presented to the cabinet because the president needs to move quickly on this reform.

The growing number of people going overseas for education and work may also herald acceptance of economic reform. Overseas workers, such as seafarers and nurses, and those studying overseas can observe the benefits of market competition in other countries, such as lower prices and better quality of goods and services. But there is no denying the point made by respondents that these people are pressed to conform to prevailing social attitudes when they return to Kiribati.

The most positive factor in the quest for economic reform is the strong commitment of the current president of Kiribati to privatization and private sector development. A graduate of the London School of Economics, he has plans for moving ahead on these reforms and demonstrates a good understanding of

the obstacles. He understands the importance of substantial progress in 2008, the first year of his second term, and intends to start by privatizing the “three or four” public enterprises deemed “easier” to privatize, such as Kiribati Insurance, Kiribati Supplies Company, Telecom Services Kiribati, and Television Kiribati. After the benefits of competition are successfully demonstrated, other public enterprises—such as those providing power, water, and transport services—should be easier to privatize.

Importantly, the president should be able to draw intellectual and ideological support from several high-quality permanent secretaries in core ministries. As Bates and Krueger (1993) found in their study of successful reforming countries, the only factor common to all was the presence of a group of well-trained and committed technocrats providing advice and support to the person or group leading reforms. Given the strongly ingrained patron–client relationship between politicians and their constituencies in Kiribati, strong leadership from the president appears to be the only way to supersede the current rules-in-use.

Reform-Supporting Measures for Development Partners

Investment Legislation

Basing reform proposals on the assumption that the culture can easily change is unrealistic, as was noted previously. It is also unrealistic to assume that indigenous private businesses will rise to take the lead in privatization or in other areas of the economy. Joint ventures between indigenous entrepreneurs and nonindigenous entrepreneurs and foreign investors seem most likely. These ventures will provide some protection for assets and incomes of indigenous entrepreneurs from the demands for *bubuti* from within the indigenous community.

It will thus be necessary to adjust legislation so that it supports equal treatment of nonindigenous and indigenous investors. The Asia–Pacific regional office of the Foreign Investment Advisory Service of the International Finance Corporation (IFC) has already reviewed Kiribati’s investment legislation and recommended changes that will provide equal treatment for all investors (IFC 1997). These recommendations should be revisited and implemented if this has not yet been done.

Kiribati appears to have two important ingredients in place for reforming the public sector and promoting private enterprise: a champion of the reforms in the president; and a small group of capable, committed, and supportive public servants. How can development partners assist the president and his supporters in implementing the reforms successfully? They can be very helpful in overcoming the collective-action problem if they support measures that will (i) improve understanding of the benefits of the reforms in the communities, and (ii) build capacity to support the implementation of the reforms.

Better Community Understanding of Economic Reforms

If the people of Kiribati are to amend their view that government revenues and donor finance are a common-pool resource, they must learn and understand that such change can generate greater benefits for all. In recent research, Chauvet and Collier (2006 and 2008) found that “insufficient social knowledge” of the effects of reform is a critical factor behind the inability of failing states to build a consensus that reform is mutually beneficial. Countries with small populations and only a low proportion of these with secondary education were most likely to be in this category. Another circumstance that contributed to this outcome was a large share of resource rents in gross domestic product. All these characteristics apply to Kiribati.

The best public case should be made for the benefits of privatizing public enterprises and promoting development of the private sector. Lessons can be learned from the favorable public reception of opening up the wholesale–retail sector and the telecommunications sector because of lower prices resulting from the former and potential benefits from competition in the latter. But particular attention should be paid to the widespread antipathy toward private markets and the difficulties most find in understanding the concepts of markets and competition in the abstract.

An assessment of public enterprises with the best potential for privatization in the near future could be the most effective assistance that development partners could provide. Decisions about which enterprises to select for privatization should be based on an assessment of benefits and costs, with particular attention to the distribution of benefits, the time lag in the realization of benefits and costs, and the likely resistance from politicians and public sector employees. The case for privatization should be spelled out in detail and publicized widely to gain as much public support as possible. It is now well understood that chances for success in economic reform are better when locals lead in developing the case for reform. The group of well-trained, committed senior civil servants that support the reforms and the president should therefore be actively involved in the assessment so that they are in a good position to lead the public relations effort.

Capacity Building

The fact that public servants in Kiribati have to retire at 50 years of age is a concern. A number of senior public servants who can best support the reform effort will apparently have to retire soon. Some means must be found to retain

their services. Because the privatization program must begin soon, there is little time to prepare their replacements.

While the group of senior public servants committed to reform has to be seen as supporting the president in leading the reforms, they will need external support in the form of mentoring. Reform is difficult, and many resisting forces have to be overcome. Those who will lead the reforms have no experience in such reforms and may well become discouraged when faced with obstacles. At such times, they must be able to draw on effective support to work their way through problems. The development partners can establish a mentoring program, with experienced people from within their organizations or from elsewhere as mentors.

While the president must move quickly on the privatization program, sustaining the reforms over the long term will require building up a network of well-trained officials in the public service who are committed to reform and the promotion of the private sector. In this regard, there appears to be no substitute for longer-term capacity building through a combination of short-term training; internships; and long-term, postgraduate training. It must be recognized, however, that a large percentage of those trained will leave for work overseas because of the poor job prospects and relatively low pay in Kiribati. This is an inevitable part of the process of training people in low-income, low-growth, high-unemployment countries. It is hoped that enough well-trained people will return to work in Kiribati to sustain the reforms.

Companion Reforms

Other reforms are needed to help ensure that privatization and private sector development progress as quickly and effectively as possible. An important area of institutional reform is property rights to land. Gaining secure access to land is a challenging process, and only indigenous I-Kiribati can own land. Nonindigenous people can secure rights to land only through leasehold, and even this is made arduous by the large number of customary landowners that in many cases must agree to lease a piece of land, and the frequency of disputes over ownership. The Government recognizes the problems associated with land rights and intends to make secure access easier to achieve.⁷ Development partners could assist in this area. The Government could also learn valuable lessons from other Pacific countries, such as Papua New Guinea and Vanuatu, which are implementing changes in their land rights institutions, and from the Australian Agency for

⁷ Improving access to land is a component of the draft privatization strategy being prepared by the Ministry of Commerce, Industry and Cooperatives.

International Development and the Pacific Islands Forum Secretariat, which have recently become more active in property rights.

As the World Bank/IFC *Doing Business* reports show (World Bank 2008), the cost of doing business in Kiribati is high because of inefficiencies associated with local regulations and licensing (including work permits for expatriates); the bureaucracy (including the island councils that issue business licenses, exercise some control of prices, and control town planning); the courts; and shipping services. Improvements in these areas would provide a friendlier environment for private investors.

The Kiribati schooling system is poor. Improvements in teacher training are obviously necessary. With an already high and rapidly increasing population and limited formal employment opportunities, the country has no alternative but to train I-Kiribati for the global labor market. Good English skills must be developed, and vocational training expanded and improved. The European Union and the New Zealand's International Aid & Development Agency are assisting the Pacific island countries with curriculum development through the Pacific Regional Initiatives for the Delivery of Basic Education (PRIDE) project at the University of the South Pacific.⁸ However, much more than curriculum development is needed. Teacher training at the Kiribati Teachers' College, the Kiribati Institute of Technology, and regional training centers such as the University of the South Pacific must be substantially upgraded.

⁸ The activities for the PRIDE project are defined in the financing agreement signed between the European Union and the Pacific Islands Forum Secretariat (representing the 14 Pacific nations) (University of the South Pacific 2009).

Appendix

A Framework for Consideration of Support for Capacity Development in Kiribati

Introduction

Consideration of support for capacity development involves more than simply evaluating the need to develop the capacity of individuals and organizations. The willingness or motivation of individuals to carry out newly developed tasks effectively must also be a concern, as should the receptiveness of government, and society in general, to the performance of new tasks.

The last-mentioned concern could be the most important of all. It recognizes the possibility that the outcomes of capacity development activities may not be welcomed by the government or acceptable to society. An example is the completion on time of accounts by ministries and public enterprises in Kiribati. Those responsible for compiling accounts accurately and on time may be trained to do so efficiently and be motivated enough to complete these tasks according to established deadlines. However, the Government may not welcome such industrious behavior if it does not wish to make known the subsidies it distributes through ministries and public enterprises. The public, as ultimate recipients of these subsidies, also may not welcome more transparency. As a result, even if accounting staff receives the necessary training, it may not be motivated or given incentives to undertake new tasks promptly, or supplied with the resources needed to carry out the tasks effectively.

When considering support for capacity development in the public service in Kiribati, development partners should have realistically modest expectations of outcomes. Given the tiny population of more than 90,000, few people will develop high-level skills. Such limitations are compounded by the poor quality

of schooling. Parents hardly expect their children to land a job even if they send them to school, making it less likely that the children will complete school. When public servants are successfully trained, a considerable number may opt for better-paying jobs elsewhere.

The trained people who stay in the public service must contend with obstacles to achieving good performance in a communal society such as Kiribati's. As described in the main report, because of the authoritarian nature of Kiribati society, measures aimed at promoting good corporate governance—such as supervision and auditing—are often ineffective. Even when poor performance or misbehavior is reported, the chances that sanctions will be applied are slim. In these circumstances, encouraging society to demand better public service by giving it a better understanding of what it should expect from government may be an effective strategy for improving performance. Working with civil society groups to give them a better understanding of what good public service entails seems particularly important because such groups may not be as bound by authoritarian structures as individuals. The media also could be enlightened to help the community better understand what level of service they should expect from government and what level of service they are actually receiving.

When designing capacity development for the Kiribati public service, financial and administrative systems must be kept as simple as possible. Budgetary systems, for example, should be designed to provide the information required in the most straightforward manner. Far too much emphasis in the Pacific has been placed on introducing management systems that are designed for developed countries, where the skills needed for their operation are plentiful. The introduction of simple management systems will minimize the demands on capacity building as well as on the limited skills available in the public service.

Incentives can encourage public service staff to develop skills and improve performance. The design of such incentive schemes is not an easy task, however, because too often consequences that are unintended or undesirable occur. The experience of the public service in Samoa in implementing an extensive reform program may offer some useful lessons for Kiribati in designing incentive-compatible contracts for the public service (Amosa 2007). Incentive systems should be complemented by effective sanctions for poor performance. As noted previously, poor performance is not effectively sanctioned in Kiribati. Arrangements for capacity development will need to be backed by conditions of employment in the public service that permit more effective sanctions of poor performance.

Outlined following is a framework for capacity development in Kiribati. It focuses on capacity development to provide the data needed to implement a multiyear planning and budgeting framework, an area in which development

partners intend to provide assistance. However, the framework for capacity development is believed to be generally applicable to other areas.

The capacity-building needs for the development of a multiyear budgeting framework were assessed on the basis of discussions in Kiribati, and the results are presented in the next section. The difficulties associated with capacity building in Kiribati are examined in the section after that. Finally, a framework is presented for capacity development over the short and long terms to support the multiyear budgeting framework.

Needs Analysis

Effective multiyear planning and budgets require accurate, up-to-date recording and compilation of revenues and expenditures from ministries and public enterprises; regular reconciliation and auditing of the accounts of these entities; and sound forecasts of revenues and expenditures. Ministries and public enterprises in Kiribati are extremely deficient when it comes to cash management and the recording of expenditure commitments. The recording of revenues and expenditures consequently is poor, and reconciliation of income and expenditure is ineffectual, if undertaken at all. Fixed asset registers are not maintained. In many cases, the accounts of ministries and public enterprises have not been audited for several years because the accounts have not been finalized and presented to the Audit Office. The accounts of the public enterprises Kiribati Oil Company and Kiribati Supplies Company, for example, have not been audited since 1999. However, judging by the number of ministries and public enterprises that claimed to have brought their accounts more up-to-date, there appears to have been a serious response to efforts of the Ministry of Finance and Economic Development (MFED) to see improvement in this area.

The capacity for financial analysis within public enterprises is weak, resulting in limited capability to assess the financial viability of these enterprises. Additionally, there has been a poor response to requests from MFED for information on investments made and proposed by ministries and public enterprises. An even more important problem with regard to public investment and its inclusion in planning and budgeting is the lack of capacity in public enterprises and ministries (including MFED) to undertake economic and financial appraisals of investment proposals. As a result, there is no basis for assessing and selecting public investments according to their social rate of return.

Most ministries and public enterprises interviewed reported low levels of English language skills and computer skills. The accounts staff lacks ability in the use of standard accounting software such as Attaché, ACCESS, and MYOB. Skills in the use of basic computer software such as Microsoft Excel are also lacking. In

his Policy Statement to the Second Meeting of the Ninth Parliament (Office of *Tē Beretitenti* 2007), the president recognized that English literacy “must improve dramatically” and committed the Government to strengthening teacher training and demanding higher standards of performance from teachers at all levels.

Most accounting cadre have only forms 4–6 schooling and received their basic training in accounting practices in secondary schools. Secondary teachers receive their training at the Kiribati Teachers' College, the Kiribati Institute of Technology (KIT), or the Kiribati campus of the University of the South Pacific (USP). Only 2 of the 19 teachers at KIT have a certificate in teaching. According to the acting principal of KIT, recruiting good-quality staff is difficult, especially in accounting. Trained accountants are looking for jobs in management, which pay higher salaries (this comment was also made in many ministries and public enterprises visited). Most of those applying for positions in KIT have a diploma or a degree. While the official language is English, the acting principal reported that only about 10% of classroom teaching is in English. The Australian Agency for International Development (AusAID) is examining a plan for English language training. It also is putting together a proposal for upgrading the quality of training at KIT. The Public Service Office (PSO) reported that it is developing with AusAID assistance a scheme for training in accounting that will upgrade KIT training in this area from a certificate to a diploma program. Scholarships toward a degree in accounting at a university in Queensland, Australia, would follow. The end result of all this activity could be better English literacy and improved training in accounting practices in secondary schools.

Accountants and accounts clerks are responsible for the data that ministries and public enterprises use to prepare financial reports. Public enterprises hire their own accounting staff. The accounting staff of ministries, on the other hand, comes from a central accounting cadre in MFED. Most of the accounting staff consist of accounts clerks (for example, most of the 16 accounting staff of the Kiribati Shipping Service and the 10 accounting staff of Kiribati Oil Company are accounts clerks). Accounts clerks are encouraged to pursue further training, but cannot enroll at KIT or the USP Kiribati campus because they have not graduated from high school. Obtaining external training is thus difficult for them. However, it seems there is little interest by these staff in capacity development. The auditor general holds a low opinion of the skills of the accounting cadre, noting they lack basic understanding of the Financial Regulations and cannot reconcile a balance sheet or maintain a fixed assets register. Their skills in the use of the Attaché software, the standard accounting software used by the Government, are also weak. The auditor general said that KIT does not undertake such basic training although it offers a diploma course in accounting, and he expressed dissatisfaction with the quality of training in accountancy at the USP Kiribati campus.

Many of the problems encountered apparently derive from poor staff motivation, as reflected in the lack of interest in upgrading skills. But it is also clear that boards of directors of public enterprises are remiss in having their books audited regularly. Similarly, senior managers of ministries do not enforce requirements for accurate and up-to-date financial reporting. If management does not expect good performance, it is unlikely to get it. As noted in the main report, appointments to the boards of public enterprises are largely political; cases of board members having inadequate skills are widely reported. However, senior managers of ministries should know and understand the Financial Regulations and their requirements.

Several public enterprises reported using service targets and rewards systems, such as bonuses, to improve motivation. They had also sent staff on secondment overseas for training. It was commonly noted, however, that social pressures constrain individuals from performing well, and motivating measures had little beneficial impact beyond their short-term effects. While capacity development may be difficult enough, it appears that, for cultural reasons, improvements in motivation may be even more difficult.

PSO is working with AusAID on a human resource development plan to improve service delivery. Included in the plan are incentives and sanctions designed to improve motivation.¹ A program of meetings and workshops to educate the public about measures to improve public service is also being developed. However, expectations of the outcomes of this plan should be realistically modest.

Other Capacity-Building Considerations

In designing an effective capacity-building framework for Kiribati, various difficulties must be overcome, and deficiencies in training methods must be rectified. Some of these difficulties and deficiencies were identified in previous attempts at capacity development. Others were identified during consultations in Kiribati for this paper.

- (i) Short-term training has not been very effective because it has not been reinforced by repeated on-the-job application of the new skills under skilled supervision. Capacity development cannot be a one-time effort; it has to be a long-term program.
- (ii) Professional trainers are rarely hired. Training skills have been given inadequate weight in the recruitment of training consultants.

¹ PSO reported that it is developing a training program for accounting staff in the public sector that involves studies to the diploma level at KIT, followed by an undergraduate degree at the University of Queensland or Griffith University in Australia.

- (iii) High-quality consultants who are willing to stay in the country for extended periods are difficult to recruit. On the other hand, poor-quality consultants who are more willing to remain in the country for extended periods may do more harm than good in passing on skills. Moreover, the longer consultants remain in the country, the more likely they are to be used in line positions and leave behind few enhanced skills among the staff.
- (iv) Training methods often do not give attention to the needs of an adult audience. Neither do they recognize that trainees often have not studied formally for some time.
- (v) Sometimes only the head of a unit is trained. Because of the high turnover of senior staff in government and the increased mobility of staff who receive training, consideration should be given to training all staff in a unit to ensure the sustainability of new skills.
- (vi) At other times, only lower-level staff members are trained. Senior staff should be given some idea of the skills being taught to familiarize it with what lower-level staff has been taught and to make management more receptive to the use of the new skills by the staff.
- (vii) The terms of reference for high-level trainers should be flexible enough to allow them to respond to any short-run needs they may identify.
- (viii) A public forum to discuss the reasons for the capacity building, such as the adoption of a multiyear budgeting framework, could increase public receptivity to the use of new skills. As noted previously, PSO intends to use public forums to promote its human resource development plan.

A Capacity Development Framework for Kiribati

Capacity building in developing countries must be considered a long-term process requiring long-term assistance. The process could take considerably longer in Kiribati than in other countries. Some capacity development activities will have to be undertaken before others can take place, and there will be short- and longer-run activities in the capacity development framework. Activities will need to be sequenced appropriately.

The capacity development framework that will underpin the implementation of the multiyear budgeting process is based on the preceding needs analysis and takes into account the constraints on capacity building described previously and in the main report. The framework should have the following objectives:

- (i) Basic training for the accounting cadre in the ministries and accounts staff of public enterprises in areas such as knowledge of the Financial Regulations; accurate recording of revenues, expenditures, and expenditure commitments; reconciliation of income and expenditure statements; balancing of petty cash; and maintenance of a fixed assets register.
- (ii) Familiarization of senior management of ministries and public enterprises with the Financial Regulations, the need for accurate and prompt recording of financial transactions, and prompt preparation of financial statements for presentation to the auditor general.
- (iii) Training of public enterprise directors to understand their important trustee responsibilities for the prompt preparation of financial accounts of the enterprises and other fiduciary duties.
- (iv) Training of MFED staff in simple methods of deriving revenue and expenditure forecasts for the multiyear budgeting framework.
- (v) Training of accounts staff in the same accounting software across all ministries and public enterprises to enable staff members to move easily from one ministry or public enterprise to another.

Short courses in basic accounting and computing skills conducted by expatriate professional trainers for the accounting cadre and accounting staff of public enterprises should initiate the capacity development activities. These trainers should also be able to provide short courses to familiarize public enterprise directors and senior managers of ministries with their financial management responsibilities. In view of the difficulties encountered in previous capacity development activities, the need to recruit well-qualified professional trainers must be emphasized. The trainers should have experience training adults and, preferably, experience training in developing countries. They should be contracted to make repeated visits to reinforce the training, and perhaps provide long-distance mentoring through the internet, using the capacity already available and expanding in Kiribati.

It normally would be desirable to contract as trainers I-Kiribati who have studied and worked overseas, or retired senior civil servants. This move would usually be expected to contribute positively to training outcomes. But, as was made clear in interviews, returning I-Kiribati find it impossible to avoid cultural pressures, which would diminish their efforts to improve discipline and avoid nepotism.

The use of expatriates cannot be a short-term solution to the poor performance of the accounting cadre and accounts staff of public enterprises.

These problems are pervasive and can be resolved by across-the-board training and improvements in motivation. However, short-term assignments for expatriates to assist MFED in setting up the multiyear budgeting framework, and provide training in revenue and expenditure forecasting and in project analysis, appear to be desirable. Again, professional trainers should be contracted for this work.

The longer-term capacity-building issues are much more wide-ranging. Ultimately, the quality of primary and secondary schooling must be improved so that students can reach their full potential. Although some form of incentives may improve school performance, opportunities for employment, both at home and overseas, must be improved to encourage parents to keep their children in school.

English literacy must be improved. Ideally, this requires teaching in the English language from kindergarten upward. For longer-term improvement in training in accountancy practices, as well as in the other vocational skills, the quality of teaching at KIT and the Kiribati Teachers' College have to be upgraded. With good-quality teaching staff, KIT could offer full-cost-recovery courses in accounting and other areas to ministries and public enterprises.

Motivational problems will remain, but they may be eased by changes in working conditions adopted by PSO. Better opportunities for overseas employment could also help increase motivation. With respect to the motivation of the accounting cadre, the fact that they have two reporting lines—to MFED and to the management of the ministry where they are working—creates a moral hazard. This is a recipe for poor performance. A single line of responsibility should be defined to remove the problem.

Motivational problems and the perverse incentives resulting from the lack of demand by politicians and the public for the greater transparency that would result from improved accounting processes appear to be the primary constraints on the needed capacity development. To help overcome these constraints, the following measures, derived from the preceding institutional analysis development framework, are also recommended. Education in the benefits of transparent budgets and the social costs of subsidizing inefficient public enterprises should receive high priority. Civil society organizations and the media should be a focus of this education, which hopefully will give rise to demand from the community for better public service. Development partners can assist in this effort by preparing the necessary background information on the benefits of transparent, forward-looking budgets and the costs of inefficient public enterprises and inefficiencies in the public service. Strong leadership is also needed from the president to overcome the perverse incentives that diminish the interest of politicians and the public in the transparency of public service and public enterprises.

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Kiribati's Political Economy and Capacity Development

This reports the result of an investigation into the social, economic, political, and institutional factors that encourage or impede inclusive economic development in Kiribati and hamper the capacity development needed to overcome obstacles to that development. Much of the information on which this report is based was collected in discussions in South Tarawa in January and April 2007. The institutional analysis and development framework of Ostrom et al. (2001) served as the analytical framework for the investigation. This framework, which was developed by researchers from the Workshop in Political Theory and Policy Analysis at Indiana University in the United States, is an effective way to explain group behavior that influences a country's economic development.

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